

CONFIDENTIAL

FOR RESTRICTED USE ONLY (NOT FOR USE BY THIRD PARTIES)

FINANCIAL SECTOR ASSESSMENT PROGRAM
RUSSIAN FEDERATION

TECHNICAL NOTE

FINANCIAL INCLUSION

JULY 2016

This Technical Note was written by Jennifer Chien, Mai Nguyen, Matthias Timm, and Marco Traversa, with research assistance by Marianna Camino. The note was prepared in the context of a joint World Bank/International Monetary Fund Financial Sector Assessment Program mission in the Russian Federation during February-March 2016 led by Aurora Ferrari, World Bank and Karl Habermeier, IMF. The note contains technical analysis and detailed information underpinning the FSAP assessment's findings and recommendations. Further information on the FSAP program can be found at www.worldbank.org/fsap.



THE WORLD BANK GROUP
FINANCE AND MARKETS GLOBAL PRACTICE

TABLE OF CONTENTS

I.	Executive Summary	1
II.	Current State of Financial Inclusion in Russia	8
	<i>Access to Finance for Individuals</i>	8
	<i>Access to Finance for SMEs</i>	12
	<i>Credit Infrastructure</i>	13
III.	Public and Private Sector Commitment.....	14
	<i>Financial Inclusion Strategy (FIS) and Coordination Mechanisms</i>	15
	<i>Institutional Capacity and Commitment</i>	16
	<i>Financial Inclusion Data</i>	19
IV.	Provider Reach.....	22
	<i>Overview of Financial Providers and Physical Reach</i>	22
	<i>Retail Payments Infrastructure</i>	29
	<i>Agent-Based and Technology-Driven Models</i>	30
	<i>Use of Agents</i>	31
	<i>AML/CFT and Identification</i>	34
	<i>Digital Finance Providers</i>	35
V.	Provider Diversity and Sustainability	39
	<i>Banking Sector</i>	39
	<i>Microfinance Sector</i>	41
	<i>Consumer Credit Cooperatives Sector</i>	44
	<i>Supervision and Self-Regulatory Organizations</i>	46
	<i>AML/CFT Compliance</i>	47
VI.	Product Range and Appropriateness.....	49
	<i>Product Range</i>	49
	<i>Product Appropriateness</i>	50
	<i>Level Playing Field</i>	51
VII.	Financial Consumer Protection.....	52
	<i>Supervisory Framework</i>	52
	<i>Legal and Regulatory Framework</i>	54
	<i>Disclosure and Sales Practices</i>	55
	<i>Debt Collection Practices</i>	57
	<i>Internal and External Dispute Resolution Mechanisms</i>	57
	Annex I: Main Components of a National Financial Inclusion Strategy.....	60

Figures

Figure 1: Financial inclusion in Russia by demographic and socioeconomic features	8
Figure 2. Financial inclusion in Russia and peer countries by demographic features	9
Figure 3. Debit and Credit Card Ownership (% age 15+)	10
Figure 4: Household deposits in selected emerging economies, % of GDP.....	11
Figure 5. Funding Sources for Investment by Firm Size in Russia	13
Figure 6. Russia’s Bank Branch and ATMs Network (per 100,000 adults and per 1,000 km ²)...	25

Tables

Table 1. Summary of Main Policy Recommendations	5
Table 2: Usage of different types of products by individuals in selected economies	12
Table 3. Government Policies and Programs by Ministry	18
Table 4: Main Types of Financial Providers in Russia.....	22
Table 5. Deposits by Type of Current and Savings Account.....	49

ABBREVIATIONS AND ACRONYMS

AFI	Alliance for Financial Inclusion
AML/CFT	Anti-Money Laundering/Combating the Financing of Terrorism
APR	Annual Percentage Rate
ARB	Association of Russian Banks
ATM	Automated Teller Machine
BCBS	Basel Committee on Banking Supervision
CBR	Central Bank of Russia
CCC	Consumer Credit Cooperatives
CGAP	Consultative Group to Assist the Poor
CDD	Customer Due Diligence
CP	Consumer Protection
CPFL	Consumer Protection and Financial Literacy
DTI	Debt to Income Ratio
EDR	External Dispute Resolution
ECA	Europe and Central Asia
EIR	Effective Interest Rate
ES	Enterprise Surveys
FAS	Federal Antimonopoly Service
FATF	Financial Action Task Force
FCP	Financial Consumer Protection
FFMS	Federal Service for Financial Markets
FIU	Federal Financial Monitoring Service
FSAP	Financial Sector Assessment Program
G20	Group of Twenty
G2P	Government to Person
GDP	Gross Domestic Product
GPMI	Global Partnership for Financial Inclusion
ICT	Information and Communications Technology
IFC	International Finance Corporation
KYC	Know Your Customer
KFS	Key Facts Statement
M&E	Monitoring and Evaluating
MFI	Microfinance Institution
MNO	Mobile Network Operator
MoC	Ministry of Communications
MoE	Ministry of Education
MoED	Ministry of Economic Development
MoF	Ministry of Finance
MoU	Memorandum of Understanding
MSMEs	Micro, Small, and Medium Enterprises
NAFI	National Agency for Financial Studies

NAMMS	National Association of Microfinance Stakeholders
NBCO	Non-Bank Credit Organization
NBKI	National Bureau of Credit Histories
FIS	Financial Inclusion Strategy
NGO	Non-Governmental Organization
NPLs	Non-Performing Loans
OECD	Organisation for Economic Cooperation and Development
POS	Point of Sale
PSP	Payment Service Provider
RMC	Russian Microfinance Center
SEC	Securities and Exchange Commission
SME	Small and Medium Enterprises
SME Bank	Russian Small and Medium Entrepreneurship Bank
SRO	Self-regulatory organization
WB	World Bank
WBG	World Bank Group

I. EXECUTIVE SUMMARY

1. The overall state of financial inclusion in Russia is relatively advanced along certain basic metrics. The number of adults with accounts at a financial institution stands at 67.4 percent, which compares well to the Europe and Central Asia (ECA) regional average of 51.4 percent. Account penetration has increased by nearly 20 percentage points since 2011, with increases experienced across all segments of the population, including for the poorest 40 percent and for women.¹ Russia also has a large number of regulated financial institutions and enjoys 36.98 branches per 100,000 adults, higher than for the United States (32.39) and China (24.03).²

2. Despite these improvements, several gaps in financial inclusion remain. Unsurprisingly given its geography and population density, Russia faces a challenge of reaching the “last mile”, those segments of the population that are difficult to reach and serve on a sustainable basis. Physical access to financial services remains centered in major urban areas, and account penetration drops outside of these urban centers, as well as for the low-income and the elderly.

3. In addition, usage of accounts and other financial services remains low among the underserved, as does the available range and quality of financial products and services. The main mode for retail payments is still via cash; while underserved individuals may own accounts, many consumers withdraw the full amount they receive from regular government payments or salaries. Most credit and deposit-taking activity still occurs among the middle-high income segments of the population, and there appear to be gaps in terms of both the availability and usage of appropriate savings products for the underserved. The microcredit products that are available to the underserved are of poor quality. There are low levels of trust in the formal financial sector among the Russian population, in particular for microfinance institutions (MFIs).

4. While there is a large number of banks, the banking sector is highly concentrated, with state-owned banks playing a dominant role. Few outlets exist in rural and remote areas except for Sberbank and outlets for payments services provided via Russian Post. Most commercial banks do not serve the underserved, although some smaller, locally-focused banks do have outreach beyond urban centers and into the district level.

5. However, banks are perceived by the Russian population as the most trustworthy service providers, and will necessarily be a key component in any financial inclusion strategy. While there are large numbers of MFIs and credit cooperatives (and increasing numbers of e-money organizations), these institutions either do not focus on the underserved, cannot provide a full range of basic products (i.e. microsavings, other appropriate deposit or transactional account products), or do not have the scale necessary to reach large numbers of the underserved in Russia. As banks have the right to accept deposits, such institutions are better positioned to both provide deposit services for the underserved as well as access lower cost capital compared to MFIs, allowing for greater potential expansion over the long-run.

¹ World Bank Global Findex, 2014.

² IMF Financial Access Survey, 2014.

6. The existing regulatory framework results in disproportionate compliance and reporting burdens on smaller, locally-focused, less sophisticated banks that may have lower risk profiles. Financial inclusion for low-income and rural communities could be improved if there was a more level playing field across providers. Facilitating a more tiered banking system with a proportionate regulatory framework for banks (or deposit-taking non-bank credit organizations (NBCOs)) with a more limited set of operations is one approach to encourage greater competition, providing the necessary space and incentives for smaller organizations that operate in limited geographic regions and provide basic banking products and services. Greater competition would also improve the quality of products and services for the underserved. The launch of Post Bank by VTB is further welcome step towards more competition.

7. MFIs have potential to play an increased role in financial inclusion if traditional microfinance were encouraged and microfinance clearly differentiated from payday lending.³ The majority of MFIs (3,852 as of April 1, 2016)⁴ are located in urban areas and do not provide microfinance in the traditional sense, but rather unsecured, short-term loans with very high interest rates (up to 2 percent per day) and loose creditworthiness assessments. The definition of microfinance and MFIs should be revised to align with international best practices, including the qualitative characteristics of traditional microfinance. The CBR has begun taking action to shift the focus of the microfinance market away from payday lending. Policy tools such as tax incentives and small and medium enterprise (SME) finance support programs could then be targeted to encourage the long-term growth of sustainable and commercially-based MFIs more focused on productive lending. At the same time, the financial consumer protection regulatory framework should be enhanced and more actively supervised via thematic reviews and spot checks in order to curb the increasing incidence of overindebtedness and abusive collection practices in the payday lending industry.

8. Around 3,500 consumer credit cooperatives (CCCs)⁵ exist in Russia and are often located in villages and towns outside of urban centers, but only serve 1 million members. Given their geographic location, they have modest potential to contribute further to financial inclusion if their capacity is increased and operations modernized, although their range of offerings is limited to basic savings and credit products.

9. Reaching the underserved in Russia will require leveraging agent-based and technology-driven strategies to provide cost-effective means of service delivery beyond physical bank branches. Mobile branches, agent-based models, and digital delivery and use of technology could all help to reach the underserved at a lower and more viable operational cost. Many of the basic building blocks are already in place, including a wide network of automated, cash-in payment terminals⁶ operated by around 12,000 payment agents⁷ as well as good mobile and internet penetration.⁸ However, the lack of sufficient cash-out points and card acceptance

³ Unlike in other countries, “payday lending” in Russia does not refer to short-term loans linked to salary payments, but rather is a more generic classification for small, short-term, unsecured loans offered at very high interest rates.

⁴ <http://www.rusmicrofinance.ru/>.

⁵ 3,430 as of April 1, 2016. Source: CBR.

⁶ Payment terminals are automated cash-in devices that allow for the payment of various types of bills and services.

⁷ For purposes of this Technical Note, the term “payment agents” is used to refer to both bank payment agents and non-bank payments agents.

⁸ Landscaping Report: Financial Inclusion in Russia. CGAP, 2012.

infrastructure such as point-of-sale (POS) devices presents an important gap in the system, limiting accessibility and functionality of accounts on the demand-side and viable outreach on the supply side.

10. Expanding the functionality of agents could help to expand use of agent-based models. A further expanded and more enabling regulatory framework for the use of bank payment agents should be put in place that allows for a wider range of permissible activities beyond payment services. This expansion of agent functionality would need to be complemented by correspondingly increased CBR regulation and oversight of such agents, using a risk-based approach that leverages limited supervisory resources while still putting in place adequate controls, including placing clear responsibilities on the provider contracting such agents. A modernized Russian Post could also play an expanded role as a potential agent for a greater number of partners, more fully leveraging its wide network of outlets.

11. A more proportionate AML/CFT framework with enhancements to make it further risk-based would also benefit financial inclusion. The current AML/CFT framework was cited as one of the main barriers to financial inclusion by a majority of stakeholders, in particular limitations on and difficulties with the use of simplified identification, requirements for repeat authentication, and high compliance costs and reporting requirements which pose a particular burden for smaller financial institutions. The next National Risk Assessment to be conducted should be used as an opportunity to better assess the precise risks posed in Russia and determine how best to adapt the AML/CFT framework accordingly, taking into consideration the tradeoffs between financial inclusion and financial integrity and achieving better alignment of requirements and related compliance costs and resource allocation. The result of the National Risk Assessment should be made publicly available if possible.

12. Digital finance has increased in recent years, but has focused primarily on urban, wealthier, and more educated consumers. Nevertheless, digital channels and digital technology and business models do have the potential to contribute to financial inclusion. Several underlying and contributing improvements will be needed to achieve this potential, including on the supply side (e.g. increased competition, expanded financial and ICT infrastructure) and on the demand side (e.g. financial education targeted to digital finance products and services). Further partnerships between e-money providers, mobile network operators (MNOs), and traditional financial providers should be encouraged in order to provide a better value proposition for consumers with respect to a broader range of product offerings and greater physical, real-world linkages to digital services. The greater untapped potential may be for traditional banks or non-bank financial institutions to leverage digital channels, technologies, and models to expand outreach.

13. The development of a national financial inclusion strategy should be fully utilized to tackle the challenge of financial inclusion from a comprehensive perspective and to generate buy-in and coordinated action across all relevant stakeholders. Achieving financial inclusion will require harnessing the potential of a range of financial providers (i.e. banks, NBCOs, MFIs, CCCs, and other financial intermediaries) and strategies (i.e. leveraging agent-based models and technology-driven solutions, increasing competition). There is no comprehensive conception of financial inclusion across stakeholders, and efforts related to financial inclusion are scattered across various agencies. The CBR is currently leading the effort to develop a financial inclusion

strategy, which provides the unique opportunity to clearly define financial inclusion challenges and objectives for the country. To be successful, the development of such a strategy will require the active contribution and support from various CBR departments. Participation of a range of public and private stakeholders will also be necessary and desirable.

14. Several important macroeconomic factors should also be taken into consideration as relevant context for this Technical Note. The Russian economy is currently in recession, with sharp declines in oil prices and economic sanctions affecting economic growth. Inflation stands at 8.1 percent as of February 2016.⁹ The economic downturn has negatively impacted consumption and income levels, and appears to have negatively impacted the general demand for financial services and the overall ability of the Russian population to save. While these macroeconomic factors provide useful context to consider, particularly when examining the current levels of usage and behavior of the underserved, the analyses and recommendations included in this Technical Note primarily focus on a systemic, long-term perspective towards increasing financial inclusion and are relevant despite of current economic conditions.

15. This Technical Note analyzes the state of financial inclusion in Russia using a systematic approach. Financial inclusion is increasingly being defined as access to, and usage of, a range of appropriate financial products and services, delivered in a responsible and sustainable manner to unserved individuals, microenterprises, and SMEs. This comprehensive conception of financial inclusion acknowledges that multiple elements must work together to achieve a long-term, sustainable level of financial inclusion, including the business case for providers and appropriate consumer protection for consumers. Achieving this conception of financial inclusion also requires an underlying foundation of an enabling legal and regulatory framework, adequate financial and ICT infrastructure, and stakeholder commitment.¹⁰ Following along these lines, this Technical Note is divided into the following sections:

- II. Current State of Financial Inclusion in Russia (e.g. levels of access, headline indicators)*
- III. Public and Private Sector Commitment (e.g. key stakeholders, financial inclusion definition and mandate, level of coordination, data infrastructure and M&E)*
- IV. Provider Reach (e.g. access points, non-branch channels)*
- V. Provider Diversity and Sustainability (e.g. competition, level playing field, entry barriers, proportionate legal, regulatory, and supervisory framework)*
- VI. Product Range and Appropriateness (e.g. sufficiency of range of products, appropriateness of products for the underserved)*
- VII. Financial consumer protection (e.g. legal, regulatory, and supervisory framework, disclosure and transparency, fair treatment, internal and external dispute resolution)*

16. Table 1 provides a high-level summary of the main policy recommendations included in the Technical Note.

Table 1. Summary of Main Policy Recommendations

⁹ Aide-Memoire, WB/IMF Financial Sector Assessment Program, March 2016.

¹⁰ As agreed with Russian authorities prior to the FSAP, the scope of this Technical Note focuses primarily on accessibility, diversity, and quality of financial products (payments, savings, and credit) for low-income adults, including those in rural areas. This Technical Note does not cover (or only lightly touches upon) other important elements of financial inclusion, such as financial inclusion for SMEs, other financial products or services such as insurance and pensions, and other important topics such as financial infrastructure.

Recommendation	Authority	Timeframe*
Public and Private Sector Commitment		
<ul style="list-style-type: none"> • Develop a clear, comprehensive definition and vision of financial inclusion in Russia across all stakeholders • Develop a financial inclusion strategy (FIS) with systemic perspective that examines key drivers and enablers from both supply side and demand side • Establish an effective coordination mechanism for the FIS and allocate responsibilities across public and private stakeholders 	CBR, MoF, MoED, General CP Regulator, other stakeholders	MT
<ul style="list-style-type: none"> • Ensure sufficient capacity, resources, and leverage to accomplish the financial inclusion mandate of the Main Office of Microfinance Market • Establish a standing CBR-wide committee on financial inclusion across relevant departments 	CBR	ST
<ul style="list-style-type: none"> • Establish a bureau or similar entity to coordinate and assess the impact of different financial inclusion and financial education programs across multiple agencies 	MoF, CBR, MoED, MoE, Ministry of Ag, Ministry of Communications	MT
<ul style="list-style-type: none"> • Develop and operationalize a robust M&E system for financial inclusion, including strengthening the supporting data infrastructure to improve the scope, consistency, frequency, and availability of data relevant to financial inclusion 	CBR, MoF	ST
Provider Reach		
<ul style="list-style-type: none"> • Encourage expansion of POS network in rural and remote areas via subsidies or other incentives • Map existing retail payment outlets, including ATMs, POS devices, payment terminals (bank and agent terminals), and payment agents 	CBR	ST/MT
<ul style="list-style-type: none"> • Revise regulatory framework to further expand functionality of bank payment agents, with corresponding expansion of oversight of agents using a risk-based approach • Modernize Russian Post and further leverage via partnerships with financial providers 	CBR, Russian Post, Ministry of Communications	ST/MT
<ul style="list-style-type: none"> • Conduct National Risk Assessment to determine appropriate improvement of AML/CFT framework for further identification development 	FIU, CBR, Ministry of Communications	MT
<ul style="list-style-type: none"> • Encourage and enable increased leveraging of digital channels and models to reach the underserved by traditional providers, including via partnerships with digital finance providers 	CBR, Ministry of Communications	MT/LT

<ul style="list-style-type: none"> Enhance financial and ICT infrastructure 		
Provider Diversity and Sustainability		
<ul style="list-style-type: none"> Encourage expansion of Post Bank to reach underserved in remote areas with basic products and services per Post Bank’s stated strategy Introduce more tiered banking system with proportionate regulatory framework for banks (or deposit-taking NBCOs) with limited set of defined operations 	CBR, VTB Group, Russian Post	ST/MT
<ul style="list-style-type: none"> Develop clear definitions for “microfinance” and “MFIs” that align more closely with traditional microfinance business models and effectively distinguish microfinance from payday lending Transform and consolidate government-run MFIs into SME support funds for greater efficiency Support long-term growth of private, commercially operated MFIs via subsidized credit from SME support funds and tax incentives 	CBR, MoED	ST/MT
<ul style="list-style-type: none"> Modernize CCCs through capacity building programs Enhance operations of CCCs via support for suitable deposit insurance schemes and greater flexibility regarding investments Enhance reporting requirements for SROs, harmonize standards, and provide capacity building for SRO staff 	CBR	ST/MT
<ul style="list-style-type: none"> Conduct National Risk Assessment to determine proportionate, risk-based AML/CFT framework to better align requirements and related compliance costs 	FIU, CBR,	MT
Product Range and Appropriateness		
<ul style="list-style-type: none"> Conduct targeted, demand-side research on digital finance and payment and savings needs and behavioral patterns of the underserved Develop targeted financial education initiatives for underserved regarding digital finance and savings 	CBR, MoF, MoE	ST/MT
<ul style="list-style-type: none"> Re-evaluate intended purpose, impact, and market consequences of current approach to interest rate caps by provider type and product type to gauge effectiveness 	CBR	ST
Financial Consumer Protection		
<ul style="list-style-type: none"> Clarify supervisory structure for consumer protection through additional MoUs among relevant authorities and/or via reform of legal framework Develop enhanced mechanisms to share supervisory data and coordinate supervisory and enforcement actions 	CBR, General CP Regulator, FAS	ST/MT
<ul style="list-style-type: none"> Harmonize legal and regulatory framework to address overlaps and gaps and to ensure harmonization of approach by issue across different provider types 	CBR, General CP Regulator	MT

<ul style="list-style-type: none"> • Introduce enhanced disclosure rules (e.g. oral explanation and visual representations of effective interest rates (EIR), price comparison and product selection websites) • Introduce targeted responsible finance rules to combat predatory lending without unduly restricting flexibility and innovation in the market (e.g. mandatory assessment of repayment capabilities) 	CBR, MoF	ST/MT
<ul style="list-style-type: none"> • Improve enforcement of regulatory provisions related to debt collection, and/or encourage passage of new, appropriately drafted law • Increase law enforcement efforts against criminal behavior or formal or informal debt collectors 	CBR	ST
<ul style="list-style-type: none"> • Clarify roles of various institutions currently functioning as external dispute resolution (EDR) mechanisms • Pass law to establish financial sector ombudsman 	CBR, MoF, General CP Regulator	ST/MT

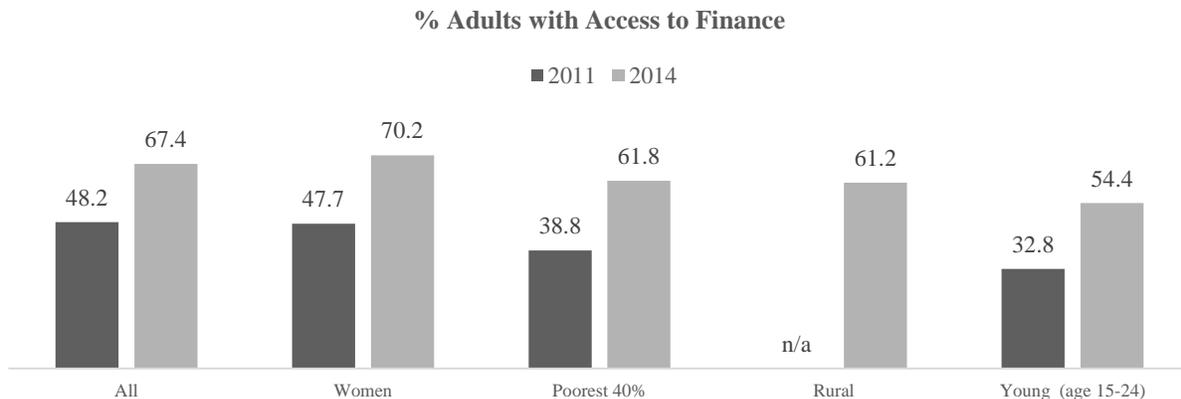
* *ST = short-term, MT = medium-term, LT = long-term*

II. CURRENT STATE OF FINANCIAL INCLUSION IN RUSSIA

Access to Finance for Individuals

17. In the past few years, Russia has made significant progress in terms of account penetration. According to the World Bank’s Global Findex 2014 data, 67.4 percent of adults (age 15 and above) have an account at a financial institution, representing an increase in nearly 20 percentage points since 2011.¹¹ Russian account penetration fares well compared with the Europe and Central Asia (ECA) regional average of 51.4 percent, though it is lower than the high-income non-OECD average of 72.8 percent.¹² As shown in *Figure 1*, account penetration increased across all segments of the population, including for the poorest 40 percent of the population and for women.

Figure 1: Financial inclusion in Russia by demographic and socioeconomic features



Source: WB Global Findex, 2014. Data for rural areas in 2011 not available.

18. Despite these significant improvements in account penetration, progress remains needed in relation to the “last mile”, those segments of the population that are difficult to reach and serve on a sustainable basis. The unserved and underserved in Russia belong to certain geographic and demographic types. As can be expected from a country with Russia’s geographic characteristics, the underserved tend to live in rural and remote areas and do not have easy access to the internet. While overall account penetration is at 67.4 percent, ownership of an account among the poorest 40 percent and individuals living in rural areas is lower, reaching only 61.8 percent and 61.2 percent, respectively.¹³ Physical access to financial services remains centered in the Central Federal District and major urban areas, and there is a clear challenge to increase overall access and usage in the remaining parts of the country. For example, according

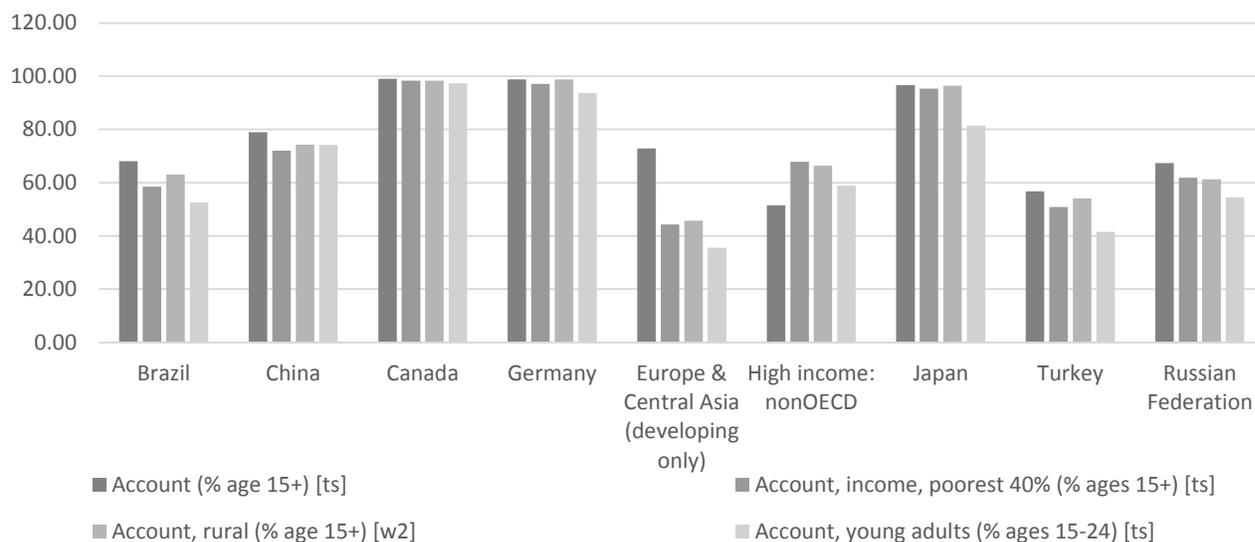
¹¹ “Account at a financial institution” includes respondents who report having an account at a bank or at another type of financial institution, such as a credit union, microfinance institution, cooperative, or the post office (if applicable), or having a debit card in their own name. Note that account penetration may actually be higher than reported in Findex due to misunderstanding by Findex respondents, as according to 2014 CGAP research, account penetration stood at 77 percent.

¹² WB Global Findex, 2014.

¹³ WB Global Findex, 2014.

to findings from a CGAP survey,¹⁴ the share of people not using any financial service is about half the national average of 23 percent in Moscow and St. Petersburg (11 and 12 percent, respectively), whereas this figure increases by 10 percent above the national average among people living in rural areas.

Figure 2. Financial inclusion in Russia and peer countries by demographic features



Source: WB Global Findex, 2014

19. In addition to the gap between urban and rural areas, disparity between regions is also high, with certain geographical pockets nearly completely underserved. For example, according to a survey on financial inclusion conducted by the National Agency for Financial Studies (NAFI) in 2015, only 9 percent of adults in the Northern Caucasus have deposits (compared to the national average of 18 percent) and 19 percent of adults have a loan (compared to the national average of 29 percent). There is a noticeable lack of service in this area; only 42 percent of the adults living in the Northern Caucasus are satisfied with the amount and quality of points of services, compared to over 70 percent for the total adult population in Russia. Furthermore, 26 percent of adults in the region say that they do not have any choice in access points (versus 7 percent for the total adult population).¹⁵

20. Beyond gaps in account penetration and access to services, actual usage of financial products and services remains low. The NAFI survey shows that 21 percent of the Russian population do not use financial services. This percentage increases among the elderly and less educated - 27 percent of respondents aged 55 years and older and 34 percent of respondents with a low level of education do not use financial services.¹⁶

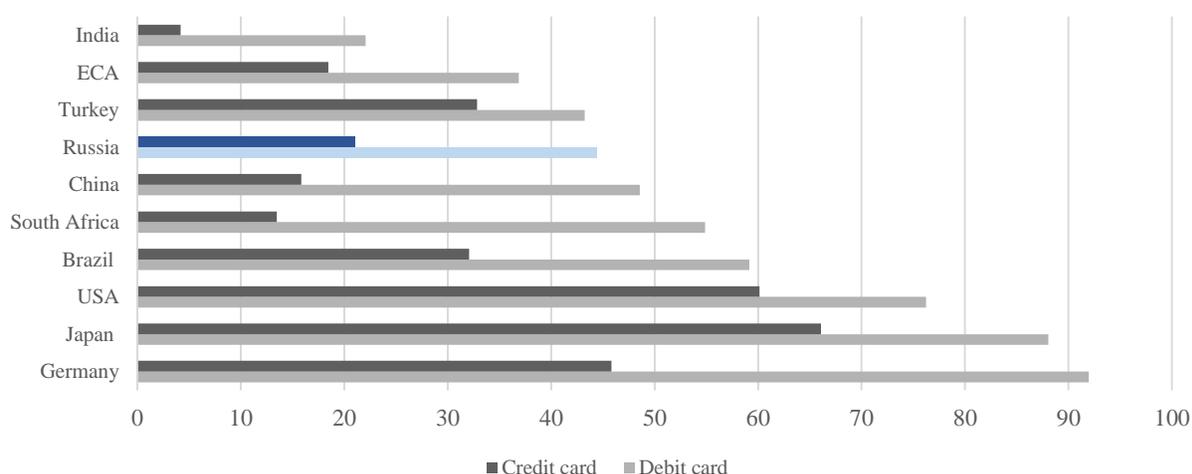
¹⁴ Imaeva, G., Lobanova, I. & Tomilova, O. (2014). *Financial Inclusion in Russia: The Demand-Side Perspective*. Moscow, CGAP.

¹⁵ NAFI Survey, 2016 available at <http://nacfin.ru/finansovaya-dostupnost-v-rossii/>

¹⁶ NAFI Survey, 2016 available at <http://nacfin.ru/finansovaya-dostupnost-v-rossii/>.

21. Usage of cash remains predominant and other transactions instruments are rarely used. A common use of accounts by the underserved in Russia is for the receipt of wages or government payments. For example, pensions are a main driver of account penetration for older generations, but uptake of accounts does not translate into usage. While 26 percent of pensioners have deposit/savings in an account, less than half of these users make cashless transactions.¹⁷ The main mode of retail payments is also via cash. Cash is used for an estimated 95 percent of consumer transactions in Russia, compared to 69 percent in Germany and 47 percent in the United States.¹⁸ Ownership and usage of electronic payment instruments remains relatively low compared to peer countries, as seen in *Figure 3*. According to WB Global Findex 2014 data, 44.3 percent of Russian adults reported to have a debit card and 21 percent reported to have a credit card. Usage is lower at 35 percent for debit cards and 16.6 percent for credit cards.

Figure 3. Debit and Credit Card Ownership (% age 15+)



Source: WB Global Findex, 2014

22. Russians are increasingly using online and mobile channels for transactions, providing an opportunity to increase both access and usage. Twenty-two percent of account owners used the internet for transactions, and 13.9 percent of adults used mobile phones to make transactions, including making payments, purchases, or sending or receiving money.¹⁹ The latter indicator places Russia in line with countries such as Germany (12.8 percent) and China (14.3 percent), and well above the regional ECA average of 3.8 percent. In 2015, more than 317 million active e-money accounts (prepaid cards, e-wallets etc.) were reported in Russia and over 1.2 billion e-money transactions were conducted, the total volume of which amounted to 912 billion rubles.²⁰ Internet payments are on the rise in Russia; in 2014, 40 percent of total payments were made through internet banking systems.²¹ Opportunities exist to further shift to digital channels to increase access and usage for consumers and lower operational costs for providers. For

¹⁷ “Уровень доступности финансовых услуг в российской федерации.” NAFI, 2016.

¹⁸ “Forging a path to payment digitization.” McKinsey&Company, March 2013.

¹⁹ WB Global Findex, 2014 and “Уровень доступности финансовых услуг в российской федерации,” NAFI, 2016.

²⁰ http://www.cbr.ru/Eng/statistics/print.aspx?file=p_sys/sheet001.htm&pid=psrf&sid=ITM_8019

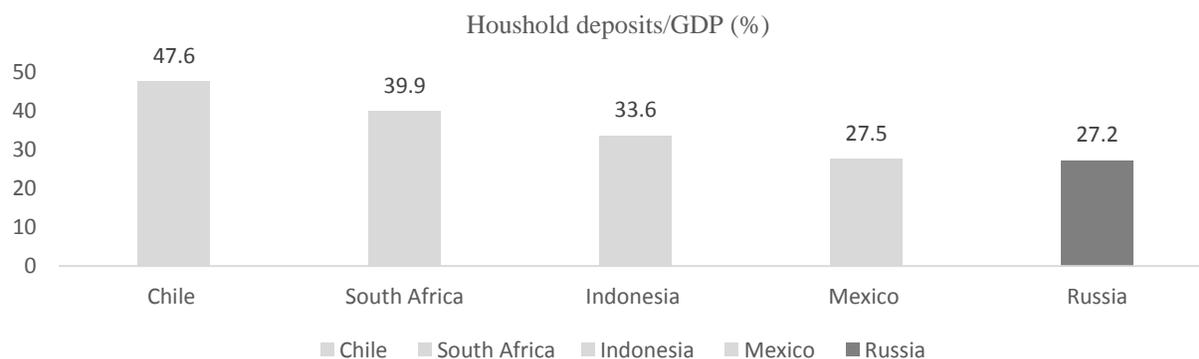
²¹ http://raexpert.org/related_activities/researches/banks/

example, of the pensioners with deposits/savings in an account, only 6 percent have used a mobile device to make payments.²² Similarly, the use of mobile channels for sending and receiving remittances stands below 10 percent, which could be further increased.

23. The level of formal savings appears to be limited. In 2014, only 40.7 percent of Russian adults reported to having saved or set money aside in the past year. In addition, only 15.5 percent of adults indicate that they save at a financial institution, implying that many Russians are using informal savings methods.²³ Most deposit accounts in the Russian Federation have very low balances. In January 2016, over 94 percent of accounts had a balance of 100,000 rubles or lower,²⁴ reflective of both a cash-based society as well as low usage of savings products. The share of formal savings in the overall structure of household disposable income is low at an average of 9.5 percent for the last three years, and overall household deposits to GDP is also low compared to peer economics, as can be seen in

24. Figure 4.²⁵

Figure 4: Household deposits in selected emerging economies, % of GDP



Source: International Monetary Fund and national central banks

25. The number of Russian adults who are not saving has been increasing in recent years. In a 2016 NAFI survey on savings, 73 percent of Russian adults reported not having deposits or savings in a formal financial institutions, an increase from 67 percent in 2012 and 61 percent in 2011. The 2016 NAFI survey results show lower levels of savings among lower-income and lower-educated individuals; for example, 20 percent of adults without a higher education have some deposits or savings, compared to 35 percent of adults with a higher education.²⁶ As can be seen in Table 2, Russia compares relatively well against countries such as Turkey and the ECA average in terms of adults savings in a financial institution, but fares less well against both developed economies such as Japan and Germany as well as developing economies such as China, India, and South Africa.

²² “Уровень доступности финансовых услуг в российской федерации.” NAFI, 2016.

²³ WB Global Findex, 2014 and 2011.

²⁴ CBR.

²⁵ Guidelines for the Development of the Russian Financial Market in 2016-2018, at 22.

²⁶ NAFI Survey, 2016, available at <http://nacfin.ru/dlya-sberezhenij-ne-vremya/>.

Table 2: Usage of different types of products by individuals in selected economies

Indicators	RUS	Comparison country / group of countries							
		BRA	CHN	IND	ZAF	DEU	JPN	TUR	ECA
% adults with a transaction account	67.4	68.1	78.9	53.1	70.3	98.8	96.6	56.7	51.4
% adults using an electronic payment instrument	7.7	16.6	6.9	2.0	13.1	64.2	44.8	11.1	8.0
% adults saving in a regulated FI	15.5	12.3	41.2	14.4	32.7	57.9	60.4	9.1	8.4
% adults with credit from regulated FI	10.3	11.9	9.6	6.4	12.1	18.6	7.9	20.0	12.4

Source: *WB Global Findex 2014*

26. In contrast, Russian adults are using more credit products, with particular growth in short-term, high interest rate loans. There is a much higher usage of credit than savings products, a trend that is more pronounced among the lowest income segments.²⁷ Consumer loans are the most used product among bank product offerings; as of February 2016, the total number of loans to individuals amounted to over 10 billion rubles, with over 50 percent of portfolio in consumer loans.²⁸ Lower income and lower literacy individuals are turning to MFIs for loans at high interest rates, in particular payday and consumer lenders, as they are increasingly unable to obtain loans from banks due to stricter lending policies at banks (and loose practices at MFIs).

27. The overall lack of trust in the financial sector poses a major obstacle to financial inclusion. While lack of trust in the financial sector has a long history in Russia, this lack of trust has been slowly increasing. In 2015, only 58 percent of Russian adults had confidence in the banking system, compared to 78 percent in 2013. In particular, distrust in MFIs and their products is increasing due to the low quality of products offered and the behavior of MFIs. In 2012, 14 percent of adults had confidence in MFIs, a low figure to begin with. In 2015, this percentage decreased further to 8 percent.²⁹ Following these trends, while 74 percent of adults declared not planning to use a MFI in 2015, this number increased to 94 percent in 2016. Furthermore, the percentage of adults declaring not wanting to use such an institution due to lack of trust grew from 24 percent in 2015 to 58 percent in 2016.³⁰

Access to Finance for SMEs

28. Access to finance is perceived by firms as a significant obstacle to doing business in Russia. According to the World Bank's Enterprise Survey (ES) 2012, 36.1 percent of Russian firms identify tax rates as their biggest business environment constraint, followed by access to finance (14.8 percent of firms) and corruption (8.2 percent of firms). Yet 28 percent of firms agree that access to finance is among their major constraints (compared to 26 percent for the high income non-OECD average). The World Economic Forum's Global Competitiveness Index for 2015-2016 reported access to finance as the third most problematic factor for doing business, after corruption and tax rates.³¹ Similarly, in the World Bank's Doing Business 2016 report, Russia

²⁷ Imaeva, G., Lobanova, I. & Tomilova, O. (2014). *Financial Inclusion in Russia: The Demand-Side Perspective*. Moscow, CGAP.

²⁸ CBR.

²⁹ NAFI Survey, 2015, available at <http://nacfin.ru/doverie-finansovym-organizaciyam-snizilos-2/>.

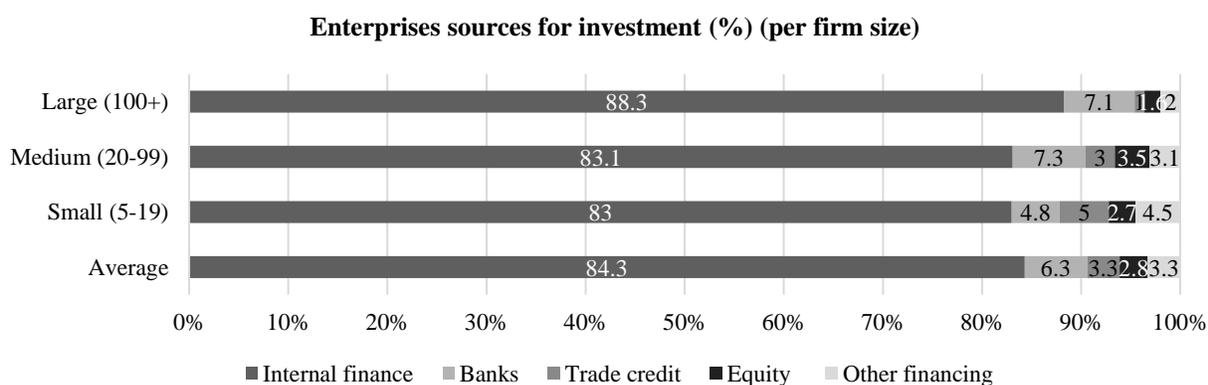
³⁰ NAFI Survey, 2016.

³¹ The Global Competitiveness Report 2015-2016 assesses the competitiveness landscape of 140 economies, providing insight into the drivers of their productivity and prosperity.

ranks 42 out of 189 economies in the ease of getting credit. Nearly 100 percent of firms report having a bank account (for small firms, account ownership stands at 99.9 percent), exceeding the high income non-OECD average of 97.1 percent, but only 21.6 percent of them have a loan or line of credit.

29. Data from ES indicates that business investments in Russia are mostly financed internally (84.3 percent), and collateral requirements are better than peer countries. The ES also found that 15.8 percent of small firms’ and 25.7 percent of medium firms’ operations are supported by working capital loans from banks. Only 21.6 percent of firms have a bank loan or line of credit, while 36.1 percent of small firms and 24.8 of medium firms reported having their loan application rejected (which is below the high income non-OECD average at 42.1 percent). Around 84 percent of loans require collateral. While collateral requirements are still elevated at around 154 percent, these figures are lower than the high income non-OECD average of 180.

Figure 5. Funding Sources for Investment by Firm Size in Russia



Source: WB Enterprise Survey, 2012

Credit Infrastructure

30. The coverage by private credit bureaus is reported to be robust, but not all regulated financial institutions are currently submitting required information to credit bureaus. As of 2016, there are currently 22 private credit bureaus in the market. Both firms and individuals information is reported by banks, with the credit bureaus covering over 70 percent of the adult population with both positive and negative data.³² Credit institutions must now submit information on borrowers to at least one credit bureau and, since 2014, do not need a consumer’s prior written consent to submit such information. MFIs and CCCs are also required to submit information on borrowers beginning in 2014. However, according to the CBR, not all MFIs are currently complying with this requirement. The largest credit bureau, the National Bureau of Credit Histories (NBKI), regularly publishes market analyses based on credit information submitted by 2,500 MFIs (65% of all MFIs). The two largest credit bureaus have recently started collecting payment information from mobile network operators (MNOs) and some utilities

³² Doing Business. World Bank, 2016.

companies. This information can be used by financial institutions to enhance their scoring models for consumer lending, thus improving their portfolio quality.

III. PUBLIC AND PRIVATE SECTOR COMMITMENT

31. Russian policymakers have increasingly recognized financial inclusion as a priority area and have adopted several measures to promote access to and usage of financial services in the country. President Putin made one of the first high-level commitments to financial inclusion in a speech in 2007.³³ Since then, the government has reaffirmed its commitment in different political settings. In 2010, Russia committed to the G20 Seoul Development Consensus for Shared Growth on increased access to financial services. The country agreed to (i) develop a national action plan for increasing access to financial services, (ii) participate in the G20 Global Partnership for Financial Inclusion (GPFI), and (iii) create of a flexible system for SME enterprise financing.³⁴ CBR is also a member of the Alliance for Financial Inclusion (AFI), and joined the Maya Declaration in 2014.³⁵

32. Despite these recent and visible commitments, financial inclusion is still a relatively new concept in Russia and a consistent, comprehensive definition of financial inclusion is currently lacking. This lack of a comprehensive definition for financial inclusion adopted by all policymakers impedes the development of a more systematic approach to tackling financial inclusion that considers both the various obstacles to financial inclusion and the potential drivers to encourage financial inclusion. It also poses an obstacle to developing consensus around clearly articulated objectives for financial inclusion across diverse public and private stakeholders. Past efforts by the Ministry of Economic Development (MoED) defined financial inclusion as “territorial and technological accessibility of five basic types of financial services – credit, savings, money transfers (payments), insurance and leasing”.³⁶ In 2015, CBR developed and adopted a definition of “financial inclusion” as part of the Plan for Financial Inclusion Promotion aimed to co-ordinate CBR’s activities on financial inclusion.³⁷ This definition is a broader definition of financial inclusion, which includes besides physical access (“Financial Infrastructure”) such dimensions as “Financial Services Usage”, “Financial Services Quality” (including safety of financial services provision, affordability, trustworthiness, effectiveness of client protection mechanisms), and “Financial Services Utility” (including financial awareness and education and impact on financial services consumers). The recent CBR Guidelines for the Development of the Russian Financial Market in 2016-2018 also includes a broader conception of financial inclusion, noting that financial inclusion involves more than physical access, but also requires a range of quality and useful products.

33. A clear, comprehensive conception of financial inclusion should be adopted for all stakeholders in Russia. Among international bodies, financial inclusion is increasingly being defined as access to, and usage of, a range of appropriate financial products and services, delivered in a responsible and sustainable manner to underserved individuals, microenterprises,

³³ Message from the President of the Russian Federation Vladimir Putin to the Federal Assembly, November 2007.

³⁴ RMC, BFA (2014). Final Report Financial Inclusion and the Linkages to Financial Stability, Integrity and Consumer Protection: Insights from the Russia Experience. Moscow, BFA.

³⁵ The Maya Declaration is a global commitment by policymakers in developing and emerging countries to unlock the economic and social potential of the poor through greater financial inclusion. Signatories to the Maya Declaration agree to make measurable commitments to increase financial inclusion. See <http://www.afi-global.org/maya-declaration>.

³⁶ RMC, BFA (2014). Final Report Financial Inclusion and the Linkages to Financial Stability, Integrity and Consumer Protection: Insights from the Russia Experience. Moscow, BFA.

³⁷ CBR website.

http://cbr.ru/finmarkets/print.aspx?file=files/development/definition.html&pid=development_affor&sid=ITM_26524

and SMEs. The key components of this conception to consider are usage (suggesting that the product or service is useful to the consumer), appropriateness of products (products or services that improve the well-being of consumers), responsible business models and provision, and the sustainability of providers involved in financial inclusion. Responsible provision highlights the need for consumer protection and financial inclusion go hand-in-hand. The last component on sustainability highlights the need for an environment where there is a viable business case and the means for a range of providers to reach the underserved on a sustainable, cost-effective basis, in order to successfully achieve financial inclusion over the long-term.

Financial Inclusion Strategy (FIS) and Coordination Mechanisms

34. Given the need for coordinated action to further advance financial inclusion in Russia, a national financial inclusion strategy should be developed. Previous efforts to develop financial inclusion strategies did not have buy-in from a wide range of stakeholders or clear leadership. With the CBR becoming a mega-regulator in 2013, an opportunity has arisen for building broader consensus and establishing leadership on financial inclusion. In 2014, the Main Office of Microfinance Market (“Main Office”) was established,³⁸ and was soon given the additional task of coordinating financial inclusion within the CBR. In 2015, the CBR adopted a Plan for Financial Inclusion Promotion and conducted its first financial access survey.³⁹ At the same time, the CBR circulated the draft Guidelines for the Development of the Russian Financial Market for 2016 to 2018. Financial inclusion plays a key role in this document, with policymakers stating the hope that “all legally capable individuals and small and medium-sized businesses shall have a guaranteed set of basic financial services.”⁴⁰

35. The roadmap for implementing the Guidelines for the Development of the Russian Financial Market includes the development of a FIS, which should leverage the potential of a range of different types of financial providers. The Main Office has been tasked with developing the FIS draft by December 2016, and has indicated that the FIS will focus heavily on MFIs. However, as further described in Section IV, MFIs serve a very small percentage of the population and consist primarily of payday and consumer lenders (by the number of financial services providers).⁴¹ Achieving financial inclusion on a larger scale and on a sustainable basis will require harnessing the potential of the full range of different types of financial providers in the Russian market (i.e. banks, NBCOs, MFIs, CCCs, and payment service providers (PSPs)).

36. The FIS should take a systemic perspective, examining key drivers and enablers necessary from both the supply side and demand side for the long-term, sustainable advancement of financial inclusion in Russia. A holistic approach should consider the critical components necessary to achieve financial inclusion, including an enabling legal and regulatory environment, underlying financial infrastructure, and information and communications technology (ICT) infrastructure. On the demand side, financial education and leveraging large-volume payment streams such as pensions and government salary payments should be considered.

³⁸ Renamed in 2015 to the Main Office of Microfinance Market and Financial Inclusion Methodology to reflect this expanded scope.

³⁹ http://www.cbr.ru/finmarkets/?PrId=development_affor

⁴⁰ Project of “Guidelines for the Development of the Russian Financial Market for 2016 to 2018”, 19.02.2016.

⁴¹ However, in terms of share of portfolio, the share of payday lending in the total MFI portfolio is 18%, and consumer loans is 44%.

Previous efforts to leverage government to person (G2P) payments to encourage account ownership illustrate the need for financial inclusion initiatives to be approached and coordinated from a holistic perspective; though successful in getting salaried individuals and pensioners to obtain bank accounts and linked debit cards, usage of such accounts and cards is low, which may be partially due to lack of card acceptance and cash-out points. Therefore, efforts on the demand-side must be matched with corresponding advancements in underlying infrastructure to achieve intended financial inclusion benefits. A range of strategies should also be incorporated that target the remaining challenges to financial inclusion in Russia, such as leveraging agent-based models and technology-driven solutions and increasing healthy competition among providers in the market.

37. Related to this more holistic approach, the development of a FIS requires effective coordination and allocation of responsibilities across numerous public and private stakeholders, and consensus building around a clear set of objectives. As a first step, the Main Office has indicated it is planning to establish a working group. Strong efforts should be made to ensure that the working group has active participation from: (1) other relevant departments within the CBR (see examples in paragraph 40 below), (2) relevant government agencies, and (3) other public and private stakeholders. Particularly given that there is not yet a widely held definition of financial inclusion in Russia nor clear consensus on specific financial inclusion strategies, the development of an effective FIS will require the close involvement of many different public and private stakeholders to begin this dialogue, including those that may not traditionally be associated with financial inclusion. The working group should be chaired by a high-level individual within the CBR to ensure that adequate buy-in and participation is garnered from both within the CBR as well as beyond it.

38. The effective design of a FIS incorporates six main components: (1) vision and definition of financial inclusion, (2) assessment of current state of affairs, (3) strategy objectives, (4) coordination & implementation mechanism, (5) monitoring & evaluation system, and (6) action plan.⁴² See Annex I for an overview of the main components of a typical NFIS.

Institutional Capacity and Commitment

39. Until 2013, there was no dedicated agency or unit in Russia directly responsible for financial inclusion. Competencies were shared between the Ministry of Finance (MoF), Ministry of Education (MoE), MoED, and the CBR.⁴³ However, with its newly defined mandate as a mega-regulator for development of the financial markets, the CBR (and other stakeholders) have interpreted this mandate to also include a mandate for financial inclusion. The CBR therefore established the Main Office in 2014. Policymakers may wish to consider whether it is worthwhile to further strengthen the CBR's legal mandate for financial inclusion by more clearly establishing it by law.

40. The Main Office consists of around 40 people and is responsible for regulation and supervision of the microfinance market and the financial inclusion promotion. The

⁴² For further information and reference materials on FIS, see http://www.worldbank.org/en/topic/financialinclusion/brief/financial-inclusion-strategies-resource-center_

⁴³ As well as the Federal Financial Market Service, the former supervisor of MFIs and cooperatives in Russia.

microfinance market includes MFIs, CCCs, agricultural credit cooperatives, pawnshops, and housing cooperatives. The Main Office directly supervises large market players, monitoring and analyzing their financial stability, while territorial CBR offices as well as the so-called “self-regulatory organizations” (SROs)⁴⁴ supervise other smaller players. In addition, one of the tasks of the Main Office is to work on improving the availability and quality of microfinance services and helps with the identification and prevention of unfair practices. With respect to financial inclusion, the Main Office has been tasked with increasing financial inclusion for individuals and SMEs, development of financial inclusion methodology, interaction with standard-setting bodies, central banks, regulators, and other government bodies, and the development of a NFIS. It has developed an initial set of financial inclusion indicators and conducts research in financial inclusion.

41. It is currently unclear whether the capacity or structure of the Main Office is sufficient to meet the demands of both supervision of the microfinance market as well as the advancement of financial inclusion, which are two related but distinct tasks. It appears that the majority of the Main Office’s staff is focused on regulation and supervision, particularly given the large number of varied players in the microfinance market. The term “microfinance market” itself is somewhat problematic, as it does not match the international usage of the term “microfinance”, which typically suggests an institutional focus on financial inclusion (further discussed in Section V). It may be preferable to revise the name of the office to more accurately reflect its scope, which covers a range of non-bank financial institutions. The focus on regulation and supervision appears to leave limited resources available to work on financial inclusion, which is a broader topic than regulation and supervision of the microfinance market that requires a different skill set, different policy objectives, and a wider, cross-cutting perspective. The two different tasks of the Main Office may at times even create a conflict of interest. In addition, the hierarchical placement of the Main Office makes it unclear whether it has sufficient scope and leverage to interact effectively with other CBR departments (e.g. banking, payments, consumer protection, licensing, financial markets development, etc.), which will be necessary to advance financial inclusion but may prove challenging given the compartmentalized nature of the CBR.⁴⁵

42. For practical purposes, while the mandate for financial inclusion needs to be housed within a functional office, attention should be paid to ensure that wherever such a mandate is housed, there is sufficient capacity, resources, and leverage to fulfill this broad mandate. The goals and objectives of any unit focused on financial inclusion should be clearly defined (and, in particular, made distinct from supervisory and oversight responsibilities over financial institutions). The working group to be set up for the FIS should help to address some the potential concerns discussed above. A standing CBR-wide committee on financial inclusion would also be useful to consider, potentially chaired by the head of the Main Office.

43. Though several government policies and programs to increase access to finance exist, they are fragmented, not well-coordinated among stakeholders, and limited in terms of size and reach. Initiatives currently include direct lending to SMEs via government programs, interest

⁴⁴ SROs are organizations with de facto delegated supervisory responsibilities, and are further described in Section V.

⁴⁵ The Main Office sits under a Deputy Governor together with other departments related to securities and insurance. Departments related to banking supervision, banking regulation, credit institution licensing, and payment systems sit under various other deputy governors.

subsidies, guarantee schemes, and financial education programs, implemented and developed by different ministries. Such efforts focus primarily on lending and not on increasing access to savings or other financial products and services needed by the underserved population. The MoF and MoE have a strong focus on financial education, having developed and implemented several projects in this area. The MoED has identified SME development as one of its priorities and the Ministry of Communications (MoC) is advancing access to broadband internet and facilitating e-government initiatives in Russia. While all of these programs contribute to improving financial inclusion, they have been characterized as “departmental”, scattered, and without coordinated strategies to increase potential impact.

Table 3. Government Policies and Programs by Ministry⁴⁶

Ministry/Entity	Related Program/Activity
Ministry of Finance	Financial Education and Financial Literacy Project ⁴⁷
Ministry of Education	Mandatory financial education module in school programs
Ministry of Agriculture	Financial services and financing to farmers via Agrarian Bank
Ministry of Economic Development	Concessionary financing program via SME Bank, selected banks, and MFIs
Central Bank of Russia	Providing funds for the development of SMEs, financial education curriculum in cooperation with the MoE
Ministry of Communications	E-government program

44. The MoED programs related to access to finance focus on MSME support. With government funded capital of 50 billion rubles yearly, the MoED supplies loans with below market interest rates for SMEs to the SME Bank,⁴⁸ which further distributes it to private sector banks. Furthermore, the MoED provides subsidized funds to regional and municipal government-run MFIs that on-lend to SMEs. Around 200 such government-run MFIs exist across the country, and it appears that many serve limited numbers of SME clients, in some cases ranging from 6 to 80 clients. A consolidation of actors, especially at the municipal level, and more coordination at the regional level may be a more efficient means of leveraging limited funds (further discussed in Section V).

45. Furthermore, the Russian government is implementing an ambitious digitalization project to advance access to broadband internet and digital financial services while also improving its e-government capabilities. The plan is to provide broadband internet to all villages and settlements with 250 people or more, with the goal of giving 95 percent of the Russian population access to broadband internet.⁴⁹ With better broadband access, the Russian government hopes to facilitate the use of more advanced financial services through digital channels. Proper

⁴⁶ Note that this table is not an exhaustive list of all government policies and programs related to financial inclusion in Russia.

⁴⁷ The project is implemented in cooperation with the CBR and the General CP Regulator.

⁴⁸ State bank set up to provide state loan support to SMEs.

⁴⁹ Finnopolis, 2015.

implementation of this project can reduce the cost of financial services and bridge the geographical barrier that Russia is facing to reach remote and underserved segments of the population. A further key area is to shift day-to-day transactions – including government and private sector payments - away from cash.⁵⁰

46. A bureau or similar entity should be established to coordinate financial inclusion and financial education initiatives across government agencies in order to better leverage the programs of multiple stakeholders to achieve greater impact. This bureau or entity could build off of efforts related to the development of the NFIS. The bureau should also be tasked with assessing the impact of such initiatives.

47. Private sector commitment to and participation in financial inclusion remains limited. Most services offered by the private sector are targeted towards the more urban and educated segment of the population, leaving out the underserved. The primary role of state banks and government funds in more rural areas, combined with the general lack of competition in the banking sector and barriers to low-cost delivery mechanisms to operate in underserved areas, impedes the development of a more vibrant and sustainable market of private sector players that reach the underserved. Long-term success in achieving financial inclusion in Russia will require more active involvement from the private sector, as well as a better understanding by policymakers of the barriers and incentives relevant to the private sector to increase their role in financial inclusion.

Financial Inclusion Data

48. The collection of financial inclusion data in Russia has been fragmented and not organized in a systematic way, though recent improvements have been initiated. The Main Office was charged with developing and implementing indicators for measuring financial inclusion in 2014. Indicators were developed in 2015 and, in cooperation with the Gaidar Institute and NAFI, a survey was conducted using this new set of indicators in October 2015. The set of financial inclusion indicators and its calculations for 2014 were published on the official CBR website.⁵¹ CBR has made a commitment to calculate financial inclusion indicators and publish them on the official CBR website annually. Separately from CBR efforts, under MoF's Financial Education and Financial Literacy project, a comprehensive survey on financial inclusion was also conducted in 2015 (as a one-time initiative).

49. CBR's financial inclusion indicators are broadly aligned with relevant indicator standardization efforts by the GPF and AFI. The indicators span key financial inclusion themes, including financial services infrastructure; uptake and usage of payment, savings, credit, and insurance products by individuals and SMEs; and the quality of financial products and services. The indicators are supported by a data infrastructure that captures information from both the supply side (i.e. from providers for financial services) and the demand side (i.e. from the users of financial services).

⁵⁰ See Technical Note on Payments for further details.

⁵¹ http://www.cbr.ru/finmarkets/files/development/acc_indicators_0116.pdf

50. The indicators could benefit from a set of summary, composite indicators that are associated with targets, indicators that are disaggregated by socioeconomic and demographic characteristics, and indicators that are explicitly linked to key actions and reforms by national authorities. The current set of indicators spans over two hundred indicators and sub-indicators. The CBR should consider a shorter set of indicators (using composite indicators, where appropriate)⁵² that can be considered as principal, high-level financial inclusion indicators and associated with achievable but ambitious targets. The indicator set should also leverage a key feature of demand-side data, namely that the data can be disaggregated by demographic and socioeconomic characteristics; key variables should be reported by target populations (e.g. women, poor, rural populations). Given current issues in the MFI market, indicators related to the quality of financial products and services could be expanded to disaggregate MFI products by type (e.g. SME, consumer, payday) and track average pricing for key products. The majority of the existing indicators measure national-level financial inclusion outcomes. These indicators could be complemented by indicators that measure progress of key reforms (e.g. regulatory or financial infrastructure) that are relevant for financial inclusion.⁵³ Finally, as digital finance and digital channels have been identified as key components of Russia's financial inclusion strategies, the CBR may wish to consider incorporating further indicators on digital financial inclusion that are currently being developed by the GPFI, to be published towards the end of 2016.

51. Greater emphasis should also be put on improving the underlying data infrastructure. As noted throughout this Technical Note, data related to financial inclusion matters were at times difficult to find and/or contradictory. For example, it appears that current CBR tracking of payment terminals only covers bank- and NBCO- owned terminals; expansion to all payment terminals in the market, including those operated by bank payment agents and non-bank payment agents, would be an important step forward, as would more comprehensive data on payments infrastructure in general, including both the total numbers as well as the geographic distribution of agents and POS devices. Russian authorities should undertake efforts to strengthen the data infrastructure for financial inclusion, with a focus on improving the scope, consistency, frequency, and availability of data relevant to access, uptake, and usage of financial products and services. This data should be drawn from both the demand-side (via surveys) and the supply-side (via financial institutions). Stakeholders involved in the collection of these data (CBR, MoF, etc.) should coordinate to ensure that these efforts share common definitions, are not duplicative, and jointly and comprehensively cover policy priorities and market developments (e.g. physical access, use of informal services, etc.). However, efforts to collect data from financial institutions must also recognize the burden of the reporting requirements, particularly for institutions with low technical and technological capacity, and balance this with the value of the data. Finally, authorities should improve the availability and dissemination of financial inclusion data, either through an online data portal or regular published reports, or both. As noted, previously, CBR has made a commitment to calculate financial inclusion indicators and publish them on the official CBR website annually.

⁵² For example, one composite indicator for physical access point penetration to summarize the 30+ indicators currently listed under the heading of 'financial infrastructure'.

⁵³ For example, indicators related to the expansion of credit reporting systems, the outreach of financial capability programs, the efficiency of consumer complaints resolution processes, and the digitalization of government-to-person transfers, etc. could track key efforts to expand financial inclusion and provide an intermediary monitoring tool to link actions by national authorities and national outcomes.

Summary of Main Policy Recommendations

- *Develop a clear, comprehensive definition and vision of financial inclusion in Russia across all stakeholders*
- *Develop a financial inclusion strategy (FIS) with systemic perspective that examines key drivers and enablers from both supply side and demand side*
- *Establish an effective coordination mechanism for the FIS and allocate responsibilities across public and private stakeholders.*
- *Ensure sufficient capacity, resources, and leverage to accomplish the financial inclusion mandate of the Main Office of Microfinance Market.*
- *Establish a standing CBR-wide committee on financial inclusion across relevant departments.*
- *Establish a bureau or similar entity to coordinate and assess the impact of different financial inclusion and financial education programs across multiple agencies.*
- *Develop and operationalize a robust M&E system for financial inclusion, including strengthening the supporting data infrastructure to improve the scope, consistency, frequency, and availability of data relevant to financial inclusion.*

IV. PROVIDER REACH

52. A country with the geography and population distribution of Russia poses unique challenges to achieving provider outreach to underserved areas and population segments.

A full range of dynamic providers and outlets is a starting point for financial inclusion. The overall legal and regulatory framework has evolved in recent years in Russia to allow for wider range of providers and channels, including MFIs and new types of payment services providers leveraging digital channels. However, the immediate impact on financial inclusion of these new providers is less clear. This section will assess the current levels of physical outreach by different types of institutions in Russia and the difficulties in increasing outreach; innovative use of technology and delivery mechanisms to address such difficulties in a cost-effective manner; and policy, legal, and regulatory reforms and infrastructural improvements that can provide an enabling environment for such strategies to be more fully leveraged.

Overview of Financial Providers and Physical Reach

53. The financial providers in Russia most relevant to financial inclusion include credit organizations and non-bank financial organizations. As of March 2016, credit organizations consist of 665 commercial banks (including state-owned banks) and 53 NBCOs, including payment service providers, and are governed by the Banking Law.⁵⁴⁵⁵ Relevant non-bank financial organizations include MFIs and CCCs, which are governed by specialist laws. There is a distinction in Russia between “credit” and “loans”. Under the Civil Code, any organization or legal entity can extend loans, whereas credit can only be issued by a licensed credit organization. Further, only banks, as participants of the Deposit Insurance System, are allowed to accept deposits; CCCs accept savings via member shares.

Table 4: Main Types of Financial Providers in Russia

Type of financial service provider	Main law regulating activities	Regulatory and supervisory bodies	Key characteristics
Credit Organizations			
Banks	Banking Law	CBR	<ul style="list-style-type: none"> • Main providers of financial services • Prudentially regulated, with high capital requirements
Non-bank credit organizations	Banking Law	CBR	<ul style="list-style-type: none"> • Most e-money issuers operate under this form • Prudentially regulated
Payment Service Providers			
Fund transfer operators	National Payment System Law and Banking Law	CBR	<ul style="list-style-type: none"> • All banks and NBCOs conducting domestic and international fund transfers considered fund transfer operators • Provide convenient and accessible payment services

⁵⁴ Bank of Russia Statistical Bulletin No. 3. CBR, 2016.

⁵⁵ Federal Law No. 395-1 “On Banks and Banking” of December 2, 1990, as amended.

Type of financial service provider	Main law regulating activities	Regulatory and supervisory bodies	Key characteristics
Electronic money operators	National Payment System Law and Banking Law	CBR	<ul style="list-style-type: none"> Providers of virtual accounts Operate as banks or NBCOs Typically target younger, internet savvy, well-educated population
Mobile network operators	Communications Law, National Payment System Law	Not regulated or supervised as financial service provider	<ul style="list-style-type: none"> Must partner with financial institution to provide financial services Prepaid airtime can be used for various types of payments, such as P2P and utility payments
Bank payment agents	National Payment System Law	Regulated by CBR, supervised by relevant financial institution and authorities	<ul style="list-style-type: none"> Can be involved in the provision of a range of payment and other banking services Operate in partnership with banks and NBCOs
Non-bank payment agents	Federal law On the activity of receiving payments from individuals pursued by payment agents	Regulated and supervised by relevant state bodies	<ul style="list-style-type: none"> Provide separate kind of payment services Operate in partnership with different goods and services providers Accept cash payments for such providers' goods and services from individuals
Microfinance Organizations			
Microfinance institutions	Law on Microfinance Activity and Microfinance Organizations	CBR, SROs	<ul style="list-style-type: none"> Providing microloans to individuals and MSMEs Can be registered in various forms both for profit and non-profit Includes payday lenders, consumer lenders, and SME lenders
Credit cooperatives	Law on Credit Cooperatives, Law on Agricultural Cooperation	CBR, SROs	<ul style="list-style-type: none"> Provide access to microlending (individuals and MSMEs) and savings services to members, particularly outside of urban areas Membership based organizations Regulated and supervised through tiered approach

Source: CGAP Landscaping Report, 2012 and Own Elaboration

54. The banking sector dominates Russia's financial sector and is highly concentrated, with state-owned banks playing a major role in the retail/consumer sector. The top five banks operating in the retail segment are all state-owned, holding around 44 percent of retail deposits

and providing 55 percent of retail loans of the total banking sector in 2015.⁵⁶ Sberbank operates through nearly 17,000 branches and retail outlets, by far the largest bank branch network in the country, and constitutes 29.3 percent of total banking assets, 40 percent of retail loans, and 45.4 percent of retail deposits as of February 2016.⁵⁷ Next in line in the retail and consumer banking sector is the state-owned VTB24, part of the broader VTB Group. Outside of large urban centers, some smaller regional banks offer basic deposit products to consumers and lending to SMEs. CBR has been proactively consolidating the banking sector over the last three years by revoking licenses of non-compliant banks. This has led to a smaller number of banks overall (1,000+ banks in 2011 vs. 681 commercial banks as of January 2016) with healthier balance sheets.

55. The economic crisis and international sanctions have negatively affected Russia's economy and banking sector, causing private banks, especially retail players, to shrink their operations and branch networks. In 2015, Alfa Bank closed 15 additional offices in smaller towns with under 300,000 people and announced plans to re-focus on high-income retail clients⁵⁸ On the other hand, Orient Express Bank has announced that it would open 143 new operational offices, including 50 offices in the Far East, 58 in Eastern Siberia, and 35 in the Western part of Russia in 2016.⁵⁹ With the recent economic crisis, retail banks have also been the ones most exposed to non-performing loans requiring additional provisioning, especially for non-mortgage consumer portfolios. The most vulnerable of the top retail lenders were reportedly Russian Standard Bank and Orient Express Bank, whose capitalization was only marginally higher than minimum capital requirements.⁶⁰

56. While Russia enjoys a large number of regulated financial institutions, uneven geographical coverage limits access in rural and remote areas. In absolute terms, at 36.98 branches per 100,000 adults, physical branch access in Russia is relatively higher than the United States (32.39), Australia (29.22) and Canada (24.03), as well as significantly higher than Turkey (19.79), India (13.04) and China (8.06).⁶¹ However, these numbers do not fully reflect disparities within and across regions. In practice, branch penetration often stops its reach at bigger towns, leaving many unserved and underserved individuals in rural areas. While cities with a population over 1 million people enjoy access to 412.5 bank branches, in cities with a population of less than 100,000 people there are only 8.5 branches. This figure drops to 0.02 in urban-type rural settlements and villages (compared to the national average of 85.9 branches).⁶² On the demand side, 7 percent of individuals have no choice in terms of access points or have no access to facilities where they can make basic payments or transfers. This figures increases for those living in villages (13 percent) and urban-type of rural settlements (11 percent).⁶³ These figures may be exacerbated by the recent closing of numerous banks, some of which operated in rural areas.

⁵⁶ EIU Industry Report: Financial Sector, Russia, 4th quarter 2015; CBR.

⁵⁷ Sberbank Financial Highlights under RAS, 1st quarter 2016. Note that these statistics suggest inconsistencies with the above data source on the market share of the top 5 state banks. This was a noticeable trend across references reviewed for purposes of this Technical Note – data for similar indicators often varied significantly depending on the data source, suggesting a lack of standardized reporting and terminology.

⁵⁸ <http://www.bloomberg.com/news/articles/2015-08-02/russian-banks-turn-away-customers-as-more-borrowers-fall-behind>

⁵⁹ <http://www.vostbank.ru/moscow/news/2016/bank-vostochnyy-rasshiryayet-set-na-40>

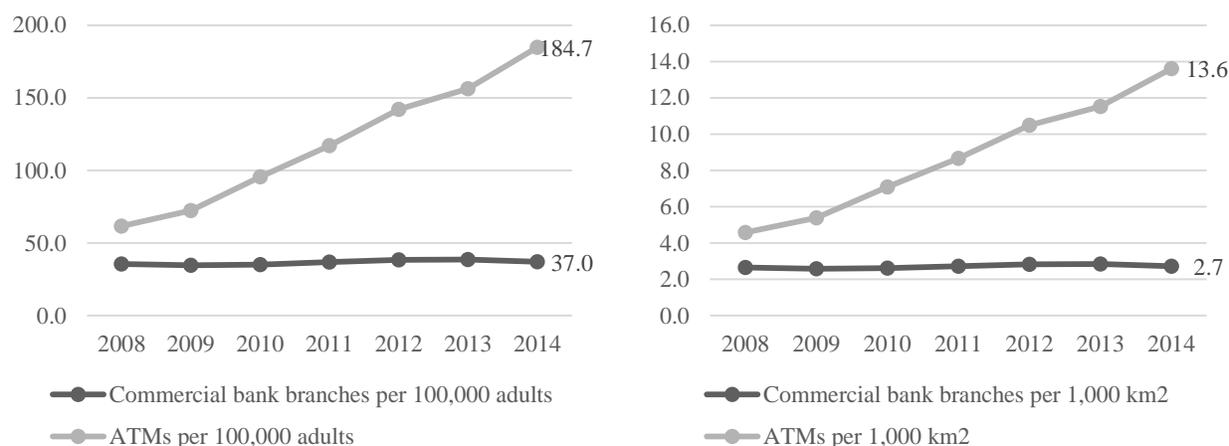
⁶⁰ https://www.fitchratings.com/gws/en/fitchwire/fitchwirearticle/Russian-Retail-Banks?pr_id=980476

⁶¹ IMF FAS 2014.

⁶² “Уровень доступности финансовых услуг в российской федерации.” NAFI, 2016.

⁶³ Levels of Accessibility of Financial Services in Russian Federation, 2016.

Figure 6. Russia's Bank Branch and ATMs Network (per 100,000 adults and per 1,000 km²)



Source: IMF Financial Access Survey (FAS)

57. While Russia enjoys a relatively high number of bank branches, the distribution of such branches does not typically reach rural areas. Most commercial banks do not operate outside of major urban areas. State banks such as Sberbank have the best coverage across the country based on an expansive physical network established throughout its long history of operations, and is often the only bank with a physical presence in remote and rural areas. While providing access to basic services, such a situation limits choice in providers and competition to provide better quality products and services. In addition, Sberbank has been closing branches and retail outlets in rural areas in recent years due to low profitability, including over 800 branches/outlets in 2013-2014.⁶⁴ Some smaller regional banks have a strong presence in their immediate market area and may reach into small towns and provincial centers. However, such banks face competitive disadvantages compared to large state banks (further discussed in Section V).

58. Russian Post outlets provide a wide network that reaches into remote and rural areas, providing basic payments and other services and serving as an agent for several banks. At present, the Russian Post has 41,640 branches of which more than 30,000 are located in small settlements. As a legacy of the Soviet times, Russian Post's outlets are present in all remote regions within 'walking distance' of 95 percent of the population. In 2013, the Russian Post offered payment services and products to a total of 60 million people, including 40.4 percent of all pensioners (16.7 million people) who receive their pensions via postal outlets.⁶⁵

59. The recent launch of Post Bank may help to expand physical outreach in underserved areas. In January 2016, the VTB Group signed an agreement with the Russian Post to establish Post Bank, a joint venture between the two entities. Post Bank will leverage Leto Bank's operations and resources (a former VTB Group bank focused on retail consumer lending) and the Russian Post's distribution network. As the Russian Post has around 42,000 outlets, the

⁶⁴ <http://www.kommersant.ru/doc/2492553>

⁶⁵ Russian Post, Yearly Report, 2014.

majority of which are located in rural areas, Post Bank will potentially have the largest branch network in Russia, surpassing even Sberbank's network, and may help to increase the level of competition in the rural market. According to the management of VTB Group, the newly created bank will provide financial services to 15 million people currently unserved due to lack of proximity to a physical bank branch, half of whom will be pensioners.⁶⁶ At least 3,500 branches/post offices will open 'banking windows' in 2016, reaching 15,000 windows within three years. In time, Post Bank will also utilize the Russian Post's 5,000 mobile offices as its mobile bank branches.

60. Post Bank's management has already indicated it plans to reach out to the unserved through various initiatives. One of its first initiatives will be to offer basic, free of charge, and interest-bearing deposit accounts, accompanied by debit cards. The target market of these efforts will be the Russian Post's rural customers. The next product Post Bank reportedly plans to provide to new clients is internet banking, primarily for payments services, which are in high demand among rural residents. The management vision is to build Post Bank as an internet bank with a physical presence, giving clients the comfort of close physical access and cash-out facilities. Credit products will be launched at 10,000-15,000 branches staffed by ex-Leto Bank's loan officers, but will be offered in regional urban centers (and not at more remote branches).

61. While Post Bank's proposed strategy and vision appears well-poised to contribute to financial inclusion in theory, it remains to be seen if the new bank will be able to implement its ambitious plans. While the philosophy and approach expressed by Post Bank's management demonstrates a good understanding of the target market, it is unclear how the bank plans to cover the costs of opening and maintaining free, interest-bearing accounts with debit cards, which are cost-intensive operations. Furthermore, as most of the Post Bank windows at Russian Post will reportedly be run by staff of the latter, the task of training a large number of Russian Post's staff will be a massive undertaking, particularly given the lack of sophistication at the more rural and remote branches of the Russian Post. Leto Bank's history as an unsuccessful consumer lender, with a high-profit, mass market strategy, lends further skepticism and caution to Post Bank's potential to advance financial inclusion.

62. The "microfinance market" consists of MFIs, CCCs, agricultural credit cooperatives, and pawnshops.⁶⁷ The analysis in this Technical Note focuses on MFIs and CCCs as the more relevant institutions for financial inclusion. There are also around 1,800 smaller agricultural credit cooperatives and over 8,500 pawnshops, according to the CBR. While these institutions provide additional points of access to credit services, their market share is small (below 0.2 percent of the banking sector).⁶⁸

63. MFIs in Russia primarily consist of so-called "payday" and consumer lenders. The number of MFIs has grown rapidly in recent years since the passage of the Law on Microfinance

⁶⁶ <https://www.rt.com/business/330464-russia-post-bank-vtb/>

⁶⁷ In Russia, the term microfinance institution (MFI) appears to be used more broadly to encompass microfinance organizations (MFOs, which would be deemed MFIs in other countries), credit cooperatives, and pawnshops. For the sake of clarity and consistency with international terminology, this technical note will use the term "MFIs" to refer to what are considered "MFOs" in Russia.

⁶⁸ http://www.cbr.ru/Eng/statistics/print.aspx?file=bank_system/4-1-3_010116_e.htm&pid=pdko_sub&sid=opdkovo

in 2010.⁶⁹ There were 3,701 registered MFIs officially active as of April 2016, and the size of the microfinance market stood at 70 billion rubles as of December 31, 2015.⁷⁰ Payday lenders account for 18 percent of the total microfinance portfolio; consumer lenders account for 44 percent, and SME lenders account for the remaining 38 percent.⁷¹ However, consumer and payday borrowers reportedly represent 90-95 percent of total MFI clients. Though no formal distinctions between MFI segments exist, payday lenders generally offer short-term microloans (1-3 months) with high interest rates of 1-2 percent per day that can exceed 700 percent annual percentage rate (APR). Consumer lenders typically offer loans of 6-12 months with an average size of 10,000-50,000 rubles and an APR of 250-350 percent. MFIs serving SMEs have loan sizes between 50,000 – 1,000,000 rubles for terms of up to 24 months and APR of at least 50 percent (government-run MFIs serving SMEs have capped interest rates).⁷² As of January 2016, NBKI recorded 3.8 million borrowers servicing loans from 2,500 MFIs.⁷³

64. While there is a large number of MFIs in Russia, the majority are located in urban centers or operate online and provide payday and consumer loans. According to the CBR, a large percentage of MFIs’ borrowers are pensioners, students, and salaried individuals. Given this type of client base, which overlaps with the lower-end segment of commercial banks, most MFIs are located in larger towns where consumption is higher. The largest payday lenders (e.g. Money Man, Dengi Srazu, and Bystrodengi) primarily operate online nation-wide, though their clientele could not be typically characterized as the underserved for purposes of financial inclusion, or their products geared towards financial inclusion purposes.

65. Unlike traditional microfinance, which are typically loans to the underserved based on the use of alternative collateral, the majority of microfinance loans in Russia are short-term, high interest loans for consumption purposes with loose creditworthiness assessments. “Traditional” microfinance includes both productive and consumption lending, as money is of course fungible and the underserved have a variety of needs, including income smoothing and consumption. However, traditional microfinance, whether for productive or consumption purposes, is typically characterized by business models premised on the use of alternative collateral (such as group guarantees or reputational collateral) as a means of ensuring creditworthiness. Many payday lenders’ business models are premised on a high default rates and do not use “character-based” lending typical of traditional microfinance. These institutions in fact already existed before the Microfinance Law as they operated under the Civil Code, and used the new licensing window for MFIs to become formalized. Anecdotal evidence suggests that some payday lenders target low-literacy and low-income individuals who are in need of cash and do not have the ability to repay, resulting in a high rate of non-performing loans (NPLs) between 35 and 45 percent for the whole MFI sector (according to the experts’ estimations).⁷⁴

⁶⁹ Federal Law No. 151-FZ of July 2, 2010 on Microfinance Activity and Microfinance Organizations, effective January 2011.

⁷⁰ <http://www.rusmicrofinance.ru/>.

⁷¹ http://raexpert.ru/researches/mfo/itog_2015/. Moscow Consulting Group, *Russian Microfinance Market – It’s Time to Grow Up*, February 2015.

⁷² Moscow Consulting Group, *Russian Microfinance Market – It’s Time to Grow Up*, February 2015.

⁷³ <http://www.nbki.ru/company/news/?id=12006>. Note that this number may not reflect the total number of MFI borrowers, as not all MFIs are currently reporting to credit bureaus.

⁷⁴ Moscow Consulting Group, *Russian Microfinance Market – It’s Time to Grow Up*, February 2015.

66. The rapid expansion of payday lenders and their business model appears to be leading to increasing incidences of multiple borrowing and overindebtedness. As of January 1, 2016, the NBKI recorded 3.8 million borrowers servicing their loans with the 2,500 MFIs⁷⁵ (which submitted credit information to the credit bureau) versus 950,000 borrowers in 2013.⁷⁶ Over 13.5 percent of these borrowers had more than one and up to five loans from MFIs. Furthermore, over 30 percent of borrowers had more than 2 loans with both banks and MFIs, indicating that there might be a substantial number of borrowers who refinance their bank loans with more expensive loans from consumer and payday lenders. Such trends may be negatively affecting credit discipline and repayment behavior, with negative repercussions for the broader financial sector.

67. By contrast, the number of MFIs that focus on productive lending to SMEs is relatively small, and consists primarily of government-run MFIs. Government-run MFIs, which number around 200 in the country, are in fact regional, provincial, or municipal microfinance funds which operate like state-owned institutions and receive subsidized credit from the national and local government and/or SME Bank, which is then on-lent to local SMEs. Such MFIs are typically located in regional and local centers. A much smaller number of “traditional” MFIs do operate in more rural and remote areas (such as FINCA), though they have notable difficulties in remaining operationally viable due to high cost of funds and operational costs. In fact, two private, commercially-operated MFIs that served SMEs went bankrupt in the last year, and FINCA has indicated that it has been unprofitable for the past three years and is consequently pulling back operations from the Volga and Siberia regions to focus solely on the North Caucasus.

68. Around 3,500 CCCs operate across the country and, unlike MFIs, are typically located outside of urban areas. CCCs fall into three categories: (1) below 1,000 members (15 percent), (2) above 3,000 members (30 percent), and (3) those in between (55 percent). Sixty-two percent of CCCs operate at the district level, outside of major urban areas.⁷⁷ While CCCs tend to operate in areas with less banking services available, thus providing access to underserved populations, as with the MFI sector, their overall market size is fairly small. As of the beginning of 2016, CCCs reportedly have around 1 million members across the country, with total assets of 62 billion, 55.5 billion rubles in loans, and around 50 billion in members’ savings.⁷⁸

69. CCCs are often small and unsophisticated, with low levels of technology and limited professional capacity. CCCs have lower cost operational structures and use 1-2 man offices. Many older CCCs were originally formed within trade unions of large industrial enterprises and still operate from informal offices granted either by local authorities or by enterprises. While the numbers of MFIs have rapidly increased, the number of CCCs has been on the decline. CCC members tend to be mature individuals and pensioners, more affluent than the low-income segment of the population, with savings accumulated in CCCs over years of membership. While

⁷⁵ <http://www.nbki.ru/company/news/?id=12006>

⁷⁶ Mamuta, Mikhail. "Microfinance Market Development: A Roadmap for 2013 – 2017." Presentation at RMC XII National Conference on Microfinance and Financial Inclusion. 2013. It is worth mentioning that up until 2013, MFIs were not obliged to provide information to the credit bureaus.

⁷⁷ System of Credit Cooperation in Russian Federation, presentation by former chairman of Russian League of Credit Unions.

⁷⁸ Presentation Credit Cooperation System in Russian Federation, 2016, by ex-chairman of the League of Russian Credit Unions, the chairman of SRO ‘Cooperative Finances’.

CCCs are able to attract savings by offering interest rates higher than commercial banks, less than 50 percent of their members reportedly borrow from CCCs, as CCCs also have to charge higher interest rates on loans to cover their funding costs.

*Retail Payments Infrastructure*⁷⁹

70. The reach of the retail payments infrastructure is critical to providing access outside of bank branches. ATMs, payment terminals, and POS devices are cost-effective means to expand access to basic payment services, and also play a key component in enhanced functionality of agent-based models.

71. There are gaps in accessibility of ATMs and insufficient levels of card acceptance in rural areas. Russians highly rely on bank tellers as the main mode of deposit and on ATMs as the main mode of withdrawal. However, there is a wide gap between availability of ATMs in major cities versus rural areas. While the number of ATMs per city with more than 1 million people is 1,201, the same indicator is 0.5 in villages and urban-type rural settlements. Sixty-three percent of ATMs and payment terminals are concentrated in Central Federal District.⁸⁰ The high costs of installing and running ATMs means that they are usually located at either bank branches, large commercial centers, or post offices within the same areas as a bank branch, and as such do not increase accessibility for the underserved. In addition, there appear to be insufficient levels of card acceptance infrastructure in rural areas, thus limiting cash-out options.

72. A unique feature of the Russian payments landscape are the high numbers of automated, cash-in payment terminals. There are estimated to be around 300,000 payment terminals (of both banks and agents) in Russia.⁸¹ Automated payment terminals, a unique Russian solution to providing payment services to consumers, are cash-in only machines that allow for making various instant payments (such as mobile phone, internet, bank account and e-wallet top-ups, payments for utilities, loan repayment) through cash or via e-wallets. Payment terminals are widely distributed, including at smaller shops and various public facilities such as post offices. Geographically, they appear to be more widespread than ATMs, mirroring the distribution of the population across the country.⁸²

73. While there is better outreach of payment terminals in underserved areas, payment terminals have limited functionality. As cash-in only machines, payment terminals do not provide for cash-out, which presents a significant gap in the retail payments infrastructure in Russia. Their benefit is their lack of sophistication, which allows for lower installation and operational costs compared to ATMs.

74. Along with the growth in payment terminals, the use of payment agents to provide access to basic payment services has been increasing. As of 2012, there were 12,479 payment

⁷⁹ See Technical Note on Payments for further details. This section will briefly discuss retail payments infrastructure in a limited manner with respect to a few key financial inclusion concerns.

⁸⁰ “Уровень доступности финансовых услуг в российской федерации” NAFI, 2016

⁸¹ CBR mission meetings.

⁸² Оценка доступности финансовых услуг, предоставляемых через банковских и платежных агентов, AFI, Committee on Payment and Settlement Systems, RMC, 2012.

agents operating through 319,000 outlets (or 2.7 access points per 100,000 adults).⁸³ Such agents can be either legal entities, such as supermarkets and electronics shops, or individual entrepreneurs. It is estimated that 70 percent of payment agents' outlets are unmanned payment terminals, while the remaining payment agents serve customers via cashiers. Payment terminals can be used by both bank payment agents and non-bank payment agents.⁸⁴

75. POS devices are lower cost devices compared to ATMs and payment terminals, with the potential for greater functionality when combined with agents. As such, expansion of the network of POS devices could contribute to advances in financial inclusion. There are estimated to be around 1.5 million electronic point-of-sale (POS) devices in Russia.⁸⁵ Typically installed in retail stores, POS devices can play a significant role in providing access to cash-out services, in particular in remote areas where a bank branch or an ATM might be a long distance away. The availability of such cash-out facilities within proximity of remote areas may help address the current situation of pensioners and salaried consumers making special trips of inconvenient distances to current access points and withdrawing the whole amount of their pensions and salaries every month. In addition to providing savings in time and travel costs to the underserved, a broader network of POS devices (including mobile POSs) could potentially increase the use of debit and credit cards in rural areas, increasing usage of existing accounts (and as building trust, to be further discussed in Section VI). Such an expansion could also enhance the potential for agent functionality, as bank payment agents with POS devices could conduct a broader range of transactions than agents managing unmanned payment terminals. Expansion of the POS network could be encouraged through subsidies for installation of such devices, particularly in remote areas.⁸⁶

76. A mapping of the existing retail payment outlets would help facilitate the development of appropriate financial inclusion strategies. There appears to be limited information available on the geographic distribution of retail payment outlets beyond high-level data. In fact, the CBR does not appear to officially track the number of payment terminals provided by agents, which vastly outnumbers the number of payment terminals provided by credit organizations (reportedly 270,000 vs 6,700).⁸⁷ Definitively determining the total number of payment terminals in the country would be a first step. A mapping of ATMs, payment terminals, POS devices, and payment agents would then help to better determine where there are geographic gaps in payments functionality.

Agent-Based and Technology-Driven Models

77. Given the limited options to expand physical branch networks on a sustainable, cost-effective basis in Russia, alternative approaches to outreach and delivery are critical to address the geographic and demographic challenges of financial inclusion in Russia.

⁸³ Landscaping Report: Financial Inclusion in Russia. CGAP, 2012. Other estimates provided were 270,000 payment terminals (see FN 71). Consistent, up-to-date statistics on the number of total payment terminals in the market is lacking, a sign of insufficient data infrastructure.

⁸⁴ Center for Research of Payment Systems and Settlements and RMC (2012).

⁸⁵ CBR mission meetings.

⁸⁶ Such an approach was taken in China, where the People's Bank of China launched an agent banking pilot in 2010/2011 that has since resulted in one of the largest agent networks in the world, with over 860,000 agents utilizing POS devices to provide payments and other services to residents in rural areas.

⁸⁷ CBR communications.

Employing strategies that expand access beyond physical branches, such as mobile branches, agent-based models, and digital delivery and use of technology, could all help to reach the underserved at a lower and more viable operational cost. Also, some financial institutions have started to cooperate with Fintech companies in order to develop additional channels of delivery. So, financial institutions are beginning to utilize such strategies, though removing certain legal and regulatory barriers may allow for more expanded usage.

78. For example four banks (Sberbank, RNKB Bank, Autograd, and AK BARS Bank) have launched mobile offices via vans. These mobile offices are staffed at a minimum by two individuals and are intended to be relatively comprehensive in their functionality, providing for account opening and other services. Sberbank has been using these mobile offices since 2005. Such mobile branches are regulated by Directive No. 3028-U of July 2013 on Mobile Cash Points, which only covers banks, limits the use of such mobile vans to strictly defined situations (such as remote and small towns and for serving natural persons), requires that banks notify the CBR of such operations, and sets certain technical requirements regarding operations and vehicle specifics.

79. In order to further encourage the use of such lower-cost outreach and delivery strategies, policymakers may wish to consider expanding the regulatory framework judiciously. For example, the use of such mobile branches could be allowed in a greater number of circumstances (such as for loan applications), and/or expanded to include serving micro and small enterprises. Use of such vans could also be specifically permitted to other financial institutions beyond banks. A related strategy is being piloted by FINCA - the usage of tablets by “mobile” staff members that are linked back to its main network and will allow for loan processing, repayments, and other transactions in the field. This type of relatively simple strategy has been utilized in many countries by both banks and MFIs for financial inclusion purposes. While it is not clear whether there are currently any regulatory obstacles to this type of operation, it may be useful to proactively clarify that such operations are permissible for financial institutions in order to further encourage the use of such technology.

Use of Agents

80. Agent-based models will be a critical component to successful strategies to expand reach beyond physical branch networks. A variety of agent-based models are already being utilized in the market. Further encouraging and expanding the usage of agent-based models will require legal and regulatory reforms that provide greater clarity on the usage of retail agents and/or expand on the functionality of bank payment agents, while at the same time appropriately managing the risks posed by such models.

81. A few larger banks are utilizing retail chain stores as outlets for their banking services, primarily related to lending services. For example, Alfa Bank uses retail chains for consumer electronics as outlets for their lending services. However, while in general the legal and regulatory framework for payment agents is relatively clear, the framework for the broader use of retail agents beyond payments services is less clear. Either Alfa staff are placed in a kiosk in the storefront, or else the retail chain store’s individual staff are hired part-time on Alfa’s behalf.

Such a process of placing own bank staff or hiring part-time staff on a contractual is presumably unwieldy and may be limiting the uptake of true agent-based models.

82. The framework for use of payment agents has been clearly established, with two types of payment agents in Russia: bank payment agents and non-bank payment agents. Both types of payment agents are increasingly important players in providing retail payment services on behalf of banks, NBCOs, and a wide range of payees. As laid out in the legislative framework on the national payments system,⁸⁸ any legal entity or individual entrepreneur can become a bank payment agent or non-bank payment agent. Bank payment agents can be involved in a wider range of payment services than non-bank payment agents, including cash-in and cash-out, providing electronic means of payment (e.g. bank cards), and client identification for purposes of funds transfer (but not for opening of accounts). Bank payment agents can take part in loan repayments, person-to-person domestic transfers, international remittances, bill payments, and merchant payments. Non-bank payment agents can only accept cash from individuals as payment for goods and services. Both bank payment agents and non-bank payment agents can contract sub-agents.

83. As noted previously, around 12,000 payment agents currently operate through 319,000 outlets in Russia, with the majority of outlets consisting of unmanned payment terminals.⁸⁹ The remaining payment agents operate via cashiers (e.g. supermarkets, electronics shops) and provide such additional services on behalf of their bank or NBCO such as cash withdrawals, payment transactions facilitation, and distribution of electronic means of payment such as cards. Most importantly, these bank payment agents can conduct in-person customer identification. The largest use of agents is for mobile top-ups and payments for other communication services, which in 2012 represented 86 percent of the total number of transactions.⁹⁰ But other payments, such as deposits into bank accounts, purchases of prepaid cards, loan repayments, and person-to-person payments, are experiencing strong growth, suggesting there is potential to expand the usage of payment agents.⁹¹

84. The Russian Post serves as the largest payment agent in Russia. Besides providing a limited range of banking services on behalf of banks and NBCOs as their bank payment agent, Russian Post primarily acts as a non-bank payment agent for various institutions, mostly government agencies and utilities. It is the main delivery channel for pensions, as well as payments of utilities bills and domestic and international money transfers. It also provides a special kind of payment service, a postal money transfer.

85. Payment agents clearly have the potential to greatly contribute to financial inclusion; however, there are regulatory barriers to further expanding this model. One issue is with respect to client identification, which will be further discussed in the next section on AML/CFT. Expanding the range of services bank payment agents are allowed to offer would also facilitate access to more banking products for undeserved consumers. Increased functionality of bank payment agents was noted as the biggest issue by financial providers. For example, bank payment

⁸⁸ Federal Law No. 161-FZ of June 27, 2011 on the National Payment System (as amended), Federal law No. 103-FZ, June 03, 2009 On the activity of receiving payments from individuals pursued by payment agents

⁸⁹ Landscaping Report: Financial Inclusion in Russia. CGAP, 2012.

⁹⁰ Landscaping Report: Financial Inclusion in Russia. CGAP, 2012.

⁹¹ Landscaping Report: Financial Inclusion in Russia. CGAP, 2012.

agents could be allowed to have an expanded role in account opening beyond collection of documents, such as account opening subject to transaction limits, and in serving as a channel for further facilitating sales of credit products their current role.

86. Creating an expanded and more enabling regulatory framework for the use of agents could also help to expand the potential of agent-based models. To this end, it would be helpful to further expand the functionality of bank payment agents to serve as delivery channels for an appropriate range of products (beyond payments). In a Basel Committee on Banking Supervision (BCBS) report, 85 percent of the 52 jurisdictions surveyed in 2013 explicitly permitted commercial banks to contract retail agents as third-party delivery channels, indicating it is a common practice.⁹² In addition to expressly allowing for usage of retail agents, their functionality and permissible activities would need to be articulated, such as conducting identification (discussed further below).

87. Expanding the functionality of agents by expanding the functionality of bank payment agents will require appropriate corresponding changes in the oversight of such agents by the CBR. Currently, there is limited oversight of payment agents; there are no specific registration processes for bank payment agents with the CBR, as they are controlled by the banks and NBCOs with which they are affiliated in accordance with guidelines set by the CBR. Limited statistics on agents are available. Oversight approaches would need to be adapted appropriately if bank payment agent functionality were expanded, using a risk-based approach given the large estimated number of agents in the market. Policymakers should focus on strategies that best leverage limited supervisory resources but still put in place adequate controls; oftentimes this involves placing clear responsibilities on the provider. In 2016, the CBR issued recommendations for banks and NBCOs with the purpose of strengthening control over bank payment agents. Agents in other jurisdictions with expanded functionality typically follow authorization procedures and reporting requirements with respective government authorities.⁹³ Issues to consider include if there are clear processes for authorization of agents, whether providers are legally liable for acts of agents, to what extent providers are required to manage the risks of contracting agents, what minimum requirements and prohibited clauses to apply to agency agreements (supervisors may wish to review and approve form agency agreements), and what minimum requirements to impose on agents that appropriately balance financial inclusion with operational and consumer protection risks.

88. The potential afforded by Russian Post could also be further leveraged by modernizing the institution and encouraging partnerships. For example, the e-money provider QIWI has partnered with the Russian Post to provide services that allow customers of both organizations to make money transfers through QIWI kiosks, website, and mobile application, and receive cash in any of the almost 42,000 Russian Post outlets across the country.⁹⁴ The combination of a more modern, sophisticated Russian Post partnered with digital financial services providers would seem optimal from a financial inclusion perspective, leveraging the innovative nature and technology of digital financial service providers with the wide network of

⁹² “Range of practice in the regulation and supervision of institutions relevant to financial inclusion.” Basel Committee on Banking Supervision, January 2015.

⁹³ For further details, see “Supervision of Banks and Nonbanks Operating through Agents: Practice in Nine Countries and Insights for Supervisors.” CGAP, 2015.

⁹⁴ <https://investor.qiwi.com/releasedetail.cfm?ReleaseID=913755>

physical access points of the Russian Post in remote and rural areas. Expanding the functionality of bank payment agents would similarly benefit the Russian Post and may make such partnerships more attractive. In particular, a more modernized Russian Post partnered with a broader range of banks and NBCOs is well-positioned to serve as a cash-out point for the underserved.

AML/CFT and Identification

89. The existing AML/CFT framework was highlighted as one of the main obstacles to increased financial inclusion in nearly all mission meetings.⁹⁵ A proportionate, risk-based AML/CFT framework is a critical component to enable agent-based models and online/digital delivery of financial products and services. Conversely, the absence of a proportionate, risk-based framework poses obstacles to the expansion of such business models.

90. Several obstacles currently exist under the AML/CFT framework that affect provider reach, particularly with respect to identification. The legal framework allows for simplified identification below certain transaction thresholds, requiring consumers to provide their mobile phone number, passport number, and a secondary identification number such as their tax payer number (which can also be done online/remotely). Requiring three separate items for simplified identification may be considered excessive. In addition, simplified identification does not appear to apply to account opening, which requires full, face-to-face identification by the financial institution (unless identification has already taken place for such individual). Repeat identification is also required for a number of transactions (e.g. transactions over 15,000 rubles), even when the client already has an account with the bank. Although a centralized database for identification and authentication exists, such databases were noted to be incomplete or not easily accessible, and could be further enhanced. Such barriers affect both provider reach as well as uptake and usage of products by the underserved.

91. Amendments to the AML/CFT framework are under consideration to modernize the identification system to allow for more flexibility in the process. Among other changes, the amendments would allow for one-time, in-person identification and subsequent authentication of a client through a bank's database; cross-authentication of the client across the members of a banking group and other permissible third parties, including bank payment agents; and easier identification via electronic documents submitted over the internet. These amendments will facilitate better access to financial services delivered by bank payment agents and the internet, critical to expanding access to finance for the underserved via digital and branchless channels. However, it is uncertain whether the current set of proposed amendments will pass.

92. It is recommended that the next National Risk Assessment be used as an opportunity to determine how best to adapt identification processes and other AML/CFT requirements for natural persons appropriately, balancing AML/CFT risks particular to the Russia context with financial inclusion impact and trade-offs. In particular, consideration should be given to expanding the use of simplified identification in a greater number of scenarios (that continue to pose low risk), including potentially transactions with higher threshold limits and

⁹⁵ The discussion in this section will focus on AML/CFT issues related to provider reach. Issues related to high compliance costs and burdensome reporting requirements will be discussed in Section V.

account opening. For example, international standards allow for flexibility in applying simplified customer due diligence (CDD) measures for occasional transactions below the threshold of USD 15,000.⁹⁶ The requirements for simplified identification should also be streamlined. Repeat identification procedures could also be simplified. Full identification could be permitted by agents and other third parties in certain situations, though with accompanying clear rules on responsibility and liability remaining with the principal/financial institution.

Digital Finance Providers

93. There are currently 101 authorized e-money issuers in Russia,⁹⁷ but uptake and usage of such products is low. Under the National Payment System Law, e-money issuers must be registered as a credit organization, meaning either as a bank or an NBCO. E-money is defined as a non-cash (electronic) money transfer without the opening of a bank account, and is explicitly not considered a deposit. As of January 2016, there were 107.6M electronic payment instruments registered in Russia, 42.4M of which were prepaid cards.⁹⁸ Most users of e-wallets are young, affluent and with a higher education, and most e-money products are designed to target this segment of the population. According to the 2016 NAFI survey, only 3 percent of respondents said they had used their e-wallets in the last 12 months. Furthermore, market players have reported that the utilization of e-wallets has declined since the onset of the recent economic crisis, as fewer users are keeping money in prepaid digital accounts.⁹⁹

94. Uptake and usage of e-wallets and e-money has also not spread to the underserved segments of the Russian population. To date, e-wallets in Russia can be viewed as a complementary service used by the already banked, for purposes of making small payments primarily related to entertainment. Unlike in other countries, e-wallets are not “transformational”, serving as the equivalent of a basic transactional account for the previously unbanked. Despite Russia’s high mobile subscription per capita and fairly good access to the internet, mobile and internet banking services remains largely underutilized. Only 22 percent of consumers use the internet to access their accounts, including 7 percent using both the internet and mobile banking.¹⁰⁰ Remote channels are used predominantly by young people (18-34 years of age), the affluent, and those with higher education.

95. Nevertheless, digital finance providers and digital channels (and digital technology and business models more broadly) do appear to have the potential to advance financial inclusion. Industry experts believe that there is significant potential for e-wallets as a banking product, including for the currently unbanked. Many of the basic building blocks are already in place. For example, mobile phone penetration in Russia was 80 percent in 2014, and projected to reach 86 percent or 122.3 million users by 2017.¹⁰¹ As of 2014, at 1.5 mobile subscriptions per capita, Russia rates higher than Brazil, China, Mexico, Turkey, and even Germany.¹⁰² A relatively

⁹⁶ International Standards on Combating Money Laundering and the Financing of Terrorism & Proliferation: The FATF Recommendations. FATF, February 2012.

⁹⁷ CBR.

⁹⁸ CBR.

⁹⁹ “Уровень доступности финансовых услуг в российской федерации.” NAFI, 2016.

¹⁰⁰ 2016 NAFI Survey. Of all respondents, 26 percent did not have bank accounts.

¹⁰¹ <http://russiansearchmarketing.com/russians-go-mobile-phone-use-russia/>

¹⁰² <http://offers.worldpayglobal.com/rs/850-JOA-856/images/GlobalPaymentsReportNov2015.pdf>

enabling legal and regulatory environment for payment services providers, including e-money issuers, is also in place.

96. The greater untapped potential may be for traditional banks or non-bank financial institutions to leverage digital channels and technology to expand outreach. The low levels of uptake and usage of e-wallets and e-money contrasted with the increasing use of online and mobile channels noted in Section II may be due to the fact that Russian consumers are increasingly accessing their bank accounts via online and mobile channels, as opposed to e-wallets provided by NBCOs (and banks). This points to the need to be strategic and targeted regarding which particular types of digital finance, digital channels, or business models that leverage Fintech have greater potential. As opposed to e-money NBCOs, banks provide a better value proposition to the underserved due to the potential to access a broader range of products and services beyond digital access to a basic account. Traditional banks, as well as MFIs and CCCs, could better leverage digital channels to reach the underserved (once other obstacles are removed and motivations increased, as discussed elsewhere). Beyond outreach, digital finance provides other opportunities that are just starting to be leveraged in Russia, such as the potential for use of “big data” to identify and assess creditworthiness of clients, even those without formal credit histories.

97. Several diverse factors are likely impeding the expansion of digital finance for financial inclusion purposes, including on the supply side (e.g. competition, financial and ICT infrastructure) and the demand side (e.g. financial capability and trust in financial providers). To expand digital financial service offerings, financial institutions require both the motivation and the means to do so. As will be further discussed in Section V, the banking sector in Russia is concentrated, with limited levels of competition. A more level playing field combined with increased competition could provide greater motivation for financial institutions to innovate to reach out to new customer segments, including the underserved. To leverage digital finance in remote areas will also require more targeted marketing and tailored product development as well as increased financial capability and trust.

98. A better value proposition for consumers may also help to increase uptake of digital finance. The current focus of digital finance is on payments, and specifically a narrow category of payments. Expanding the product offering of digital finance beyond payments can both help to address financial inclusion objectives as well as improve the business case for providers. Recent trends in this area are positive. There are increasing partnerships between e-money providers, MNOs, and traditional financial providers, with e-wallets increasingly linked to cards and payment terminals. For example, QIWI¹⁰³ now offers physical Visa prepaid cards to its QIWI wallet users. The major MNOs have also partnered with financial institutions to offer their customers facilities to make payments via airtime/mobile phone accounts and credit cards. In January 2016, Beeline (a MNO) launched a service that allows subscribers to cash out their airtime at ATMs. Beeline has teamed up with a bank operating primarily in Siberia and the Far East as well as two payment services providers, which jointly operate around 40,000 ATMs around the country.¹⁰⁴ Linking e-wallets and mobile money to real world infrastructure will increase the convenience and usability of the product. Policymakers should encourage and enable such partnerships, while balancing with stability and other risks.

¹⁰³ Previously a PSP and now a bank, as well as the owner of the largest franchise of payment terminals in Russia.

¹⁰⁴ <http://www.1prime.biz/news/0/%7BA89ADAA6-7D37-4BB6-974A-97EE225094F4%7D.uif>

99. Further enhancements in the financial and ICT infrastructure would also improve the business case for providers and the value proposition for consumers. As noted previously, cash-out points and POS devices are currently limited in remote areas of Russia. Without cash-out points and acceptance infrastructure, the value proposition of e-wallets (and accounts more broadly) is limited for rural consumers, as e-wallets cannot substitute for cash transactions. To cash-out, an e-wallet user in a rural area would have to first transfer their balance to a card, then travel to a cash-out outlet in a town. Given the high affinity of Russian people for cash, especially those living in rural areas, a combination of online/mobile banking and POS terminals, which allow for cash withdrawal, would give users more peace of mind that they can cash out their deposits, e-money or even airtime at any time, and encourage them to use distant access to financial services.

100. Improvements in internet coverage would help to provide the necessary underlying infrastructure for further advancements in digital finance, including a range of the approaches discussed in this section (e.g. mobile banking, e-wallets, etc). Internet penetration in Russia has been growing steadily, but pockets of inadequate access to the internet remains in rural and remote areas. In 2014, Russia was ahead of Brazil, China, Mexico and Turkey in terms of the internet penetration with 61 percent, according to Global Payment Report.¹⁰⁵ Furthermore, 42 percent of the population access the internet from mobile devices. However, internet penetration reportedly remains uneven, with remote rural areas having poorer internet connection.

101. The CBR is in fact in the process of developing a Roadmap for Digital Financial Services (D-Project), targeting 70 percent of basic non-payment financial services to be delivered via digital means in the near future. The primary target market for the D-Project is Russia's unbanked population. The project envisages a symbiosis between banks and MNOs, where the latter takes the 'front office' role to actively market financial services to their existing clients. The various issues discussed above should be incorporated into this roadmap. The development of the roadmap should also be well-aligned with the development of the FIS.

Summary of Main Policy Recommendations:

- *Encourage expansion of POS network in rural and remote areas via subsidies or other incentives*
- *Map existing retail payment outlets, including ATMs, POS devices, payment terminals (bank and agent terminals), and payment agents*
- *Revise regulatory framework to further expand functionality of bank payment agents, with corresponding expansion of oversight of agents using a risk-based approach*
- *Modernize Russian Post and further leverage via partnerships with financial providers*
- *Use the annual National Risk Assessment to determine appropriate expansion of AML/CFT framework for identification development*
- *Develop centralized database for identification and authentication*
- *Encourage and enable increased leveraging of digital channels and models to reach the underserved by traditional providers, including via partnerships with digital*

¹⁰⁵ <http://offers.worldpayglobal.com/rs/850-JOA-856/images/GlobalPaymentsReportNov2015.pdf>

finance providers

- *Enhance financial and ICT infrastructure*

V. PROVIDER DIVERSITY AND SUSTAINABILITY

102. A range of different types of providers exist in Russia, with different levels of potential for contributing to financial inclusion and different types of challenges. A comprehensive approach towards financial inclusion will require leveraging this full range of institutions. Banks are ultimately the biggest players in the financial sector, and efforts to expand the level of competition in the banking sector and create a more level playing field will be necessary to provide both the motivations and the means to reach the underserved. At the same time, the MFI sector can play a greater role in financial inclusion if payday lending is clearly differentiated from microfinance and the growth of sustainable, commercially-based MFIs focused more on productive lending than payday lending is supported. CCCs can similarly play an enhanced role in financial inclusion with greater modernization of the sector. Finally, a risk-based approach towards AML/CFT is needed to better align compliance costs and reporting requirements with levels of risk.

Banking Sector

103. Banks are perceived by the Russian population as the most trustworthy service providers, and will necessarily be a key component in any financial inclusion strategy. Seventy-four percent of Russian consumers trust banks, versus 44 percent trusting insurance companies and only 14 percent trusting MFIs.¹⁰⁶ While there are large numbers of MFIs and credit cooperatives (and increasing numbers of e-money providers), these types of institutions either do not focus on the underserved, cannot provide a full range of basic products (i.e. deposit products), or do not have the scale necessary to reach large numbers of the underserved in Russia. Therefore, commercial banks, as the largest players in the financial sector in Russia, must play a significant role in developing a long-term, sustainable, financially inclusive system. As banks have the right to accept deposits, such institutions are better positioned to both provide deposit services for the underserved as well as access lower cost capital compared to MFIs, allowing for greater potential expansion over the long-run.

104. However, the existing legal and regulatory framework results in disproportionate burdens on smaller, locally-focused, and less sophisticated banks. The regulatory and prudential framework is rules-based and geared towards universal banks. There is little differentiation for those banks that are not engaged in a broad range of more sophisticated activities. Although arguably beneficial for stability, the existing legal and regulatory framework results in relatively higher costs on smaller, locally-focused, and less sophisticated banks that generally have lower risk profiles as they operate in limited geographic regions and provide basic banking products and services. For example, requirements for daily balance sheet submission or other frequent and detailed reporting (particularly for activities that some smaller banks may not commonly engage in, such as forex), complicated valuations of loan portfolios, or strict audit requirements or staff qualifications may be difficult for smaller, less sophisticated banks to comply with and create undue regulatory burdens.

105. As a result, smaller, locally-focused, less sophisticated banks with the potential to reach the underserved are unable to compete with large state-owned banks. Smaller, locally-

¹⁰⁶ Financial Inclusion in Russia: the Demand-Side Perspective. CGAP, 2014.

focused banks often have a better understanding of the needs of the local population, and can offer customers more tailored services and operate more flexibility than large state-owned banks which utilize more standardized, centralized processes toward product development and delivery. Such banks are already at a disadvantage with respect to the wide branch infrastructure of state-owned banks such as Sberbank, as well as large banks' access to cheaper funding. Furthermore, the cost of serving underserved segments is already higher by necessity, compounded by the negative effects of the economic downturn. Disproportionate regulatory burdens and compliance costs adds a further, significant barrier to the operations of such banks and leads to an unfavorable cost-benefit ratio for providing microfinance services.

106. Financial inclusion for low-income and rural communities could be improved if more players were competing in the lower-end market segment. Sberbank currently plays and will continue to play a central role in reaching remote populations. However, as a large institution, Sberbank operates in a centralized and bureaucratic manner and, given its brand name and lack of competition in rural areas, is not flexible in its product offerings and, in some instances, can afford to offer products at higher rates. Underserved consumers could potentially access a broader range of more tailored products and services if Sberbank had competitors, especially in remote areas. To this end, the creation of the Post Bank by VTB is a welcome step. Greater competition can help to improve the quality of products offerings for the underserved as well as provide the push necessary for banks to move further down-market.

107. Competition could also be increased by facilitating a more workable tiered banking system to allow for a more level playing field, with a proportionate regulatory framework for banks (or deposit-taking NBCOs) with a limited set of defined operations. The objective of such a tiered system would be to provide the space for smaller, locally-focused, less sophisticated banks or deposit-taking NBCOs to operate on a lower cost basis, with lighter compliance and supervisory costs that are proportionate to their scope of operations. The concept of introducing more proportional regulation and optimization of regulatory burdens on financial providers has already been introduced in the CBR's 2016-2018 Guidelines for the Development of the Russian Financial Market, which highlights the need to increase competition in order to improve pricing as well as decrease provider costs.

108. Defining the elements of a tiered system will require careful consideration that balances risks with other policy objectives. The main areas to consider are what limited set of activities would be allowed under a particular license, and which riskier and more sophisticated activities would be prohibited. While initial minimum capital for smaller, locally-focused banks may be lowered, licenses for a new tier of banks should explicitly permit certain activities (e.g. accepting deposits, providing loans) and explicitly prohibit others (e.g. forex operations, derivatives, trading in securities or commodities, operating beyond certain geographic limits), thereby reducing risks as well as related reporting and compliance costs. For example, the Basel Committee on Banking Supervision's (BCBS) 2010 report on "Microfinance activities and the Core Principles for Effective Banking Supervision" notes that "*lower initial capital requirements for ODTIs¹⁰⁷ may be appropriate given the limited complexity, scope and size of their operations, especially in rural areas. However, the threshold should be high enough to discourage unviable candidates and yield a manageable number of institutions to supervise. In exchange for lower*

¹⁰⁷ Other Deposit-Taking Institutions.

initial capital, supervisors should limit the kinds of activities permitted to ODTIs.” The BCBS 2010 report also provides examples of tiered approaches to capital and other requirements (such as corporate governance), noting that tiered licensing frameworks can provide some flexibility to supervisors to decide what type of license to grant relative to the scope of operations and target clientele of an applicant.¹⁰⁸ Similarly, the updated BCBS 2015 report notes that “*a proportionate approach to licensing (e.g. different licensing criteria and procedures) allows countries to allocate the level of supervisory resources appropriate for the type of financial institution and the risk posed to the financial system or depositors.*”¹⁰⁹ Furthermore, the BCBS 2015 report notes that any differential (lighter) approach should cease once the relevant category of institution becomes “material” or “significant.”

109. Changes to prudential ratios, if any, will require further, more detailed analysis. Any adjustments to prudential ratios will depend on the determined scope of any new license. The majority of prudential ratios will likely stay the same, and in a few cases may even be stricter than for universal banks. The main benefit to “lower” tiered banks will come from lower initial minimum capital and proportionately lighter compliance, reporting, and supervisory burdens.

110. The licensing process should be carefully designed and utilized to ensure the appropriateness of applicants. Any tiered approach introduced or further facilitated in Russia should be limited to new entities, in order to ensure that existing, less scrupulous banks do not take advantage of the regulatory window. All applications for lower tier banks should be closely scrutinized by CBR to avoid weaker players or past failed banks from re-entering the market and ensure that applicants fit the policy objectives for the new tier.

111. Finally, it should be noted that a more workable tiered system does not necessarily entail the creation of a new type of banking license. There are presumably multiple approaches that can be taken to achieve a similar effect. One such approach is to develop a more proportionate regulatory framework along the lines discussed above for a clearly designated category of deposit-taking NBCOs. At present, there is in theory a type of “depository-credit” NBCO that can accept deposits from legal entities and extend loans. However, no such NBCO currently exists in the Russian market; current NBCOs are either payment NBCOs or settlement NBCOs. Allowing a category of NBCOs to accept deposits from both natural persons and legal entities (an expansion of current permissible activities) and developing a proportionate regulatory framework for such NBCOs is one approach towards creating a more tiered banking system. Further research is required on the current legal and regulatory system to determine the optimal approach to developing a more tiered banking system in order to best achieve intended policy objectives of increasing competition in the banking sector, particularly for providers serving the underserved.

Microfinance Sector

112. Although small, the microfinance sector could play a greater role in financial inclusion if productive microfinance were expanded and clearly differentiated from payday

¹⁰⁸ “Microfinance activities and the Core Principles for Effective Banking Supervision.” Basel Committee on Banking Supervision, August 2010.

¹⁰⁹ “Guidance on the application of the Core principles for effective banking supervision to the regulation and supervision of institutions relevant to financial inclusion.” Basel Committee on Banking Supervision, December 2015. Consultative document issued for comment by March 31, 2016.

lending. As previously noted, the majority of MFIs are consumer and payday lenders, with payday lenders providing short-term, unsecured microloans at high interest rates of 2-3 percent per day. Payday lenders do not utilize traditional microfinance practices, such as lending to the underserved based on alternative collateral, and in fact have business models based on loose creditworthiness assessments and premised on a high rate of defaults. The definition of microfinance and MFIs should be revised to align with international best practices, including both qualitative and quantitative characteristics of traditional microfinance models, in a manner that specifically carves out payday lending. Policy tools such as tax incentives and SME finance support programs could then be targeted to encourage the growth of traditional microfinance, with a greater emphasis on productive lending. At the same time, payday lenders should be clearly distinguished from MFIs, and strong financial consumer protection rules put in place and supervised via thematic reviews and spot checks in order to curb the increasing incidence of overindebtedness and abusive collection practices in the payday sector.

113. The reputation of the microfinance sector among the public currently suffers from the negative association with payday lending. As noted above, payday and consumer lenders comprise the largest proportion of the MFI market. The payday lender sector in particular has grown significantly in recent years. The sector has been viewed as attractive because of low entrance barriers and high profitability - companies can still turn a profit with past-due levels exceeding 34 to 45 percent, with cases reaching up to 60 percent.¹¹⁰ While contributing little to financial inclusion, payday lenders are primarily responsible for the low level of trust in MFIs among the general population due to their predatory marketing methods targeting financially vulnerable and illiterate, as well as their aggressive collection practices. Such collection practices include extreme cases of harassment and physical assaults, which are generating increasing attention in the mass media.¹¹¹

114. The CBR has fully acknowledged the need to clean up the MFI sector and has begun to take concrete steps to do so. In addition to enhancing consumer protection requirements, the CBR recently passed amendments to the Microfinance Law (which came into force on March 29, 2016) aimed at differentiating larger MFIs (presumably more focused on productive lending) from MFIs focused on consumer and payday lending. MFIs are now split into two categories: (1) microfinance companies, and (2) microcredit companies. Microfinance companies are allowed to accept loans from individuals above 1.5M rubles, while microcredit companies are not allowed to take loans from individuals. Microfinance companies can offer loans up to maximum size of 1M rubles for individuals and up to 3M for sole proprietors and legal entities, while microcredit companies can offer loans up to a maximum size of 500,000 rubles for individuals and up to 3M for individual entrepreneurs and legal entities. All MFIs will be supervised by the CBR through SROs, while microfinance companies will also be supervised by the CBR directly (with presumably stricter regulations applied to such companies, though these have not been issued to date). Microfinance companies will have a minimum capital of 70M rubles, with the CBR indicating that around 150 MFIs can currently claim sufficient capital levels to meet the requirements to become a microfinance company.

¹¹⁰ Moscow Consulting Group, Russian Microfinance Market – It’s Time to Grow Up, February 2015.

¹¹¹ See examples at <https://www.opendemocracy.net/od-russia/sean-guillory/russia-s-in-red>.

115. While potentially a step in the right direction, it is not clear whether these changes will fully address the issue of differentiating payday lending from the broader MFI market. Some payday lenders will presumably be able to operate as either type of entity, and hence have access to greater amount of funding to fuel expansion. It is not clear why the criteria for microfinance companies will necessarily focus this type of MFI on productive lending, nor is it clear that a smaller MFI that is focused on productive lending would be able to qualify as a microfinance company.

116. More basic, fundamental changes that clearly define microfinance and MFIs and distinguish it from payday lending may be more effective. The current legal definitions of microfinance and MFIs are somewhat circular. A “microloan” is defined as a loan not exceeding 1M rubles; “microfinance activities” are defined as activities of microloan issuance; and a “microfinance organization” is defined as an organization engaged in microfinance activities.¹¹² These definitions are overly broad and do not provide any characterization for the type of lending or type of institution aside from the size of the loan. These definitions also conflate microfinance with microloans, two concepts that should preferably be kept distinct, as microfinance typically suggests a broader range of products and services targeted to the underserved beyond microloans, such as savings.

117. The CBR should consider incorporating aspects of usage and other qualitative characteristics associated with traditional microfinance into the definition of microfinance. Appropriate definitions of “microfinance”, “microcredit”, and “microfinance institution” is a complex topic, with many tradeoffs to consider. As noted in CGAP’s Guide to Regulation and Supervision of Microfinance from 2012, the regulatory definition of “microfinance” and “microcredit” should be tightly framed to meet specific regulatory objectives.¹¹³ In the case of Russia, it does not appear that a definition centered on a quantitative cap (e.g. 1M or 3M rubles) effectively serves the policy objectives of financial inclusion. Elements that could be incorporated into the definition of microfinance or microcredit include the usage of the loan or type of customer, and should be made specific to the Russian context. Whatever elements of the definition are chosen, they should result in specifically and effectively carving out payday lending and the business model associated with payday lending, while allowing sufficient flexibility for genuine MFIs which will likely provide a mix of production and consumption loans to a range of consumers.

118. An approach that has been followed in some countries is to broadly convey the general social purpose and typical clientele of microfinance, without being overly specific in terms of maximum loan size. For example, “micro credit” in Bangladesh is defined as the provision of loan facilities by microcredit organizations for “poverty alleviation, employment generation and [to] facilitate a small entrepreneur”.¹¹⁴ Importantly, a definition of microfinance may also include qualifiers such as “primarily”, “including” or “usually” to provide the necessary flexibility for MFIs in terms of target clientele or loan methodology. In Uganda, “microfinance

¹¹² Law on Microfinance, Art. 1.

¹¹³ “Guide to Regulation and Supervision of Microfinance.” CGAP, October 2012.

¹¹⁴ Micro Credit Regulatory Authority Act, Act No. 32 of 2006, Bangladesh. Different definitions would be required for non-profits as opposed to for-profit organizations, which would be recommend for the Russian market too, as currently government funds and MFOs are regulated through the same structure.

business” is defined as accepting deposits and employing such deposits wholly or partly in the provision of “short term loans to small or micro enterprises and low income households, *usually* characterized by the use of collateral substitutes, such as group guarantees or compulsory savings” (emphasis added).¹¹⁵ Such qualifiers serve to focus MFIs primarily on traditional microfinance and traditional microfinance business models and lending methodologies (carving out payday lending), but without restricting MFIs solely to such models and allowing the flexibility to, for example, serve larger clients with secured loans in some cases. Such flexibility is necessary for the long-term viability of MFIs.

119. In addition, the definition of a MFI should also be clarified and built off of a more targeted definition of microfinance. The current situation under the Microfinance Law allows for too many organizations to obtain the status of a “MFI”, even with the new amendments. Similar to the definition of microfinance, the definition of a MFI should incorporate clear policy objectives. The definition of a MFI could incorporate the concept that such an institution primarily provides microfinance services. Again, some flexibility should be allowed for a portion of a MFI’s business to extend beyond underserved segments and into other activities or customer segments, for purposes of the commercial viability of the MFI.

120. In parallel, Russian policymakers should take steps to further support the expansion of MFIs focused on more productive lending. There are currently very few private, commercially-operated MFIs serving SMEs in Russia. As noted previously, there are around 200 government-run MFIs that receive subsidized credit to on-lend to SMEs in their localities. These funds do not operate like MFIs, and it is not clear why they are classified as such. In some cases, regional and municipal funds serve fewer than 80 clients. They do provide loans to sole proprietors and SMEs, in contrast to commercial payday and consumer lenders.

121. It is recommended that government-run MFIs be transformed from MFIs back into the SME support funds that they are in actuality, consolidated, and used to funnel subsidized credit into private, commercially-operated MFIs as opposed to directly to SMEs. This shift in approach has numerous benefits. It will increase the efficiency of operations of SME finance support programs, which should not be treated as MFIs. It will also help to support the growth of the private, commercially-oriented MFI sector, which will have a greater long-term impact on increasing access to finance for SMEs and traditional microfinance provision more broadly. Tax incentives could also be designed to further support and encourage the growth of a healthy, sustainable industry of MFIs focused more on traditional microfinance and lending for productive purposes.

122. With respect to payday lenders, enhanced consumer protection and responsible finance provisions should be put in place to curb abusive practices. This topic will be discussed further in Section VII.

Consumer Credit Cooperatives Sector

123. CCCs also have the potential to provider greater contributions to financial inclusion once the sector is cleaned up and modernized. Unlike the typical bank or MFI, CCCs are

¹¹⁵ Micro Finance Deposit-Taking Institutions Act, Act No. 5 of 2003, Uganda.

located in villages and towns outside of urban centers, and hence have greater potential to serve as physical access points for the underserved. The sustainability of CCCs and their growth potential will depend on modernizing the sector to improve their appeal to consumers and regulatory reforms that may help to further improve operations.

124. Similar to the MFI sector, the CBR has been cleaning up the CCC sector through a variety of means. All CCCs are required to join one of the industry SROs, and the CBR has been closing down those CCCs that are either dormant, do not meet the regulatory requirements (e.g. reserve requirements, maximum exposure limits, accounting standards, unapproved investments, etc.), or fail to join one of the SROs (reportedly, half of CCCs are not members of a SRO, and half of these are inactive). The Credit Cooperative Law¹¹⁶ also put in place minimum prudential requirements for CCCs and used a tiered, risk-based system (based primarily on membership size) to set requirements to improve the overall health and stability of the sector.

125. While a CCC may be suitable provider of basic savings and loans products in rural areas, a major limitation for CCCs is the lack of an effective deposit insurance scheme. This situation puts CCCs at a disadvantage compared to banks, which are covered under the Deposit Insurance Agency. While CCCs have compensation funds of 0.2 to 0.5 percent of aggregate member assets, it is not clear whether these funds would be sufficient to protect members' shares/deposits. The availability of an insurance or guarantee scheme on one hand would enhance the attraction to save with CCCs, and on the other would allow CCCs to lower their cost of funding. Such schemes could be potentially operated by "second-level" CCCs (credit cooperatives whose members are solely credit cooperatives).

126. Other regulatory and reporting requirements also constrain CCC operations. These include AML/CFT reporting rules, similar to other financial institutions (discussed below), restrictive reserve requirements (CCCs can only invest in government bonds), the applicable tax regime, and cash operations which must be performed through banks (which apparently treat CCCs as SME clients as opposed to credit institutions). The CBR is reportedly considering ways to support healthy growth in the CCC sector by addressing some of these obstacles, such as via guarantees for CCC savings and access to corporate bonds. As with MFIs focused on lending to SMEs, various incentives for CCCs could also be considered. CCCs have also cited severe funding constraints and limited options for external borrowing as an obstacle.

127. To truly expand the sector will also require modernization of CCCs. The majority of CCCs appear to operate in a simple, low-tech fashion. Their membership is older and declining, and awareness of CCCs is limited. A 2012 NAFI poll indicated that 63 percent of adults were not aware of CCCs, and 94 percent of adults do not plan to use them.¹¹⁷ To counter-balance this low lack of awareness and relevance, CCCs will need to upgrade to more professional, modern financial institutions. Policymakers could consider providing professional training and capacity building.

¹¹⁶ Federal Law No. 190-FZ on Credit Cooperation of 2009.

¹¹⁷ NAFI Survey, 2016, *available at* <http://nacfin.ru/nuzhny-li-kreditnye-kooperativy/>.

Supervision and Self-Regulatory Organizations

128. Given the large numbers of MFIs, CCCs, and other financial institutions, the CBR has introduced a system of self-regulation centered around SROs. The SRO Law,¹¹⁸ which came into force in January 2016, covers SROs of all types in the financial sector and aims to establish a uniform system of self-regulation, granting SRO status only to those who meet certain requirements (several SROs have been granted official status by the CBR since January 2016). The law requires mandatory participation in a SRO for a respective type of institutions; each SRO must account for at least 26 percent of the total number of financial organizations in their respective market segment (meaning there will be no more than three different SROs per sector). The law lays out a SRO's duty to develop basic standards for its members, such as with respect to risk management, corporate governance, internal controls, and consumer protection. The CBR's Standards Committee reviews the base standards developed by each SRO. SROs have duties of supervision over their members, including conducting planned and random inspections, to ensure compliance with laws and regulations of the Russian Federation, CBR regulations (including prudential norms), SRO standards, and other by-laws. In effect, SROs have a quasi-delegated supervisory role.

129. In order for clean-up efforts in both the MFI and CCC sectors to be effective, supervision will need to be effective as well. Relying on SROs for supervision, while most likely a necessary strategy given the sheer numbers of MFIs and CCCs, is ambitious and poses certain potential challenges. One potential issue is SRO arbitrage. Given that there will be up to three SROs per sector, there will inevitably be a lack of consistency in the depth and technicality of supervision, even with harmonized standards across SROs. Supervising and monitoring compliance with all applicable laws and regulations in Russia as well as SRO standards and by-laws is also a significant undertaking, particularly for entities and individuals with no supervisory training. Finally, there is a potential conflict of interest between a SRO that serves both as an advocacy organization for its members as well as a delegated supervisor that supervises, monitors, and enforces the law against violations by its members.

130. Specific strategies to address these potential challenges include standardized, strategically tailored reporting by SROs and hands-on training for SROs. To be able to effectively monitor MFIs and CCCs remotely, the CBR will require enhanced reporting that, while not imposing undue or unrealistic burdens on either SROs or their members, provides the CBR with sufficient data to be able to conduct more thorough analyses. SROs staff will also require intensive, hands-on training in supervisory planning, strategies, inspection techniques, supervisory tools, etc. in order to successfully fulfill their role of delegated supervision. The CBR should also work to ensure that key standards are harmonized across SROs for each industry, as has been the CBR's stated intention.

131. Credit bureau data could also be further leveraged for supervisory purposes. In the absence of a public credit registry, the CBR could request information from private credit bureaus to monitor and supervise the sector. This applies to the banking sector, and in particular to the MFI segment, which has been generating a large number of parallel loans, NPLs, and a bad reputation among consumers due to high interest rates and abusive collection practices (as

¹¹⁸ Federal Law No 223-FZ of July 13, 2015 on Self-Regulatory Organizations in the Financial Market Area.

discussed in previous sections). Besides raw data, the CBR could also arrange, for example with the largest credit bureaus, to have market analysis done to order for specific purposes. Some market analysis is already received from the largest credit bureaus, and this practice could be further expanded. This practice is used by regulators in some countries which do not have public credit registries, for example, Banco de Mexico, Czech National Bank, and the National Bank of Slovakia. Most recently, the Bank of England has decided to use credit bureaus' data and analysis for its regulatory purposes, in view of rising NPLs in the consumer segment.

AML/CFT Compliance

132. AML/CFT regulation has been duly strengthened in recent years, with elements of a risk-based approach introduced; however, the risk-based approach could be further enhanced. As noted previously, the existing AML/CFT framework was noted by the majority of financial providers as one of the main obstacle to financial inclusion. In addition to difficulties with identification, the high compliance costs and reporting requirements related to AML/CFT pose a challenge, particularly to smaller financial institutions.

133. Recent reforms have increased reporting and compliance requirements significantly. All financial institutions as well as agents are covered by the AML/CFT Law. In recent years, reforms have been introduced tightening customer due diligence (CDD) requirements and requiring financial institutions to conduct ongoing identification. The introduction of these new requirements on a blanket basis for all institutions and all scenarios, without taking into consideration capacity constraints and without taking a more enhanced risk-based approach, can have a negative impact on provider sustainability. Many financial institutions have cited reporting procedures related to AML/CFT as unduly burdensome, particularly the situations that require next day reporting, and multiple, quarterly reporting requirements to internal boards, the CBR, and the FIU. CCCs and MFIs both noted difficulties in identifying and regularly updating information on the beneficial owners of their members/clients who are legal entities, as access to appropriate databases is expensive. In addition, smaller institutions noted the difficulty in establishing separate, 2-person AML/CFT compliance units as required by law.

134. As discussed previously, a National Risk Assessment should be conducted to better assess the precise risks posed in Russia and adapt the AML/CFT framework accordingly, taking into more careful consideration the tradeoffs between financial inclusion and financial integrity. Reforms should aim to better align requirements and related compliance costs, as well as resource allocation, with the risks posed. The FATF envisages that where lower money laundering and terrorist financing risks are identified, simplified measures may be allowed for certain FATF Recommendations, such as reporting requirements based on suspicion rather than strict, automatic, and frequent reporting requirements. Moreover, a proportionate compliance function or structure should be commensurate to the size of an entity. It is unreasonable to expect a small firm of 5-10 people to have a comprehensive compliance structure similar to a bank or other big financial institution.

Summary of Main Policy Recommendations:

- *Encourage expansion of Post Bank to reach underserved in remote areas with basic products and services per Post Bank's stated strategy*

- *Introduce more tiered banking system with proportionate regulatory framework for banks (or deposit-taking NBCOs) with limited set of defined operations*
- *Develop clear definitions for “microfinance” and “MFIs” that align more closely with traditional microfinance business models and effectively distinguish microfinance from payday lending*
- *Transform and consolidate government-run MFIs into SME support funds for greater efficiency*
- *Support long-term growth of private, commercially operated MFIs via subsidized credit from SME support funds and tax incentives*
- *Modernize CCCs through capacity building programs*
- *Enhance operations of CCCs via support for suitable deposit insurance schemes and greater flexibility regarding investments*
- *Enhance reporting requirements for SROs, harmonize standards, and provide capacity building for SRO staff*
- *Conduct National Risk Assessment to determine proportionate, risk-based AML/CFT framework to better align requirements and related compliance costs, as well as allocation of resources*

VI. PRODUCT RANGE AND APPROPRIATENESS

135. Overall, the range of financial products and services for the underserved does not appear to be sufficiently diverse or appropriate in Russia. There is low uptake and usage of savings products among the underserved. Payment service providers (PSPs) offer store-of-value like products which could be leveraged for low-income consumers, but are mainly targeted to and used by urban consumers. Opportunities to expand Islamic banking may help address limited levels of financial inclusion among Russia’s Muslim population. There is a lack of small value, short-term “liquidity bridge” financing for individuals that can normally be addressed by credit cards; few banks offer credit cards with low borrowing limits, which may be encouraging the proliferation of payday lending. While the Microfinance Law allows for special rules for MFIs and microloans, the lack of entry barriers or clearly prescribed definitions of microfinance result in a plethora of payday loans that are inappropriate for underserved consumers.

Product Range

136. While Russia performs better than the regional average and its peers in some areas with respect to access to accounts, opportunities exist to improve the access to and usage of a broader range of appropriate products, in particular savings products. Banks are currently the only financial service providers in Russia authorized to take retail deposits. As noted previously, savings rates are low in Russia, and have been declining in recent years. There appears to be low uptake and usage of short-term micro-savings products and channels, as indicated in Table 5. Anecdotal evidence suggests that basic savings products do exist, but are not well-marketed to the underserved. There is also limited awareness among the underserved regarding such products.

Table 5. Deposits by Type of Current and Savings Account

Deposits in Rubles from physical persons	2011	2014
Current accounts	21.1%	19.2%
Up to 30 days	0.1%	0.2%
From 31 to 90 days	1.3%	3.8%
From 91 to 180 days	3.9%	6.3%
From 181 to 360 days	15.3%	17.7%
From 1 to 3 years	48.9%	46.4%
Over 3 years	9.5%	6.3%

Source: Gosstat

137. Various issues previously cited may be contributing to low levels of usage of savings products among the underserved. Of course, low income levels, currency devaluation, and the general economic downturn have played in a role in impacting the capability of the underserved to save. However, regulatory and infrastructural issues may also be playing a role in the lack of appropriate savings products. In remote areas, identification for an account can be difficult, as AML/CFT requirements require the physical presence of the account holder for the first time. The lack of cash-out options in remote and rural areas may also discourage savings, and the lack of cash-out options limits the convenience and accessibility of savings services. Low levels of trust are likely a contributing factor as well. Recent research shows that debit cards, by providing ready access to savings and monitoring balances (via the corresponding infrastructure to use them) can

help to build trust in financial institutions among the poor, resulting in increases in savings.¹¹⁹ Such research again points to the need for greater card acceptance in rural areas, without which account ownership will not translate into usage.

138. With a Muslim population of around 20 million in Russia, Islamic banking has potential to help address the needs of the underserved in this particular segment of the population. The first Islamic Banking Center in Russia opened its doors in March 2016 in Kazan, the capital of the majority Muslim region of Tatarstan. It remains to be seen how successful this center will be. Expansion of Islamic banking in the North Caucasus could be particularly beneficial for reaching the underserved. Policymakers may wish to examine how to better promote this system and facilitate its expansion into more remote and unbanked areas. For expansion of Islamic banking, amendments to the current legislation of the Russian Federation may be necessary to allow for the use of Islamic banking tools, as they are currently not covered. This includes repayments that cover profit sharing and other forms of refinancing.

Product Appropriateness

139. While e-wallets have the potential to reach the underserved, barriers exist in terms of product design and the level of understanding of the needs of the underserved. Targeted, demand-side research among the underserved on their understanding of digital finance products and uses may be useful, as well as mapping of their current, recurring payment transactions. Such research would help to determine which products and services are needed by the underserved, as well as what features and functionality are demanded, which could help to inform better and more appropriate product design and interface.

140. Financial education efforts should be targeted towards digital finance as well as savings products. The lack of demand among the underserved may be partly attributed to lack of familiarity and comfort with technology along with lack of awareness of digital finance and savings products and services and their uses and benefits. Addressing these specific concerns via practical, targeted financial education initiatives could help to increase demand. Digital channels such as mobile phones can also be leveraged for targeted financial capability efforts, as has been conducted in other countries.

141. While a popular product, payday loans are generally not appropriate for purposes of financial inclusion. Within the microfinance sector, it is especially easy to receive loans in small amounts of under 15,000 rubles and with a term of 30 days. Payday loans are especially popular with people who have no documentation of income, a bad credit history, and would not receive a loan from a bank. While highly in demand by the lower segment of the market, these uncollateralized consumer loans are highly predatory in nature, offering interest rates of up to 2 percent per day and leading to over-indebtedness. As described in the following section on Financial Consumer Protection, the CBR has begun making efforts to curb such practices.

¹¹⁹ “Banking on Trust: How Debit Cards Help the Poor Save More.” Bachas, Pierre and Paul Gertler, Sean Higgins, Enrique Seira, April 2016.

Level Playing Field

142. A large number of interest rate caps, which are provided for in the Consumer Credit Law, apply for credit and loan products.¹²⁰ Interest rate cap categories vary based on loan size, maturity, collateral, type of creditor, intended purpose of credit, use of electronic payment facility, and availability of credit limit. The CBR calculates the average market value for the previous quarter by calculating the mean weighted value for at least 100 of the largest creditors for each relevant category of consumer credit, or at least one-third of the total number of creditors in the relevant category. The full cost of consumer credit cannot exceed by more than one-third the average market value of the full cost of consumer credit as calculate by the CBR for the relevant category and applicable for relevant calendar quarter.

143. While interest rate caps are intended to address a legitimate concern with high interest rates, the current approach has several drawbacks. The system of interest rates caps creates an unlevel playing field and, most importantly, may not be effective in achieving its policy goals. For credit institutions, there are 20 categories of caps for different types of consumer loans. For MFIs, there are 18 different categories of caps. For example, for unsecured loans with terms from 6 months to 1 year and up to 30,000 rubles, the cap is 193.49 percent as of February 2016. The “cap” for an unsecured MFI loan up to 1 month and up to 30,000 rubles is 806.95 percent.¹²¹ Different caps apply for the same type of loan offered by different types of institutions. In addition, payday lenders indicated that they actually calculate their pricing based on the cap itself, which clearly suggests that the cap is not achieving its policy objective, which was presumably to place downward pressure on high interest rates. Given their complex and rigid structure, the caps may also reduce innovation in the market, as they assume static categories.

144. It is suggested that policymakers reevaluate both the intended purpose and impact of interest rate caps. Although interest rate caps do not appear to have any serious negative impact on the market, they are potentially confusing and limiting for providers and do not seem to be effective. Alternative approaches may be better to achieve the same policy objectives, but in a more direct and targeted manner, such as strict creditworthiness assessment requirements, enhanced disclosure, and other recent initiatives by the CBR with respect to responsible finance.

Summary of Main Policy Recommendations:

- *Conduct targeted, demand-side research on digital finance and payment and savings needs and behavioral patterns of the underserved*
- *Develop targeted financial education initiatives for underserved regarding digital finance and savings*
- *Re-evaluate intended purpose, impact, and market consequences of current approach to interest rate caps by provider type and product type to gauge effectiveness*

¹²⁰ Federal Law No. 353-FZ dated 12/21/2013 on Consumer Credit (Loans).

¹²¹ CBR website.

VII. FINANCIAL CONSUMER PROTECTION¹²²

Supervisory Framework

145. The overall institutional and supervisory framework for financial consumer protection in Russia is fragmented, with overlapping mandates. As evidenced by a World Bank Consumer Protection and Financial Literacy Diagnostic (WB CPFL Diagnostic) in 2009,¹²³ the key issue on financial consumer protection is the complex structure of responsibilities across various supervisory agencies. At present, there are several institutions working on financial consumer protection, with the General CP Regulator established in 2004 to oversee and enforce the Law on the Protection of Consumers' Rights, which also covers financial services and products; the CBR's role is not only to maintain stability in the Russian banking system and protect the interests of depositors and lenders but also to provide protection for investors and shareholders in the financial market and consumers of insurance and non-governmental pension funds services,¹²⁴ and the Federal Antimonopoly Service (FAS) which is responsible for monitoring advertising in the financial markets.

146. Although the role of the CBR in relation to consumer protection still requires clarification, a financial consumer protection unit has been created within CBR. To effectively perform CBR's duties to protect the rights of financial consumers, the Service for Protecting the Rights of Financial Services Consumers and Minority Shareholders was set up in March 2014. However, its mandate is incomplete as it covers non-credit organizations only (i.e. it does not cover banks and NBCOs). The main role of the Service to date appears focused on handling complaints from consumers, financial education efforts, and providing inputs into the development of the legal and regulatory framework with respect to consumer protection under financial sector-specific legislation. In case of any violations revealed (as a result of consumer claim handling), the Service has the power to take enforcement action against violations or in order to prevent future violations and impose administrative sanctions.

147. Given its mandate among the various institutions, the General CP Regulator seems the most proactive in conducting consumer protection supervision and enforcement. The General CP Regulator has a mandate to enforce compliance with the provisions of the General Consumer Protection Law ("General CP Law").¹²⁵ It conducts inspections, though its powers and mandate are limited to the General CP Law and regulations which arise from this law. With offices present throughout the country, it can conduct several types of supervisory activities. It has the power to conduct planned and unplanned inspections of all types of financial service providers, administrative investigations, bring administrative "liability", and appear in court proceedings against financial service providers.

¹²² The analysis in this section should not be considered comprehensive, as it focuses only on a few select concerns with respect to financial consumer protection that were identified during the mission. Financial education is not covered as Russian authorities have already undertaken a significant amount of research and work on the topic.

¹²³ World Bank Russian Federation CPFL Diagnostic, 2009, *available at* http://siteresources.worldbank.org/INTECAREGTOPPRVSECDEV/Resources/RU_CPFL_Vol_I_draft_EN.pdf.

¹²⁴ Federal Law of No. 86-FZ, of 10.07.2002, "On the Central Bank of Russian Federation (Bank of Russia)", Art. 4 and Art.76.1.

¹²⁵ Law of The Russian Federation on The Protection of The Consumers' Rights No. 2300-I of February 7, 1992 (as amended).

148. The main supervisory role to date of the General CP Regulator has been to conduct inspections both planned and unplanned. Although the number of inspections has been declining over the years it still remains high. For example, in 2014, the General CP Regulator conducted 1,606 inspections. While the bulk of inspections is on banks (72 percent of the total), inspections on MFIs are increasing, reaching 123 inspections in 2014.¹²⁶

149. Inspections have uncovered many violations of legal and regulatory requirements. In fact, during the inspections, it was revealed that the average violation rate for all financial service providers is around 60 percent, meaning out of all institutions inspected, violations have been found in 60 percent of them. The highest number of violations resulted in the microfinance sector with 85 institutions out 123 inspected having violated some of the legal and/or regulatory requirements with regard to consumer protection.¹²⁷

150. Lastly, the legal framework also gives a role to consumer organizations and unions and most recently to SROs as well to develop rules in this field. Under the General CP Law, consumer organizations and consumer unions enjoy broad powers, functions, and rights and their activities must be carried out in cooperation and under the control and supervision of the relevant regulatory body. Consumer organizations and consumer unions may do the following: (i) participate in the drafting process of instruments imposing requirements on financial service providers, legislation and other regulatory or legal instruments that regulate the relationship between financial service providers and financial service consumers; (ii) implement non-governmental control over the observance of consumer rights, and inform the General CP Regulator about consumer rights' violations; (iii) disseminate information on consumer rights and take actions, necessary to protect these rights; and (iv) file lawsuits in court to protect consumers' rights and legitimate interests of individual consumers (group of consumers, consumers at large).¹²⁸ The new SRO Law has expanded the role and powers of SROs, giving them the mandate to regulate and supervise financial consumer protection related issues under the provisions of the Basic Standard for Financial Services Consumer Rights Protection. The Basic Standard should be elaborated in accordance with the requirements set up by the CBR for every type of activity in the financial market specified by the SRO Law.

151. There is a general lack of clarity regarding what various institutions can do and how efforts are coordinated. The main issue in the current model is that the General CP Regulator is responsible for all segments of the Russian consumer market. This creates concerns of overlap regarding the supervision of financial consumer protection, as the CBR also (i) supervises the activities of credit institutions and banking groups, and (ii) exercises regulation, control, and supervision over the activities of non-credit financial institutions in compliance with federal laws. In addition, the FAS has oversight over issues pertaining to competition, even where it impacts consumer protection.

152. The supervisory structure for consumer protection should be clarified, with overlaps managed and coordination and communication across relevant agencies further

¹²⁶ Ministry of Finance, Progress Report on Financial Consumer Protection, 2014, at 105-106.

¹²⁷ Ministry of Finance, Progress Report on Financial Consumer Protection, 2014, at 106-107.

¹²⁸ Law of The Russian Federation on The Protection of The Consumers' Rights No. 2300-I of February 7, 1992 (as amended), Art. 45 and 46.

strengthened. Supervisory information in particular should be shared in order to effectively track issues across the financial sector. Enforcement procedures should also be coordinated. These steps are necessary to ensure consistency and harmonization across different types of providers and products, for the protection of all consumers. The CBR and the General CP Regulator reportedly have a MOU in place regarding information sharing and the principles of division of labor and complaints based on areas of competence, a positive sign of coordination. Such coordination efforts should be further enhanced to ensure that a consistent and harmonized approach is taken with respect to financial consumer protection supervision that enables effective supervision of the market, which requires both a broad perspective along with comprehensive data.

Legal and Regulatory Framework

153. Similar to the supervisory framework, the legal and regulatory framework is fragmented, overlapping at times and containing gaps in other instances. For example, the powers and functions given to the General CP Regulator are not cohesive and comprehensive. The law regulating consumer protection and the General CP Regulator does not have a specific section and/or specific provisions touching on financial sector issues. Additionally, it does not give the power nor provide for the General CP Regulator to provide inputs on legislation related to financial services and products.

154. However, the General Consumer Protection Law does outline key principles which are also relevant to financial services and products. The law touches upon: (i) the right to be informed, including what types of information the provider should give to the consumer and obliging providers to give consumers information about the circumstances/issues that can possibly affect the quality of the service or product offered; (ii) the right to choose, which prohibits providers to bundle and tie products and services; and (iii) the right to redress. In fact, full consumer redress should be provided in case of provision of misinformation about the product or service, provision of defective product or service, presence of invalid contract terms prejudicing consumer rights, and moral injury inflicted by the violation of consumer rights.

155. In addition, each “specialist” financial sector appears to contain separate provisions related to consumer protection.

- The Law on Credit Cooperation addresses a subset of consumer protection challenges for clients of credit cooperatives, necessary due to the fact that CCC members are not technically considered to be consumers but rather legally are co-owners of CCCs.
- The Microfinance Law also includes some conduct of business rules, establishing general information disclosure requirements. MFIs have to inform their customers of the rules relevant to microloans, including rules on loan application procedures and review, and rules of loan agreement signing and repayment schedules. However, the law does not specify how MFIs are supposed to implement these consumer protection requirements and leaves room for various interpretations. It also does not address in detail business practices that could potentially be harmful to consumers (such as penalties and debt collection).

- The National Payment System Law also addresses some consumer protection issues. In fact, one of the objectives of the law was to define clear rules for the legal relationship between e-money issuers and their customers. Customers are now served by credit organizations that are subject to the consumer protection rules specified by the CBR.

156. The current legal and regulatory framework creates the potential for both overlapping mandates and gaps, as well as inconsistencies in coverage and approach to consumer protection across different types of financial institutions. While the General CP Law generally covers all financial service providers, the “specialist” laws impose different rules on the various providers they regulate. This situation results in inconsistencies and gaps in protection for consumers across provider type. The introduction of the Consumer Credit Law, which includes some consumer protection provisions (see below), partially tackles this issue as it applies only to credit/loan providers. Policymakers should aim for certain basic consumer protection standards to apply across all financial products and providers, as consumer protection issues can be similar regardless of provider type.

Disclosure and Sales Practices

157. Although there are some provisions regulating disclosure and transparency, most violations in terms of consumer protection appear to be in this area. From the inspections conducted by the General CP Regulator in 2012, the majority of violations were concerned with disclosure and transparency, namely the obligation for providers to give clear and transparent information to consumers in relation to themselves and to the products and services offered. Similarly, in 2014, the majority of inspections which found violations of legal requirements concerned the failure to comply with the obligation to inform consumers about services and products as well as invalidity of certain clauses and terms of contracts.¹²⁹

158. Misleading advertising and sales material is forbidden, a rule that applies to all regulated financial service providers. There are specific provisions in the Advertising Law which touch upon financial services and products, covering “*advertising of bank, insurance, and other financial services*”.¹³⁰ Financial service advertising cannot contain promises of future conditions which cannot be “*determined at the date of the conclusion of the contract*”.¹³¹ The law further states that advertising material: (i) cannot withhold information on the cost or profit of a product; (ii) if it mentions any cost in the relation to the provision of credit, it should also mention the total cost; and (iii) specific provisions are given on how housing cooperatives can advertise their products and services. The violation of any of these norms results in the liability of the financial service provider to compensate for the losses suffered by consumers.

159. Although there are further provisions in terms of disclosure and sales practices, these are limited and often not applied by all providers. The General CP Law does not contain a list of information on what needs to be disclosed with regard to banking activities and services. Similarly, there is no specific provision on the format in which the information needs to be

¹²⁹ Ministry of Finance, Progress Report on Financial Consumer Protection, 2014, at 106.

¹³⁰ Federal Law of 03.13.2006 38-FZS (rev. of 02.09.2007) “On Advertising” (adopted by the Russian Federation Federal Assembly State Duma on 02.22.2006), Art. 28.1

¹³¹ *Id.*, Art. 28.2.

provided to users; the only obligation in the General CP Law is for banks to give consumers a copy of the terms and conditions. Although it is not mandatory for banks to comply with it, when offering credit products, they can consult “*The recommendations for credit organizations concerning the information disclosure standards when granting consumer credits*” (26 May 2005), which is a document jointly developed by FAS and the CBR and includes recommendations on what information should be provided. Similar measures apply to MFIs. MFIs are required to inform loan applicants about loan agreement conditions, the possibility to change the agreement at the initiative of either the MFI or the borrower, all fees and commissions and their amounts charged in connection with loan disbursement, servicing, and repayment, and delinquency penalties.

160. The Consumer Credit Law¹³² was passed to raise the standards for disclosure across all credit providers. The law sets standards for signing a consumer credit contract (Article 7) as well as in relation to loans delivered digitally (Article 8). The law also introduces the concept of effective interest rate (EIR), representing the total cost of a loan expressed as a percentage, and its calculation method. It specifies that EIR must be provided in the right top corner of a standardized format similar to a key facts statement.¹³³ The formula for EIR seems to be in line with international best practices; in fact, the law specifies which costs need to be included and what assumptions need to be made for its calculation. The law also lays down what information needs to be provided upon conclusion of the contract (Article 10), including a repayment schedule, outstanding balance, and a free monthly statement upon request.

161. Despite the above rules regulating disclosure and transparency, irresponsible practices appear to continue in the market. Payday lenders in particular use aggressive sales practices to sell short-term, high interest rate microcredit, often taking advantage of low-income and low-literacy consumers, with business models based on earning a profit from penalties and fees. Complaints against these type of providers are increasing.¹³⁴ Consumer complaints relate to hidden fees and charges,¹³⁵ abusive debt collection practices, unprofessionalism, and high penalty charges.¹³⁶

162. Responsible finance provisions may be warranted, particularly given the behavior and business model of payday lenders. The CBR recently imposed a cap on the total cost of a loan, including all interest, fees, and principal, to four times the principal. Another tool that may be useful is requiring providers to assess a consumer’s repayment capabilities and banning the issuance of loans to borrowers who are identified as being unable to repay the loan. If a lender does not comply with these requirements, the borrower can go to court and get his debt annulled. Such an approach was utilized in South Africa, and proved to be a strong and effective means to curb predatory practices in the consumer and payday lending market. The CBR is reportedly considering a debt-to-income ratio (DTI), which is a similar measure but potentially broader

¹³² Federal Law 353-FZ on Consumer Credit.

¹³³ *Id.*, Art. 6.

¹³⁴ Ministry of Finance, Progress Report on Financial Consumer Protection, 2014.

¹³⁵ In spite of the fact that from 2015, all fees and charges are included in APR which is provided to a potential client prior to signing of the loan agreement.

¹³⁶ Ministry of Finance, Progress Report on Financial Consumer Protection, 2014. In addition, on consumer websites such as sravni.ru, irecommend.ru, and kredit-otzyv.ru, a significant number of complaints about MFIs appears to be about misleading information provided and hidden charges.

measure. Such measures should be carefully calibrated to target the root problems without negatively impacting legitimate businesses.

163. Enhanced disclosure requirements should also be considered, as they have less potential to distort the market. Such measures could include requiring oral explanation of EIR, visualizations of the total cost of credit specifically designed with behavioral insights and impact in mind, and increasing the prominence of representative calculations of EIR in advertising and sales materials. In addition, price comparison and product selection websites may be helpful to encourage consumers to shop around, as well as to impose competitive pressures on financial providers.

Debt Collection Practices

164. Despite regulatory provisions on the topic, there appear to be some issues in the market in relation to abusive debt collection practices. From a regulatory perspective, financial institutions are prohibited from turning over the collection of overdue debts to collection agencies without the debtor's consent, and the Consumer Credit Law sets acceptable practices with regards to debt collection.¹³⁷ However, these rules do not seem to be followed or enforced effectively, considering that debt collection is one of the most complained about issues before the General CP Regulator.¹³⁸ Abusive debt collection practices are on the rise, in particular in relation to the microfinance sector and payday lending. While unpaid consumer debt is high, soaring by 48 percent in 2015 and hitting 1.15 trillion rubles according to the United Credit Bureau, collection practices are becoming more abusive. There have been reports on “deadly” debt collection practices in the mass media that have attracted widespread attention, negatively impacting the reputation of all MFIs.¹³⁹ Parliament is considering a draft law to try to regulate this phenomenon, though the industry has noted that the manner in which the draft law is currently drafted would severely affect legitimate lending business. While a new law, if appropriately drafted, should help improve the situation, it should also be noted that some practices may arise from informal/unregulated debt collectors. Such institutions will require law enforcement to address.

Internal and External Dispute Resolution Mechanisms

165. There are certain provisions which oblige institutions to have adequate internal complaints handling mechanisms; however, these do not appear to be complied with consistently. As mentioned above, the General CP Law provides for institutions to have adequate measures for consumers to seek redress. Similarly, the Consumer Credit Law (Article 13) establishes that claims/complaints from borrowers should be addressed in accordance with Russian legislation. Despite these obligations, there appears to be a lack of effective mechanisms dealing with consumer complaints at the provider level. In fact, policymakers and regulators appear to be focused primarily on their own role in handling complaints, which should only be secondary, as internal complaints handling mechanisms at the provider level are the first

¹³⁷ Civil Code Russian Federation, Art. 338, 384, 388; Banking and banking activities law, Art. 26; Resolution No. 17 of the Plenum of the Supreme Court of the Russian Federation as of 28.06.2012.

¹³⁸ Ministry of Finance, Progress Report on Financial Consumer Protection, 2014, at 101.

¹³⁹ As Consumer Debt Rises In Russia, Collectors Get Violent, Radio Free Europe Radio Liberty, February 2, 2016.

line of defense. It is suggested that there be a shift in supervisory and enforcement efforts to ensure that financial institutions have in place adequate mechanisms providing efficient and effective forms of redress for financial consumers.

166. Although there are no overall provisions on external redress mechanisms (EDR), there are currently several institutions in place providing EDR functions, leading to risks of potential confusion for consumers. The Consumer Credit Law (Article 13), specifically establishes that credit providers and borrowers can use an EDR scheme. However, at present, there is no specialized agency dealing with complaints and consumers bring their complaint to a number of organizations depending on the nature of the complaint, service, and provider. Both the General CP regulator and the CBR CP Service receive and deal with complaints of financial consumers. Moreover, while awaiting for the passage of the law formalizing the institution, there is also an informal Ombudsman Service provided by the Association of Russian Banks. Consumers also go to other organizations such as the Administration of the President or the Prosecutor General's Office, and MFIs' clients also have the possibility of bringing complaints before certain SROs.¹⁴⁰ Given the lack of clarity in mandates and considering the fact that often consumers have little, if any understanding, of the financial services they are using, this multitude of institutions could lead to confusion among consumers, and is also a missed opportunity to consolidate and analyze complaints data statistics for purposes of supervisory planning.

167. The General CP Regulator receives complaints from the public with respect to financial services, and the number of complaints has been rapidly increasing. In 2012, the General CP Regulator's territorial branches received 15,552 appeals from citizens on issues relating to financial consumer protection (representing 6.7 percent of all complaints received). The number of complaints relating to financial consumers received by the General CP Regulator increased to 28,727 appeals in 2014, 84.7 percent more than in 2012. While complaints against credit organizations still dominate, complaints against insurance companies and MFIs are slowly increasing.¹⁴¹

168. The CBR is increasingly receiving more complaints. While its functions in relation to financial services complaints still remain undefined, the CBR is receiving more complaints from financial services consumers. In 2015, it received more than 68,000 complaints (78 percent of which related to insurance companies) against non-credit organizations, insurance, MFIs, broker-dealers, depositories, trust managers, and non-state pension funds. Nine percent of the total complaints received were against MFIs on issues such as repayment of overdue debts, late payment fines, and un-registered MFIs. The CBR has also received 180,000 complaints against credit organizations which are dealt with jointly with other departments within CBR.

169. The recommendation from the WB 2009 CPFL Diagnostic Review to establish a dedicated financial ombudsman to whom financial consumers could submit their complaints still stands.¹⁴² There were plans to adopt a special law creating a government-appointed financial ombudsman in 2012. The law should provide for the centralization of

¹⁴⁰ Ministry of Finance, Progress Report on Financial Consumer Protection, 2014, at 103.

¹⁴¹ Ministry of Finance, Progress Report on Financial Consumer Protection, 2014.

¹⁴² See, World Bank CPFL Diagnostic Review – Russian Federation, 2009.

financial consumer protection and dispute resolution mechanisms and ensure that the Financial Ombudsman has the independence, authority and capacity necessary to handle financial consumer complaints.¹⁴³ However, this law is still in draft form. Concrete forward progress on this law should be pursued.

Summary of Main Policy Recommendations:

- *Clarify supervisory structure for consumer protection through additional MoUs among relevant authorities and/or via reform of legal framework*
- *Develop enhanced mechanisms to share supervisory data and coordinate supervisory and enforcement actions*
- *Harmonize legal and regulatory framework to address overlaps and gaps and to ensure harmonization of approach by issue across different provider types*
- *Introduce enhanced disclosure rules (e.g. oral explanation and visual representations of effective interest rates (EIR), price comparison and product selection websites)*
- *Introduce targeted responsible finance rules to combat predatory lending without unduly restricting flexibility and innovation in the market (e.g. mandatory assessment of repayment capabilities)*
- *Improve enforcement of regulatory provisions related to debt collection, and/or encourage passage of new, appropriately drafted law*
- *Increase law enforcement efforts against criminal behavior or formal or informal debt collectors*
- *Clarify roles of various institutions currently functioning as external dispute resolution (EDR) mechanisms*
- *Pass law to establish financial sector ombudsman*

¹⁴³ CGAP Landscaping Report, 2012, at 13.

ANNEX I: MAIN COMPONENTS OF A NATIONAL FINANCIAL INCLUSION STRATEGY

