

**The Effect of Non-interest Income on Competition and Financial Stability:
Evidence from the Russian VIP-banking Segment**

**Влияние непроцентных доходов в VIP-сегменте российских банков на
состояние межбанковской конкуренции и финансовую стабильность**

Private banking industry is one of the fastest-growing areas of banking and is associated with the increasing number of wealthy individuals and the expansion of VIP-banking services. Presently, global wealth totals to US\$70,2 trillion¹, whereas private banking industry manages only US\$21,1 trillion² of wealth assets, which creates significant potential of this area for further development and growth.

The Russian VIP-banking (private) segment witnesses a steady upward trend, and experts predict its increase by 17% in 2023. This segment is also characterized by a high concentration of large private capital: there are 172 thousand individuals who are dollar millionaires.³ An augmenting demand of potentially wealthy customers, on the one hand, and the need to stem capital outflow, on the other, turn VIP-banking services into a perspective direction for further development in the Russian financial market.

In this paper, we identified key features of the VIP-banking sector and assessed the effect of bank competition among Russian financial institutions providing VIP-banking services on banking system resilience to external shocks based on the previous findings in this area. We proposed two hypotheses to find out whether stability of the Russian banks extending the VIP-banking services is affected by the increased competition in the VIP-banking services segment, and whether stress resilience of the Russian banks extending the VIP-banking services

¹ World Wealth Report 2018 // Capgemini, 2018: <https://www.worldwealthreport.com>

² Global Private Banking Benchmark 2017 // Scorpio Partnership, 2017: <http://www.scorpiopartnership.com/knowledge/report/scorpio-partnership-global-private-banking-benchmark-2017/>

³ Global Wealth Report 2018 // Credit Suisse, 2018: <http://publications.credit-suisse.com/tasks/render/file/index.cfm?fileid=77A4E912-A32D-8E84-CC8C21144CEE52E2>

depends on the share of non-interest income in their total income base. We test the hypotheses using three main regression models estimations: linear regression, fixed effects regression, and random effects regression. For testing the hypotheses we modified the Lerner index as a main measure of competition in the Russian banking sector where it was previously applied by Anzoátegui et al. (2012), and used the approach of Amidu and Wolfe (2013) when measuring both non-interest income and non-interest expenses. We also employ Z-score as an indicator of financial stability for measuring bank's insolvency risk based on Chiaramonte et al. (2015). Our model specification suggests grouping of the selected micro-level variables to assess the extent of income diversification, control variables involving assets and liabilities, and macroeconomic indicators.

We found that a decrease of the level of bank competition negatively affects stress resilience of the Russian banks extending VIP-banking services that supports the “competition-stability” concept. We also found that bank competition enhances stability as diversification of banking income strengthens stress resilience of Russian banks extending VIP-banking services. Besides, an increase in equity of Russian banks with a higher level of income diversification positively affects financial stability, while the growth of loans in bank assets yields the opposite effect.

The research results are essential for managerial decision making in banks aiming at improvement of their operating models amid systemic risks, in particular, for the optimal distribution of interest and non-interest income sources, which contributes to financial stability. Moreover, our study may have an appeal to banking regulators, as searching for a balanced relationship between daily banking services and bank competition and financial stability matches the objective of searching for a balance between the rigor of banking regulation and bank efficiency during the post-crisis recovery.

Key words: bank; non-interest income; VIP-banking services; banking sector competition; financial stability; Russia