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НОВА РАМКА НА БАНКОВИЯ НАДЗОР В ЕВРОПЕЙСКИЯ СЪЮЗ

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NEW FRAMEWORK OF BANKING SUPERVISION IN THE EUROPEAN UNION

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Abstract

Aim of the article is conducting of analysis of the contemporary framework of banking supervision. The new reality poses a critical review of existing policies on banking supervision. The need for a new framework for the supervision of banking activities is dictated by the expansion abroad and the effects of the global crisis.

Results of the paper show new framework in banking supervision based on coordinated approach since 2008. The taken measures of individual countries regard the activities and assets in their own territory without taking into account spill-over effects on other EU Member States. The coordinated approach to supervision paves the leading role of stakeholders' interests over shareholders' interests.

Keywords: *banking supervision, bank groups, corporate governance*

JEL Codes: *E58, G38, G21*

1. Introduction

Banking is based on the activities of commercial banks and the supervision of the competent authority of their policies. The main objective of supervision as a public good is to protect the interests of citizens, households and businesses. With the development of society, the role and instruments of banking supervision notes a dynamic.

The Pan-European policies for free movement of capital and achieving greater competitiveness stimulate the formation of banking groups. The created complex organizational structure and the provided new services hinder the

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implementation of effective supervision. The expansion of banking activities beyond national borders ahead the possibilities to adapt the supervisory regime. The EU policies create an environment in which funding is becoming increasingly cross-border, while the architecture for financial stability - remain decentralized at the national level (Nieto & Schinasi, 2008).

Individual EU Member States taken independent actions and introduce their own measures to mitigate and overcome the negative effects of the economic crisis, mostly linked to the provision of government loans and guarantees. However, results are unsatisfactory, which puts on the agenda the need for coordination of national and supranational policies to prevent new crises. The modern European framework of banking supervision should be seen as a consequence of the effects of the global financial crisis and the measures taken to restore it (Posner, 2010).

Restructuring of the architecture of the EU banking system is in line with the new reality. It is a fundamentally new stage of financial integration, incorporating the delegation of powers to the sovereign rights of national governments to pan-European institutions. The measures aim to prevent situations in which the failure of banks to be borne by national governments and by taxpayers. The expectations are the single supervisory mechanism to help restoration of trust in the banking sector. The new initiative for a common European supervision will contribute to improved cooperation between national supervisory authorities and to develop a unified regulatory framework for financial services in the EU.

2. European Policies for the Banking System

The modern banking system is dominated by cross-border financial groups. Their development is dictated by the extreme effects of the imposition of policies adopted in the EU, leading to synergies:

- The integration of EU financial market is predetermined by the adoption of the single currency. The Euro sets high liquidity and the potential for expansion abroad. Internal growth of banks should be regarded as a leading factor of external growth and competitiveness of the national economy. In this situation some banks are systemically important to the national economy, for example Fortis Bank is a major participant in the clearing system of Belgium and France (Cornford 2010). The Single Market (1993) and the creation of Economic and Monetary Union (1999) did not achieve widely expected consolidation in the EU. In contrast, successes in this regard have some domestic mergers, such as the merger of ABN-Amro (1991) and the creation of BNP Paribas Group of the merger with BNP and Paribas (1999). It should be noted, that until 1993 in the euro area are not observed large domestic mergers, then their volume increases. Most bank mergers are reported after the introduction of the euro (1999).

- The EU policy on competitiveness contributes to the consolidation between financial intermediaries from the same country. Achieving competitive position in national economy determines the wave of mergers between financial intermediaries of different financial sectors and achieved financial capacity – for outsourcing abroad. This policy is defined as the beginning of the trend towards the creation of "national champions"[2]. The Member States retain the national ownership over their large banks on the basis of "strategic management" (Dewatripont & Rochet, 2009). For example, the Single Market program accelerates cross-border banking relationships, and as a result in 2007 the Belgian bank Fortis acquired Dutch bank ABN-Amro and sets two national supervisory authorities. The change in the ownership of one systemically important bank leads to negative reactions in the Netherlands, which are reflected in the subsequent decision of the salvation by nationalization of Dutch part in Fortis, including the former bank ABN-Amro (Stichele, 2008). Conflicts between the Belgian and the Dutch supervisory authorities after the acquisition, related to the definition of a leading supervisory authority in 2008 (Beck, 2009). Efforts to coordinate national measures recapitalize failed to calm the markets and after the nationalization each country gets its share of the bank on its territory. Increasing competitiveness is achieved primarily through organic growth, i.e. growth by acquisition and merger with other banks. Obtaining approval from competent authority is often done in a short time, without taking into account all possible consequences. Such is the case with Bear Stearns, Lehman Brothers, Fortis and the Icelandic banks when acquiring banks have little time to conduct due diligence, or valuation of assets or to obtain shareholder approval.

- The banks' plans to acquire competitors in other Member States have been blocked by national supervisory authorities (Kerjean, 2008). Key measures of the banking practice, imposed by the European Commission for violation of the principles of the Single Market by national authorities when trying to buy a

[2] "Local champions" in Germany include public Landesbanken and savings banks; "European champions" in France are five banks with a large presence in the euro area; the UK "international champions" are three of the four largest British banks with international activities (Howarth & Quaglia, 2014).

local bank foreign competitor: the Portuguese bank Champalimaud from Spanish banking group Banco Santander Central Hispano (1999); the Italian bank Banca Nazionale Lavoro from Spanish banking group Banco Bilbao Vizcaya Argentaria (2005); the Italian bank Antonveneta from Dutch ABN-Amro (2005); the Polish bank Bank Przemysłowo-Handlowy from Italian Unicredito (2006). The principles of the Single Market give two rights: right to free movement of capital and right of establishment. In practice, these two rights have collisions in cases when the bank from a Member State wishes to acquire control over the bank in another Member State because of the procedural requirement for the consent of the supervisory authority of the country of the acquired bank. In these cases, the European Commission identified the implementation of the discretionary powers of national supervisory authorities a reasonable assessment of cross-border mergers and acquisitions as a violation of both rights, with the right to establishment as the most affected.

To maintain the level of competition in the EU, the European Commission imposed restrictions on the provision of state support. The measures to rescue troubled banks, in some cases led to organizational growth, which led to the use of the approach "from case to case." For example, in acquisition of Dresdner Bank by Commerzbank in 2008, the European Commission has imposed restrictions on Commerzbank to buy other competing financial institutions within three years (Gerard, 2010).

- The adoption of Second Banking Directive provides for banks to work in another Member State without re-licensing. Introduction of notification regime defines harmonized environment for banks and alignment of their strategies of organizational growth. An additional effect is the beginning of universal banking - banks are starting to provide investment services to maintain the level of profitability before growth. A good example of this is the expansion of the Belgian bank KBC, which reaches its size through mergers in Belgium, to expand its operations in Eastern Europe (Wouters et al. 2012). Provision of complex financial instruments leads to profit mergers and expansion, which is the financial base at a later stage, has negative effects.

- The current framework of recovery and resolution to credit institutions (2015) extends the range of the supervisory authorities. In order to achieve a significant degree of coordination without interfering with the constitutional and administrative systems of the Member States, are divided the supervisory functions for current activities from the insolvency and restructuring functions. There are introduced two new institutions: restructuring board[3] and competent ministries[4]. The leading role is played by European Central Bank which is more determined than finance ministers in response to the global financial crisis. Conventional monetary policies were accompanied by unconventional measures. The latter includes resolving banks to use a wide range of assets as collateral if the borrower is from the Eurosystem.

3. The National Frameworks of Banking Supervision in the EU

The transnational nature of the activities of bank groups combines complex organizational structure and offering of new financial services, and creates difficulties for the national authorities. In practice, it begins apply a new supervisory tool - a memorandum of understanding. Its use is based on the activity of large cross-border bank groups in several jurisdictions, such as Nordea in the Nordic countries and Fortis in the Benelux countries (Quaglia et al. 2009). The memorandums of understanding limited exchange of information between the host and home supervisory authorities. The consolidated supervision is carried out by the home authority, which requires a high level of coordination, defining the high cost of maintenance obligations in the framework of the memorandum[5].

At the beginning of the current crisis, national legislation in the EU provides various supervisory authorities, which in most cases are central banks. The effectiveness of supervisory policy is further reduced due to various rescue plans for individual Member States. Various types of banking strategies to identify bad credits create problems in the monitoring and supervision of banks (Hubenova, 2015). National laws provide for different times for the beginning and the forms of intervention to save the banks (Alexander, 2013). For prevention of insolvency, the national supervisory authorities do not exercise control in the same degree, or do not have the same opportunities for restructuring credit institutions. Each Member State takes its own measures, which are ad hoc, and actions related to the salvation of the assets in its territory. The absence of *ex ante* arrangements for *ex post* effects of cross-

[3] Representatives of the national authorities involved in the reorganization of the bank, in coordination on cross-border or on European level.

[4] Ministry of Finance and other ministries of the Member States responsible for decision-making in economic, financial and budgetary matters at the national level in accordance with national allocation of jurisdiction.

[5] The crisis of Fortis began after the introduction of a "Memorandum of Understanding", which promotes cooperation on financial stability and crisis management (Dewatripont & Rochet, 2009).

border insolvency determines the need for policy coordination. Changes for individual policies and their consequences are considered common. The current Directive (Directive 2014/59/EU) provides for the provision of finance to be carried out depending on the origin of capital.

The experience from the financial crisis shows that in cross-border conversion dominate national interests. National authorities seek the lowest costs to local taxpayers. This leads to a shortage of public good to ensure global financial stability. International banks are managed by national legislations, but in the presence of independent subsidiaries have the power to maintain liquidity and capital buffers in any jurisdiction.

In order to keep the EU internal market in banking imposes the adoption of a supranational approach to banking supervision and restructuring. Large cross-border banks should be supervised directly by the European Banking Authority, and in case of liquidity problems and solvency have access to the European Central Bank and the European authority for the restructuring. Access to government funds can be based on a prior exchange of information between participating countries sharing the financial burden.

Past experience to overcome the crisis is based on the active and reactive actions at the national level. National supervisory authorities shall take measures to save the banks because of concerns the transfer of risks caused by the mistakes of other supervisory and the risk of a systemic crisis (Govani, 2011). For example, problems with liquidity in a subsidiary of Depfa Bank in Ireland force the German government to take measures to save their bank Hypo Real Estate (Hodson & Quaglia, 2009). National authorities in most cases reduced the losses accumulated to stakeholders (depositors and other creditors, taxpayers and the insured depositors) in their jurisdiction (Basel Committee on Banking Supervision, 2010).

- As a first measure to overcome the consequences of the crisis is considered the Ireland's experience to guarantee their depositors in full amount of deposits (Hodson & Quaglia, 2009). As a source of financial resources were used taxpayers. Given the limited scope of the policy, only for Irish banks and foreign banks in Ireland, identified the reaction of depositors from other countries, mainly from the United Kingdom, with areas of deposits of Irish banks. The Irish experience and its impact on the United Kingdom gave start to the unilateral actions without considering the effects on other countries. Some countries such as Austria, Denmark, Greece and Slovenia quickly routed to the Irish practice for full guarantee of bank deposits in their territory.

- Iceland takes unilateral action to freeze the assets and deposit accounts at the largest banks in bankruptcy, which had an impact on the investors in the EU, incl. the Netherlands and the UK (Andenas & Chiu, 2013). For protection the interests of local depositors, the United Kingdom froze the assets of Icelandic banks located in its territory.

- In addition, the competent authority should take into account the decision of a judicial authority. Following the acquisition of its stake in Fortis, the Belgian government is trying to sell it to the French bank BNP Paribas, which has been suspended by the Court of Appeal in Brussels, as the decision on the sale has to be approved by the general meeting of shareholders (Cornford, 2010).

The legal integration and financial stability can be summarized in the case of Fortis, whose ownership is split between the Benelux countries. The low level of coordination of national measures is demonstrated by the actions of individual governments to inject capital within their territories only. Ultimately this leads to negative results and the Netherlands nationalized its part of Fortis, Belgium does the same, but quickly ceded its share of BNP Paribas, and Luxembourg sold his share to the insurance group La Baloise.

An analysis of the Basel Committee on the measures taken by individual governments outlines the general features (Basel Committee on Banking Supervision, 2010). General characteristics of national policy are reduction the loss for the persons concerned, which authorities reporting and reluctance on the division of losses in cross-border insolvency. The differences between the separate national policies are protection of stakeholders through two approaches. The first approach, the territorial approach, focused on measures of activities and assets of the "ring fence" - the separation of activities and assets of the foreign bank or a subsidiary of a foreign affiliate, in which each of the national authorities applying its own insolvency proceedings under its jurisdiction. The second approach, the universal approach, is based on the process of mutual recognition of the effects of measures, under which the decision on insolvency is accepted by the home supervisory authority and covers the activities and assets in other jurisdictions.

Plans to rescue banks should be considered depending on their geographical location. In most countries of Northern Europe, banks were rescued by governments at a high price as private property has been replaced by the state. In Southern Europe the rescue measures can be summarized in attracting strategic investors. Regardless of the approach, the cost of the rescue is transferred to taxpayers.

4. Pan-European Framework of Banking Supervision in the EU

At the beginning of the crisis, governments are focusing on action at the national level, but after accounting for unsatisfactory effects arises the need for pan-European coordination (Nedelchev, 2016b). Success is registered in monetary policy and in the coordination between the European Central Bank and the national central banks of the EU as a lender of last resort. However, there were a number of weaknesses: fiscal policy and recapitalization of banks are similar in different countries but were conducted independently and uncoordinated. All this requires policy makers in individual countries to solve three problems at once: bank illiquidity, bank deleveraging and economic recession.

By 2008 coordinated supervision in the EU is carried out only in the field of reinsurance. For other financial markets the supervision remains national and leads to the so-called Balkanization (Vaughan & Calabria, 2015), which is characteristic mostly for bank wholesale markets. In such an environment, supervisors reduce dependence on their banking systems of the higher risk of lending abroad.

Declaration on a joint plan of action in the euro area (2008) provides the use of a new approach for banking supervision - the coordinated approach. This ensures the removal of national measures and the introduction of a uniform supervision for troubled banks. To do this, is set up the European Banking Authority, which acts as a mediator to reach an agreement between the national supervisory authorities. The principles require a coordinated approach for control of state aid, especially with regard to compliance with competition rules. The agreed principle requires that each country use its own methods and means in a coordinated manner, taking into account any cross-border effects of implemented national decisions.

The principles at a high level of cross-border cooperation for crisis management, adopted by the Financial Stability Board (2009), define the characteristics of the coordinated approach. They include the obligation for the national supervisory authorities on the preparation of preliminary plan of action in a financial crisis. The participation of national supervisory authorities has been extended to the supervisory boards, where plans are made for emergencies from each parent bank for the entire financial group, regardless of the scope of activities and in accordance with national legislation. Harmonization of procedures for the restructuring of financial institutions under threat establishes a new principle - the sources of funding should not be at taxpayers' expense.

The Directive 2001/24/EC adopts the universal approach to the exchange effects of cross-border insolvency, but, in practice, the national authorities choose the territorial approach.

The positive effects of the implementation of the coordinated supervision can be established under the agreement to share the financial burden between the supervisory authorities of Belgium, France and Luxembourg in the case of Dexia (12 billion Euros). The agreement allows the bank to continue to participate in the interbank market (Cornford, 2010). After the rescue package, the state plays a dual role: as a supervisor and as a governing body - following the acquisition of 50.02% of Dexia, to the Belgian government is granted the right to choose five of the nine members of the Board of Directors (European Commission, 2012).

The coordinated approach provides restrictions for banks that received state aid to overcome the effects of the crisis. For example, the European Commission decides for separation of investment from commercial activities in Commerzbank (Beck, 2009). Requirements of the European Commission on the separation of banking from other activities have the greatest impact on ING. Starting from 2014 in the Dutch conglomerate is created a separate company, NN Group, which brings together several services - life insurance, pension and asset management business. In contrast to the EU policy on incentives for creation of financial conglomerates before crisis, the ongoing effects of the new policy was brought to the deconstruction of complex organizational structures and create preconditions for the implementation of prudential supervision.

The financial market development until 2008 tends to prevailed preferences of national governments to unilateral actions. The lack of a strategy to solve the crisis of pan-European level causes side effects (spillover effects). Most EU member states take limited in scope and location actions to rescue the assets and operations of their territory. The preferred tool is a "good bank" (nationalization) or creating a "bad bank" at the expense of taxpayers. These actions lead to a new wave of protectionism and transfer effects in another country where they can be operated in an unpredictable way. The legal integration based on bilateral agreements between Member States does not affect system stability.

To stabilize the financial system and prevent systemic risk at the end of 2007, the European Central Bank decision to provide 100 billion Euros must be regarded as a start for the rescue measures. The amount is for short-term financing of the German IKB Deutsche Industriebank and French BNP Paribas.

The first bank was closed by the German government due to its large losses, and the second - after its decision to close three of its investment funds.

The European Commission has approved a merger of banks with cross-border implications. The proposal for a cross-border acquisition of Fortis Belgium by BNP was approved by the Directorate General for Competition subject to the conditions for the transfer of some activities on credit cards in Belgium. In the cases of Fortis and Dexia application of the competition rules do not contribute to solve problems and not limit the recapitalization and restructuring, but rather the result of errors made competition to minimized.

In a merger at national level the EU competition law does not have provision of public interest, but the European Commission acknowledges that the decisions must be pragmatic. An example is the case of Lloyds TSB-HBOS, which is reviewed by the authorities in the United Kingdom only. They state that despite possible competition problems merger is in the public interest and the Directorate General for Competition at the European Commission not to oppose the decision of the British government.

To ensure proper implementation of the rescue plan, the European Commission puts certain conditions:

- The behavioral requirements are oriented to the obligation of shareholders/investors and managers of credit institutions to prevent the opportunity to be exposed to risk in the future. For this purpose, shareholders and investors must take their share of responsibility in financial difficulties in the distribution of funds associated with the rescue measures granted by Member States. Managers do need to be guided by proper motives and contribute to the achievement of financial stability. Examples of improper management European Commission states Sachsen Landesbank and Fortis, and poor risk management and corporate governance practices at Commerzbank.

- Structural requirements are aimed at troubled banks, the goal is to avoid the application of erroneous business models and achieve their effective participation in the restructuring and reasonable strategies. In this connection, the European Commission placed several conditions on access to endangered institutions to recapitalize measures (capital injection) in preparing the state guarantee schemes. One of them is the availability of adequate remuneration in obtaining guarantees, which take the form of a fee for services based on the specific risk of the institution.

Another condition to beneficiaries of state aid is to limit the ability to communicate in the market for customers or to develop a commercial strategy on that basis. In some cases, mainly involving Dutch financial institutions, introduces a universal requirement for beneficiaries to "refrain from expansion of business activities that require capital injections" in the case of Fortis Bank Belgium the European Commission recommends acquiring BNP Paribas not to resell the assets of Fortis Netherland over four years.

5. Conclusion

The policy in the EU creates financial group that transcend national boundaries and exceed the GDP of the home country. The measures taken by individual country to rescue operations and assets in its territory raise spillover effects on other Member States. The accompanying directives and decisions to deal with primary and secondary effects of the global crisis affect only the euro area countries, but not on the Member States outside the euro area.

Before the global financial crisis of 2008, the regulatory paradigm is based on the principles involving a great deal of self-regulation by soft law - conclusion of memorandum of understanding. The leading role is the supervisory authority of the home country who must be satisfied that there is sufficient capital and reserves to cover risks on its territory.

By the end of 2008 governments have taken individual measures to reduce the effects of the global crisis. The results did not contribute to restoring confidence between banks and society. In ad hoc actions, some governments used taxpayers' funds to rescue troubled banks. National policies provide rescue of bank assets and activities in their territory only, causing contagion in other Member States and provide competitive advantages of the rescued banks. Individual jurisdictions use different criteria for beginning a form of unilateral interference by the state. The EU financial integration is accompanied by contradictory trends - on the one hand, countries retain their national legislation for financial stability, on the other hand, occur "balkanization" of supervisory policy. In individual cases were achieved positive results, such as the measures taken by itself banking group (where a subsidiary is crucial for the survival of the whole group), and the measures introduced by several countries (where the parent bank and its overseas subsidiaries were systemically important).

Since 2009 is constituted the modern supervisory framework of the EU banking system, which is in line with the new reality. It is a fundamentally different stage of financial integration with the delegation of powers to the sovereign rights of national authorities to pan-European institutions. The ultimate goal is to prevent new crises and putting public interest before corporate. The guiding principles provide for the protection of taxpayers' interests, taking all the financial consequences of shareholders temporary nature of financial intervention and real opportunities for governments to change management. The introduced restrictive measures on banks that received state aid during the crisis, lead to deconstruction of financial groups. This is achieved thanks to the European Commission requirements for the separation of commercial banking from insurance activities and separation between investment and commercial banking activities, contraction of branch network and the formation of foreign subsidiaries.

The new reality is characterized by equality between supervisors in the home and host country. The modern supervisory framework provides ex ante arrangements for ex post sharing of losses on cross-border insolvency. By taking measures in this regard, governments should plan the spillover effects on other Member States. The coordination of supervisory policy provides financial stability throughout the EU (pure public goods) as opposed to "exceptional public goods" that are provided mainly to citizens of different countries (Nedelchev, 2016a).

The new reality in the banking system requires a new framework for supervision. This is a consequence of globalization of banking activities and the effects of the global crisis. National policies should be adapted to changes in the pan-European level.

The differences in the responses of individual countries show a convergence. Common points between the measures is the priority of public's interests instead of corporate's interests, reducing the burden on taxpayers for rescue of insolvent banks, for achievement of preliminary arrangements for sharing the financial implications of cross-border insolvency and to report for systemic importance of each financial group.

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