

REDEFINING THE ROLE OF BANKING REGULATION IN THE BANKING SECTOR OF EUROPEAN UNION

Violeta Todorović

University of Kragujevac, Faculty of Economics, Serbia

✉ v.todorovic@kg.ac.rs

Milena Jakšić

University of Kragujevac, Faculty of Economics, Serbia

✉ milenajc@kg.ac.rs

Lazar Sedlarević

PhD student, University of Kragujevac, Faculty of Economics, Serbia

✉ lazar_sed@hotmail.com

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Abstract: During the last two decades there have been significant changes in the structure of the banking sector at the European level. Factors such as globalization, integration and development of information technologies had a significant impact on these changes. In terms of the economic integration of Europe and structural changes, there is a need to redefine the regulatory infrastructure, due to inadequate institutional arrangements. The problem topics about reform of banking regulation and establishment of a banking union, as a new level of economic integration of Europe, has been put in the focus of interest during the global financial crisis. For this reason, the paper attempts to give a comprehensive analysis of the reasons and ways to reform regulation of the banking sector. Using a critical review of the implemented reforms of banking regulation at the national and supranational level will be reconsidered their applicability in specific problem situations and suggest measures for further improvement.

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1. Introduction

Banks are financial institutions whose main role is to raise funds from the economic subjects with a surplus in the form of deposits and placing collected

funds in the form of loans to economic subjects with a deficit. However, in order to perform these functions as the banks take big risks, so the question of the adequacy of the system of banking regulation has become important. In Europe this question is further complicated by attempts of authorities to create a single economic area. In fact, the idea of economic integration of Europe has been present since World War II, and the effects of the global economic crisis largely pointed to the negative side of the achieved level of integration. Limiting the economic integration of Europe at the level of the monetary union, in the absence of fiscal integration, has caused problems in the banking sector. One of the proposed solutions for existing problem is reflected in the establishment of a banking union on the territory of Europe, which is to ensure the safety of banks that operate in this area. In this context, the particular organization of the banking union is essential, because the inadequately structured system can create new problems.

Therefore, the aim of this study will be focused on the analysis of structural and regulatory changes in the European banking sector with a critical overview of the structure of the banking union. More specifically, the focus of the research will be the analysis of specific regulatory measures in Europe that are undertaken with the aim of ensuring the stability of the banking sector. With respect to presented aim of research, the main objective consists in critical analysis and review of the regulatory measure effectiveness, taken in terms of the stability of the banking sector.

Starting from defined subject and the research objectives, the work will test the following hypothesis: regulatory reform in Europe, has consistently contributed to the improvement of the system of banking regulation. For testing the initial hypothesis, this paper will primarily apply a qualitative methodology, based on studying and descriptive analysis of the described problem. After examining the relevant literature, based on theoretical assumptions and conclusions of the various authors, it will be possible to confront different standpoints in order to derive general conclusions about the effectiveness of the banking union as a measure of problem-solving non-harmonized regulations.

Taking into consideration the represented object and purpose of research, as well as a defined hypothesis, the paper will first analyze the structure of the banking sector in the area of Europe with emphasis on the factors that led to changes in the structure. After highlighting the changes of structure attention will be focused on the analysis of regulatory measures aimed at achieving stability of the banking sector. Due to the current global economic crisis, it will be particularly addressed to the actuality of the banking union in the new circumstances. Critical review of the relevant issues concerning the banking union will complete this analysis.

2. Factors of Change in the Banking Sector Structure

Starting from the structure of one country's financial system, it is necessary to emphasize the importance of banking institutions in the external financing of companies. Thus, as the basis of external financing companies make banking institutions; the financial sector of the European Union can be characterized as bank-centric (Allen and Carletti, 2008). For this reason, changes in the structure of the banking sector in the EU over the past 20 years have had far-reaching effects on the functioning of financial markets and the economy as a whole. Structural changes are mainly a result of a higher degree of economic integration of EU countries. In this context, the acceleration of integration process caused the convergence of the former socialist countries with developed countries of Western Europe. In order to become equal members of the EU and use the advantages of the high degree of integration, Transitional government is expected to improve its legislature and harmonize with EU laws and international standards (Staikouras and Koutsomanoli-Fillipaki, 2006; Allen *et al*, 2005). Accessing the above mentioned countries to the EU has been a challenge since the collapse of the socialist regime until the accession of these states passed about 15 years ago. Therefore, the question of accession of these countries to the EU was subject of discussion since mentioned period by some authors' perception was not sufficient to establish an economic system based on market principles.

As an indicator of success of reforms in the banking sectors in transition countries, EBRD index can be used. The values of the EBRD indicators are presented in Table 1, and indicate that the former socialist countries, through EU accession in 2004, have greatly improved the conditions of the banking sector.

Table 1 EBRD Index¹ of Banking Sector Reform (2004)

Country	2004	Country	2004
Czech Republic	3,7	Hungary	4,0
Estonia	4,0	Poland	3,3
Latvia	3,7	Slovakia	3,7
Lithuania	3,3	Slovenia	3,3

Source: <http://www.ebrd.com/pages/research/economics/data/macro.shtml#ti>

¹ Methodological note: EBRD index indicates the efficiency of the process of liberalization and institutional reforms in the banking sector and can take values on scale from 1 to 4.3. Value 1 of this index indicates that the sector has not undergone significant changes compared to the socialist banking system, except for separation of the functions of central banks and commercial banks. If it is established internal convertibility of the currency, and lending is done on the basis of market principles, then the value of the EBRD index near 2. When the index value close to 3, there has been significant progress in creating conditions for effective prudential regulation and supervision, while the value of 4, 3 indicates that reforms implemented fully with the standards and norms of the market economy, reprezentovanih standards of the Basel Committee on Banking supervision.

EBRD reform index values indicate that at the time of accession, the EU banking sector business conditions in observed transitional countries were largely in accordance with international standards. However, it is possible to make a distinction between, on the one hand, the banking sectors in transitional countries and EU member states on the other. The reason for that can be found in the fact that these countries through the transition followed similar patterns which caused huge similarities in the structure of their banking sectors.

Table 2 Number of Banks and Credit Institutions in EU countries

Country	2002	2008	2012	Country	2002	2008	2012
1 Austria	823	803	751	15 Latvia	23	34	29
2 Belgium	111	105	103	16 Lithuania	68	84	94
3 Cyprus	408	163	137	17 Malta	15	23	28
4 Czech Republic	84	54	56	18 Netherlands	539	302	266
5 Denmark	178	171	161	19 Poland	666	712	695
6 Estonia	7	17	16	20 Portugal	202	175	152
7 Finland	369	357	313	21 Slovakia	22	26	28
8 France	989	728	639	22 Slovenia	50	25	23
9 Germany	2.363	1.989	1.869	23 Spain	359	362	314
10 Greece	61	66	52	24 Sweden	216	182	176
11 Hungary	227	204	189	25 United Kingdom	451	396	373
12 Ireland	85	n.a	n.a	26 Romania	43	45	39
13 Italy	821	818	714	27 Bulgaria	34	30	31
14 Luxembourg	184	153	141	EU	9.398	8.024	7.389

Source: <http://sdw.ecb.europa.eu>

Compared to other countries of Western Europe, differences are the product of a different understanding of banks' role in the financial system. In fact, despite the high degree of bank-centricity of financial systems in Western Europe countries, the financial systems of transitional countries are stated at a higher level of bank-centricity. Today, after a decade of joint development, we can say that these differences are almost non-existent, which is a result of structural changes in the banking sector EU. When it comes to changes in the banking sector in the first place we can talk about the continuation of trends from the 90s of XX century, such as the integration of banking activities,

consolidation of the banking sector and increasing of bank asset. In addition to these changes, significant changes in the structure of the banking sector caused the global economic crisis, whose ultimate effects are not completely visible today. The EU banking sector today is characterized by average concentration, asset growth and high competition. But banks are not only facing competition from other banks, but also from competition from non-banking institutions that offer a variety of services. However, the implications of increased competition are reflected in the reduction of the number of banks and increase in the assets of the banking sector, and it is possible to talk about the growing financial strength of banks. Table 2 provides data about the number of banks and credit institutions in the EU in the period 2002-2012.

Table 3 EU Countries' Banking Sector Assets (in 000.000 euro)

Country	2002	2008	2012	Country	2002	2008	2012
1 Austria	554.528	1.060.157	974.264	15 Latvia	n.a	32.348	28.555
2 Belgium	775.977	1.276.321	1.085.303	16 Lithuania	n.a	26.542	24.405
3 Cyprus	n.a	118.142	128.127	17 Malta	n.a	42.476	53.527
4 Czech Republic	81.272	157.074	191.686	18 Netherland	1.356.397	2.231.514	2.492.764
5 Denmark	534.215	1.090.493	1.157.645	19 Poland	n.a	262.591	354.687
6 Estonia	n.a	22.105	19.673	20 Portugal	311.035	482.141	557.078
7 Finland	170.780	396.238	600.304	21 Slovakia	n.a	65.509	59.716
8 France	4.161.732	7.710.574	8.075.875	22 Slovenia	n.a	49.010	50.788
9 Germany	6.408.924	7.892.671	8.226.623	23 Spain	1.395.872	3.409.442	3.581.073
10 Greece	212.396	464.746	442.214	24 Sweden	487.211	907.530	1.213.374
11 Hungary	n.a	127.962	111.574	25 United Kingdom	5.875.291	8.727.497	9.559.302
12 Ireland	615.932	1.731.538	1.170.002	26 Romania	n.a	84.541	91.176
13 Italy	2.066.122	3.693.938	4.219.490	27 Bulgaria	n.a	36.825	45.407
14 Luxembourg	781.342	1.271.786	961.507	EU	25.789.026	43.371.711	45.476.139

Source: <http://sdw.ecb.europa.eu>

As it can be seen in Table 2, the trend of strong reduction of the number of banks was present during the entire period. However, Allen et. al, (2005) argue that the cause of reduction in the number of banks in the period before and after the reduction is different. On the one side, reduction in the number of banks in Western European countries is a result of sector consolidation rather than bankruptcy of the banks. On the other side, the socialist countries, reveal a variety of trends, where it is possible to see a decrease in the number of banks in the Czech Republic and Hungary due to liquidation, while in other countries is noted an increase in the number of banks in the pre-crisis period. Another observed trend in this period is an increase of banks' assets despite large pressure from other banks and institutions from financial markets. There are different views on the causes of growth in assets of banking institutions

(Likainen 2012, Adrian and Shin 2008). On the one side, Likainen (2012), believes that this trend is based on technological innovation and off-balance sheet activities of banks that do not require pre-deposit growth. Adrian and Shin (2008), as factors in the rapid growth of banks' assets emphasize low short-term interest rates, since they are determinants of the cost of borrowing and thus determine the capacity of banks as financial intermediaries. However, perhaps the most important factor in the growth of bank assets is increase of financial leverage, on which basis it was possible for banks that with the same amount of capital realize this asset growth. Data about the amount of assets in the banking sector of each of the EU countries are presented in Table 3.

The data in Table 3 indicate strong asset growth where an average annual growth rate until 2008 was approximately 10%. However, due to the effects of the global economic crisis, the slowing down of asset growth in the banking sector is present, and in some countries, reduction of assets in the absolute amount is noted.

Overall, these changes in the structure of the banking sector in the EU are result of influence of many different factors, where some of these factors are categorized as global, since their effects are globally visible. Other factors are represented as a specific, because due to its characteristics relates to EU banking sector changes.

As factors of changes could be distinguished deregulation, integration and technological innovation. Deregulation of banking activities refers to the reduction or complete abolition of laws that impose restrictions on banks in terms of geographic area, types of products they can offer and the interest rates they may charge. The elimination of these restrictions will contribute to greater efficiency and increase of competition in the entire financial system. The process of deregulation is primarily reflected in the reduction of barriers in cross-border banking business which was consistent with the aim of creating a single market for financial services. Therefore, it is concluded that the process of deregulation is closely linked with the process of European integration, which has been in place since the Second World War. In banking, the most important moment in terms of its integration is adoption of the Second Banking Coordination Directive, which establishes: a single European license under which banks operate throughout the EU area; supervision of the home country, which could be responsible for the supervision of domestic banks operating in the EU. Despite all efforts to address integration of financial markets, barriers are still present in retail banking. This segment of the banking business is heavily segmented and limited by national boundaries, where the differences between countries stand in taxes, protection of consumer rights and the structure of product offer (Goddard *et al.*, 2010, 833). In such environment, local banks have access to more detailed information and are able to, depending on clients' needs, create an offer with which foreign banks are not in a position to compete.

Technological innovation is manifested in the development of information and communication technology (ICT). The rapid development of information technology has led to a shift in the functioning of the banks, where a special place in this process takes the development of the Internet. ICT on the one hand provides realization of significant cost savings and time of providing services. On the other hand, leads to an increase in revenue due to the development of new financial products. Cost savings are primarily achieved by replacing paper-based instruments and labor-intensive methods in the process of gathering information, with automated processes.

Today, instead of term banking more appropriate is to use term electronic banking, as banks, no matter what size, within their traditional functions implement electronic mechanisms, channels and instruments. Due to the different financial potentials, implementation of technological innovations may deepen the gap between small and large banks. In this context, large banks may have a comparative advantage over small banks. However, small banks, which are able to develop their own technology can test systems developed by major banks, which may result in an advantage of small banks relative to large in terms of efficiency (Casu *et al.*, 2006, 363).

These changes in the banking sector structure have required changes in the way of its regulation. Extraordinary relevance of regulatory measures arises from the significant role of the banking sector in the financial system, and it is therefore necessary to establish an adequate regulatory framework with a focus on further integration of the banking sector.

3. Regulatory Changes in the European Banking Sector

Banking regulation is reflected in the establishment of certain rules related to the preservation of stability and minimizing bank risks. Over the past three decades, the regulation was based on the idea that markets are generally highly effective in sense of asset allocation and can be characterized as a self-regulating (Schooner and Taylor, 2010, xiii). This claim is based on the notion that in the absence of regulation, banks have an incentive to prevent their own bankruptcy, and the regulation was justified only in the case of major threats to the stability of the banking sector. However, due to the nature of the business, the banking sector is largely dependent on the trust of users. As for the problems of a single bank, due to the connection of the banking sector possible occurrence of a banking panic and a systemic crisis, banking regulation is necessary in the context of a system stability and trust of clients.

During the 1970s and 1980s, there has been a significant step towards the regulation of the banking business within the then European Economic Community (EEC), by adopting two banking directives (First Banking

Directive and the Second Banking Directive). The First Directive highlighted obligation of the host country (host country rule), under which the banks permitted to do business in foreign countries if they have the permission of the national regulator of the host country. The Second Banking Directive established the principle of home country control (home country rule), according to which responsibility for a national bank, no matter in which country it operates, shall be borne by the national regulatory authority. In this environment, banks EEC countries are able to offer their products and services around these economic groups, and access to national banks' non-member EEC was limited (Gruson and Nikowitz 1988).

Implementation of prudential rules and prudential supervision of banks in each country performs the appropriate institution for prudential supervision (Ćirović, 2007, 387). However, financial integration in Europe has caused the need for adjusting the regulatory framework and supervision. In fact, in a new environment, banks thanks to unique licenses were able to open branches throughout the EU, with the growth in the volume of cross-border business in the forefront noted limitation of national supervisory systems.

Establishment of the European Monetary Union (EMU) was the next step in the process of economic integration of Europe. In the new economic and monetary environment, the European Central Bank (ECB) is the central institution responsible for the implementation of the single monetary policy in the area of monetary union. In addition, the ECB has an important role in regulating banking institutions, which coordinates its activities with those of national central banks has great significance.

Lack of harmonization between different regulatory frameworks, incomplete fiscal integration in EU countries, problems in the functioning of the monetary union and the lack of financial market integration contributed to expectations in terms of economic integration of the European continent are not achieved. For this reason, the actions aimed at improving regulation and countering the effects of non-harmonized implementation of directives and regulations were unavoidable, and two important documents are Financial Service Action Plan (FSAP) and the Lamfalussy procedure. FSAP is an initiative for establishing a single market in the EU, which included a uniform regulatory framework and elimination of barriers. The basis of the FSAP was the Markets in Financial Instruments Directive (MiFID). In order to implement MiFID (level 1), the European Commission adopted two documents, in the form of the Directive (Commission Directive 2006/73 / EC) and rules (Commission Regulation No. 1287/2006) (level 2), which has declared intention to achieve the basic objectives of the FSAP: secure, legally regulated and comprehensive process of creating a single European market; adapting to changes and innovations in the financial markets and the protection of an investment from

fraud and abuse by creating a deeper, more efficient and more competitive market (European Commission 2007).

Implementation of FSAP was followed by a period of strong development of European capital markets and the financial system in general. Having in mind that the dynamic financial markets require a more flexible system of decision making and implementation of regulatory decisions and measures, in July 2000 the Committee of Wise Men was appointed, whose work was coordinated by Alexandre Lamfalussy. The report of the committee presented an integrated approach to solving the problem of inconsistency in the tax and legal settings EU member states. This approach included four levels (Lamfalussy 2001):

- Level 1 - Defining the procedure for directives and regulations proposition.
- Level 2 - Preparation of implementation, where significant role have four committees: the European Banking Committee (EBC), the European Securities Committee (ESC), the European Insurance and the Pensions Committee (EIOPC), the Financial Conglomerates Committee (FCC).
- Level 3 - Harmonization of regulatory frameworks of different countries within the EU. This is accomplished through additional consultations with expert committees such as the Committee of European Banking Supervisors (CEBS), the Committee of European Securities Regulators (CESR) and the Committee of European Insurance and pensions (CEIOPS).
- Level 4 - the process of implementation and control of the implementation of regulations and directives.

According to this procedure, the European institutions, on the Commission's proposal, shall approve the regulations, that the regulations were primarily the result of political decisions (level 1). After that, the regulations adopted at the first level become the subject of consideration of four Committees, which operate within the second level. Especially important is the intensive Commission collaboration with expert committees, whose role in the implementation of EU legal acts and harmonization of supervisory practices in the European financial services market is extremely important. Finally, on the fourth level of the coordinated actions determine the consistency of the implementation of the adopted legislation. The most important and final phase of regulatory reform within the Lamfalussy procedure relates to the adoption of MiFID, in addition to that from June 2006 to force another three Lamfalussy procedure: Prospectus Directive; Market Abuse Directive and Transparency Directive.

The Lamfalussy procedure has largely contributed to the acceleration of the legislative process in the EU. Of course, as the implementation of new legislation and regulation can have both positive and negative effects, the question arises whether the Lamfalussy procedure contributes to the quality of the adopted regulations, given the rapid adoption of regulations. In this context,

if the system cannot determine the boundary between the tasks of each level, and if it does not clearly define the type of regulation that makes on a concrete level, there is a fear of the expansion of non-performing legal acts and their overlapping.

A critical assessment of the Lamfalussy reform implementation effect, as the largest positive effect emphasizes the achievement of transparency of banking and financial regulation and intensify cooperation between the expert committees in order to provide a more effective implementation of the adopted legislation on the national level. Remarks addressed to the procedure of adoption regulations are following: existence of a large number of expert committees complicates the decision-making procedure in relation to regulations and contributes to cost inefficiencies. Also, as the timetable of implementation the short, in order to meet obligations, members often inconsistently applied rules and regulations.

Independently of the reform of financial regulation, presented by FSAP and Lamfalussy procedure, there was a need to reform the supervisory structure in Europe. As main reasons there could be identified (Speyer and Walter, 2007; 4-5):

- Effectiveness of existing financial supervision - the structure of financial supervision could be characterized as fragmented, as it was constituted by different national supervisors. Thus, in conditions where exists asymmetric information, problems immanent to national markets can be quickly transmitted to all other (spill-over effect).
- The efficiency of financial supervision - in non-harmonized environment, there is an increase in the number of financial reports submitted to the different institutions. In this way, the multinational institutions commit on multiple reports, which reduces their efficiency and competitiveness.
- Political responsibility - for adequate supranational supervision, an important issue is the question of political responsibility.
- The international competitiveness of the European market - the problem of financial regulation and supervision of unique financial markets can be solved only if regulation at national level is accompanied by harmonized institutions in terms of structure.

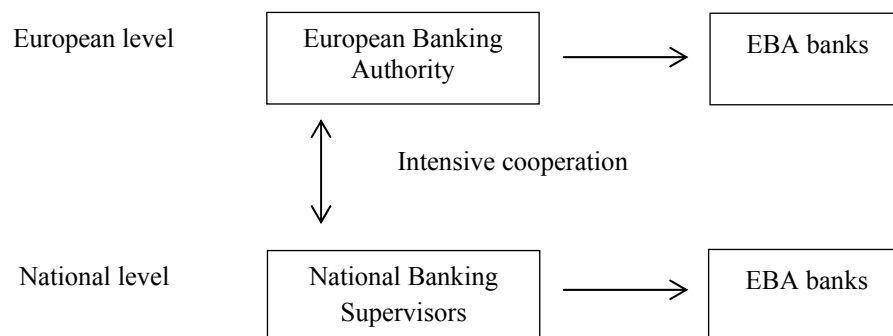
However, despite the EU representatives' intention to centralize banking regulation on higher institutional level, this was not possible due to lack of economic integration and absence of fiscal union. The weaknesses of this system are fully expressed under global economic crisis effects, and the establishment of the working group of the European Commission (De Larose 2011) had the task to redefine the regulatory framework whose weaknesses are reflected in the absence of prudential supervision; an inefficient mechanism for early warning and lack of efficiency of the institution responsible for individual countries regulatory frameworks coordination. Analysis of the effectiveness and

interoperability of different national regulatory framework, determined the need for the existence of two interdependent pillars of supervision, including:

- Macro-prudential supervision, with aim to control and eradicate the risk inherent to the financial system of the EU. In that context the European Systemic Risk Board (ESRB) has been established, whose role in the increased risk identification has particular importance. Although it has the option of issuing a general or a specific type warning, they are not legally binding which present problem in terms of system effectiveness;
- Micro-prudential supervision, a pillar which includes national supervisory authorities and the European System of Financial Supervision (ESFS). In order to improve interoperability, the European Supervision Authority was established, as long as the institutions those are in the fields of banking, insurance and securities, assumed jurisdiction CEBS, CESR and CEIOPS. The European Commission has selected a model where within the ESFS operate the national and professional supervisors (European Banking Authority - EBA), the European Insurance and Pension Occupational Authority (EIOPA) and the European Securities and Market Authority (ESMA).

This approach to banking supervision is recommended by Veron (2011), which states that a complementary approach to banking supervision can bring benefits in terms of banking business soundness. Under such organized system national supervisors would be responsible for supervising national banks on a daily basis, while the EBA would be responsible for the supervision of EBA banks and national authorities.

Figure 1 Dual Approach for Supervising European Banks



Source: Schoenmaker D., 2012, *Banking Supervision and Resolution: The European Dimension*, DSF Policy Paper, No. 19, Duisenberg school of finance, p. 7

The significant issue of regulation of the banking sector reform, especially in the context of the global economic crisis is the adequacy of the deposit

insurance model. Due to lack of deponent's confidence in the banking sector, it was necessary to reform the Directive on Deposit Insurance Act in 1994. The strategic objectives of deposit insurance model reform were: highlighting the transparency of the deposit insurance system; increasing deponent's confidence in the banking sector as a prerequisite to prevent the occurrence of banking crises. Development of a single model of deposit insurance is very important for EU financial system harmonization, having in mind that the difference between the existing systems was too big.

The new model distinguishes four potential sources, financing liabilities to depositors:

- The appropriate percentage of collected deposits. Specifically, each bank is required to set aside 1.5% of the collected deposits, whereas this amount may vary depending on the risks that bank undertakes within its operations.
- If the collected funds are insufficient for the payout of liabilities to depositors, banks are required allocation of an additional 0.5% of the amount of deposits collected.
- Possible additional funding can be obtained by special institutions. In doing so, it is necessary to take care that the upper boundary of this amount is 0.5% of collected deposits.
- If that didn't obtain the necessary amount, there is the possibility of contracting arrangements with other financial institutions.

The basis of this model is required for banking operations transparency. In order to minimize the frequency of interventions in terms of payments to depositors, it is necessary to ensure the cooperation between deponents, banks and credit institutions (Mülbert and Wilhelm, 2011). In this way, transparency in operations can be enhanced; otherwise depositors will be exposed to higher risks than presented by banks and other credit institutions.

However, despite attempts to unify deposit insurance model in Europe, the differences are still present and they are the result of different institutional settings. In addition, regulators in some countries take action effective only in a specific system, without any reference on supranational level. The Cyprus banking crisis of 2013 raised many questions related to tax on deposits. Deposits in the Cyprus banking sector grew rapidly and reached a level where it was no longer possible to guarantee their safety. The idea advocated by representatives of the EU, IMF and ECB involved introduction of different tax rates on deposits (9.9% on the amount exceeding 100.000 € and 6.75% on the amount up to € 100,000). However, due to the occurrence of a banking panic and the unwillingness of Cyprus politicians, only tax liability for deposits of deposit amount over 100,000 € stand.

4. Banking Union in Europe

The Infrastructure of the banking regulation system was based on the supervision, regulation and protection at the national level. Under such conditions, the stimulation of national banking systems may result in increased costs of bank recovery. On the other hand, the existence of a single regulatory framework at supranational level would eliminate weaknesses, ensure system security and provide necessary assistance to the banking sector in case of high systemic risk. Systematic approach to bank supervision contributed to the improvement of risk identification and elimination, while the consistent application of regulations across the EU has led to a reduction in national disproportions regarding the manner of organizing systems and regulations. Therefore, the idea of establishing a banking union in Europe encountered approval, as it would eliminate the shortcomings in the functioning of the monetary union and achieve conditions for credit growth in the banking sector. One of the questions that impose concerns is about the ability of the banking union to prevent the appearance of public debt crisis. In this context, it is clear that the banking union could not prevent the occurrence, but it could contribute to the weakening of the negative effects of the economic recession on the performance of the banking sector.

One of the central bank roles is the lender of the last resort, which means that in case of necessity provide assistance to vulnerable banks. However, the ECB insists on the absence of this role, for which there are two reasons (Wyplosz, C., 2012, 20):

- First, the ECB has limited access to information about daily condition of banks. Despite clear requests for information, they can be modified by national supervisory authorities. There is a problem if knows that the ECB has no right to liquidate problematic banks, but can only provide them assistance, taking into mind the role of lender of last resort. It can be concluded that the problem of the supervisory role of the ECB arises out of lack of availability to completely control problem-banks and possession of inadequate information.
- Second, acting as a lender of last resort ECB could incur losses. Within the Eurozone, the European Treaty foresees the intervention of the ECB, but the question is who is going to incur losses in terms of cross-border banking operations. If the bank operates within one country the Government would bear the costs, but arising problem is related to public debt, with a real danger of not fulfilling the obligations stipulated by problems with the amount of public debt.

The banking union is necessary in view of the problems to EMU and reported weakness of banking systems. That is why, the banking union should include all types of banks, not just the system big, or vulnerable, due to that it

will have great contribution to the equalization of business conditions in Europe and eliminate opportunities for regulatory arbitrage. However, the way of organizing the banking union has great impact on the efficiency of the entire financial system. In this context, it is important to understand that the partially formed banking union is not efficient and effective in terms of the stability of the banking sector. If it is assumed that the banking union formed in the context of a single regulator that controls the operation only large banks, it can cause large problems in the functioning of the entire system. Taking care only about the safety of large banks, the ECB can ignore the needs of small banks for liquidity, which could seriously complicate their business and create problems throughout the system. However, Acharya (2012) points out that achieving the full banking union will probably lead to a reallocation of credit risk, whereby the credit risk of weak bank portfolio will be transferred to the portfolios of Government. Hence, it is desirable to limit state requirements that banks take on high-risk, non-collateralized securities, requires the establishment of an adequate level of capital in accordance with the amount of risk.

The European Commission proposal from September 2012 (European Commission 2012) referred to the creation of a Single Supervision Mechanism (SSM) and more precisely defined the role of the European Banking Authority (EBA). The proposal is meant to take on the role of supervisor of the ECB, where the focus of supervisory institutions would be on banks, which have already sought external help and the banks that are in the recapitalization process. Although the ECB would be in the center of the system, as the main supervisory institutions, national central banks would remain in charge of banking supervision at the country level. Therefore, in order to have an effective system operation, it is necessary to enable the ECB and national central banks action coordination.

Certain aspects question the justification for the emphasizing of the ECB as the main institution which should be responsible for the functioning of the banking union (Ioannidou 2012, 88). The author states that the ECB, in addition to the possible functions of a single regulator and supervisor, has other functions, among which stands out the conduct of monetary policy. In so conceived system, ECB decisions necessary for conducting monetary policy, may be in conflict with the function of a single regulator. Goyal *et al.* (2013) also point out that concentration of function supervision and conduct of monetary policy within the ECB may lead to conflict of interest and, therefore, recommend separating the functions of the ECB and ensuring maximum transparency in its operations. In addition, in order to achieve adequate functioning of the supervision system, it is necessary to separate the responsibilities and powers of their national central banks from the responsibilities and powers of the ECB. For better interoperability of the ECB, it is necessary to establish institutions at the level of the whole of Europe, led by experts and the ECB.

The creation of banking union, in addition to benefits, brings certain costs, which are also reflected in the finding of adequate human resources solutions. As new infrastructure requires quality and trained personnel, the question is what will happen to the existing infrastructure and personnel. Since its formation involves generating new institutions, the question is who should bear the costs of establishing these institutions. In this context, bearing in mind that the new infrastructure requires high quality and trained personnel, the question is what will happen to the existing infrastructure and personnel. Ioannidou (2012) believes that the solution lies in providing a higher level of authority to national supervisors when it comes about small institutions, which due the special characteristics can have huge importance. On the other hand, for maximum gains European supervisors must provide a harmonized framework on the level of functioning of EMU. Efficiency of supervision is necessary to respect the following two approaches:

- An approach based on application of Basel standards, whose fulfillment is sometimes necessary to take a long time. Therefore, this approach can be characterized as long-term and directed towards the establishment of an adequate structure of supervision.
- Pragmatic approach that enables rapid response in case of need. In addition, approach enables solving the weak banks problem and setting up the instruments necessary for the supervision of these banks by the ECB.

The need for the existence of the single regulatory institution, a single supervisor and adequate deposit insurance system is obvious. However, the establishment of a banking union is largely a political decision and depends on the willingness of national authorities to transfer certain part of their jurisdiction to supranational institutions. The national government, in terms of increasing cross-border business and global capital mobility have to improve business conditions and adapt national policies to supranational environment, thus they lose their autonomy in decision-making (Underhill D.R.G. 2012, 149).

Finally, the banking union in Europe may be very important for the future of European integration, regulating relations between banks and national governments. Based on unique rules at the supranational level, the banking union represents an institutional framework in which the problems regarding the responsibility of the state will mostly be resolved (Zettelmeyer *et al.*, 2012, 65). Of course, problems with this solution are present and in the first place it is necessary to point out reluctantly letting of national powers to supranational institutions. Additionally, financing of future banking union can be characterized as a possible problem. However, in view of the foregoing, immediate benefits are far greater than the potential costs and the banking union imposes a rational solution.

5. Conclusion

Examined issue, emphasizing the factors and ways of regulating the banking sector has opened an important theoretical and practical questions and dilemmas. Analyzing the key aspects of regulatory changes in the banking sector in Europe in time when each decision may be crucial for the future of one form of integration, points to actuality, importance and complexity of the problems treated.

This paper analyzes changes in the structure of the banking sector in Europe, which are the result of several factors. In the first place, we can talk about significant changes in the size and the financial potential of the entire banking sector, given the significant growth of bank assets. Being at the same time there was a decrease in the number of banks it is possible to speak about the significant growth of financial strength of banks. As the causes of these changes can be identified mergers and acquisitions within the sector, which represent one dimension of economic integration in Europe, significant technological innovations, and finally, the effects of the global economic crisis. The resulting effects of these factors are reflected in the creation of the need for redefining the role of banking regulation in a new environment. The economic integration of Europe, which is reflected in connecting different business entities affected the need for regulation of banking business. However, the problems in terms of achieving the desired level of integration produced a need for actions aimed at improving the regulation and countering the effects of non-harmonized implementation of directives and regulations. In this context, it is important to note the Financial Service Action Plan and the Lamfalussy procedure, which contributed to the transparency of banking regulation and cooperation of the responsible institutions.

Despite a predominantly negative effects of the global economic crisis, the problems encountered in the banking regulation field can be seen in a positive context. The weaknesses that apparent in crisis time only confirmed the need for its restructuring. The idea of creation a banking union is actually and represents a real solution for improving the regulation of the banking sector. It is important that the setting of the system is subject of criticism, with particular emphasis on those that provide loss of the powers of the national government and the effective functioning of the ECB as an institution responsible for preserving the stability of the system.

Analysis of experiences and effects of implementing measures in the design of the regulatory framework is of key importance for understanding the needs in the field of regulation of the banking business. On that basis, strengths and weaknesses of the proposed solutions are determined. Exposed statements were developed with the aim of a critical review of taken regulatory measures. The presentation concluded that measures consistently promoted regulatory

system and made it adaptable to new conditions, confirming the initial hypothesis in the paper.

However, the limitation of this paper refers to the fact that the focus of the research was on supranational level, within which there are more banking sector with its specifics. Additionally, the paper has not analyzed the impact of regulatory reforms implemented by multilateral institutions (such as the Basel Committee on Banking Supervision). Therefore, future research should focus on the analysis of the effects of global initiatives to regulate banking (Basel Accord), which could be complemented by adequate empirical research capacity of banks to carry out business activities without negative repercussions on the stability of the system.

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REDEFINISANJE ULOGE BANKARSKE REGULATIVE U BANKARSKOM SEKTORU EVROPSKE UNIJE

Apstrakt: Tokom poslednje dve decenije došlo je do značajnih promena u strukturi bankarskog sektora na prostoru čitave Evrope. Faktori kao što su globalizacija, integracija i razvoj informacionih tehnologija imali su značajan uticaj na pomenute promene. U uslovima ekonomske integracije Evrope i pomenutih strukturnih promena javlja se potreba za redefinisanjem regulatorne infrastrukture, zbog neadekvatnih institucionalnih rešenja. Problematika pitanja reforme bankarske regulative i formiranja bankarske unije, kao novog stupnja ekonomske integracije Evrope, aktuelizovana je pojavom globalne finansijske krize. Iz tog razloga, rad predstavlja pokušaj sveobuhvatne analize razloga i načina reformi regulative bankarskog sektora. Kritičkim osvrtom na sprovedene reforme bankarskih regulativa na nacionalnom i nadnacionalnom nivou preispitaće se njihova primenljivost u konkretnim problemskim situacijama i predložiti mere za eventualna unapređenja.

Ključne reči: regulisanje bankarskih aktivnosti, reforma regulative; globalna finansijska kriza; bankarska unija