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Formation of optimal model of regulation of the banking system of Ukraine

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Abstract. The basic principles of regulation of banking activity, worked out by the Basel committee on questions of supervision and regulation of banking activity, were investigated. The advantages and drawbacks of pro-cyclical and countercyclical models of regulation of banking activity were examined. The expediency of realization of regulation on the basis of individual estimation of particular banks and also estimations of risks that have system character was proved. It was recommended to implement the principle of countercyclical regulation in Ukraine taking into account the business cycle of economy.

Key words: principles of effective banking supervision, supervision on the basis of individual estimation of risks, supervision on the basis of estimation of system risks, countercyclical regulation, pro-cyclical regulation.

INTRODUCTION

The extremely rapid increase of active operations of banks, the advancement to the financial market of the wide range of banking services, the insufficient concentration of banking capital, the imbalance of long-term assets and liabilities in terms of volumes and terms of payment, the absence of the proper transparency of banking sector and necessary level of corporate management lead to the increase in risks in the activity of banks. Thus, the investigation of question about reformation of the system of regulation of financial market is worth attention and is of current concern.

The problems of organization of the proper system of regulation of financial market are covered in works of foreign and domestic authors. So, in the publications of Petryk O. [9], Pons J. [10], Reinhart K. [11] the attention is paid to impossibility of the system of regulation of banking market to prevent the development of a crisis effects. It induces the range of scientists, namely: Borkivets N. [4], Lisna R. [4], Simanovskyj A. [12], to search the ways of solving the problem

On the other hand, in the publications of such domestic scientists, as Bregeda O. [5], Savluk S. [5], Karcheva G. [7], Koval O. [8] the possibilities of the increase of efficiency of regulator processes are examined by the input of international principles of organization of regulation and supervision in domestic bank practice; the adopting of experience of application of methodological tools of regulation of financial markets. However, considering the further difficult situation of banking market of Ukraine the aim of our research is development of optimal methodology of realization of the banking regulation in Ukraine that would allow opportunely discover and protect domestic banks from the possible threats.

MATERIALS AND METHODS

Methodological basis of the banking regulation and supervision on a world scale is formed by the normative documents developed by the Basel committee. The most essential of them are: Key principles of effective bank supervision, that became the answer of international community to the threats of bank crisis at the end of XX century; Basel concordat (principles of supervision of subdivisions of foreign banks, that defined the concerted principles of mutual relations of international banks with the central banks of host countries); Basel agreement of a capital, that provides international converging of measuring of capital and standards of capital.

In August of 1987 the Basel committee published "Key principles of effective banking supervision", that became the basic source of recommendations for development of national banking laws of countries that formed the national banking systems or reformed them, in accordance with the world standards of organization of banking activity.

After the implementation of the key principles of effective banking supervision by some countries the International Monetary Fund and the World Bank at the request of the Basel Committee made the estimation of efficiency of the national systems of banking supervision [14, 16, 17, 19]. Such research showed controversial interpretation of positions of key principles of banking supervision by the national body of the banking regulation. Taking it into account, the working group of the Basel committee in 1999 made "The methodology of key principles", that contained the detailed explanation in relation to their application. The base principles of effective bank supervision are those minimum requirements without inhibition of which supervision cannot be considered strong and effective. Key principles were implemented in legislation and created bases of the existent system of banking supervision not only for EU but also for many other countries of the world.

The principles consist of 25 positions that can be grouped according to such directions : conditions for an effective banking supervision (principle 1); licensing and structure (principles 2-5); prudential norms(principles 6-15); methods of current banking supervision (principles 16-21); standards of accounting (principle 22); measures of the observant reacting (principle 23); interbank international activity (principles 24-25). Exactly these principles are stage-by-stage implemented in the system of regulation of banking activity in Ukraine and form the foundation of the regulatory process. However, modern threats of financial stability force regulatory authorities to make methodological structures in the regulation of banking activity with the aim of taking into account tendencies and cycles of economic processes.

RESULTS AND DISCUSSIONS

By the previous estimation of the General mission of IMF and World Bank from 30 principles of the Basel committee (taking into account, that 1st principle has six constituents estimated separately) Ukraine fully or mostly obeys 25 [366, p. 28]. In particular, it concerns the increase of norm of adequacy of regulatory capital, the input of tougher economic norms which regulate loan transactions with related parties, the severe requirements to form backlogs for loan operations, the introduction of the system of estimation of risks during realization of supervision, the creation of legal base on questions of fight against money laundering received in a criminal way and by financing terrorism.

The achievement of more complete compliance of Basel principles largely depends on the acceptance by Ukrainian Parliament the corresponding laws and also development and acceptance of changes of the legislation of Ukraine which will allow to settle such questions : providing of plenary powers of National Bank of Ukraine in relation to refusing of delivery the banking license or permission for acquisition of the substantial participating in a bank if it is impossible to define the structure of ownership and real owners of bank (principles 3, 4); determination at legislative level of requirements for the banks in relation to the systems of their risk management and principles of corporate management (principles 3, 7, 17, 22); input of requirement to the parent companies of financial groups in relation to presentation of statements on the consolidated basis and about activity of separate participants of group, and also providing effective risk management (principles 21, 24).

Further implementation of the marked principles must take place in connection with realization of institutional changes in a macroeconomic environment because a bank supervision can be effective only when it is carried in the mode of the balanced and stable macro-economic politics and well-developed financial infra-structure, with presence of effective market discipline and mechanism able to provide the proper level of system protection to the participants of bank market.

However, the basic document of committee is the Basel agreement concerning the convergence of systems of bank regulation regarding capital measurement and standards which are applicable for the capital. In particular, in 1988 recommendation about "International convergence of estimation and standards of capital" ("Basel I") was released, it contained minimum requirements for activity of banks. It was directed to increase the strength and stability of the international banking system, and also to provide a unified database of prudential regulation [1].

Dynamic development of banking market required the improvement of existent norms of bank supervision. "Basel I" was subjected to sharp criticism for absence in the norms of regulation positions for consideration of risks which were taken by banks in the process of activity. Therefore, requirements are too stringent and burdensome to banks which work with financially stable borrowers and which have quality system of risks management. Such criticism has begun since "Basel I" was accepted and until its decade attained the apogee. Taking this into account, in 1998 consultations concerning the conclusion of new agreement were begun, which led to the acceptance of "Basel II" in 26.06.2004. This document declared a transition from the principle of universalization to the principle of individualization of regulation taking into account the specifics activity of each individual bank and shift of emphasis of normative requirements related to economic capital [2].

In "Basel II" were established new requirements for sufficiency of capital of credit organizations. This approach was based on three supports in relation to determination of sufficiency of capital, namely: minimum requirements to the capital of credit organizations; supervisory process and market discipline.

In basis of conception of economic capital stands an idea of dependence of rational level of capital from the level of possible losses which are not covered by current income. In other words, losses which should cover the economic capital are determined by a risk level which was taken over by a bank, and quality of risks management. Such capital is named sensible to risk.

"Basel II" within I and II component suggested to supervisory authorities to apply stress-testing oriented at the evaluation of financial stability of banks on condition of unfavorable environment of activity (pessimistic scenario of development). At the same time in a component I was offered a horizon of estimation of requirement in the capital of credit institution for the term of 1 year which orient banks at the optimistic scenario of development of events. Such horizon conduces to the increase of assets and accumulation of risks. The methodology embedded in the "Basel II" is somewhat contradictory, that influenced certain blanks in the national systems of the banking regulation and supervision. In particular, in part of active support of macroeconomic politics the increase was not in time identified by authorities of prudential regulation and was not prevented massive threat to systemic crisis [2].

The breakaway from the conservative regulation, which would combine stress-testing and the horizon of estimation of capital, oriented to the cycle, would lead to the orientation of banks on a future crisis, that would result in the increase of capital base. Taking into account, that in "Basel II" period time horizon of 1 year is offered, "Basel II" formed methodology of supervision on the basis of estimation of capital according to risks in the phase of the economic growth.

Although methodology contained stress-testing which bank regulators actively used in the process of their activity, it could not prevent the dynamic increase of risk assets in banking structures, which eventually led to the financial crisis. Connecting the optimal loading on the capital of banks and support of the economic growth in the sphere of finance, regulator has moved from a relatively neutral position on the cycle of capital regulation to pro-cyclical, which is inconsistent with the general concept of regulation. Therefore, the international community faced the question about developing new methodological approaches to the regulation of credit institutions. Existing trends indicate a preference for countercyclical regulation as opposed to pro-cyclical, whose methodology of implementation was laid in the liberal version of the "Basel II".

The methodology of countercyclical policy is actively discussed in academic circles. It certainly has its advantages and disadvantages. The countercyclical regulation is interpreted as an element of macro-prudential regulation, which should complement microeconomic regulation. Regulators of "Group of 20" macro-prudential regulation recognized as priority direction of improving the regulatory system.

The developers 'Basel III' had the task to improve the methodological basis by the provisions countercyclical regulation and to develop the best mechanism which is able to provide effective achievement by this system of practical results – more moderate, but at the same time more resistant economic result.

The countercyclical policy of regulation has not been sufficiently tested in practice yet. Opponents of this methodology doubt the efficiency of its application. In particular, there are arguments which show not after its favor [12]: introducing stricter requirements for financial stability of banks in terms of economic growth, the regulator triggers banks to implement aggressive policies, guided by an aspiring to obtain even greater profits, leading to an increase in risks and deteriorating financial condition in the future; countercyclical model of regulation applies to independent participation in the system of micro regulation along with monetary and credit, tax and fiscal policies.

This leads to additional correction of actions of different elements of macro regulation. In case of uncoordinated use of instruments it can cause negative macroeconomic effect; lack of opportunity to predict with great accuracy the economic imbalances in the financial systems of the world leads to difficulties in determining the timeliness of use of instruments of prudential regulation of countercyclical direction; countercyclical regulation will contribute to the overall system of banking regulation certain elements of asymmetry. For example, the traditional banking regulation focused on risks of particular banks and countercyclical – on systemic stability through regulation of the economic cycle by introducing prudential requirements for banks [15]. Without taking into account the risks of specific banks, this type of regulation can have a more negative effect on the activity of conservative banks, rather than benefit from the inhibition of risks of banks which conduct unbalanced policy of asset and liability management [13].

So, despite the financial crisis, regulators of national systems of banking supervision are looking for new alternative ways to build an effective methodological base of regulating the banking system, which would ensure the financial stability of the banking systems in different phases of the business cycle.

CONCLUSIONS

In our opinion, the methodological basis of the formation of the national system of banking regulation and supervision should be based on an individual assessment of the risks of individual banks and assessment of the risks that are systemic in nature. In Ukraine a two-tier system of banking regulation and supervision should be built. The first level would include the development and use instruments with the help of which it could be possible to regulate individual financial stability of banks, specific individual risks (of unsystematic character) of banking institutions, covering transformed into individual risks of systemic origin.

The second level of regulation would be appropriate to aim at regulation of systemic stability, whose risk factors have systemic (macroeconomic) causes. The formation of the second level provides creation of mechanism to ensure systemic stability, which would allow solve the problems of stability under stress of system origin.

The regulation of individual resistance should be carried out by determining the basic parameters of activity of the credit institution on the basis of empirical data. For example, the capital requirements of banks can be determined by analyzing reports on actually incurred expenses arising out of individual risk (unsystematic reasons). The source of such costs is the individual shortcomings of risk management, covering flawed lending standards, investment, failure of standards of lending to connected persons, bank insiders, excessive risk concentration, unreliable accounting and reporting, manipulation by indicators of the level of risk. Such regulation should be neutral to the phase of the business cycle and used during recession and in a phase of economic growth.

However, it would be appropriate to introduce differentiation in determining the prudential requirements for banks depending on the level and quality of risk management. Requirements for bank capital should be determined according to its ability to cover individual risks of unsystematic nature. In particular, the regulatory burden on the bank with a low-risk and quality management system should be significantly lower than the normative certain level.

Conversely, for banks with significant deficiencies in risk management and poor quality of their management should be determined normative values of capital which are higher than average defined norm of adequacy of capital [21]. In this approach, risk assessment and quality its management should be provided with an appropriate level of transparency (clarity) and business risks of the bank to the regulator and the market. At the same time administrative and criminal responsibility of management and beneficial owners of the bank for unfair business practices and inadequate transparency should be established, covering liability for misrepresentation in registers.

The second level of regulation should to be realized through a mechanism to ensure the financial stability of the banking sector, which should include a system of macro-prudential analysis of the financial stability of the banking segment and creating a centralized insurance fund to provide financial support to banks affected by adverse conditions in the global financial markets. Such regulation should take into account the phase of the business cycle: during recession to apply incentive actions to expansion and in a growth phase – restrictive.

The system of macro-prudential analysis should include calculating of financial firmness indicators of the banking system to provide information about its strength and vulnerability, as well as for the timely use of instruments to limit the probability of crisis arising [16]. To calculate the financial soundness indicators of the banking system it is necessary to create aggregate reports on financial results and reserves of assets and liabilities of the banking system. Such reporting is necessary for future stress testing of financial stability of the banking sector.

The monitoring of financial stability of the banking system should be built on timeframes: daily, weekly, monthly, quarterly and yearly. Periodical monitoring of an indicator is determined by the frequency of updating the information base and expediency of monitoring for these or other parameters in the corresponding timeframes [20].

The macroprudential analysis of bank stability should be implemented in such directions: assessing the level of capitalization, evaluation of the quality of the loan portfolio, evaluation of liquidity, quality assessment and risk of assets, evaluation of resistance and quality passive base, evaluation of the efficiency of activity).

Carrying out continuous monitoring of the financial stability of the banking system in specified directions, regulatory authorities will be able to timely react to the challenges of internal and external threats, preventing and minimizing the losses of the banking sector from the financial crisis.

The second component of the mechanism to ensure the financial stability of the banking sector – is the creation of insurance stabilization fund to assist the largest banks. This fund should be directed at reducing (reasonable compensation) risks of loss of financial stability of the bank, which were caused by a systemic crisis.

To do this, at the legislative level an additional income tax for the banks (which according to the NBU classification belongs to the first group of banks by volume of their assets), the consequences of bankruptcies which threaten financial security and stability of the country, as they have priority for obtaining the assistance from the regulator the banking system through the mechanism of refinancing and nationalization. In addition, asset and liability management is carried out in the largest banks worse than in small banks, where centralized system management with the use of balanced methods is usually implemented. Deductions on this tax should be directed to accumulation of targeted stabilization fund.

Introduction of additional income tax for the accumulation of the trust fund will prevent unreasonable increase in assets of banking institutions and uncontrolled growth of risks on active operations of banks. The quality of risk management in such a bank can be improved by differentiating tax rates depending on the quality of risk management in the bank.

Payments from the purpose reserve need to be conducted on the basis of expert estimates losses under conservative methods. In this case, the main task of the regulator should be the development of methods of identification and separation of losses caused by deficiencies in the management (which is not covered by the fund), and losses that banks have suffered as a result of a systemic crisis (which are covered by the fund).

The amount of insurance, which exceeds the amount of tax deductions for full-time participation in the purposed stabilizing fund, can be considered as a contribution of the state in the share capital of the bank. Thus additional financial and organizational options for effective restructuring of banks can be created, which without external help cannot continue to work under system stresses.

Thus, building a system of banking regulation in accordance with the outlined provisions would promote the systematic stability and would enable to achieve the main goal of regulation: when the growth of bank assets is carried out not by a cost of decrease of financial stability of banks and the insurance of financial stability does not prevent the growth of banking business.

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