

Global Banking System Regulatory Environment

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ABSTRACT. The international and domestic experience shows that the main factors of financial destabilization during the financial crises are in the banking sector. The article reveals that the vulnerability of the financial system is connected with functions, deposit and credit transactions, risks distribution and ensuring liquidity; banks act as a major factor in stabilisation measures in the current context of globalization processes, since the economic stability of banking activities relates directly to all the entities and only stable banking system can withstand the crisis phenomena. Therefore, as a result of the analysis, it is proved that not only reduction of risks of banks is needed, but also introduction of the effective supervision system over implementation of the requirements and standards to prevent these risks. According to modern international approaches, banks use the so-called prudential supervision, which is based on the risk management assessment policy on the part of the Bank's management, and regulatory bodies contribute to implementation of such policy. The authors have concluded that not only modern specificity of banks, but also the impact of supervision systems and regulation of modern trends in development of the banking should be analysed. Application of the general regulatory principles and banking risks methodology is required. The task of supervision is distribution of reliable risk management practices in the banking system, taking into account national peculiarities of development.

KEYWORDS. International banking, banking regulation, banking supervision, banking regulatory environment, the Basel Committee on Banking Regulations and Supervisory Practices, EU Directives.

Introduction

Introduction of Basel standards (Basel II, Basel II.5 and Basel III) in Ukraine requires participants of the national banking sector to act actively in the direction of further development of their own methods, systems and processes to support capital adequacy and risk management. Unlike the European financial institutions, which have been consistently implementing these standards for more than 10 years, participants of the Ukrainian banking sector face a difficult task of applying the banking regulation standards, which have been developed by the Basel Committee.

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In 2010, the Basel Committee published the Third Basel Accord², which is the key regulation, aimed at improving the quality of risk and capital management of financial institutions. This document sets new minimum requirements for the capital, new indicators of liquidity and leverage, as well as new methods and approaches to measurement and assessment of risks. In addition, the document introduces stringent standards for the supervision of banking activities, as well as the increased requirements for information disclosure and risk management. Foreign research papers concerning the formation of the regulatory environment of the European Union belong to Matthias Haentjens and Pierre de Gioia-Carabellese³, the research of the bank management belongs to Western analysts-practicians Timothy Koch and Scott MacDonald⁴. It is necessary to point out outstanding achievements of the Ukrainian (Kyiv) school in the theory and practice of banking regulation and management of such scholars as: L. Prymostka⁵, K. Raievskiyi, L. Konopatska, V. Domrachev⁶. It should also be noted that banks also have their powerful research opportunities about methods, mathematical models and program-methodical complexes. Thus, their achievements in risk management also deserve attention.

The main objective of this article is to study the evolution of the modern bank regulation environment in circumstances of the global crisis and to outline problems of implementation of methodological regulations of the Basel Committee in the banking system of Ukraine.

Main part

Foreign banking systems have been developing for quite a long time. This development has been carried out under the influence of historical, economic and political factors, as well as legal and judicial practice. The international and domestic experience show that: first of all, the main factors of financial destabilization in the period of financial crises are concentrated in the banking sector. The vulnerability of the financial system is related to functions, deposit and credit transactions, risk distribution and provision in liquidity; secondly, banks, in the current conditions of the globalization processes, are the main factor of stabilization measures, since the economic stability of banking directly affects the sphere of activity of all the economic entities and only a stable banking system can withstand crisis phenomena.

² "Third Basel Accord " Bazel's'kyy komitet bankivs'koho nahlyadu. <http://www.bis.org>. [In Ukrainian].

³ Haentjens, M. *European Banking and Financial Law*. Abingdon: Routledge, Taylor & Francis Group, 2015.

⁴ Timothy, W.K., and S.S. MacDonald. *Bank management*. USA: Thomson Higher Education, 2006.

⁵ Prymostka, L.O. *Finansovyy menedzhment u banku : pidruchnyk*. 3rd ed. K.: KNEU, 2012. [In Ukrainian].

⁶ Rayevs'kyy, K. Ye., L. V. Konopat's'ka, and V. M. Domrachev. *Bankivs'kyy nahlyad: Navch.-metod. posibnyk dlya samost. vyvch. dysts.* K.: KNEU, 2003. [In Ukrainian].

Financial crises that have affected various countries around the world over the last fifteen years (for example, in Latin America, South East Asia, Russia, the US mortgage crisis) have shown the importance of analysing the country's credit risk, as well as the importance of the local financial regulation system and local financial markets performance analysis. Globalization, technological development and liberalization have become the main driving forces behind development of banking in recent decades, along with various risks. The country's risk relates to those risks, inherent in the international banking business and has three main types: political, transfer and state risk (sovereign risk). Threats, posed by these risks, are quite serious for modern banks, so they will be able to perform their functions only through a favourable regulatory policy. Banking crises in recent years have also intensified a long discussion between those who advocate for more effective banking regulation and supervision, and those who attribute excessive regulation to causes of crises. Banks try to overcome restrictions, imposed by regulators, trying to find "loopholes" in resolutions and laws. In response to this, the supervision authorities take reinforced measures, and the struggle begins again. This confrontation stimulates the emergence of financial innovation (as a way of existence from restrictions), and also explains the very process of occurrence of innovations in the financial system. Financial laws and regulations should be analysed, because good intentions, contained in them, can sometimes lead to adverse results. European banking systems have developed for a long time under the influence of historical, economic and political factors within the relevant legal field. The analysis of the regulatory bank environment shows that treaties are the main sources of legal regulation and supervision of the European countries. Thus, the 1992 Maastricht Treaty aims at creating the European Economic and Monetary Union (EMU) through establishment of the European System of Central Banks (ESCB), which includes the European Central Bank and 28 national central banks of the EU. The ESCB is regulated by the decision-making bodies of the ECB. The ECB is one of seven EU institutions under this treaty and has been created by the Amsterdam Treaty in 1998 with its headquarters in Frankfurt, Germany. The European Central Bank assumed the responsibility for monetary policy in the Eurozone from the Member States in January 1999, two years before the circulation of the euro currency. Since then, the European Central Bank has been working with the national central banks of these countries within the Eurozone to establish a single currency in the Eurozone, as well as to ensure transparency of prices. Other legislative acts and official decisions, adopted by the European Union and its various bodies, are considered as those of "secondary

level". Such secondary legislation may be mandatory (regulations, directives and decisions), or optional (recommendations and opinions).

The so-called "First Banking Directive" – Directive 77/780/EEC was issued in 1970⁷. This directive is of no effect any more, it referred to the fact that any banking activity shall be preceded by a corresponding permit from the competent authority that controls performance of certain agreements in a particular country. The next Directive 89/646/EEC, the so-called Second Banking Directive⁸, has determined that the permit, which is granted to a banking business in one Member State of the European Union, is sufficient to conduct such a business in other EU countries. This principle – now almost inviolable as the European principle of the banking and financial law – is commonly referred to as "certification".

In October 2008, financier Jacques de Larosière was instructed by the President of the European Commission (José Barroso) to lead a group of experts to develop practical proposals in the sphere of financial regulation and supervision. These studies were commissioned amid the difficult financial crisis and recession in the Eurozone countries against the backdrop of the 2009 sovereign debt crisis, which primarily affected the peripheral countries of the Eurozone. The European Union has faced the need to make a choice: critical point: On the one hand, each country independently makes its own decisions on how to act in these conditions, or to join efforts to strengthen cooperation within the EU countries in order to ensure a united front against economic consequences of the financial crisis. The decision was found during the preparation of the De Larosiere Report, which essentially identified three key components to protect against any likelihood of a future collapse: new regulatory order; strong and coordinated supervision; effective anti-crisis management procedures⁹. According to this document, the regulatory framework, which had been effective until the recent crisis, was not coherent, i.e. each Member State had significant discretion in regulation, which led to a wide variety of national approaches, related to local traditions and legislation. De Larosiere Report has resulted in creation of the European System of Financial Supervision (ESFS) aimed at ensuring control over the financial system of the Union. The ESFS consists of three European supervisory

⁷ "First Council Directive 77/780/EEC of 12 December 1977 on the coordination of the laws, regulations and administrative provisions relating to the taking up and pursuit of the business of credit institutions". www.eur-lex.europa.eu/legal-content

⁸ "Second Council Directive 89/646/EEC of 15 December 1989 on the coordination of laws, regulations and administrative provisions relating to the taking up and pursuit of the business of credit institutions and amending Directive 77/780/EEC". www.eur-lex.europa.eu/legal-content

⁹ DeLarosiére, J. "The high-level group on financial supervision in the EU chaired by Jacques de Larosiere" *Report.Brussels*, 25 february 2009. www.ec.europa.eu/interal_market/finances/docs/de-larosiere_report_en.pdf

authorities: the European Banking Authority, located in London; the European Securities Markets Authority, located in Paris; and the European Insurance and Occupational Pensions Authority, located in Frankfurt. The relevant national supervisory authorities are involved in activities of these bodies and have the right to issue binding regulatory technical standards and the application of technical regulations in addition to the existence of non-binding guidelines and recommendations. In addition, the European Systemic Risk Board is a part of the ESFS, which is responsible for macro-prudential supervision of the financial system within the Union in order to assist in preventing or mitigating systematic risks to the financial stability in the Union, arising from events within the fiscal system, and taking into account macroeconomic changes in order to avoid the periods of a large-scale financial insolvency. This would contribute to the normal functioning of the domestic market and thus ensure the sustainable contribution of the financial sector to economic development¹⁰. The creation of the Banking Union within the European Union, i.e. transfer of responsibility for conducting the banking policy from the national level to the EU level in a number of countries of the European Union, is a key feature of regulating the banking environment of the Eurozone countries. This process began in 2012 in response to the financial crisis in European countries. The creation of the Banking Union was encouraged by weakness of many banks in the Eurozone. Private debts that arose as a result of the mortgage crisis in a number of countries have been converted into sovereign debts as a result of the weakening of the economies of countries in the post-crisis period. The task of the Banking Union has been to take some measures in response to this challenge. While all the participating banks will be under the control of the ECB, this will be done in cooperation with the national supervision authorities. The most significant institutions, including those holding more than EUR 30 billion, or 20% of GDP of the state, in which they were incorporated, and those which are directly funded by the European Stability Mechanism or the European Financial Stability Facility, or applied for such funding, will be under the direct control of the ECB. Smaller banks will remain under the direct control of the national authorities, although the ECB has the right to assume direct management of any bank (Fig. 1). The ECB's monitoring regime includes stress tests on financial institutions. If any problems are identified, the ECB has the opportunity to early intervene in the management of the bank to remedy the situation, for example by

¹⁰ "Directive 2009/14/EC of the European Parliament and of the Council of 11 March 2009 amending Directive 94/19/EC on deposit guarantee schemes as regards the coverage level and the payout delay" <http://eur-lex.europa.eu/legal-content>

intervening in the capital and imposing restrictions, or requiring changes in management.

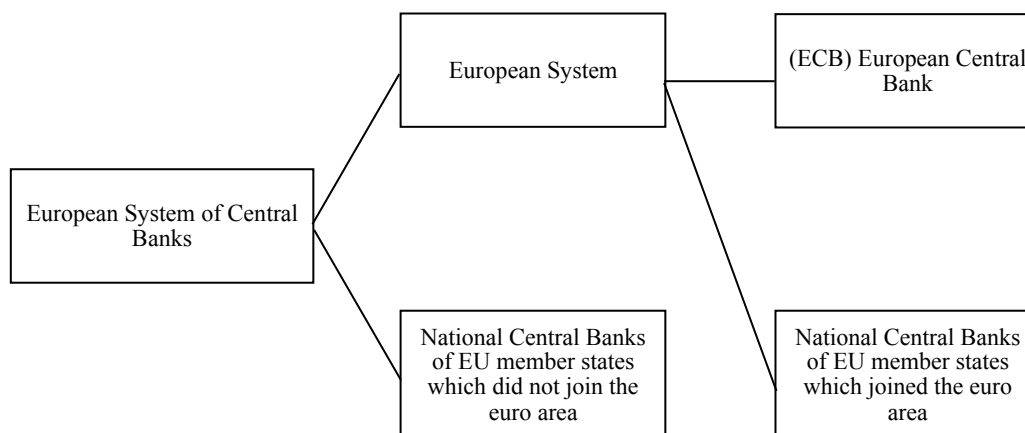


Fig. 1. Scheme of the European System of Central Banks

Activity of the Banking Union is based mainly on two main initiatives, the Single Supervisory Mechanism and the Single Resolution Mechanism, which in turn are based on the general financial regulatory framework¹¹. So, if a bank is threatened by insolvency, the responsibility shall be borne by participants in the Single Resolution Mechanism (SRM). The agreement creating the SRM came into force on January 1, 2016. As of January 2016, all the Member States of the Eurozone participate therein. Such a mechanism is intended directly for the control of systemically significant banks of the Eurozone, as well as through the national supervisory bodies by means of prudential supervision of all the other banks. In December 2012, the European Council announced the establishment of the Single Resolution Mechanism (SRM). The European Banking Union has been identified by many analysts and politicians as an important structural policy initiative that plays an important role in resolving the crisis in the Eurozone. For Member States that use euro as their currency, the Banking Union will assist in achieving the same application of the general rules of prudential supervision through the so-called Single Supervisory Mechanism (SSM), which has given the European Central Bank (ECB) control over implementation of uniform rules of the financial sustainability of banks, supporting member states.

¹¹ "Council Regulation (EU) No 1024/2013 of 15 October 2013 conferring specific tasks on the European Central Bank concerning policies relating to the prudential supervision of credit institutions, OJ L 287". www.ecb.europa.eu/press/key/date

Thus, the problem of integration of banking regulation has long been a key policy of the EU, as an addition to creation of the domestic capital market, and to a single European currency (since the 1990s). However, strong political barriers at the level of Member States led to the failure of previous attempts to create a European structure for banking supervision, including during the negotiation of the Maastricht Treaty in 1991 and the Nice Treaty in 2000. During 2000, the emergence of pan-European banking groups through cross-border mergers and acquisitions, such as the purchase of Abbey National Santander Group, Hypo Vereinsbank UniCredit and Banca Nazionale del Lavoro BNP Paribas, led to restoration of calls for banking integration policies, in particular the International Monetary Fund, and creation of the Committee of European Banking Supervisors in 2004.

Deterioration of lending conditions during the Eurozone crisis, as well as financial instability for large Member States of the Eurozone since mid-2011, led to a resumption of discussions on the interdependence of the banking policies, financial integration and financial stability. On April 17, 2012, the IMF Managing Director Christine Lagarde advocated for the integration of the banking policy, referring to the need to strengthen the European Monetary Union, she said that she favoured “the support of a strong financial integration and that our analysis should be in the form of a unified supervision, in the form of a single permit authority of a bank with a general reverse, and creation of a single deposit insurance fund”¹². And just next week, on April 25, 2012, President of the European Central Bank, Mario Draghi, repeated these thoughts, pointing out in his speech to the European Parliament that “ensuring a well-functioning of the EMU involves strengthening banking supervision at the European level”¹³. The report on June 26, 2012, by President of the European Council Herman Van Rompuy, who called for a deeper integration into the Eurozone and proposed major changes in four directions, was another important step in the European banking integration process. Firstly, he called for the Banking Union on the basis of the European Stability Mechanism, the General Financial Supervision and the Deposit Guarantee Fund. Secondly, proposals for the financial union included stringent control over the budgets of the Eurozone countries, and he called for the placement of Eurobonds in the medium-term perspective. Thirdly, he called for the close integration of banking supervision with economic

¹² Lagarde, C. "MFI/CFP Policy Roundtable on the future of financial regulation" *International Monetary Fund, Washington DC*, April 17. <http://www.imf.org>

¹³ Draghi M. "Hearing at the Committee on Economic and Monetary Affairs of the European Parliament: Introductory statement by Mario Draghi, President of the ECB". *European Central Bank*. 25 April 2012. www.ecb.europa.eu/press/key/date/2012/html

policies, and fourthly, he advocated for strengthening democratic legitimacy and accountability¹⁴.

The summit of Heads of States and Governments of the Eurozone on June 28-29, 2012 was a key point of decision-making. This event resulted in the announcement of two major initiatives: firstly, creation of a single control mechanism within the powers of the European Central Bank, using Article 127 (6) of the Treaty on the Functioning of the European Union; and secondly, establishment of an effective single control mechanism, as well as the possibility of direct recapitalization of banks by the European Stability Mechanism.

Such discussions and negotiations resulted in the development of a new regulatory framework with the general rules for banks in all 28 Member States, which became the basis of the Banking Union. These general rules should help to prevent banking crises. The rules principally focus on adoption of a legislative package of the capital requirements for banks, in particular, Capital Requirements Directive IV (CRD IV)¹⁵ and the Capital Requirements Regulation (CRR)¹⁶. If the bank has financial difficulties, then these prudential supervisory rules can strengthen it, which also corresponds to the Directive on Bank Recovery and Resolution (BRRD)¹⁷. The Capital Adequacy Directive is a European directive, aimed at establishing the uniform capital requirements both for banking institutions and non-banking firms dealing with securities. This directive was first issued in 1993 and revised in 1998. The updated Capital Adequacy Directive, as Capital Requirements Directive IV (CRD IV), has entered into force since 2006.

The Capital Requirements Directive (CRD IV) was aimed at regulating the financial services industry of the European Union, namely introduction of a supervisory system in the European Union, which reflected the Basel III Rules for the capital measurement and standards. This legislative package replaced the previous Capital Adequacy Directives (2006/48 and 2006/49), and it was effective from

¹⁴ Herman, Van Rompuy. "Towards a Genuine Economic and Monetary Union. Speech at the Peterson Institute for International Economics" *Washington DC*, 12. www.consilium.europa.eu/uedocs/cms

¹⁵ "Directive 2013/36/EU on access to the activity of credit institutions and the prudential supervision of credit institutions and investment firms (CRD IV)" *The European Parliament and the Council* 2006. ec.europa.eu/finance/bank/regcapital/legislation-in-force/index_en.htm.

¹⁶ "Regulation (EU) No 575/2013 of the European Parliament and of the Council of 26 June 2013 on prudential requirements for credit institutions and investment firms and amending Regulation (EU) No 648/2012 (Text with EEA relevance)" *The European Parliament and the Council*. 2006. ec.europa.eu/finance/bank/regcapital/legislation-in-force/index_en.htm.

¹⁷ "Directive 2014/59/EU of the European Parliament and of the Council of 15 May 2014 establishing a framework for the recovery and resolution of credit institutions and investment firms" *The European Parliament and the Council*. 2006. ec.europa.eu/finance/bank/regcapital/legislation-in-force/index_en.htm.

1 January 2014, and consisted of Regulation (EU) No.575/2013¹⁸ and Directive 2013/36/EC¹⁹. This is the third package of amendments to the original directives, following the two previous sets of amendments, adopted by the Commission in 2008 (CRD II) and 2009 (CRD III). The global goal of this new set of rules is to strengthen the resilience of the EU banking sector in order to make it better under conditions of perturbations in the economy and to create the necessary conditions for banks to finance economic activity and growth..

Thus, creation of the Banking Union within the European Union is the process of transferring responsibility for the banking policy from the national to the EU level in a number of countries of the European Union. This process began in 2012 in response to the financial crisis in the Eurozone. The creation of the Banking Union was encouraged by weakness of many banks in the Eurozone. Private debts that have been caused by the mortgage crises in a number of countries have been transferred to a sovereign debt, which has slowed down these crisis phenomena. The Banking Union was formed as a response to this challenge and consisted of two main initiatives, the Single Supervisory Mechanism and the Single Resolution Mechanism.

Unlike directives of the European Commission, which serve as legal documents, the principles of the Basel Committee on Banking Supervision do not have that status. In addition, the Basel principles are applied on a consolidated basis. The EU directives are applied at the state's request on an unconsolidated basis. If the branch operates in the country, in which the institution was established. In 2009, the Basel Committee on Banking Regulation and Supervision responded to the crises by taking measures to strengthen the banking regulatory framework and approving proposals to strengthen the global capital and liquidity in order to promote a more sustainable banking system. II Basel Accord²⁰ caused a lively discussion between regulators on its advantages and disadvantages, while about 100 countries planned to adopt a new regulatory and supervisory system by 2015. The Basel II effect was emphasized by Raghuram Rajan, the IMF Chief Economist, who argued that rethinking of banking regulation was a big issue and

¹⁸ "Regulation (EU) No 575/2013 of the European Parliament and of the Council of 26 June 2013 on prudential requirements for credit institutions and investment firms and amending Regulation (EU) No 648/2012 (Text with EEA relevance)" *The European Parliament and the Council*. 2006. ec.europa.eu/finance/bank/regcapital/legislation-in-force/index_en.htm

¹⁹ "Directive 2013/36/EU of the European Parliament and of the Council of 26 June 2013 on access to the activity of credit institutions and the prudential supervision of credit institutions and investment firms, amending Directive 2002/87/EC and repealing Directives 2006/48/EC and 2006/49/EC Text with EEA relevance" *The European Parliament and the Council*. 2006. ec.europa.eu/finance/bank/regcapital/legislation-in-force/index_en.htm.

²⁰ "Mizhnarodna konverhentsiva vvmiru kapitalu ta standartiv kapitalu (Bazel' 2)." Bazel's'kyy komitet bankivs'koho nahlyadu. <http://www.bis.org>. [In Ukrainian].

criticized the current banking regulation and supervision practices. Indeed, recent financial turmoil and bankruptcies have revealed numerous shortcomings in the Basel II, which prompted a revision of this Accord, although it entered into force in the EU in 2007, i.e. when the financial crisis began²¹.

To overcome differences in the world regulatory environment, coordination and exchange of information between supervisors are important, as well as active participation of the national regulatory authority in multilateral and bilateral negotiations with foreign supranational regulators. Creation of such a world organization as the G20 in September 1999 contributed precisely to overcoming such negative phenomena. This happened at the official meeting of finance ministers and heads of central banks of seven leading industrialized countries (Canada, France, Germany, Italy, Japan, the United Kingdom and the United States) in Washington, DC. The period after the financial crisis of 1997-1998 showed the vulnerability of the international financial system against the backdrop of globalization of the economy, as well as the need to involve key developing countries in the discussion and decision-making on the global economic problems. This led to the transformation of the group that initially worked at the level of finance ministers into the Financial Stability Forum, where heads of states and governments decided to promote development of the global regulatory framework. Thus, the G20 has evolved into a major political initiative in the public that promotes solution of challenges such as the policy coordination between its members in order to achieve the global economic stability and sustainable growth, promoting financial rules that reduce risks and prevent future financial crises, promote modernization of the international financial architecture. Finance ministers of the G7 and heads of central banks, according to the recommendations of the President of Deutsche Bundesbank, established the Financial Stability Forum (FSF) in 1999. It was transformed into the Financial Stability Board (FSB), which became the G20 secretariat for regulation, and which issues the global political documents, directed at the national regulatory authorities to incorporate their regulatory framework into the policies and principles of the G20. The FSB facilitates coordination of rule-making bodies to overcome contradictions of the national and regional regulatory structures, related to prudential supervision and systemic risk.

The Bank of International Settlements (BIS) is a global regulator. This is a forum of world central banks. Since the global banking regulation has become a major issue for central banks, this issue falls

²¹ Pavlyuk, O.O. "Bazel' III: aktual'nist' ta problemy zaprovadzhennya." *Ekonomichnyy visnyk Zaporiz'koyi derzhavnoyi inzhenernoyi akademiyi* 5 (2016): 32.

within the competence of the BIS represented by the Basel Committee on Banking Supervision (BCBS), which develops and issues the banking rules, in particular, the rules on the capital adequacy, as well as three series of the banking regulatory principles. Advantage of the BIS in the global leadership of banking regulation is that the dialogue between leaders of the world's central banks creates a unique forum for analysing and discussing problems of the monetary and fiscal policy, thus forming a powerful group of influential world financial leaders.

The International Monetary Fund (IMF) is an organization of 188 countries that work to stimulate the global monetary cooperation, financial stability, promote the international trade, maintain a high level of employment and sustained economic growth, and reduce poverty throughout the world. The unstable banking system of the Eurozone countries complicates development of the economy of these countries, for example, provision of loans to the real sector of the economy. Healthy banks are needed to support the economic recovery, and in some cases they need additional bank capital. Therefore, tasks of the IMF is to ensure interventions for improving and stabilizing the financial system. In addition, the IMF monitors development of the situation in the banking sector in countries with developing economies, but this organization does not have the jurisdiction to intervene in the restructuring of the banking system. During the financial crisis, the IMF's omission was often criticized, but these accusations were unfounded, because the function of this organization is not related to prediction of the banking crisis, which is, for example, a function of the BIS.

The International Organization of Securities Commissions (IOSCO) was established in Madrid and is a forum, in which the securities regulators discuss and publish common rules on a wide range of issues that affect the integrity of the securities markets. The IOSCO, established in 1983, is a recognized international body that brings together the world's securities regulators and is recognized as a global standard for the securities sector. The IOSCO develops, implements and promotes the observance of the internationally recognized standards in the field of regulation of the securities market, and actively cooperates with the G20 and the FSB regarding the global regulating reform programme.

The IOSCO has not any rights, established by the law, which could impose rules on the national regulating bodies as opposed to, for example, the U.S. Securities and Exchange Commission (SEC). Thus, the IOSCO report, "Suitability Requirements with Respect to the Distribution of Complex Financial Products" published in January 2013, has been rejected by the SEC.

The International Accounting Standards Board (IASB) develops the International Financial Reporting Standards (IFRS), including those that apply to financial institutions. The main purposes of the IFRS are development of a single set of high quality, understandable international financial reporting standards to be enforced worldwide through the legislative body – the International Accounting Standards Board. The convergent international accounting standards, the basic principles of which are contained in the so-called Conceptual Framework, are one of the main tools that are necessary to create a global coordinated financial system. Accounting of impact of financial assets and transactions can be explained in different ways, thus creating economic misunderstandings between countries. This is really important, because regardless of the economic rules and regulations that are set by each country, establishment of unified accounting rules, that measure the same realities by the same standards, supports the overall functioning of the world financial system. However, the current rules are the subject of serious disagreements between Europe and the United States.

The International Association of Insurance Supervisors (IAIS) is a global regulatory forum, where the principles and directions of the insurance policy are discussed. It has been founded in 1994 and brings together insurance regulators in more than 200 countries and has over 130 observers. It aims at promoting the effective supervision of insurance harmonized at the international level in order to develop and support fair, safe and stable insurance markets to provide benefits and protection of policyholders, as well as to promote the global financial stability. The report “Global Insurance Market” was published for the first time in November 2012, and was a comprehensive analysis of problems, faced by the insurance industries and their regulators.

The Solvency II Directive, as amended by the Omnibus II Directive, was approved at the political level on November 14, 2013. It was a compromise that reduced the influence of the European Insurance Authority. However, the deal was criticized by some national governments that demanded broader and coordinated powers for the European insurance and pension coverage. In contrast to such rules, the U.S. Department of the Treasury has recently called for more supervision over insurance companies. The reason for this call largely lies in the fact that insurance companies are regulated by states, which are engaged in collecting taxes from insurance companies. The global regulation of insurance is not certainly a simple business. While the insurance companies call for consistent regulation to avoid regulatory arbitration, they should take into account a number of aspects of the global regulation. A structured dialogue between the United States and

Europe relates to the key issues and formally compares two insurance regulatory regimes — Solvency II in the European Union and United States insurance regime. The fact is that the Glass-Steagall Act, which was enacted in 1933 in the United States, banned commercial banks to engage in investment activity, by limiting the rights of banks on securities transactions, as well as the introduction of obligatory insurance of bank deposits. This regulatory document gave rise to the creation of three individual financial industries: commercial banks, investment banks and insurance firms. Restrictions, which had been established, were cancelled in 1999 by the Financial Services Modernization Act, which is called by names of its initiators Gramm — Leach — Bliley Financial Services Modernization Act. This Act was adopted by the United States Congress on November 4, 1999 and signed by the President of the United States on November 12 of the same year. However, the global economic recession that began in 2007, according to financial analysts, was a consequence of cancellation of the Glass-Steagall Act, and led to resumption of attempts of its re-enactment. Discussion that continued to be held between the United States and Europe concern such major directions as: professional secrecy and confidentiality, group supervision, solvency and capital requirements, requirements for reinsurance, supervisory reporting, data collection and analysis, independent third-party assessment and on-site supervision inspections. The so-called theory of re-engineering arose in the American scientific school at the end of 1990s. The theory of re-engineering was developed by American economist, Professor at the Harvard Business School M. Hammer. According to this theory, re-engineering involves radical changes in business processes for saving time and costs, and creating organizations that respond to the changing market situation, and achievement of competitive advantages being the most relevant in today's business. The world's leading companies such as: General Motors, Procter and Gamble, IBM, Kodak have started to use re-engineering methodology since 1990s. Today, the theory of re-engineering is the main in the global economy in terms of solution of problems related to increase of the economic efficiency of enterprises. The concept of "business process" is fundamental in the theory of re-engineering. According to M. Hammer²², it is a combination of different types of activity, within which one or more input resources are used, and the output product is created, which is valuable for the consumer. Therefore, organizations should concentrate its resources and management in their business processes (main and auxiliary). The main business processes for banks are as follows: lending, deposits servicing,

²² Khammer, M. *Reynzhynyrynh korporatsyy. Manyfest revolyutsyy v byznese*. SPb: Yzdatel'stvo S.-Peterburhskoho un-ta, 1999: 138-151.

cash servicing, settlement activities, foreign exchange transactions, factoring services, leasing services, transactions with precious metals, depository services. Those processes which do not create value for the customer, but are necessary to ensure implementation of the key business processes are supporting ones. These are such operations as: accounting, economic activities, provision of cash transactions. Re-engineering of bank processes is aimed at simplifying banking transactions due to modern technologies and management.

Thus, the process of forming the economic environment in the EU, the main component of which is creation of a regulatory framework for the financial sector and the Banking Union, represents an important milestone in the economic and monetary and financial integration in the EU. The banks recently tend to be consolidated in Europe and in the United States. The number of banks in Europe decreased by 10% for the last 10 years. Analysts distinguish some reasons for this development: the first reason, in their opinion, is connected with the necessity to achieve the maximum effect from the use of automation and technology resources. The second reason lies in compliance with the certain development strategy of the bank. In addition, these studies tend to rely on traditional performance and productivity indicators, derived from simple bank accounting ratios. One of these studies showed the impact of a wide range of regulatory instruments and supervisory practices on bank development, in particular, performance, stability and degree of corruption in bank lending. This study contains a detailed report on such practice for more than 150 countries, including the study of three major components of Basel II, namely the capital rules, formal supervision and market discipline. In addition, the existing studies on the relationship between different types of regulations on supervisory practices and banking activity indicate that they are very limited in nature, and that they are focused on individual countries. The changes in the organization of banking should be also aimed at consolidation and enlargement of the banking business. The restoration of financial stability and creation of favourable conditions for the financial sector through financing the real sector of economy will help to stimulate the economic recovery and job creation.

The main directions of reforming the financial sector of Ukraine were outlined in the Integrated Financial Sector Development Program of Ukraine until 2020²³. According to this program, the development of the financial sector of Ukraine until 2020 is primarily aimed at creation of a financial system, capable to ensure sustainable economic development through efficient redistribution of financial resources in the economy on

²³ *Kompleksna prohrama rozvytku finansovoho sektoru Ukrayiny do 2020 roku Postanova Pravlynyya NBU №391 18.06.2015.*, 2015. www.bank.gov.ua/doccatalog

the basis of development of a fully-fledged market competitive environment in accordance with the EU standards. One of the ways to create the prerequisites for long-term sustainable development of the financial sector is to approximate the standards of regulation of solvency and liquidity of banks to the recommendations of the Basel Committee, by implementing the recommendations of Basel III. In particular, according to the Comprehensive Action Plan for implementation of the Program, it is planned to improve the financial sector regulation and supervision systems, to continue transition from compliance based supervision to risk based supervision and the principles of continuous preventive monitoring (from 1.04.2015 to 31.12.2016), as well as introduction of new capital requirements of banks in accordance with the principles of Basel 3 and the EU requirements (from 01.01.2015 to 31.12.2019). In my opinion, there are real problems related to implementation of these plans, because, as the experience of foreign countries shows, projects for implementation of the Basel standards for banks are very complex and costly. The complication of the regulatory process affects the conducting of banking business, especially in the context of devaluation of hryvnia and total bankruptcy of banks. Therefore, there is a considerable doubt that there will be resources in the context of the financial and banking crisis to introduce new standards for the Basel supervision. In addition, in recent years, there has been no preparatory work for implementation of the Basel Committee standards, in particular Basel II and Basel II, 5, which are interim baselines for implementation of Basel III. There is an old system of standards that minimizes risk management costs for management of banks, because risk management is a formal process for meeting standards. The banking system of Ukraine requires from the national regulator to ensure transparency in business by issuing an instruction, recommendation that would regulate risk management and prevent bankruptcy of banks.

Conclusions

1. As the EU experience shows, implementation of modern banking regulation recommendations is a rather complex and costly process, but improvement of risk management and measurement methods in general provide the banks with more competitive field of operation and also increase the role of the market discipline.

2. Taking into account the current situation, the conceptual issues of risk management should be considered in the context of methodological developments, adopted by the international banking community in the Basel Accords. Comments and additions, made by bankers from different

countries, are taken into account in the “Basel-II” document, which complemented the previous versions of the Accord – Basel I. The financial markets have been undergoing rapid evolution and widespread adoption of models for assessing credit, market and operational risks since 1990s, especially after introduction of Basel 2. Banks have invested time, funds and resources to improve their data and availability to them, their risk models, and their internal processes. Those banks that applied all the provisions of Basel 2 realized that investing in improving the risk management process was a competitive advantage. And such a strategy yields the relevant results today.

3. The analysis of the banking system of Ukraine and the main regulatory aspects shows that there are problems, which indicate the crisis phenomena in the banking system of Ukraine, in particular, in the banking regulation and supervision system. To overcome these phenomena, it is necessary to introduce a comprehensive strategy for a gradual transition to the restoration of the banking business in Ukraine taking the further steps of implementation of the recommendations of the Basel Committee. In general, this problem is complicated enough, since it is subject to resolution both in the context of both economic and political issues, and therefore needs further research.

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