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FACULTY OF LAW
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Department of Financial Law and Economics

SYSTEM OF FINANCIAL LAW

FINANCIAL MARKETS

Conference Proceedings

Jiří Blažek (ed.)

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Preface

The Information and Research Center of Public Finance and Tax Law of Central and Eastern European Countries is an association at the Law Faculty of the University of Bialystok, founded in 2002.

The main objectives of the Center are to gather information about scientific activities of its members, exchange information, introduce common research and conference initiatives, and to support the achievement of these goals. The Center develops exchange of information among research and university centers in CEE countries and around the world, initiates cooperation of institutions in CEE countries and cooperates with the government and non-governmental organizations. One of the crucial goals of its activity is to promote European standards in the fields of public finance and tax law in CEE countries, and to share experiences with other countries. The Center also focuses on publishing activity and the organization of workshops, seminars and conferences. The main aspect of the Center´s activity is the support of research exchange between scientific centers in Eastern and Western Europe. Among its members, the Center assembles distinguished scholars and academics specializing in public finance and tax law as well as in related fields from CEE and other countries.

So far, the Center has initiated and together with local institution organized several scientific international conferences:

- Methods and Instruments of Limiting Public Debt and Budget Deficit in Countries of Central and Eastern Europe, September 2002, Bialystok, Poland, with the University of Finance and Management in Bialystok;
- Tax and Local Fees Reforms – Polish and Selected European Countries Experiences, November 2002, Bialowieza, Poland, with the University of Bialystok;
- Problems of Public Finance and Tax Law in Central and Eastern European Countries before the Accession to the European Union, September 2003, Brno, Czech Republic, with Masaryk University;

- The Problems of Financial Law Evolution in Central and Eastern Europe within the Integration Processes, September 2004, Vilnius, Lithuania, with Mykolas Romeris University;
- Current Questions of the Efficiency of Public Finance, Financial Law and Tax Law in the Countries of Central and Eastern Europe, August 2005, Kosice, Slovakia, with Pavol Jozef Šafárik University in Košice;
- Establishing and Implementation of Financial Law in Central and Eastern European Countries, September 2006, Grodno, Belarus, with the State University in Grodno;
- The Modern Problems of Tax Law Theory, September 2007, Voronezh, Russia, with the State University in Voronezh;
- The Basic Problems of Public Finance Reforms in the 21st Century in Europe, September 2008, Paris, France, with the Polish Academy of Sciences;
- Public Finance and Financial Law in the Context of Financial Crises in the Eastern and Central Europe, September 2009, Lviv, Ukraine, with the State University of Lviv;
- Current Issues of Finance and Financial Law in Terms of Fiscal and Monetary Support of Economic Growth in The Countries of Central And Eastern Europe after 2010, September 2010, Prague, Czech Republic, with Charles University in Prague;
- Public Finances – Administrative Autonomies, September/October 2011, Gyor, Hungary, with Szechenyi Istvan University;
- Annual and Long-Term Public Finances in Central and Eastern European Countries, September 2012, Bialystok, Poland, with the University of Bialystok;
- Problems of Application of Tax Law in Central and Eastern European Countires, September 2013, Omsk, Russia, with Omsk F. M. Dostoevsky State University.

The materials from the conferences were published in a book-form after the events:

- Deficyt budżetowy i dług publiczny w wybranych krajach europejskich - The Budget Deficyt and the Public Debt in the Selected European Countries. Bialystok: Wyższa Szkoła Finansów i Zarządzania, 2003. ISBN-83-87256-5;

- Europejskie systemy opodatkowania nieruchomości - European Systems of Real Estate Taxation. Warszawa: Kancelaria Sejmu, 2003. ISBN 83-909381-6-2;
- Financování územní samosprávy ve sjednocující se Evropě - Funding of Local Government in Unifying Europe. Brno: Masarykova univerzita v Brně, 2005. ISBN 80-210-3677-X;
- The problems of the financial law evolution in Central and Eastern Europe within the integration processes. Bialystok-Vilnius: WP UwB & Talmida, 2004;
- Aktuálne otázky efektívnosti verejných financií, finančného práva a daňového práva v štátoch strednej a východnej Európy - Current Questions of the Efficiency of Public Finance, Financial Law and Tax Law in the countries of Central and Eastern Europe. Košice: Univerzita Pavla Jozefa Šafárika v Košiciach, 2005. ISBN 80-7097-604-7;
- Finansovoe pravotvorčestvo i pravoprimenenie v gosudarstvach centralnoj i vostočnoj Evropy - Establishing and Implementation of Financial Law in Central and Eastern European Countries. Grodno: Grodenskij gosudarstvennyj universitet imeni Janki Kupaly, 2006. ISBN 985-417-835-8;
- Sovremennye problemy teorii nalogovogo prava - The Modern Problems of Tax Law Theory. Voronež: Voronežskij gosudarstvennyj universitet, 2007. ISBN 978-5-9273-1340-2;
- Bialostockie Studia Prawnicze – Bialystok Legal Studies, Bialystok: Temida 2, 2009, 5. ISSN 1689-7404;
- Finanse publiczne i prawo finansowe w Europie Centralnej i Wschodniej w warunkach kryzysu finansowego - Public Finance and Financial Law in the Context od Financial Crisis in Central and Eastern Europe. Białystok - Lwów: Temida 2, 2010. ISBN 978-83-89620-85-9;
- Aktuální otázky financí a finančního práva z hlediska fiskální a monetární podpory hospodářského růstu v zemích střední a východní Evropy po roce 2010 - Current Issues of Finance and Financial Law in Terms of Fiscal and Monetary Support of Economic Growth in The Countries of Central And Eastern Europe after 2010. Praha: Leges, 2010. ISBN 978-80-87212-57-8;

- Public Finances – Administrative Autonomies. Győr: Universitas-Győr Nonprofit Kft., 2012. ISBN 978-963-9819-87-0;
- Annual and Long Term Public Finances in Central and Eastern European Countries. Białystok: Temida 2, 2013. ISBN: 978-83-62813-33-9;
- Problems of application of tax law in Central and Eastern European Countries. Omsk: Omsk F. M. Dostoevsky State University, 2013. ISBN 978-5-7779-1628-0.

In 2014, the annual conference of the Center took place in Mikulov, Czech Republic. It was organized together with the Masaryk University. The conference topic was the system of financial law. Research papers that encompass the following areas were invited:

- Views on the definition of financial law as a branch of law in particular countries;
- Jurisprudence and financial law relationships to other branches of law;
- Approaches to jurisprudence systematization of financial law;
- Problems concerning constitutionalisation of financial law;
- European Union‘s impact on system of financial law;
- Atomization of financial law (diversification);
- System of didactics in financial law;
- Economic aspects of financial law.

As there were many participants with many contributions, organizers decided to publish three volumes of conference proceedings:

1. System of Financial Law - General Part of Financial Law and Budget Law;
2. System of Financial Law - System of Tax Law;
3. System of Financial Law - Financial Markets in the System of Financial Law.

This third volume on Financial Markets in the System of Financial Law is dealing not only with the position of financial markets regulation in the system of financial law, but it concerns a lot of specific issues of financial law connected with the financial markets. Legal theorists all over the world are not uniform about the place of financial markets legal regulation in the system

of law generally or in the system of financial law specifically. Moreover, the regulation of financial markets is very broad covering banking, insurance, capital markets, etc.

All contributions were double blind reviewed by experts in the area of financial law.

Jiří Blažek, Michal Radvan

THE CONSTITUTIONAL POSITION OF THE MONETARY POLICY COUNCIL AND THE REGULATIONS OF THE ACT ON THE NATIONAL BANK OF POLAND

Zbigniew Ofiarski[1]

Abstract

This contribution deals with The Monetary Policy Council, as a body of the National Bank of Poland. The special status of the Monetary Policy Council is provided by the way of regulating its legal position and basic tasks and forms of operation directly in the Constitution. Equipping the NBP, including the MPC, with the power to exercise legally defined instruments of monetary policy is a guarantee of implementation of the adopted monetary policy guidelines. The main aim of the contribution is to confirm or disprove the hypothesis that arrangements made by this authority produce certain effects of a macro-economic dimension.

Key words

Central bank; Monetary Policy Council; monetary policy guidelines; particular constitutional status of the Monetary Policy Council.

JEL Classification

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1 Introduction

The Monetary Policy Council, as a body of the National Bank of Poland, was established in 1997. Its constitutional status is specified directly

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in the Constitution. It is one of the three bodies of the NBP (other bodies include the President of the NBP and the Management Board of the NBP). It is a tenure body, in which its members serve for a period of six years. The MPC position stemming from its placement and granted legal competence leads to the conclusion that, despite its place in the structure of the NBP as a body of the central bank, it is at the same time an authority of the monetary policy of the state, independent of other bodies of the NBP as it exercises governance and supervisory functions over them. What is noticeable is the dual nature of the MPC which is both a body of NBP (acts as the supervisory board in the central bank), as well as a specific constitutional authority of the Polish state of an executive nature in the sphere of monetary policy.

2 History of the Monetary Policy Council

The creation of the Monetary Policy Council (MPC) as a body of the National Bank of Poland (NBP) occurred in 1997. Its constitutional status was defined in Art. 227 of the Constitution of the Republic of Poland (hereinafter the Constitution). Under this provision, the MPC is one of three bodies of the NBP (other organs include the President of the NBP and the NBP Management Board). It should be stressed that the provision of Art. 227 of the Constitution was contained in Chapter X on public finances, but the NBP is not an organizational unit of the public finance sector. According to Art. 9 point 14 of the Act of 27 August 2009 on public finance, the public finance sector includes, among others, other state legal persons established under separate laws in order to perform public duties, but excluding banks. Similarly, regulations concerning the types and names of bodies of the NBP are contained in the provision of Art. 6 of the Act of 29 August 1997 on the National Bank of Poland.

The concept and method of positioning the MPC in the structure of the NBP indicate the legislator's basing on specific historical experiences. Decree of 15 January 1945 on the National Bank of Poland, with the aim to regulate the circulation of money and credit, brought to life a state institution under the name of "the National Bank of Poland" equipped by the State with the privilege of issuing bank notes. The created NBP Management

Board gave the NBP a general direction and exercised oversight and control over the activity of the bank and operations of its executive bodies. The President of the NBP presided over the NBP Management Boards, watched over the implementation of its resolutions and held general management at the NBP.

In particular, the duties of the NBP included: the appointment at the request of the NBP Management Board of members of Discount Commissions; approving the spending plan of the bank presented by the Board; submitting proposals to the Minister of the Treasury as to the amount of discount rates as well as interest rates and bank commission rates; deciding on purchasing and disposing of real estate; submitting annual reports to the Minister of the Treasury for approval; auditing various activities of the bank, examining books and bank evidence. The NBP Board was composed of the President of the National Bank of Poland and 10 members appointed and recalled from office by resolution of the Council of Ministers at the request of the Minister of the Treasury; half of them were appointed from amongst representatives of the ministries concerned in the economy of the bank, and half from amongst representatives of economic spheres and the co-operative movement. Members of the NBP Board were paid for their participation in the sessions in the amount determined by the Minister of the Treasury.

The NBP Board was convened by the NBP President at least once a month. At the request of third members, the NBP Board should be convened within a week. In the absence of the President of the NBP at the NBP Board meetings, it was chaired by its member appointed by the Minister of the Treasury. Resolutions of the NBP Board were adopted by a simple majority of votes, and in case of equality of votes, the vote of the President of the NBP was decisive. It was not a fully original idea as in the inter-war period, in the then functioning Bank of Poland, a Bank Board of similar structure and similar competencies operated (cf.: Statute resolution of the President of the Republic of Poland of 20 January 1924 concerning the determination of the statute for the bank of issue).

For the duration of validity of the Act of 2 December 1958 on the National Bank of Poland (the act was in force from 10 December 1958 until 30

June 1975) the NBP Board functioned by the NBP Management, but only as an advisory body. It was set up to ensure closer links between the work of the NBP with the needs of the national economy. The tasks of the NBP Board included examining matters from the scope of core activities of the NBP, taking into account the interests of the various areas of the national economy. The Board consisted of: the NBP President as Chairperson, members appointed from amongst economic activists, prominent experts in various fields of economy and academics. NBP Board members were appointed and dismissed by the Prime Minister at the request of the Minister of Finance agreed with the President of the NBP. The NBP Board acted on the basis of its by-laws passed internally, which at the request of the President of the NBP were approved by the Minister of Finance. Moreover, the President of the NBP could establish at the branches of the NBP, among representatives of economic institutions and organizations, advisory committees for consideration of important issues in the field of monetary and credit operations of the branches.

In the next period, prescribed by provisions of the Act of 12 June 1975, The Banking Law (the act was in force from 1 July 1975 until 30 June 1982), the President of the NBP could set up advisory committees by provincial (voivodeship) branches of the NBP to deal with most important issues in the field of monetary and credit activities from among the representatives of economic institutions and organizations. New developments in this field were introduced in the banking reform conducted in 1982. Pursuant to the provisions of the Act of 26 February 1982 on the Statute of the National Bank of Poland (this act was in force from 1 July 1982 until 9 February 1989), the Scientific Council operated by the President of the National Bank of Poland as a consultative and advisory body. The President of the NBP determined the number of its members and appointed and dismissed the Chairperson and members of the Scientific Council, and issued by-laws as the basis for the activities of that body. In addition, the Council of Universal Savings Bank, chaired by the Vice President of the NBP appointed by the President of the NBP, operated by the NBP Management (in this period Universal Savings Bank was part

of the central bank, and its separation from the bank was only conducted in 1987). The scope of activities of the Universal Savings Bank included the following:

a) inspiring activities for the development of people's savings, assessment of projects for the improvement of principles and forms of services provided to the population in terms of savings and checking accounts turnover and cash settlements,
b) evaluation of projects improving the terms and conditions for granting loans to people and their collateral and repayment,
c) issues related to the organization of the system of savings and the network of providers of services resulting from this system to the public.

The Council of Universal Savings Bank comprised representatives of academia, social and professional organizations and employees of the bank, appointed by the President of the NBP. The Council of Universal Savings Bank operated on the basis of regulations issued by the President of the NBP.

In the period immediately preceding the entry into force of the provisions of the currently in force Act on the NBP, collegial bodies of different scopes of tasks and responsibilities were created in the structure of the central bank. In accordance with Art. 60 of the Act of 31 January 1989 on the National Bank of Poland (this act was in force from 10 February 1989 until 31 December 1997) the Economic Council and the Scientific Council operated by the President of the NBP acting as consultative and advisory bodies. The President of the NBP determined the number of members of these bodies and appointed and dismissed their Chairperson and members from amongst representatives of industrial and commercial circles, financial circles and scientific circles, except that the appointment of the Chairperson and members of the Economic Council followed consultation of opinion of a relevant Sejm (parliamentary) committee. The Economic Council and the Scientific Council acted on the basis of regulations issued by the President of the NBP.

The provision of Art. 227 of the Constitution governs not only basic issues related to the organization and appointment of NBP bodies, but also defines its position in the political system, giving the National Bank

of Poland the rank of the central bank of the state, which holds the exclusive right to issue money and to formulate and implement monetary policy. In addition, the provision entails that the NBP is responsible for the value of Polish currency, which in the literature is not equated with the imperative to strive to increase this value or merely to maintain it at a constant level. The task is defined as assigning the NBP with duties and possibilities to conduct the monetary policy in a manner conducive to comprehensive economic development and raising the standard of living of citizens (Winczorek, 2008: 423).

The currently functioning Monetary Policy Council of the NBP in the range of tasks and powers granted to it is most similar to the original concept of the Board of the Bank of Poland created in 1924 and to the NBP Board from the period in which the Decree of 15 January 1945 on the National Bank of Poland was in force. Just as the then NBP Board, also the currently functioning MPC has certain authoritative powers over other bodies of the central bank, as well as powers of an external nature covering mainly the realm of shaping the monetary policy (Jończyk, 1998: 32-34).

Position of the MPC resulting from its legal positioning and prerogatives granted leads to the conclusion that, regardless of how it is located in the structure of the NBP as its body, it is at the same time a body of state's monetary policy, independent of other bodies of the NBP as it exercises managerial and supervisory functions over them. The doctrine emphasizes the dual nature of the MPC, which is both a body of the NBP (acts as a supervisory board of the central bank), as well as a specific constitutional authority of the Polish state of an executive nature in the sphere of monetary policy (Knosala, 2010: 64).

2.1 Shaping the composition of the Monetary Policy Council

The literature emphasizes the problem of the independence of the NBP, especially from public administration, as well as possible limits of this independence (financial, functional, institutional, cf.: e.g. Huterski, 2000: 249). Especially important is the institutional independence which relates primarily to the central bank's position in the system of state bodies and the manner of appointment and dismissal of its organs. The provisions

of the Constitution relating to the NBP indicate that the legislator took into account all three of the above-mentioned aspects of central bank's independence. Nevertheless, the Constitution does not explicitly formulate the principle of independence of the state's central bank (Zubik, 2001: 32). The jurisprudence of the Constitutional Tribunal has pointed out, that implementation by the NBP of the above-mentioned tasks requires in a large extent its independence (Judgement of the Constitutional Tribunal of 24 November 2003: K 26/03).

The postulate of granting NBP's independence determined the wording of the provisions of this legal entity. One of the guarantees of the independence is the adoption by the constitutional parity of the mode of shaping the composition of the Monetary Policy Council by three separate authorities (the Sejm, the Senate (lower and upper house of parliament, respectively) and the President of the Republic of Poland) and the appointment of MPC members for a period of six years, and therefore longer than the term of the appointing bodies themselves. According to the criteria set out in Art. 227 para. 5 of the Constitution, the MPC comprises of the President of the National Bank of Poland as its Chairperson and persons distinguished by their knowledge of financial matters, appointed for six years, in equal numbers, by the President of the Republic, the Sejm and the Senate. The qualifications required of candidates for the MPC are therefore defined in a very general and at the same time flexible manner. In particular, no certain level and specialization of education is required, nor practical experience of working within financial institutions. Methods for measuring "knowledge of financial matters" and for the evaluation of the candidate's distinctive attributes against other people aspiring to membership in the MPC were not defined. An important limitation, addressed, among others to members of the MPC, follows from Art. 103 paragraph 1 of the Constitution, because the mandate of a Member of Parliament cannot be combined with the office of the President of the NBP or member of the MPC.

Directly from the provisions of the Constitution follows that the President of the NBP is the Chairperson of the MPC, and therefore one of the bodies of the NBP (monocratic) presides over another body of the central bank

(a collective body). The special status of the President of the NBP is also decided on by the provisions of Art. 227 para. 3 and 4 of the Constitution, according to which the President of the NBP is appointed by the Sejm at the request of the President of the Republic for six years. A constitutional prohibition of membership of a political party, a trade union and of carrying out public activities incompatible with the dignity of his office was formulated against the President of the NBP.

In accordance with Art. 144 of the Constitution, the President of the Republic, exercising his constitutional and statutory authority, issues Official Acts. They require for their validity the signature (countersignature) of the Prime Minister who, by such signature of the Act, accepts responsibility to the Sejm. Countersignature is not required for the appointment by the President of the Republic of members of the Monetary Policy Council, nor for the proposal to the Sejm to appoint the President of the NBP.

Art. 227 para. 6 of the Constitution formulates basic tasks of the MPC, the scope of which includes formulating annually the aims of monetary policy and presenting them to the Sejm at the same time as the submission of the Council of Ministers' draft Budget. Within 5 months following the end of the fiscal year, the Council for Monetary Policy submits to the Sejm a report on the achievement of the purposes of monetary policy. There is no doubt that the constitutional tasks entrusted to the MPC should be implemented in a manner appropriate to the constitutional status of this body; this concerns in particular the aspect of credibility in the area of implementation of constitutional tasks. The provision of Art. 227 para. 5 of the Constitution should therefore be interpreted in a manner conducive to personal stabilization of the MPC and sustainability of the policy introduced by it, while limiting negative consequences of the impact of the political cycle on this policy.

Customization of the term of members of the MPC, which in perspective brings the effect of diversification of the moment of appointment of each of the members of the MPC, provides a smooth exchange of MPC members and therefore ensures its functional and institutional continuity. In turn, the term structure of the entire MPC as a collective body involves - in case of difficulties with the appointment of a new composition of the MPC

- the risk of occurrence of an inter-term gap. The system of individual terms eventually leads to the "overlapping" of terms of office of individual persons-members of the collegial body, which in relation to the MPC may reduce the likelihood of being dominated in six-year sequences by members appointed by a certain political force at the moment - as a result of the election – holding the majority of seats in parliament (Justification of CT judgement of TK of 24 November 2003: K 26/03).

In accordance with the original version of Art. 13 paragraph 7 of the Act on the NBP, the appointing authorities engaged in completing the composition of the MPC in the place vacated before the expiry of the term of office of a member of the MPC no later than 3 months from the dismissal or declaration of expiry of the mandate of a member of the MPC. An MPC member appointed in this mode was in office until the end of the term for which his predecessor was appointed. This objection was declared incompatible with Art. 227 paragraph 5 of the Constitution by the Constitutional Tribunal. The Constitutional Tribunal concluded that Art. 227 paragraph 5 of the Constitution should be construed as establishing a 6-year individual term of particular persons composing MPC and the introduction by way of statute of solutions shortening the term of office is incompatible with the constitutional provision. As a result of that CT judgment, Art. 13 paragraph 8 of the Act on the NBP was also repealed, according to which re-appointment to the MPC was possible in a situation where previous appointment occurred during the term of office for less than three years. The above quoted part of paragraph 7 and paragraph 8 of Art. 13 of the Act on the NBP constituted a normative sum. Therefore, the consequence of a declaration of unconstitutionality of the fragment of the challenged regulation, which was included in Art. 13 paragraph 7, was also the unconstitutionality of paragraph 8 in Art. 13 of the Act on the NBP (Judgement of the Constitutional Tribunal of 24 November 2003: K 26/03).

The Constitution settled the composition of the MPC, its Chairperson, who by the will of the legislator is always the President of the NBP and observing a certain kind of parity (Zubik, 2005: 37-52), because the MPC members - in equal numbers – are appointed by the following authorities explicitly mentioned in Art. 227 para. 5 of the Constitution: the President

of the Republic of Poland, the Sejm and the Senate. The purpose of this solution is to maintain a balance of powers facilitating preserving the apolitical nature of the MPC understood as independence from implementing a policy of only one authority in the state in which the majority is held by members of a particular political party (Banaszak, 2008: 721-722). The provisions of the Constitution do not specify, however, the composition of the MPC in terms of quantity, i.e. how many members besides the President of the NBP should there be in this body. They are confined only to the determination of the abovementioned parity, detailing of which was left to the legislature. According to Art. 227 para. 7 of the Constitution the organization and principles of operation of the NBP and the detailed rules for the appointment and dismissal of the bodies were established by the Act.

In accordance with Art. 13 of the Act on the NBP the MPC is composed of: its Chairperson, who is the President of the NBP and 9 members appointed in equal numbers by the President of the Republic of Poland, the Sejm and the Senate, from amongst specialists in the field of finance. The appointment of new Council members should take place no later than on the day the term of office of the previous members expires. Used both in the content of the constitutional provisions and in the Act, the word "appointment" means an official decision on naming (selecting) a person to perform a certain function (their designation, Dubisz, 2003: 786). This appointment cannot be understood as "the establishment of an employment relationship from the appointment" (Piłat et al, 2004: 181-190). Subordination of a worker to management of the employer means an obligation to comply with the instructions of seniors relating to the organization and conduct of work. Such an element does not occur in relations between the members of the MPC and the President of the NBP. MPC members do not have specific duties assigned personally to them. The Chairperson of the MPC, in turn, cannot order them an individual performance of specific tasks or jobs. The position of the Chairperson of the MPC is in no way superior to other members of the MPC. The President of the NBP only features

as an organizer of a group of people having to perform duties defined statutorily and within statutory deadlines (Judgement of the Court of Appeal in Warsaw of 4 December 2003: III APa 83/03).

Art. 13 of the Act on the NBP also defined the conditions for dismissal of a member of the MPC. The catalogue of these premises is closed (Mikos, 2006: 93), as determined by its preceding phrase "solely in the event of". The right of dismissing MPC members is granted to the same authorities that are entitled to their appointment. A dismissal of an MPC member before the end of the 6-year term of office takes place solely in the event of: resignation of a member of the MPC, illness permanently preventing the performance of his/her responsibilities, a conviction of a criminal offence under a legally binding court sentence, his or her submitting an untrue vetting statement, as pronounced by a binding court ruling; failing to suspend for the term of office his/her activity in political party or a trade union by an MPC member who is a member of a political party or trade union (during term of office an MPC member cannot hold any other positions or engage in profit-gaining or public activity other than academic work, teaching or writing, however, with the consent of the MPC expressed by way of resolution (without the participation of the person concerned) a member's engagement in the activities of international organisations is permitted). In the event of death of a member of the MPC, the appointing body declares the expiry of his mandate. The appointing authorities shall carry out completion of the composition of the MPC in the place vacated due to reasons set out above no later than three months of the dismissal or declaration of the expiry of the mandate of a member of the MPC.

MPC members are not employees of the NBP, which may by suggested by the use by the legislator in the Act on the NBP of separate terms: "NBP staff"; "Council members" and "consultative and advisory bodies." In accordance with Art. 14 paragraph 3 of the Act on the NBP, MPC members are entitled to remuneration equivalent to that of the NBP Vice Presidents. Such remuneration is also due for a period of three months following the expiry of the term of office, except where the reason for the dismissal of the member is a conviction of a criminal offence under a legally binding judgment of a court.

In accordance with Art. 15 of the Act on the NBP, Vice-Presidents of the NBP participate in MPC meetings, without the right to vote. In addition, upon consent of the MPC, the following may be invited by the Chairperson of the MPC: other members of the Management Board of the NBP and NBP staff competent in the matters on the agenda of the meeting. External experts may also be invited by the Chairperson of the MPC to its meetings, upon consent of the MPC, to present opinions (cf.: § 5 of the MPC resolution of 15 February 2011 on the By-Laws of the Monetary Policy Council).

2.2 Tasks of the Monetary Policy Council

The MPC's tasks were listed in a general manner in Art. 227 para. 6 of the Constitution (Dziekański, 2007: 124-134). Under this provision, the MPC annually formulates the aims of monetary policy and presents them to the Sejm at the same time as the submission of the Council of Ministers' draft Budget. Within 5 months following the end of the fiscal year, the Council for Monetary Policy submits to the Sejm a report on the achievement of the purposes of monetary policy. The doctrine recognizes that setting monetary policy aims is the primary task (function) of the MPC (Szymanek, 2010: 9). The monetary policy guidelines present the basic elements of the monetary policy strategy implemented by the Polish National Bank's, as well as the outline of macroeconomic factors that may affect this policy in a given year. In addition, monetary policy guidelines include a description of monetary policy instruments (cf.: e.g. MPC resolution of 3 September 2013 on formulating monetary policy guidelines for 2014).

After 2008, i.e. since the onset of the phenomenon of the global financial crisis, a partial modification of views on the appropriate way to conduct macroeconomic policy has been made. The central bank more flexibly than ever uses the inflation targeting strategy and incorporates a macro-prudential policy towards the catalogue of instruments of stabilization policy. The experience of the global financial crisis and prolonged recession in many countries have shown that stabilization of inflation is a very important, but not sufficient condition to maintain a balance in the economy. That is why central banks more and more often allow longer periods of deviation

of inflation from the target, if it supports macroeconomic stability. Greater flexibility of inflation targeting also justifies the growing influence of international capital flows on domestic economic processes. It was considered that macro-prudential policy, in addition to monetary policy, is an important instrument of counter-cyclical policy. The use of this instrument stems from the belief that in addition to classical business cycles, the stabilizing of which is usually the job of a monetary policy, are also longer cycles in the economy, the stabilization of which should be dealt with by macro-prudential policy. The central bank's playing a key role in the macro-prudential policy is supported by its experience in analysing the economic situation from the macroeconomic perspective, as well as its independence enabling making decisions which may limit economic activity in the short run, but they are necessary for the maintenance of macroeconomic equilibrium in the long run.

In accordance with Art. 53 of the Act on the NBP the monetary policy guidelines, the report on the implementation of the monetary policy guidelines and normative acts of the NBP bodies (with the exception of acts of NBP bodies on the functioning of banks and the balance sheet and profit and loss account of the NBP) are be published in the Official Gazette of the Republic of Poland "Polish Monitor" (*Dziennik Urzędowy Rzeczypospolitej Polskiej "Monitor Polski"*).

Monetary policy guidelines are the basis for the exercise by the MPC of specific tasks listed in Art. 12 paragraph 2 of the Act on the NBP. The catalogue of these tasks has an open character, because it was preceded by the phrase "in particular". It includes: setting the NBP interest rates; setting the minimum reserve requirement ratio for banks and credit unions and setting the remuneration rate thereon; setting ceilings on the liabilities arising from the NBP borrowings from foreign banking and financial institutions; approving the NBP financial plan and the report on the activity of the NBP; accepting the annual financial statements of the NBP. The Council shall assess the activity of the NBP Management Board in terms of implementation of the monetary policy. Against the background of the analysis of these tasks one can conclude the dual nature of the MPC (Machelski, 2009: 56-68). It performs both the function of the supervisory board in the central bank

in relation to the executive body, i.e. the NBP Management Board, as well as the function of a particular organ of the state in the sphere of its monetary policy, the effects of which relate to entities located outside the central bank (Knosala et al, 2008: 55-89). There is a view expressed in the literature, according to which the MPC is the supreme organ of state administration (Stasikowski, 2007: 00-123).

The monetary policy guidelines play an important role in the relationship between the NBP and the state authorities. In accordance with Art. 21 of the Act on the NBP, in carrying out its tasks the NBP collaborates with the competent State bodies with regard to developing and implementing the state economic policy, striving at the same time to ensure the proper implementation of monetary policy guidelines, in particular:

a) it submits the monetary policy guidelines as well as reports on the implementation of monetary policy and on the situation within the banking system to State bodies,
b) it collaborates with the Minister of Finance in developing financial plans of the State,
c) it presents its opinion on draft legislation relating to economic policy,
d) it presents its opinion on draft laws concerning the activity of banks and draft legislation of significance to the banking system.

The significant difference between the provisions of Art. 227 para. 6 of the Constitution and the provision of Art. 21 paragraph 1 of the Act on the NBP is pronounced. In the Constitution the obligation to submit monetary policy guidelines to the information of the Sejm is addressed directly to the Monetary Policy Council, whereas in the Act on the NBP, the same obligation rests with the NBP and not its specifically indicated body, i.e. the MPC. Submitting to State authorities, and thus also the Sejm, monetary policy guidelines forms, in light of the provisions of the Act, responsibilities of the NBP. The legislature, therefore, does not indicate in this provision which of the NBP bodies should perform this duty.

Art. 23 paragraph 1 point 2 of the Act on the NBP establishes, in turn, that the President of the NBP – on behalf of the MPC – provides the Council of Ministers and the Minister of Finance with draft monetary policy guidelines, opinions on the Draft Budget Act, balance of payments forecasts

and the MPC's decisions. It is not specified though, for what purpose are the monetary policy guidelines submitted by the President of the NBP to the authorities of government administration. It should be emphasized that, in the light of Art. 227 of the Constitution, in the performance of its tasks, the NBP is independent of the legislative authorities. The Monetary Policy Council - as one of the bodies of the NBP – decides independently on the annual monetary policy guidelines and submits them to the Sejm only for information purposes (Bałaban, 2001: 79-84; Tupin, 2001: 84-93; Oniszczuk, 2000: 18-30) and not for approval, at the same time as the submission by the Council of Ministers of the draft budget, as well as submits to the Sejm a report on the achievement of purposes of monetary policy. The Sejm therefore receives a final document in the form of a resolution of the MPC on monetary policy guidelines.

In accordance with Art. 24 of the Act on the NBP, the central bank implements currency policy laid down by the Council of Ministers in consultation with the Monetary Policy Council. The principles for setting the exchange rate of the zloty against foreign currencies are laid down by the Council of Ministers in consultation with the MPC, while the NBP announces current foreign exchange rates and rates for other types of foreign exchange values.

In the framework of applicable instruments of monetary policy, the legislature granted special powers to the Monetary Policy Council, which on the basis of Art. 46 of the Act on the NBP - should the implementation of monetary policy be jeopardised - may by way of a resolution introduce:

a) restrictions on the volume of funds granted to loan takers and borrowers by banks,
b) the requirement of holding non-interest-bearing deposits with the NBP against foreign funds used by banks and domestic entrepreneurs.

The scope of competence of the MPC also includes principles for creating and releasing NBP reserves to cover the risk of the exchange rate of zloty against foreign currencies (MPC Resolution No. 12/2010 RPP of 14 December 2010 on the principles for creating and reversing a provision for the risk of changes in the exchange rates of the Polish zloty

at the National Bank of Poland). The amount of this reserve is estimated based on the generally accepted and consistently applied by the NBP methods of estimating financial risk. It is created as an expense and may not bring about a negative financial result for the NBP for the current year. The reserve is used only to cover unrealized costs resulting from changes in the exchange rate of zloty against foreign currencies in the amount that would result in a loss.

In addition, the MPC prescribes the NBP's accounting rules, a sample balance sheet, profit and loss account and the contents of additional information, and also selects the auditor who examines the annual financial statements of the NBP.

Relations between the MPC and the Management Board of the NBP indicate a classical division of roles in which the MPC performs the function of the supervisory board in the central bank, while the NBP Management Board acts as the executive body (Zięba – Załucka, 2000: 46-57). In accordance with Art. 17 of the Act on the NBP, the NBP Management Board implements resolutions of the MPC, as well as prepares and examines draft resolutions and other materials to be submitted to the MPC. Detailed reports in this regard stem from provisions of by-laws of the NBP Management Board (The NBP Management Board resolution of 24 September 2013 on the By-Laws of the Management Board of the National Bank of Poland). Sessions of the NBP Management Board are held not less often than once every two weeks, according to the meetings schedule approved by the NBP Management Board, which is determined taking into account the dates of meetings of the Monetary Policy Council. The NBP meetings' minutes that are public or those labelled with a "classified" clause are given to members of the Monetary Policy Council in the scope of draft resolutions and other materials. These drafts addressed to a session of the Monetary Policy Council are examined first by the Management Board of the NBP. The opinion of the Management Board of the NBP in these cases is presented at a session of the Monetary Policy Council by the President of the Management Board of the NBP or a member of the Management Board of the NBP individually indicated by him on each occasion. The Monetary Policy Council may request at the NBP Management Board:

a) commissioning the preparation by a third party of a specific study concerning the subject-matter of the work of the MPC,
b) examination of the draft resolution or other material presented at the MPC meeting by a member of the MPC that was not previously examined by the NBP Management Board in the time frame allowing for the examination by the MPC of the draft resolution or other material at the next meeting of the Council,

c) preparation of certain other analysis and information materials concerning the subject-matter of the work of the MPC.

The NBP Management Board submits the tasks determined by the Monetary Policy Council for the NBP for the implementation of the relevant departments and organisational units in the central bank.

2.3 Mode and forms of operation of the Monetary Policy Council

In accordance with Art. 16 of the Act on the NBP, the Monetary Policy Council meetings are convened by its chairperson at least once a month. An MPC meeting may also be convened at a written request of at least three members of the MPC. In the absence of the Chairperson of the MPC the meeting is presided over by one of its members. Vice-Presidents of the NBP participate in MPC meetings, without the right to vote. Upon consent of the MPC, the following may be invited by the Chairperson of the MPC: other members of the Management Board of the NBP and NBP staff competent in the matters on the agenda of the meeting as well as external experts for the purpose of presenting opinions.

The mode of operation of the MPC and of the election of the member who presides at the proceedings in the absence of the Chairperson of the MPC is defined in the by-laws adopted by the MPC by a majority vote. MPC rulings are made in the form of resolutions adopted by a majority vote in the presence of at least five members, including the Chairperson of the MPC. In the event of a tied vote, the Chairperson of the MPC has a casting vote. When voting on resolutions, the MPC members may vote “for” or “against”. There is not possibility to “refrain” from taking a particular position. The President and members of the MPC have the right

to submit a dissenting opinion if they do not agree with the contents of the adopted resolution. The MPC resolutions signed by the Chairperson and all MPC members taking part in the voting.

A literal interpretation of the phrase "resolution of the Monetary Policy Council", referring to individual MPC resolutions provided in the laws may lead to the conclusion that the term "resolution" can denote:

a) a normative act addressed to entities of the banking law with the purpose of implementation and enforcement - for example, resolutions on banks' reserve requirement and remuneration on it,
b) a planning act - for example, resolutions relating to monetary policy guidelines,
c) communication addressed to all stakeholders - for example, resolutions on interest rates of the National Bank of Poland which present specific figures (Lefik, 2012: 144).

Positions taken by the MPC members in voting are announced in the Court and Economic Monitor (*Monitor Sądowy i Gospodarczy*) after 6 weeks, but no later than three months from the date of adoption of the resolution. Within the deadlines set by the MPC, its Chairperson or the person presiding over a meeting, with the participation of two members of the MPC, submits to the mass media a communication about the arrangements made at the session. The MPC members may provide information to the media about basic findings made by the MPC.

3 Conclusion

The special status of the Monetary Policy Council is provided by the way of regulating its legal position and basic tasks and forms of operation directly in the Constitution. The legal status of the MPC is the result of the special position of the NBP, including its heavily accented independence (Kozłowska, 2010: 260-261). Bodies of the NBP, including the MPC, are tenure bodies, and therefore their revocation or dismissal is not possible without good reason. The relatively long duration of their term of office (6 years) allows the running of a stable monetary policy, independent from the political situation (Bałaban, 2002: 344).

Specific tasks fall to the MPC in the sphere of monetary policy of the state. Arrangements made by this authority produce certain effects of a macroeconomic dimension. The primary objectives adopted in the monetary policy guidelines set annually by the MPC should serve the implementation of the constitutional objective formulated in Art. 227 para. 1 of the Constitution. In light of this provision, the National Bank of Poland is responsible for the value of Polish currency, and according to the Act on the NBP the basic objective of NBP activity is to maintain price stability while supporting the economic policy of the Government, insofar as this does not restrict the basic objective of the NBP.

Equipping the NBP, including the MPC, with the power to exercise legally defined instruments of monetary policy is a guarantee of implementation of the adopted monetary policy guidelines. The most important instruments of the monetary policy of the central bank in this respect include: setting interest rates of the central bank, conducting open market operations, determining the level of reserve requirements ratio for the reserves created by banks, the possibility of conducting deposit-credit operations and foreign exchange intervention. An important element in the process of implementation of the monetary policy is the central bank's communication with its surroundings. Within its framework, the MPC presents its assessment of the current state of the economy and future economic developments. The most important instruments in the sphere of communication is information following the MPC sessions and press conferences following the sessions of the MPC, as well as descriptions of the discussion of a decision-making meeting of the MPC, results of the voting of MPC members, reports on inflation, monetary policy guidelines and reports on the implementation of the monetary policy.

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PRIVATE LEGAL AND PUBLIC LEGAL INTERACTION OF THE FINANCIAL MARKET LEGISLATION[1]

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Abstract

In this article the status of the financial market legislation in the legal system is considered. The focus is placed on its dynamic development, interconnections to the areas of the private law and public law and the resulting interdisciplinarity. In conclusion it also indicates pedagogic relations of these interactions.

Key words

Financial market; financial market legislation.

JEL Classification

G10, G18, K20

1 Introduction

It is perhaps no secret that the financial market legislation as it is understood today, is under our conditions a product of historical development of social and economic relations of the last quarter of the century. Surely, even in earlier periods we had banks and insurance companies that were active on our territory. The central planning economic system did not, however, offer a space for activities of other participants on the financial market, or for the dynamic development of trading with the financial market instruments as it was evidenced in more than two past decades. The objective of this article is to identify the nature of legislation in the field of financial market,

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to clarify its private legal and public legal interactions, and against this background to specify the problem issues in the teaching of the financial market legislation.

2 Financial market

The financial market, just as any market, is a place where the supply faces certain demand resulting in a price. The commodities marketed on financial markets are individual financial market instruments and several types of participants are involved in this trading.

The first type of participants are the persons who are short of resources (money in any form). These participants come to the financial market with the objective to acquire necessary resources at the lowest possible costs. As acquirers they become also the debtors with obligation to pay back the resources acquired in this way, but at the same time we have to keep in mind that they are frequently debtors in order to apply their newly available resources for the achievement of the profit. These persons may be designated as the so called deficit units and they may be the governments, municipalities and other public legal participants (institutions), as well as legal or physical persons. The important criteria that are taken into account by the deficit units when looking for available resources are the costs of these resources and the time period for which the deficit units acquire the respective resources (Veselá, 2011:21).

The second type of the participants are the persons that have at their disposal temporarily and/or permanently available free resources (money). These persons, also called the excess resources units, come to the financial markets with the objective to invest these resources effectively and profitably. As a result they become creditors. Profitability may be considered as immanent feature of trading on the financial markets, frequently referred to in the literature as actually materially motivated purchase and sale of money (Liška, Gazda, 2004:29). The excess resources units ready and capable to lend their free resources to deficit units are e.g. physical persons (households), legal entities (investment companies and other business entities) and banks that are the decisive group of the excess resources units.

The essential criteria of the excess resources units when placing their free resources on the market is especially the profitability and the level of risk that is as a rule balanced with the guarantees provided by the debtor or the third person.

The third type of participants that are involved in the trading on the financial markets are the financial intermediaries. Their main role is to secure effective, economic and safe flow of free financial resources from the surplus units (investors, creditors) to deficit units (interested parties, debtors). The objective of their inclusion in the trading is motivated by security function and the increase of the legal security of creditors that the lent or invested resources would be repaid.

The trading on the financial markets is implemented voluntarily while respecting the basic principle of the contractual freedom, i.e. the agreement of the participants in the contents of the business, or about the mutual rights and obligations that the trading brings about. The contractual freedom in the area of the financial market legislation is not and cannot be absolute. The requirement of a safe functioning of the financial market and of its stability as well as the requirement concerning protection of the involved participants (the excess resources units as well as the deficit units) necessitates the need of a certain legal regulation of the contractual relations that come into being and are implemented on the basis of these legal regulations representing the sources of the financial market legislation (Babčák et al., 2012: 68 and seq.).

As a result the financial market may be defined as the system of relations, instruments, participants and institutions enabling accumulation, distribution and placement of temporarily available financial resources on the basis of supply and demand (Bakeš et al., 2006: 107).

As a result the basic function of the financial markets is to secure through the financial intermediaries the transfer of financial resources between individual economic entities.

3 The objective of the financial market legislation

The financial law as the traditional legal branch is usually classified in the specialized literature as one sections of the public law (Knapp, 1995: 68). It is typical for the public law (and consequently also for the financial law) that the public legal methods of regulations of the legal relations prevail based on the superior position of one participant of the legal relationship as compared with the other participant. The legal relationships that come into being on the financial market are of mixed nature – they involve both **public legal** as well as **private legal elements**. This fact has an impact on the inclusion of the financial market legislation under a certain legal branch. In recent years the financial legal science includes the financial market legislation in the subsystems of a special part of the financial law (Bakeš et al, 2006: 13). However also opinions appear that the development would lead to full liberation of the financial market legislation from its subjection to the financial law (Králik, Jakubovič, 2004: 116), which has to do especially with the special features of the legal regulation objective.

The financial law objective are the social and economic relations (money relations) that are directly or indirectly related to creation, distribution and use of government and other public financial funds specified to cover the financial needs of the government and of other public legal entities.

The objective of the financial market legislation regulation are, however, the social and economic relations that are related to the existence of the financial market instruments, to the system of the financial market participants and to the financial market regulation.

The simplified view of the relevant issue indicates that the legal regulation of the instruments and of participants on the financial market would be characterised by the methods of private legal regulations, and, therefore, it would be a part of the private law, while the financial market regulation would be more likely of a public legal nature. It follows from this point of view that the financial market legislation is in many respects close especially to the business law that regulates a whole series of financial market

instruments and specifies also the basic assumptions and conditions for doing business by the financial market participants more closely specified by special regulations as sources of the financial market legislation.

3.1 Private legal interactions of the financial market legislation

Private legal element of the financial market legislation is related to the legal regulation of the financial market instruments and participants. Considering its interrelationship with the business and businesses activities it is only natural that the decisive role would be played especially by the business law standards.

As already indicated the objective of the financial markets is to facilitate the transfer of financial resources between the individual economic participants. The first category of the financial market participants includes the persons with excess funds who wish to invest these resources and achieve profit on the financial market. These persons may be simply designated as investors, or creditors. The second category of financial market participants are the persons in need of financial resources and come to the financial markets for their acquisition. These persons may be simply designated as debtors.

There is a third entity entering between these two categories of participants and is designated as a financial intermediary whose role is to mediate the financial resources flow between the individual economic participants. The financial intermediary actually borrows money from creditors and lends them to the debtors (Balko - Babčák, 2006: 610).

The traditional financial market participants include especially the banks and the subsidiaries of foreign banks, insurance companies and subsidiaries of foreign insurance companies. Other participants on the financial market are for example the stock exchange, contract saving banks, retirement pension funds, asset management companies or businesses trading with securities.

The Commercial Code specifies the rules for incorporation, formation and dissolution of business companies that are among the major group of these participants acting on the financial markets as financial intermediaries. Apart

from these rules the Commercial Code also regulates their organizational and legal base, method of actions and decision making by their bodies, as well as property and legal standing of their partners.

A special regulation is in force for several groups of financial intermediaries from the point of view of the legal form of their activities. The banks may remain active as public limited companies, the insurance companies as public limited companies, or eventually as European companies, and the stock exchange is ex lege also a public limited company.

Legal regulation contained in the Commercial Code is, therefore, applicable also to legal existence, activities and business of these legal entities. Later it will be shown that the essence and especially the possible risks of doing business on the financial market necessitated that the position and activities of financial intermediaries are limited by other legal conditions where the public legal elements of regulation would dominate the framework of business legal regulation.

In the same way as far as the existence of the financial market instruments is concerned, considering the contractual freedom for doing business with them, the basics of regulation are also to be found in the private law standards.

Financial market legal instruments are the objects of trading in individual financial markets, or the objects that motivate individual economic entities to enter the respective financial markets. The literature considers them to be representatives that embody funds supplied and demanded on the financial market (Bakeš et al., 2006: 583). Other authors designate the financial market instruments as the mechanism for acquisition of funds and their effective economic use to the benefit of the owners (Balko, Babčák, 2006: 584).

The financial market instruments include short-term securities (e.g. treasury bills, deposit certificates, bills of exchange, cheques), as well as credits (consumer, non-specific, bridge credits etc.)

The capital market instruments include credit securities (e.g. bonds, mortgage bonds) and property securities (shares).

Current and effective legal regulation defines security as an entry conforming legal regulation and form that can be valued in money that involve rights

subject to the Securities and Investment Services Act and the rights subject to special laws, especially the authorization to request certain property benefits or to apply certain rights from persons specified by law.

The system of securities include shares, temporary certificate, share certificates, bonds, deposit certificates, treasury bills, deposit books, coupons, bills of exchange, cheques, travellers cheques, bills of lading, storage certificates, storage bonds, commodity bonds, cooperative share certificates, investment certificates, other types of certificates designated as securities by a special act.

The principles of legal regulations of these instruments can be found primarily in the private legal standards. The objective of this article is to provide brief overview of some significant types of securities.

The shares and temporary certificates as securities are some of the central concepts of the Commercial Code in its treatment of the public limited companies. The share from the point of view of its legal specification represents the right of the shareholder as the partner to have a share in the management of the company, in the profit and liquidation balance in case of dissolution of the company on the basis of liquidation that are related to the share as a security, unless differently specified by law. The temporary certificate is an inscribed security involving rights related to a share that is replaced by the respective temporary certificate, and the obligation to pay their issue rate. The company would replace the temporary certificate of the shareholder for shares after the nominal value of the share represented by the temporary certificate is paid.

The share certificates are regulated by the Collective Investment Act. The share certificate is a security involving the right of the shareholder for the relevant share in the property in the share fund and the right to share earnings from this property.

The bond is a security representing the right of the owner to request repayment of the owed sum in the nominal value as well as the payment of earnings from the bond by a specific date and the duty of the person authorized

to issue bonds (the issuer) to meet its obligations. The Bonds Act regulates also the mortgage bonds, government bonds, communal bonds and employees bonds as special types of bonds.

Treasury bond is a security with the maximum repayment period of one year from the date of its issue. The treasury bond confirms the right of the treasury bond owner to request the repayment of the nominal value of the treasury bond upon its maturity.

The deposit books and deposit certificates are regulated by the Civil Code. The deposit book is a confirmation in writing from a bank or a subsidiary of a foreign bank that the deposit was accepted as a security with the right of the depositor to have deposit withdrawn from the bank or the subsidiary of the foreign bank. The deposit certificate as a security is a confirmation of a bank or of a subsidiary of a foreign bank regarding fixed single deposit.

The bill of exchange and the cheque are securities regulated by the Bill and Cheque Act and they have special significance in the payment, credit and guarantee relations of the market economy. The bill of exchange is a special document giving right to the legal owner to pay outstanding debt in the amount indicated in the respective document. The bill of exchange owner may exercise its title for the payment from the person issuing and signing this binding document. The cheque contains unconditional order to pay certain amount of money. The cheque is issued for the bank in which the issuer of the cheque has a credit and according to the explicit or implicit agreement the issuer is entitled to use this credit at its option.

The system of the financial market instruments also includes the credit defined by legal regulation as a temporary provision of funds in any form including factoring and forfaiting. The credit agreement is regulated in more details in the Commercial Code as an independent type of the contract. The credit agreement is a commercial relationship of the so-called absolute business category that is regulated by the provisions of the Commercial Code irrespective of the nature of the parties to the credit agreement. The banks and the subsidiaries of foreign banks extend credits as the main objective of their activities, even though it needs to be said that in recent years in the Slovak Republic and elsewhere there was striking growth of other entities (non-banking) that also extend credits, but unlike in case of banks,

these credits of non-banking institutions are from their own resources. According to the current legal regulation only a bank on the basis of its license may accept deposits and extend credits from these deposits.

The system of financial market instruments was in the recent past supplemented by the consumer credit which means temporary provision of funding on the basis of the consumer credit agreement in the form of a loan, credit, deferred payment or similar financial facility provided to the consumer by the creditor.

The typical feature of the financial market instruments is the fact that trading takes place on a contractual basis where the mutual position of the parties in trading does not involve subordination but is based rather on equality. Surely the economic power of the bank and its client is in its essence incomparable. However, for the conclusion of any business involving any financial market instrument necessitates consensus of the parties on conclusion of the business and about the essential provisions of the relevant contract.

3.2 Public legal interaction of the law on financial market

Public legal regulation of instruments as well as of the participants on the financial market which amends and completes the private legal level is not without wider impact. The volume of funds traded on financial markets is so high that it necessitated emergence and existence of instruments and institutions with the objective to protect the parties of this market. From the historical perspective it is obvious that the crisis even on a local financial market may result in serious consequences. The world depressions caused by the collapse of financial markets or of any of its participants with extraordinarily grave consequences do not need any special mention at this point.

The basic objectives of the legal regulation of the financial markets may be seen especially in the endeavour to create legal environment that would secure proper and safe functioning of the financial markets, that would lead to stability of the financial system as a whole and that would at the same time ensure effective and efficient protection of rights and legally protected interests of the parties whose relations are regulated by standards of the financial market legislations.

Related to this appears the full effect of the regulative function of the financial legislation. The decisive public legal element in the financial market regulation appears to be the supervision done on the national level by the National Bank of Slovakia (NBS) and on the European level the role of the direct supervision over the major credit institutions[3] would be assumed in the near future by the European Central Bank (ECB)[4].

The integrated supervision over the financial market is currently done exclusively by the NBS in following four basic fields: banking, capital market, insurance business and retirement pension saving.

In the field of banking the participants under supervision are primarily the banks, the subsidiaries of foreign banks, the Deposit Protection Fund, electronic money institutions and the subsidiaries of foreign electronic money institutions.

In the field of the insurance business the participants under supervision include insurance companies, reinsurance companies of the foreign insurance companies, subsidiaries of foreign reinsurance companies, Slovak Office of Insurance Brokers (Slovenská kancelária poisťovateľov), financial agents, financial consultants,

In the field of capital market the participants under supervision are the securities traders, subsidiaries of the foreign securities traders, Investment Guarantee Fund, stock exchange, central depository of securities, subsidiaries of the foreign asset management companies, share funds, foreign participants of collective investing.

In the field of retirement pension saving the participants under supervision are retirement pension savings management companies, retirement savings funds, supplementary retirement pension companies and supplementary retirement pension funds.

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3 According to the current, even if preliminary list of significant credit institution published by the European Central Bank, three Slovak banks would be subject to ECB supervision: Slovenská sporiteľňa, a.s., Tatra banka, a.s., and Všeobecná úverová banka, a.s

4 GOVERNMENT REGULATION (EU) No. 1024/2013 of 15 October 2013, by which the European Central Bank is entrusted by special tasks related to the policy of prudential supervision over the credit institutions.

The NBS implements various activities as a part of the supervision of the financial market. As a part of its primary supervisory and decision making activities the NBS

1. specifies the rules of prudential business, rules of safe operation and other requirements related to business activities of the participants under supervision;
2. supervises the adherence to the legal regulations and to other generally binding legal regulations related to the participants under supervision or their activities, as well as the adherence to legally binding acts of the EU that are related to the participants under supervision or to the activities if specified in these legally binding acts;
3. is in charge of the proceedings, grants licences, approvals and preceding approvals, imposes sanctions an remedies, issues other resolutions, opinions, methodological regulations and recommendations subject to the law, and monitors fulfilment of its decisions including adherence to the conditions specified in these resolutions;
4. exercises in situ and remote supervision of the participants under its supervision.

There is no reasonable doubt about the public legal essence of these financial legal standards that regulate the area of supervision under the NBS. As a matter of fact the NBS is in the relationship to the supervised participants in the superior position that can also make decisions or impose sanctions.

The NBS can influence the start of business activities of these participants (i.e. their operation in the financial market) in that as a part of individual decision making power it issues the licences that authorize regulated activities in this area, such as banking licences, license for insurance activities etc.

During the implementation of the regulated activities the NBS supervises fulfilment of the legal assumptions and conditions; it evaluates the organization of management, creation of reserves, or coverage of possible risks. It is authorized to impose upon the supervised participants the remedies, even such as compulsory administration and sanctions (especially fines).

In conclusion we wish to point out that the decisions of the NBS do not relate only to start of implementation of the regulated activities of the supervised participants but also to termination of their activities in the financial

market. The NBS is namely authorised in cases specified by law to withhold the license for implementation of the regulated activities either on obligatory or facultative basis.

3.3 Closing reflections and pedagogic consequences of the indicated interactions of the financial market legislation

Every scientific work resulting in the article should naturally contain some conclusions. As already indicated the hybrid nature of the financial market legislation cannot be disputed. Trading on financial markets is based on the contractual freedom and on the freedom of choice of the parties whether, or under what condition they conclude the relevant business. At the same time there is a strong public legal aspect determining relative narrow scope of participants that are active on the financial market and implement regulated activities under the supervision of the NBS. The NBS and since November 2014 also ECB in relationship to the major banks within the system also act as imaginary guardians of the safety and of the rule of law in trading on financial markets and their legal authorizations are at the base of their fulfilment of the defined objectives of the supervision.

For the practising academicians the considerations concerning the pedagogic consequences of the mixed nature of the financial market standards should also be of essence. At our home Faculty of Law the teaching of individual instruments of the financial market is from the pedagogic point of view included in the curricula of other courses such as financial law (especially commercial law, civil law, bills of exchange and cheques law, securities law). The courses on the commercial law include also the basics on business of commercial companies active on the financial market.

More precise characterisation of these participants including their legal specifics and the complex of relations as a result of the regulation of their business activities are the contents of teaching of the financial law courses. The courses on financial law also include the teaching of the financial market supervision on the national and European level.

Surely there are those that are in favour of such organization of teaching of financial market legislation, but at the same time we can imagine also a different model. This model could be (probably) based on the optional course

that would with its complexity cover the issues of the financial market legislation. Personally I would prefer the combined teaching of the issues under question where the findings from the private law would be combined with the findings of its public counterpart. This model would necessitate also suitable timing and continuity with the contents covered in the past which is unfortunately not always respected.

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JUDICIAL REVIEW OF DECISIONS BY THE POLISH FINANCIAL SUPERVISION AUTHORITY[1]

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Abstract

The focus of this article is a discussion of the model of judicial review applied in Poland as pertains to decisions issued by the authority responsible for oversight of the financial market – the Polish Financial Supervision Authority (PFSA). One of its objectives is to illustrate the manner of proceedings before the PFSA, including an attempt to answer the question of whether the principle of two-tiered administrative proceedings is adhered to in respect proceedings by and before that body. In addition, this paper includes an analysis of jurisprudence from Polish administrative courts (provincial administrative courts in the first instance and the Supreme Administrative Court in the second instance) hearing appeals against decisions issued by the PFSA in 2012-2013, with the objective of portraying application of the law in practice.

Key words

Polish Financial Supervision Authority; oversight of the financial market; banks and insurance supervision; capital market supervision; payment institution supervision; credit union supervision.

JEL Classification

G10, K42, G18

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1 Introduction

The Polish Financial Supervision Authority was commissioned under the Financial Market Supervision Act of 21 July 2006 Dz.U. 2012, item 1149 with amendments; hereinafter FMSA. In the view of the legislator, the necessity of introducing integrated supervision resulted from the necessity of adapting national regulations to the requirements of EU legislation (Directive 2002/87/EC of the European Parliament and of the Council of 16 December 2002 on the supplementary supervision of credit institutions, insurance undertakings and investment firms in a financial conglomerate). The Financial Supervision Authority replaced several entities previously responsible for oversight of the Polish financial market (Insurance and Pension Fund Supervision Authority, Securities and Exchange Supervision Authority, Bank Supervision Authority), which were liquidated. Supervision of the financial market encompasses bank supervision, pensions supervision, insurance supervision, capital market supervision, payment institution supervision, ratings institution supervision, complimentary supervision and credit union supervision (Art. 1(2) FMSA).

The legal character of the PFSA is controversial, owing to the absence of an explicit statutory provision assigning the PFSA a place among other public institutions, a structure, and a mode for appointing members of the organ itself (Dyl M.: Środki nadzoru na rynku kapitałowym, Warsaw 2012, s. 96 – T. Nieborak, in: Ustawa o nadzorze nad rynkiem kapitałowym. Komentarz, T. Nieborak, T. Sójka (eds.), pp. 67 – 69). The Constitutional Tribunal has ruled that, given the shape of statutory regulation, the PFSA is a special public administration body with a high degree of independence, situated outside the structure of governmental administration, which results inter alia from the fact that PFSA members are nominated by various segments of the executive branch (the Council of Ministers, President, National Bank of Poland) (Verdict of 15 June 2011, K 2/09) Controversies surrounding the verdict are discussed by M. Dyl, *Środki*, pp. 97-98. The PFSA is undoubtedly a central authority of public administration (A central organ is one whose jurisdiction encompasses the entire territory of the state, *Prawo administracyjne. Część ogólna*, Toruń 1997, p. 156).

Oversight of the PFSA's activities is exercised by the Prime Minister (Art. 3(3) FMSA). The absence of any real oversight authority on the part of the Prime Minister, however, indicates that there is no hierarchical relationship of authority present between the PFSA and its supervising authority (Nieborak, *Status prawny Komisji Nadzoru Finansowego w świetle orzeczenia Trybunału Konstytucyjnego z dnia 15 czerwca 2011 r. (sygn.. K 2/09), w: Finanse publiczne i prawo finansowe. Realia i perspektywy zmian. Księga jubileuszowa dedykowana Profesorowi Eugeniuszowi Ruśkowskiemu*, ed. L. Etela, M. Tyniewickiego, Białystok 2012, p. 582). Indeed, the legislator has neglected to regulate the scope, criteria, means and form of such supervision. There are also no provisions in the Act that would render any other organ, not to mention the Prime Minister, as an authority of higher rank in relation to the Financial Supervision Authority (Supreme Administrative Court in Warsaw of 10 June 2011, II GSK 476/10ONSAiWSA 2012) , similarly, ruling of the Supreme Administrative Court in Warsaw of 30 August 2011, II GSK 1605/11, accessible at: http://orzeczenia.nsa.gov.pl.

In addition, the activity of the PFSA is subject to review by the Supreme Audit Office pursuant to the Act of 23 December 194 on the Supreme Audit Office (Dz.U. 2012, item 82 w/amendments).

Among the legal forms of activity applied by the PFSA are resolutions, individual administrative acts, normative acts, registration activities and auditing activities. The legislator has expressis verbis vested administrative acts with the character of decisions and administrative rulings, stipulating that they are set out in other legislative provisions (Art. 11(1) FMSA). What should be kept in mind is that the manner in which juridical acts are undertaken is determined by the collegial structure of that organ. In particular, it is worth pointing out that decisions – unusually in the Polish legal system – are issued by a collective body, and then signed by one member of that organ indicated by statute. Resolutions and administrative decisions are not separate categories of acts undertaken by the Authority: a resolution of the Authority is at the same time an administrative decision (SAC verdict of 21 November 2013, II GSK 931/12). A resolution is adopted during a session of the Authority, and that resolution contains the grounds for the manner of resolving a given issue. A document containing the text

of the decision and substantiation is later delivered to the party concerned. Decisions of the Authority issued collectively are signed by the Chairman of the Authority (authorized Deputy). Except where specific regulations stipulate otherwise, proceedings conducted by and before the PFSA are governed by the provisions of the Code of Administrative Procedure of 14 June 1960 (Dz.U. 2013, item 267 w/amendments), hereinafter CAP.

2 Two-tiered administrative proceedings

One of the derivatives of the principle of a democratic state ruled by law expressed in Art. 2 of the Constitution of the Republic of Poland (Dz.U. no. 78 item 483 w/amendments), hereinafter the Polish Constitution, is the right to appeal against rulings and decisions issued in the first instance. This is one of the fundamental remedies for the protection of basic rights and freedoms. The principle of two-tiered administrative proceedings is doubtlessly a materialization of Art. 78 of the Polish Constitution, while at the same time an element of the principle of procedural justice. That principle is composed of two important elements: the duty of public authorities to provide a justification for their decisions, and the right of parties and participants in administrative proceedings to petition against decisions issued in the first instance as guaranteed in Art. 78 of the Polish Constitution (Constitutional Tribunal verdict of 14 June 2006, K 53/05, OTK ZU 2006, no. 6A, item 66). See A. Wróbel, *Komentarz do art. 15 Kodeksu postepowania administracyjnego, in: Kodeks postepowania administracyjnego. Komentarz*, M. Jaśkowska, A. Wróbel, Lex/el 2014). The principle of two-tiered administrative proceedings referred to in Art. 15 CAP sets out a rule that decisions which are not yet final may be challenged by a qualified entity submitting a petition to the public administration body of a higher degree above the body that issued the decision. The two-tiered principle ensures the possibility of exercising the right to the remedy that is an appeal to a higher authority against an administrative decision issued by an authority in the first instance (Art. 127 § 1 CAP). Review of administrative decisions in the administrative due course of instance is performed exclusively on the basis of a petition by a party to proceedings which takes the form

of submission of a standard appeal; the relevant appeals authority (organ of the second instance) may not act ex officio (Verdict of SAC in Warsaw of 25 May 1984, II SA 2048/83, ONSA 1984, no. 1, item 51).

The two-tiered principle is, however, subject to limitations set forth in Art. 127 CAP, as well as in other legislation. Derogation from the principle of two-tiered administrative proceedings, or the introduction of another legal remedy, may only be effected by way of statute and must be explicit and unambiguous. One such particular provision is contained in Art. 11(6) FMSA, which declares that "Except where specific regulations stipulate otherwise, Art. 127(3) of the Code of Administrative Procedure of 14 June 1960 shall apply accordingly to the PFSA's decisions." When the use of appeal as a remedy is not possible owing to the legal construction of a given situation, it is possible to apply a legal remedy not involving devolution: a petition for reconsideration of a matter. The ratio legis of this legal remedy in the Polish legal regime stems from situations in which supreme (central) public administration bodies are the authorities of the first instance, and there is no other organ vested with the power to review appeals (Adamiak, 1978: 11). Art. 127 § 3 CAP declares that "an appeal may not be lodged against decisions issued in the first instance by a minister; however, a party that is dissatisfied with such a decision may petition that organ for reconsideration of the matter." Here the concept of 'minister' should be understood to encompass the heads of central organs of public administration subject to the authority of the Prime Minister […], as well as the heads of other equivalent state authorities responsible for matters enumerated in Art. 1(1) and (4) CAP. The principle of "appropriate" application of Art. 127 § 3 CAP implies that the legislator does not treat the PFSA as a 'minister' under the provisions of the CAP. The PFSA and its Chairman are organs of public authority, but they are not subject to state oversight. "Appropriate application" means that, within the relevant scope, provisions concerning deadlines for resolving matters, the exclusion of individuals constituting a given organ and inaction on the part of a given organ are also applicable. The norm expressed in Art. 127 § 3 CAP thus constitutes formal observance of the principle of two-tiered proceedings (Jozefoficz, 1996: 72), whereby

appropriate legal grounds are necessary in every case. Exhaustion of this course of appeal is a precondition for the permissibility of filing a petition to an administrative court.

3 Administrative court proceedings

Final decisions may be subjected to judicial review by an administrative court in respect of their compliance with statute under the provisions of the Act of 30 August 2002 on proceedings before administrative courts (ACA). This right is derived not only from Art. 45(1) of the Polish Constitution, which states that "Everyone shall have the right to a fair and public hearing of his case, without undue delay, before a competent, impartial and independent court,"(Chlebny, 12: 20) as well as Art. 2, which declares that "(t)he Republic of Poland shall be a democratic state ruled by law", principles from which the right of access to courts is derived, but equally results from standards upheld by the European Union, including the Charter of Fundamental Rights of the European Union (OJ C 83, 30.3.2010: 389). In a democratic law-governed state, not only must the rights of the majority be protected, but the voice and the will of minority groups in society must also be given recognition(Skrzydlo, 2013).

Administrative courts (provincial administrative courts in the first instance, and the Supreme Administrative Court in the second) exercise oversight of the activities of public administration. In article 3 § 2 and 3 the ACA establishes the jurisdiction of administrative courts, indicating the catalogue of legal acts and actions involving public administration that may constitute the subject matter of a petition. These provisions stipulate that review of the actions of public administration by administrative courts encompasses ruling in matters concerning petitions appealing administrative decisions (Art. 3 § 2(1) ACA). Administrative courts also rule in cases for which legislation foresees judicial review, applying the remedies set forth therein.

The principle of judicial review of final decisions (Art. 16 § 2 CAP) means that such decisions may be appealed against before an administrative court due to their unlawfulness, pursuant to the rules and mode set forth in statute. The Polish legislator has established this rule *expressis verbis* as a positive

norm, and thus it need not be extrapolated from other norms. Exceptions to the rule that the lawfulness of administrative decisions is subject to review by administrative courts must be interpreted strictly, and all doubts as to the scope of such review should be resolved by assuming its applicability, thus leading to the broadest possible scope of permissibility in the submission of an appeal (Supreme Court of 14 June 1991, III AZP 2/91, OSNCP 1992, no. 1, item 3).

The criterion of lawfulness marks the boundary of judicial review. This is understood to mean assessment of the correctness with which substantive and procedural law have been applied. Suitability is not considered. Courts do not assume the powers of administrative bodies in shaping the situation of individuals, but are rather limited to the authority to abrogate a faulty administrative act. Under current regulations, the jurisdiction of provincial administrative courts encompasses *inter alia* petitions against inaction on the part of organs of public administration (*vide*: Art. 3 § 2(8) ACA), evaluating the activities of such organs from the perspective of compliance with substantive and procedural law. The court's jurisdiction thus applies to the failure of administrative authorities to undertake actions to which they are obliged by law, as well as in individual cases. Thus, filing a petition against inaction by public authorities is justified not only when the deadline for resolving a matter is not met, but also when the authority refuses to issue an act even though it is under statutory obligation to do so, even if that authority mistakenly believed that the matter at hand did not require the preparation of the given act (Tarno, 2004: 28).

Organs of public administration are obliged to resolve matters without undue delay (Art. 35 § 1 CAP), which means that an organ may not refrain from taking up a given matter in the absence of justification, as it is obliged to conduct proceedings without unwarranted stoppages or prolixity. Concluding a matter requiring investigatory proceedings should take place within one month, and in particularly complicated cases not longer than two months from the day of commencement of proceedings; appeal proceedings should be concluded within a month of the day of receipt of the petition (Art. 35 § 3 CAP).

One example in which a court held that the PFSA was guilty of inaction is the verdict of the Provincial Administrative Court in Warsaw handed down on 25 November 2009 (VI SAB/Wa 50/09, unpublished), concerning proceedings for issuance of a banking license. Under Art. 33(1)(2) of the Banking Act of 29 August 1997 (Dz.U. 2012, item 1376), the PFSA issues decisions on banking licenses within three months of submission of an application or its completion.[3] Every failure to resolve such a matter within the three-month statutory deadline and failure to inform the founders of an extension of that deadline means that the organ of public administration is officially considered 'inactive' (For more see Z. Ofiarski, *Prawo bankowe. Komentarz*, Warsaw 2013, p. and cited therein verdict of the Provincial Administrative Court in Warsaw of 31 May 2007, II SAB/Wa 33/07, unpub.; verdict of the SAC of 20 July 1999, I SAB 60/99, OSP 2000, vol. 6, item 87). The court emphasized that materialization of the right to speedy review of a matter in general administrative proceedings is provided by the system of procedural guarantees adopted in the CAP. "Of fundamental significance is the principle of speed and simplicity of proceedings as expressed in Art. 12 CAP, which places the obligation on public administration bodies to act thoroughly and quickly, and to adopt the simplest and most direct means of resolving a matter. In accordance with the general directive that derives from Art. 35 § 1 CAP, administrative matters should be resolved without undue delay, which means that an organ may not refrain from taking up a given matter in the absence of justification, as it is obliged to conduct proceedings without unwarranted stoppages or prolixity." The court obliged the Polish Financial Supervision Authority to issue a decision in respect of the complainants' application within 30 days of receipt of the judgment, and ordered the PFSA to refund court costs to the complainants.

4 Judgements upholding decisions by the PFSA

Analysis of matters that have reached administrative courts in the years 2012-2013 in conjunction with complaints against the PFSA indicates that they are not uniform in nature. One dispute was associated with the removal of a natural person from the register of investment advisors. Courts in two

[3] In justified cases this can be extended by the PFSA.

instances took the side of the PFSA, holding that the complainant took advantage of information that had not been made public, and thus had taken advantage of confidential information as defined under Art. 154(1) and 156(1)(1)(d) of the Trade in Financial Instruments Act of 29 July 2005, Dz.U. 2010, no. 211, item 1384 w/amendments; hereinafter TFIA. (Verdict of the SAC of 25 March 2014 II GSK 250/13 on review of a petition for cassation of a verdict of the Provincial Administrative Court in Warsaw of 25 September 2012, VI SA/WA 559/12. The Provincial Administrative Court rejected the complaint against the aforementioned decision.).

In another matter subjected to judicial review, the dispute concerned the issue of a legal interest in proceedings regarding a petition for the ascertainment of invalidity of a decision on issuing a license for brokerage activity, see Verdict of the SAC of 27 February 2014, II GSK 1771/12, following review of a petition for cassation of a verdict of the Provincial Administrative Court in Warsaw of 18 July 2012, VI SA/WA 796/12 (WSA rejected a complaint against the PSFA's decision). The complainant demanded ascertainment of invalidity of a decision granting a particular company a license to conduct brokerage activity. The complainant was not a party to proceedings, but did claim that it was entitled to submit its petition in conjunction with funds entrusted under contract to the company, which were later lost as a result of the improper conduct of administrative proceedings concluded with the granting of a license to that company. A declaration that the license had been issued unlawfully would have provided the complainant with grounds for seeking damages from the State Treasury. Courts in two instances took the side of the PFSA in holding that the complainant could not effectively demand ascertainment of the decision's invalidity owing to not having standing pursuant to the requirement set forth in Art. 157 § 2 CAP[4].

Courts in two instances upheld a fine assessed by the PFSA, as the oversight authority had declared that a company was at fault for not informing investors in a timely manner of the conclusion of currency option contracts, as information about entering into such agreements constitutes confidential

4 The court held that in no case can the source of the legal interest be the provisions cited by the complainant in Art. 417 § 1 and art. 417^1 § 1 and 2 of the Civil Code, as they do not determine the complainant's situation in respect of substantive law.

information under Art. 154(1) TFIA (See Verdict of the SAC of 19 February 2013 r. II GSK 2226/11, after hearing a petition for cassation of the verdict of the Provincial Administrative Court in Warsaw of 12 April 2011 VI SA/WA 2431/10). The court in both the first and the second instance acknowledged that upon its release into the public domain, such information could be used in taking investment decisions by a rationally-acting investor. Information concerning high-value contracts and high-risk financial instruments, such as those on the futures market, generates reactions on the part of investors that directly influence price levels. Even if the financial result of a contract is unforeseeable at the moment of its conclusion due to random external factors, this does not influence the assessment of information about the conclusion of such a contract and that information retains its precise character. The position of the PFSA concerning the assessment of financial penalties was also upheld by courts in another case (See Verdict of the SAC of 21 November 2013 r. II GSK 931/12 after hearing a petition for cassation of the verdict of the Provincial Administrative Court in Warsaw of 8 February 2012, VI SA/WA 1604/11).

The Polish Financial Supervision Authority refused to approve an individual nominated for the position of Chairman of the Board at an insurance firm, stating that the individual in question was not able to guarantee that the insurance company's matters would be conducted properly. The PFSA stated that in his past performance of the function of Deputy Chairman of the Supervisory Board at a bank, he did not undertake to block the passage of a resolution during a sitting of the Supervisory Board approving the bank's involvement in two transactions with external entities in spite of his awareness that the terms of the contracts were extremely detrimental to the bank's interests, and could even constitute a real threat to its solvency. The PFSA determined that by participating in the adoption of resolutions accepting the conclusion of those contracts, the candidate was responsible for a situation in which the bank's interests had been exposed to risk. It was held that the candidate in no way fulfilled the criteria for offering a warranty of conducting activity in a safe and lawful manner. Assessment of the activity of a specific natural person in conjunction with that person's performance as a member of a bank's Supervisory Board impacts the assessment

of the warranty of properly conducting the affairs of an insurance firm, which implies that the criterion is not met in reference to every particular insurance firm. The court sided with the PFSA in its decision to not give its consent to the appointment of the aforementioned individual as Chairman of the Board of an insurance firm (See Verdict of the SAC of 8 February 2012 II GSK 1481/10 concerning the PFSA's petition for cassation of the verdict of the Provincial Administrative Court in Warsaw of 13 July 2010 VI SA/WA 647/10). According to the Supreme Administrative Court, the condition of warranty of properly conducting the affairs of an enterprise encompasses a positive prognosis in respect of conducting the affairs of a financial institution interpreted broadly, *i.e.* an insurance company as an institution on the financial market, with a positive identification in this aspect providing the basis for determining if there is a warranty of properly conducting the affairs of a particular insurance company. Assessment of the attitude and hierarchy of values presented by a candidate is standardized across all sectors of the financial market, as each of those sectors is burdened with the risk of placing corporate interests before those of clients and customers.

In two instances courts upheld a decision of the PSFA in another case involving refusal to grant a license, holding that shareholders did not provide warranty of conducting affairs in a manner sufficiently protecting the interests of insurers, insured, beneficiaries and obligees from insurance contracts (See verdict of the SAC of 10 December 2013 II GSK 1249/12 – following the petition for cassation of the verdict of the Provincial Administrative Court of Warsaw of 24 February 2012 VI SA/Wa 2277/11).

In another case (Verdict of the SAC of 25 February 2014 II GSK 1890/12 – petition for cassation of the verdict of the Provincial Administrative Court of Warsaw of 25 April 2012 VI SA/WA 469/12), the matter was one of whether the PFSA is authorized to examine security that has been submitted, and whether the submission of a promissory note signed *in blanco* was sufficient to determine that the complainant had not fulfilled statutory requirements. Article 77(1) of the Act of 29 July 2005 on Public Offering, Conditions Governing the Introduction of Financial Instruments to Organised Trading, and Public Companies does not establish a catalogue

of security types, nor does it define the term "submission of security "[5]. The SAC held that since security means protection (from or against something), it follows that such security must be real and not illusory. We may thus speak of the submission of security when that security fulfils a defined function; in this case, it is intended to ensure settlement of transactions within a legally-defined timeframe. The court sided with the PFSA, which argued that a promissory note issued by a purchaser does not constitute appropriate security. Such security must ensure settlement of a transaction by a specific deadline, and this condition is not met by the issuance of a promissory note *in blanco*, for at the moment of its issuance it is not possible to assess whether the property of the issuer is sufficient to satisfy the claim, nor whether the aforementioned deadline will be met.

The court has also concurred with the PFSA in respect of its position in the matter of placing a company on the list of public warnings. In the opinion of the court, the actions of the PFSA consisting in entering the complainant/company on the list of public warnings is not subject to the jurisdiction of administrative courts, as it leads to neither direct nor indirect legal effects, such as the deprivation of any rights or imposition of any duties (Ruling of the Provincial Administrative Court in Warsaw of 30 October 2013 VI SA/Wa 2356/13). It was the court's opinion that the entry merely constitutes information that the company does not hold a license to engage in a given form of banking activity. This information in and of itself is not the source of any restriction on conducting such activity. Also, its publication does not violate any personal interests of the company, as such effects cannot be assigned to the declaration of circumstances which are legally and factually indisputable[6]. A court has also held as proper the decision of the PFSA in respect of appointing a compulsory receiver at a co-operative savings and credit union (Decision of the Provincial Administrative Court in Warsaw of 29 November 2013 VI SA/Wa 2529/13).

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5 The Regulation of the Minister of Finance of 19 October 2005 on templates of calls to register for the sale of exchange of a public company, particular means of announcing them and conditions for the acquisition of shares following such calls (Dz.U. no. 207, item 1729).

6 This is confirmed in SAC jurisprudence, which ruled on 30 sierpnia 2011 II GSK 1561/11 that entry of an entity on the list of public warnings maintained by the PFSA is not an act or action referred to in Art. 3 § 2(4) ACA.

5 Verdicts questioning decisions by the PFSA

There are few examples of courts questioning decisions by the PFSA. Firstly, we may point to a judgement issued in respect of a dispute involving the declaration of improprieties in the activities of an investment fund company and funds managed by it which were ascertained in the course of an audit (Verdict of the SAC of 7 August 2013, II GSK 567/12 concerning the petition for cassation of the verdict of the Provincial Administrative Court in Warsaw of 13 October 2011 VI SA/WA 995/11). The court held that violation of procedural rules constituted sufficient grounds for cassation (Art. 145 § 1(1)(b) in conjunction with Art. 151 ACA in conjunction with Art. 27 § 1and Art. 24 § 1 (1, 5) and § 3 CAP) – through the failure by the court in the first instance to quash a decision of the PFSA when the Authority did not exclude a member from reviewing the case in spite of being required to do so under statute.

Secondly, one verdict against the PFSA was handed down in conjunction with a dispute concerning the manner of determining the period of proscription for assessing a fine against a board member (Verdict of the SAC of 27 January 2014 II GSK 1626/12 after hearing the petition for cassation of the verdict of the Provincial Administrative Court in Warsaw of 16 March 2012 VI SA/WA 2309/11). The court agreed with the charge of violation of substantive law, specifically of Art. 96(7) of the Public Offer Act, through incorrect interpretation of that provision, which consisted in the Authority's finding that the 6-month period envisioned for levying a fine against a member of the board of an issuer of securities (Art. 96(6) of the Public Offer Act) commences not with the day on which the decision to impose a fine on the issuer is issued, but rather from the day on which the issuer is served with the decision to impose a penalty on it. Furthermore, the penalty referred to in paragraph 6 may not be imposed if more than six months has elapsed from the date of issuance of the decision referred to in paragraph 1 (Art. 96(1) and (6) of the Public Offer Act). The beginning of the period within which the PFSA may impose a penalty in conjunction with a gross violation of informational duties on a person who performed the function of a member of the board of a public company is the date of issuance by the PFSA of a decision to impose a financial

penalty on the public company, *i.e.* the date on which it is drawn up and signed pursuant to the requirements of Art. 107 CAP, not the date on which it is served to the company (Similarly, verdict of the SAC of 17 September 2013 II GSK 767/12). The decision was issued by the PFSA after the expiration of the period referred to in Art. 96(7) of the Public Offer Act.

Thirdly, the court failed to concur with the PFSA regarding the imposition of a financial penalty in conjunction with the PFSA's determination that share prices of a company had been the subject of manipulation. The court acknowledged the claim of the complainant that the PFSA had violated rules governing evidentiary proceedings by failing to sufficiently clarify all the circumstances of the case, as well as through "a subjective and one-sided assessment of the evidentiary material gathered, and exceeding the scope of the principle of free assessment of evidence" (Verdict of the SAC of 6 February 2013 II GSK 2074/11 following the petition for cassation of the verdict of the Provincial Administrative Court in Warsaw of 12 April 2011 VI SA/Wa 2436/10). The subject matter in dispute concerned determining who the source of the information was, that is whether it came from representations of the complainant, and whether statements had been "over-interpreted" by a journalist whom the complainant had granted an interview. In the opinion of the court, another matter of dispute was the circumstances surrounding authorization of the interview, which, according to the journalist, had taken place during the same conversation.

Additionally, during the period under review, a court determined that the PFSA had grossly violated the law through inaction, assessing a penalty on the Authority of PLN 20,000. The situation occurred at the beginning of the PFSA's operation, when it assumed the powers of the Bank Supervision Authority (BSA), and the complainant submitted a petition to the Prime Minister to declare the invalidity of a BSA resolution. Proceedings took place with the participation of an unauthorized organ, e.g. the Prime Minister, in respect of review of a petition for declaration of the invalidity of a BSA decision (Verdict of the Provincial Administrative Court in Warsaw of 19 December 2012 VI SAB/Wa 49/12. See also related

verdict of the SAC II GSK 476/10)[7]. In defence of the oversight authority it should mentioned that the PFSA did summon complainants to submit clarifications concerning their status as a party to the proceedings, including filing a declaration of the current status of the complainant/company.

6 Conclusion

The PFSA is an independent financial sector regulator. In the course of supervision, a typical administrative law relationship, there are situations in which the PFSA exercises unilateral authority in deciding about the rights and interests of entities under its jurisdiction. There is no appeal against decisions of the supervisory authority, but there is the potential to apply a legal remedy of a non-devolutional character: a petition for reconsideration of a matter. This is justified by the fact that supreme (central) organs of state administration are the sole instance of consideration of a given matter, and there are no authorities that could be vested with the power to review appeals.

Judicial review of a dispute involving the PFSA and a market participant is performed by an independent court, and the parties hold the procedural status of equals. However, an administrative court may not assume the role of an organ of public administration by issuing a decision addressing the merits of the matter.

Judicial review of administrative decisions, apart from providing the possibility for materialization of the right of individuals for review of a matter by an appropriate, independent and unbiased court, doubtlessly contribute to improving the quality of work done by public administration bodies. It shapes uniform interpretation of the law. Research conducted in conjunction with this publication has demonstrated that the majority of judicial verdicts issued concerning PFSA decisions have upheld that body's findings. Only a few of them, in the cases presented above, have overturned rulings

[7] The Provincial Administrative Court partially acknowledged the PFSA's arguments in that until the day of the issuance in the matter concerned and in which a verdict had been issued by another court (verdict of the SAC of 10 June 2011 II GSK 476/10) there were legal barriers to review of the application by the PFSA. This verdict determined the jurisdiction of the PFSA concerning declaration of invalidity of the decision of the Bank Supervision Authority.

by the PFSA. The analysis conducted above should thus lead to approval for the manner in which the Polish financial market authority has exercised its powers in practice.

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THE SCOPE OF REGULATIONS OF ALTERNATIVE TRADING SYSTEMS ORGANIZED BY STOCK EXCHANGES - A COMPARATIVE ANALYSIS

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Abstract

The article presents the issues relating to the exchange regulations of securities markets dedicated in particular to small and medium-sized enterprises. These markets, known as alternative trading systems (ATS), second-tier markets or junior markets, have a much more liberal and flexible requirements to issuers and listed companies than regulated markets. The smaller range of adjustment facilitates access to these platforms for small businesses, at the same time increasing the investment risk for investors. For this reason, one of the key aspects of ATS is the regulatory regime adapted to the needs and expectations of both groups.

The aim of this study is to analyze the scope of regulations governing selected stock exchange alternative trading systems. Markets selected for the analysis include Polish NewConnect and two Japanese: Mothers and PRO Market. The study was based on the analyzed markets regulations, relevant legislation and statistical data obtained from the websites of the organizers of these markets.

Key words

Capital markets; stock exchanges; securities; NewConnect; Mothers; PRO Market.

JEL Classification

G15, G18, K22

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1 Introduction

The first alternative trading systems (ATS) operated as early as in the 1970s, but their legal status remained unresolved for a long time and no uniform definition of these platforms existed. The emergence and development of ATS is inextricably linked to technological progress, growing universal access to the Internet, and the investors' search for new and more convenient forms of investment. Alternative markets derive from OTC securities trading between professional institutional investors, who began to use modern communication technologies (Mazurkiewicz et al., 2005: 24-25). In time, exchanges began to form alternative markets in addition to their regulated markets (so-called junior markets, second-tier markets), characterized by a more liberal regulations in terms of marketing and quotations for financial instruments. The main feature differentiating small exchanges, thereby enabling them to compete for issuers, is the scope of existing regulations regarding the conditions of entry and participation in the exchange quotations. Smaller regulatory regime means greater availability of these platforms for small companies (also newly founded), but on the other hand increases the investment risk for investors, resulting in their low activity. Issues concerning the scope of the ATS regulations are now one of the key aspects of the functioning of stock exchanges, arising not only from their poor growth caused by the crisis in the financial markets, but also from the growing number of companies removed from the listing due to the bankruptcy and a number of irregularities and fraud.

The aim of this study is to analyze the scope of the selected stock exchange alternative trading systems regulations. Markets selected for the analysis include Polish NewConnect (NC) and two Japanese trading platforms: Mothers and PRO Market. NewConnect was created by Warsaw Stock Exchange (WSE) in 2007 and is largely modelled on one of the biggest ATS, i.e. Alternative Investment Market (AIM), organized by London Stock Exchange. The legal basis for the operation of NewConnect is provided in the rules of the market and the current ordinances of the WSE Management Board. The requirements for issuers, limited to the minimum, and small regulatory regime resulted in the number of listed companies exceeding the number of issuers in the main regulated market,

functioning since 1991, after only a few years of operating. On the other hand, the availability of NewConnect for almost any joint stock company caused a significant deterioration in the quality of listed issuers, and thus a threat to the effective functioning of the market. For this reason, the WSE Management Board decided to tighten the rules on both IPOs and listed companies. Japanese counterpart of NewConnect, PRO Market, formed two years after NC, is also modelled on AIM. Despite using similar organizational solutions and regulations, this market is practically in stagnation. Another Japanese market, Mothers, included in the analyses, is also dedicated to small and medium-sized innovative companies, but at significantly greater regulatory regime. The study was based on the analyzed markets regulations, relevant legislation and statistical data obtained from the websites of the organizers of these markets.

2 Concept and development of alternative trading systems

The world's first alternative market was an American OTC market, NASDAQ (National Association of Securities Dealers Automated Quotations) launched in 1971. It operated on a much more flexible and less restrictive regulations than New York Stock Exchange. Originally, it listed equity securities of companies principally associated with modern technologies. According to the data of 30 April 2014, assets of 2819 entities operating in the area of new technology, telecommunications, biotechnology, and financial services were traded on NASDAQ.

In Europe, the need to create alternative platforms dedicated to companies too small to meet the requirements of regulated markets was first discussed in the 1930s. In 1931, the report of Macmillan Committee was published in the UK ("Report of the Macmillan Committee about deficiencies in the supply of capital, especially equity capital, the smaller British business"), which drew attention to the existence of the gap between insufficient capital supply and demand, primarily experienced by operators in the small and medium-sized enterprises sector (Arcot et al., 2007:11-12). The report noted that the financial market does not meet the demand for medium- and long-term capital in the amounts from £5,000 to £200,000. The first European alternative stock exchange markets, however, emerged only

in the late 1970s. In 1977, the French stock market created Compartiment Special, a year later Mercato Ristretto was created in Italy. Over the next three decades, almost every stock exchange in Europe launched an alternative market (Posner, 2009:4-5).

Table 1: Capitalization and number of companies listed on selected alternative investment markets (as of 31 March 2014)

Stock Exchange	Market	Date of origin	No.of companies	Marekt cap. (€ mln)
Athens Exchange	EN.A	Feb.2008	14	140.8
BME Spanish SE	MAB Expansión	Jan.2008	21	3 530.3
Bratislava SE	Bratislava SE	Jul.2001	64	664.1
CEESEG–Vienna	Dritter Markt	Nov.2007	21	1 435.4
Cyprus SE	EC Cyprus	Sept.2009	19	915.6
Deutsche Börse	Entry Standard	Oct.2005	180	43 947.9
Irish SE	Enterprise SM	Apr.2005	26	81 992.4
Istanbul SE	ISE SNM	Apr.1995	86	5 792.5
London SE	AIM	Jun.1995	1 094	94 469.5
Luxembourg SE	Euro MTF	Jul.2005	213	387.4
NASDAQ OMX	First North AM	Dec.2005	135	4 381.5
NYSE Euronext	Alternext	May 2005	184	10 495.0
Oslo Børs	Oslo Axess	May 2007	32	2 420.8
Warsaw SE	NewConnect	Aug.2007	442	2 421.0
Toronto SE	TSX Ventures	Nov.1999	2 107	24 291.2
Hong Kong SE	GEM	Nov.1999	195	16 199.4
Korea SE	KOSDAQ	Jul.1996	1 008	89 971.8
Singapore SE	Catalist	Dec.2007	139	5 381.6
Tokyo SE	Mothers	Nov.1999	195	21 076.4

Source: own elaboration based on data from stock exchanges listed in the table above.

Currently, the biggest alternative trading system in terms of capitalization is Alternative Investment Market (AIM) organized by London Stock Exchange. In terms of capitalization and number of listed companies, only Korean KOSDAQ market is comparable with AIM. On the other hand, the TSX Ventures in Toronto lists twice as many companies as AIM, but its market value is only a quarter of the capitalization of AIM (see Table 1).

Analyzing the data presented in Table 1, it is noteworthy that the length of the functioning of some markets does not translate into an increase in the number of issuers or their capitalization. The oldest in this comparison, ISE Second National Market (established in April 1995 in Istanbul), listed the shares of only 86 companies at the end of March 2014, although their total market capitalization was higher than the capitalization of 135 issuers present at NASDAQ OMX Nordic. Similarly, uneven development is discernible in the case of ATS launched at the same time, e.g. Polish NewConnect, formed in August 2007, listed 442 issuers with assets of almost €2.5 billion at the end of March 2014, while Viennese Dritter Markt, launched a few months later, listed instruments of 21 companies with a total value of just over €1.4 billion.

The unequal development of alternative trading systems results from a number of reasons. In addition to the location or prestige of the exchange market organizing ATS, the existing regulations are a considerable factor that differentiates individual platforms. Different arrangements appear already at the stage of admission to trading. Some ATS organizers have no quantitative requirements for issuers (e.g. the London AIM). There are also exchanges with more restrictive conditions for admission to trading, requiring a certain level of capitalization and dispersion of shares from IPOs (e.g.: Mothers in Tokyo or GEM in Hong Kong). A number of alternative trading systems rely on the important role of special advisors (Nomads, authorized advisers) who not only support the issuers in the IPO and then in fulfilling disclosure requirements, but also interact with the organizers of the market in the development and proper functioning of the ATS. In some cases, advisers are responsible for assessing whether the issuer meets the requirements of the ATS and is ready to be listed. In some instances, however, the organizer plays the key role in the admission of a company into trading (e.g. Mothers) (Mizuno et al., 2008: 595-597). Further differences exist in terms of disclosure obligations of listed companies (scope and frequency of reporting) and the application of the principles of corporate governance.

In the EU legal order the ATS status was regulated only in 2004 under the Directive on markets in financial instruments (Directive 2004/39/EC). Until then, it was generally considered that ATS is a different kind

of automated trading platform, out of the category of traditional stock exchanges (Mazurkiewicz et al., 2005:23). This document uses the term of a multilateral trading facility (MTF), indicating that it is a multilateral system organized by an investment firm or an entity conducting a regulated market, defined by the rules set in advance by the operator of the system, for the purpose of locating purchase and sale offers of financial instruments to result in transaction (Directive 2004/39/EC, Article 6).

In the Polish legal system, the concept of alternative trading system is defined in the Act of 29 July 2005 on trading in financial instruments. In accordance with Art. 3, an alternative trading system is a multilateral system locating buy and sell financial instruments outside the regulated market organized by an investment firm or entity conducting the regulated market. A regulated market, in turn, is: "(…) acting as a permanent system of trading in financial instruments admitted to trading, providing investors with universal and equal access to market information at the same time by combining purchase and sale offers of financial instruments, and the same conditions of acquisition and disposal of these instruments, organized and supervised by the competent authority under the terms of the Act, as well as recognized by a Member State to satisfy those conditions, and indicated to the European Commission as a regulated market" (Act on Trading, Article 14). In practice, this means that the conditions of admission of financial instruments to trading on a regulated market, as well as all rights and obligations of the participants, are strictly regulated by the national law and the EU law.

It is worth noting that in both the EU MiFID Directive, as well as in Polish legislation, the definition of the alternative trading system primarily indicates all entities authorized to organize such a market and highlights the OTC status of ATS. In turn, the definition of ATS developed by the *Federation of European Stock Exchanges* (FESE) also states the purpose of these platforms. An alternative trading system is defined by FESE as a market or market segment managed by the stock exchange on which the turnover is regulated by other laws than on the main market and which is designed specifically for small and medium-sized companies with high growth potential, representing the new technologies sector (FESE, 2008).

Regardless of the type of the ATS organizer, or the definition of these platforms, they are characterized by less restrictive regulations and requirements for IPOs and listed companies compared to the regulated markets. Lesser regulatory regime implies consequences for many stakeholders. For companies, especially SMEs and start-ups, it allows to raise capital from the stock market and provides a good alternative to other sources of financing (loans, equities, loan funds, etc.). It also significantly reduces the costs of IPO, and then of fulfilling the obligations of a public company listed on the stock market. For ATS organizers, the decision on establishing less restrictive regulation is an opportunity to attract companies, thus resulting in the development of the market. On the other hand, it increases the risk of marketing issuers of poor quality, failing to meet their obligations, or even committing fraud or abuse, which ultimately contributes to the deterioration of the ATS image and discourages investors and potential issuers. Investors, in turn, have the opportunity to diversify investment portfolios through alternative trading systems, and often achieve above-average rates of return on investments made in securities listed in ATS. On the other hand, unregulated markets involve a much higher risk compared to regulated markets and as a result many investors refrain from investing their savings there.

3 Alternative trading system in Poland

NewConnect is an equity-related financial instruments alternative trading system[2], dedicated especially to small and medium-sized enterprises, including start-ups, representing innovative sectors. It is organized by Warsaw Stock Exchange. As mentioned above, under the legislation of the European Union and the Polish legal system, a market operating as an alternative trading system is not a regulated market. This means that it is not subject to supervision by the Polish Financial Supervision Authority (PFSA), and its operation is based mainly on the rules and regulations set by the organizer (Mosionek-Schweda, 2013: 348). In the case of NewConnect, a set of rules for issuers, investors, and market participants was included in the Alternative

2 In September 2009, Warsaw Stock Exchange and BondSpot launched Catalyst market - a system of authorization and trading debt instruments which also consists of alternative trading systems.

Trading System Rules and the current resolutions of the WSE Management Board. The ATS Rules provide basic regulations concerning the introduction and trading of financial instruments, the conditions of acquisition and loss of rights for market participants, as well as the rights and obligations of listed companies. It is a framework document and it is detailed in six annexes on specific areas of functioning NewConnect.

Table 2: Basic criteria for listing on WSE main market and NewConnect

Criterion	Main market	NewConnect
Requirements for issuers	1. Relevant admission document 2. Unlimited transferability of shares 3. No bankruptcy or liquidation proceedings are due in relation to the issuer	
	1. The minimum capitalization of all shares of at least PLN 60 million or its equivalent in PLN of at least €15 million (in the case of companies listed for at least 6 months in ATS or other market, €12 million or PLN 48 million) 2. The dispersion of shareholding (15% of the shares covered by the application for admission to trading and 100 000 shares with value equal to at least €1 million or PLN 4 million in the hands of shareholders holding less than 5% of votes at the General Meeting) 3. The financial statements for the last 3 financial years (audited) 4. Obligation to cooperate with the brokerage house and the auditor	1. Equity of the issuer of at least PLN 500,000. 2. At least 15% of the shares covered by the application for admission to trading in possession of at least 10 shareholders, each of which has no more than 5% of the total number of votes at the General Meeting and is not affiliated with the issuer 3. Assistance of an authorized advisor and a market maker 4. Nominal value of shares is at least PLN 0.10. 5. The financial statements for the last fiscal year (audited)

Financial instruments sales method	Public offer	Private or public offering
Approval document	Prospectus approved by the Financial Supervision	Private offer: information document approved by the Authorised Adviser Public offer: the prospectus or information memorandum approved by the Polish Financial Supervision Authority
Disclosure obligations	Reports Quarterly reports - I, III and IV quarter consolidated financial statements, unaudited Semi-annual reports - the first half, financial statement, audited Annual reports - financial statement, audited	Reports - to a lesser extent than on the main market Quarterly reports - selected balance sheet items and selected items of the profit and loss for each quarter Annual reports - financial statement, audited

Source: own elaboration based on: *Exchange Regulations* as adopted by Resolution No. 1/1110/2006 of the Council of the Stock Exchange on 4 January 2006, as amended (codified according to the legislation in force as of 1 January 2014), *Rules of Alternative Trading System* (by legal status as at 14 October 2013) *Regulation of the Minister of Finance of 19 February 2009 on current and periodic information published by issuers of securities and conditions for recognizing as equivalent information required by the laws of a non-Member State*, Journal of Laws 2009, No. 33, item. 259

Despite a gradual tightening of regulations in force on NC, in comparison to the main floor, the market is still characterized by a simplified and flexible procedures for the introduction and quotations of financial instruments, as well as significantly lower fees paid by issuers (see Table 2). In addition, NewConnect allows to sell shares through a so-called private offering (addressed to a maximum of 149 investors), a much faster and less expensive procedure compared to public offering (addressed to at least 150 entities or to unlimited recipient) applicable to the main market. A sale of shares

through private placement does not require the preparation and approval of the prospectus by the PFSA, but a much simpler information document. The correctness of its preparation, and the reliability and accuracy of the data is approved by an authorized advisor of the issuer, which significantly shortens the formal procedures of IPO. The scope of the disclosure obligations the companies are subject to, also differs significantly between the two trading floors. NewConnect issuers need not prepare semi-annual reports, and in the case of current and quarterly reports, the range of information presented is much narrower (see Table 2).

In the initial period of NewConnect operation, in order to encourage issuers to enter the market, only minimal formal requirements were specified to newcomers: the status of a joint stock company or limited joint-stock partnership, the use of authorized advisor for a year from listing, and the obligation to prepare the information document (instead of the prospectus). In contrast to the regulated market, no requirements were set for the minimum period of operation, capitalization or shareholder dispersion. Both start-up companies as well as companies with years of experience could apply for listing on NC (Mosionek-Schweda, 2013: 348). These properties enabled NC, despite unfavourable conditions in the capital markets resulting from the financial crisis, to develop at a rapid pace, and after only six years of operation, the number of companies listed on the NC exceeded the number of issuers in the regulated market. Due to the different purpose of the two WSE markets, and thus other terms of issue and listing, these trading floors should not be unconditionally compared in terms of the number of IPOs, capitalization, and issue values. Lower requirements for entry to trading on NewConnect result in several times larger number of IPOs, while the distinctive profile of issuers effects in much lower values obtained by these shareholders. In total, in the period from 30 August 2007 to 30 April 2014, 508 companies were listed on NewConnect attracting a total of about PLN 1.482 billion. At the same time, 205 issuers were admitted to trading on the main market, gathering a total of over PLN 16.683 billion in the new issue.

Following bankruptcies, low activity of investors discouraged by the high risk incurred in connection with investing on NewConnect, and worsening

of the market image influenced the decision of the Management Board to tighten the provisions contained in the rules of the ATS. The first changes were enacted in May 2012 and focused on three main areas: sanctions against companies and authorized advisers, disclosure requirements, and the information document (Huczek, 2012). Fines of up to PLN 20,000 against unreliable issuers were introduced as well as the obligation to produce the report on the state of the issuer for companies having financial problems or changing the nature of business. In the case of authorized advisers, a warning and a fine of up to PLN 20,000 were added to the existing catalogue of sanctions already including delisting or suspension of privileges.

In terms of disclosure requirements, the concept of "significant agreement" was clarified, of which the issuers are obliged to inform in current report. So far, the company's management decided if a contract was material and whether or not to inform the investors. The introduction of clearly defined eligibility of agreements as significant was to improve the transparency of public companies in the market. Additionally, the companies are required to provide a current report on the change or termination of the cooperation established with an authorized adviser - previously this information was passed only to the WSE Management Board. The scope of information presented in the information document was also extended. The contents of this document were supplemented with a detailed description of the subscription or sale of shares, the presentation of personal relationships, property, and organization between the company, members of its bodies, shareholders, the authorized advisor and the members of its organs, as well as the requirement to identify all shareholders holding at least 5% of voting rights.

Subsequent changes in the rules NewConnect took place in 2013 and related primarily to IPOs. From 1 March 2013, at least 15% of the shares of the company applying to list on NewConnect for the first time, must be in possession of at least ten shareholders, each of whom has no more than 5% of the total number of votes at the General Meeting. The duration of compulsory cooperation with an authorized advisor was increased from one to three years. In addition, monetary penalties for non-compliance with the ATS Rules, introduced less than a year earlier, were increased

from PLN 20,000 to PLN 50,000. Further tightening of the rules took place in April of the same year, and significantly limited the circle of persons entitled to listing on NewConnect. Starting from June 1, 2013, the information document must include audited financial statements for the last fiscal year, which excludes IPOs of companies operating for less than the period required to produce such a document. Additionally, the criterion of minimum equity of PLN 500,000 was introduced, although this value may include the capital pertaining to the future registration of the shares covered by the offering (WSE, 2013). The range of data presented in the information document was again extended. Companies are required to supplement this document with CVs of the Management Board and the Supervisory Board members, the auditor's opinion on the value of in-kind contributions brought in during the last two fiscal years, and, in the case of newly established entities, additionally a draft on planned investments and a detailed timetable for their implementation. In the area of information obligations, the scope of the data presented in the quarterly reports was increased.

The first effects of the changes appear in the number of IPOs on NC. In subsequent years, after the record set in 2011, the number of IPOs and the values obtained by the companies decreased. In 2013, only 42 issuers were listed, attracting an average of about PLN 2.2 million (amounting to a total of PLN 95.4 million). In the first four months of 2014, there was only 8 IPOs worth PLN 6.4 million in total, with an average of about PLN 0.8 million per issuer. In contrast, the positive effect of the NewConnect reform is a gradual increase in turnover in the subsequent months of 2014 (according to WSE, the total turnover in April 2014 increased by 21% to PLN 98.9 million, compared to April 2013, and the number of transactions increased from 48,800 in April 2013 to 72,200 in April 2014).

4 Mothers and PRO Market in Tokyo

Tokyo Stock Exchange (TSE) is the world's fourth largest exchange in terms of capitalization after New York Stock Exchange, NASDAQ OMX and London Stock Exchange. In April 2014, TSE listed 3 415 domestic and 12 foreign issuers with total capitalization of more than $4.215 trillion (WFE, 2014). This exchange conducts five markets of equity securities, including

two of lesser regulatory regime. One of them, Mothers (market of the high-growth and emerging stocks), was launched on 11 November 1999. The purpose of this market is to facilitate access to public financing for innovative companies with high growth potential, especially in the early phase of their operation (Tokyo Stock Exchange (c): 9-10). Mothers is also available for foreign entities and, seeking to attract issuers from outside of Japan, in November 2000, TSE reduced requirements for companies listed on other stock exchanges (see Table 3). Still, the conditions for listing are relatively stringent compared to other small exchanges, rendering Mothers uninteresting for foreign companies. Since the launch of the market, companies from only four foreign countries were listed, including the Cayman Islands (it was the first foreign issuer listed on the Mothers), the UK, the USA and Hong Kong (withdrawn from trading in 2007).

Table 3: Basic criteria for listing on Mothers and main market

Criteria	Main market (First Section)	Mothers
Number of shareholders	2,200 or more.	200 or more; Foreign companies: 200 or more in Japan.
Amount of profits and market capitalization (a. or b. must be satisfied)	a. The total amount of profits in the last 2 years of at least 500 million ¥; b. The market capitalization as of the listing day is expected to reach at least 50 billion ¥, except cases where sales for the last year are less than 10 billion ¥.	No requirements.
Amount of net assets (ss of the listing day	1 billion ¥ or more.	No requirements.

Tradable shares*	a. The number of tradable shares: 20,000 units** or more; b. The market capitalization of the tradable shares: 1 billion ¥ or more; c. The number of tradable shares: 35% or more of the listed stocks.	a. Number of tradable shares: 2,000 trading units or more; Foreign companies: 1,000 trading units or more; b. Market capitalization of tradable shares: ¥500 million or more; c. The number of tradable shares: 25% or more of the listed stocks.
Number of consecutive years of business conduct	No less than 3 years under the board of directors.	No less than 1 year under the board of directors.
Market capitalization	25 billion ¥ or more (as of the listing day).	1 billion ¥ or more (as of the listing day).

* "Tradable Shares" refers to listed shares excluding shares held by parties with a special interest such as officers, shares owned by the company itself, and shares held by persons who individually own 10% or more of listed shares.

** 1 unit is the minimum number of shares necessary for 1 voting right..
¥100 = $ 0,98

Source: own elaboration based on: Tokyo Stock Exchange, *New Listing Guidebook, Mothers*, Tokyo 2014, pp. 34-55; Tokyo Stock Exchange New *Listing Guidebook*, 1st and 2nd Section, Tokyo 2014, pp. 25-73.

Companies wishing to join the Mothers market, in addition to quantitative criteria (adequate number of shareholders, number and value of shares in free float), must demonstrate that they have high growth potential, which is not limited only to certain areas of the company, but the constant development of the whole entity. During the application process, TSE evaluates the possibility of the development of the sector and the markets in which the company operates, examines the competitive advantages of the issuer, its position in the competition, the ability to cope with competition and the quality of products or services (Tokyo Stock Exchange (c): 9-11). The entire process of evaluation of the company is definitely longer and

more formal in comparison with other small exchanges, and most importantly, TSE is the only entity responsible for the assessment of the applicant, the approval of the documents, and admission to trading. During the application process, representatives of the Exchange meet with the management, employees and advisers of the applicant and visit the place of business to be able to observe the daily operation of the company in practice. All these measures are intended to ensure investors that Mothers lists only the reliable, high quality companies. It is worth noting that TSE has developed a very detailed and rigorous criteria for the removal of a company from trading, including, among others: the minimum threshold for the number of shareholders, the company's capitalization and the financial results it achieves, the value and number of shares in free circulation, the volatility of the exchange rate and the trading volume (Tokyo Stock Exchange (b): 125-135).

Although the scope of the regulations in force on Mothers is lesser than on the main market, its relatively stringent requirements for IPOs, especially the quantitative criteria, are a significant barrier for many companies. As a result, after almost fifteen years of operation, about 320 companies listed on Mothers, however, the average value of capital raised was as much as ¥3.14 billion (about $31.4 million). Every fourth listed company conducted another issue of shares attracting an average of ¥ 5.6 billion (about $56 million) (Tokyo Stock Exchange (c): 14). Finally, according to data from the end of April 2014, Mothers listed values of 194 issuers, including three foreign companies.

Tokyo Stock Exchange leads yet another market intended for smaller companies. In June 2009, together with London Stock Exchange, TSE launched Tokyo AIM, modelled largely on the British Alternative Investment Market. In 2012 the name was changed to TOKYO PRO Market. The level of existing regulation and the process of issue and admission to trading are much less restrictive, not only in relation to the main floor of TSE, but also to Mothers. The key role on the PRO Market is played by advisers called J-Nomad (Japanese Nominated Advisor) who are responsible for evaluating a company, its preparation for the IPO, and then the care and guidance throughout the period of listing (Tokyo Stock Exchange (d)). PRO

Market is also more accessible to foreign issuers, as it permits the preparation of documents and fulfilling the disclosure obligations in English, while the official language of Mothers is Japanese only (see Table 4).

Table 4: Overview of listing requirements of TOKYO PRO Market, Mothers and main market

Criteria	TOKYO PRO Market	Main Market, Mothers
Disclosure language	Japanese or English	Japanese
Listing criteria	No set requirements Criteria judged by J-Adviser	Numerical criteria for the number of shareholders and market capitalization, etc.
Period from listing application to listing approval	10 business days (J-Adviser to express intent before listing application)	2 months (standard examination period)
Audit period before listing	Last 1 year	Last 2 years
Internal control report	Optional	Mandatory
Quarterly disclosure	Optional	Mandatory
Investors	Qualified institutional investor (financial institutions, etc.), national government, Bank of Japan	No restriction

Source: own elaboration based on: Tokyo Stock Exchange, New *Listing Guidebook For Foreign Companies*, Tokyo 2014, p 15.

Lesser regulatory regime encourages few issuers to use the offer of this new market. In less than five years of Pro Market, only seven companies were listed: Mebiopharm Co. Ltd. (listed 15 July 2011, at the request of the issuer of 7 June 2013, the company was removed from trading), Goyo Foods Industry Co. Ltd. (listed 28 May 2012) Shintokyo Group Co. Ltd. (25 September 2012) HEKI Co. Ltd. (4 June 2013), Habit CRAFT Co.. Ltd. (31 July 2013) Ad Me Tech Co. Ltd. (4 September 2013) and Eco Green Co. Ltd. (31 October 2013) (Tokyo Stock Exchange (e)). In April 2014, PRO Market listed shares of six companies, and two more were preparing for IPOs planned for July. In turn, the J-Nomad register, at the time, consisted of seven advisors. It is noteworthy that, similarly to NewConnect,

the company applying for the status of the J-Nomad must employ at least three J-Qualified Specialist employees licensed by TSE (Tokyo Stock Exchange (a)).

The founders of PRO Market expected the trading floor to receive recognition among small companies and share the success of his British model. The possibility of replacing Mothers was also considered. After five years of operation, however, the validity of its existence raises a lot of doubts.

5 Conclusion

A common feature of junior markets operating in the capital markets is the lesser regulatory regime in relation to main stock exchanges. Alleviating requirements for issuers is aimed to enable entities too small to meet the regulations applicable to the main trading floors to enter the market and raise capital by issuing shares. In the era of globalization, which also affects the capital markets, the creation of ATS is also one of the ways for an exchange to gain advantage or maintain its position in an increasingly competitive environment. However, not all alternative platforms develop as expected by the organizers. The example of Polish NewConnect proves that even in times of crisis capital markets can successfully launch a new trading platform to become a place for trading assets of more than 400 companies in only a few years. The main problem, however, is the low level of interest of investors, partly due to unfamiliarity with junior markets, but also large risks associated with investment. A lesser regulatory regime and the lack of penalties in case of failing the requirements provided NewConnect with a significant number of issuers, but discouraged investors. On the other hand, the stringent requirements of Mothers limit the number of companies to be admitted to trading in this market, but increase the security of investments and, consequently, the volume and value of trading. Tokyo PRO Market, however, proves that it is not always the liberalization of regulations that translates into the development of the market, at least in terms of the number of listed companies. Organizers of ATS should therefore adapt to keep the level of regulation to the specificities of the capital market

and the changing market environment, taking into account the views and needs of all market participants, who play the actual key role in the success or failure of the platform.

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BAIL-IN PRINCIPLE AS THE BASIC OF THE BANK RECOVERY AND RESOLUTION MECHANISM IN EUROPEAN UNION

Rafal Mroczkowski [1]

Abstract

The transposition of the Bank Recovery and Resolution Directive (BRRD) provisions into national legislation will create a paradigm shift in the field of crisis management in the EU Member States regarding banks in danger of bankruptcy. The *bail-out* principle, transferring the costs of restructuring a bank to the taxpayer, will be replaced by the *bail-in* principle, restoring the responsibility of creditors for their financial decisions such as buying bonds or placement of deposits. The main aim of the contribution is to confirm or disprove the hypothesis that the application of the *bail-in* principle in restructuring and orderly liquidation of banks will reduce the scale of: 1) the moral hazard associated with the management of these institutions by increased responsibility and control of bondholders and creditors, thus contributing to the financial stability growth; 2) the involvement of individual countries in financial assistance for banks, thus translating into increased fiscal stability.

In relation to the EU financial system as a whole, it is expected to effect in the reduction of systemic risk between private and public financial sectors.To accomplish the adopted objective, the use of legal research methods, especially methods: general theoretical and formal dogmatic is required. As a result of analyzes, the adopted research hypotheses were positively verified. The introduction of the *bail-in* principle for restructuring and orderly

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liquidation procedures of banks in EU Member States should be significant for the stability growth of the EU financial system, both in terms of financial stability and fiscal sustainability.

Key words

Bail-in principle; resolution; Bank Recovery and Resolution Directive.

JEL Classification

G18, G21

1 Introduction

The rise of regulations defining the legal framework for restructuring and orderly liquidation of banks[2] is inextricably linked to the recent financial crisis. The period from 2008 to 2013 revealed the scale of negative feedback between financial markets and the public financial sector. Member States were taken hostage by the financial situation of systemically important banks (*too big to fail*), and, in turn, banks were taken hostage by the solvency of countries issuing bonds, an important component of bank assets. The banking crisis not only had an indirect impact on the level of public revenues (through the relationship: decline in lending - reduction of economic activity - declining public revenues), but also directly resulted in the growth of public expenditure in the form of public funding for assistance programs for banks. Between 1 October 2008 and 1 October 2011, the Commission approved the Member States' assistance to banks totalling more than EUR 4.5 trillion, i.e. 36.7 GDP of the EU (European Commission, 2013: 1).

The observed bilateral *contagion effect* between the public and private financial sector points to the necessary reduction of systemic risk present in their interaction area. To restore the stability of the EU financial system and to prevent crises on the scale similar to the most recent one in the future, the toxic relationship between banks and countries requires loosening[3]. The expected

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2 In this article, the word "bank" will be used interchangeably with the phrase "credit institution" and it will be assigned the same meaning.

3 The relationship between banks and governments as one of the main causes of the debt crisis as well as the need to terminate this relationship is discussed in the program prepared by the President of the European Council (van Rompuy, 2012, p. 4).

result involves strengthening the resilience of banks to the imbalance of public finances and the risks associated with financing the borrowing requirements, and symmetrically – the immunization of the public finance system to the condition of banks and the situation on the financial markets.

The crucial point for strengthening the stability of the financial system is a gradual creation of a *banking union* based on four pillars: 1) a single legal framework, 2) a single banking supervision, 3) a uniform system of crisis management, 4) a common deposit guarantee scheme.

Undoubtedly, the first pillar of the *banking union*, a uniform legal framework already in force, together with its currently implemented second pillar, a single supervisory mechanism, will contribute to the reduction of systemic risk arising from credit institutions operating in the internal market. Even the most effective regulation and supervision, however, will not protect against the risk of insolvency of individual banks. It is both unrealistic and pointless. A limited and controlled risk failure has positive significance for the proper functioning of the market economic system called "creative destruction" (Weidmann, 2013: 1 et seq.). It is therefore necessary is to complete the legislative work on the third pillar of the banking union constituting a single framework for crisis management, and restructuring and orderly liquidation of banks in particular. The first phase was completed by the adoption of the European Parliament and of the Council directive of 15 May 2014 establishing a framework for the conduct of corrective actions as well as restructuring and orderly liquidation in respect to credit institutions and investment firms, and amending Council Directive 82/891/EEC and Directives of the European Parliament and of the Council 2001/24/WE, 2002/47/EC, 2004/25/EC, 2005/56/EC, 2007/36/EC, 2011/35/UE, 2012/30/UE and 2013/36/EU, Regulation of the European Parliament and Council Regulation (EU) No 1093/2010 and (EU) No 648/2012 (EU Official Journal of 06.12.2014, No. 173:190) (Bank Recovery and Resolution Directive, BRRD). Implementation of the Directive in the Member States will contribute significantly to the harmonization of the existing procedures used in the context of restructuring and orderly liquidation of institutions.

The next milestone to be reached is the adoption of a legal framework for a single resolution mechanism for restructuring and orderly bankruptcy[4] for the euro area. This, however, will require a political compromise, which will determine the final shape of the crisis management system in eurozone[5]. Single resolution mechanism for restructuring and orderly liquidation will be apply in the Member States participating in the single supervisory mechanism, ensuring:

1. an integrated decision-making structure with the leadership role of the Single Council for Restructuring and Ordered Liquidation
2. a uniform procedure and
3. support for subject institutions from a single restructuring and orderly liquidation bank fund.

The purpose of the new regulations defining the legal framework for restructuring and orderly liquidation is to prevent the insolvency of credit institutions and investment firms, hereinafter referred to as institutions (the BRRD, Recital 1 in the preamble). Should it come to the state of insolvency, the regulations are to minimize its negative effects by ensuring the continuity of critical functions of these institutions[6]. Protecting depositors and investors as well as the public finances by reducing the risk of loss financing from public institutions should be of equal importance. The operational objective is to minimize the costs of restructuring and orderly liquidation, and to protect the value of assets (article 31.2 and 3 of the BRRD). Such a definition of objectives is a departure from the *bail-out* principle in favour of the *bail-in* principle.

4 Proposal of 10 July 2013, the Regulation of the European Parliament and of the Council laying down uniform rules and uniform procedure for the orderly restructuring and liquidation of credit institutions and certain investment firms under a single mechanism for restructuring and an orderly liquidation and a single bank restructuring fund and the orderly liquidation and Regulation of the European Parliament and Council Regulation (EU) No 1093/2010, COM (2013) 520 final.

5 Due to the ongoing work on the proposed legislation of the above regulation, further analysis will be based solely on the provisions of the BRRD.

6 Pursuant to article 2.1 point 35, it must be understood as activities, services or operations, the cessation of which could result in disturbances in key services to the real economy in one or more Member States, or could disrupt the financial stability due to the size of the institution or group, or their share of the market, the external and internal interconnection, their complexity or cross-border activity, especially taking into account the substitutability of these actions, services or operations;

The main aim of the contribution is to confirm or disprove the hypothesis that the application of *bail-in* procedures of restructuring and orderly liquidation of banks will reduce the scale of:

1. the moral hazard associated with the management of these institutions by increased responsibility and control of bondholders and creditors in order to contribute to the growth of financial stability;
2. the involvement of individual countries in financial assistance for banks in order to increase fiscal stability. The expected effect in relation to the EU financial system as a whole is the reduction of systemic risk between public and private financial sectors.

To accomplish the adopted objective, the use of legal research methods, especially methods: general theoretical and formal dogmatic is required.

2 From *bail-out* to *bail-in* in restructuring and orderly liquidation of banks

The concept of *bail-in* permeated into the economic jargon during the recent economic crisis as a term for the restructuring process of systemically important financial institutions and investment firms[7] with the participation of its shareholders and creditors. It is emphasized in the literature that a restructuring involving funds from the private financial sector is an alternative to the rehabilitation of institutions with the use of public funds (Zhou, et al., 2012: 6). *Bail-in* is defined as a restructuring procedure that uses instruments of redemption regarding creditors' liabilities or conversion of these liabilities to equity (Pollner, 2013: 27).

The analyzed concept emphasizes the inclusion of shareholders, bondholders, and depositors in the process of restructuring through their co-participation in losses and costs of the procedure with priority over taxpayers. In practice, this means a full or partial waiver of claims against the creditors or relatively a change in the maturity date, a transformation of liability forms or alternatively a conversion of liabilities into shares or other instruments of ownership. The primary purpose of the *bail-in* procedure is to assist an institution on the verge of bankruptcy, or being threatened with bankruptcy, by the involvement of the shareholders and creditors, to eliminate

7 Hereinafter referred to as institutions.

the necessity of its public funding, or reduce the necessary level of such support. The result of its use in restructuring is essentially a reduction in liabilities or service charges to a level that will further its functioning. This does not preclude the option of granting institutions other forms of financial assistance.

The BRRD does not explicitly define the term of *bail-in*. From the article 2.1 point 57 of the BRRD, however, it can be inferred that this is the mechanism of the write-down and conversion powers in relation to liabilities of an institution under restructuring and orderly liquidation procedures.

The process of restructuring institutions based on the *bail-in* principle is presented in the literature in opposition to restructuring liabilities of countries and companies (including institutions) using funds provided by a third party who is neither the creditor nor other stakeholder (the *bail-out* principle) - (Mroczkowski, 2014: 56-57). The word "bail" derives from the Latin verb *bajulare*, "to bear the burden". The etymology of this word may also be derived from the English noun "bail", meaning a wooden bucket or dipper. Together with the word "out", it was used as a verb of nautical origin describing the action of removing water from a sinking ship with a designated bucket (Online Etymology Dictionary, 2014: v.1). The essence of the *bail-out* procedure is to provide external repayable financing (e.g. a loan) or a non-refundable financing (e.g. acquisition of shares) by a third party, in particular by the State or a public body, in the case of liquidity loss or insolvency of a public debtor (e.g. state) or a private borrower (e.g. a company). Financial assistance for an institution under *bail-out* procedure substantially increases its equity. This method does not exclude the use of assistance consisting of liability reduction such as remitting public debts, debt takeover, assumption of debt liability.

The *bail-in* principle, relating to restructuring and orderly liquidation of banks, is the equivalent of the *no bail-out* (no-assistance) principle, applied on the grounds of public finances. The *no bail-out* principle is the cornerstone of the financial system of Economic and Monetary Union. It is expressed explicitly in article 125 TFEU[8], according to which both the EU and indi-

[8] In the original version, which differs from the current, this principle was regulated in article 104b of the Maastricht Treaty and later in article 103 of the EC Treaty.

vidual Member States are not responsible for the liabilities of central governments, regional, local or other public authorities, other bodies or public undertakings of Member States, nor do they assume any liability, without prejudice to mutual financial guarantees for the joint execution of a specific project. The essence of this rule is to exclude responsibility of the EU and the Member States for the liabilities of other Member States and their administrative and economic structures, and as a consequence to prohibit assistance from the EU budget and the budgets of the Member States. The few exceptions are explicitly expressed in articles 122 and 143 TFEU allowing the possibility of granting financial assistance to the Member States in specific situations, as well as article 136.3 TFEU providing the basis for the establishment and operation of the European Stability Mechanism, hereinafter referred to as the ESM (Mroczkowski, 2014: 55-57). In the decision of 27 November 2012 issued on Pringle (C 370/12), the European Court of Justice ruled that article 136. 3 TFEU as the basis for the creation of the ESM does not violate the principle of prohibiting the acquisition of financial liabilities of the Member States referred to in article 125 TFEU. The importance of the analyzed principle was emphasized in the decision of the Federal Constitutional Court, in legal justification of which it is recalled that the concept of monetary union as a "community stability" is the foundation of the German approval for the creation of the EMU (decision of Federal Constitutional Court of 7 September 2011, BvR 987/10, BvR 1485-1410 and BvR 1099-1010).

The *no bail-out* principle, expressed in article 125 TFEU, is not directly applicable to institutions. The adoption of this principle in a modified form of the *bail-in* principle as the conceptual basis for restructuring and orderly liquidation procedures is a major step in building a banking union. The implementation of the new regulations should lead to an increase in the stability of the financial system of the EMU. It will increase not only the stability of financial markets in the European conditions, where banks play a key role, but also fiscal stability. The Member States will be participating in restructuring banks covering the losses and the costs of the restructuring process not firstly, as it has been so far, but lastly.

3 Implementation of bail-in principle in BRRD provisions

The reversal of the responsibility sequence regarding loss and restructuring costs is the essence of the new regulations defining the legal framework for restructuring and orderly liquidation of an institution. In the first place it will be borne by the shareholders. Then the losses are incurred on subordinated creditors, in accordance with order of claim settlement under standard bankruptcy proceedings. None of the creditors, however, should incur losses greater than suffered in a hypothetical situation of the institution being liquidated in bankruptcy proceedings conducted in accordance with the general principles laid down in the directive's "no creditor worse off" principle. The main category of the institution's creditors are its bondholders and depositories. Any loss, however, may be covered only from deposits exceeding the amount included in the deposit guarantee scheme. Covered deposits are absolutely protected. (The BRRD, Article 34. 1).

Assuming the use of solutions indicated above, the restructured institutions are to be given access to resolution funds, which are elements of national funding mechanisms for restructuring and orderly liquidation referred to in article 100 of the The BRRD. Means of the resolution funds appointed at national level are to come from:

1. contributions raised *ex ante* up to the target level of 1% of the amount of guaranteed deposits of all institutions that have obtained the permit to operate in the territory of a Member State;
2. xtraordinary contributions raised *ex post*, if the amount of funds accumulated in the fund is insufficient to cover the losses, costs or other expenses incurred in connection with the use of funding mechanisms;
3. loans and other forms of support from institutions, financial institutions or other third parties.

Resolution funds may be used only in connection with the use of instruments of restructuring and orderly liquidation for the purposes of guarantee, loan or compensation as well as acquiring assets and making contributions. The purpose of these measures is defined exhaustively and in detail in article 102.1 of the BRRD.

Only when all of the above sources of financing institutions prove inadequate, after the total fulfilment of strict conditions laid down in article 37.10 and article 56.3 and 4 of the BRRD, public support is allowed in the form of government instruments of financial stability. This is acceptable in the following situations:

1. in an emergency situation of systemic crisis
2. after other instruments of restructuring and orderly liquidation have been used to the highest extent (the final character)
3. upon payment of contributions by the shareholders and holders of other instruments of ownership in order to cover losses and recapitalize an institution in the form of redemption or conversion equal in value to at least 8% of the total liabilities of the institution,
4. upon the determination that the use of other instruments of restructuring and orderly liquidation would not be sufficient to:
   a) avoid significant adverse effects on financial stability or
   b) protect the public interest - where the institution has previously received extraordinary liquidity support from the central bank, or if public capital support from the instrument of capital support has already been granted to the institution[9].

Financial stability instruments include public equity support tool (recapitalization pursuant to article 57 of the BRRD) and temporary public ownership tool (a temporary form of a change in ownership of equity securities in an institution from private to state under the procedure referred to in article 58 of the BRRD).

The above sequence of updates responsibility of the various categories of actors, represents a departure from the principle of bail-out and at the same time practical expression of the new rules for bail-in. As a result of the application should be strengthened self-regulation in terms of market discipline banks - contributing to financial stability. You can also expect to reduce the frequency and size of public funds in the restructuring process and the orderly liquidation - which will have a positive impact on fiscal sustainability.

9 Further evidence of general nature arise from article 32.1 of the CRR Directive.

4 Conclusion

The consequence of basing the mechanism for restructuring and orderly liquidation on the *bail-in* principle is a paradigm shift in crisis management of situations of bankruptcy risk of banks. Up to now, the banks on the verge of insolvency or threatened with insolvency were in the first place granted assistance from public funds. In fact, it meant the application of the *bail-out* principle. The activities of banks resulting from those practices led to moral hazard phenomenon, extensively analyzed in the literature (Coeuré, 2013: 1). In times of prosperity, banks took excessive risks maximizing profits to be divided among the shareholders, in the form of dividends, and the management, in the form of bonuses. This led to the privatization of benefits. During the crisis, banks applied for assistance and received it based on the *too big to fail* principle. It resulted in the nationalization of losses incurred in banking operations and restructuring costs.

The replacement of the *bail-out* principle with the *bail-in* principle will shift a relevant part of losses and costs resulting from the restructuring or bankruptcy to the shareholders and creditors of the institution on the verge of bankruptcy. This means the transfer of risk between the taxpayer based public finances sector and the private sector, especially bondholders and depositors. The reversal of loss and cost incurring sequence indicated above will increase the responsibility of each stakeholder group of an institution (shareholders bondholders, depositors) and the intensity of their control of banks in standard market conditions. This processes will be encouraged by providing stakeholders with new, relevant tools.

Eventually, the implementation of restructuring and orderly liquidation systems should contribute to the maximum reduction of costs of these procedures borne indirectly by the taxpayers. This system should allow for the restructuring and orderly liquidation of systemically important institutions without jeopardizing the stability of financial markets. In time, this mechanism, by reducing systemic risk manifested in a negative feedback between financial markets and the sector of public finances, should contribute to the stability of the financial system as a whole.

The increase in responsibility of bondholders and depositors may have a negative effect of an increase in the cost of market financing for banks. However, it should be noted that so far the profitability of bonds issued by banks was derated by the effects of the *bail-out* principle in conjunction with the "too big to fail" doctrine, which meant a lower risk for bondholders. The introduction of the *bail-in* principle will therefore correct the risk assessment for potential bond buyers. Furthermore, this effect may be temporarily neutralised by the ECB using the monetary policy instruments.

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EU FINANCIAL SERVICES LEGISLATION TERMINOLOGY CHAOS

Johan Schweigl[1]

Abstract

This paper surveys the system of definitions and key concepts used in the EU financial services legislation. In a previous paper (2013), the author reviewed the European Commission´s *"Cross-Sectoral Study on Terminology as Defined in the EU Financial Services Legislation"* and presented his recommendation on how the study may be extended. In this paper, the author supported the original results, and extended his analysis. Not only did he focus on the complexity of the EU financial services terminology, but he also pointed out the issue of legal language and translation of the financial services legislation.

Key words

Financial Services; European Commission; Cross-Sectoral Study on Terminology; Legal Translation; Financial Stability; Financial Services Action Plan.

JEL Classification

G18, K20

1 Introduction

In a previous paper (Schweigl, 2013) I employed several arguments to show that the definitions and key concepts used in the EU financial services legislation are inconsistent in some areas. I pointed out that the European Commission ("EC") took several steps in order to improve the existing status quo, and I analyzed the study entitled *"Cross-Sectoral Study on Terminology*

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as Defined in the EU Financial Services Legislation" (the "Study"), which was published by EC and presented as a step toward *"the smooth functioning of the European financial services market."* (European Commission, 2010) The scope of the Study was also investigated. I will recall here just a few highlights.

The principal issue regarding my original work on standardization of terminology used in the EU financial services legislation was to show inconsistency in some terms used throughout the EU legislation and to outline the basic steps EC had taken. The results of the Study were argued to serve as a good stepping stone for further analyses. I concluded that although the Study gave basic overview of the topic, it should be extended and cover more areas, e.g. terminology of international law.

This paper supports and extends the original results. In this paper, I also focused on the effect of language used and appropriate translation of legal terms. I begin restating the original assertion that free movement of services is one of the so-called four freedoms, which are often looked on as the cornerstones of the Single market, enshrined in the Treaty on the Functioning of the European Union ("TFEU"). It is clear that *"regulation within the EU must also support the development of the single market. Irregularity in the implementation of regulations across the 27 EU Member States can undermine the effectiveness of the single market in financial services."* (House of Lords, European Union Committee, 2009: 10)

The concept of free movement of services generally implies the right of individuals and companies to render services throughout all the EU Member States with no hindrances. It applies to all different kinds of services, such as financial services, transportation, telecommunications, broadcasting, etc. The concept of freedom of movement of services has been put in practice by means of directives, regulations and consequently by the decisions of the European Court of Justice (now, the Court of Justice of the European Union "CJEU") (Schweigl, 2013).

EU economy cannot thrive without a healthy, efficient and competitive banking sector. *"Apart from its direct contribution to the economy, the banking sector facilitates economic activity by providing for the most efficient allocation of capital around the economy; and supplying financial liquidity and instruments to control and spread*

risk." (European Banking Federation, 2007: 4). Some argue that the efficiency in this sector is necessary also due to its multiplier effect (European Banking Federation, 2007: 4), which is explained as follows: *"From the production side, it lowers operating costs for other parts of the economy, acting as a catalyst for economy-wide gains in growth and productivity. From the consumers' side, it improves the price, quality and variety of financial services available. The more flexible, competitive market place should allow each client, whether based in a city or a village community, entrepreneur or farmer, to benefit from a similarly broad range of appropriate and attractive services."*

2 Language Used in EU Financial Services Legislation

The existing EU legislation in the area of financial services has been gradually growing over the years so as to form an extensive corpus of law, which regulates many aspects of the financial services. The increasing number of the EU laws brought a specific challenge, i.e. use of certain definitions and concepts which shall be consistent. Legal language is an integral part of general language. Proper selection and use of a language may result in emphasizing or suppressing certain facts (Škop, 2014). The language used in EU financial services terminology, for the area regulated by it significantly influences many aspects of human lives, shall be paid great attention. Some argue that some of the definitions and key concepts used in the EU financial services legislation *"are inconsistent and might lead to differences in the implementation of the EU rules in the Member States."* (European Commission, 2010: 3) It is obvious that inconsistencies in terminology might not only be an obstacle to proper functioning of the legislation on the EU level, but also cause many difficulties with respect to implementation and transposition of EU laws into national legal orders.

As the pursuit of financial stability, which is sometimes understood as *"the common goal of both regulation and supervision"*, (House of Lords, European Union Committee, 2009: 10) is one of the key arguments for having "supranational" regulation represented by EU legislation, there is no doubts that such legislation should be as consistent and clear as possible; *"rules should be as simple and clear as possible, to avoid both confusion and loopholes."* (House of Lords, European Union Committee, 2009: 10) More regulation

is not necessarily better, as it is likely that hastily applied excessive regulation addressing newsworthy problem may cause more harm than good. The quality of regulation is therefore more crucial than the quality. (House of Lords, European Union Committee, 2009: 10)

It is believed that consistent terminology and clear rules are essential for legal certainty in the EU and for smooth functioning of the EU financial services. Not only that the persons and entities regulated by the legislation feel more certain while either rendering or receiving financial services, but also the courts and government authorities applying such legislation are more consistent with their decisions on that matter. While drawing EU financial services legislation, use of a clear and consistent language shall be kept in mind. Aside from that, there is another specific feature of the EU legislation: the EU directives and regulations are translated into the official languages of EU Member states. Confusion however may also occur from improper translation or use of terminology which has multiple meanings in some languages.

As Rek-Harrop pointed out, legal translation has been described by researchers as a category in its own right (Garzone, 2000: 395). According to Rek-Harrop, this is *"mainly due to the complexity of legal discourse that combines two extremes: the resourcefulness of the literary language used for the interpretation of ambiguous meanings and the terminological precision of specialized translation. The translation of legal terminology requires particular attention because it 'consists primarily of abstract terms deeply and firmly rooted in the domestic culture and intellectual tradition' (Chromá, 2004: 48) and thus entails a transfer between two different legal systems, each with its own unique system of referencing."* (Rek-Harrop, 2009: 1). Alchini argues that in the case of a treaty or a specific law written abroad [e.g. on the EU level] which are also intended for application at a national level, it is important that the text in question is properly translated into the national language in order to be accessible not only to experts in the field, but also to lay people or to those who are not familiar with the English language (Alchini, 2012: 3). Such a translation shall be made by experts educated in the respective national law. At least a general expertise in law or/and legal science shall be a requirement for translators or EU directives and regulations into the languages of EU Member states.

As Januleviciene and Rackeviciene explain, legal terms denote the concepts which are created for a particular legal system whereas their creation is based on values and experience of a given nation, so they are closely related to the culture of the nation. *"Most of them are to be ascribed to the category of "culture-bound terms"."* (Januleviciene and Rackeviciene, 2011: 1074). Januleviciene and Rackeviciene argue that *"legal terms will hardly ever contain the same semantic content in both source and target legal systems. In order to understand a legal concept, the translator has to analyse the source legal system - the legal setting the concepts are used in, their functions and purposes and relations with each other, etc. In order to present the concept in a way understandable to a recipient, the translator has to possess sufficient knowledge of the target legal system as well."* In my opinion, the explanation presented by Januleviciene and Rackeviciene point out the most significant issue, i.e. a legal concept cannot be translated without the translator´s having analyzed the source legal system and the recipient of the translated text.

3 The European Commission´s Approach to the Terminology

As argued by Stichele, EC plays a leading role in dealing with the financial sector at the EU level, by organizing the EU wide operation of the financial sector and having the right to initiate financial regulation in many but not all financial services areas (Stichele, 2008: 10). With respect to the EU financial services legislation, EC has repeatedly stated that one of its goals is to *"implement, enforce and continuously evaluate the existing legislation"* so that EU financial market is integrate, open, inclusive, competitive and economically efficient (European Commission, 2005: 3) Stichele further explains that the Treaty of Nice deals specifically with financial services liberalization (Stichele, 2008). Article 51 stipulates that: *"the liberalisation of banking and insurance services connected with movements of capital shall be effected in step with the liberalisation of movement of capital"*, and the article 53 bans all restrictions on payments (current account capital movements) between Member States and between Member States and third countries. Stichele reminds us that not all capital movements related to the capital account are being liberalized immediately

as countries can still take measures for the prudential supervision of financial institutions (Art. 58) and impose restrictions on capital movements with third countries in exceptional circumstances (Art. 59-60) (Stichele, 2008: 10).

Such process of liberalization and the power to Member States to take measures for the prudential supervision of financial institutions requires that a clear, comprehensive and consistent terminology is used. The complex and vast effects the EU financial services legislation has should be kept in mind while drafting the legislation. As Posner and Veron argue, the common public purpose of regulation is however often forgotten: *"Nevertheless, our findings suggest that European decision-makers tried mainly to secure full market integration inside the EU rather than shape regulation to meet a common public purpose."* (Posner and Veron, 2010: 400).

It was already stated in the Financial Services Action Plan 1999-2005 ("FSAP") that *"a fresh look at the present organization of the Union´s structures and procedures for financial services is needed."* (European Commission, 1999: 16). The EC´s White Paper on Financial Services Policy 2005-2010 ("WPFS") emphasized that there should be certain sectoral and cross-*sectoral* consistency checks which would ensure the coherence of terminology: *"investigating legal coherence will necessarily involve studying the approaches taken by Member States, to understand better how Community law is applied in practice, and to ensure that the level of legal coherence that markets need is in fact being delivered."* (European Commission, 2005: 6).

The Financial Services Action Plan was replaced by the White Paper on Financial Services which set out the EC´s objectives to be achieved between the years 2005 and 2010 in order to create "the best financial framework in the world" (Stichele, 2008). *"Studies show that the more integrated financial markets are, the more efficient the allocation of economic resources and long-run economic performance will be. Completing the single market in financial services is more and more recognised as one of the key areas for EU's future growth and jobs, essential for EU's global competitiveness and thus a crucial part of the Lisbon economic reform process."* (European Commission, 2005).

Trying to advance the single market in financial services, the EC set forth an objective that there should be carried out an analysis of the terminology used throughout the EU financial services legislation. Stichele explains that

ithin the EC, it is Directorate General Internal Market and Services, commonly abbreviated as "DG Markt", that has been responsible for implementing the mandate regarding financial services and capital movements, and the freedom of establishment. *"In general, DG Markt7 wants to ensure coherence and consistency between the various related policies such as banking, retail financial services, insurance securities, investment funds, financial market infrastructure and payments systems. The development and application of EU banking and financial conglomerates legislation has been a key policy of DG Markt."* (Stichele, 2008: 13).

On March 10, 2008, the Financial Services Committee's subgroup chaired by Bernard ter Haar published a report on long-term supervisory issues (the "ter Haar Report"). The chapter IV.3, article 91 of the Report emphasizes the significance of clear rules for efficient functioning of the EU financial services legislation: *"There might however be difficulties owing to inconsistencies in terminology between and within financial services Directives, which might lead to differences in the implementation of EU rules in Member States and to legal uncertainty. For instance, some definitions in the financial services Directives are different from those used in company law Directives."* (EU Financial Services Committee, 2008: 47).

In the ter Haar Report, there was repeated the EC shall carry out sectoral and cross-sectoral consistency checks in order to identify any inconsistencies in the respective terminology. The Financial Services Committee's subgroup chaired by Bernard ter Haar invited EC to carry out the consistency checks to foster coherence of terminology and effect across all EU financial services laws.

Further, EC was asked by the ECOFIN Council meeting held on December 4, 2007 to carry out the consistency checks (Council of the EU, 2836th Council meeting, 2007: 16).

4 European Commission´s Cross-Sectoral Study2

Following the invitations by the ter Haar Report and by the ECOFIN Council meeting of December 4, 2007, EC elaborated and published a study entitled *"Cross-Sectoral Study on Terminology as Defined in the EU Financial Services*

[2] This chapter was already published in the original paper (Schweigl, 2013) as a chapter entitled "European Commission's Cross-Sectoral Study".

Legislation" (the "Study") in 2010 (reflecting the situation as of November 27, 2009. Although several years have already passed since the Study was published, it keeps it significant importance for well-functioning concept of free movement of services. As I explained in the previous paper (2013), the scope of the Study and the analysis carried out should be reviewed again and extended. Below, I will outline updated recommendations on where, in my view, the analysis should be extended and the Study amended.

So far, the Study contains four chapters: (i) *Introduction*, in which mainly the background and objectives of the Study, as well as used methodology are presented; (ii) *Main Findings of the Study*, which lays down the results of the analysis carried out by the EC services; (iii) *Further Steps to Be Taken*, in which there is recommendation on what steps should be made in the future and (iv) *Detailed Analysis*, in which there are summoned the core findings of the analysis.

The main objective of the Study was to identify the terminology which is defined differently in the EU financial services legislation, with a cross-sectoral perspective, and to assess whether those differences might lead to an inconsistent implementation of the EU legislation in the Member States (European Commission, 2010:4-5). The researchers limited the analysis to the following areas of (i) the financial services legislation: banking, insurance, pension funds and securities; and (ii) the company law: corporate governance, accounting and auditing. Also draft legislation was analyzed. The researchers analyzed not only the "definitions" article, which is often included in the EU laws, but also *"the terms which are defined in other parts of the texts including the preambles and the annexes."* (European Commission, 2010: 5).

The goal of the analysis was to assess whether the use of different terms or definitions for identical concepts was done properly and systematically and, if not, whether it might cause implementation or interpretation problems. One can see that the goal of the analysis corresponds with the objective of the Study, which was mentioned above.

Based on the Study, it was concluded that *"a great number of definitions which appear more than once in the EU financial services legislation are fully consistent with one another, either because they are drafted in the same way or because they refer to the same*

"leading" definition. At the same time, the majority of differences between the various terms, definitions and concepts were considered as minor or justified, in particular while taking into account the scope and objectives of those legal texts." (European Commission, 2010: 7). Thus most of the findings were assessed as not being likely to cause any interpretation or implementation problems.

In the analysis, there were reviewed the following terms that are being used throughout the EU financial services legislation and company law legislation: professional client vs. qualified investor/eligible counterparty; investment business vs. investment services and activities/ancillary services; financial holding company; parent undertaking; payment account/deposit; (re)insurance undertaking / (re)insurance company; asset management company; participating interest vs. participation; financial sector vs. financial sector activities; member state of origin vs. home member state; reinsurance undertakings; payment transaction; shareholder; firm vs. company / undertaking; financial institution; investment company; business day vs. working days; electronic money holder, etc.

5 Updated Recommendation on the Further Steps to Be Taken

While putting together the Study, EC has reviewed hundreds of laws in which the above terms have been used. Most of the definitions seem to be used consistently. There are however several problematic ones, which, as laid down in the Study, should be aligned or adjusted so that they are more coherent and easier to implement. There are also several aspect on which the Study did not focus, such as language of the financial services legislation, translation into the languages of the Member States and international implications of the terminology used.

According to Bassanini and Reviglio, it is understandable that in the aftermath of the crisis, regulators and policy makers had to be and have been very determined about strengthening the financial system to avoid the repeat of another crisis. *"The new regulation aimed at making the banking system safer by addressing many of the flaws that became visible during the crisis. Improvement in the quality and depth of the capital base and a renewed focus on liquidity management*

are intended to redirect banks underlying risk-management capabilities." (Bassanini and Reviglio, 2011: 15). Such an attempt to improve the quality of financial services legislation shall necessarily be connected with an effort to balance the inconsistency revealed by the Study.

The Study, for instance, finds that EC shall endeavor to align the definition of a "qualified investor" in the Directive 2003/71/EC of the European Parliament and of the Council of November 4, 2003 on the prospectus to be published when securities are offered to the public or admitted to trading (Prospectus Directive) with the definition of a "professional client" and that of an "eligible counterparty" in the Directive 2004/39/EC of the European Parliament and of the Council of April 24, 2004 on markets in financial instruments (MiFID). Further, with respect to the terms investment business vs. investment services and activities/ancillary services, it was set forth in the Study that the alignment in the wording of the Council directive 93/22/EEC of May 10, 1993 on investment services in the field of securities with MiFID shall be considered.

Next, the terms "insurance company" and "reinsurance company", which are used in the Directive of the European Parliament and of the Council of June 14, 2006 relating to the taking up and pursuit of the business of credit institutions, the used term of "company" should be replaced with the term "undertaking" so that it corresponds with the terminology used in the insurance directives. Further it was suggested that the term "member state of origin" should be replaced by the term "home member state" in the Directive 2001/24/EC of the European Parliament and of the Council of April 4, 2001 on the reorganization and the winding-up of credit institutions. Further, *"there should be good reasons for clarifying the meaning and the use of the terms "firm", "company" and "undertaking" in the EU legislation."* (European Commission, 2010: 15). This is just a brief review of some of the findings of the Study.

Another important area in which there are certain inconsistencies is accounting. This particular area should be paid a special attention due to its global interconnection. Not only the terminology, but also general regulation of accounting should be considered. Johnson and Schott argue that accounting standards is another area that some argue is ready for greater

convergence on both sides of the Atlantic. *"There are some major differences between US Generally Accepted Accounting Principles (GAAP) and International Financial Reporting Standards (IFRS), and harmonizing some of them could make doing business more efficient without harming the safety of banks and the system. But both sides already use a process for converting the accounting standards on reporting of derivatives and other matters. It is already possible, for example, to convert US GAAP accounts at least roughly into their IFRS equivalent values. Accounting is a complex topic, involving both market and regulatory considerations - and already covered in the relevant forums."* (Johnson and Schott, 2013: 5).

The Study represents a valuable tool for the future. The Study itself mentions that *"the overview of definitions in the EU financial services legislation will be helpful for the future drafting of legislation, particularly when carrying out cross-consistency checks."* In the previous paper, I explained that there is one much more important use for the Study. Despite its relative complexity, the Study covers only a limited share of the concepts used throughout the EU financial services legislation. The Study with its annexes may serve as a good starting point for further analyses and researches, which shall extent both the depth and scope of subject researched.

The extent of the analysis conducted within the Study shall be extended and systemized. It shall be considered that in the following studies the scope of the study shall cover the entire financial sector and shall take into consideration also the terminology used in international treaties. Currently, the Study mentions international documents just with respect to international rules applying in the accounting and auditing fields, but the terminology has not been examined: *"Since these rules are applicable in the EU Member States, it was argued that they might, indeed, be inconsistent with the terminology as defined in the EU legislation. However, the terminology used in those international rules has not been examined, as it would have, indeed, represent a substantial increase in the scope of the study."* This conclusion was based on the assertion that, anyway, EC does not have any means to exercise any direct influence on those international rules.

In my opinion, it shall be considered that any further analysis carried out by EC based on the Study also include certain international treaties or rules applying in the accounting and auditing fields. It will be helpful if on both

sides of Atlantic same terminology of accounting and auditing is used. In the globalizing world, more and more entities are economically active in more countries, or eventually continents, and harmonized terminology will bring more legal certainty. According to a survey by National Small Business Association and Small Business Exporters Association, as for small businesses, in 2013 there was 52 per cent total increase in the export volume over the 5 preceding years (National Small Business Administration, 2013: 6). In that survey, 47 per cent small business owners stated that they themselves *"manage the bulk of their exporting activities."* This applies not only to USA, but also to EU. Exporting activities of small businesses are on the rise.

A consistent and complex terminology used in accounting rules used in the USA and EU and EU Member States would help to lower their expenses connected with exports. Johnson and Schott remind us that *"at the same time, however, we recognize the contrasting challenges facing US and European regulators and caution against creating international frameworks that could constrain the ability of financial officials and regulators to safeguard their own financial systems."* (Johnson and Schott, 2013: 2). This however does not prevent EC to take into account the different financial environment while carrying out further analysis of the EU financial services terminology.

I agree that EC does not have any direct tools for influencing the wording of thereof, but once such an extended analysis is carried out, it will be useful for drawing further EU legislation which uses certain terms that also appear in international treaties or rules. While drawing further EU legislation, the general meaning of certain terms used in international treaties or rules could be properly considered based on the extended study and could be, where appropriate, put in order with the international standards.

However there is at least one more advantage that such an extended analysis may bring. The drafters of the international treaties or rules applying in the accounting and auditing fields will definitely find it helpful and from then on they might even stick with the EU legislation definitions. In the end, it would have positive consequences on the EU financial services legislation as well. If the international treaties and rules apply same definitions which

are used coherently in the EU legislation, many interpretation challenges arising out of incoherent terminology of such international treaties or rules might be reduced.

According to Olsen, the unavoidable differences between the language versions of the a single document raise questions about how they are produced, and highlight the tension between the expectations of lawyers and the realities experienced by translators. Stern further explains that there has been only limited success in achieving equivalence among multilingual documents with an equal legal status (Kischel); *"but lawyers, as Brand highlights, are unaware of the nature of languages, demand a literal rather than an analytical translation, and are reluctant to embark on a more interdisciplinary approach to the interpretation of legal texts. Linguists and translators, on the other hand, are highly aware that the symmetry of translation is an illusion, and that the concept of equivalence is highly problematic (José Lambert 'The Status and Position of Legal Translation: a Chapter in the Discursive Construction of Societies'). Translators have traditionally used loan words, explanations, adaptations, and footnotes to resolve the problems of discrepancy between legal systems and to compensate for the lack of adequate vocabulary, and in the process have imported foreign concepts into some newer legal systems (Jean-Baptist Bigirimana 'Translation as a Dynamic Model in the Development of the Burundi Constitution')."* (Olsen, Lorz and Stein, 2009: 163). In this respect, it was argued by Galdia that the perception of the denotative character of translation can be traced back to Mincke. In his opinion, legal terms refer to the relevant areas of a legal system; a technical translation therefore requires a descriptive language that can render the incompatible legal terms without any material losses in terms of content (Galdia, 2003:2).

According to Galdia, in the translation of legal terms, one often resorts to pairs of terms which appear somehow connected by a relationship of equivalence. *"The legal denoters which have to date been applied in the descriptive model – e.g. Versäumnisurteil (German for "default judgment") and yksipuolinen tuomio (Finnish for "ex parte decision") have the same legal "meaning", but the question is what do they denote? The difficulty of answering this question may provide more fertile ground for further analysis than the eventual answer itself. At the very least, the difficulty may illustrate that the two designated terms might lack a common denoter."* (Galdia, 2003: 3).

Galdia and Olsen's comment seem to be crucial. It may be recommended that while updating the Study, EC shall also focus on translations of directives and regulations, i.e. consider whether such translations shall be accompanied with additional comments, explanations and adaptations. There should be more experts invited to provision of the analysis to be carried out in order to update the Study. I recommend that not only legal experts should participate in the analysis, but also linguists, legal historians and economist shall take a part in it, as many questions from their field of work should be analyzed.

6 Conclusion

As I concluded in the previous paper (2013), the Study carried out by the EC makes a very important step on the way to further development and enhancement of the complexity and coherence of the EU financial services legislation.

I recommended that the analysis be extended especially in the following matters: (i) international aspects, i.e. while extending the Study, EC should also focus on analyzing the terminology used in international documents regarding financial services and terminology used in national documents of other large jurisdictions and (ii) use of proper language and translations, i.e. experts on national laws and legal translations should be invited into the team of researchers working on the Study.

The current trend in the EU legislation shows that the financial services legislation and other respective legislation connected with it will be regulated more and more on the EU level. EU laws also have however great impact on relations with other jurisdictions. As it was stated in this paper, the Study may serve as a base for further analyses. It was argued that the sooner the Study is extended and updated, the better.

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GENESIS OF INSTITUTION OF BILL OF EXCHANGE AND BILL OF EXCHANGE LAW

Marek Kopyściański [1]

Abstract

The promissory note is an institution functioning in the course of trade (the merchant) for many hundreds of years. Documents used by bankers for the exchange of money, of course, played a slightly different role than the modern promissory note, nevertheless, can be seen in them a basic mechanism links the entities participating in the exchange. Economic basis for the issue of convertible letters, however, was only the beginning of the exchange of money. The real breakthrough was, however, only a simplified formula for the transfer of rights arising out of this type of document, called the endorsement. The institution was "popularized" until the turn of the sixteenth and seventeenth centuries for its cause clearly evolved revolution bill of exchange, while the widespread discounting of bills of exchange. By the end of the sixteenth century law on bills of exchange was only the habitual nature, acting without a doubt an important part of the medieval lex mercatoria. The first bill bills of exchange were made in Germany. The oldest of them was adopted in Hamburg in 1603. The oldest system of law of a bill of exchange is a system based on the French Commercial Code of 1807. The important step in the development of Bills of Exchange Law was the Geneva Conference on Bills of Exchange Law of 1930, which led to the adoption of the three conventions ratified by Poland.

Key words

Tax; law; bill of exchange; promissory note; endorsement; Geneva system; course of trade.

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1 Introduction

The promissory note is an institution functioning in the course of trade (the merchant) for many hundreds of years. The beginnings of its development can be sought as early as the tenth century, when the favorable geographical position in the Italian cities developed both internal trade and external. The political situation, the development of overseas trade, the multiplicity of urban republics beating its own coins in a relationship, among others the need to preserve the independence and therefore a variety of currencies (differentia argenti) were associated with progressively increasing chaos in the circulation of money. Natural, as it seems, the consequence was the development of a specific type of financial services and the emergence at that time groups of people who professionally exercise the exchange of money. They were called money-changers (cambiatores, campsores), or bankers (from banco - table on which were placed the bags of money).

Documents used by bankers for the exchange of money, of course, played a slightly different role than the modern promissory note, nevertheless, can be seen in them a basic mechanism links the entities participating in the exchange. In the twelfth century already formed and the first unification of bankers (Genoa, Venice, Bologna) (Kuliszer, 1965: 270). From 1282 years worked in Florence powerful and influential features of the money changers (Arti di cambio) (Borkowski, 2001: 3). There is no doubt, however, that the institution uses so complicated legal structures, such as a bill of exchange can not arise suddenly. The promissory note as a product marketing practices have to be the result of long-term experience of the merchants of various countries, and to some extent different eras. So probably the first exchange liabilities preceded the much earlier forms of written commitments favorable traded (Koziński, 2000: 313). It seems reasonable, therefore, the search for the origins of the bill in the institution of a debenture, already known to the Roman law (Koziński, 2000: 314), as well as other institutions that were created and developed in the Middle Ages.

2 Documents related to the bill of exchange law

For the formation of the institutions bill, in addition to long-standing trade experience, you were also relevant political and social circumstances. The development of commodity economy and external trade in the Middle Ages certainly favored the development of a simplified yet the credit relations. Credit institution is indeed a product of commodity-money economy. There is no doubt that the emergence and development of various form of credit was strongly associated with the current in the Middle Ages ban on usury (Inglot, 1949: 247).

Lending from XI century was accompanied by the organization of seafaring trade, and later also expeditions land (Kuliszer, 1961: 345-347). In its original form had a character credit personal commitment, and his award was not related to the issuance of any document. Roughly speaking it can be said that the loan "secured the" mutual trust creditor and debtor (Zwierz-Furtak, 2000: 65). In fact, only from the twelfth century began to form documents which form the basis of exchange, which later became the principal instrument of credit (Samsonowicz, 1968: 69). The exchange of money enabled document issued by the banker. The basis for the issue of such a document, seen today as the prototype of the bill, was the agreement on the exchange of money.

A list of parts, because I called them, allow merchants to not only secure exchange, but also travel without risking the loss of money held (Kuliszer, 1965: 270). If you wish to purchase goods in another republic was possible to deposit with the banker the right amount of local currency and in return obtain certification of its recovery with simultaneous repurchase payment equivalent in a foreign currency at a fixed location (Kuliszer, 1965: 271). Withdrawals achieved another banker, working with the issuer, and later mostly belonging to the same unification under a separate letter addressed just to him by the banker, who took the money. The document given to the purchaser, with its own commitment of the issuer to pay a determinate sum of money at a fixed place and time, can be considered as the prototype of a promissory note. It facilitated the exchange of not only money, but also to investigate possible claims against the issuer in the event

of refusal to exchange, thus providing yet at the same time very simple form of security rights, strengthening the creditor's claim. While taking into account the fact that the mere payment followed by a second document, confirming the relationship between the two bankers (merchant was not a participant in this respect), the ratio of the object of which was to provide consisting of the payment of a designated amount of money to the command of the issuer, the issuer relationships, merchant and banker debtor is presented as a prototype of the modern media.

Economic basis for the issue of convertible letters, however, was only the beginning of the exchange of money (Janczewski, 1990: 396). As you would expect the need to simplify the structure caused the exchange of money in a short time, a combination of both documents. The resulting list of subsequent remittance, which confirmed the mutual relations between the three entities already. Banker - exhibitor recommended to a trustee - the banker who is often a partner to this at the designated time and buyer paid - the holder of the letter, a certain amount of money (Żabicki, 1933: 3-4; Bogobowicz, Kulikowski, 1987: 7). While the construction of parts of letters corresponds to the basic outline of the structure of communication, it authorizes the construction of transfer letters for finding compounds with bankers stiff.

Comparing the medieval parts of transfer letters or the promissory note, routed and transmission is justified only at the level of basic research the relationships between the issuer who is responsible to fulfill the obligation and is entitled to its receipt. In fact, until the sixteenth century, these documents do not possess the characteristics circulation, which no doubt largely characterized by contemporary bills. Origins shaping circuit parts and transfer letters can be traced already in the centuries XI - XIII. Then arose the institution Mandatory merchant, making the exchange of money (Żabicki, 1933: 4). Trustee did not acquire the rights, but he was entitled to receive a sum of money in the name and for the account of buyer. He made a collection, though yet simple form. So it was not a document workflow in today's sense of the word (Zwierz-Furtak, 2000: 65). Authorization for Mandatory

originally was granted in a separate document, but over time it has developed the habit of putting it in the same letters, usually anyway on the reverse side (Doliński, 1925: 61).

Another manifestation of the formation of the primary circulation of documents to exchange money was to organize so. markets (fair) bills (Bogobowicz, Kulikowski, 1987: 8; Koziński, 2000: 316). Mention of the first of them date back to the twelfth and thirteenth centuries (Żabicki, 1933: 5). The fair champagne while trafficking trade took place not just a simple exchange of money, but also were concluded loan and credit transactions. Participants fairs bills were bankers (money-changers), because in the Middle Ages turnover of documents related to the exchange achieved in principle solely through them. At the fairs occurred to settlements between the bankers who were exposed to a list of remittance and those who performed on the basis of the exchange of documents. Mutual settlements leveled cash. Italian Bankers in the thirteenth century used the bills, understood as a form of exchange (or conversion) of money. Operations consisted of the promissory note or the direct exchange of money carried out immediately on the spot, or, as already mentioned, the use of pass-letter certifying the deposit of a certain amount from the banker. As customary international merchants at the time was guaranteeing payments, hence less well-known merchants increasingly banked in a more well-known to give yourself the opportunity to "pay" for their name exhibited bills. However, since only a portion of the deposited cash was needed to pay the amounts taken, a large part of the deposits was used for the purchase of discounted bills of exchange, that is, in fact, on interest-bearing loan. So actually began to form the first systems of deposit banks (Rosenberg, 1994: 174).

In addition to used in the Middle Ages transfer letters merchants and bankers were exposed to other documents proving the debt, or debt. Forming in the way institutions, mainly at the fair anyway bills are treated today as a source of some currently used in the course of the institution. For example, the institution receptum argentarii, which is an agreement between a banker and merchant, in which the banker was undertaken against the third party to pay a debt owed by the buyer, in its basic structure resembles today's bank guarantee (Tracz, 1998: 23), in any case receptum argentarii it was

very similar function. It later was supplanted by constitutum debiti alieni (Kolańczyk, 1976: 417), or a promise to pay someone else's debt, which is a promise to outline corresponds to a different provision of a guarantee, namely the provision by a third party. In turn, a trade letter of credit, which is located in widespread use in the twelfth century (especially in the environment of the merchants of London), gave rise to growing in later centuries documentary letter of credit institutions (Fenichel, 1933: 193). Letter of credit was a command merchant, addressed to the banker, authorizing him to pay certain amounts to the beneficiary mentioned in this list. So promissory note and related institutions, such as the purchasing of documents by bankers, rose and stood next to many other activities, which today is known as credit. This was the first phase of one of the fundamental instruments for the exchange of money, evolving over time toward lending to commercial buyers and at the same time promoting development of the first institutions lending money for profit.

At this stage, the decisive role played by economic relations involving the activities of the exchange bankers. They influenced the development of institutions and the creation of bills of exchange bills of exchange standards. Bankers also defines the rules for buying bills from the merchants. The law on bills of exchange were as by international practice and based on the habits produced in the course. Doubts related to the form and content of the bill was settled by the courts guild fairs bills, and that its rulings were widely accepted. Yes developed today known institutions acceptance, protest or recourse (XIV century). Judgments guild also influenced the shaping of the bill features (Czarnecki, Bagińska, 2000: 7). The real breakthrough was, however, only a simplified formula for the transfer of rights arising out of this type of document, called the endorsement. The institution was "popularized" until the turn of the sixteenth and seventeenth centuries for its cause clearly evolved revolution bill of exchange, while the widespread discounting of bills of exchange. The endorsement allowed the first holder to transfer all rights to another person. It can be treated as an extension of the mandate of the Collection of the institution, as it was more convenient time, from a practical point of view, to transfer all rights to the assignee. Sam endorsement also underwent various stages of development. Initially, he was

only allowed a one-time endorsement (hence began to develop the institution endorsement in blank), and the signature of the endorser must have been authenticated by the notary (Zwierz-Furtak, 2000: 65). Only after some time, it was possible to transfer the rights to another person. The formation of multiple endorsement was preceded by the formation of strong opposition from bankers, exemplified by the prohibitions endorsement, even under pain of nullity of the document (Koziński, 2000: 315). These prohibitions have also been circumvented by issuing promissory notes do not contain markings issuer (Szczygielski, 1934: 9). There were indeed blank promissory notes corresponding to modern fantasies, because failure to formal requirements was not related to the core of the blank promissory note of protective function (Machnikowski, 2002: 1). Such documents, however, perfectly facilitate the circulation of the bill. With time, ie, in the seventeenth century opposition bankers in relation to the use of endorsement weakened. Although agreement on a formula endorsement was associated with a "release" bill of exchange of the exclusive marketing agency of bankers, nevertheless, were also important benefits such consent meant for bankers. Instead of one merchant for the payment of a promissory note corresponded a few endorsers, which was not without significance for the purchase bill. Even then the discount in its fundamental structure was similar to today concluded agreements in banking practice. The transaction was not, of course, entrenched so many rigors, however, as now resulted in the payment by banker indicated on the bill of exchange amount, after deducting a certain percentage, in exchange for the transfer of a bill by endorsement on his name. Thanks to the merchant, who gave credit terms, selling goods without collecting dues, could recover the money before the deadline for payment of a promissory note issued by the purchaser of the goods. On the other hand, the ability to discount the bill with a banker it easier to secure the claims of all persons who have made commitments, the principal debtor was all the time a merchant who enlisted in trade credit.

Lending activities in the nineteenth century were mainly private bankers and banking houses, initially combining the credit operations of trade in goods, activities consignor, forwarder and operations of the promissory note. The discount is often merely promissory notes were taken from the same

business, which also dealt with the bank. This involved, of course, better and more secure means of assessing the solvency of debtors. Gradually, however, followed the resignation of activities other than financial. Banks by lending to actively influence the development of industry, transport, trade, and agriculture. At the end of the nineteenth century there was a process of concentration of banks, which have received more evident the role played in the economy by these entities.

In assessing the role of credit, including a promissory note, in evolutionary terms, it is clear gradual increase its importance in the economy. Modern banks, derived essentially from the medieval moneylenders have become specialized financial institutions. They are diversifying their portfolio of assets and ensure optimal allocation of funds between the various possible types of loans and financial investments. With the passage of time significantly enriched forms of credit. In addition to the traditional, such as cash credit or bill of exchange is, new, such as leasing, factoring, or forfeiting. Changed the procedures for lending, repayment terms, and collateral. Above all, however, a much larger role imposed at the expense of trade practices and mutual trust, credit policies resulting from the laws of individual states.

In fact, by the end of the sixteenth century law on bills of exchange was only the habitual nature, acting without a doubt an important part of the medieval lex mercatoria. Seventeenth century has already had the first attempts at legislation and the gradual abandonment of cities from relying on bills of exchange traded exclusively on customs (Koziński, 2000: 316). Contributed to this undoubtedly spread trading bills of exchange, which resulted in more and more serious difficulties in resolving disputes between the holder of the promissory note and the person who had to pay for the bill of exchange. Just mass-circulation produced numerous and often conflicting practices.

3 First regulations

The first bill bills of exchange were made in Germany. The oldest of them was adopted in Hamburg in 1603, the other important Act is the law of Leipzig (1621) and the Act of Nuremberg (1654). Seventeenth and eighteenth

centuries, moreover, brought a number of regulations resulting in different cities of Western Europe. We should mention the most important, ie those that have the greatest impact on the rights of the Ox in the later period: the law Neapolitan, "pragmatic" (1648); Regulation Lyon's (1667); Swedish law on bills of exchange (1671); Danish law on bills of exchange (1681); Italian decree on promissory notes (1704); Russian law promissory note (1729); The bill the Frankfurt Act (1739); The bill Augsburg Act (1778); Austrian law on bills of exchange (1763).

Dissemination of the said bill of exchange operations and legislative attempts to break the consistency of the bill of exchange. Ceased to be purely professional, what was the reason for admission in almost every national legal system of separate solutions. This ultimately led to the formation of three basic systems Bills of Exchange Law.

The oldest system of law of a bill of exchange is a system based on the French Commercial Code of 1807, an important feature was to give his commitment causal character, making the validity of the promissory note from the economic causes of issue. In this way was linked legal interest underlying the issue of a promissory note of the promissory note. For the transfer of a bill of rights was necessary inclusion of the clause "to order". French law system influenced the bill of exchange regulations such, among others. countries like Greece, Belgium, Turkey, Spain, the Netherlands, Egypt, Argentina, Bolivia, Ecuador, Chile, Mexico, Colombia.

Another system, the German system is based on the General Ordinance Exchange gave commitment abstract in nature. A characteristic feature was the far-reaching formalism in the requirements as to the form the bill. The German system treated as a promissory note in the document order, so he does not have to be provided in the clause "not to order". The German system was established with the unification of the existing 56 electoral bills in the nineteenth century Germany and contributed to the regulations of many countries, such as Hungary, Bulgaria, Sweden, Norway, Denmark, Russia, Switzerland, Italy, Romania, Portugal, Japan, Peru.

Completely different solutions have been adopted in the Anglo-Saxon system, whose basic principles are contained in the Act of 08.18.1882 on The Bills of Exchange Act. Great freedom in the requirements as to the form

and entry bearer bill, and the ability to interest and repayment installment is essential to solve this system (Janczewski,, 1990: 400). It is also worth noting that in British law a bill and check institutions are not clearly separated. The system is used in Anglo-Saxon countries such as Australia, New Zealand, India, Pakistan, Israel, Uganda, Malta.

4 Harmonization of laws on bills of exchange in the framework of the Geneva Convention

The variety and diversity of systems regulation bill payables presented serious difficulties in international trade. In time became a factor impeding development. These circumstances gave rise to attempts unification on a global scale. Eventually, they were the result of Hague Conventions of 1910 and 1912, representing a model for the laws of the Interior. These conventions have not been implemented, but have some impact on bills of exchange law of the Member (Koziński, 2000: 319). The next step in the development of Bills of Exchange Law was the Geneva Conference on Bills of Exchange Law of 1930,[2] which led to the adoption of the three conventions ratified by Poland, moreover:

1. on a uniform law for bills of exchange and routed their own;
2. on the settlement of certain conflicts of laws in bills of exchange and capital;
3. on the stamp duty on the bills of exchange and equity.

Following the entry into force of the Geneva Convention with effect from 1 January 1934, the merger of the French and German systems.

The Geneva Conventions did not resolve all the difficulties in international trade, especially in relation to their rejection by such countries as the United States or United Kingdom. Therefore, after the Second World War work on the approximation of the two systems of law bill of exchange (continental and Anglo-Saxon) was taken by the Commission on International Trade Law United Nations (UNCITRAL). Originally it was intended to persuade the state to adopt the Anglo-Saxon modified the Geneva Convention,

2 A detailed discussion of the process of codification bills of exchange at the beginning of the twentieth century, including works on the rules of the Hague and Geneva to prepare for the conference Sułkowski, 1930: 5.

however quickly abandoned this idea as unworkable. Finally, the Commission has limited its activities to the development of the Convention on the so-called. international bills. After more than twenty years of work adopted the United Nations Convention of 9 December 1988 on the international bill of exchange and international promissory note own. However, it has not entered into force today, as it has still not been signed and ratified by the required number of ten countries. UNCITRAL Convention combines elements of Bills of Exchange Law of continental and Anglo-Saxon. It is of minor importance because it concerns only international bills of exchange, ie. those in which content is included placemarks issuance, payment, or residence of the drawee lying in more than one country. Moreover, the application of the Convention in a particular case depends on the will of the parties expressed by the relevant clause inserted in the header of the bill, such as "International promissory note UNCITRAL Convention".[3]

In Poland, along with the development of commodity-money economy also appeared receivables turnover accompanying trade. The basic legal structure used in the initial phase to change the creditor was a Roman cessio legis. The subsequent period brought the use of debentures, of which evolved bearer documents, similar to today functioning in the course of other states bills. The original bills were known earthly Polish law before the formation of the local electoral bills in larger urban centers (Koziński, 2000: 317). The first attempts to interfere in the legislative matter analyzed in the Polish lands took place in Gdansk (1701) and Elblag (1758) and were based on the regulations of German law. In contrast, the first law of general application promissory note was the Constitution of the Sejm of the Constitution of 04.13.1775 cover not only issues of law on bill of material, but interestingly also process (Koziński, 2000: 317). Modelled on the German law recognized the work of a German lawyer Heineccius "Elementa iuris cambialis" for the alternative source of Polish law a bill of exchange (ius subsidiarium).

Bills of Exchange and its legal regulation contributed to the formation of the first Polish banking institutions. Bills become an instrument of easy credit, besides contributing to the ruin of many noble fortunes. This resulted in a number of restrictions on the use of bills of exchange, such

3 On the UNCITRAL Convention, see. eg. Sieber, 1995: 167

as the prohibition of borrowing notes payable by the nobility to 24 years of age, a ban on issuing promissory notes to bearer by the nobility, until the ban on issuing promissory notes by the nobility (1780).

After regaining independence in 1918, enacted by the Polish lands under the occupation Promissory Notes Act and the provisions of residues from the legal system of the Duchy of Warsaw. In 1918, together functioned Act: German, Austrian, French, Hungarian and Russian (Goldszein, 1925: 11).

In 1921, the Codification Commission began work on the law of bills of exchange. The bill was developed on the basis of the so-called. Rules of bills of exchange, developed at an international conference in The Hague in 1910 and 1912, Regulation of 14 November 1924 (Journal of Laws No. 100, item. 926) the President of the Republic of Poland introduced a new law on bills of exchange [Regulation of the President of the Republic of Poland of 14 November 1924 on the Law Promissory Notes (Dz. U. Nr 100, poz. 926)].

Almost at the same time, the initiative of the business community in the world resumed work on the codification of rights bills of exchange, which, as already mentioned, resulted in the adoption of international conventions, including the Convention on the uniform law for bills of exchange and routed own. Poland is a signatory to the Convention to ratify it, and eventually force today adopted the Act of 28 April 1936 law on bills of exchange [The Act of 28 April 1936 law on bills of exchange (Dz. U. Nr 37, poz. 282, ze zm.)].

During this period he was mainly a bill credit function. Banks willing to fullest advantage by paying bills promissory note holders sum, minus the appropriate percentage. In many cases, the rediscount bills were in Polish Bank, which, among others. In this way the influence on the economy (Szpunar,1994: 7).

Neither, however, the rules of the discount or rediscount were not, just as now, included in a defined legal framework. Both transactions were made on the basis of rules developed respectively by the banks and the Bank of Polish.

The next stage of evolution of the Bills of Exchange Law was closely associated with the transition to a centrally planned economy. The promissory

note ceased during that period serve as a credit card. Disappeared completely circulation bill of exchange. The promissory note during this period was basically used in two situations:

1. as security for a loan granted to natural persons;
2. as security for any claims for compensation units socialized against their employees or other persons having a contractual relationship (eg. a contract agency) (Szpunar,1994: 8).

At the beginning of its development was shaped bills of exchange law based solely on the habits formed during carried out by bankers and merchants trading. Introduced gradually reduced the importance of codification of customary law until the almost complete abolition. Today, it plays no significant role (Czarnecki, Bagińska, 2000: 13). Must be different while the relevance of the judiciary for the functioning of a bill of exchange trading. It is not a true source of law bill of exchange, it is nevertheless the case law of the Supreme Court has by its activities interpretative big influence on the content of the law. Not to be underestimated is the role played in this regard by the doctrine. Especially the pre-war literature abounded in a variety of proposals for the use of individual bills of exchange law. Many of the ideas have survived to the present day anyway.

In pre-war Poland until 1925 regulation in two opposing systems, German and French. From January 1, 1925 came into force the President of the Republic of Poland of 14 November 1924, the law on bills of exchange based on the regulations of the Hague Convention, which partially unified rules are already in force on Polish territory. Currently, the primary source of Polish law a bill of exchange is the Act of 28 April 1936, the law on bills of exchange. It shall apply from 1 July 1936 and is based on the Geneva system (continental). The Act does not, however, contain a number of regulations of a general nature relating to the contract obligations and their effective implementation. Given this, and given the fairly widely held view in the literature that the law of bills of exchange is part of the civil law, in particular contract law (Koziński, 2000: 321), additional sources of law for bills of exchange to be considered the law of 23 April 1964 of the Civil Code and the Act of 17 November 1964, Code of Civil Procedure. In particular, the provisions of the general part of civil law significantly complement

the law on bills of exchange. Moreover, due to the fact that the promissory note is subject to the rights of property, and probate bond, the provisions of those parts of civil law are also applicable to the relevant bill. A number of legal norms relating to business transactions also apply to the bill. This is mainly due to the fact that, in practice, the bill of exchange turnover is largely economic turnover.

5 Conclusion

The promissory note is an institution functioning in the course of trade (the merchant) for many hundreds of years. Natural, as it seems, the consequence was the development of a specific type of financial services and the emergence at that time groups of people who professionally exercise the exchange of money. They were called money-changers (cambiatores, campsores), or bankers (from banco - table on which were placed the bags of money). Documents used by bankers for the exchange of money, of course, played a slightly different role than the modern promissory note, nevertheless, can be seen in them a basic mechanism links the entities participating in the exchange. The promissory note as a product marketing practices have to be the result of long-term experience of the merchants of various countries, and to some extent different eras. So probably the first exchange liabilities preceded the much earlier forms of written commitments favorable traded.

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BANKING UNION: EUROPEAN UNION'S IMPACT ON SYSTEM OF FINANCIAL LAW

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Abstract

This Article presents the changes of EU regulation of financial system after the global financial crisis of 2008. Economic efficiency and financial stability issues are central to the governance of financial system, and the achievement of either requires effective institutions, regulations and policy. Following of the crisis, the Commission therefore announced a consistent response to the crisis across the whole EU. This approach resulted in essential changes of financial services legislations. Moreover, the establishment of the European Banking Union with single oversight and resolution of banks in the Member States of the euro area created the new legal framework of financial safety net.

Key words

Banking union; financial crisis; financial market regulation; EU financial market law; financial system.

JEL Classification

G21, G28

1 Introduction

The global financial crisis that erupted full force in late 2008 challenged the existing architecture of financial services regulation and supervision. In the immediate aftermath of the crisis, the European Union took the regulatory response and created a fundamental overhaul of the regulatory and supervisory framework of the financial sector (European Commission, 2014a). The EU financial regulation agenda has been guided by the aim

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of building a safer, more resistant, and more responsible financial system. As the financial crisis evolved and turned into the Eurozone debt crisis in 2010/2011, it became clear that, for those countries which shared the euro and were even more interdependent, a deeper integration of the banking system was needed. Therefore in June 2012, Heads of State and Government agreed to create a banking union, completing the economic and monetary union, and allowing for centralised application of EU-wide rules for banks in the euro area (and any non-euro Member States that would want to join) (COM/2012/0510)[2].

The new regulatory framework, based on a **Single Supervisory Mechanism** and a **Single Resolution Mechanism**, with common rules for banks in all Member States, set out in a single rulebook of prudential requirements and also in Bank *Recovery and Resolution Directive and Deposit Guarantee Schemes Directive,* is the foundation of the banking union (MEMO/14/294).

2 The EU's reform of financial services regulation after the global crisis[3]

The recent financial crisis highlighted the need for better regulation and supervisionof the financial sector. Turning to the changes in the overall structure of financial market regulation that took place in direct response to the crisis of 2008, the most obvious effect has been a shift away from private self-regulation towards public regulation (Mayntz, 2012: 14). Research into change of in respect of financial market regulation addresses the structure and practice of supervision and resolution, as well as the creation of new rules, the amending of existing laws, and the modification of existing standards taking place at the different political levels, from the European Union to the national. It should be emphasized that the changes in financial market regulations motivated by the last global financial crisis are part of a long historical process. Since World War II, the globalization of financial markets

2 A Roadmap towards a Banking Union, Communication from The Commission to the European Parliament and the Council; COM/2012/0510 final.

3 Overview of the EU's regulatory response to the global financial crisis and the measures adopted by EU institutions in response to that crisis. The book makes comparisons with the measures adopted by institutions in the US and the UK. (Bilbao-Ubillos, 2014).

and the financial crises in different parts of the world, have repeatedly led to institutional change in financial market regulation and supervision[4]. (Mayntz, 2012: 11-12).

The pre-crisis framework of financial market regulation and supervision was not capable of responding to the financial crisis, in particular its systemic nature. There were for example no tools in place to deal with the collapse of large cross-border banks. Before the financial reform, EU financial services legislation was largely based on minimum harmonisation, allowing Member States to exercise considerable flexibility in implementation. This sometimes led to uncertainty among market participants operating cross-border, facilitated regulatory and supervisory arbitrage and undermined incentives for mutually beneficial cooperation. Following of the crisis, the Commission therefore announced a consistent response to the crisis across the whole European Union (European Commission, 2014b). This approach resulted in essential changes of financial services legislation. The European Commission has since 2010 proposed nearly 30 new rules to better regulate, supervise, and govern the financial market so that in future taxpayers will not foot the bill when banks make mistakes. Most of these rules are now in force or being finalised.

New directives based on maximum harmonisation and new UE Regulations set a coherent legal framework of common rules to strengthen the stability and resilience of the financial system. Moreover The Commission proposed the establishment of a single rulebook, providing a single regulatory framework for the financial market and its uniform application across the EU.

4 On the one hand there has been increasing regulation, on the other hand, financial markets were increasingly deregulated.

3 First reaction to the crisis: the EU New Framework of Financial Supervision[5]

Before the crisis 2008 different jurisdictions had different arrangements in place for the supervision of the financial market. It is characteristic feature of the financial markets that, while supervisory practices differ from country to country, always show a "home bias", that tends to favour their own financial institutions, in sense that national considerations prevail. Moreover while cross-borders banking groups are dominant, reflecting market integration, much of bank and financial supervision remains domestic. The recent financial crisis highlighted very important flaws in the existing supervisory architecture of the EU Single Financial Market (Argimón et al, 2014: 31-34).

In September 2009 the Commission brought forward proposals to replace the EU's existing supervisory architecture with a European System of Financial Supervisors (ESFS), consisting of three new European Supervisory Authorities – a European Banking Authority (EBA), which deals with bank supervision, including the supervision of the recapitalisation of banks; a European Securities and Markets Authority (ESMA), which deals with the supervision of capital markets and carries out direct supervision with regard to credit rating agencies and trade repositories; and a European Insurance and Occupational Pensions Authority (EIOPA), which deals with insurance supervision (COM, 2009: 252). Their creation aims at enhancing the mechanism to coordinate cross-border supervision, facilitate cooperation between national supervisors, promote convergence of supervisory practices, and monitor implementation of the so-called single rulebook, a single set of rules across the European Union.

[5] To clarify, the term supervision is used in this article to cover both rule-making (regulation) and rule implementation and enforcement (supervision narrowly defined). The former consists in establishing the rules which financial institutions are required to follow, whereas the latter is concerned with enforcing compliance with the regulations and examining the risk exposures and management of institutions.

The three European micro-supervisory authorities (ESAs) were established as from January 2011 to replace the former supervisory committees[6]. The ESAs are regulatory agencies of the European Commission, accountable to the European Parliament and the Council of the European Union[7]. They have legal personality as well as administrative and financial autonomy. It should be noted that the European System of Financial Supervision is established, bringing together the actors of financial supervision at national level and at the level of the Union, to act as a network. Pursuant to the principle of sincere cooperation in accordance with Article 4(3) of the Treaty on European Union, the parties to the ESFS should cooperate with trust and full mutual respect, in particular to ensure that appropriate and reliable information flows between them.

The new regulatory framework to implement the reforms endorsed by the G20 provides the New Supervisory Authorities with a major opportunity to move towards the establishment of the Single Rulebook[8]. The term Single Rulebook was coined in 2009 by the European Council in order to refer to the aim of a unified regulatory framework for the EU financial sector that would complete the single market in financial services. This will

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6 Regulation (EU) No 1093/2010 of the European Parliament and of the Council of 24 November 2010 establishing a European Supervisory Authority (European Banking Authority), amending Decision No 716/2009/EC and repealing Commission Decision 2009/78/EC, OJ L 331, 15.12.2010, p. 12 - 47; Regulation (EU) No 1094/2010 of the European Parliament and of the Council of 24 November 2010 establishing a European Supervisory Authority (European Insurance and Occupational Pensions Authority), amending Decision No 716/2009/EC and repealing Commission Decision 2009/79/EC, OJ L 331, 15.12.2010, p. 48 - 83; Regulation (EU) No 1095/2010 of the European Parliament and of the Council of 24 November 2010 establishing a European Supervisory Authority (European Securities and Markets Authority), amending Decision No 716/2009/EC and repealing Commission Decision 2009/77/EC, OJ L 331, 15.12.2010, p. 84 - 119.

7 For a detailed argumentation and analysis about the legal aspects referring to accountability of the European supervision authorities (the European Banking Authority, the European Insurance and Occupational Pensions Authority, the European Securities and Markets Authority, the European Systemic Risk Board) in the financial field towards political forums and stakeholder. (Iglesias-Rodríguez, 2014: 185)

8 The Single Rulebook derives from the idea that technical rules should be defined at the European Union level and adopted through EU Regulations. That would ensure their direct applicability to all credit institutions, eliminating the additional layer of domestic rules. Such single rules would reduce costs of compliance, limit the scope of regulatory and supervisory arbitrage, and prevent loss of competitiveness of EU wide banking groups.

ensure uniform application of Basel III in all Member States. It will close regulatory loopholes and will thus contribute to a more effective functioning of the Single Market. Consequently, without a common rulebook there can be no Single Market (Larosière, 2013). Regulatory arbitrage[9], which has been a major cause of the financial crisis, always flourishes on national regulatory differences.

The European Banking Authority plays a key role in building up of the Single Rulebook in banking (EBA, 2014). The agreement reached in 2011 on a common rule book is one of the most remarkable achievements of the EU. In line with the Directive **2013/36/EU**[10] and the Regulation (EU) **No. 575/2013**[11] on capital requirements[12] (the so-called CRD4/CRR) EBA has begun the preparatory work to draft " binding technical standards" that will define and specify the content of European legislation in a truly uniform fashion through a Regulation directly applicable throughout the Single Market. The EBA is mandated to produce a number of Binding Technical Standards (BTS) for the implementation of the CRD IV package. BTS are legal acts which specify particular aspects of an EU legislative text (Directive or Regulation) and aim at ensuring consistent harmonisation in specific areas. BTS are always finally adopted by the European Commission by means of regulations or decisions. They will be legally binding and directly applicable in all Member States. This means that, on the date of their entry into force, they become part of the national law of the Member States and their implementation into national law is not only unnecessary but also prohib-

9 Regulatory arbitrage has historically been a driving force in the financial markets. This is avoidance of regulation that would otherwise apply, by range of techniques including the use of offshore financial centres and structuring. Regulatory arbitrage is associated with creative compliance. (Benjamin, 2007: 505-507)

10 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, OJ L 176, 27.6.2013, p. 338 - 436.

11 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, OJ L 176, 27.6.2013, p. 1 - 337.

12 The CRD IV/Capital Requirements Regulation implemented new international standards for the capital adequacy and liquidity framework for internationally active banks published by The Basel Committee on Banking Supervision (know as the "Basel III package") in EU laws.

ited. Additionally ESMA has a vital role to play in contributing to the development of a single rule book through drafting technical standards and providing advice to the Commission. Contrary to the EBA and ESMA, EIOPA has not yet been provided with a basic EU legislative bedrock - Solvency II is still to be agreed upon by the members of the EU.

The most innovative change has been the new emphasis on macro-prudential supervision. Prior to the crisis, there was no institution responsible for macro-prudental supervision, that is to say, an institution with objectives defined in terms of contributing to the stability of the financial system as a whole, monitoring its resilience to systemic risks and ensuring that financial sector makes a suitable contribution to economic growth. The 2009 De Larosiere Report identified as one of the causes the 2008 crisis the lack of attention paid to so-called macroprudential issues, and references to such macroprudential problems started to occur in legistative proposal for future attention. Through no definition is provided, the reference is to problems that lie at the interface between macroeconomic policy and financial system regulation, including cyclicality, counter-cyclicality and leverage (Theissen, 2012: 1166-1179).

In support of macro-prudential regulation, monitoring financial market stability has been re-emphasized at the international, European and national level. Therefore in its Communication of 27 May 2009 entitled 'European Financial Supervision', the Commission suggested a series of reforms to the current arrangements for safeguarding financial stability at the Union level, in particular including the creation of a European Systemic Risk Board (ESRB) responsible for macro-prudential oversight, as the Union-level macro-prudential financial supervisor. On 16 December 2010 the legislation establishing the ESRB entered into force[13]. According to the ESRB Regulation: "The ESRB shall be responsible for the macro-prudential oversight of the financial system within the Union in order to contribute

13 Regulation (EU) No 1092/2010 of the European Parliament and of the Council of 24 November 2010 on European Union macro-prudential oversight of the financial system and establishing a European Systemic Risk Board, OJ L 331, 15.12.2010, p.1 and Council Regulation (EU) No 1096/2010 of 17 November 2010 conferring specific tasks upon the European Central Bank concerning the functioning of the European Systemic Risk Board, OJ L 331, 15.12.2010, p. 162.

to the prevention or mitigation of systemic risks[14] to financial stability in the Union that arise from developments within the financial system and taking into account macro-economic developments, so as to avoid periods of widespread financial distress. It shall contribute to the smooth functioning of the internal market and thereby ensure a sustainable contribution of the financial sector to economic growth." Consequently, the ESRB is a new independent specific body responsible for macro-prudential oversight across its financial system, which identify risks to financial stability and, where necessary, issue risk warnings and recommendations for action to address such risks (addressees of recommendations should act on them and provide an adequate justification in case of inaction – "act or explain" mechanism).

It must be emphasized, that the ESRB's recommendations are not legally binding and hence questions have been raised in academic literature as to whether they have an appropriate effect. However, the ESRB have no legal personality and is not a classic "soft law" body as it is anchored in the EU institutional framework. It is thought that its close connection to bodies which have formal powers may enhance the ESRB's effectiveness (Ferran et al, 2011: 30).

The ESRB attaches great importance to the design and effectiveness of the macro-prudential policy frameworks of the Member States. To ensure the effective follow-up to its recommendations and warnings, as well as supporting any policy measures adopted by Member States on their own initiative, the ESRB outlined some guiding principles for national macro-prudential oversight in Recommendation ESRB/2011/3 on the macro-prudential mandate of national authorities.

It is nevertheless evident that macro prudential oversight can only work well if it relies on good and strong micro-supervision: indeed macro orientations are, in the event, implemented by financial institutions. Such a trend is particularly relevant, given the need for macro-prudential oversight of the financial

14 Systemic risk is defined in Article 2(c) of Regulation (EU) No 1092/2010 as "a risk of disruption in the financial system with the potential to have serious negative consequences for the internal market and the real economy, [whereby a]ll types of financial intermediaries, markets and infrastructure may be potentially systemically important to some degree".

system to cover all financial sectors and to build on the existing information and expertise of micro-prudential supervisors within the EU. As the consequence, the roles of the European Central Bank and the national central banks in the European Systemic Risk Board are justified by their expertise and existing responsibilities in the area of financial stability (Głuch, 2013: 11-14). The approach adopted is also justified by the fact that central banks have a broad overview of the financial sector and by the close link between monetary and financial stability. In addition, generally the powers and responsibilities of central banks in financial supervision have been substantially strengthened in recent years.

4 European Central Bank and the Single Supervision Mechanism

The financial stability area cannot be ignored by central banks; moreover, it should be the focus of further debate and research[15]. It should be highlighted, that financial stability is now generally recognized as an objective of central banks. It is sometimes explicitly started as such in the domestic legislation. In other cases, specific functions assigned to a central banks, such as lender of last resort role, the oversight of the payment system, and the supervision of banks, reflect an implicit common objective of financial stability (Gianviti, 200: 474). Whether supervision over banks, securities, insurance and payment services institutions should be integrated or not, and whether central banks should also perform supervisory function has been an issue for decades. Thus, the role of central banks in the pursuit of financial stability occupies a 'land in between' monetary policy and prudential supervision (Padoa-Schioppa, 2005: 93).

Financial stability has become an overriding policy objective of the European Central Bank in the aftermath of the financial crisis (Lastra, 2012). Thus, in addition to price stability and support of the general economic policies of the European Union, we must add financial stability (mentioned in Article

15 Financial stability is a broad concept, encompassing the different aspects of finance (and the financial system) - infrastructure, institutions, and Markets, (Schinasi, 2004)

127.5 Treaty on the functioning of the European Union) to the enumeration of objectives. Furthermore, we should remember that the ECB has played a key role during the twin financial and sovereign debt crisis in Europe.

The Single Supervisory Mechanism (SSM) for banks is the first pillar of the Banking Union. It gives the European Central Bank responsibility for supervision over banks in the euro area (and other SSM participating Member States). As a result, the SSM creates a new system of **financial supervision** comprising the ECB and the national competent authorities of participating EU countries. Among these EU countries are those whose currency is the euro and those whose currency is not the euro but who have decided to enter into close cooperation with the Single Supervisory Mechanism.

The Single Supervisory Mechanism for the oversight of banks and other credit institutions is based on the Regulation 1024/2013[16] (has entered into force on 3 November 2013) and Regulation 1022/2013 (has entered into force on 30 October 2013)[17]. According to the Article 6(7) of the SSM Regulation, ECB adopted a framework to organise the practical arrangements for cooperation between the ECB and the national competent authorities within the SSM[18]. With its publication an important milestone has been reached.

The European Central Bank will assume its supervisory tasks in full on 4 November 2014, subject to implementation arrangements. The ECB will directly supervise of up to 130 significant groups, which represent almost 85% of all banking assets in the euro area and which comprise around 1,200 individual credit institutions. Credit institutions are considered significant

16 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, 29.10.2013, p. 63.

17 Regulation (EU) No 1022/2013 of the European Parliament and of the Council of 22 October 2013 amending Regulation (EU) No 1093/2010 establishing a European Supervisory Authority (European Banking Authority) as regards the conferral of specific tasks on the European Central Bank pursuant to Council Regulation (EU) No 1024/2013, OJ L 287, 29.10.2013, p. 5.

18 Regulation of the ECB of 16 April 2014 establishing the framework for cooperation within the Single Supervisory Mechanism between the ECB and national competent authorities and with national designated authorities (SSM Framework Regulation), ECB /2014/17, OJ L 141, 14.5.2014, p. 51.

by the ECB according to specific criteria[19]. The SSM Framework Regulation enables ECB to determine which of the around 4,900 individual credit institutions in the euro area will be deemed significant. Moreover in each participating country, at least the three most significant credit institutions will be subject to direct supervision by the ECB, irrespective of their absolute size[20]. All **other credit institutions** in the SSM participating countries will continue to be supervised by the national competent authorities. However, the ECB may decide at any time to exercise direct supervision of any one of these credit institutions in order to ensure consistent application of high pan-European supervisory standards.

5 Crisis Management in the European Banking Union

The recent global crisis highlighted the drawbacks associated with the absence of burden-sharing arrangements to be applied in the event of failure a transnational credit institutions. Repeated bailouts of banks have increased public debt and imposed a very heavy burden on taxpayers. The approved state aid measures in the form of recapitalisation and asset relief measures between October 2008 and December 2012 amount to €591.9 billion or 4.6% of EU 2012 GDP (estimates by European Commission). If we include guarantees, this figure would amount TO€1.6 trillion or 13% of EU GDP (estimates by European Commission) for the period 2008-2010 only (Communication from the Commission, 2013)[21]. If the financial situation of a bank were to deteriorate beyond repair, the new EU crisis management framework would ensure that banks' shareholders and creditors would have to pay their share of the costs through a "bail-in" mechanism.

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19 According to the SSM Regulation, the "significance" of credit institutions, is based on: the total value of their assets; the importance for the economy of the country in which they are located or the EU as a whole; the scale of their cross-border activities; whether they have requested or received public financial assistance from the European Stability Mechanism (ESM) or the European Financial Stability Facility (EFSF).

20 The ECB has published a draft list of credit institutions which have been notified of its intention to consider them significant. The final list of supervised entities notified of the European Central Bank's intention to consider them significant will This list presents such credit institutions together with their euro area subsidiaries, forming a single banking group. (European Commission, 2014c)

21 Communication from the Commission, State aid: Commission's new on-line state aid benchmarking tool shows less aid to banks, Brussels, 20 December 2013.

6 Calculation

The European Parliament on 15 April 2014 adopted the Commission's proposal for a Single Resolution Mechanism (SRM), Bank Recovery and Resolution Directive (BRRD), and revision of the Deposit Guarantee Schemes Directive (DGSD) to complete the legislative work underpinning the banking union[22]. Those three new regulations are interconnected. The BRRD provides a complete framework for the crisis management of banks, while the DGS Directive strengthens the protection of citizens' deposits in case of bank failures. The adoption of those directives contributes to making the Single Rulebook for the banks of the 28 Member States a reality and pave the way to its centralised implementation within the Banking Union. In the European Banking Union, the national resolution funds set up under the BRRD as of 1 January 2015 will be replaced by the Single Resolution Fund as of 1 January 2016 and those funds will be pooled together gradually.

The Bank Recovery and Resolution Directive 2014/59/EU[23] (BRRD) sets new rules for all 28 Member States to put an end to the old paradigm of bank bail-outs, to avoid of use taxpayers money. For the first time, it enshrines in binding rules the principle of bail-in so that shareholders and creditors pay for banks' troubles, not taxpayers. Any additional funds exceptionally required will come from the banking sector itself in the shape of specially set up resolution funds (European Commission, 2014d). So, as the still to be adopted BRRD bail-in tool will not yet be applicable at the time of the conduct of the comprehensive assessment/stress test, burden sharing will apply, in full respect of EU State Aid rules ensuring a level playing field and with a view to safeguard financial stability (European Commission, 2013).

22 Finalising the Banking Union: European Parliament backs Commission's proposals (Single Resolution Mechanism, Bank Recovery and Resolution Directive, and Deposit Guarantee Schemes Directive), Statement of Internal Market and Services Commissioner Michel Barnier, European Commission, Brussels, 15 April 2014.

23 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 and amending Council Directive 82/891/EEC, and Directives 2001/24/EC, 2002/47/EC, 2004/25/EC, 2005/56/EC, 2007/36/EC, 2011/35/EU, 2012/30/EU and 2013/36/EU, and Regulations (EU) No 1093/2010 and (EU) No 648/2012, of the European Parliament and of the Council, OJ L 173, 12.6.2014, p. 190.

All Member States will ensure that the necessary tools are in place enabling them to proceed with such burden sharing, including changes to national legislation as appropriate, in accordance with the EU and international legal order.

*It must be emphasized that t*he Bank Recovery and Resolution Directive relies on a network of national authorities and resolution funds to resolve banks. That's why while this network is a major step forward to minimising different national approaches and fragmentation of the Single Market, it is not sufficient for Member States who share the common currency or are supervised by a Single Supervisor, the European Central Bank (ECB) in the Banking Union. Hence, the Single Resolution Mechanism implements the BRRD in the Euro Area and any other participating Member State.

The Single Resolution Mechanism[24] (SRM) complements the Single Supervisory Mechanism. Supervision and resolution are in fact two complementary aspects of the establishment of the internal market for financial services whose application at the same level is regarded as mutually dependant. Therefore, the Single Resolution Mechanism overlapped with the process of harmonisation in the field of prudential supervision, brought about by the establishment of the European Banking Authority, the single rule book on prudential supervision (CRD IV/CRR package), and, in the participating Member States, the establishment of a Single Supervision Mechanism to which the application of the EU prudential supervision rules is entrusted. The Single Resolution Mechanism will to ensure that if a bank subject to the Single Supervisory Mechanism should face serious difficulties, despite stronger supervision conducted by the European Central Bank, its resolution could be managed efficiently with minimal costs to taxpayers and the real economy. The SRM will also guarantee a neutral approach in dealing with failing banks and therefore increase stability of the banks

24 European Parliament legislative resolution of 15 April 2014 on the proposal for a regulation of the European Parliament and of the Council establishing uniform rules and a uniform procedure for the resolution of credit institutions and certain investment firms in the framework of a Single Resolution Mechanism and a Single Bank Resolution Fund and amending Regulation (EU) No 1093/2010 of the European Parliament and of the Council, COM(2013)0520.

in the participating Member States and prevent the spill-over of crises to non-participating Member States and will thus facilitate the functioning of the whole of the internal market.

The Single Resolution Mechanism is directly responsible for the resolution of all banks (about 6 000) in Member States participating in the European Banking Union. Its structure reflects the division of tasks under the Single Supervisory Mechanism. Moreover, the SRM Regulation establishes the Single Resolution Fund which will be constituted from contributions from all banks in the participating Member States. The Fund has a target level of €55 billion. It will reach the target level over 8 years.

The new Deposit Guarantee Schemes Directive 2014/49/EU[25] (DGSD) preserves the harmonised coverage level of EUR100 000 per depositor and per credit institution even if a bank fails. This guarantee gives savers a sense of financial stability and means that they do not rush to make excessive withdrawals from their banks, thereby preventing severe economic consequences, especially a banks run. (European Commission, 2014e) For the first time since the introduction of DGS in 1994, there are financing requirements for DGS in the Directive. In principle, the target level for ex ante funds of DGS is 0.8% of covered deposits (i.e. about € 55 billion) to be collected from banks over a 10-year period. If the ex-ante funds prove insufficient, the deposit guarantee scheme will collect immediate ex-post contributions from the banking sector, and, as a last resort, the deposit guarantee scheme will have access to alternative funding arrangements such as loans from public or private third parties. There will also be a voluntary mechanism of mutual borrowing between deposit guarantee schemes from different EU countries. Furthermore, access to the guaranteed amount will be easier and faster. Repayment deadlines will be gradually reduced from the current 20 working days to 7 working days in 2024. While DGS will remain responsible for all banks authorised in their jurisdictions, they will also act as a "single point of contact" and manage, on behalf of the home DGS, the claims of depositors of local branches of banks opened in other EU Member States. It should be noted that, under the Bank Recovery and

25 Directive 2014/49/EU of the European Parliament and of the Council of 16 April 2014 on deposit guarantee schemes, OJ L 173, 12.6.2014, p. 149.

Resolution Directive (BRRD), individuals and small businesses with deposits of more than EUR 100 000 will benefit from preferential treatment ("depositor preference"). They will not incur any losses before other unsecured creditors so are at the very bottom of the bail-in hierarchy. Further, Member States can even choose to use certain flexibility to exclude them fully. As a result, together with the provisions on preferential treatment for depositors set out in the BRRD rules, the recast Directive on Deposit Guarantee Schemes, strengthens even further the protection of depositors.

7 Conclusion

Financial crises tend to prompt financial regulatory and supervisory reforms that revise the regulatory and supervisory architecture, so as enhance its effectiveness, with the ultimate aim of increasing the resilience of the financial system. The last global financial crisis brought old domain conflict to the surface again and provided a window of opportunity for reform initiatives that previously did not receive political attention and support. The financial crisis did appeal to be a "bing bang" event that could well have led to radical change.

It is now widely recognized that the neglect of financial stability prior to the crisis was an important contributing factor. Therefore, financial stability should be the ultimate goal of supervision, regulation and crisis management. The immediate reaction to the crisis was crisis management: at the national, European and international levels. However, it is noteworthy that three elements of financial regulations need to be addressed: first, crisis prevention (largely focusing on regulation and supervision); second, crisis management (largely focusing on liquidity arrangements); third, crisis resolution (focusing on mechanisms to address both sovereign and global financial institution crises) (Buckley, 2011: 152-184).

The EU's response to the global financial crisis is important research topic because EU rules to a large extent provide the framework for national regulatory changes in the Member States. Completing the Banking Union is a strategic priority. The establishment of the Single Supervisory Mechanism in autumn 2014 will be an important milestone towards a banking union

in Europe. The banking union aims at building an integrated financial framework to safeguard financial stability and minimise the budgetary costs of bank failures. Thus, together with sustained fiscal and structural efforts and the legislative measures (BRRD, CRDIV/CRR, DGSD), the European Banking Union it is key in ensuring financial stability and a more efficient functioning of the EMU and, as will be apparent, the EU Single Market. While conceptually and economically (not only geographically) distinct from the EU Single Market, the euro-area has, nevertheless, inherited the regulatory and supervisory framework designed for the Single Market. Effective supervision that will, eventually, restore confidence in the banking system and avoid supervisory arbitrage. So, in a EU with two groups of countries (ECB and non- ECB supervised banks) we need strong harmonizing and well functioning pan-European Supervisory Authorities.

Finally, it should be noted that legislative powers to effect institutional change are still concentrated at the national level, but national decisions are affected by higher level demands and ruling. The financial crisis precisely showed that no Member State alone can regulate the financial system and supervise financial stability risks when internal financial market is single.

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ECONOMIC ASPECTS OF LAW REGULATION OF NON-BANK INSTITUTIONS IN THE CZECH REPUBLIC

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Abstract

The paper deals with economic aspects of law regulation of non-bank institutions in the Czech Republic. Non-bank institutions are divided in two groups in the Czech Republic – the first group is organized by the Czech Leasing and Finance Association and the second group called predatory lenders creates the shadow banking. Predatory lenders have a negative impact not only on individuals and their households, however on whole of economics. It will be present some unfair practices of predatory lenders and it will be analysed current law regulations in the Czech Republic and in the EU. The goal of this paper is to point out some possibilities lead to improvement. Description, analysis, comparison and synthesis are the methods used to prepare this paper.

Key words

Non-bank institutions; predatory lenders; the Czech Republic; the EU.

JEL Classification

G23, G28, K20

1 Introduction

Companies and consumers need money for their activities and investments. Only few people have enough money, the rest people have to borrow. They

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often ask relatives and friends or banks and non-bank institutions. Non-bank financial institutions are specialized companies which do not have a full banking license or are not supervised by a national or international banking regulatory agency. Their offer includes investment, e. g. leasing, risk pooling, contractual savings and market brokering. They substitute banks by offer with financial services to individuals and companies. Non-bank institutions specialize on specific segment of clients which are clients with deficits.

The paper is focused on economic aspects of law regulation of non-bank institution in the Czech Republic. We would like to present some unfair practices of predatory lenders and analyse current law regulations in the Czech Republic and in the EU. The goal of this paper is to point out some possibilities lead to improvement. Description, analysis, comparison and synthesis are the methods used to prepare this paper.

2 Banks and non-bank institutions in economics

Generally, financial institutions play an important role for economic growth because they can evaluate, finance, and monitor potential businessmen in their innovative activities. Authors notice fourth reasons of financial institutions importance. According to Boyd and Smith (1992) and Sirri and Tufano (1995) they 1) increase capital accumulation. Greenwood and Jovanovic (1990) point out the next reasons. 2) Financial institutions reallocate capital to its best use. 3) Financial institutions are a good inspectors of a companies – if the companies have problems, financial institutions know that. 4) Financial institutions make it possible to diversity investment risk, which enhances output and economic growth.

King and Levine (1993) realized empirical research in 80 countries over the period 1960 – 1989. They know that finance correlates positively with growth. According to them, level of financial development determines long-run economic growth, capital accumulation, and productivity growth. Levine and Zervos (1998) continue with their work. They find out that initial stock market liquidity and banking development are both positively correlated with future rates of economic and productivity growth. They have used a sample of 42 countries over the period 1976 – 1993.

Next group of authors deals with analysis of exogenous part of financial development. According to La Porta et al. (1998) legal system of a country is very important part of financial development. Their empirical results show that differences among legal systems in terms of protecting the rights of stakeholders and in terms of legal enforcement may account for differences in financial development. Jayaratne and Strahan (1996) confirm that the economy grew faster in deregulated states than in regulated states. They think that the reason for higher economic growth in the deregulated states is improvements in loan quality.

Laurenceson and Chai (2003) notice that some non-bank financial institutions emerged such as rural and urban credit cooperatives, trust and investment companies, and financial companies are only reactions to developments in banking system. They marked non-bank institutions as informal finance. This mark is used in other next studies, e. g. Ayyagari et al. (2007), Allen et al. (2005). According to Cheng and Degryse (2010), both type of institutions has significant an economically more pronounced impact on local economic growth.

3 Development of non-bank institutions in the Czech Republic

Market in the Czech Republic is still very interesting for non-bank institutions. Number of members of the Czech Leasing and Finance Association is still increasing. Current data shows that there are 61 non-bank institutions organized by the Czech Leasing and Finance Association. These institutions offer leasing transactions, consumption loans, instalment scales and others. The Czech Leasing and Finance Association report rank of non-bank institutions according to income debt. Table 1 shows five non-bank institutions with the highest income debt.

Table 1: Non-bank institutions with the highest income debt

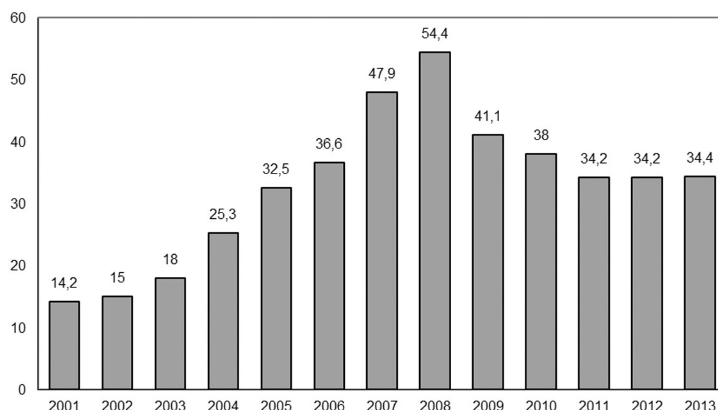
	Non-bank institutions	Income debt in bil. CZK
01.	CETELEM ČR, a.s.	11 151,79
02.	ČSOB Leasing, a.s.	10 689,73
03.	ŠkoFIN s.r.o.	9 119,98

04.	Home Credit, a.s.	8 754,97
05.	UniCredit Leasing CZ, a.s.	8 006,36

Source: Czech Leasing and Finance Association

According to Czech Leasing and Finance Association, 2014), the non-bank financial institutions invested 118.2 bil. CZK (about 4.38 bil. EUR) to the economics in 2012. Consumers involved 35.7 bil. CZK of this investment, businessmen 82.5 bil. CZK of this investment (about 3.1 bil. EUR). In 2013, the most volume of investment is connected with factoring contractions (145.4 bil. CZK), leasing (40.5 bil. CZK), business credits (35.4 bil. CZK) and consumption credit (34.4 bil. CZK). The main reason for low value of consumption loans is the last economic crisis. Current volume of new consumption loans is on two third of level in 2008. Development of new consumption loans is shown in Graph 1. (Czech Leasing and Finance Association, 2014)

Graph 1: Development of new consumption loans lending by non-bank institutions (bil. CZK)



Source: Czech Leasing and Finance Association

Price of loan at non-bank institution is higher than at banks. The main reason is rate of risk from repayment. Non-bank institutions provide money without register inspection, without guarantor, in very short time. These

characteristics are only positive for clients. However, the negative characteristic is low level of transparent because non-bank institutions want not to publish APR. Non-bank institutions argument that: 1) APR is individual; 2) it is difficult to determine APR because it depends on frequency of repayments and repayments time; 3) employees do not inform about APR, only representatives do.

Second negative characteristic of non-bank institutions is low level of information about their products and difficulties in determination of credit. Non-bank institutions argument that credit is not fixed because it differs at premature repayment. (mesec.cz, 2014).

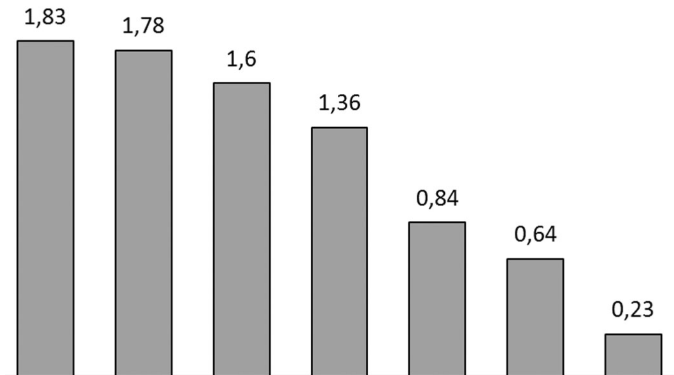
Estimated approximately price for provide money without register inspection is from 60 to 400 % APR. Approximately price of loan for short-term consumption is about 13.3 % p.a. (in banks is about 10.2 % p.a.). (mesec.cz, 2014).

Predatory non-bank institutions are characterized with a number of other negative criteria. The most important negative criteria are: 1) Loan intelligibility; 2) Special sanction for overdue loan; 3) High cost for delay; 4) Arbitral clause.

All these criteria with total price of loan at regular repayment are monitored by People in Need. People in Need added four other criteria in 2011 and created Ethical loan index. The next four criteria are: 1) Use of hedging documents (as bill, agreement about wage deductions) – clients are not possible for fair evaluation of their situation; 2) Repayments revision – how many percent of regularly repayment will be used for sanctions, delay interests, loan interests and principal sum; 3) Court or arbitral costs; 4) Joint actions – to joint all actions. (People in Need, 2014).

The aim of this Ethical loan index is monitor and inform about the behaviour of non-bank institutions according to fair play offer and risk of individual loans in the Czech Republic. It ranges the large non-bank institutions. Ethical loan index divided non-bank institutions according to fulfilling of ethical principles. Institutions on the top range fulfil ethical principles beyond the law.

Graph 2: Ethical Loan Index in the Czech Republic in 2012



Source: People in Need

However, the offer by these largest non-bank institutions does not have to differ from the offer by banks. Some banks in the Czech Republic do not be as transparent and advantageous as banks in the other European countries. The reasons could be sanctions for delay. According to Daniel Hůle, author of Ethical Loan Index (People in Need, 2014), contractual conditions of some banks are worse for customers than 3 years ago. He mentioned that government, Czech National Bank and Czech Leasing and Finance Association put a strain only on non-bank institutions to improvement their conditions. According to him, three largest non-bank institutions set ethical behaviour and trends in approach of their clients. The results from Ethical loan index in 2012 show that banks do not offer customer loans for lower prices than non-bank institutions.

Disadvantages of banks in the Czech Republic: 1) Very complicated contraction conditions; 2) Contraction conditions are not transparent because they do not involved all information, e.g. sanctions or it is not clear how often banks can send reminders and total price for these reminders; 3) High price for extraordinary repayment at some banks or some loans or fees for that; 4) High fees for request of clients, e.g. high fees for change address at some banks.

Banks still do not unify conditions despite repeated notices (Bankovní poplatky, 2014). Sanction conditions of banks show Table 2.

Table 2: Sanction conditions of banks

Banks and their sanction conditions	1.reminder (CZK)	2.reminder (CZK)	3.reminder (CZK)	Frequency of reminders
PS – ERA	300	500	500	is not present
mBank (credit card)	150	500	500	no more than 3
GE Money Bank	600	600	600	1 per month, no more than 4
LBBW	300	500	500	no more than 3
Zuno Bank	350	350	350	is not present
Raiffeisenbank	300	500	1000	no more than 3
UniCredit Bank	350	500	650	is not present
Česká spořitelna	300	300	300	no more than 3 (it is marked as fee for repayment administration moreover postage)
Komerční banka	100	500	500	is not present

Source: Bankovní poplatky

Some selected non-bank institutions have lower fees, e.g. Cetelem or Home Credit. The first reminder costs 100 CZK at Cetelem and 150 CZK at Home Credit; the second reminder costs 200 CZK at Cetelem and 360 at Home Credit; the third reminder is not sent by Cetelem, and it costs 360 CZK at Home Credit. Frequency of reminders is no more than 2 at Cetelem and no more than 2 per a month at Home Credit. Home Credit forgives the fee if it is sent for the first time to client. (Bankovní poplatky, 2014).

We can see, that conditions by banks and the largest non-bank institutions are closer. The worst situation is at small non-bank institutions. There are a lot of small companies with poor information on web pages or without web pages. Loans from these companies have high level of risk. Clients of predatory lenders don't improve their finance, the other way around they have to solve bigger financial problem. A lot of clients by these small non-bank institutions often end with personal bankruptcy. Number of loans offered by these institution is estimated at least 100 bil. CZK. (Bankovní poplatky, 2014).

We have analysed some non-bank institutions according to their web pages. The main information is shown in Table 3.

Table 3: Sanction conditions of banks

Non-bank institution	Loan providing	Contraction conditions	Price of loan	Publish sanctions in CZK	Specifics
Mimořádná půjčka	online	no	no	no	Company can use personal information to all partners for marketing purpose
Kouzelná půjčka	online	no	only APR 1716 %	no	Company can use personal information to all partners for marketing purpose
Dollar Financial Czech Republic s.r.o.	Revolving loan online	yes	Only APR 2333.95 %	300 (1. reminder) 600 (2. reminder) 840 (3. reminder)	Company can use personal information to all partners for marketing purpose
Everyday Plus	online	yes	APR 247.58 %	121 for every 30 delay days	Contract conditions are not easy to understand
Fair Credit	online	no	no	no	All information will be presented by representative at home
Simplepujcka.cz	online	yes	only example: APR 340 %	500 for 1. week, after then 200 % of total loan	Contract conditions are not easy to understand
Crediton.cz	online	yes	APR up to 1000000 %	depend on the loan	Contract conditions are not easy to understand
Pujcka.tv	online	yes	APR up to 520 %	300 for every reminder	no
Tommy Stachi	online	no	no	0,5 % of total loan for every day	Special loans for pensioners
Zaplo Finance, s.r.o.	online	only universal	APR up to 88474.5 %	300 for every reminder; 0,25 % of total loan for every day	no

Source: own processing

It is necessary to increase intensity of inspection from **The Czech Trade Inspection Authority and increase penalty for unfair practices of non-bank institutions.** Number of predatory lenders that operate on the Czech market is only estimated, but it can be more than 34 000 institutions (Tůma, 2013). Czech Trade Inspection controls only about 250 lenders in a year, furthermore the average amount of penalty reaches only to 10 000 CZK, which is about 370 EUR (Navigátor bezpečného úvěru, 2013).

Simply solution is, that clients should read conditions of contract, analyse price of loan and sanctions. Every client has to choose only companies with published whole information.

4 Current law regulations in the Czech Republic and in the EU

In connection with credits from non-bank institutions, there are valid some European directives, especially Directive 2006/48/EC of the European Parliament and of the Council relating to the ranking up and pursuit of the business of credit institutions and Directive 2008/48/EC of the European Parliament and of the Council on credit agreements for consumers in the EU countries. The goal of Directive 2008/48/EC is to make provision for a harmonized Community framework, which should lead to creation a well-functioning internal market in consumer credit. Directive 2008/48/EC establishes the obligation to draw up of credit agreements on paper or on another durable medium or to assess the creditworthiness of the consumer, specifies which information have to be included in advertising or in credit agreement including information concerning the borrowing rate, the consequences of missing payments, the required insurance and other terms and conditions. By this Directive, the consumer shall have a period of 14 calendar days in which to withdraw from the credit agreement without giving any reason. The consumer shall early repay the credit. In this case, interest and the cost of consumer will be reduced for the remaining duration of the contract, however, the creditor shall be entitled to fair and objectively justified compensation for possible costs directly linked to early repayment of credit. Directive 2008/48/EC defines an annual percentage rate of charge (APR) and mathematical formula for its calculation.

The calculation of annual percentage rate of charge was changed later by Commission Directive 2011/90/EU. Moreover, Directive 2005/29/EC of the European Parliament and of the Council concerning unfair business-to-consumer commercial practices in the internal market protects the consumers against unfair or misleading practices of creditors.

The Directive 2008/48/EC is translated into Czech legislation, specifically in Consumer Credit Act (Act No. 145/2010 Coll., as amended) and its novel which became effective 25th February 2013. Consumer Credit Act expanded consumer rights by conclusions of credit agreement. Credit agreement has to be concluded in writing and has to include for example the duration and total amount of credit, the borrowing rate and APR or the right of early repayment. Consumer Credit Act forbids unfair practices, however these practices appear. Furthermore, the novel of Consumer Credit Act enabled to withdraw from the credit agreement without giving any reason within 14 calendar days. Consumer Credit Act relates only to loans from 5 000 to 1 880 000 CZK, which can be considered problematic. However, this limitation comes from the Directive 2008/48/EC, which is involved the credit agreements in amounts more than EUR 200, but less than EUR 75 000.

The usury is often connected with non-bank credit institutions. Nowadays, the usury is covered by civil law and criminal law in the Czech Republic. The Czech Penal Code (Act No. 40/2009 Coll., as amended) defines usury as taking advantage of another's weakness, distress, inexperience, carelessness or disturbance to arrange to be provided with a performance which is in gross disproportion to the mutual performance (§ 218). New Civil Code (Act. No. 89/2012 Coll.) understands usury in the same sense. Usury contracts are as null and void (§ 1796). However, according to some opinions (e. g. Kučera, 2013), New Civil Code sides with usurer, because it enables paying interest from interests too. A court ruling of the Highest Court of the Czech Republic from 15th December 2004, No. 21 Cdo 1484/2004, defines when an interest rate is considered to violate good morals and thus a credit contract as null and void. This is when the interest exceeds quadruple of an ordinary interest provided by commercial banks for the given credit type.

The usury as a legal concept is included in both criminal and civil codes in Belgium, Austria, Germany, Greece, Portugal, Slovakia, Poland, Sweden and Italy too. Estonia, France, Hungary, Bulgaria and Spain have incorporated usury only within civil code, while Denmark, Finland, Latvia, Romania, Slovenia and Malta only within criminal code. (Reifner et al., 2010). According to Reifner et al. (2010), thirteen states of EU have no stated ceilings in place that limit the amount of contractual interest that can be charged on typical credit agreements, including Czech Republic. On the other hand, fourteen states have some form of ceiling. Greece, Ireland and Malta use absolute ceilings, thus fixed nominal rate caps. Relative ceilings, which are calculated in relation to a variable such as the average market rate or base rate, are used in Belgium, France, Germany, Estonia, Italy, Netherlands, Poland, Portugal, Slovakia, Slovenia and Spain. How Reifner et al. (2010) added, the spread of interest rate ceilings is quite high. It ranges from as high as 453 % p.a. for a small loan in Slovenia to a cap of 5.72 % p.a. for some forms of credit in France in March 2010.

5 Conclusion

Non-bank institutions are introduced by two groups in the Czech Republic. The first group is organized by the Czech Leasing and Finance Association and is useful for the economic system because it is competitor for banks. This type of non-bank institution is positive for economic system. Banks have to improve quality and quantity of their services and everything for lower prices.

The second group is created by predatory lenders - institutions outside the control for Czech National Bank and outside the Czech Leasing and Finance Association. They have only negative impact on individuals, their households and whole economics. This type of non-bank institutions ranks among shadow banking. Behaviour of predatory lenders is often non ethic and unfair. Predatory lenders are aimed for under banked consumers especially because they often have some current financial problems and simultaneously they have limited law and financial information. However, behaviour of predatory lenders depends on regulations and there are a lot of possibilities to improvement rules in the Czech Republic and whole the EU.

In our opinion, it is important to control and penalize lenders that don't abide with legislation as well. Non-bank institutions should control and penalize Czech Trade Inspection. But non-bank sector is only one of many supervisory ranges of Czech Trade Inspection. Even so, Czech Trade Inspection has about 420 employees whereas about 34 000 credit institutions create the non-banking sector. According to some opinions (with them we can agree) it might help increasing budget and staff of Czech Trade Inspection. Additional we think that higher penalties should be imposed. So far, in practice the imposed fines were rather symbolic (average amount of penalty is about 10 000 CZK), contrary to what the amount is allowed by law.

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FINANCIAL ASSISTANCE OF THE EUROPEAN STABILITY MECHANISM

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Abstract

The European Stability Mechanism commenced operations on 8 October 2012 providing support for the euro area Member States experiencing or threatened with serious financial problems. From this point of view, financial assistance programs offered by this institution are of key importance. The paper presents a thorough analysis of these programs and their financing. This analysis allows for the verification of the hypothesis that the ESM financial assistance programs are insufficient to achieve the objective to which the institution is set. The study utilizes legal and dogmatic analysis as basic research method.

Key words

Debt crisis; The European Stability Mechanism; financial assistance programs.

JEL Classification

G28

1 Introduction

On 2 February 2012, the euro area countries signed an intergovernmental Treaty establishing the European Stability Mechanism (ESM). This international financial institution started its operations on 8 October of the same year. Its purpose is to offer support to those Member States that are experiencing or are threatened with serious financial problems. Thus the ESM can be considered a permanent mechanism for crisis response in the euro area.

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Fulfilling the functions with which this institution was entrusted is dependent on many factors. The form and volume of ESM stability support as well as the granting procedure, however, appear to be of key importance.

The article has two parallel goals. The first is the analysis of defining the principles on which the ESM programs are based. The second is an attempt to verify the hypothesis that these programs are insufficient to achieve the objectives of the institution. The basic research method used in the study is legal and dogmatic analysis.

2 Forms of the ESM assistance programs and granting procedures

The purpose of the ESM is to support Member States that are experiencing or are threatened with serious financial problems, as long as it is necessary to ensure the financial stability of the euro area and its participants. The maximum amount of assistance offered by this institution has been set to EUR 500 billion. The instruments to implement the ESM financial assistance are as follows:

1. precautionary financial assistance consisting of two credit lines:
2. a loan, provided that the borrower is subject to a macroeconomic adjustment program,
3. the recapitalization of financial institutions through loans to countries belonging to the ESM,
4. purchase of bonds in the primary market (Primary Market Support Facility, referred to as PMSF),
5. purchase of bonds in the secondary market (The Secondary Market Support Facility, referred to as SMSF).

The above assistance programs are regulated in general in articles 14-18 of the Treaty. This agreement gives the Board of Directors, and thus one of the organs of the ESM, the power to define specific guidelines of the implementation of the various instruments. This body also holds the right to revise the list of assistance programs and modify them.

Precautionary financial assistance is addressed to countries characterized by stable economic situation (ESM, 2012a). It consists of two credit lines:

1. Precautionary Conditioned Credit Line (PCCL)
2. Enhanced Conditions Credit Line (ECCL)

Conditions for entitlement to benefit from the individual credit lines are varied. PCCL is available to countries based on pre-established conditions. These include:

1. compliance with the obligations under the stability and growth pact. The fact that the country concerned falls under an excessive deficit procedure does not equal the inaccessibility of the assistance program. The benefits are conditioned by compliance with the decisions and recommendations of the Council of the European Union aimed at the efficient correction of the fiscal balance,
2. ability to service public debt,
3. fulfilling the obligations arising from the excessive imbalance procedure. As above, the implementation of this procedure does not deprive the country concerned of the assistance program benefits. It must, however, aim to resolve the imbalances identified by the Council of the European Union,
4. documented access to international capital markets on reasonable terms,
5. a sustainable external position,
6. the absence of bank solvency problems that would pose systemic threats to the stability of the euro area banking system.

Members of the ESM with a stable economic situation, who do not meet certain eligibility criteria can, however, apply for ECCL. The beneficiaries granted this line of credit need to adopt corrective measures designed to remedy the identified weaknesses and avoid future problems with financing market borrowing requirements.

The aim of precautionary financial assistance is to maintain the beneficiary's access to the market for financing borrowing requirements. It is implemented by enhancing the credibility of the macroeconomic position of the beneficiaries of the program while ensuring adequate safety nets. Thus, the precautionary financial assistance performs primarily a preventive function against crisis situations.

Credit lines that constitute the precautionary financial assistance are granted for one year and may be renewed twice, each time for a period of 6 months. The deployment of funds is initiated by program beneficiaries and amounts to borrowing or selling of bonds in the primary market.

A loan depending on the adoption of macro-economic adjustment program is intended for members of ESM with large financing needs and at the same time lost main access to market financing (ESM, 2012b). This situation results from little interest from lenders or too high a level of profitability expected, which may have a negative impact on the sustainability of public finances. In order to return the country to full market funding and a sustainable economic and financial situation, all loans are subject to macro-economic adjustment program with conditions determined in consultation with the European Commission and in cooperation with the European Central Bank (ECB).

Within the framework of PMSF, the ESM may acquire debt instruments issued by the Member States in the primary market (ESM, 2012c). These purchases are an addition to the support provided in the framework of precautionary financial aid or loans depending on the adoption of macro-economic adjustment program. The purpose of PMSF is to maintain or restore the ESM Member States' participation in the debt market.

The aim of SMSF is to support the smooth functioning of the market of debt instruments issued by the Member States of the ESM (ESM, 2012d). This program runs only in exceptional circumstances, where the lack of market liquidity becomes a threat to fiscal stability. This situation is reflected by an increase in the profitability of bonds to a level that makes it difficult to refinance existing debt and creates problems in access to financing for the banking sector. The activities within the SMSF framework are a form of market making, increasing liquidity and activating investors to further participation. These forms of assistance are available to countries pursuing macro-economic adjustment program as well as those of sustainable economic situation based on pre-established conditions.

Managing instruments acquired as part of PMSF or SMSF enables the ESM to:

1. sell these instruments in the secondary market,
2. hold them in the portfolio to maturity date,
3. resell them to the issuer,
4. use them in repo transactions concluded with commercial banks in order to shape their own liquidity.

The procedure of granting support by the ESM, which lasts about 3 to 4 weeks (Trzcińska, 2013: 21), is governed by article 13 of the Treaty. It is initiated by a formal request of financial support from a euro area country. This country should specify for which assistance program it applies. The Chairperson of the Board of Governors, acting in consultation with the ECB, entrusts the European Commission with the assessment of:

1. the risk that the situation poses to the financial stability of the euro area understood as a certain whole and for its members,
2. The ability to service public debt - as far as possible, this assessment should be carried out jointly with the International Monetary Fund (IMF),
3. the current and potential borrowing requirements of the State requesting financial assistance.

The decision to grant financial assistance is taken by the Board of Directors. Then the European Commission, acting in consultation with the ECB, and - if possible - with the IMF, is entrusted with negotiating the terms of support, to be included in the Memorandum of Understanding. Minutes, approved by the Board of Directors, are signed by the European Commission, acting on behalf of the ESM.

In parallel, the Managing Director of the ESM prepares a draft agreement on the assistance program. It defines, among others, the instruments used and the financial aspects of support. The Agreement is approved by the Board of Directors.

3 Financing ESM assistance programs

The financial foundations of the ESM create a share capital of more than EUR 701.9 billion. Participants include all members of the euro zone. Their share is calculated with a modified ECB capital key[2]. This modification is based on the preferential treatment of the countries whose GDP *per capita* is less than 75% of the EU average.

The share capital of the ESM is divided into two parts. The first part, amounting to more than EUR 80.2 billion, is called paid-in capital. It is composed of contributions from the members of the euro zone in five equal instalments over the period of 2012-2014. These funds are not used for the implementation of assistance programs. On the basis of paid-in capital, an investment portfolio was created for the EMS, providing the institution with a high level of liquidity. The second part of the share capital, amounting to more than EUR 621.7 billion, is created by capital calls. As the name suggests it is paid by euro zone countries to the relevant request (ESM, 2012e). Theoretically assistance programs can be funded from the ESM through capital calls. It is difficult to expect, however, that euro zone countries could significantly increase its equity interest in the institution. The process of bringing paid-up capital, spread over a period of three fiscal years is a certain determinant of the financial ability of the ESM members. In a situation of permanent budget deficit, fulfilling obligations of a capital call would require a public loan. Finally, the need of financing a capital call covering a larger amount would have a negative impact on the creditworthiness of the euro zone countries, and thus the profitability of bonds issued by those countries. It is also an open question whether such a large supply of these instruments would be met by a sufficient demand from investors. In this situation, the capital call can be regarded only as a form of guarantee the members of the ESM gave this institution. This makes repayable funds, raised by the body primarily through the issuance of own debt instruments, the only way to finance assistance programs.

2 This modification is based on the preferential treatment of the countries whose GDP *per capita* is less than 75% of the EU average.

In theory, the ESM is to raise repayable funds primarily for the implementation of assistance programs. This significantly determines the conduct of lending policy by the entity. In its activities, the institution should take into account the high variability in demand for funding from assistance programs reported by Member States. This means that the ESM must have the ability to quickly raise large amounts, even during periods of high uncertainty in financial markets. In addition, this process must involve a reasonable cost. Only in this way, the ESM may provide beneficiaries of assistance programs with favourable conditions for repayable financing.

The above factors are the basis of the ESM equipment in rich catalogue of debt instruments (ESM, 2012f). This allows for a better adjustment of its issuance offer to the needs of potential investors. Nevertheless, the key factor in this offer should be played by plain vanilla instruments, i.e. simple, common and stable financial instruments. Additionally, an appropriate issuance strategy should be adopted to ensure a high level of liquidity. The ESM loan guidelines also allow this institution to apply more sophisticated financial instruments, namely derivatives. The only acceptable reason for their use is hedging against risks, foreign currency risk and interest rate risk in particular.

Existing solutions allow the ESM to participate in both the money market and the capital market. Due to the nature of these markets, they are used to implement a variety of purposes. The money market, a source of short-term financing, focuses activities related to the management of the ESM liquidity. Meanwhile, raising funds necessary to implement assistance programs should take place in the capital market. It is the place of issuing held-to-maturity bonds of 1 to 30 years denominated in euro.

The ESM ability to raise funds is largely dependent on the creditworthiness of the institution, which, due to the method of contributing share capital, depends on the creditworthiness of its members. The ratings of Germany, France, Italy and Spain, the four largest euro area economies, are of key significance. The total share of these countries in the share capital of the ESM is in excess of 77%. Thus, an increase in debt associated with a decrease in the rating of its largest members is primarily the threat to the creditworthiness of the institution. It reduces real guarantees arising from the call

capital for additional bonds issuance by the ESM. It is worth noting that this institution is rated by Moody's and Fitch Ratings. They amount to Aa1 and AAA[3] respectively. Moody's rates the creditworthiness of the ESM lower than the credibility of some of its members (including Germany). The rating of the institution has been reduced from Aaa in November 2012, as a simple consequence of the corresponding reduction in the creditworthiness of France - also from Aaa to Aa1 (Moody's, 2012).

4 Evaluation of ESM assistance programs

Similarly to the IMF, the ESM acts as an international lender of last resort. The institution was equipped with the assistance programs designed for countries having temporary problems with liquidity as well as states struggling with excessive debt. The former are addressed with precautionary financial assistance, while the latter with loans conditional on the adoption of macroeconomic adjustment program. Supporting both groups of beneficiaries, the ESM may also purchase their bonds in the primary and secondary markets. This enables the provision of euro countries with multifaceted assistance in the form of direct support for beneficiaries as well as indirect impact on the debt market, important at least from the point of view of the demand from private investors. Additionally, the ESM provides financial assistance to Member States on the basis of predetermined conditions, and using transparent procedure. The authority to establish new aid programs without having to resort to time-consuming treaty change granted to the Board of Directors is also not without significance. It allows the ESM flexibility in terms of the instruments used.

The amount of funds that ESM can allocate for the implementation of assistance programs is an important limitation. Meanwhile, these programs would be effective if the entirety of requests from beneficiaries could be covered. In this regard, a certain extreme is set by the examples of Italy and Spain. Both countries are indicated as potential beneficiaries of assistance from the ESM in the medium term perspective. In 2013, the borrowing requirements of Italy and Spain were to reach the level of respectively

[3] As of 15 July 2014. More on the EMS website: www.esm.europa.eu

370 and 226 billion (Data from Eurostat website: epp.eurostat.ec.europa.eu). Meanwhile, the maximum ESM lending capacity, which refers to all the countries of the euro area, is only EUR 500 billion. This simple presentation clearly indicates that the institution is not able to finance the borrowing requirements of the largest economies of the euro zone even over several months. In addition, the ESM does not have the mentioned amount of EUR 500 billion. Financing large assistance programs would require an increase in the issuance activity of the institution with the decreasing ability to raise low-cost repayable funds. The following risk factors are of key importance:

1. a large supply of bonds issued by the ESM,
2. the falling ratings of countries with a large share in the ESM share capital, and thus important for the creditworthiness of the institution,
3. an increasing level of the ESM debt.

Such factors would have a negative impact on the profitability of bonds issued by the ESM. It would translate into a deterioration of the conditions under which euro countries were offered assistance programs. In an extreme situation, the ESM could also lose the ability to raise repayable funds. The financing of large assistance programs from call capital is only hypothetical.

In this perspective, the ESM should be regarded only as one of the elements in the set of solutions whose objective is to prevent or manage debt crises. It is possible to outline two frameworks for these activities. In relation to countries with temporary liquidity problems, the ESM may provide them with precautionary financial assistance and initiate bond purchase in the primary or secondary market. In the latter case it will be supported by the Outright Monetary Transaction program. From the formal and legal point of view, its essence is constituted by unlimited purchases of Treasury bonds issued by beneficiary countries under the European Financial Stabilisation Mechanism and the ESM by the ECB on the secondary market. In practice, this program can be compared to the system of warranties provided to buyers of these instruments by the ECB (Panfil, 2013: 486).

In a situation where a country has lost the ability of market financing its borrowing requirements, it may be necessary to restructure its debt, which

in fact is a form of controlled bankruptcy. To facilitate this process, starting from 1 January 2013, Collective Action Clauses are to be applied by members of the euro zone to all new issues of bonds with a maturity date of over one year. They allow a qualified majority of Treasury bonds holders to accept proposals to restructure the debt in order to bind all creditors (Mark, 2012: 6). This restructuring may include, among other things, a postponement of repayments (Das, 2012: 7). Thus ongoing borrowing requirements of the country concerned are limited. In the best of all possible scenarios, their volume is reduced to the level of the budget deficit. In this case, the ESM, additionally supported by the IMF, can provide even a large euro zone economy with repayable financing in the medium term perspective. The basic instrument of assistance would be a loan subject to the adoption of macroeconomic adjustment program by the beneficiary. After stabilizing the fiscal situation of the country, the ESM should also initiate the purchase of bonds issued by the country in the primary market. This allows the beneficiary of the assistance to count on a faster return to market financing of its borrowing requirements.

5 Conclusion

The ESM offers a wide range of direct and indirect instruments to support the euro area Member States and its assistance programs are implemented using a simple procedure on the basis of transparent policy. The limited ESM lending capacity turns out to be the problem. It amounts to EUR 500 billion, which should be considered too small an amount for financing medium-term borrowing requirements of the largest euro area countries. In addition, funds for the implementation of the ESM assistance programs do not come from share capital brought by its members but are raised through the issuance of bonds in the financial market. As a consequence, the ability to raise repayable funds by this institution becomes crucial. Thus, the decline in the creditworthiness of the ESM, which may occur even due to a reduction in the ratings of the largest euro area countries, is an important risk factor for the implementation of assistance programs.

The analysis confirms the hypothesis that the ESM assistance programs are not sufficient to achieve the objectives set for the institution. In this regard, it should be considered only as one of the elements of the set of solutions whose objective is to prevent or manage debt crises.

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CHANGES IN REGULATIONS CONCERNING PRUDENTIAL REQUIREMENTS AND REGULATION OF ORGANIZATIONAL STRUCTURES OF THE LOCAL BANKING SECTOR IN EUROPEAN UNION MEMBER STATES

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Abstract

The presented article contains a discussion of particular aspects of prudential requirements applicable to credit institutions operating in a diverse range of affiliation structures (groups, unions, networks), whose internal connections allow for them to be qualified under the CRR (Regulation 575/2013) as groups under an institutional protection scheme (IPS) or groups in which institutions are permanently affiliated to a central body.

The primary research assumption in this publication is to present the requirements placed by the CRR before both categories of bank groups in order for them to be able to apply waivers and derogations from prudential requirements that are applicable in respect of credit institutions permanently affiliated with a central body or encompassed by an IPS, as well as the very waivers and derogations themselves. Following that, there will be deliberations of how the amended prudential requirements may affect legislative activity in EEA states. The most appropriate methodologies for the stated objectives are the dogmatic and comparative methods.

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Key words

Financial Institutions; Banks; Law.

JEL Classification

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1 Introduction

Successive financial market crises have served as an impulse for the introduction of new measures to increase the security of the banking system. One of these solutions is the implementation of prudential requirements for credit institutions. The ongoing search continues for a certain standard of security that will facilitate equilibration of risk in banking activity while minimizing the potential for the loss of capital liquidity and solvency by such institutions. As a continuation of previous legislative efforts intended to ensure the stability of the EU's financial market and of commercial entities active on it, as well as to provide protection for depositors and their funds, in 2013 the EU adopted a group of legal acts introducing new means of regulating prudential requirements for credit institutions[2]. The justification for introducing the new regulations, as previously mentioned, is the need to shore up security of the banking system and financial market participants. At the same time, the EU legislator has demonstrated in the CRD IV's recitals (Directive 2013/36/EU) its intent to ensure not only a balanced but a diverse banking culture in the European Union; this goal is to be served by such means as encouraging small-scale banking activities, such as cooperative banks (recital 46, CRD IV)[3]. Taking into consideration that small-scale banks are primarily local banks serving local communities, the question arises of whether the EU legislator has succeeded

[2] They have replaced previous capital requirements directives consisting of two Directives: the Banking Consolidation Directive (2006/48/EC) (BCD) and the Capital Adequacy Directive (2006/49/EC) (CAD) (since its inception, the CRD has been amended several times, with major changes in 2010 (CRD II) and 2011 (CRD III)).

[3] As research demonstrates, the co-existence of various categories of institutions providing banking services on the European banking market contributes to enhancing the stability of the banking system (ECB, 2010).

in locating the right compromise between the need to ensure the safe operation of credit institutions and the possibility of conducting activity by local credit institutions.

Observations of recent years lead to the conclusion that in order for local banks to stay afloat on the financial market, they have been forced to operate within banking groups of diverse structures and affiliations between individual members. This begs the question of whether the introduction of more and more robust prudential requirements will necessitate further changes in the structure of the local banking sector, and what normative models for the organization of such structures will be introduced by the EU legislator. The objective of this article is firstly to present two normative categories of banking groups – those whose internal associations allow them to be qualified under the CRR (Regulation 575/2013) as groups with an institutional protection scheme or as groups in which institutions are permanently affiliated to a central body. The second objective is to present solutions concerning waivers and derogations from the generally applicable methods of calculating prudential requirements in respect of credit institutions permanently affiliated with a central body and credit institutions encompassed by an IPS. Membership in such groups allows for the use of preferential methods of calculating those requirements, which may incline participants in such groups of local banks that previously exhibited looser ties to make changes enabling the introduction of an IPS or strengthening the integration of such groups. Increased capital requirements in respect of both the quality and quantity of capital, as well as new requirements concerning liquidity (Gortsos, 2013: 158-160) established in the provisions of the CRR and CRD IV have forced credit institutions to review their own funds and to assess their compliance with the remaining regulations. While these more robust requirements concerning own funds are primarily addressed to global credit institutions of systemic importance and are designed to compensate for the greater risk posed by these institutions to the financial system, changes to prudential regulations apply to all banks regardless of the scale of their activities. The new approach to calculating capital ratios and other prudential requirements in credit institutions will therefore also impact local banks. In other words, credit institutions that, regardless of their organizational

and legal form, take territorial and social considerations into account in their operations and are oriented on providing services to the benefit of the local community (Zalcewicz, 2013: 69-72). It will be impossible for many local credit institutions as individual organizations to fulfil the new prudential requirements; however, by operating under the umbrella of a group they may take advantage of the waivers available to credit institutions permanently affiliated to a central body or those with an Institutional Protection Scheme, which in turn will enable them to comply with prudential requirements.

2 The model of a group of credit institutions permanently affiliated to a central body

The model of a group in which credit institutions are permanently affiliated to a central body was initially envisioned precisely for credit institutions operating at the local level[4], and regulations adopted by some EU Member States allowed for banking groups to operate based on that very model[5]. Presently the CRR defines the requirements that must be fulfilled by a group to determine that a permanent affiliation to a central body has been established. Under Art. 10 of the CRR, qualification for the purposes of applying the relevant prudential requirements requires the following conditions to be met:

- the commitments of the central body and affiliated institutions are joint and several liabilities or the commitments of its affiliated institutions are entirely guaranteed by the central body;
- the solvency and liquidity of the central body and of all the affiliated institutions are monitored as a whole on the basis of consolidated accounts of these institutions; and also
- the management of the central body is empowered to issue instructions to the management of the affiliated institutions.

4 Article 3 of Directive 2006/48/EC as of the day preceding entry into force of the Directive of the European Parliament and of the Council of 16 September 2009 amending Directives 2006/48/EC, 2006/49/EC and 2007/64/EC as regards banks affiliated to central institutions, certain own funds items, large exposures, supervisory arrangements, and crisis management, OJ L 302 of 17.11.2009, p. 97.

5 Denmark (1990), Finland (1996), France (1984), the Netherlands (1978), Luxembourg (1984). For example, under Luxembourg law (Art. 12 of the Law of 5 April 1993 on the financial sector, as amended) so-called rural banks operate under this model.

Concerning the last condition, an explanation should be given of the phrase "empowered to issue instructions". This means the authority to issue recommendations intended to protect the stability of the group and ensure that affiliated institutions operate in compliance with legal regulations and their contract. It must correspond with the authority to monitor and assess whether the affiliated institutions are operating in compliance with those recommendations.

It should be emphasized that permanent affiliation does not preclude the voluntary withdrawal of an institution from the group, nor its expulsion. One possibility is that the central body may propose to exclude affiliated institutions from the group if the affiliated institutions do not comply with the documents and instruments governing the affiliation's arrangements[6].

It should also be mentioned that credit institutions permanently affiliated to a central body which are exempt from observing certain prudential requirements are not able to use an individual EU "passport". Under the adopted conception, in this model a group composed of a central body and affiliated institutions comprise a whole. As a result, they are treated as credit institutions with a large network of branches. In consequence, they may take advantage of the passport as a group, or the central body may use its own passport.

3 Institutional protection scheme

The provisions of the CRR allow for national supervisory authorities to take another approach in respect of fulfilment of prudential requirements by credit institutions under Institutional Protection Schemes (IPS). This applies to some of the prudential requirements set forth in the Regulation under discussion.

Institutional Protection Schemes provide for ensuring the stability of credit institutions associated in a banking group by developing an appropriate system for of intra-group relationships. Elements present in every IPS are:

6 For more, see CEBS's guidelines regarding revised Article 3 of Directive 2006/48/EC, http://www.eba.europa.eu/documents/10180/105091/cebs15_Guidelines.pdf

protection of credit institutions and measures ensuring their liquidity and solvency; a foundation based on private arrangements and financing from private means (Consultative Document, HG/VH/WSC/B2/11-117, 2011).

As a result of differences among EU Member States[7] concerning agreements on guarantees and support for credit institutions encompassed by IPS, the CRR contains the conditions that must be met for such institutions to be subject to more beneficial prudential requirements. However, the Regulation does not contain a typical legal definition of an IPS. Nevertheless, its provisions allow us to say that an IPS is a contractual or statutory liability arrangement[8] which protects credit institutions (IPS members) in order to prevent their insolvency; in particular, it guarantees their liquidity and solvency, and is compliant with the conditions set forth in Art. 113(7) of the CRR. Those conditions address guarantees of support from IPS members, monitoring and classification of risk, reporting obligations, IPS members' own funds and the transfer of them, as well the operational profile and seats of IPS members, and the permanence of affiliation.

A closer analysis of these requirements indicates that, considering the purpose for which an ISP is adopted – to ensure the financial stability of its members – it is first necessary to establish affiliations within the group as well as institutional solutions that will facilitate the provision of assistance

7 IPS function in Germany or Spain.
The German IPS is the world's oldest system of protection (in Germany there are two separate IPS in operation: BVR-Protection Scheme and Institutional Protection System of the Sparkassen-Finanzgruppe; Cuper, 2013).
In Spain, there are IPS for savings banks (e.g. in July 2010 Caja de Ahorros y Monte de Piedad de Madrid, Caja de Ahorros de Valencia, Castellón y Alicante (Bancaja), Caja Insular de Ahorros de Canarias, Caja de Ahorros y Monte de Piedad de Ávila, Caixa d'Estalvis Laietana, Caja de Ahorros y Monte de Piedad de Segovia and Caja de Ahorros de La Rioja signed an integration agreement to establish a Contractual Group organised as an IPS (a Sistema Institucional de Protección under Spanish law) and cooperative banks (see: Zurdo, Palacio, 2010: 191). The first IPS in Spain (a soft SIP, with no mutualisation of profits) set up four rural savings banks in 2009 (the Grupo Cooperativo Cajamar); Giagnocavo, Gerez, Sforzi, 2012: 281-315. At present "the Bank of Spain is (…) only authorizing SIPs that mutualise all their profits and give each other unlimited support" (García, 2011: 15).

8 A certain problem arises, however, when interpreting the provisions of Directive 2013/36/EU due to the fact that in Art. 56 and 57, mention is made of contractual and institutional protection systems referred to in Art. 113(7) of the CRR Regulation, as contractual and statutory liability arrangements fall under the conception of an IPS under Art. 113(7).

to IPS members under their mutual obligations from funds readily available to the IPS[9]. The existence of such funds and obligations (guarantee of support) is a necessary condition for declaring that a given IPS fulfils the requirements of the CRR.

Secondly, the necessity of providing for a comprehensive assessment of the risk borne by individual IPS members and by the institutional system of protection as a whole results in the next legal requirement that an IPS be equipped with appropriate and uniform mechanisms for monitoring and classifying risk, as well as the appropriate tools for action. An Institutional Protection Scheme must also provide its own risk assessment and make it available to individual members. The adequacy of such mechanisms is subject to verification by national supervisory authorities, who are obliged to regularly monitor them.

Another requirement is that an IPS annually prepares and publishes a consolidated report concerning the IPS as a whole.

In respect of own funds, the following must be excluded: the practice of "multiple gearing" and all inappropriately established own funds between IPS members.

Another condition of the EU legislator is that an IPS be based on the broad participation of credit institutions of an essentially uniform operational profile. Such systems are thus created within the framework of cooperative banking groups (e.g. in Germany the BVR-Protection Scheme) or savings banks (e.g. in Spain). Also, IPS participants must have their seats in the same Member State.

The CRR also requires that the affiliations within the system be of a permanent nature. Permanence is to be ensured by an appropriately long notice period preceding the cessation of participation in the IPS. The EU legislation referred to herein sets forth a minimum period of 24 months (in various states this permanence is enhanced, such as in Spain, where under the Royal

[9] As indicated: "The institutional scheme shall have adequate resources at any point in time to fulfil its statutory objective of ‚protecting institutions' and ‚ensuring their liquidity and insolvency to avoid bankruptcy in case it becomes necessary'", ID 502. Institutional protection scheme – eligibility criteria, http://ec.europa.eu/yqol/index.cfm?fuseaction=question.show&questionId=502

Decree Law 6/2010 credit institutions must remain in the IPS for a minimum period of 10 years and give at least 2 years' notice of their intention to leave it upon expiry of that period).

Considering the objective of adopting an IPS, which is to ensure the financial stability of its members, it is necessary to establish connections within the group and to ensure solidarity among its members, which inevitably leads to certain limitations in the self-determination of the group's individual members[10].

In summarizing the above deliberations, it should also be mentioned that the legislation adopted in 2013 addressing prudential requirements does not change the rules concerning IPS (as in the case of the rules for groups of credit institutions permanently affiliated to a central body); only their formal status has been modified (Koleśnik, 2013: 284-285). At present these issues are addressed within the scope of the CRR (previously in Directive 2006/48/EC).

4 Waivers and derogations from prudential requirements for credit institutions permanently affiliated with a central body and credit institutions participating in an IPS

In the case of credit institutions permanently affiliated with a central body, Art. 10 of the CRR allows for partial or whole waivers from capital requirements in respect of own funds and liquidity[11] for one or more credit institutions situated in the same Member State and which are permanently affiliated to a central body which supervises them and which is established in the same Member State. Apart from this rather general provision, the Regulation under discussion also contains norms addressing specific rules applied in determining fulfilment of prudential regulations

10 This result directly from e.g. the provisions of the Articles of Association of the BVR-Protection Scheme, whose preamble emphasizes that "Although this solidarity limits the cooperative principles of self-responsibility and self-management, it is an essential precondition for the independence of the cooperative institutions and the decentralized structure of the cooperative network", http://www.bvr.coop/coop/download/Statut-eng-RZ.pdf

11 Under the wording of Art. 10 of the CRR, this concerns the potential to derogate from the application of the requirements set out in sections II-VIII of the CRR.

by credit institutions permanently affiliated with a central body. Thus, under Art. 84(6) of the CRR:

> Where credit institutions permanently affiliated in a network to a central body and institutions established within an institutional protection scheme have set up a cross-guarantee scheme that provides that there is no current or foreseen material, practical or legal impediment to the transfer of the amount of own funds above the regulatory requirements from the counterparty to the credit institution, these institutions are exempted from the provisions of this Article regarding deductions and may recognise any minority interest arising within the cross-guarantee scheme in full[12].

Regarding credit institutions encompasses by an IPS,[13] exemptions may be applied from the rules for calculating own funds. In addressing "Exemptions from and alternatives to deduction from Common Equity Tier 1 items", Art. 49(3) of the CRR states that for individual calculation of own funds by institutions operating under an IPS[14], competent authorities may, for the purposes of calculating own funds on an individual or sub-consolidated basis permit institutions not to deduct holdings of own funds instruments when an institution has a holding in another institution and further conditions contained in the Regulation are met[15].

Another exemption concerns the application of the Internal Ratings Based Approach (IRB). Credit institutions permitted to apply the IRB Approach in the calculation of risk-weighted exposure amounts and expected loss amounts for one or more exposure classes may apply the Standardised Approach for exposures between institutions which meet the requirements of Article 113(7) (Art. 150(1)(f) CRR).

Credit institutions engaged in an IPS are also subject to some exemptions concerning limits to large exposures. Under Art. 400 of the CRR Regulation,

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12 These institutions are excluded from applying provisions of Art. 84 of the CRR concerning write-offs.

13 In the remainder of the article the term IPS will only be applied to schemes that meet the requirements set out in Art. 113(7) of the CRR.

14 And also on a sub-consolidated basis.

15 The conditions set out in Art. 49(3)(a)(i - v) of the CRR.

Art. 395(1) is not applicable to exposures to claims on partners referred to in Art. 113(6) or (7) if they would be assigned a 0% risk weight under Part Three, Title II, Chapter 2 of the CRR.

Credit institutions engaged in an IPS as well as those permanently affiliated to a central body are also subject to Art. 84(6), which means that they too (upon fulfilment of the same requirements concerning cross-guarantee schemes[16]) may recognise any minority interest arising within the cross-guarantee scheme in full.

In respect of liquidity coverage requirements, banks under an IPS may apply lower risk weights for outflows of deposits from other IPS members, apply preferential rules in respect of inflows, and also apply a lower percentage inflow ratio in individual cases (Art. 422 and 425 CRR)[17].

Concerning capital requirements, under Art. 133(7) of the CRR credit institutions operating under an IPS may apply a 0% risk weight to internal group exposures.

5 Conclusion

Presentation of the requirements of the CRR concerning banking groups and their potential to apply exemptions and waivers from generally applicable prudential requirements allows for capturing the directions of changes taking place in legal regulations addressing model structures for the organization of banking groups that are the result of further EU-level legal acts and prudential requirements, and primarily induces reflection on further changes to the organization of the local banking sector in EU Member States.

In comparing present regulation for the models of banking groups with that of the previous regime, it should by acknowledged that no changes have occurred. However, the requirements placed before banks concerning prudential requirements have stiffened quite a bit. Local banks are particularly exposed to difficulties in meeting those requirements. The small scale

16 Which were mentioned earlier in reference to institutions permanently affiliated to a central body.

17 Permission from the appropriate supervisory authority is required in order to apply some of the preferential solutions given.

of their activities, their social aspects and their often unique organizational and legal form that is the cooperative all make it tougher for them in comparison to other credit institutions to acquire the capital required by law and to meet new standards concerning capital requirements and own funds structure, as well as liquidity and solvency requirements. In order to fulfil these requirements, it has become necessary to participate in a range of different banking group structures. However, the implementation of the CRR 's provisions into national law and the obligation to transpose the CRD IV will again force a revision of legal solutions within individual states, not only in respect of banks' financial management but also the organization of the entire sector.

Legislatures in EEA members must assess the need to introduce regulations facilitating the creation of tighter bonds within banking groups, in order for those groups to have the capacity to fulfil the requirements set out in the CRR for IPS groups, as well as for groups in which the institutions are permanently affiliated to a central body. This leads to the conclusion that changes to EU law in respect of prudential requirements will impact not only national regulations on banks' financial management, but may also lead to significant changes in regulations addressing the entire local banking sector.

Against the backdrop of the deliberations conducted above, the question also arises of to what degree local credit institutions forced into closer cooperation within new structures will be able to maintain their independence and perform their tasks on behalf of the local community. Further implications thus arise. Indeed, if entry into an Institutional Protection Scheme or permanent affiliation to a central body reduces local banks' autonomy and the capacity to perform their mission, would this not be in conflict with the declarations of the EU legislator, and would it not lead to a degradation in the EU's diverse banking culture rather than its strengthening – and is this not against the interests of the EU's citizens? It may turn out that local banks lose their identity, and while they may fulfil the prudential requirements thrust upon them, they may not be able to effectively perform their social function to the benefit of the local community, thus blurring the lines between them and other credit institutions.

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REGULATION OF THE FINANCIAL SERVICES IN THE SLOVAK REPUBLIC[1]

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Abstract

The objective of creation of a single common European market for financial services is the effective functioning of the financial market facilitating stable economic growth supported by the fact that the financial services have become one of the most dynamically developing sectors of the economy in recent years. The aim of our article is to evaluate critically on the basis of standard scientific methods (comparison, analysis, synthesis, deduction) the existing regulation in the field of provision of financial services in Slovakia with special accent on the banking sector in relationship with the existing and planned transnational regulation objectives within the EU area as it exists today with expected positive and/or negative effect. This article analyses the current legal regulation that should ensure adherence to the rules of prudent business practices in the field of provision of financial services as well as the regulation by the organizational unit in charge of supervision over the financial market in the banking sector of the Slovak Republic.

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Key words

Financial services; regulation; supervision.

JEL Classification

G28, K20

1 Introduction

The recent financial crisis that resulted in the economic depression has proven mutual intensive interaction between the commercial financial and other sectors of economy as well as the immediate effect of the development on the financial markets on global economic development and at the same time accented the fact that this issue needs permanent attention especially due to the fact that inadequate liquidity in individual financial institutions (banks) and their limited access to financial market may have significant negative impact on functioning of the financial system as a whole. The reason[4] for regulation of activities of the financial market participants is the fact that the financial markets in some cases fail during transfer of available funds from participants with excess of funds to participants experiencing the deficit funding (Veselá, 2007: 30) resulting in the ***information asymmetry*** (functioning of the financial markets assumes participation of perfectly informed participants but various participants in the financial market do not have equal access to information or have different skills when evaluating the information that is accessible); ***misuse of information***, (this appears especially in the form of utilization of private information for trading, the so called insider dealing, when the investors trading on the financial markets aware of the relevant information gain earnings at the expense of other market participants, or if the investor is deceived with incomplete or misleading information, or when the clients of the financial institution receives biased advise in order that the security trader may maximise its profit); ***system risks*** (is represented by the risk related to disturbance of the overall stability of the financial system that may come about from

[4] General reasons for regulation of markets include consumer protection, restriction on monopoly tendencies of participants, public protection against criminality, restrictions of negative consequences of externalities.

the processes inside the financial system resulting in appearance of vulnerable areas, but also as a result of shocks that may be caused by institutional changes, unfavourable macroeconomic development, negative change in the economic situation of the creditors and debtors of financial institutions resulting in the risk of massive insolvency. Long-term and cumulated effect of these developments may result in the collapse of the whole financial system.); ***misuse of a dominant position*** (is understood to be a certain position of a participant or participants on the market that allows to a certain extent behaviour independent of other parties on the market, even though the actual dominant position does not represent the actual misuse but a threat that the competitive environment might by undermined; misuse of the dominant position enables certain group of participants to achieve more than average profits or other benefits on the market). (Musílek, 2011: 112).

2 Financial services – economic overview

Business in the field of financial services is currently, among other things, significantly influenced by the phenomena such as integration and globalization[5]. Trading with financial instruments on financial markets does not involve only transfer of funds from participants having excess funds to participants with financial deficit, but also to diversification of the risk among individual economic participants. The financial market offers a wide scope of financial services. On a simple level these services can be subdivided into four categories: ***1. Transaction services*** that essentially create financial instruments (products) and secure their smooth movement thus enabling individual economic participants to implement effective payments and settlements (they provide extensive supply of products and services including the services of e-banking); ***2. Insurance services***, that in many developed countries are offered by financial institutions on the basis of the long lasting tradition based primarily on trust (their main task is the quantification of risks and provision of financial security for their clients). Their characteristic feature is considerable conservatism in management; ***3. Services***

5 For example globalisation facilitated deregulation in the banking and enabled non-bank financial institutions to do business with liberalized bank products.

related to trading with securities, including trading with securities and investments in the securities implemented mostly through the agency of the non-deposit financial institutions especially through the investment companies; ***4. Intermediary services***, that form the biggest group of financial services enabling to concentrate temporarily available funds and extend them for a certain period to participants that are capable to use them effectively and stimulate the growth of savings, investments and consequently the growth of the whole economy. ***The financial system*** provides the mechanism through which the savings (primarily of the households) are transformed into investments (especially in the business sector). The financial markets substantially facilitate the implementation of this trading thus fulfilling specific economic functions: ***1. Price determination function*** (the prices of the financial instruments are determined by mutual interaction of supply and demand on the financial markets); ***2. Liquidity provision function*** (enables the owners of financial instruments to sell respective instruments on the secondary market before its maturity); ***3. Transaction cost reduction function***. (Polouček, 2010: 256). The authors Horniaková and Čunderlík in their publication *Financial market* itemize other important functions of the financial market, including: mobilisation function[6], redistribution function[7], allocation function[8], selective function[9], liquidity function[10], political function[11]. (Horniaková, et al, 2009: 11). Considering the basic role of the financial system, which is the transfer of scarce loan capital from the participants that save to the participants that demand financial capital for consumption and investments, we may also itemise several functions of the financial system: ***credit function*** representing the supply of credit facilities for the companies in order to secure their consumption

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6 It relates to the fact that the financial market through its intermediaries mobilizes savings from all accessible sources so that they can be used as financial investments.

7 The funds are transferred from the location with temporary excess availability to the locations where they are in short supply.

8 It means that the accumulated funds will be located on the financial markets offering better returns, i.e. where their use is the most effective.

9 This function focuses on creation of space for support and development of businesses with perspective and acceleration of dissolution of businesses with no future.

10 This function means that the wealth in the form of diverse instruments may be mostly very easily changed into cash with very little risk of loss.

11 This function promotes creation of the environment for implementation of the financial measures as well as of the overall government economic policy.

and investment spending as a part of their economy; ***liquidity function*** that is related to the acquisition of the funds as a result of exchange of securities for cash on hand; ***deposit function*** that offers relatively profitable but less risky options for deposits in the securities; ***wealth assurance function*** that provides instruments for maintenance of purchasing power until it becomes necessary for purchase of goods and services; ***protection against risk function*** representing the offer of measures for protection of companies, consumers and governments against the risk resulting from the activities of the people or in the field of property or incomes; ***payment function*** representing the mechanism for payments for purchase of goods and services, and ***political function*** that facilitates implementation of the government objectives concerning common economic objectives[12]. Based on the above presumed function or tasks of the financial markets it is possible to conclude that the financial market together with the financial institutions and financial tools is at the base of the whole financial system that launches the economic processes enabling the financial intermediaries, using financial instruments[13] to accumulate, allocate and reallocate temporarily available funds on the basis of their supply and demand.

3 Financial services – legal supervision

The beginnings of formation of the financial market in Slovakia date back to 1990 when the transition from the centrally planned economy to market economy was launched. Changing conditions gradually facilitate formation of ***legislative preconditions*** for functioning of the financial market and strong institutions with the state of the art technology started to emerge with their structure corresponding to that of the advanced financial markets (Chovancová, 2002: 24). According to V. Babčák the ***basic source of the financial market legislation*** should be seen in the Constitution of the Slovak Republic that anchors the *National Bank of Slovakia* as the independent central bank supervising the whole financial market in the Slovak

[12] Assurance of positive employment rate development, reduction in the inflation rate, reasonable economic growth.

[13] The concept of financial instruments includes securities, diverse types of financial derivatives, deposits, credits, special credit forms as factoring, forfaiting and leasing.

Republic. The author includes among the basic legal sources of the financial market legislation *the National Bank of Slovakia Act, the Bank Act, the Protection of Deposits Act, the Insurance Business Act, the Stock Exchange Act, the Slovak Republic Eximbank Act, the Contract Savings Act, the Financial Market Supervision Act, the Foreign Exchange Act, the Securities Act, the Bonds Act, the Collective Investments Act, the Commercial Code, the Bill of Exchange and Cheque Act, the Civil Code, the Consumer Credit Act and the Acts on Other Types of Credits and Loans for Consumers.* As the author himself admits the above number of legal sources of financial market legislation is not definitive but it does provide the basic overview of the financial market legal regulation (Babčák, 2012: 474). Subject to the Directive 2002/65/EC the ***financial service*** is any service of the banking, credit, insurance, personal retirement, investment or payment nature. According to the Slovak legal regulation (the Article 4 of the Act No. 186/2009 of the Legal Code *on financial mediation and financial consulting*) the ***financial service*** is any service provided by financial institution or the activity pursued by the financial institution in the sector of insurance and reinsurance, capital market, supplementary retirement saving, deposit acceptance, credit provision, consumer credits and old-age retirement saving.

There is no legal definition of the ***financial market participant*** or of the ***financial intermediary*** in the Slovak legal regulation. Expressis verbis the financial mediation is defined by the Act No. 186/2009 of the legal code *on financial mediation and financial consulting*. According to the Article 2 of this Act the ***financial mediation*** is considered to be the activity of the financial agents, financial intermediaries from a different member country of the European Economic Area in the sector of insurance, reinsurance as well as bound investment agents. ***The financial intermediaries*** are a category of economic participants of diverse legal form[14] and of diverse methods of investment of funds. As of 01 January 2010 *the National Bank of Slovakia* (NBS) registers financial agents, financial consultants, financial intermediaries from other member countries in the sector of insurance or reinsurance and bound investment agents based on the provisions of the Article 13 paragraph 1 of the Act No. 186/2009 of the Legal Code. The relevant reg-

14 We have in mind primarily legal entities that are designated as institutional investors.

ister includes persons[15] involved in financial mediation or providing financial consultancy on the territory of the Slovak Republic depending on individual sectors of the financial market[16], including: independent financial agents, subordinated financial agents, bound financial agents, financial consultants and financial intermediaries from other member country in the insurance and reinsurance sector. As a result currently we may classify ***financial intermediaries*** in the Slovak Republic basically according to types of participants whose position and implementation of activities is regulated by individual acts[17] regulating financial market pursuant to the Acts No. 483/2001 of the Legal Code *on banks*, No. 310/1992 of the Legal Code *on contract savings*, No. 566/2001 of the Legal Code *on securities and investment services*, No. 429/2002 of the Legal Code *on stock exchange*, No. 203/2001 of the Legal Code *on collective investments*, No. 8/2008 of the Legal Code *on insurance business*, No. 186/2009 of the Legal Code *on financial mediation and financial consulting*, No. 43/2004 of the Legal Code *on old-age retirement saving*, No. 650/2004 of the Legal Code *on supplementary retirement saving* and No. 492/2009 of the Legal Code *on payment services*. The most important acts providing legal framework for the insurance market is the Act No. 8/2008 of the Legal Code *on insurance business*, the Act No. 381/2001 of the Legal Code *on compulsory contractual insurance of liability for damage caused by operation of the motor vehicle*, the Act No. 747/2004 of the Legal Code *on financial market supervision* as well as the Act No. 40/1964 of the Legal Code (*Civil Code)*.

4 Regulation and supervision (bank sector)

The issue of financial market regulation is interrelated with the supervision. In this context the ***regulation*** is understood to be primarily determination

15 The persons registered under the current regulations, i.e. the Act No. 340/2005 of the Legal Code *on insurance and reinsurance mediation*, the Act No. 566/2001 of the Legal Code *on securities and investment services*, the Act No. 650/2004 of the Legal Code *on supplementary retirement pension savings*, are as to 01 January 2010 automatically listed in the register pursuant to the Act No. 186/2009 of the Legal Code *on financial intermediaries and financial consulting*.

16 Insurance and reinsurance sector, capital market sector, supplementary retirement pension savings sector, deposit acceptance sector, credit extensions and consumer credit sector and old-age retirement savings sector.

17 The relevant laws as a whole are referred to under the reference No. 1 at the foot of the Act No. 747/2004 of the Legal Code *on financial market supervision*.

of binding conditions and rules[18] that need to be met if the participant wishes to function on the financial market. The concept of ***supervision*** is in practice connected with the activities that are related to preceding determination of the rules on the basis of control[19] that the rules and conditions are adhered to, or as the case may be, that their adherence is enforced, and also with the obligation to supply the supervisory authority various reports, statements etc. (see Jeník, 2011). The concept of regulation of financial services in practice means essentially determination and enforcement of certain rules and conditions including the conditions of access in the banking sector as a summary of rules regulating the formation, activities and dissolution of the financial institutions. ***Supervision*** over the financial institutions may be characterised as a concrete form of a control that these rules and measures for their application are adhered to, and that sanction for non-adherence or violation are imposed. (Zimková, 2006: 10). Healthy financial system is achieved on the basis of various instruments and measures. In general the most significant instruments and measures involve duty to provide information[20] that the issuers and other specified participants should meet within the periods specified by the legislator or the regulation authorities. Significant regulation instruments also include a set of measures serving to eliminate illegal practices and businesses[21]. Frequently used instrument is also specification of conditions for granting the license to form and operate financial institution on the market or the duty to inform about the share in the voting rights. (Veselá, 2012: 40).

The financial crisis that inflicted the European financial sector[22] especially in years 2008 and 2009, revealed shortcomings in the field of bank

18 Drafting and enactment of laws, decrees, regulations, guideline etc.

19 The control is done in various ways such as the remote control or personal control.

20 Obligation to inform is based on publication of results of business activities, securities prospects and other information related to functioning of the regulated participants. The objective of publication of this information is assurance of the current, relevant, full and correct information on securities and their issuers.

21 Illegal practices include money laundering, doing business on the basis of available confidential information (insider trading), manipulation with the rate of exchange, or with the market or intentional damage to the client or investor.

22 Principally there are three significant reasons for this unfavourable situation: 1. Several banks did not dispose with the adequate amount of capital, 2. In order to observe the conditions of reasonable adequacy of the capital some banks have artificially increased their balances with respect to the capital (leverage ratio) using underbalanced instruments, 3. The banks frequently tied short-term resources in log-term assets causing low liquidity on the market. (see Szpyrc, 2013).

businesses that led to modification of the existing ***regulation measures***. The Basel Committee issued in July 1988 regulatory rules (*International Convergence of Capital Measurements and Capital Standards*[23]) that specify the capital adequacy for active banks. Their first version contained only the credit risks and imposed upon the banks the duty to maintain minimum level of capital adequacy of 8%. In addition several addenda to Basel I were published, the most important addendum being from 1996 that as its most significant feature includes the market risks (related to shares, interest rates, exchange rates and commodities) as a part of the concept of the capital adequacy. The original capital with the basic components in the Tier 1 capital (basic own resources) and Tier 2 capital (additional own resources) defined also the Tier 3 capital (supplementary own resources). The next step involved the so-called block approach, which is still applied and which adds in the ratio disposable regulatory capital and the capital requirement formulated as $K/(KPA+KPB)*0{,}08 \geq 8\%$. In April 2003 the Basel Committee published the document of the new capital accord and its final version was approved on 26 June 2004 as *The New Basel Capital Accord* (NBCA or Basel II) that covers the bigger area of risk management than BCA, as it expands and improves the credit risk management procedure and introduces the capital requirement for other type of risk (operation risk). Apart from that it places more emphasis also on other areas, such as bank quality, bank supervision and market discipline. Basel II consists of three pillars[24] applied on individual and consolidated basis. The capital adequacy subject to the rules of Basel II is represented by the following relationship: $(Tier1+Tier2+Tier3-O)/(KPA+KPB+KPC)*0{,}08 \geq 8\%$. The Basel II rules proved to be inadequate for the banking sector during the financial crisis. The new standards[25] for commercial banks business presented as the ***Basel III*** brought changes related to liquidity, capital, leverage, extended risk coverage, rating agencies, anti-cyclical measures, remuneration, taxes for financial sector, new supervi-

23 Known better as the *Basel Capital Accord (BCA or Basel I)*.

24 Pillar 1: minimum capital requirements – quantitative base of the system; Pillar 2: the procedure of the supervising authorities – qualitative specification of the capital in relationship to the bank risk profile; Pillar 3: market discipline – publication of bank information;

25 The draft proposals were approved in November 2010 by the representatives of G20 countries.

sion architecture, financial institutions that are important from the system point of view and individual rules that would be gradually implemented from 2013 until 2019. The *Basel III* framework specifies the requirement concerning the total capital as KPTier1+KPTier2+KKV+PKV+KSDB. The *Basel III* rules introduce new definitions of elements of the regulatory Tier 1 and Tier 2 capital. The Tier 1 (going-concern capital[26]) would consist of equity capital and additional capital[27]. The Tier 2 (gone-concern capital[28]) would enable to secure if in case of liquidation the depositors and creditors would be paid out with priority right. The capital requirements included in the Tier 1 group would be more stringent apart from the equity capital. On the other hand the Tier 2 capital would be simplified and its subcategories cancelled. The Tier 3 capital that could cover the market risks would be excluded. The process of introduction of *Liquidity Coverage Ratio* started in 2011, the indicator of the short-term liquidity (up to 30 days) and its introduction is expected in 2015. The monitoring of the *net stable funding ratio* indicator started as late as in 2012 and it is expected that it would be practically introduced in 2018.

Table 1: Stages of raising capital within the Basel III framework

v %	2013	2014	2015	2016	2017	2018	2019
Minimal Tier 1 capital	4.5	5.5	6	6	6	6	6
Minimal total capital	8	8	8	8	8	8	8
"Cushion" capital	-	-	-	0.625	1.25	1.875	2.5
Minimal total capital +"cushion" capital	8	8	8	8.625	9.25	9.975	10.5

Source: Processed on the basis of: Zimková E., *Basel III – slow steps in the right direction*.

Table 1 illustrates the process of implementation of the *Basel III* rules that started in 2013 and should be completed on 01 January 2019. The monitoring and preparatory stage was implemented during the years 2011 – 2012,

26 Capital absorbing the losses while continuing the activities.
27 It represents hybrid capital that is always available and that can effectively absorb the losses during continuation of activities.
28 The capital absorbing the losses upon termination of activities.

the Tier 1 capital would be increased from 4.5% to 6% during 2013 – 2019. The minimal amount of the total capital will stay on the level of 8% as today. The minimal amount of the overall capital will be supplemented by the "cushion" capital as a result of anti-cyclic measures that would reach the value of 0.625% in 2016. In the following year it would amount to 1.25%, in 2018 to 1.875% and it would reach the final value of 2.5% by 01 January 2019, so that its total value including the minimal total capital would reach 10.5%. To make sure that the banks face no problems of capital adequacy liquidity, gradually capital conservative cushion and anti-cyclical cushion capital would be introduced as a part of *Basel III*, the limit of Tier 1 capital would be increased and additionally the capital requirement in case banks important from the point of view of the system would be increased (the banks important from the system point of view should be able to absorb unexpected losses). *The Basel Committee and the Council for Financial Stability* is developing well integrated approach to the financial institutions that are important from the system point of view; the approach should involve combinations of extra capital charges, conditional capital and debt securities (see Szpyrc, 2011, 2013). The conservative cushion capital[29] would have to be created by the banks for eventual unfavourable events starting from 2016 and gradually should reach the amount of 2.5% by 01 January 2019. The closer the regulation indicators of capital adequacy would get to the minimal requirement the higher would be the restrictions placed on profit distribution (Basel II rules did not include the conservative cushion capital). Anti-cycle cushion would be within the range from 0% to 2.5% of the common capital, or any other loss of the capital coverage, and would be implemented in accordance with the national circumstances (which means that it would depend upon the GDP indicator, growth of number of credits and upon the bad credits, but also upon the supplementary indicators, such as real estate prices, accessibility of housing). The banks keeping this capital under the limit lower than 2.5% would have to face restrictions on payments of dividends, shares in the repurchase and bonuses. Anti-cyclical cushion capital shall be applied at a level of 0.625% since 01 January 2016. Gradually

29 Conservative cushion capital in the amount 2.5% would be met by the registered capital after deductions.

it would grow up to 2.5% required since 01 January 2019 (Basel II rules did not include anti-cyclic cushion). The main idea of the authors of the *Basel III* capital adequacy rules is to create a system that would be resistant to crises.

An important role when drafting the tasks of ***supervision*** over the financial market in the field of banking is played by the Directive of the European Parliament and Council 2006/48/EC *relating to the taking up and pursuit of the business of credit institutions* in the version of the Directive of the European Parliament and Council 2006/49/EC *on the capital adequacy of investment firms and credit institutions.* In accordance with these directives the supervision is focusing also on assessment of minimal capital requirements for business of supervised participants as related to the assumed risks, monitoring of exposition of credit institutions that must take place independently in accordance with the principles of sound bank management. One of the criteria for evaluation of the bank safety is the amount of the bank equity capital and the related indicator of adequacy of the equity capital. In accordance with the Council Directives: No. 73/239/EEC *on the coordination of laws, regulations and administrative provisions relating to the taking-up and pursuit of the business of direct insurance other than life assurance,* No. 2002/83/EC *on life assurance*, No. 2002/92/EC *on insurance mediation* and No. 2005/68/EC *on reinsurance*, as well as other legally binding acts of the EC and EU, the ***supervision*** over the participants in the field of insurance is focusing especially on creation and assurance of stable market atmosphere that contributes to the protection of the needs of clients, intermediaries and insurance companies, on evaluation of the formation, adequacy and coverage of the technical reserves of the insurance companies, on assurance of solvency with regard to internal and external risks of insurance companies, regulation of cross border implementation of activities and sharing the coordinated cross border supervision.

As a part of its ***regulation activities*** in the field of banking the NBS issued during the years 2012 and 2013 four amendments of measures regulating the banking sector and one recommendation No. 1/2012 of 16 January 2012 *on support of stability of the banking sector* that was prepared in order

to secure fulfilment of the capital equity adequacy indicator (Tier 1 capital)[30] on the level of 9% (NBS recommended the banks to maintain the adequacy of the basic capital equity at least on the level of 9%). The NBS considers fulfilment of this indicator as meaningful on grounds that it facilitates the banks fulfilment of their obligations related to the provisions of the Article 27 paragraph 3 of the *Banking Act* that would enable prevention of application of remedy measures and fines in accordance with the Article 50 *of the Banking Act. The NBS Department of Financial Market Supervision* as a part of its regulation activities in the banking sector issued one methodological guidance for protection against legalization of income from criminal activities and against the financing of terrorism that significantly reflects the identification of unusual business transactions and significantly eliminates the practical problems. The Amendment to the Act No. 352/2012 of the Legal Code (*on consumer credits and on other credits and loans for consumers*) is related to the obligation of the Slovak Republic to transpose in the Slovak legal order the Commission Directive 2011/90/EU of 14 November 2011, that changes and amends the part II of the Annex I to the European Parliament and Council Directive 2008/48/EC determining *adequate assumptions for calculation of the annual percentage rate of costs*. The amendment exactly specifies when the consumer credit is interest free even in case of gross violation of the creditor's obligations regarding the assessment of debtor's ability to pay back the credit provided and it specifies the possible expectation of the creditor from the debtor. It relates also to the issues of settlement of the obligations when withdrawing from the contract on bound consumer credit in case of premature repayment. The Amendment of the Act No. 352/2013 of the Legal Code that entered into force on 10 June 2013 forbids the banks, the foreign banks and the subsidiaries of the foreign banks to charge consumers fees or any remuneration for managing, recording and administration of the credit or for the credit account that needs to be opened and managed as a part of the credit relationship. These provisions do not relate to the exactly defined credit types where the credit account management is important for both parties to the agreement, i.e.

30 Pursuant to the above recommendation the indicator represents the ratio of the bank's basic own resources of financing to 12.5-fold of the overall requirements concerning own resources.

for the bank as well as for the consumer (e.g. payment account, current account enabling allowed overdraft and the credit card). In 2012 and 2013 the regulation activity of the *Department of the Financial Market Supervision* in the field of banking related to legislative cooperation during preparation of the draft proposals of the acts (the Acts Nos. 234/2012, 132/2013, 352/2013, 352/2012 of the Legal Code), preparation of the related sublegal standards and last but not least the advance preparation for the new banking regulation on the EU level, i.e. implementation of the regulatory Basel III rules. Major part of the new banking regulation was transferred from the original directive form into the regulation form that has from the legislative point of view substantial significance due to its direct application in the legal order of the national regulators. The objective of the amendment[31] of the Act No. 234/2013 of the Legal Code, that amends the Act No. 483/2001 of the Legal Code was to introduce a basic bank product in order to enable consumers access to current account and to basic payment related services, so that especially the consumers with social handicap that do not use current account and the basic payment services may start using them for reasonable fee so that even the socially handicapped consumers who use current account already could use it under more favourable price conditions in that they close their current account or any other accounts used so far and open a basic bank product after fulfilment of other conditions specified by the law.

Apart from the NBS an important role is played in the field of regulation of financial services in the Slovak Republic also by the *Ministry of Finance of the Slovak Republic* (*Financial Market Section*), which follows the Act No. 575/2001 of the Legal Code (version of the Act No. 403/2010 of the Legal Code) and meets the tasks in the field of development of the financial market, capital market and banking, insurance, protection of the financial consumer and foreign exchange area, assurance of implementation of recommendations of the EU, ECB, OECD and of other international financial institutions, capital market and commercial insurance,

31 The Amendment is based on the Recommendation of the Commission 2011/442/EU of 18 July 2011 on access to the basic payment account, according to which the accessibility of the basic payment services is currently not secured by providers of payment services or guaranteed by all EU member countries.

under the auspices of the *Committee for Financial Services of the EU Council, Committee of the European Commission for Securities, Committee of the European Commission for Insurance Business, European Banking Committee of the European Commission, OECD Council for Financial Markets, OECD Committee for Insurance Business,* banking (within the scope specified to the Ministry in the Acts No. 483/2001 and No. 566/1992 of the Legal Code), foreign exchange management (within the scope specified to the Ministry in the Act No. 202/1995 of the Legal Code), settlement of claims and obligations related to privatisation agreements concerning the sale of shares of selected banks and of *Slovenská poisťovňa, a.s.* (Slovak Insurance Company, public limited company), cooperation in assurance of activities and procedures related to the position of the government as the incorporator in *EXIMBANK of the Slovak Republic*, rights and obligations of the government represented by the Ministry as the shareholder in the *Slovenská záručná a rozvojová banka, a.s.* (Slovak Guarantee and Development Bank, public limited company), *Slovenská konsolidačná, a.s.* (Slovak Consolidation public limited company) and in *TIPOS, a.s.* in accordance with the Act No. 80/1997 of the Legal Code *on Export-Import Bank of the Slovak Republic, the Banking Act*, the Act No. 171/2005 of the Legal Code *on hazardous games,* version of the Act No. 659/2007 of the Legal Code, enforcement of receivables due to non-payment of fines resulting from the government supervision over the capital market even before the Act No. 329/2000 of the Legal Code *on the Financial Market Office* entered into force, consumer credits within the scope specified for the Ministry in *the Act on Consumer Credits*, preparation of the draft concepts and of the generally binding legal regulations in the field of the capital market, banking, insurance business, foreign exchange and hazardous games, presentation of the project draft proposals for the foreign aid for the financial market sector and implementation of the approved projects, monitoring, relevant agenda and EU priorities and their integration in the job description of the section, cooperation in the field of the European agenda with the section of the European and international affairs and with relevant international financial and economic institutions, as well as with the organizations

of the EU member countries, cooperation with the section of the European and international affairs during preparation of the materials for discussions at the *World Trade Organization* (WTO).

5 Results and discussion

The financial crisis started as a problem of one economic sector (real estate market) and spread all over the world through the financial sector especially through the banking and insurance business and obviously the proposed changes were focused especially in this area. *Basel III* is one of the instruments that should protect the financial system against the next crisis. Since 01 January 2006 Slovakia implemented the integration of the complex ***supervision*** over the financial market in the field of banking, capital market and retirement savings under the auspices of the *National Bank of Slovakia.* As a part of integration of supervision over the financial market the *Financial Market Office* was dissolved on the basis of the respective law and its competences were transferred in their complexity to the NBS in order to contribute to the stability of the financial market as a whole as well to secure a healthy functioning of the financial market in order to maintain credibility of the financial market, protection of the clients and respect of the rules of economic competition. Since the beginning of 2006 NBS was issuing licenses, approvals, antecedent approvals and other decisions in the field of financial market that until the end of 2005 were issued by the *Financial Market Office,* while the legal effectiveness of acts taken before the beginning of 2006 remain in force. The implementation of the integrated ***supervision*** over the financial market is subject especially to the Acts No. 747/2004 and No. 566/1992 of the Legal Code. The integrated supervision over the financial market is currently implemented by the NBS (*Department of Financial Market Supervision* instituted by the *Bank Council of the NBS,* even though this Department does not have independent legal standing, but from the legal point of view this Department is clearly identified in the Article 5 of the Act No. 747/2004 of the Legal Code). The main areas of the activities of the integrated financial market ***supervision*** include: supervision in situ, remote supervision, supervision over the relevant participants in the financial market in the field of banking, insurance business, capital

market and retirement savings, actions and decision making related to supervision. *Department of Financial Market Supervision* focuses also on early identification of risks of individual supervised participants related to their activities, as well as identification of the risks of the financial market as a whole. Every supervised participant is assessed from the point of view of risk faced by the respective participant as well as from the point of view of the introduced systems of management of these risks. The scope and orientation of the supervision in case of individual participants under supervision is based on the assessment of their risk profile while applying the principle of proportionality after the size of the participant, the scope and the complexity of the implemented activities and significance of the participant for the stability of the financial sector is taken into account.

As a part of its ***regulation activities*** the NBS issues general binding legal regulations for implementation of individual laws in the field of financial market and also methodological directives, standpoints and recommendation related to the financial market supervision and provides explanations concerning application of individual laws and other generally binding legal regulations in the field of financial market related to the participants under the supervision or their activities. In the first phase the secondary legislation is passed (measures and regulations based on valid and effective laws especially the *bank law*). In the next phase the remote supervision is implemented (accepting reports, news and other information in regular and irregular intervals used for analysis and evaluation of the quantitative indicators of the participants under supervision). The activities of the remote supervision are coordinated in close cooperation with the in situ supervision that in the next phase verify the concrete institution directly. An inseparable part of the supervision are the first stage and the second stage proceedings and decisions concerning supervision (e.g. proceedings and decisions related to application for granting licences, approvals or antecedent approvals and also proceedings and decisions related to sanction and remedy measures). Also the new mode of ***regulation*** of the insurance sector in EU, the *Solvency II* directive effective within the EU and consequently also in the Slovak Republic since 01 January 2013 has significant impact on the activities of the NBS concerning the supervision of the insurance

sector. The introduction of the new rules of prudent business means not only new regulation environment and the need of insurance companies to seek harmonization with these rules, but it also overlaps the activities of the NBS, especially in its everyday supervision. ***The supervision*** over the participants in the field of insurance business concentrates primarily on creation and assurance of a stable market atmosphere that contributes to protection of the needs of the clients, intermediaries and insurance businesses, to assessment of the creation, adequacy and coverage of technical reserves of insurance companies, to secure solvency, while taking into account the internal and external risks of insurance companies, regulation of cross-border activities and sharing in the coordinated cross-border supervision. The NBS is a member of the *European Insurance and Occupational Pensions Authority* (EIOPA)[32] and its members agreed, based on protocol, to cooperate while implementing regulations about the life and non-life insurance, the Directive 98/78/EC *on the supplementary supervision of insurance undertakings and insurance groups,* as well as while implementing the Directive of the European Parliament and Council 2002/92/EC *on insurance mediation*. The most important ***objective*** of the NBS in supervising the participants in the field of insurance businesses is to monitor adherence to rules of the prudent business of the insurance undertakings and to draw consequences from their violations, support of credibility of the insurance market, provision of information for its participants and elimination of the system risks.

The main ***objective*** of supervision of the NBS over the participants in the field of banking is to monitor adherence to the rules of prudent business activities of the banks and drawing consequences in case of violations of these rules (significant part of the regulatory activities of the *Financial Market Supervision Office* in the field of banking in 2012 and 2013 rested primarily on advance preparation of the new banking regulation that was drafted on the level of the European Union which is constantly working intensively on introduction of the Basel III in the legislation in the form of the CRR regulation and the CRD IV regulation). ***The regulation*** comes

32 This authority came into being on 01 January 2011 as a legal successor of the *Committee of the European Authorities Supervising Insurance and Employee Retirement Funds* and assumed all existing and running tasks and responsibilities.

with four new capital cushions: anti-cyclical cushion capital, cushion for significant institutions from the system point of view, cushion for system risks, cushion for preservation of capital. ***The objective*** of introduction[33] of new regulatory rules of the *Basel III* is to secure[34] the ability of the financial sector to withstand in the future turbulences on the financial markets. Several opinions of top representatives of the banks in Slovakia an Germany regarding formulation and functioning of the *Basel III* rules are interesting: e.g. the Chairwoman of the Board of Directors of *Volksbank Slovensko* B. Neiger made it clear that the requirement of higher liquidity or stronger capital base of the banks were O.K., even though she believed that this requirement did not serve for the purpose that it should have served, i.e. in order to make banks system safer that would be capable to prevent other financial crises; the crisis did not occur because the banks had little capital, but because the products were developed that were not understood by the sellers or the clients and the risks these products carried with them were not taken into account…and where the banks would get more money?…on capital markets?…these are less developed in Europe than in the USA, and especially in the countries of the Central and Eastern Europe are partially non-existent." (http://banky.sk/20.3.2014); the Chairman of the Board of Directors of *Deutsche Bank AG* Anshu Jain made it clear at the lecture at the University in Frankfurt am Main in June 2013 "that too much regulation could suffocate the European banking system, liquidate the universal banks and slow down the economic growth, even though in the past five years the bank industry was reformed with unprecedented speed… there is a threat in Europe that the attempts to control would go too far… regulation may mean the end of the universal European banking…however the importance or the need to have the banks regulated by the governments is not questioned…at the same time he noted that the cumulative impact of the new rules might significantly limit the ability of banks

33 The Basel III would be introduced gradually from 01 January 2013 until 01 January 2019.

34 The Basel III Rules focus on improvement and strengthening of the capital structure and liquidity of the banks that should lead to stabilization and improvement of the capital quality with additional anti-cycle cushions. It is expected that the regulation would reduce the probability of the future crises and at the same time would support the long-term economic growth potential of the Eurozone, including Slovakia.

to extend credit to the economy". Our view on introduction of new or eventually modified rules serving to ***regulate*** financial markets is based especially on a different understanding (microeconomic and macroeconomic). From the macroeconomic point of view it is possible to agree with the conclusion that the new *Basel III* capital structure would bring better use of the instrument of capital adequacy when slowing down the credit expansion[35] and of the assurance of liquidity[36]. From the microeconomic point of view the evaluation of the development of the capital adequacy and assessment of the factors influencing this indicator shows that the Slovak banking participants have at their disposal sufficient quality capital that may even represent certain competitive advantage. The basic Tier 1 equity capital and its share in the total own resources of the banks decreased under the level of 90% only during three years 2007-2009, when the Slovak banks, due to the crisis, used additional own resources as subordinated debts and thus fine-tuned the values of the capital adequacy indicator to the required level. Also positively is valued the flexible correction of the long-term trend of mild growth of the overall own resources of the banks to bigger volume changes as a result of the economic crisis indicating that the banks should be capable in time and as needed to manage the amount of capital also during the crisis period.

Table 2: Capital adequacy of the banking sector of the SR

v %	2007*	2007	2008	2009	2010	2011	2012	2013**
Capital adequacy	12.8	11.7	11	12.57	12.68	13.41	16.08	16.84

* See Basel I;
** Data as to 30 September 2013 (without inclusion of the data from the foreign bank subsidiaries).

Source: Prepared by the author on the basis of the NBS report: *Analysis of the Slovak financial sector for 2007 to 2013 and the NBS report: Analytical data of the financial sector for the period of 2007 to 2012.*

35 Increased requirement to provide quality capital leads the commercial banks to use less risky assets (especially securities and short-term credits) that could limit credit expansion.
36 That should secure the requirement (Tier I) related to the value of equity capital.

The Table 2 documents the value of the capital adequacy of own resources for the Slovak banking sector excluding the data from the subsidiaries of the foreign banks. The value of the capital adequacy in the Slovak banking sector reached the lowest value in 2008; this value started to grow on a year-on-year basis in 2009 and except 2010 the capital adequacy in the banking sector grew fast during the following three-year period (the changes in the development of the capital adequacy were caused primarily by the course of the crisis which erupted fully in 2008). The development of the value of capital adequacy was to a major extent influenced by introduction of the new Basel II rules in 2008 and also by introduction of the new currency in 2009. According to the new rules the calculation of the capital adequacy should take into account also the operation risk. Due to implementation of the new Basel II rules the value of the capital adequacy was reduced by one percentage point. The banks increased their own resources in order to get ready for a change in the rules and later, after the start of the crisis, they tried to create adequate capital for the case of unexpected losses. From 2008 until 2013 each bank met its minimal obligatory capital adequacy above 8% (as specified by the Basel II) and since 2009 above 10.5% (as specified by the Basel III).

We are of the view that the current attempts to achieve ***transnational regulation*** in order to prevent occurrence of crises in the future is of little effectiveness considering the related costs, because the financial crisis occurrence is simply subject to natural cyclical fluctuations of the market economy. According to the public opinion research done between the citizens of the EU, more than a half of the citizens is of the view that the European banks should be regulated primarily on the level of the Union and believe that they would be better protected against the impacts of the economic crisis if individual member countries coordinated anti-crisis measures with other member countries of the EU. Mário Draghi, President of ECB, expressed his view on the banking union saying that the banking union should become the miraculous medicine of the *European Union* for the bank problems, but is not very popular…in spite of ambitious plans the banking union in its current form would not solve the problems of the banking sector. In June 2012 the *European Council* adopted the conclusion that the legislation should

be prepared to maintain the unity and integrity of the single market in the field of financial services in order to break through the negative feedback between the banking systems and the governments that deepened the economic crisis in Eurozone. The relevant legislation should create between the member countries of the Eurozone the so-called bank union based on three pillars: single supervision mechanism, single mechanism for solution of crisis situations, the system of deposit protection with the European element. The single supervision mechanism means that the competences related to bank supervision should be transferred from the national supervision authorities, meaning the NBS in the Slovak Republic, to the *European Central Bank*. This mechanism should be implemented during the second half of 2014 as the first pillar of the bank union depending on the date of final approval of the legislative draft proposal. Even though ECB would be responsible for all banks, it would supervise directly only the most significant banks or bank groups (in Slovakia that would mean the following banks: *Slovenská sporiteľňa, VÚB, Tatra banka, ČSOB, UniCredit and ČSOB stavebná sporiteľňa*). The ECB would delegate the supervision over the other banks to the NBS. The second pillar of the bank union would be the common fund for bank recapitalization in order that other countries do not experience similar problems as those of some countries (e.g. Portugal, Ireland), so that the banks with problems do not have to be saved by individual countries independently, but the banks should be recapitalized directly from the *European Stabilization Mechanism* and the funds would not have to go through the budgets of individual countries. Consequently the salvation of the bank would not increase the public debt of individual countries. The common fund for deposit guarantee would represent the third pillar of the bank union. In case of problems in any of the banks the guarantee of all bank deposits should prevent massive withdrawal of funds and their transfer to other banks (see http://www.iness.sk/20.3.2014).

6 Conclusion

Financial services are an integral part of the ***financial market*** and formation of a single common European market of financial services should enable its effective functioning. In accordance with the current economic

objective of the EU countries to maintain economic stability, the financial markets are subject to regulation in the form of determination of concrete rules[37]. This process does not end by determination of rules but continues with supervision as a continuous control of adherence to the respective rules. If any shortcomings are detected the competent supervisory authority has at its disposal various sanctions that may or must be applied in case of the supervised participant. The microeconomic impulse for supervision over the participants offering financial services is primarily the protection of investors (depositors) on grounds that the financial institutions (even if in accordance with their business objectives, including the priority of the profit objective), would obviously behave in conflict with the objectives of the majority of investors (depositors) represented by reasonable earnings at acceptable risk. Under the unfavourable circumstances this could lead to bankruptcy of the participants doing business on the financial market. The capital adequacy of the EU banks, including those in the Slovak Republic, is currently regulated by the Directive of the European Parliament and Council 2006/48/EC of 14 June 2006 *relating to the taking up and pursuit of the business of credit institutions* (recast) by the Directive of the European Parliament and Council 2006/49/EC of 14 June 2006 *on the capital adequacy of investment firms and credit institutions* (recast). In the Slovak Republic the area of capital adequacy is integrated in the measure of the NBS No. 4/2007 *on own resources of bank financing and the requirements on own resources of bank financing* including consequent amendments.

Obviously in the current globalizing business environment the individual countries have only limited power to prevent individually possible economic threats to the financial markets which also means the need to introduce the transnational regulation[38] and supervision (even if currently the EU banking is considered to be the most regulated economic sector). Assurance of the stability of the financial sector is currently the objective of the bank supervision in accordance with the specified rules (the acts and other gener-

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37 Directed to e. g. prudent business or restrictions on implementation of specified activities.

38 For the purpose of coordination of measures to prevent emergence of financial crisis; at the time of a crisis to introduce the measures aimed to economic recovery; elimination of the possible regulation arbitration etc.

ally binding legal regulations) in the field of provision of financial services. If we look at the development of the regulation rules in the field of banking its focus over the years was obviously on the capital adequacy. As a part of the *Basel I* rules the process of regulation concentrated on the credit risks complemented by the *Basel II* market and operative risks. In the current stage of regulation much is spoken about the need to regulate not only capital, but also the liquidity and other important areas. The requirements concerning regulation of the liquidity reflect the fact that the financial crisis found its expression in the low level of liquidity, and the crisis in trust of financial institution whether they can borrow this liquidity mutually.

From the macroeconomic point of view the effective regulation should primarily prevent deficient system procedures in individual economies. We believe, however, that even more essential is the influence exerted on behaviour of individual participants on the financial markets (microeconomic approach) in the sense of rational economic decision making of individuals that can be achieved especially by high quality and continuous education not only of students in the schools of economics. We believe that the overall economic environment forms and influences all economic participants in the respective society. It is imperative that the long-term strategy of economic growth should be based on the increased economic literacy of the population, realization of everybody's influence on economic behaviour of the whole, everybody's perception of responsibility for economic decisions that would result in the natural stability also on financial markets. The primary motivation behind this assertion is in the historical development of the economic life of human societies clearly documenting that introduction of the ***regulation measures*** related to functioning of the economy is no guarantee for elimination of occurrence of economic crises and assurance of the increased economic wellbeing of individuals. In this sense any rules introduced to manage activities of individual economic participants, even if introduced with the best intentions, would be just another macroeconomic experiment and only the future generations would perhaps be capable to assess realistically their results[39].

[39] E.g. the steps aimed to create "artificial" environment for the functioning of the financial markets would with the highest probability have more intensive market deformation as a consequence.

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FINANCIAL MARKET SUPERVISION AND ITS POSITION IN THE SYSTEM OF FINANCIAL LAW[1]

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Abstract

The terms: system of financial law, financial market with an emphasis on explaining the differences between financial market regulation and financial market supervision are defined. The primary aim and purpose of this paper is to present some theoretical approaches and theories in the context of the actual experience. The main part of the paper deals with financial market supervision, referring to the degree of concentrated power concerning financial supervision, and also mentioning some international aspects of financial supervision. The authors drew on literature on the financial market, the National Bank of Slovakia, the commentaries to statutes, electronic collections of law, economic journals, and other publications of legal matters. In addition, the internet articles as a source of professional literature were used, too, and the authors also worked with the Act on financial market supervision and the Act on the National Bank of the Slovak Republic. Based on that all, the following hypothesis, set on the basis of hypothetical premises included in this paper should be confirmed. The first hypothesis is an assertion that the banking union will apply to all euro area countries, but not to all countries of the European Union. The second hypothesis concerns the fact that the banks in Slovakia are ready to enter into the banking union, mainly because of their competitiveness and profitability.

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Key words
Financial law and its system; financial market; financial market supervision; financial system; National Bank of Slovakia; banking union.

JEL Classification
G28, K40

1 Introduction

The main aim of this paper is to emphasize the significance of financial market supervision for the financial stability and "health" of financial institutions, the management of theoretical information on financial market, as well as the follow-up analysis of the position of the National Bank of Slovakia. Similarly, the development of the policies of prudential banking, the role of the National Bank of Slovakia, as a component of the banking union and an entity performing supervision over the financial market, are of great importance, too.

The banking union aiming to "break the vicious circle of indebted banks and states" is to be built on three pillars: a single supervision mechanism (already approved), a single mechanism of crisis management, the so called single resolution mechanism (quite extensively prepared) and the common system of bank deposit protection (most problematic pillar, the solution of which has so far been postponed).

The introduction dealing with theoretical definitions of the financial law system, the financial system and the financial market, refers also to the new trends in the development of financial markets. In the next part the authors discusses the legal status of the National Bank of Slovakia and its position in relation to the European Central Bank, also pointing out to its independence. In the essential part of the paper, the financial market supervision is defined, describing the degree of concentrated power concerning financial supervision, and also mentioning some international aspects of financial market supervision. When dealing with the key issues, comparative methods and cognitive scientific approaches were used. Various methods, determined by the aims of this paper, include the theoretical analysis and synthesis method, comparative method, concretization method, and inductive method.

2 Explication of the terms: financial law and its system, financial market, and financial market regulation

The financial law plays an important role in modern economies. The financial law is divided into two parts: the general and the special ones. The system of the Slovak financial law is objectively determined by the system of social and financial relations, their internal structures, grouping, and the scope of financial and legal norms arranged in definite progression of the component parts, segments, subdivisions and institutions, through which financial transactions may be realized, securities traded, interest rates determined, and all other financial services provided. The system of financial law represents an internal division of an independent autochthonic branch of the uniform legal order contained in relatively independent sets of financial and legal rules forming the sub-branches according to their content-related similarities or identities of financial relations regulated by them (Králik, 2004: 38).

The system embraces of all segments of the financial market: financial instruments traded on financial markets, financial institutions, other economic entities, and the rules set out to regulate their activities in the financial market. Within the financial system, the financial entities, respecting the set rules, trade on the financial instruments or give support to such trading by their activities. The financial system may be simply defined as a mechanism, through which the financial funds are distributed from the entities with excess financial funds to the entities which are short of the available funds. Every financial system is a part of the economic system, whether national or supranational in nature. An important feature in the economic policy strategy is activation of the finances and their new function in the economic processes. An important role is played by the process of creating a financial market, often referred to, in the economics, the top of the market pyramid. The financial market is the place at which demand and supply of financial resources meet (Il'anovská, 2006: 109).

Apart from the issues governed by the civil and commercial law, the financial market embraces, in the system of financial law, also the regulations of capital and monetary operations, the public-law regulations relating to the entities active on the financial market, and the regulation concerning

the particular financial market instruments and their operations, including securities and the most modern instruments in the form of financial and commodity derivatives, such as *forwards, options and swaps* (Pavličková, 2007: 30).

A functional financial market ensures optimal allocation of limited financial funds. Effective functioning of market economies is based on the market existing in various structures and forms. The market represents the basic aspect of a functioning market economy, a component of a functioning market mechanism, through which the financial funds are transferred from those with excess financial funds to those who need them. The financial market represents a logical part of market mechanisms. Its origin, gradual development and especially its active operation is a sign of highly intensive spending of financial and capital resources. In other words, based upon the economic utilization of monetary relations, in addition to the commodity market, the services market and the job market, also the financial market is, quite logically, taken advantage of (Balko, 2002: 76).

Within the period of ten years the legal regulation of financial market had the form of primary legislation, mainly statutes, but also the form of secondary legislation, i.e. regulations and other rules of lesser legal force, especially the rules concerning commercial banks, insurance companies, etc., crucial for effective functioning of our financial market, even though they are not a source of law (Králik, 2004: 111). In practice the term financial market regulation is often used interchangeably with that of financial market supervision (in theory these two terms are differentiated), therefore the difference between them should be explained.

Through financial market regulation, the rules for effective financial market are set out, and compliance with the rules needs to be checked and kept under the surveillance. In a broader sense this means that complex rules laid down for the purpose of effective financial market are monitored for compliance, and the activities of financial institutions are held under review. As the financial market regulation is construed as laying down the rules, it may be noticed that the rules may be both legal and extra-legal. The general legislative framework set forth by the state may be further complemented by self-regulations of individual organizations, or by the rules set

out by multinational organizations or those arising in the actual situation in the society. Primary, i.e. statutory, regulation in the form of rules passed by the legislative branch is distinct from secondary regulation in the form of rules issued by the executive branch (Richtárechová, 2012: 12).

The law governing financial market and its rules provide for the necessary organizational condition s for an ***effective financial market*** **rising and functioning well.** The legal acts in this area are in fact a vehicle of all the steps essential for the commencement and carrying on the activities of a well-functioning financial market;in this context, the current efforts of the Slovak Republic, as regards its successful participation in the international and European structures, are to be brought to the foreground, with the role of approximation of the legal normative of financial market regulation in the area of the EU law being of paramount importance for Slovakia.

Also in the area of financial market legislative activity is extensive, though not sufficient, save for some original sources of law, the banking law in the form of statutes focusing mainly on the legislative activity of the Ministry of Finance and the National Bank of Slovakia. The legal rules, which are binding and enforceable) represent important components of regulatory instruments. It may be implied from what has been said that the financial market law included in the legal order of the Slovak Republic, not reduced to a code, consists of a number of legal norms of primary and secondary nature. This is a direct consequence of extensive and diverse social and economic relations that are the subject-matter of normative legal regulation in the field of financial market law. With regard to this fact, and primarily with regard to practical implications of the financial market law within our legal order, systemization of this branch of law is a very important issue (Králik, 2004: 111).

The primary objective of financial markets regulation and supervision is to create a long-term stability and the conditions of effective functioning and transparency of the financial system and safe functions of the financial market. It is the tasks of financial markets regulation to ensure equal market conditions, eliminate risks related with the financial markets, and last but not least, strengthen credibility of financial markets in the eyes of the public.

The National Bank of Slovakia issues generally binding rules and regulations, the **regulatory instruments of financial market,** for the purpose of implementing the individual statutes in the field of financial market, provided that the National Bank of Slovakia is empowered by relevant statutes to do so. This applies in particular to the rules of prudential business activities, rules of safe operation practices and other requirements concerning business activities pursued by the supervised entities. The National Bank of Slovakia issues methodical guidelines, instructions, observations, opinions and recommendations in relation to the financial market supervision, explaining the application and implementation of individual statutes and other generally binding rules and regulations issued in the field of financial market in relation to the supervised entities and their activities.

3 Legal Regulation of Financial Market Supervision and the National Bank of Slovakia as the Authority of Financial Market Supervision

Given the enormous flow of financial funds through the financial market, it is necessary to utilize a set of instruments of the protection of the entities operating on this market. Absence of any "*rules of the game*" could result in a financial disaster with significant impact on the functioning of the national and international communities. Therefore, some relatively precise and verified mechanisms of financial market regulation were put into practice, which are set in the financial market in Slovakia, too. The largest segment of the financial market intermediaries is formed by the banking institutions –the commercial banks concentrating the largest volume of financial means they obtained; the banks manage the broadest scale of financial market instruments, the *monetary and capital ones*. So it is legitimate that modern states have adopted some economic and legal mechanisms, the aim of which is to guarantee reliable operation of the financial intermediaries. This is achieved through a complex mechanism of economic regulation of the banks by means of regulatory norms. The basic cause of banking regulation is the protection of depositors (Kenneth, 1990: 6).

Thus, the normative legal regulation of financial market has been established through:

- *banking regulation realized through the bank supervision performed by the National Bank of Slovakia (Králik, 2004: 386).*

The financial market supervision performed by the National Bank of Slovakia became integrated on 1 January 2006 in the area of banking, capital market, insurance business, and pension insurance. **In the framework of this integration, the Financial Market Authority was closed down by law and its powers were assumed in full by the National Bank of Slovakia**.

The purpose of the financial market supervision is to contribute to the stability of the entire financial market, and its safe and smooth operation in the interest of maintaining credibility of the financial market, protection of customers, and compliance with the rules of economic competition.

Basic activities within the integrated financial market regulation include:

- on-site and off-site supervision over the entities of financial market in the fields of banking, capital market, insurance industry and retirement income savings,
- acting and deciding on supervision issues (e.g. acting and deciding on applications for grant of permissions, licenses or previous consents in the area of financial market,
- acting and deciding on sanctions and corrective measures, the actual conduct of on-site and off-site supervisions, and the preparation of drafts of implementation regulations (secondary legislation) in relation to financial market laws.

Since the beginning of 2006, the National Bank of Slovakia has issued permissions, approvals, licenses, previous consents and other decisions concerning the financial market, which were previously issued by the Financial Market Authority, till the end of 2005; however the legal effects of the acts undertaken before 2006 remain the same.

The conduct of the integrated financial marker supervision is mainly governed by:

- The Financial Market Supervision Act (Act no. 747/2004 Z. z., as amended),

- The National Bank of Slovakia Act (Act of the National Council of the Slovak Republic No. 566/1992 Zb., as amended).

The conductor financial market supervision is within the jurisdiction of the National Bank of Slovakia, as provided by Act No. 747/2004 Z. z. governing financial market supervision. In performing such supervision, it is in the interests of the National Bank of Slovakia to be a competent institution, efficient professionally, independent in decision-making, and thus recognized by those participating in the market. Through the supervision by the National Bank of Slovakia, the powers of the central bank over the other commercial banks are exercised.

The basis of legal regulation governing the powers of the bank supervision is Act No. 566/1992 Zb. on the National Bank of Slovakia, as amended (the *National Bank of Slovakia Act"*or the "*Act").* It should be mentioned in this context that the authority of the National Bank of Slovakia authority in relation to commercial banks is not defined by the National Bank of Slovakia Act but by the Act on banks.

Similarly, the Deposit Protection Fund as a legal institute protecting the clients' deposits is not incorporated in the National Bank of Slovakia Act, or in the Act on Banks, but it is regulated by a special law, the Act on Deposit Protection Fund (e.g. unlike the Guaranty Fund, a protective and guaranty institute serving the securities traders[4] which is incorporated straight in the Securities Act). With regard to the factual and legal situation mentioned before and the necessity of a consistent legal analysis, the bank

4 The National Bank of Slovakia made accessible – within its *Securities Market Supervision – the website offering consultation materials published* on the **European Securities and Markets Authority (ESMA) website.** Currently the consultations are held in relation to the materials **"*Discussion paper on Calculation of counterparty risk by UCITS for OTC financial derivative transactions subject to clearing obligations*"** (between 22 July 2014 and 22 October 2014), "***Consultation paper on ESMA's technical advice to the European Commission on delegated acts required by the UCITS V Directive"***(between 26 September 2014 and 24 October 2014), ***"Consultation paper on the implementing measures of the Regulations on EuSEF and EuVECA"***(between 26 September 2014 and 10 December 2014),***"Consultation paper on draft Implementing Technical Standards on main indices and recognised exchanges under the Capital Requirements Regulation"***(between 29 September 2014 and 1 November 2014), and ***"Consultation paper on draft guidelines on the application of C6 and C7 of Annex I of MiFID"*** **(**between 29 September 2014 and 5 January 2015)**.**

supervision realized by the National Bank of Slovakia was referred to within the discussion concerning the commercial banking business –at this point, a brief summary thereof may be offered (Králik, 2004: 385-386).

For the purpose of ensuring the price stability, the National Bank of Slovakia has the authority, pursues the activities and exercises the rights and responsibilities arising from its involvement and participation in the European system of central banks. The National Bank of Slovakia submits to the National Council of the Slovak Republic (the Parliament) semi-annual and annual reports of the monetary development. Information on the monetary development must be published at least every three months. Upon its authority vested by the Government of the Slovak Republic, the National Bank of Slovakia represents the Slovak Republic in the international financial institutions and ensures the fulfilment of tasks arising from such representation. The National Bank of Slovakia represents the Slovak Republic also in the operations on the international financial markets related with the pursuance of monetary policy.

3.1 The National Bank of Slovakia as Part of the Banking Union

The National Bank of Slovakia, as an independent central bank of the Slovak Republic, is a part of the European system of central banks, and since the euro introduction in the Slovak Republic it became also a component part of the Eurosystem as the system covering the European Central Bank and the central banks in the euro area. In June 2012, the European Council adopted a resolution, stressing that for the purpose of breaking with the negative feedback concerning the banking systems and various countries, which brought about the economic crisis growing deeper and deeper in the euro area, it is necessary to prepare the legislation for maintaining the unity and integrity of the single market in the area of financial services.

The legislation will build the banking union on the three pillars:

- a single supervision mechanism,
- a single mechanism of crisis management,
- common system of deposit protection (containing an European element)

Since November 2014, the National Bank of Slovakia (NBS) together with other central banks in the euro area, led by the European Central Bank (ECB), will participate in the preparation of the Single Supervision Mechanism. In other sectors of the financial market, NBS will pursue its tasks as previously.

3.2 Mission, Objectives and Main Tasks of the National Bank of Slovakia Performing Financial Market Supervision

The new aspects concerning the financial market supervision were presented at the Forth International Conference ETER 2013 (Economic Theory and Economic Reality) held on 8 November 2013 on the premises of the National Bank of Slovakia. Its main topic was *International Rating Agencies and the Contagion Effect in the Euro Area in the Period of the Debt Crisis.* The so called contagion effect applies to a situation in which instability of a certain market is transferred to another market. The activities of international rating agencies played a significant role during the global financial and debt crises. The international rating agencies, not subject to any regulations, have enormous power, and by their decisions they have a great impact on various (financial) institutions, and consequently on millions of people.

The main objectives of the National Bank of Slovakia in performing the financial market supervision are to contribute to:

- the stability and integrity of the financial market, and the systems supporting the creation of financial market and the provision of services within its framework,
- the transparent, safe and sound functioning of the financial market in a fully competitive environment, in which the supervised entities are willing to respect the rules of economic competition and also the requirements concerning their business activities set forth by the generally binding legal regulations and other valid regulatory measures,
- the creation and promotion of credibility of the financial market,

- the creation of adequate protection of reasonable interests of the customers, investors, insured persons, persons participating in the pension insurance and pension schemes, and the other persons to whom services are provided by the supervised entities active on the financial market,
- the creation of legal and regulatory framework and structure of the financial market by means of generally binding regulations, directives and recommendations for the entities on the financial market;

In performing the financial market supervision, the National Bank of Slovakia objective aims to secure that

- the financial market entities have competent and expedient owners, management and other persons with the necessary professional qualification for the performance of their licensed activities,
- the financial market entities have the capital, equity or any other requisite property in the amount and structure set forth by the applicable laws and other generally binding regulations in relation to the particular entity for the purpose of reducing and distributing the risks and fulfilling the strategy,
- the financial market entities act prudently when performing their licensed activities in compliance with the applicable laws and other generally binding regulations,
- the problems arising in various areas of the financial market could be promptly and efficiently dealt with in a manner that will protect the parties to the largest possible extent, by which any possible threat to financial market stability as a whole may be prevented to the largest possible extent.

The aims of the National Bank of Slovakia in performing the financial market supervisions are:

- to maintain reasonableness as for the requirements imposed in relation to business activities of supervised entities as regards the anticipated gains for the market and its participants resulting from the regulation of their business activities,
- to promote the introduction and provisions of the products and services that meet the requirements of the legal framework of the European Union,

- to promote competitiveness of the supervised entities without unnecessarily limiting it,
- to respect the international nature of financial services and markets,
- to prevent the use of the financial market for money laundering and funding terrorists,
- to respect the primary responsibility of the persons who are professionally qualified to perform the activities of financial market entities, especially responsibility of members of statutory and supervisory authorities and the authority of internal supervision .

3.3 Banking Union and Single Supervision Mechanism in the European Union – the European Financial Supervision System

*Since 1 January 2011, the European financial supervision system began to operate in the European Union to contribute to improved cooperation among supervisory authorities in the EU Member States, to strengthen supervision over the cross-borders groups, and to create a set of single European rules for all financial institutions active on the internal market. Supervision over the financial market entities remained at the national level. Due to the impact of the ongoing financial and economic crises, the European institutions proposed, in the middle of 2012, the creation of the banking union that may possibly bring centralization of the performance of supervision in the euro area (Čilíková, 2*012: 1).

On 26 June 2012 Herman von Rompuy, President of the European Council submitted the European Council a report **Towards a Genuine Economic and Monetary Union,** defining the four essential building blocks for the "genuine economic and monetary union" in future:

1. An integrated financial framework, i.e. elevating responsibility for the bank supervision in the euro area to the level of the European Union, and providing for the common mechanisms with the aim of orderly winding-down non-viable institutions, and thus protecting customer deposits. It is proposed to create a single European banking supervision system at the European and a national level The European level will have ultimate responsibility.
2. An integrated budgetary framework to ensure sound fiscal policy-making at the national and European levels (more vigorous enforcement of budgetary discipline and steps towards common debt issuance and fiscal solidarity).

3. An integrated framework of economic policy with sufficient mechanism to promote sustainable growth, employment and competitiveness.
4. Ensuring the necessary democratic legitimacy and accountability of decision-making within the European Monetary Union, based on the joint exercise of sovereignty, the common policies and solidarity.[5]

The European banking union is not yet a new legal facility. It is mostly a political vision of a greater integration of the European Union to be based on recent significant measures made to strengthen the regulation of the banking sector, and will go also further. The conception of the banking union was proposed by the European Commission President, Emanuel J. Barroso, at an informal meeting of the European Council held on 23 May 2014. Ever since this conception draws a lot of attention within the political discussions as the number one priority in the agenda of the next European summit (www.europa.eu, 13.11.2013).

The banking union needs institutional and legislative frameworks to be able to function efficiently.

Just as in the case of other EU institutions it became apparent that the institutional structure and framework need more than just allocation of the powers, and it must react promptly. The existence of a single authority of a banking union, the European Central Bank contributes greatly to the functioning of the future banking union, as well as the present monetary union (Tkáčová, 2009: 222).

Further condition for the functioning of such institutional architecture is the existence of the European Financial Stabilisation Mechanism (EFSM), the European Stabilisation Mechanism (ESM) and the European Financial Stability Facility (EFSF). As all of these facilities, significant for the finance business, are in existence now, further discussion will concern other authorities. For the future form of the European banking union, the European Commission has proposed two other authorities to be created, with one central authority, the European Banking Authority already existing within the institutional structure, as mentioned in the ESFS system. The two

5 For more details see the National Bank of Slovakia website (www.nbs.sk).

authorities (Supervisors College and the Bank Supervisory Board), not having been created yet, should be a part of the institutional background of the banking union (Urban, 2014).

4 Conclusion

The National Bank of Slovakia makes a lot of effort to perform all activities related with the financial market supervision efficiently, economically, and at a high professional standard. Into the category of the financial market supervision, new rules, instruments and methods of their utilization are gradually introduced in all countries of the European Union. It is necessary to provide and make mutually accessible all the information required for effective functioning of financial markets. The banking union may be an efficient facility ready to respond to future banking crisis, as it is properly drafted and has unambiguously defined pillars upon which it will operate, all of which bears a clear message for the financial markets about how the European Union will develop and how it will a factor in eliminating and preventing the debt and banking crises in future. The set hypotheses may be evaluated on the basis of the analyses accomplished: 1. First hypothesis may be confirmed only in part. The banking union will apply primarily to the euro area countries, not splitting any interests, but pursuing every country's own interests. The banks in Slovakia are ready to join the banking union, however this hypothesis cannot, be confirmed in full, as the readiness for the banking union and the third pillar have not been endorsed yet.

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FINANCIAL COUNSELLING – ECONOMIC AND JURISTIC VIEW AND ITS PLACE IN REGULATION OF CAPITAL MARKETS (CZECH AND SLOVAK APPROACH)

Matej Pustay [1]

Abstract

This contribution deals with phenomenon of financial counselling as part of the financial system. Paper approaches regulation of financial counselling from both, economic and juristic view in order to fully comprehend the content of the term.

Author compares perception of financial counselling regulation in Czech and Slovak Republic and critically evaluates both systems in order to identify their strengths and weaknesses.

Finally, the contribution provides possible steps to be undertaken in order to maximize affectivity of financial counselling regulation.

Key words

Financial counselling; financial planning; investment counselling; financial intermediation.

JEL Classification

G29

1 Introduction

This paper deals with a phenomenon of financial counselling, an economic and legal term and its place in the regulation of financial system in Slovak and Czech Republic. With ever increasing development pace that is typical for financial system, availability of professional advice becomes more and

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more crucial. Importance of financial counselling lies mainly in the fact that clients of financial counsellors are usually people without deeper knowledge of financial system. This often creates strong asymmetry in information available to both sides[2] and calls for the legal rules that will provide protection for a consumer, who is recognized as the weaker side.

With relatively short tradition of united regulation of financial counselling in Slovak Republic and virtually none complex regulation in Czech Republic, this area is can be described as the legislative "grey zone". That being the case, relative shortage of the relevant literature on the subject can be observed. From Czech and Slovak authors publishing in the field of economy it is possible to mention e.g. G. Oškrdalová (Oškrdalová, 2009) and her article *About financial counselling*.

More extensive writings have been published abroad, such as *Personal finance* (Kapoor et al, 1988) or *The changing role of financial planner* (Dubofsky et al, 2009).

This article firstly aims to explain an economic view of a term "financial counselling". This is crucial in order to fully comprehend extent of the services that can be viewed as provision of financial counselling.

Following the establishment of basic definition, the paper provides distinction of financial counselling and other services that are close to financial counselling and can be often incorrectly labelled as the counselling.

With economic approach in mind, paper further describes foundations of regulatory view of financial counselling in both, Slovak as well as Czech Republic.

With crucial differences in the regulation effective in Slovak and Czech Republic, main aim of the article is to compare both systems, identify their strengths and weakness and device possible ways to improve regulation of financial counselling.

2 With counsellor usually being ones with far better information combined with professional marketing skills.

2 Financial counselling as the economic concept

Economic perception of financial counselling phenomenon can serve as a good stepping-stone to a description of legal definition. This is mainly because financial counselling is, at least from my point of view, an economic concept. The fact that legal rules apply to its provision has no effect on this allegation. If this premise is accepted, one of the questions that we have to ask with regard to legal definition of financial counselling is whether it respects the economic view. Even if one would tend to refuse understanding of financial counselling as primarily economic term, value of economic definition of financial counselling has to be recognized in legal systems that lack united regulation of financial counselling. In such systems[3], economic approach is then the only way through which we can perceive true meaning of the financial counselling.

Despite the fact that even between economists themselves, financial counselling has not definitive content; common uniting principles can be derived quite successfully.

One of the least scientific yet quite accurate ways of describing the activity of financial counsellor is to compare the counsellor to common doctor. As we probably would not try to cure acute pneumonia ourselves, provided that we are rational enough to know our limits, consumers should not perform financial operations without adequate knowledge regarding mechanism that fuels various financial products.

However consumers may find themselves in the situations, when they will not only want, but will need to enter the financial system[4], even though they will not have sufficient knowledge. And that is exactly the time, when financial counsellor shall step in as the expert, who will provide necessary advice regarding selection of the most suitable product with regard to client's needs (Kozup, 2008: 2).

Another way to define the services provided by financial counsellor is through description of specific tasks undertaken by financial counsellors.

3 Czech Republic being a good example.
4 Perhaps they will need to finance their consumption as they will not command sufficient funds at the moment.

Based on this approach, financial counsellor is a person, who meets with clients, explains different financial services, educates its clients and answers their questions regarding investment activities and risks, provides investment recommendations, helps with preparation of plans for important live events[5], monitors clients' accounts and proposes changes in the composition of portfolio and finally monitors possible investment opportunities (Bureau of Labour Statistics, U.S. Department of Labor, 2014).

There are also authors, who claim that the job of financial counsellor is in a significant part created by social interactions and help with non-financial matters – various personal dramas or weaknesses (Dubofsky et al, 2009).

Different approach represented e.g. by Grable (Grable, 2014) sees financial counselling as a short term activity aiming for modification of behaviour through education and leadership. Counsellor therefore helps client to realize its possibilities and sort out priorities.

Despite the valid nature of an approach understanding the financial counselling as a kind of "mentoring" or "couching", throughout this article I will stick to more common perception of financial counselling that is recognized also in Czech literature.

Oškrdalová defines financial counselling as "provision of individualized counselling to natural and juristic persons regarding finance, understood in the broader sense" (Oškrdalová, 2009). Insurance, investment, savings or tax counselling are mentioned as the specific areas in which the financial counsellors will be providing advice to clients.

In a nutshell it can be said that economists view financial counsellor as a person, who provides expert advice to clients, regarding all aspect of their finances, specifically in those cases, when clients' knowledge is not adequate enough to handle their financial matters in ever evolving financial system.

Important fact to keep in mind is that financial counselling is not strictly related to specific area of finance - in other words, financial counselling represents provision of professional advice regarding numerous services provided in financial system. Whether this advice is given about insurance or pension savings plays no role. If the qualitative aspects are fulfilled,

5 Such as reaching pension age or obtaining university education.

service provided will be financial counselling. In fact in order to fully exploit benefits of financial counselling all aspects of one's finances shall be subjected to financial analysis performed by a counsellor.

3 Of course it is financial counselling…or is it?

Previous chapter focused on provision of positive definition of financial counselling. This may prove helpful, but it can be quite useful to provide also negative definition of financial counselling. This is because number of activities can be[6] incorrectly classified as the financial counselling.

3.1 Financial planning

Needless to say, financial planning and financial counselling are definitely connected. With financial planning as the way for creating the balance between current and future incomes and simultaneously finding effective and feasible[7] way to fulfilment of one's financial goals (Málek et al, 2010) we can stipulate that financial planning shall definitely be a part of financial counselling. As a part of financial counselling, financial planning is therefore narrower term.

Also subjects who provide these services can be different. Whereas financial counselling is provided by professional, financial planning can be easily done by individual himself as a part of future planning.

3.2 Investment counselling

Another service often misinterpreted as the financial counselling is investment counselling. Bearing in mind the economic approach to financial counselling described above, it is not difficult to realise the difference. Investment counselling is simply one part of financial counselling – individualized counselling regarding investment tools.

3.3 Financial intermediation

Job of a financial counsellor is to "propose optimal arrangement of personal and family finances, or corporate finances of client" (Oškrdalová, 2009).

6 And unfortunately often are.
7 With respect to possibilities that exist under current state of financial market.

Financial intermediation is different. Its focus is on distribution of financial products to consumers. Of course counsellor can be empowered to conclude contracts in the name of client, but that is completely different matter because conclusion of a contract is not the main aim of counsellor.

Counsellor can just as well provide client with advice and left realization solely on client.

Despite the fact that counselling and intermediation can be closely linked, it is essential to differentiate between these services. This is crucial mainly in order to ensure adequate protection of clients. It is not uncommon for financial intermediaries to call themselves counsellors. However their prime aim is different. Financial intermediary aims to conduct business, make client sign the contract. Financial counsellor, on the other hand, aims to find best possible solutions for client[8].

Therefore if subject calls himself counsellor it is understandable that client will expect that products he has been offered represent the best possible solution for him. Often this is not the reality. Intermediaries often offer products based on the contracts with banks or insurance companies and provisions agreed upon in these contracts rather than on objective analysis.

4 Juristic perception of financial counselling

Now that we have successfully stipulated basic economic understanding of financial counselling, we can make one step further - to legal definition of financial counselling.

This step may prove to be rather difficult. Slovak and Czech legislators decided to adopt quite different approaches to regulation of financial counselling.

8 The reimbursement is provided principally by client and in exchange for provided advice.

Slovak regulation of financial counselling is united in Act on Financial Intermediation and Financial Counselling and provides general rules for counselling in various sectors of financial system.[9]

On the other hand, regulation in Czech Republic is comprised strictly to individual sectors without any arching legal act. Under this model, regulation of counselling in various sectors respects their specifics but fails to provide common rules for subjects acting simultaneously in various sectors. Such approach can lead to creation of multiple standards than can be very difficult for consumers to recognize and comprehend.

4.1 Regulation of financial counselling in Czech Republic

First and foremost it is necessary to ask whether there actually exists "true" financial counselling in Czech Republic. I have already stipulated that existence of regulatory frame cannot be equated with existence of financial counselling because it is primarily economic concept.

Therefore, under the Czech model, we can define financial counselling through one of proposed economic definitions and then use this definition to identify various services that are provided in different sectors of financial system and together satisfy this definition. The regulation of financial counselling will be built from regulation of these individual services and will be quite complicated.

Unfortunately this model is not uncommon. Regulation of European Union also does not recognize financial counselling as specific service[10].

We can identify 4 main areas that will be of our interest: (i) risk protection (consisting mainly from insurance products), (ii) appreciation of assets (investment, long-term deposits, savings accounts and similar products), (iii) financing (e.g. consumer credits) and (iv) other areas (e.g. tax counselling).

9 Term financial system is more accurate than financial market. Financial market comprises of financial operations than are devised to increase the value of assets. Some products, e.g. non-life insurance, do not aim to increase value of assets but rather secure the risk. Such products are therefore the part of financial system but not financial market. When talking about financial counselling in the meaning described in first chapter, term financial system is more accurate.

10 Despite the fact that we can see gradual convergence of rules applied in insurance and investment sector.

We can also create more specific list, saying that financial counselling consists of various services provided in area of insurance (both life and non-life insurance), investment (securities, collective investment, bank products), building savings, pension savings (pension insurance, pension savings and supplementary pension savings), provision of credits (consumer credits, mortgages) and tax counselling.

Each of these areas has its own regulation regarding distribution of products and communication with clients. Basic standards set by different legal acts[11] differ greatly. On the one side there are areas like investment counselling or insurance intermediation[12] that are quite heavily regulated.[13] Other side of regulation is represented by areas in which the regulation is virtually non-existent.[14]

All of the abovementioned leads to a state when regulation of financial counselling in Czech Republic can be characterized by lack of any unification, by differences between economic and legal perception of financial counselling[15], by different standards set for subjects who provide counselling in various sectors of financial system and finally by insufficient standards set for counsellors.

All of these "defects" in regulation of financial counselling lead to legal environment that common consumer cannot fully apprehend. Common consumer is often approached by subjects who provide services belonging to various sectors of financial system and are regulated by numerous legal

11 Their detailed analysis is far beyond the scope of this paper.

12 Act No. 277/2009 Coll., Insurance Act, as amended understands counselling regarding insurance products as a part of intermediation.

13 Subjects who want to provide services in these areas need to at least register with Czech National Bank and offer defined minimal standard of required knowledge (secondary school). Also, there are rules regarding information that client has to be provided with or which counsellor needs to get from client before advising on any further steps.

14 Good example is provision of analysis of investment opportunities or investment recommendations in accordance with the Act No. 256/2004 Coll., on Business Activities on the Capital Market, as amended that only requires trading license or e.g. distribution of building savings.

15 E.g. interpretation of counselling provided in insurance sector as a part of intermediation.

acts.[16] If a consumer would like to check if behaviour of such subjects complies with law, he would have to be familiar with basically complete regulation of financial system. With respect to the extent and complexity of this regulation this is virtually impossible.

Consumer is therefore left with very few possibilities to learn his rights and furthermore, with number of subjects that are supervised[17], Czech National Bank can be quite ineffective in handling of few complaints that are actually filed.

5 Regulation of financial counselling in Slovak Republic

Under Slovak approach, legislative understanding of financial counselling is very close to the economic definition presented in previous chapters. As the explanatory report to the Act on Financial Intermediation and Financial Counselling stipulates; financial counselling is provided in order to give information, analysis or recommendations based on which the client will be able to make an informed decision about conclusion of contractual relationship with financial institution. Such information than necessarily have to be based on the analysis of sufficient number of products available in the economic system.

Financial counsellors "sell information" and that is the fact that differentiates counselling and intermediation. Aim of financial counselling is to help a client making most effective decision. Financial intermediation on the other hand is provided with the simple purpose of distribution of financial products to clients. Despite the fact that intermediation and counselling can be very similar in various aspects, their purpose varies greatly.[18]

We can further say that regulation of financial counselling in Slovak Republic can be perceived as an independent part of financial system regulation,

16 Such as investment intermediaries, who are not limited in the extent of service they can provide beside investment services listed in the Act on Business Activities on the Capital Market. Investment intermediaries will therefore often offer not only investment products but insurance products as well.

17 E.g. there are more than 7000 investment intermediaries and more than 140 000 insurance intermediaries.

18 Note that this description of differences between counselling and intermediation is almost identical to that provided in subchapter 3.3.

linking regulation of various services belonging to different sectors of financial system, e.g. banking, capital markets, and insurance. As such it creates important role in the non-fiscal branch of financial law with focus on consumers' protection.

By adoption of the Act on Financial Intermediation and Financial Counselling, provision of financial counselling has been united for insurance, capital market, supplementary pension savings, and deposits, provision of credits and consumer credits and retirement pension savings (National Bank of Slovakia, 2013).

This regulation therefore creates united rules for protection of consumers in all of areas mentioned above. We can see the sharp contrast with regulation in Czech Republic described in previous chapter.

Without any prejudice to Czech system, we can say that Slovak approach managed to solve majority of shortcomings associated with Czech regulation.

Besides clearly defining financial counselling as a service and distinguishing it from financial intermediation, Act on Financial Intermediation and Financial Counselling improves position of customers in many ways.

First of all using of term "financial counsellor" as well as its translations or other word forms derived from it can be used only by entrepreneurs who possess license issued by National Bank of Slovakia (Act on Financial Intermediation and Financial Counselling, Art. 10/3). This is in fact one of the most important parts of the regulation. It allows clients to quickly identify financial counsellor and find regulation of this profession. In the absence of this rule[19], term financial counsellor can be freely used by any subject without any regard to true extent of its services. Client can therefore expect provision of complete counselling, as he is dealing with "financial counsellor" when in fact consumer is dealing with intermediary bound by contract to specific institution which products he will offer to client.

Another important part of the Act on Financial Intermediation and Financial Counselling is that it sets common rules for professional qualification. With four different levels of qualification introduced by the act,

[19] Like in Czech Republic.

financial counsellor[20] has to satisfy highest level of qualification, its employees providing financial counselling at least at higher level (Act on Financial Intermediation and Financial Counselling, Art. 21/8,9). This means that financial counselling will always be provided by a person, who graduated from secondary school or university, has at least three years of practise on financial markets and passed professional examination. Furthermore, this qualification has to be continuously updated and examinations undertaken each four years (Act on Financial Intermediation and Financial Counselling, Art. 22).

Act on Financial Intermediation and Financial Counselling also regulates business conduct of financial counsellors in area of dealing with clients. Professional care, confidentiality, liability of financial counsellors[21] or extent of information that counsellor is required to disclose to client are just some of the covered areas. Worth of mentioning is definitely the fact that financial counsellor cannot accept any monetary or non-monetary payments connected to financial counselling beside payments received from client (Act on Financial Intermediation and Financial Counselling, Art. 32/6). Also the assessment of clients is regulated – financial counsellor is obliged to find out what are requirements and needs of client, his knowledge and experience regarding financial service in question and what his financial situation is. Financial counsellor than have to provide counselling that is appropriate with regard to information obtained (Act on Financial Intermediation and Financial Counselling, Art. 35). Once again we can draw the parallel with regulation in Czech Republic, where similar rules apply to investment counselling, but then again regulation is not united and different standards are set for insurance intermediation and basically none for remaining sectors.

In a nutshell we can say that Slovak regulation of financial counselling provides complex set of rules for all aspects of counselling that aims to secure position of consumer in such a way, that any service that will fall under the definition of financial counselling will always be provided by person with adequate knowledge, minimal standard of dealing with clients will

20 Or member of its bodies and senior employee provided that financial counsellor is legal person.

21 As well as obligation to conclude liability insurance.

be met and financial counselling will be provided based on satisfying amount of information. Clearly this approach far better reflects the nature of financial counselling.

6 Conclusion

Financial counselling is definitely power to be recognized on the financial markets. With its importance lying in the fact that it affects mainly consumers with limited knowledge of financial system, regulation of financial counselling seems to be crucial.

In this paper I have described economic view of financial counselling and then two extreme approaches to financial counselling regulation. One pole is represented by Czech approach that basically does not recognized financial counselling as a specific service. This approach, even so that legislation of European Union is quite similar[22], gives rise to many shortcomings and problems. In general, we can say that the lack of regulation of financial counselling respecting its ties to various sectors of financial system is in contrast with social reality when it is not uncommon for subjects active on financial markets to provide services that consist of counselling in various sectors.

Slovak regulation that understands financial counselling as specific service that is not bound to any specific sector of financial system but rather is defined by its content represents counterpart to fragmented regulation in Czech Republic. This approach improves the position of consumer in such a way that consumer is more easily able to judge whether counsellor complies with legal regulation. This is achieved through the fact that regulation provides basic requirements and standards for financial counselling provided in various sectors of financial system.

Not only that this approach is quite similar to economic understanding of financial counselling, it also improves the position of consumer and therefore seems to be more legit then approach based on various rules set for different sectors of financial system[23].

22 Means it is focused on regulation of specific sectors, without any arching regulation.
23 On the other hand this approach is less strict for legislator, who does not have to create laws that will be applicable on services from various financial sectors.

First recommendation can therefore be aimed for Czech legislators, who, if serious regarding development of financial counselling, should definitely pass united regulation of financial counselling.

But regulation of financial counselling can evolve even further than to unified regulation. I believe that the financial counselling holds the potential to become profession such as advocacy or medicine with own chamber, disciplinary board and ethic codex. Even though this probably will not be feasible in next few years, it is definitely one way to go in more distant future.

At the very end I would like to mention one other phenomenon that is in my opinion very closely linked with financial counselling – financial literacy. In many parts of this contribution I have been stressing the role of regulation of financial counselling in consumers' protection. But even the most perfect regulation will prove useless if people will not understand it. Therefore the only way to ensure the sustainable development of financial system[24] is simultaneous improving of regulation and consumers' knowledge regarding financial system.

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HEALTHCARE AND FINANCE

Monika Ježková [1]

Abstract

The article Healthcare and Finance deals with the system of financing healthcare in the Czech legal environment. Firstly, the economy of healthcare as an academic discipline is introduced and a comparison of healthcare market with a perfectly competitive one. Next comes a chapter about financing healthcare with its three main sources: insurance companies, households, and public budgets. The main part of the article analyses the first source in great detail as it contributes with no less than three quarters towards the overall sum. In this subchapter the reader will find information about the way money is gained as well as spent and, furthermore, what the comparison is between a perfectly competitive market and the one with health insurance. The chief objective is to confirm or disprove the existence of a competitive market with health care.

The article was written using methods of comparison, compilation and deductive analysis.

Key words

Competitive market; financing health care; health care providers; health insurance companies; reimbursement decree.

JEL Classification

I11, I13, I18, H51

1 Introduction

The paper deals with a highly complex issue of financing healthcare. The topics appears to be a hotly-debated one due to regulatory fees, payments for premium care and a general lack of funding in health-related

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institutions. Another important area of interest, namely that of financing healthcare via health insurance companies, is rather neglected and it is therefore in particular focus. As these companies annually spend vast amounts of money, the paper is primarily concerned with the status of health insurance companies on the market with healthcare and on the way of obtaining and redistributing finances.

The paper is divided into two chapters. The former deals with the economics of healthcare and the healthcare market, which is compared to a perfectly competitive one. The latter one is then concerned with financing healthcare and the three main sources:: insurance companies, households, and public budgets. The subchapter financing by health insurance companies aims to provide information about the system of benefits from public health insurance, the redistribution of finances and, furthermore, it also draws comparison between a perfectly competitive market and the one with health insurance. The author tries to inform the reader of the many complexities of the healthcare market and the reasons behind frequent state interventions; she does not try to offer its evaluation as well.

The basic methods used in this paper are comparison, compilation and deductive analysis.

2 Health economics

This discipline is now a relatively independent discipline of economics which analyses the behaviour of individual economic subjects in connection with the production and consumption of healthcare. The healthcare market, unlike a perfectly competitive market, is often regulated by the state which does so for two principal reasons:

1. If the market were naturally effective, a high number of people would not be able to afford even the basic health care, which is generally considered to be socially undesirable. In order to prevent such cases there are goods in the healthcare system that are protected by means of limiting an individual's choice.
2. Market failures are frequent and they cause that the allocation of goods and services by a free market is not efficient. The main

> microeconomic failures include problems with competitiveness, the existence of public goods and externalities. (Malý, being prepared for print)

This market is in fact divided into two extremely close-knit markets. (Howel, 2006)

1. Health insurance market

People (group A) pay health insurance to insurance companies against the risk of incurring medical expenses in the future. Insurance companies then pay for the health care benefits specified in the insurance agreement between themselves and people who fall ill (group B). Insurance companies thus need to try and balance the interests of groups A and B on this market.

2. Healthcare market

This market involves the providers of health care and people who pay the insurance and, simultaneously, claim their health benefits (group B).

Table 1: The comparison of a perfectly competitive market and a health care market

	Perfectly competitive market	Health care market
Price	Contractual price between supply and demand	limited competition due to legal restrictions
Optimality	The satisfaction of all subjective needs	Desire to limit wasting health care and to make health care as available as possible
Supply		
Flexible access to the market	Free to enter and leave the market	Entrance to the market is restricted by means of licences and by the demanding and expensive education thaat is
Number of providers	Unlimited	Limited
Status of providers	No specifics	Specific status of the doctor who prescribes medicaments and types of treatment. He/She also co-decides budgets of health organisations. Their behaviour must be completely free from pursuing their own benefit.

Competiti-veness of providers	Competitive behaviour	Largely restricted: no advertising, doctors often co-operate
Substituta-bility of providers	Frequent	Limited: doctors' work cannot be performed by nurses or robots
Types of commodi-ties	Homogeneous	A great number of heterogeneous ones
Characte-ristics of commodi-ties	Designed by the provider	Ultimate goal very uncertain: will the patient be cured if de lege artis is observed?
Supply of commodi-ties	Determined by the comparison of benefit from goods on offer and the potential loss suffered by not offering other goods	Quantity and quality of supply is largely determined by non-commercial forces
Supply of other products	Recommended with a view to increasing sales	Further treatment recommended according to individual needs of the patient
Demand (Feldstein, 2011: 114)		
Regularity	Regular	Irregular
Predictabi-lity	Predictable	Unpredictable
Intensity and flexibility	Influenced by market factors	Influenced by non-market factors as wellfaktory (Arrow, 1963: 941)
Need	Based on subjective feelings of deprivation	Focus placed as well on objective needs irrespective of feelings and wishes of the individual
Quantity	Up to the demand side to decide	The demand side offloads part of its sovereignty onto the doctor
Payment	Made by the demand side	The demand side only covers a small part

Source: Author

The healthcare market suffers from overproduction as patients offload part of their consumer sovereignty onto the provider. This overproduction unbalances the health insurance market, which forces health insurance companies to enter the healthcare market as well, this time as a representative

of patients claiming their benefits (group B). Their main aim is to influence the conditions of providing health care. The best way of doing so seems to be the practice of signing contracts between insurance companies, people paying insurance and healthcare providers. Further details are discussed in subchapter 2.1.

3 Financing healthcare

The system of financing the healthcare system reflects its aim to be as economical as possible. Funds are distributed in two ways: directly and indirectly. The former is done by means of payments from patients with the exception of insurance but including their financial participation in services offered in the indirect form. The latter is then represented by

- public budgets (state and regional)
- compulsory insurance
- voluntary insurance
- occupational insurance
- charity
- foreign help

The direct way of financing involves payments for services without paying the insurance but including financial co-participation in services incurred within the indirect forms. (Malý, being prepared for print)

In fact it is not of such importance who makes the payment but what matters is how the money is distributed. The total healthcare expenses in the Czech Republic reach 292,002 million CZK., which makes 7.6% of the GDP. The biggest share (77.4%) is represented by insurance companies, followed by households (14.9%), public budgets with 6.7% (state 3.1% and regional 3.6%), and, finally, other sources, e.g. travel insurance, preventive occupational care and non-profit organisations, (1%). The Czech Republic (84.1%) is one of the countries with the biggest share of public expenses spent on financing healthcare. (Czech Statistical Office, 2014)

In the next part a particular focus is placed upon the system of financing by health insurance companies, while those by household and by public budgets scarcely warrant more than a brief mention.

3.1 Financing by insurance companies

The biggest source of finance are insurance companies which cover 77.4% of all health expenses (226,035,000,000 CZK in 2012). These companies typically obtain money from health insurance that is compulsory for all citizens of the Czech Republic who are employed or self-employed. This insurance is paid by the state on behalf of members of the army and unproductive groups of people such as children, students, the unemployed, pensioners and others who are for one reason or another out of work.

Health insurance in the Czech Republic is 13.5% of the so-called 'assessment base', which is in fact the gross wage from which the employer contributes by 4.5% and the employee by 9%. Since 2006 the assessment base for the self-employed has been 50% of their income after all deductions and allowances to maintain their business have been made. For contributions paid by the state the assessment base is at the moment 6,259 CZK (this was established on July 1st 2014) but the assessment base for this can change every year before June 30th. The last change was made after four years of inactivity. (Act no. 592/1992 Coll., on premiums for general health insurance, as amended)The state finds funds for such contributions in the Social Security Fund.

The following table displays contributions towards health insurance in the first half of 2014.

Table 2: Health insurance in the first half of 2014

(in mil. CZK)	state	insurers	total
January	9.567	17.084	26.843
February	4.822	12.539	17.554
March	4.835	13.835	18.862
April	4.872	16.269	21.333
May	4.815	13.017	18.025
June	4.792	14.337	19.322

Source: Ministry of Finance, 2014

1. **The system of payments from public health insurance**
   Public health insurance finances all health care guaranteed by Act no. 48/1997 Coll., on public health insurance and on changes

to certainrelatedlaws, as amended, according to a reimbursement decree that is passed every year. The reimbursement decree sets point values[2], the maximum payment for covered services and regulatory restrictions. Providers can agree with insurance companies on the conditions of reimbursement even without the decree (as happened in 2014 when GPs and gynecologists did so). (Ministry of Health of the Czech Republic, 2013b) This decree is negotiated by representatives of VZP (in English GHIC - General Health Insurance Company), other insurance companies and the associations of professional providers.

If the negotiations are successful and an agreement is reached, the proposed decree is referred to the Ministry of Health for approval in case the decree is in accordance with legal requirements and public interest. If the approval is granted, the decree becomes valid in the form of a legally-binding decree as of January 1st the following year. If, on the other hand, the negotiations are fruitless or the Ministry of Health does not grant the approval, it is up to the Ministry of Health to set point values, the maximum payment for covered services and regulatory restrictions on its own.

To give an example: the current reimbursement decree is valid from 1/1/2014 to 31/12/2014. The negotiation period lasted from 20/3/2013 to 21/8/2013 and in only five out of eleven sections was full agreement reached. Another section managed to reach partial agreement. The referential point (year) was 2012. (Ministry of Health of the Czech Republic, 2013a)

Actual payments are made through contracts between health care providers and insurance companies. These must be made in accordance with the ordinance that stipulates framework contracts.

The reimbursement decree would be absolutely useless if it were not for ordinance decree No. 134/1998 Sb., which determines a list o foperations with point values, as amended.

In the Czech Republic the system works on pay-per-intervention basis, which seems more economical than pay-per-patient or pay-per-time basis. The pay-per-intervention system offers numerous modifications, the one used in the Czech Republic is determined

2 The reimbursement decree states how many CZK one point is worth

by point values for specific medical interventions. The point refers here to an established number that enables ready comparison between individual interventions and services in terms of their time demand or the required qualification to perform the given intervention. These criteria can of course be combined or some other can be added to these basic two. The overall income is then set by its value expressed in money.

2. **The redistribution of financial sources**

Apart from the biggest insurance company called GHIC (see above), there are six other health insurance companies, all of which provide services predominantly (though not exclusively) to their employees (Alliance of health insurance companies of the Czech Republic, 2013):

- Vojenská zdravotní pojišťovna České republiky,
- Česká průmyslová zdravotní pojišťovna,
- Oborová zdravotní pojišťovna zaměstnanců bank, pojišťoven a stavebnictví,
- Zaměstnanecká pojišťovna Škoda,
- Zdravotní pojišťovna ministerstva vnitra České republiky,
- Revírní bratrská pokladna, zdravotní pojišťovna.

Despite there being no less than seven insurance companies on the Czech market, the environment is far from competitive. All competition is perfectly destroyed by the system of total redistribution of the collected money. The system is based on act no. 592/1992 Coll., on premiums for general health insurance, as amended.

The system of redistribution has been in effect in the Czech Republic since 1993 although at that time only 60% of the total sum was redistributed and it was not taken into account how expensive individual insurers were. The system itself was introduced with the aim of balancing the revenues and expenses of individual insurance companies. Further, the system aims to help maintain a certain level of solidarity of the rich with those in need and of healthy people with those who are not so lucky. The amount of redistributed funds was, however, insufficient and it was thus in 2005 decided to increase it to 100% with ever so increasing complexity of the criteria according to which the system operates.

At present the system of redistribution has two main phases. The first looks at indexes of expensiveness of age and sex groups, thereby maintaining solidarity between the pre-selected 36 groups of insurers. The second phase looks at individual insurers across all age groups who incurred big charges for health services (fifteen times as big as the average sum for one insurer per calendar year). This measure should ideally help protect insurance companies from over-the-average number of expensive patients, which could possibly cause the insurance company in question some financial troubles (GHIC is particularly vulnerable in this respect).

The mechanism of 100% redistribution completely cancels all links between collecting the insurance and actual revenues of insurance companies. This might potentially lead to insurance companies losing motivation to be effective, try and reduce the costs and it can also bar their development. From a certain perspective the system of 100% redistribution totally destroys competitiveness between insurance companies as they are mere redistributors of the collected money. Such a situation prevents any future individualisation of their services because it makes it impossible to create alternative insurance plans based on different amounts of insurance. Likewise it does not allow awarding bonuses to those insurers who do not incur any or little charges. The redistribution system thus evens out the system of public health insurance. (Malý, being prepared for print)

3. **Health insurance companies and their market**

The previous subchapter shows convincingly that the state promotes 100% solidarity between insurance companies and upsets their naturally competitive market. These interventions by the state directly cause wastefulness: the more an insurance company spends one year, the more it gets the following year from the redistributed revenues. The market is hence far from effective. The following table offers compares a naturally competitive market of private insurance companies with the ineffective market as it is in the Czech Republic now. The main criteria are both the level of autonomy and the possibility to behave in a competitive manner.

Table 3: Comparison of demand on a perfectly competitive market with that on the current market of health insurance

	Competitive market of private insurance providers	Health insurance companies market
Market environment	Predictable, Clearly-stated criteria	Unstable and unpredictable, Frequent interventions by the state
Access to the market	Unlimited	Highly regulated
The mutual relationship of the entities	Equal, competitive.	Privileged status of GHIC over the rest, competitiveness limited by the law
The influence of the state on the entities	None, competitive behaviour	High, often by way of legal regulations issued by the Ministry of Health
Financing the entities	Not regulated by the law, the result of supply-and-demand pressures	By way of public insurance – its amount set by the law, The resulting revenues then redistributed
The relationship with providers	Contractual freedom, contracts made on the basis of evaluation of quality of the provided service	Contracts made on the basis of the reimbursement decree and its framework contracts

Source: Author

Table 3 clearly demonstrates that natural competition of health insurance companies is heavily influenced by the state in the Czech Republic. Although this is seemingly to ensure equality between them, in reality the outcome is to provide support for the GHIC, which has the biggest portfolio with the highest number of expensive and unprofitable insurers. Moreover, the current system brings about wastefulness and a severe lack of motivation to improve services because these must, as it is anchored in the law, be more or less the same with all insurance companies (with only minute differences). The health insurance market is largely imperfect but others in Europe have also many drawbacks so it is hopefully not true that the system in the Czech Republic is altogether wrong.

3.2 Financing by households

In the past years this has only been a subsidiary source of funding healthcare. Since 2008 its significance has increased due to the introduction of regulatory fees; however, these are gradually being done away with now and the amount of finance coming from households is diminishing as a result. In the future it is expected to rise again though because of the reintroduction of the so-called premium care, which was in existence for a certain period before being cancelled by the Constitutional Court of the Czech Republic. In 2012 households contributed 14.9% towards the entire budget, being thus the second biggest source after insurance companies. The following table shows households and their share in the system of financing healthcare from 2000 to 2012. Since 2005 the amount of finance households spend every year has been increasing by 9.5% on average. The biggest share of household expenses is represented by payments made for medicaments and aids - 63% in 2012, 80% of which was for medicaments. The next on the list are payments for premium service at the doctor's, in particular at the dentist's and in spa resorts. (Czech Statistical Office, 2014)

Table 4: Financing by households

(in mil. CZK)	2000	2005	2010	2012
Medical care	3.061	4840	12.923	12.838
Rehabilitation care	427	817	2.941	3.125
Medicaments and medical aids	10.385	17.454	26.003	27.671
Total	13.873	23.110	41.867	43.634

Source: Czech Statistical Office, 2014

3.3 Financing from public budgets

Public budgets account for 6.7% of the total revenues used to cover healthcare. In 2012 the state budget as well as local budgets provided for an expenditure of 15,647 million CZK while insurance companies provided no less than 231,270 million (222,769 million was spent on health care). (Institute of Health Information and Statistics of the Czech Republic, 2014)

Public budgets are generally used to finance specific medical interventions that are not covered from general health insurance, e.g. expenditure

on medical science, further education for medics, preventive programmes, public hygiene authorities and, last but not least, civil service institutions connected with healthcare.

1. **State level**

   The Ministry of Health is the body that, as a subject of public service, organizes financing in healthcare. Disposable financial sources are derived from the relevant section of the national budget. This year (2014) the budget was passed in the form act no. 475/2013 Coll., State Budget of the Czech Republic fortheyear 2014, as amended. Expenditure on healthcare accounts for 0.56% of the total state expenditure. The following table displays the anticipated revenues and expenditures in section 335 - Ministry of Health.

Table 5: Financing health care from the state budget in 2014

Section 335- Ministry of Health	
Total revenues	869.958.768
Total expenditures	6.810.656.472
Specific indicators-revenues	
Tax revenues	9.200.000
Non-tax revenues, capital revenues and accepted transfers	860.758.768
From non-tax revenues from EU budgets	207.281.768
Specific indicators-expenditures	
Expenditures on public service	1.711.017.680
Medical research	1.327.744.000
Institutional care	1.424.083.706
Special health institutions and services	1.054.414.682
Health programmes	693.639.303
Other health-related activities	599.757.101

Source: Act No. 475/2013 Coll., as amended

2. **Borough and town level**

   Borough and town budgets are negotiated on the basis of act no. 250/2000 Coll., on Budgetary Rules of Territorial Budgets, as amended. Budgets are then approved by borough/town councils.

   Revenues at this level only account for 10% of total expenditures. Expenditures on healthcare then account for 6.9% of total

expenditures in individual boroughs. The lowest amount is in the borough of Karlovy Vary (178,515,000 CZK) whereas the highest in the Moravian-Silesian borough (905,045,000 CZK).

Given the fact that there are over five thousand cities and towns health allowances at this level are hugely scattered over many local budgets where the sums are rather minute. To illustrate this the city of Brno's total expenditures reach 11,735,886,000 CZK and the part allocated to healthcare is a mere 243,148,000 CZK.

Boroughs and towns often on their own (or sometimes together with insurance companies) finance hospitals, emergency wards, post-mortem examinations, ambulance services, drunk tanks, various projects and consultation activities. Boroughs then provide direct investment into properties.

4 Conclusion

The paper deals with the comparison between a perfectly competitive market and the one with health insurance, demand on the healthcare market and the system of financing via health insurance companies. The results show that state interventions are rather frequent in this field; the state often controls insurance companies and their revenues as well as the system of financing health care, thereby destroying natural competitiveness of the market and its effectiveness. This paper should provide a platform for my further academic research. The next logical steps include a close inspection of the situation abroad, a more detailed analysis of the system of financing healthcare via insurance companies, and, last but not least, offer alternative ways of redistributing their revenues, thereby, it is to be hoped, helping to improve the overall system of financing healthcare.

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THE POSITION OF FINANCIAL MARKET SUPERVISION IN THE SYSTEM OF FINANCIAL LAW

Michal Janovec[1]

Abstract

Supervision of the financial market is a specific part belonging to financial law. Specific part of the Czech financial law is mainly divided to fiscal part and non-fiscal part. Because financial law is public law, than everything in the system of financial law should be done in the public interest. Supervision of the financial market in system of financial law might be classified as an non-fiscal public system of supervision (control) in the public interest. At least according to Czech law.

Key words

Supervision; financial market; financial law; system of law; in the public interest; non fiscal.

JEL Classification

K40, H83, G18

1 Introduction

The aim of this article is to classify financial market supervision in the system of financial law, in other words, it is about finding a location for financial market supervision in financial law. I think it is very important to define and determine the exact location for each institute before that institute will be subjected to a more thorough exploration and that is also the case for financial market supervision. From the name it is obvious that

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this supervision has something common with financial law, but financial law is not so small law sector, so it´s necessary to accurately classify its own different parts.

Financial law is relatively young and dynamic law sector, which has become independent to a certain extent, from administrative law, to which also has the closest relationship. About its independence and systematics will be dealt with below.

Of course there is a necessity definition of financial market supervision (hereinafter also referred to as "supervision"), because to find the right and as precise classification within the financial law, it's necessary to realize what supervision all includes.

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2 System and systematics of Financial law

For definition of a specific law sector it´s first necessary to make short self-defence of this specific sector. Its without any doubt, that financial law is independent branch of law, especially because it has a sectorial forming criteria, which generally "justify" the existence of a separate law sector.

These criteria are:

- Independence and specificity of the subject of legal regulation,
- Method of legal regulation,
- Systemic coherence of the legal norms,
- Social acceptance of the sector. (Mrkývka, 2004: 32)

All these criteria and financial law fulfils and at the same time that defines and distinguishes it from other legal disciplines. For the purpose of this article of course the most interesting sectorial forming criterion is systemic coherence of legal norms, respectively system characteristics of financial law.

The defining elements of the system characteristics are:

- Higher level of mutual relations of legal norms making up the law sector compared with relations to the norms of other branches of law
- The relative autonomy of that set of legal norms from norms of the other branches of law (Průcha, 1994: 124)

Despite the apparently existing scheme of financial law, financial law is not codified and unified and it's fragmented into several separate legal codes. That together gives a wide range of more liberal connections between legal norms. I believe that the financial law is not possible to be codified, because of the wide frame of disciplines that fall into financial law. The closest and most are more mutual connections within each subsector of Financial Law and between the mutually related subsectors forming within the financial law the purpose and character of the two different systems of fiscal and non-fiscal sections of financial law.

The subjects of financial law are specific social relations within the various financial activities, reflecting on the amount of financial effects. Financial law regulates primarily those relations in which the performs or in which intervenes state government and which are directly or at least indirectly related to monetary masses or their parts. (Bakes, 2012: 12) Basically here do not belong relations based on a contractual basis, which rather belongs to the civil law or commercial law[2].

System of financial law itself includes all internal differentiation of sector financial law to integrated filefwithins or groups of legal financial norms with regard to their content and to similarity of social relations, which are regulated by these financial legal norms. (Mrkývka, 2004: 56)

With the gradual rate of globalization, the scope of public financial activities (which regulation defines the financial law) changes and thus creates new constraints defining financial law. Extend of the range of financial law increasing with the number of public sector financing activities and with a measure of state intervention in the economy, which means that economy of countries that are characteristic of higher interference in the economy, have a wider range of financial law, which has impact on its system.

2 This is not correct without exemption, because also field of government's loans or state property selling also belongs to financial law

Most legal financial theorists divided system of financial law on the general and special part (Bakeš, 2012: 12), but a definite conclusion about the existence of the common parts is not. Pointing to the fact that there is a common institute for all subsector of financial law, also do not appear common sources of law in the formal sense, nevertheless, I believe that the general part of the financial law may be accepted, because there are common general principles and institutions for entire financial law.

The major division of financial law can be found in a special part of financial law, which can be divided into fiscal and non-fiscal part. Fiscal part is defined by interests of such social relations within which regulation is a primary concern to cash flows. On the other hand, non-fiscal part of the financial law regulates social relations in which the actual flow of money plays a minor role and a major interest is in regulating the nature of money and the monetary system. The actual separation of these two subsectors is particularly important for public institutes, concepts and principles on which it is made general part of the specified subsector, which helps to provide better and clearer interpretation and application of financial legal norms.

Fiscal part of the financial law includes adjustment of budgetary law, tax law and customs law. Within the non-fiscal part we talk about monetary law, foreign exchange law, public banking law and the insurance law, the legal regulation of capital market supervision, legal regulation and supervision of credit unions and State Assay law.

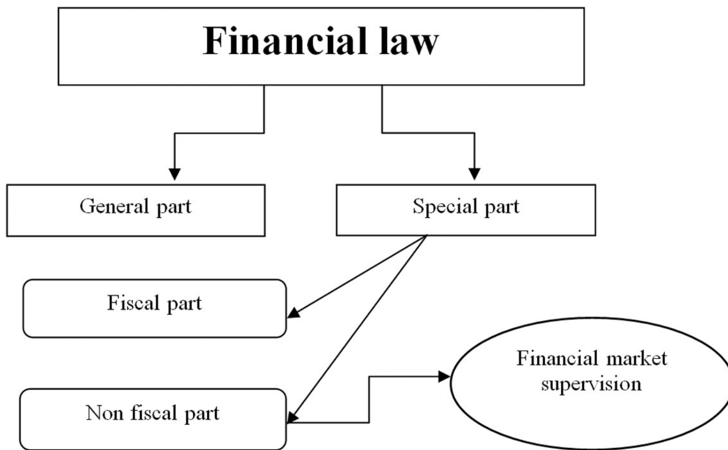
Within the system of a special part of the financial law could be further divided into procedural financial law consisting of a procedural norms,[3] financial administrative law and financial criminal law. These subsectors are not important for the purpose of this article.

Just for clarification it should be noted that the capital market is a place where there is a exchange of capital through securities and their derivatives. We could also say, its subset of financial market (Wikipedia.org). Financial market supervision is supervision of the banking sector, credit unions,

3 Procedural status of subjects, procedural aspects of decisions in relation to superiority and subordination and procedural aspects of subordinate entities - such as auto application in tax law and the legislative process

capital market, insurance and pension companies, pension funds companies, bureaux de change and also supervision of institutions of payment transactions.

The above explanation, we came to the area - the sub sector of financial Law, in which it appears and is firmly embedded in the subject of this article, ie financial market supervision is section occurring particularly in the context of legal regulation of non-fiscal financial law, which is well documented in the following diagram.



3 Financial market supervision and its position in the system of financial law

In my own words I would describe supervision of the financial market as exercised function by the a public authority - competence, which is also supported by the power of state guarantees of the possibility of sanctioning subjects for breach of the laws set by regulation of the financial market.

With supervision and with it associated control, there are established rules to protect the stability of the banking sector, capital market, insurance and pension funds sector. Thus it is systematically regulated, then "supervised" and if necessary, than comes afflictions in case of not following the rules. I dare say that in the Czech Republic it´s already effectively regulation

a subset of supervision, because it was highly integrated in the supervision and therefore, in my opinion, supervision includes 3 phases and it´s the regulation, supervision, and the possibility of sanctions. The rationale for this bold conclusion is the fact that all three of these activities were (at least in the Czech Republic) integrated into a single body that is the Czech National Bank (hereinafter referred to as the "CNB").

Legislation in the financial market includes both laws prepared by the Ministry of Finance or the Ministry of Justice and the implementing decrees and measures issued by the CNB usually. CNB also issues to support a number of market participants interpretative and methodological materials in the form of official statements and answers to questions. Directly binding rules and guidance materials are increasingly issued by the European Union institutions. (CNB methodological materials)

In the Czech Republic is performed and is responsible for overseeing the financial market CNB (Act on the CNB). Since that supervision takes relatively wide spectrum of areas, competence and duties of the various sectors of the financial market are regulated in framework of sectorial laws (Act of the supervision of the capital market).

Basic purpose, principles and supervisory functions in all areas are very similar, but there are some specifics resulting from the diversity of activities within individual types of financial market institutions and for this reason it will be useful to get to know financial market supervision in more detail.

3.1 Financial market supervision

Maintaining proper functioning, credibility and financial stability is not and cannot be only a matter of free market mechanisms, but this area is subject to a large number of restrictive and commanding rules, especially legislation. The range of regulations is quite diverse and wide, and supervision of compliance with the rules of the entire system, including drawing conclusions and consequences of their breach of is known as the supervision of the financial market. This supervision includes supervision of all financial market institutions.

In scope of care of the stability of the financial system in the Czech Republic is the supervision performed over the financial institutions and

key objectives are to promote healthy development, market discipline and competitiveness of the financial institutions, preventing systemic crises, protecting investors and clients and to strengthening public confidence, in my opinion, especially in banking system. Banking regulation is the prevention activity consisting in the drafting and enforcement of conditions, rules and operational frameworks of banking institutions.(Mrkyvka 2004: 219) Motivation or the reason for the supervision of financial market institutions is not entering into private relations between individual institutions and their clients; the aim is not to replace the courts or criminal law authorities. It´s not expected that supervision prevents bad strategic or investment decisions of institutions or individual failure, but supervision is mainly here for regulation and control of functionality and effectiveness of the system of governance of financial institutions, which are responsible for managing bodies of the financial institutions, which are subject to different requirements for expertise and experiences. Supervision is mainly here for the fact that supervisions' public instruments could intervene, where discrepancies are found, thus impose forced administration or withdrawn license. In principle supervision is basically here for system protection, not only for protection of financial institutions, but the protection of entire financial market and also prevention of failure, or unlawful conduct in the future.

Supervision of Financial Market and its institutions includes decisions on applications for licenses, permits, registrations and prior authorization according to special legislation, monitoring of compliance with the conditions stipulated in public licenses and permits, monitoring compliance with laws, and for this control CNB is authorized by law or by special legislation.

Furthermore monitoring of compliance with regulations and provisions issued by the CNB, obtaining information necessary for supervision and its enforcement, verifying the veracity completeness and timeliness of such information, remedial actions and sanctions proceedings on administrative offenses and misdemeanours. (CNB, Supervision of credit institutions).

4 Conclusion

Financial market supervision has its own place not only in the financial law, but also in the entire legal system of Czech Republic and worldwide.

I am convinced that the classification of supervision in the system of financial law as it is set, it is logical and clearly defined, while designed primarily to strengthen the stability of the economic system itself, not only for the supervision of financial market institutions, their entry into the market and compliance with their presence on the market, but also strengthening public trust in the financial market itself, respectively in its individual segments that constitute the financial market.

The financial market is an area in which enters not only a large number of institutions, but also a considerable part of the public, whether professionally equipped, as well as laic either in the form of investors, small savers or just a single actions participants. For that reason, its instability and frequent danger in the form of bankruptcy of some large institutions operating on the financial markets could have far-reaching economic consequences not only for individuals but also for the stability of the economic system itself.

Classification of Financial law is at first sight quite standard compared to some other, older branches of law, but the way the functioning of financial law and its arrangement in the form of this systematics, public acceptance and its capabilities to respond to the social needs already long time ago justified and defended position and status of Financial law in the legal system as an independent branch of law.

System of Financial law is a fundamental prerequisite in order to further scientifically examine and in the same time put into practice the individual segments of financial law and subsequently adapts them to social and economic needs for the public interest.

Status of supervision in such a system is the firmly established and cannot be assumed that there would be a shift or change of such a status or rearrange of the financial law system, which in itself allows the development

and stabilization of financial market supervision and thereby strengthening public confidence not only in the supervision itself, but also in the existence of a functioning financial law as an independent branch of the law.

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LEGAL ASPECTS OF ELECTRONIC MONEY

Otakar Schlossberger[1]

Abstract

The term "electronic money " first appeared in the law of the Czech Republic in Act No. 124/2002 Coll., on the Transfer of financial means, electronic payment tools and payment systems (Act on the System of Payment). Electronic money was a category of the Directive of the European Parliament and the Council 2000/46/ES dated 18th September 2000 on the Approach to the operation of Electronic Money Institutions, on their performance and caution supervision over this operation that was transposed into this act in addition to other directives. After the abrogation a new act was adopted, published under 284/2009 Coll., on the system of payment, reflecting the Directive of the European Parliament and the Council 2009/110/ES dated 16th September 2009 on the Approach to the operation of Electronic Money Institutions, on their performance and caution supervision over this operation. As a result of the transposition of two directives that among others modified the term "electronic money" and other potential categories related to electronic money, this category underwent and is undergoing certain changes which, however, can have substantial impact on the current practice in terms of issuing and subsequent use of electronic money. The essay shall thus focus on the analysis of the legal characteristics of the original category "electronic money" and its subsequent changes. Their definitions will be compared and author´s opinion on their possible practical impact will be presented.

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Key words

Electronic money; payment services; provider of electronic money; payment card.

JEL Classification

K 220, G 210

1 Introduction

Electronic money as a category first appeared in the law of the Czech Republic (hereinafter referred to as "ČR") in Act No. 124/2002 Coll., on the Transfer of financial means, electronic payment tools and payment systems (Act on the System of Payment) (hereinafter referred to as "ZPS 2002"). ZPS 2002 was the transposition of several directives of the European Union (hereinafter referred to as "EU"), for ČR was preparing for its joining the EU, thus proceeding with this transposition to the harmonization of selected services in the area of the system of payment and accounting with EU countries. One of the directives was also the Directive of the European Parliament and the Council 2000/46/ES dated 18th September 2000 on the Approach to the operation of Electronic Money Institutions, on their performance and caution supervision over this operation (hereinafter referred to as "Directive 2000"). ZPS 2002 in its provisions §§ 14 to 22 discussed the issue and use of electronic payment tools, defining electronic money, the electronic payment tool and for the first time presenting the legal definition of a new subject authorized to issue electronic money, which was the electronic money institution. This essay will focus on the category "electronic money" only, the other new terms will be left out.

2 The term „electronic money"

By consulting ZPS 2002 and its comparison with Directive 2000 we discover that the term "electronic money" was in fact taken over from the directive, however, with small differences. Its art. I par. 3 letter b specifies that

"electronic money" stands for cash value expressed as a claim towards the issuing institution and

a) stored on an electronic medium;
b) issued against the receipt of financial means, the value of which is not lower than the issued cash value;
c) received as a payment tool by other companies than the issuing institution."[2]

ZPS 2002 defined electronic money as follows:

"Electronic money is the cash value that

a) stands for a claim towards the issuer,
b) is stored on an electronic financial tool,
c) is issued against the receipt of financial means in lower value than the value of issued electronic money and
d) is accepted as a payment tool by other persons than its issuer." [3]

Beyond the terms of Directive 2000, ZPS 2002 defined the electronic payment tool in its provision § 15 par. 2 as "a payment tool" that maintains the cash value in the electronic form.

By a simple comparison of the text of Directive 2000 and ZPS 2002 we can learn that the harmonization norm furthermore emphasized in the list of provisions as a separate condition the fact that it refers to "a claim towards the issuer". This requirement is logical in terms of the nature of electronic money and its issue[4]. There is a certain difference in the provision related to maintaining the value of electronic money. The directive specifies that the value of financial means must be maintained on an electronic medium;

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2 A quotation from Directive of the European Parliament and the Council 2000/46/ES dated 18th September 2000 on the Approach to the operation of Electronic Money Institutions, on their performance and caution supervision over this operation

3 A quotation from Act No. 124/2002Coll., on the Transfer of financial means, electronic payment tools and payment systems (Act on the system of payment, § 15 par. 3, as amended, indicating that the original characteristics included provisions specifying only that "the electronic money is the cash value maintained on an electronic financial tool".

4 Electronic money can be issued only against the receipt of cash or its transformation from cashless, i.e. by transfer at the suggestion of the holder of electronic money towards its issuer from the current or payment account of the holder to the registration "bank subaccount" of the issuer of electronic money. No form of issue (e.g. fiduciary) is permissible.

the version of ZPS 2002, however, refers to maintaining the value on an electronic financial tool. This difference of this criterion is important in terms of practical significance. The electronic financial tool was considered e.g. the so-called electronic wallet, i.e. a sort of "payment card" with an electronic record about the specific amount of electronic money contained in the body of the electronic financial tool, i.e. a data medium that at first sight looks as a standard payment card. If we focus on the provision of Directive 2000, it can be considered "more general", since the electronic medium can be regarded as a magnetic or chip entry on any data medium that could function as "an electronic financial tool", however, it can also be regarded as "the computer memory" or "the computer server".

Nevertheless, we can state that ZPS 2002 clearly defined the characteristics of electronic money, which was also applicable both in practice and for the theory of the system of payment. The theory dealing with banking in various literature sources[5] adopted without further discussions the characteristics of electronic money as it was defined in ZPS 2002. However, it is also true that available sources did not deal with electronic money as another form of money. Theoretical literature still classified the forms of money into "cash" and "cashless". The aforementioned characteristics, however, clearly defined the term "electronic money", and unless the four specified criteria of ZPS 2002 were met, the financial means in question could not be considered electronic. According to the author, ZPS 2002 thus introduced a new term in terms of viewing the money, i.e. electronic money. With effect of ZPS 2002, money as for their form can be classified as follows:

1. cash – banknotes and coins,
2. cashless – accounts at banks or other authorized financial institutions,
3. electronic – cash value entered in the electronic financial tool.

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5 E.g. compare Dvořák, P.: Bankovnictví pro bankéře a jejich klienty (Bankingfor the bankersandtheirclients), 3rd revised and extended ed., Praha: LINDE, 2005, p. 388, Schlossberger, O., Hozák, L.: Elektronické platební prostředky (Electronicmeans of payment), Praha: Bankovní institut vysoká škola (College of Banking), 2005.Klimiková, M.: Platobný styk (Payment System), Bratislava: MARADA, 2008. an., e.g.. Nováková, V. et al: Slabikář finanční gramotnosti (Primerfinancialliteracy). 2nd ed., Praha: COFET, 2011, p. 128, or Barák J. et all: Zákon o bankách – komentář a předpisy související (The Lawon Banks-commentandregulationsrelated), Praha: Linde, 2003, p. 293 an.

3 Change in 2009

In 2009 a new act on the system of payment was issued, published under No. 284/2009 Coll. (hereinafter referred to as "ZPS 2009") and it was again a transposition of several EU directives referred to in § 1 ZPS 2009. This also involves Directive of the European Parliament and the Council 2009/110/ES dated 16th September 2009 on the Approach to the operation of Electronic Money Institutions, on their performance and caution supervision over this operation, on the amendment to Directives 2005/60/ES and 2006/48/ES and on the cancellation of Directive 2000/46/ES (hereinafter referred to as "Directive 2009"). This norm among others introduced a subject defined as "the electronic money institution" that under conditions stipulated by the directive could issue (not emit) electronic money[6]. However, this directive also contained a new definition of electronic money. Article 2 of par. 2 of Directive 2009 defines electronic money as follows:

"Electronic money maintains electronically as well as magnetically cash value expressed by the claim towards the issuer, issued against the receipt of financial means for the purpose of performing payment transactions defined in art. 4 point 5 of Directive 2007/64/ES and received by a natural person or body corporate that are different than the issuer of electronic money."

These characteristics are similar to those specified in Directive 2000, nevertheless we no longer find the requirement that electronic money should be maintained on an electronic medium, or according to the transposition of ZPS 2002 on an electronic payment tool, but it is sufficient if the cash value is maintained electronically or magnetically. Any specification of the place for maintaining electronic money was left out. Directive 2009 no further specified where the cash value is maintained…whether on the financial or payment tool or in the central server of the bank or another issuer. The other two criteria basically remained the same. It needs to be pointed out that both Directive 2000 and Directive 2009 put stress on the fact that electronic money can be issued only if its value of the same amount (or not

6 See provisions art. 2 par. 1 of Directive 2009.

lower value) was received by this issuer. It fails to mention again whether this applies to the receipt of cash or cashless via bank transfer of a client – a potential holder of electronic money by the issuer of electronic money.

Transposition of this part of the Directive part into ZPS 2009 in the Czech Republic results in this definition:

"Electronic money is cash value that

a) stands for a claim towards those who issued it,
b) is maintained electronically,
c) is issued against the receipt of financial means for the purpose of performing payment transactions and
d) is received by other persons than those who issued it" (A quotation § 4 of Act No. 284/2009 Coll., on the system of payment.)

Compared to the original text in ZPS 2002, we can find a small change in the second condition for meeting the requirement for electronic money, which is the condition related to maintaining the cash value electronically, not on an electronic financial tool.

This small change in the characteristics of electronic money, according to the author, however, initiated speculations whether money can be really classified into cash, cashless and electronic. Is this thought even well-founded? Before we start this evaluation, we will try to define cashless money in relation to the current law.

4 Cashless money

As mentioned before, general theoretical literature is based on the fact that **cashless money can be represented by accounting entries at bank accounts of clients registered at banks or other authorized institutions.** Cashless money is transferred to those accounts via cashless transfer or by paying in cash at counters of such an institution that produces a written account of the cash receipt to the client´s account and the cash is put in the safe room of the institution or it is sent to ČNB, or to another bank. The providers of payment services are represented mainly by banks or savings and credit associations since financial means paid in this way are usually regarded as deposits. Since 2009, however, in accordance with ZPS 2009

financial means can also be received by payment institutions or by providers of small-scope payment services for the implementation of payment services on the grounds that non-implemented financial means of the client may be deposited with the payment account registered at this institution. Nevertheless, these means are not considered deposits[7].

Neither ZPS 2009 nor ZPS 2002 specified the cashless money. But the legal regulations of the cash can be considered Act No. 136/2011 Coll., on the Circulation of banknotes and coins incl. related implementing regulations. However, it does not directly describe the term "cash" either. In short – this act mainly deals with the characteristics of banknotes and coins and how to handle them.

If we approach the topic of cashless money as the entries at the clients´ accounts at a respective institution, it is possible to keep those records in a day book from the technical point of view, i.e. on paper or in another form. For the past several tens of years this record-keeping has been carried out electronically, i.e. in electronic entries of banks or other institutions. But it does not and did not refer to electronic money. These records either stand for a deposit (often sight deposits) of the client of a bank or a savings or credit association or for "hot" financial means registered at a payment account of a payment institution or a provider of small-scope payment services. In both cases, however, the financial means are going to serve as a future payment. Moreover, at a bank or at a savings and credit association, such registered financial means can become another deposit by virtue of Act No. 89/2012 Coll., Civil Code, §§ 2676 an. It may involve a savings book or one-time deposit of different type in accordance with the regulations of the bank or of a savings or credit association. Financial means entrusted to a payment institution or to a provider of small-scope payment services, however, cannot change their role. They cannot even be interest-bearing, for – as we emphasized – cannot function as a deposit and must not be used for other activities of the payment institution either unless ZPS 2009 sets down differently[8].

7 See § 19 ZPS 2009.
8 Compare § 20 par. 4 ZPS 2009.

5 Cashless money vs. electronic money

This part of my essay is going to focus on the analysis – comparison of electronic money as it was defined by ZPS 2009 with the characteristics of cashless money as mentioned before.

In order to be considered electronic, money must meet fixed criteria that were discussed in the introduction of this paper. The first criterion that needs to be met in order to consider money electronic is the condition that it applies to **a claim towards the issuer of electronic money.** However, if we deposit cashless money with a bank or with a savings or credit association (in this part we can skip the fact that cashless money can also be received by payment institutions or by providers of small-scope payment services under conditions stipulated by ZPS 2009), it also refers to a claim of a client towards the bank or the association. On the contrary, the bank or the association registers in its accounting such received financial means as a liability towards the client. Financial means should also be registered this way by the Electronic Money Institution although this will depend on how electronic financial means were handed over to the holder. Nevertheless, this criterion can be evaluated as identical both for electronic money and for cashless money.

Let´s take a closer look at the second criterion. It is the fact that **electronic money must be maintained electronically.** It means that money is directly deposited either in the electronicfinancial tool (e.g. the electronic wallet) or it is registered in the central computer system. The fact whether electronic money is registered at the account or not is not mentioned in ZPS 2009 (nor in ZPS 2002). Nevertheless, we can assume that there must be some record-keeping, for the holder of electronic money is legally entitled to request a reverse exchange from the issuer at a ratio of "one to one" (See § 124a an. ZPS 2009). The issuer thus has to know how much of the electronic money of the client was not spent and if the holder requests reverse exchange for cashless money or for cash, the issuer is bound to do so. If we focus on the cashless money, it is currently also registered electronically in the central computer of the bank or of the savings and credit association, nevertheless it is not statutory duty. ZPS 2009 refers to managing a payment account

(or we should say that the bank payment account is described as the current account, which, however, – by virtue of Act 513/1991Sb., Commercial Code[9] – was always regarded as a deposit account), but it does not say anything about the method or technology of its management. We assume it could be possible to manage these accounts in the book accounts as it was common in the old days when there was no computer technology. It would be unfeasible with electronic money as the process directly requires its electronic (by virtue of Directive 2009) management (registering) or "insertion" on the respective medium. We can therefore conclude that this criterion is absolutely necessary for electronic money but cashless money does not need to follow this principle. However, real-life experience shows that cashless money is currently also registered electronically at banks or other providers of payment services.

Another criterion is the fact that electronic money **is issued against the receipt of financial means for the purpose of performing payment transactions.** This criterion is unique in terms of the comparison of both categories. This condition specifies that electronic money cannot be created with no further underlying interest. Electronic money can be issued only by an authorized subject that has to ensure that electronic money will always be covered with a real value paid in cash or it will be transferred to the credit of the issuer´s account managed at a financial institution (often at a bank or savings association) as cashless money. There is no such criterion for cashless money since it is not issued but simply transferred from one account to another. It was created either by the issue of ready money that the client physically delivered to the financial institution and it was put down to his account in the form of a book entry or it was obtained as a result of fiduciary issue of cashless money. However, one thing is identical, i.e. both electronic money and ready money or cashless money serve as transaction payments. Electronic money is used as payment for goods or services. Its clearance is conducted cashless, nevertheless there might be a different transfer. If it is maintained in the electronic payment tool, electronic money is then transferred from its medium into the terminal of the goods-and-services provider who forwards it for clearance athis processing bank. It is

9 Act was repealed as at 1. 1. 2014.

then put down to account as cashless money, most often to his current or payment account. However, if electronic money is anelectronic entry in the central computer of the issuer, the use of the payment tool initiates the transfer of the input for clearing the relevant amount of electronic money as debit to the issuer´s account and to the credit of the account of the respective goods-and-services provider. The issuer of electronic money then has to carry out the mirror "accounting" in the accountancy books of the respective client and to lower the value of electronic money by this accounted sum.

The last criterion is the condition that electronic money has to be accepted by other persons than those who issued it. It means that the acceptance of issued electronic money is ensured by more than one subject who is the issuer. This criterion is quite common with cashless money but it is also true that cashless money can stand for money that ensure the transfer of financial means between two accounts of the same client and the same financial institution. If we used the value of electronic money only for the payment of goods or services which is provided solely by its issuer, it would not refer to electronic money by virtue of ZPS 2009, even though other criteria might be met. In that case it might have referred to subscribed services or advance payment for goods or services of the respective subject. ZPS 2009 does not require either that the subject providing these services should have a special licence for this business relationship. These trends are quite common as prepaid loyalty cards are issued by various shops etc.

6 Conclusion

The presented report focused on:

1. the analysis of the characteristics of the term "electronic mone" as it was defined by Directive 2000 and its recodification – Directive 2009 with the comparison of their transpositions into ZPS 2002 and ZPS 2009,
2. comparison of the category "electronic money" in accordance with ZPS 2009 with the term "cashless money" that is not defined by the law of the Czech Republic (nor by the EU) .

The performed analysis presents following conclusions:

1. the transposition of the definition of Directive 2000 into ZPS 2002 was not identical as there was difference in the second criterion of the value that can be regarded as electronic money. In accordance with the transposition norm (ZPS 2002), only the value that was contained (maintained) in the electronic financial tool was considered electronic money,
2. the transposition of the definition of Directive 2009 into ZPS 2009 basically corresponded to this directive as well as to the requirement of the original directive 2000, which was, however, cancelled,
3. the terms "electronic money" and "cashless money" are two different legal terms and they have their place in the theoretical interpretation. The term "electronic money", however, is amended by a legal regulation, whereas the category of "cashless money" is not directly amended. Valid legal regulations, however, work with this term.
4. the category of "cash" or "ready money" has been clearly defined, even legally, in the relevant legal regulation.

According to the author, electronic money is going to play a more important role during the implementation of payment services, although issuing electronic money is not considered payment service (See § 3 ZPS 2009).

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Act No. 89/2012 Coll., Civil Code.

FINANCIAL MARKET SUPERVISION IN THE SYSTEM OF FINANCIAL LAW

Libor Kyncl[1]

Abstract

This contribution deals with the financial market supervision and its place in the system of financial law. The main aim of the contribution is to confirm or disprove the two hypotheses. The first hypothesis is: "The regulation of financial market supervision is closely connected with the regulation of the payment system, with the foreign exchange law and with the currency law." The second hypothesis is also discussed: "The financial market regulation is the independent public law segment of the financial law field." The scientific methods of analysis, comparison, description and synthesis are used along with the doctrinal interpretation of law and in some areas with the historical method.

Key words

Financial market; supervision; regulation; financial law.

JEL Classification

K23, K40

1 Introduction

The aim of this article is to discuss the financial market supervision and its place in the system of financial law. It sets the specific boundaries of financial market and enumerates various areas of its regulation. On the basis of this

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discussion, the financial market supervision is defined as a legal instrument and as a set of institutions.(Kohajda, Kotáb In: Bakeš et al., 2012: 420 – 423). The Czech Republic's regime has been founded relatively short time ago in comparison with countries like United Kingdom or Germany. Therefore the system sometimes lacks the theoretical background and explicit connection between the intended goal of the regulation and regulatory methods which have been selected may not be clear. This article intends to provide this new and constantly growing area of regulation with theoretical outlining.

The first hypothesis is the following: "The regulation of financial market supervision is closely connected with the regulation of the payment system, with the foreign exchange law and with the currency law." The second hypothesis has this wording: "The financial market regulation is the independent public law segment of the financial law field." While building an argumentation for confirming or disproving these hypotheses, I will use the analysis method for deconstruction of the general concepts to the specific issues, the comparison method for comparing the areas of the theoretical jurisprudence and the specific legal regulatory regimes, the description method for outlining the issues and regulatory regimes in the field and the synthesis method for concluding the conclusions of the article. I will base the interpretation of legal acts on the doctrinal interpretation of law and in some areas on the historical method.

The article will begin by explaining the concept of financial market and summarizing the regulatory issues in this field. In the second part, I will outline the issues of financial market supervision, basic regimes of the supervision and an answer to the first hypothesis through discussing the relations between the regulation of financial market supervision and other segments of financial law. In the third part, the text will outline whether there is a possibility to identify the financial market regulation as a separated segment of financial law and react on the second hypothesis.

The main sources which will be used in the article include Čunderlík's discussion on financial market regulation in Slovakia (Čunderlík, 2011: 53 – 63) and the latest outline of financial market regulation in the Czech Republic by Šulcová and Janovec (Janovec, Šulcová In: Kyncl et al., 2013: 97 – 101, 109 – 110). The theoretical aspects on the supervision will be discussed

on the basis by prof. Llewellyn (Llewellyn, 2006: 6). The private law discussion has been contained in (Kotásek, 2012: 5 – 15). The article also involves using other theoretical and statutory sources.

2 Financial Market and its Regulation

The financial market is a specific segment of the economy of the state. If we abstract from practical issues to the general level, it allows creating deposits and lending money – on the market of financial intermediation – along with issuing and buying securities – on the capital market (Pavlát et al., 2003: 11 – 14). Both types of transactions exist between surplus subjects (debitors and subjects emitting securities) and deficit subjects (depositors and subjects buying securities). The market includes institutions, subjects, real investment instruments and financial investment instruments (Kohajda, Kotáb In: Bakeš et al., 2012: 420 – 423).

When we assess the types of services which form the important part of the financial market, we identify these two:

- deposit services according to the New Civil Code (Civil Code: Art. 2662 - 2700),
- credit services according to the New Civil Code (Civil Code: Art. 2395 - 2400).

As it is obvious from both sources of the basic regulation of services, the regulation on financial services is usually the private law regulation. It is a basis for the public regulation of these services' providers.

The deposit services may be provided only according to Banking Act (if provided by a bank) or according to Credit Unions Act (if provided by parabank, i.e. credit union). Banking Act in its § 2 section 1 constitutes the banking monopoly for deposit services offered to the public, the credit unions are considered an exception according to this provision in connection with Credit Unions Act (Act on Credit Unions: Art. 1 section 2) – the credit unions may offer deposit services only to their members. The Czech National Banks is allowed to offer deposit services to all financial and credit institutions, to its own employees and to all public agencies including the self-administration.

There are also other types of services provided by banks or their subsidiary companies in the financial conglomerate:

- payment services and electronic money emission according to the Payment System Act (Act on Payment System: Art. 3 - 4),
- cash processing services according to the Act on Circulation of Banknotes and Coins (Act on Circulation of Banknotes and Coins: Art. 15 - 23),
- investment services according to the Act on Business Undertakings on the Capital Market (Act on Business Undertakings on the Capital Market: Art. 4 - 20),
- management services according to the Act on Management Companies and Investment Funds (Act on Management Companies and Investment Funds: Art. 5 - 17),
- insurance services according to the Act on Insurance (Act on Insurance: Art. 13 - 35),
- cash foreign currency exchange services according to the Act on Bureau-de-change Activity which is regulating cash foreign currency exchange services in bureau-de-changes, in banks and in credit unions (Act on Bureau-de-change Activity: Art. 2 – 3, 10 – 16). It may not be mistaken with Foreign Exchange Act which involves state‘s actions in foreign exchange market (Foreign Exchange Act: Art. 1 - 2).

The aforementioned list is not exhaustive; the exact enumeration is in fact impossible. Other subjects on the capital market also provide services like administration services in collective investments (or newly management companies and investment funds), regulated market operating or pension management services.

Financial market regulation is a more general area than the supervision over the market because it involves all the regulation of the market. Financial markets in various countries are regulated by basic areas including:

- financial market supervision,
- consumer protection on the financial market,
- alternative dispute resolution on the financial market,
- shadow banking,
- deposit guarantee scheme and investor compensation scheme,
- EU banking union.

The public law financial market regulation in European Union is regulated by statutory acts in national legal systems. The European Union harmonizes this area by its directives which are accompanied by a smaller number of EU regulations. The regulations issued by the European Parliament and the Council involve common sub-segments such as rating agencies, EUR payments and foundation of EU financial market supervisory bodies.

Besides this public law regulation there are numerous areas of private law:

- securities, types of securities and contracts regulation (Civil Code: Art. 514 - 544),
- consumer protection in contracts concluding (Civil Code: Art. 1810 - 1851),
- conditions and operations which are involved in the contract (depending on the specific type of contract, some contracts have already been mentioned),
- fulfillment of the contract duties and contract modifications (Civil Code: Art. 1721 - 1809),
- civil procedure in dispute resolution (although the organization of judicial bodies itself is a part of public law the relations being decided by the civil court are private law relations).

The private law regulation of financial market is based on the national regime and may be found in Civil Code, for example in new Czech Civil Code (Civil Code: Art. 514 – 544) or in a special act, for example Slovak Act on Securities (Act on Securities and Investment Services: Art. 2, 5, 6). The private law regulation is usually discussed in the commercial law books (such as Kotásek, 2012: 5 - 15) and is not considered to be the part of financial law.

As we may see in the economic literature, economists discussing the over-regulation issues usually mean the over-regulation in the form of too many public law duties imposed on the service provider in the financial market (Llewellyn, 2006: 5).

It may be summarized that the regulation of the financial market in general contains both private law and public law norms, they have internal system and internal relations between the norms.

In this chapter, I have used services regulation to define the financial market more specifically. The provisions in specific legal acts are usually organized according to the specific types of services (payment services in the Act on Payment System, credit services in the Consumer Credit Act, investment services in the Act on Business Undertakings on the Capital Market, cash processing services etc.).

3 Financial Market Supervision

The financial market supervision agencies exist both at the national level and European Union level. The body for the unified supervision on the Czech financial market is the Czech National Bank. It is also a consumer protection supervision agency for persons subject to its financial market supervision in the conduct of the business enabled by an authorization or license registration (Act on Consumer Protection, Art. 23/9).

On the European Union level, there are five agencies conducting supervision and one cooperation-aimed committee:

- European Banking Authority (EBA, microeconomic supervision, based on the Regulation (EU) No 1093/2010 establishing a European Supervisory Authority: Art. 1 – 3),
- European Insurance and Occupational Pensions Authority W (microeconomic supervision, based on the Regulation (EU) No 1094/2010 establishing a European Supervisory Authority: Art. 1 – 3),
- European Securities and Markets Authority (ESMA, microeconomic supervision, based on the Regulation (EU) No 1095/2010 establishing a European Supervisory Authority: Art. 1 – 3),
- European Systemic Risk Board (macro-prudential supervision, ESRB, based on the Regulation (EU) No 1092/2010: Art. 1 – 3) and
- European Central Bank (banking union supervision body, based on the Treaty on European Union: Art. 13 and the Treaty on the Functioning of the European Union: Art. 127 – 133)

All aforementioned bodies cooperate within the Joint Committee of the European Supervisory Authorities.

The international bodies such as Bank for International Settlements with its Basel Committee and Committee on Payments and Market Infrastructures, International Monetary Fund or World Bank are participating in setting up the mechanisms of financial market supervision.

The financial market supervision is closely connected with the financial market regulation per se. But these two concepts cannot be commuted for because financial market regulation is much broader area.

In the Czech Republic, the lawmaker for the area of financial market in the Czech Republic is the Ministry of Finance and in areas of supervision the Ministry of Finance in cooperation with the Czech National Bank.

Specific regimes of supervision involve the application of several legal acts. They are either:

- special acts regulating the type of service (including supervision over its conduct), or
- special acts regulating the type of the provider(including supervision over its business undertaking), or
- general act regulating the supervisory process.

The Czech supervision is conducted according to the specialized legal acts on specific segments of the financial market. These special acts usually do not contain specific link to the procedural act, it is contained in the organization legal act. Organizational linking is placed in the Act No. 6/1993 Sb., on Czech National Bank (Act on Czech National Bank: art. 43C section 2 and 45 section 1), it links to the Audit Code, the Act No. 255/2012 Sb. The most general act, the Administrative Procedure Code, is linked to the Audit Code by the subsidiary use provision with exception set by law (Audit Code: Art. 28). Audit Code forms a special regime in comparison with the most general regime of Administrative Procedure Code, for example the special process of objections existing instead of appeal (Audit Code, Art: 13 – 15).

The main aspects of Slovak supervision regulation are contained in the single Act on Supervision over the Financial Market (Act on Supervision over the Financial Market, Art. 1). The special provisions regarding the specific subjects are contained in the special acts such as Act on Banks (Act on Banks, SK: Art. 6 – 20).

As it has been shown, the supervision identifies non-compliance on the side of the regulated subjects. On these bases, the supervision issues a decision ex post and imposes administrative sanctions upon the service provider. We may have seen this in the Key Investments case where the investment service provider failed to provide all the information to the customer – the local administration bodies (Supreme Administrative Court of the Czech Republic: 1 Afs 67/2012 – 48). This case has actually taken 8 years from the first level of decision at the Securities Commission until the administrative judgment at the Supreme Administrative Court which we cite.

Financial market supervision strongly affects other areas of regulation. The trading of the financial market is coupled with monetary regulation, payments and with the trading of in general.

Some authors (Mrkývka, 2012: 185) consider the payment system regulation a part the financial market regulation. Other authors discuss the payment services as the separated area of law (Schlossberger, 2012: 19 – 23). When the European Union regulatory authorities have been introduced, the supervisory body over a part of financial market has also conducted the supervision connected with functionality of payment systems (the European Banking Authority, closely cooperating with the European Central Bank conducting the rest of payment system supervision).

Although, there are separated supervisory activities in the jurisdiction of the Czech National Bank in the Czech Republic and of the European Central Bank in the Eurozone.[2] These activities include large value payment systems, conducting liquidity operations, organizing monetary operations and monetary reforms (Šulcová In: Kyncl et al., 2013: 97 – 108 or Llewellyn, 2006: 6).

Practically, a major part of financial market trading in Czech Republic is executed in foreign currencies, like EUR, USD or CNY (Chinese Yuan Renminbi). Only the part of trading in the Czech Republic is organized in CZK as it is not one of the world's major financial currencies. The factual construction of the foreign exchange law in the Czech Republic has

2 The aforementioned central banks usually operate the main large value payment system, in the Czech Republic the CERTIS system is the only large value payment system for CZK in the country.

been significantly modified by adopting Act No. 284/2009 Sb. on Payment System which has come into effect as of November 1, 2009. Since this date the foreign exchange license which existed before has been replaced by the specific licenses given for providing payment services (cashless ones).

The relations of the norms inside the financial market supervision exist in a majority of legal acts. Also, the links between separate acts regulating the financial market exist. Supervision is very often connected with specific subjects of the financial market, with their payments, with foreign exchange processing and with the currency in general. The supervision oversees these processes in financial services providers along with many other types of activities.

Therefore the general regulation in this area is very tightly connected with the supervision regulation. As it has been proven in this chapter, I consider the first hypothesis to be confirmed: "The regulation of financial market supervision is closely connected with the regulation of the payment system, with the foreign exchange law and with the currency law."

4 Financial Market Law as a Separated Segment of Financial Law

I will test the hypothesis whether the financial market law is a separated segment of financial law by adopting Průcha's requirements for separate legal field (Průcha, 2007: 36 – 41) in a modified version. He identified four field-creating requirements for a legal field. These requirements have been adopted by some authors for financial law as a separate legal field but I decided to use the primary version.

I have transformed the aforementioned requirements to the following four segment-creating requirements:

- dependent but specific object of regulation (which is more specific and much narrower than the object of regulation in the requirements on the entire legal field, however it is not an independent object of regulation like the requirement on the legal field),
- own method of regulation (it is the same method of regulation, an abstraction of specific regulatory tools),

- systemic cohesion of the segment (the segment of legal field has far greater cohesion than the field because it does not include a large area of legal relations as in the legal field, the relations in the field may be loosely connected),
- social reasonability of the financial law segment's existence (this last requirements may have been altered by other authors, this form comes from the version in: (Průcha, 2007: 40 – 41)).

As it is obvious, the requirements for the segment are clearly lower than the requirements for a legal field. Therefore fulfilling the segment requirements has much lower standard of independence and specific aspects of all requirements then fulfilling the legal field-creating requirements.

By using these segment-creating requirements, I have come through this argumentation:

1. Object of Regulation in the Segment

   It is clear that the relations between the financial service provider and the customer are different from the relations between the provider and the central bank. The second mentioned relation enables the existence of the limitations which are very important in order to keep the stability of prices in the economy and in order to keep the stability of financial system.

   The object of regulation in financial market law has already been discussed in chapter 1: Financial Market and its Regulation. Therefore I have come to the conclusion that this requirement has been met on the basis of the previous text.
2. Method of regulation in the segment

   As it has been pointed out by Janovec and Šulcová, financial market regulation is a part of financial law in general (Janovec, Šulcová In: Kyncl et al., 2013: 97 – 101, 109 – 110). It shares its modified administrative method of regulation (or so called financial law method of regulation) with the rest of the financial law. On the basis of the aforementioned I have proven that the segment shares its method of the regulation with the legal field and therefore meets the second requirement.
3. Systemic cohesion of the segment

Assessment of the area as the segment of financial law depends on the internal and external relations with other areas of law. The internal relations in the financial market law have been described in the previous parts of this article.

The financial market law also has direct connection to other parts of financial law and also to other legal fields. The regulation of the financial market in general contains both private and public regulation.

The Czech regulation on supervision is more complicated as both the substantive law and procedural law provisions are placed in many different legal acts. It lacks the theoretical ordering and has usually been adopted using the simple harmonization transposition without proper incorporation to currently existing legal structures. In some cases, the legislative technique modifications have been done after a few years, such as restructuring some parts of payment system regulation; in some cases they have never been done.

The internal regulatory relations of financial market supervision connect the legal instruments of the supervision with the organizational regulation of the Czech National Bank which is usually sorted into the segment of monetary law. The foreign exchange law is also very closely connected because trading foreign currencies and financial instruments connected with them practically forms a large portion of the financial market in a small open economic such as Czech Republic. The investments on the financial market also include investments in financial instruments based on precious metals (the precious metals products themselves are regulated by the hallmarking law, the connected structured instruments such as options are regulated by the financial market law). There are also connections with tax law (taxes, charges etc.), budgetary law (e.g. supervision conduct financing) or accountancy law.

All these areas are based on the constitutional law principles. Supervisory activities are conducted according to the Administrative Code. The financial market regulation is also connected with the criminal law in securities forgery, market misuse, general fraud and many more types of crimes harming economy in general and/or property.

The private regulation is usually called securities law (teamwork, 2012 or Kotásek, 2012: 5 – 15). The opposite part of regulating the same legal subjects is the public law, the financial market law (Čunderlík In: Sidak, 2013: 155). These authors mention the state correction in the relations between service providers and the state. The financial market law involves institutes which are backed by the legal relations created by the private law. All the contracts a service provider in banking and finance concludes are then subject to a possible supervision by the supervision body. Also, at the beginning of the bank's existence, there has been a license issued for a bank by the Czech National Bank.

Therefore the systemic cohesion of the segment in the legal field has been proven and the third requirement has been met.

4. Social reasonability of the segment's existence

   Some authors, like Čunderlík (Čunderlík, 2011: 53 – 63), are discussing the financial market regulation and its delimitation and deem the financial market law as a separate part of financial law. In the works of these authors, the social reason for its existence is given in upholding the price stability (as a main goal of central banks in EU) or financial stability (as a main goal of the supervisory processes themselves). Therefore the last requirement has also been complied with.

   By testing these four requirements, it has been proven the segment of financial market law clearly exists in the Czech Republic and also in majority of all other legal systems. It has important goals to achieve connected with the stability of prices, of financial system and it may often affect the economy as a complex. On the basis of aforementioned facts, I confirm the second hypothesis: "The financial market regulation is the independent public law segment of the financial law field."

5 Conclusion

The article has contained a discussion on the regulation of financial market in general, which is named "financial market law" as a segment of financial law itself. The supervision over the financial law involves many activities of the Czech National Bank which are conducted in the regime of the Czech

Administrative Procedure Code. It is regulated as a part of financial law, having special procedure in the general regime of the Audit Code, the Act No. 255/2012 Sb.

The first hypothesis has also been confirmed: "The regulation of financial market supervision is closely connected with the regulation of the payment system, with the foreign exchange law and with the currency law." The financial market regulation affects economy as a complex through many mechanisms. The customers of financial market involve citizens, corporation and international legal entities, mainly in banking, but also in insurance, investments, and pension management services.

The second hypothesis has been confirmed: "The financial market regulation is the independent public law segment of the financial law field." In the third chapter, it has been proven that the financial market regulation has its specific object with internal relations and has external connections to other areas of law.

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SOVEREIGN DEBT RATING

Eva Šulcová[1]

Abstract

The regulation of credit rating agencies and their activities has been evolving significantly in recent years as the response to difficulties experienced during the economic crises. According to number of post-crises analysis, it is claimed that rating agencies played a role and are guilty for much of the crisis events. Until then the regulators somehow neglected to regulate these financial market entities, despite the important role they perform in the whole financial system. The paper addresses the background and process of assigning sovereign ratings, role of sovereign ratings on the financial marketand current regulation on providing sovereign rating in the European Union. The aim is to confirm or disprove the benefits of restrictions put on sovereign debt ratings by the European rules using mostly the descriptive and empirical method.

Key words

Rating; credit rating agency; sovereign debt.

JEL Classification

K23, H30

1 Introduction

The role of credit rating agencies (CRAs) has been mentioned in connection with the recent financial crisis from various point of views, mostly emphasizing their failure to assess the risk related to structured types of securities

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and in the context of the problems with the issuer pays model. However, CRAs made their significant mark also during the European sovereign crisis, which is further dealt in this paper.

Rating of sovereign debt is different from other commercial debt. It is a very sensitive issue in the eyes of the states and the European Union. The reason is that downgrading sovereign ratings is claimed to have immediate impact on the stability on financial market. This means that the activity of a rating agency has the ability to directly affect situation on the market and price of the borrowing for the particular state and its entities. For these reasons, the activity of rating agencies and transparency of rating procedures are very much subject of interest of states and other bodies ensuring financial stability in the Eurozone (for example European Securities and Market Authority that is assigned to perform certain regulatory tasks in respect of ratings).

The way rating agencies operate and provide sovereign ratings now has been put under much stringent regulation compared to situation in the past. European regulation on credit rating agencies together with its amendments have brought considerable changes to the business of CRAs.

Apart from rules generally applicable to ratings of other issuers, more stringent requirements are imposed on CRAs agency in case of sovereign ratings. European regulation contains a provision that allows to provide only three unsolicited ratings or sovereign debt rating in a year. A calendar must be set up in advance and any deviation from this schedule is possible only under particular criteria, subject to detailed explanation. Special rules also apply on the very publication of sovereign debt rating.

Ratings of sovereign debt are crucial for financial stability and also for costs of funding for the particular state. An example could be taken from the recent crisis events when downgrading of selected European sovereigns caused spillover effect across countries. Question to be asked is whether the existing limitations on sovereign ratings are reasonable and effective or whether there is a better answer for concerns of European states in respect of implications from sovereign ratings. The aim of this paper is to confirm or disprove the benefits of restrictions put on sovereign debt ratings by the European rules using mostly the descriptive and empirical method.

This paper investigates the role of ratings and announcements provided by rating agencies in respect of sovereign debt taking a glance back to actions by credit ratings agencies during the European sovereign crisis. It should help to understand the process behind activities of rating agencies and related regulatory measures taken by the European Union in this field which are described in following part of the paper. The last section concludes.

2 How rating of sovereign debt work

The history of rating sovereign debt by a third professional entity is dated to 1918 when the Moody's Investors Services became the first to measure the creditworthiness of foreign government bonds (Gaillard, 2013: 208). Behind the general idea of rating business is the existence of information asymmetry between the issuer and investors. Since the investors are not able to assess the capability of the issuer to keep with his obligations and consequently to price the risk derived from their investment, there is a risk of inefficiency and less liquidity on the market. The function of a rating is to help investors to acquire and assess information about the ability of the issuer to repay the debt (IMF, 2010: 88).

In terms of the business model, it is important to see what are the incentives and motive the issuer, investors and the rating agency have. At the very beginning of the history it were investors who needed to gather and process all information sufficient to produce reliable assessment of the issuer's creditworthiness. The costs related to this process were borne by investors. Later, issuers wanted to make securities more attractive for potential buyers and paid for providing the information by CRAs to public for free. This is called "issuers pays" model. This model later prevailed, notwithstanding the potential for conflict of interest. The conflict of interest was heavily debated and became also addressed by certain regulatory measures. This model could be applied also in the situation where the issuer is the government – when CRA is paid by the government to provide rating for the government securities (Petit, 2011: 589). However, the conflict of interest is missing in case of sovereign rating since CRAs are not paid by the state for providing the rating.

Typically, the way how states are rated is different from the way corporate issuers are rated. The reason for this is a specific nature of the sovereign debt and the probability to be repaid. As the probability is very much based on other factors, including the willingness of the state to pay the debt, CRA needs to take into account many other factors that are very often qualitative – like political stability or monetary flexibility. This also makes the final rating rather subjective (Petit, 2011: 592).

To make the relationship between a government-issuer and CRA more clear, the ratings paid by the government are solicited only in relation to each particular issuance of bonds. In addition to this, CRA do rate also outside of this specific situations and provide also a non-solicited ratings on government issuers (Petit, 2011: 591).

The character and importance of ratings require CRAs to deal with two requirements – stability of ratings and the accuracy of ratings. This means that changing the rating according to the issuer's situation needs to be of a permanent character although often changes to rating are not beneficial either. For these reasons rating agencies do use additional tools. Often these are very important tool – sometimesahead of the actual rating (Gwilym and Alsakka, 2011: 248). CRAs use these additional tools to keep up with the actual situation and take into account ongoing changes. These supplemental tools are credit outlooks and watch and CRAs use them to adjust their opinions of issuer's credit quality (Alsakka and Gwilym, 2013: 145). Indeed, the outlooks and watch are more important and provide stronger economic effects than the rating itself, since the rating does not provide for surprise once previously indicated through the supplemental tools (Alsakka and Gwilym, 2013: 145).

Very often the largest institutional investors do their own investigations and ratings relying on their own risk assessments, and it seems that ratings published by CRAs are used as the main source of information by smaller investors (Paudyn, 2011: 260). However the reliance on ratings become very high during the past and in the trouble times this proved to be one of the main problem leading to negative consequences (OECD, 2010: 7). One part of the problem were investors who very often took the ratings as the only basis for their investment decision, and the other part of the problem were

regulatory rules that required institutions to value their portfolio based on ratings. Similarly, the reliance on ratings could be seen in the private sector corporate governance requirements (Petit, 2011: 589).

It also needs to be bear in mind that ratings do not have implications for the sovereign debt instruments only, but the very opinion of thecredit rating agency published influences sovereign's cost of borrowing (Alsakka and Gwilym, 2013: 145).

The financial crisis showed failures in judgements made by CRAs. Questioning the ability of ratings to predict crisis in not a completely new feature related to most recent financial crisis but have already been subject to research earlier after earlier market failures that took place in 1990's (as an example see: Sy, 2003).

The ratings assigned to problematic countries did not suggest the rising problems in advance. Only few negative actions were actually taken by CRAs before July 2008. The data on ratings and actions by CRAs before and during crisis could be interpreted in the sense that CRA were not able to predict the problems – for example Moody's changed the positive outlook for Greece late in February 2009 (Gwilym and Alsakka, (2011: 250). Reason for this inability could be partly attributed to lack of accurate data and transparency as the states did not provide full information that could be used by investors as well as rating agencies.

As a certain defence of CRAs it is claimed that to predict a financial crisis is very difficult, if not impossible (Gunter, 2011: 233). Based on literature and previous research it could be said that sovereign ratings are more of a following character, rather than preceding the crisis; the markets would have reacted similarly even without the announcement of downgrading ratings (Gunter, 2011: 234). The findings usually take the conclusions that ratings do show the probability of default, but not the probability of currency crisis.

3 Rating market

The rating market is significantly centralized with only three main players where the two of them has about 40% share each – Standard & Poor's and Moody's; Fitch counts only for 15% market share (Masciandaro, 2011: 255

As part of the discussion, attention has been paid to the question of a competition on the market, since solutions based on competition legal framework might provide some advantages. It could be argued that the rating industry shows features of a significant market power (Petit, 2011: 594). This means that firms operating in this market can set the level of prices and cause that some part of the market is not served dues to reservation price that does not fit. This brings the issue of inefficiency and economic welfare, as well as limitations in innovation and, most importantly, deteriorations of product quality (see further Petit, 2011).

In markets like rating markets, the price is not the only driver of the competition; other qualitative features do matter – accuracy, veracity, timeliness (Petit, 2011: 595). This is very true for the rating industry – investors ask for accuracy and this is where the CRAs actually compete. Another important reason for customer decision is the reputation of CRAs. It follows that in a effective market the inaccurate rating would lead to reputation decrease and also to low demand for the product. But since we are at market with significant market power the dynamics is twisted and CRA does not suffer from her failures. Nevertheless, some authors does not agree with the arguments that there is lack of competition in the CRA market. Sovereign ratings are provided usually by more independent agencies at the same time and it is not uncommon that rating agencies do split and disagree in their ratings (Gwilym and Alsakka, 2011: 252-253).

Some would argue that the relevance and impact ratings have on the market does not come out from the special knowledge or incentives of agencies but rather is based on regulatory frameworks that largely involve reference to ratings (Masciandaro, 2013: 55-56).

Despite many errors made by CRAs in previous 15 years the big three CRAs have maintained their market shares and also high profits that might suggest certain lack of competition on the market (Petit, 2011: 601).

3.1 Role of ratings in the European sovereign crises

We now use the European example to show the behaviour of CRAs during the European sovereign crises.

After the crises in 2007-2008 many governments invested large amounts of money to bailout their banks. This has implications for the government budget and eventually the government debt has risen significantly. Most affected were countries like Italy or Greece (Baum et al, 2014: 6). Yet, CRAs spotted this risk first at 2009 when they managed to made total of 151 announcements in 831 trading days, with overhwelming negative view (Baum et al, 2014: 8). The depreciation continued until beginning of 2012, accompanied with further massive downgrading of EU countries in 2012 (for the timeline of the crises events see Santacana and Stiles, 2013, 27-29).

In addition, large investments into government securities were held by banks in their portfolio and therefore the situation of these issuers would had have indirect impact on the situation of banks and other institutional investors who had previously invested in government securities as these were perceived to bear no risk and were largely wanted by investors (Baum et al, 2014: 6). The market and governments were under pressure.

Then the CRAs made another move – on January 13, 2012 S&P downgraded nine EU countries – France was stripped the AAA rating and other countries were even given junk ratings. Generally, downgrading of sovereign debt has spillover effect. The spillover effect of the sovereign debt is very likely to happen when exposures to the sovereign debt are held by bank – and this exactly happened as foreign banks hold large amount of debt of Greece, Ireland, Italy, Portugal and Spain.

What was considered to be the misconduct by the rating agencies was the rash with which they made the downgrade and also some doubt that the downgrading had actually been not correct and accurate (Gwilym and Alsakka, 2011: 249). At least from the affected sovereign's point of view. The reaction of political representation on this CRA's action was to ask for more regulation of agencies to restrict CRAs from similar actions against sovereign debt. The downgrading has caused volatility even though taking the step to downgrade was not correct, at least this is what political representatives

thought. The reason behind the restrictions imposed on the rating agencies is that they should not be allowed to this kind of behavior influencing the market and causing volatility.

It is claimed that part of the rating is not based on economic fundamentals but is of subjective character and eventually influences the market interest rates. Therefore the negative downgrade leads to higher spread for the sovereign debt security (Gärtner et al, 2011: 288). This means that the arbitrary part of the rating matters and should have impact on the spread.

The major drivers of ratings having the most impact on the sovereign ratings outcome are per capita GDP, real GDP growth, government debt level and government deficit (Alfonso et al, 2011). In addition to quantitative factors as decisive variables influencing the assigned rating, the final opinion of the rating agency are very likely to be influenced by some qualitative indicators – these could be political situation or even corruption index (Zheng, 2012: 45); the differences in ratings provided by individual agencies are caused by different subjective weights given to indicators (see Zheng, 2012: 43, analysing the cause for differences between ratings by S&P and Dagong). Based on this assumption, the downgrading of European countries taken in 2010-2011 should not be a surprise as the countries dealt with increasing government debt levels and deficit.

But why should be worry about increase of spreads and volatility? Volatility in respect of sovereign debt is a source of uncertainty which is not desirable. Reasons for this is the relatively large share of financial assets that is represented by sovereign debt held largely by small investors; moreover it affects volatility of securities issued by local private issuers too (Masciandaro, 2013: 50).

May be there is more than just this rational explanation on the political responsive events related to downgrading. The psychological grounds for further actions might be of more than minor importance. Hostile reaction and criticism is a natural reaction to downgrading the countries (in other words downgrading politicians, basically saying to somebody he is not doing

a good job) and in this case there is a slightly big chance that the downgrading by agencies simply triggered such kind of human reactions (Gwilym and Alsakka, 2011: 248).

Besides calling for more regulatory measures to curb activities of rating agencies, some proposals to establish a quasi-public European credit rating agency were made that should ensure objective ratings for European countries. For number of reasons this idea did not prove to be liveable, one of the potential issue being the credibility, impartiality and competence of ratings produced by such agency (Paudyn, 2011: 260). On top of that, there is no reason to believe that any such entity would become any better in predicting future financial crisis since it is generally not possible to be fully successful in this kind of assessments (Tichy, 2011: 234). Instead, the Commission decided to prefer a network of existing rating agencies enhancing the cross-border cooperation and to reduce the entry barriers for new credit rating agencies (Eijffinger, 2012: 918).

4 Regulation of CRAs

The regulatory response by the European bodies to the role of CRAs in the crisis became in a form of the Regulation 1060/2009 on Credit Rating Agencies; the Regulation came into effect on 7 December 2010. The current regulation on credit rating agencies in EU is in force since late 2010, yet has been already been amended twice. The aim of the new regulatory framework, amended for the first time in May 2011[2], was to limit the conflict of interest, improve the methodology and quality of ratings and foster transparency of rating activities. CRAs operating in Europe were required to be registered with the European regulator; supervision of CRAs was agreedto be centralised on the European level when originally CESR (Committee of European Securities Regulators) and from 2012 ESMA (European Securities and Markets Authority) have been assigned the direct supervisory

[2] The amendment took the form of the Regulation (EU) No 513/2011 of the European Parliament and of the Council of 11 May 2011 amending Regulation (EC) No 1060/2009. Regulation (EU) No 513/2011 is often referred to as CRA II Regulation.

powers. Nonetheless this was just the beginning of CRAs' new life under regulatory scheme. The amendment of the Regulation came in 2011 which brought further restrictions and rules for CRAs.

The most recent amendment to the Regulation, so called CRA III[3], was prepared to deal with the remaining issues, since the previous rules did not regulate the use of ratings and their impact on the market.[4]This was basically the response to CRA's activities in 2010-2012 with the aim to curb rating agencies when issuing ratings and outlooks for sovereign and sovereign debt instruments, covering also regional and local authorities.

The new regulatory package brought the requirement to reduce overreliance on credit ratings (implemented also through amendments in sectoral regulation), liability of credit rating agencies, elimination of conflict of interest and increasing competition and last but not least improving quality of sovereign debt rating.

Special requirements and limitations need to be followed by the agency to avoid infringement of the rules and potential punishment in a form of fines. These rules cover areas of sovereign rating considered as most important, based on the experience from the European sovereign crises: transparency of the ratings, keeping the rating up-to-date and timing of announcement (preamble para 1 of the Regulation No 462/2013).

In order to reduce the volatility risk, ratings could be announced only after close of business of venues in the European Union and at least one hour before their opening. In addition to that, CRAs have to publish a calendar for the next year providing the dates of publication (maximum three dates) of unsolicited sovereign ratings and outlooks – with the requirement that these days need to be on Friday. Shoulditbe necessary to comply

3 The reform brought a regulatory structure in a form of a combination of the Regulation (Regulation (EU) No 462/2013 of the European Parliament and of the Council of 21 May 2013 amending Regulation (EC) No 1060/2009 on credit rating agencies) and the Directive (Directive 2013/14/EU of the European Parliament and of the Council of 21 May 2013 amending Directive 2003/41/EC on the activities and supervision of institutions for occupational retirement provision, Directive 2009/65/EC on the coordination of laws, regulations and administrative provisions relating to undertakings for collective investment in transferable securities (UCITS) and Directive 2011/61/EU on Alternative Investment Funds Managers in respect of over-reliance on credit ratings).

4 The external use of regulation was included only in sectoral financial regulation.

with the legal obligations, announcement can take place outside the pre-set dates, however further explanations on such deviation from the calendar needs to be presented by the agency (new Article 8b of the Regulation No 1060/2009).

Form and information basis for sovereign rating is subject to restrictions too. For example, when publishing sovereign ratings, the agency has to provide explanation on key elements underlying the rating. However, it is expressly prohibited to ground the explanation on national policies – those policies could serve only for the assessment of the creditworthiness and sovereign ratings, the agency should refrain from recommendations on sovereign's policies (preamble para 45 of the Regulation No 462/2013). Moreover, sovereign ratings would have to be reviewed at least every six months.

The EU regulation requires the Commission to prepare a review of the situation in credit rating market by July 2016 (and if necessary to follow up with appropriate legislation), and by the end of 2014 report on appropriateness of the development of a European creditworthiness assessment for sovereign debt. It is very likely that the review will come up with new wave of regulation, although it might be questionable whether strengthening the regulation of CRAs as intermediaries of information does really solve the real causes of problems within the financial market.

Similarly in US, from 2006 onward the rating market become subject to regulatory framework aimed to deal with more transparency and conflict of interest, the core rules brought by Dodd-Frank Act in 2010. However, the approach in US is not completely the same as in Europe as the EU regulatory rules provide generally for more powers of EU regulator to interfere with CRA's business (for example see Santacana and Siles, 2013: 35).

5 Conclusion

There is no doubt that CRAs and their ratings played a very important role in the market procedures and functioning, however this is result of previous regulatory framework which has allowed the ratings to become such

an important feature in the financial market. The attempts to clear the regulatory rules from reliance on ratings are the necessary step forward, however it is difficult to find appropriate and effective alternative solution.

The undesirable implications of CRA's activities on the market volatility and increasing pressure on the already distress governments could be treated different ways. Obviously, Europe has chosen to go the regulatory path and decided to make sovereign debt ratings subject to more stringent regulations.

The CRA's options to publish rating of a sovereign are restricted. The goal is to limit the influence of ratings and rating agencies on the situation and volatility related to sovereign debt. Nonetheless it seems, that the market already had those information and the simple downgrading was not the main cause of those disruptions. The downgrading further triggered the problematic regulatory requirements on bank's portfolios. This kind of limitation does not seem to be reasonable in a sense that it is in conflict with the requirement for accuracy and correctness of ratings.

Based on recent research and experience it is now known that ratings do not fulfil all those function that were expected by regulators or investors. Ratings are simply not a reliable prediction of future financial disruptions. They should serve only as an assessment of creditworthiness of the issuer. Investors need to bear in mind that CRAs do mostly react on the situation on the market rather than show on future development. Further, the subjective character of ratings is important. Structures that would allow appropriate reactions on failures and inaccuracies by CRAs might be a good solution for today's limited competition in on CRA's market. Base on that conclusion, the hypothesis on expected benefits from restrictions put on sovereign debt ratings by the European rules seems to be disproved. The problematic circumstances of the credit rating agencies should be dealt under competition rules and further enhancement of competition rather than by limitation on publication of ratings.

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