

Anita Pavković, PhD, Associate Professor

University of Zagreb, Faculty of Economics and Business Zagreb
Trg J. F. Kennedy 6, 10 000 Zagreb, Croatia
anita.musa@efzg.hr

Dario Hlupić Radić, LL.M., Legal advisor

Croatian National Bank
Trg hrvatskih velikana 3, 10 000 Zagreb
dario.hlupic@hnb.hr

LEGAL REGULATION OF CREDIT INSTITUTIONS ACTIVITIES IN THE REPUBLIC OF CROATIA AND THE EUROPEAN UNION

ABSTRACT

Credit institutions are financial institutions which main activities are taking deposits from those who have surplus of money and to grant credits to those who have deficit of money and who needs money for investment or spending. By providing its services, credit institutions perform an important social function which is transferring money from people or corporations who has surplus to the people who has deficit of money. In addition to these core banking services, credit institutions provide other services such as payment services, exchange services, investment services etc. By providing their services, credit institutions manage significant amounts of money collected from the public. In order to protect depositors and investors, credit institutions' operations are heavily regulated by a number of legal rules and regulations.

In this paper it will be presented an overview of the EU legal system which regulates the activities of credit institutions in European Union. Those rules and regulations also apply in the Republic of Croatia as one of the member of the European Union. It will be presented a single rulebook that is a legal base of EU Banking Union. In brief, the Regulation (EU) No. 575/2013 and Directive 36/2013/EU, which regulates access to the activity of credit institutions, prudential requirements for credit institutions and the prudential supervision of credit institutions. Also it will be presented the Directives 2014/49 / EU and 2014/59 / EU which regulates deposits insurance and recovery and resolution of credit institutions. Finally, an overview of the regulation development in Croatia starting since 1990 up to today will be given, including the laws transposing the above-mentioned EU directives.

Keywords: *Credit institutions, EU, EU Banking Union*

1. DEFINITION OF A CREDIT INSTITUTION AND SERVICES THAT CREDIT INSTITUTIONS PROVIDE

A credit institution can be defined as an institution which provides services of collecting deposits and granting credits or loans from these deposits and which provides other financial market assisting services such as payment services, bank account managing services, credit card issuing and managing services, investment services and other similar services.¹

A credit institution, by providing its services, performs a very important social function of transferring monetary surpluses from people who spend less than their income and save money (depositors, investors, etc.) to the people who wants to spend more than they currently have for investment or for consumption (loan users).

Of all aforementioned services that credit institutions provide, the most important one is collecting deposits from the public. Credit institutions are the only financial institutions authorized to collect deposits from the public and no other institution can collect deposits from public. Because of that feature we often call them deposit institutions. However, in the EU regulations, for the institutions that are authorized to collect deposits is used the term credit institution². It is not quite clear why EU legislators have opted for the term credit institution, when we know that credits and loans can be offered and granted by any other financial institution and by any other legal or natural person. Logical term for an institution that is authorized to collect deposits is deposit institution instead of credit institution. However, legislators in the European Union have opted for the concept of credit institutions, so the term credit institution is used in the legal regulations and other documents of the European Union and all EU Member States, including the Republic of Croatia.

For reasons of simplicity, credit institutions are often identified with banks. Credit institutions are broader term but at least of 90% or more of credit institutions are banks. In Croatia, more than 98% of credit institutions are banks and other, less than 2%, are saving banks and housing saving banks.

In regulations it can be found a legal definition of a credit institution. In Croatia and the European Union, a credit institution is defined in Article 4, paragraph 1,

¹ Rose, P. S. *Commercial Bank Management*. 4th ed. Singapore: The McGraw-Hill Companies, p. 10

² 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., Further in the text: Regulation (EU) No 575/2013)

item 1 of Regulation (EU) No. 575/2013 and credit institution means an undertaking the business of which is to take deposits or other repayable funds from the public and to grant credits for its own account.

In Croatia, a credit institution can be established as a bank, a savings bank or a housing saving bank. At the end of 2016, we had 25 banks, 1 savings bank and 5 house saving banks operated in Croatia. At that time banks had approximately than 390 billion HRK, which is about 98% of the total assets of credit institutions in Croatia.

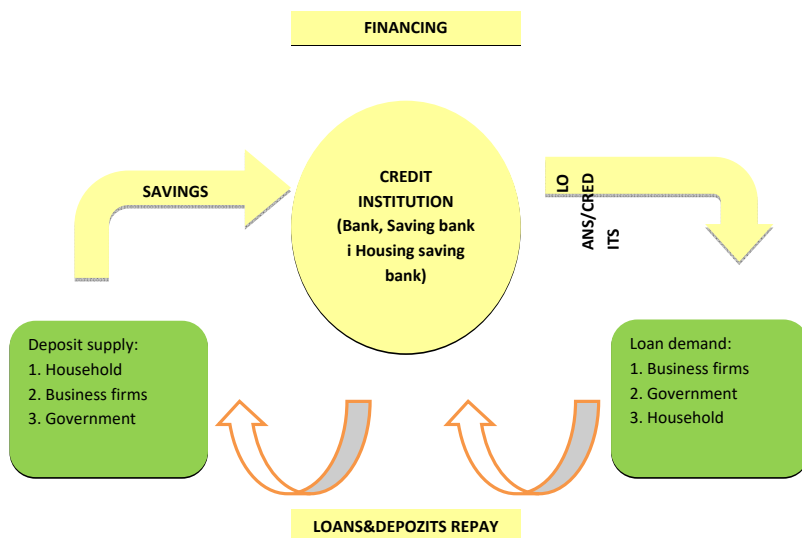
Table 1: Credit institutions in Croatia at the end of 2016 (in 000 HRK)

Credit institutions	Number	Total Assets	% of Assets
Banks	25	388.718.279	98,02%
Saving banks	1	3.643	0,01%
Housing saving bank	5	7.811.079	1,97%
Total	31	396.533.001	100,00%

Source: Croatian National Bank statistics, 2018

A Bank is a credit institution that can provide all banking and financial services in Croatia and outside the territory of Croatia while savings banks, and housing savings banks can provide only a limited number of banking and financial services.

Figure 1: Flows of Funds



Source: Adjusted according with Mishkin F.S, Eakins E.G., *Financial markets and institutions*, Mate d.o.o. 2005, p. 16

As mentioned earlier credit institutions collect deposits and transfer it to those who need funds and this activity is extremely important for the whole economy. People who save money and spend less than earn are usually not entrepreneurs and they do not know how to invest their funds. Credit institutions act as intermediaries between those two groups. They offer an opportunity to earn an interest with low risk to the people with surpluses of money, and they offer fund to the people who need it. If there were no credit institutions acting as intermediaries, people with money surpluses would have to find profitable business themselves and take the whole risk of investing or not invest at all. Not investing would have a significant negative impact on economic activity, because entrepreneurs need money for new projects and consumers need money for consumption. Without the loans economic activity would shrink.

The graph shows how the money comes from depositors/creditors through credit institutions to borrowers/consumers based on lending and after a certain period of time the loans will be repaid and the depositors claim their savings. And the cycle can start all over again.

In general, household and individuals save more money than they use loans but entrepreneurs and business firms need funds for investments and they use more loans than they save.³ As it is shown from the figure, depositors invest their money in credit institutions. Credit institutions grant loans to business firms, government and individuals. Doing that credit institutions take all the risk that can arise from non-payment of debtors.

2. REASONS WHY CREDIT INSTITUTIONS ARE REGULATED

Businesses and individuals hold a significant portion of their funds in credit institutions. In most of countries in the world, total assets of credit institutions exceed the GDP of that country. Managing significant amounts of money credit institutions affect the whole economy and they have the substantial impact on the entire financial system. For these reasons, credit institutions are commonly treated as a matter of public interest.⁴

³ Mishkin, F.S., Eakins, S.G., *Financial markets and institutions*, Eighth edition, p. 20

⁴ Spong, K., *Banking Regulation: Its Purposes, Implementation and Effects*. Fifth edition. Kansas City: Federal Reserve Bank of Kansas City, p. 7

Table 2: Total assets of credit institutions and GDP comparison

2016 (in billions of US\$)	Total assets of credit institutions	Total assets of all financial institutions (%)	Total assets CI and GDP ratio (%)
USA	17.986	23,90	103,28
Eurozone	38.087	55,27	288,22
Croatia	60,89	69,47	114,88

Sources: FED, ECB and CNB, 2018

Development of special regulation for credit institutions has been gradual and every major bank or financial crisis initiated new rules. Prior to the deposit insurance system or liquidity support system or supervision there were numerous cases of financial panics and bank runs. Thus, in the 19th century, bank crisis in the United States occurred every 20 years, in 1819, 1837, 1857, 1873, 1884, 1893, and 1907.⁵ During that period, banks' insolvencies and failing represented a major problem. As credit institutions grant long term loans they cannot have enough liquidity for all depositors in case of bank runs. However, in situations of financial crisis, depositors doubt the ability of a credit institution to pay off deposits. In financial crisis depositors of all credit institutions are doing the same thing they try to withdraw their own funds from the bank. In the past there were no liquidity support and banks could not find enough liquidity to repay all deposits. For that reason and among other things, the Federal Reserve System – FED was established in 1913 by Federal Reserve Act.⁶

The Federal Reserve –FED was established to prevent such situations by providing a reserve base and by allowing banks to borrow funds from Reserve banks to meet depositor needs and

demands. To provide further confidence to depositors, the U.S. Government instituted federal deposit insurance system in the 1930s. The main aim of deposit insurance system was to eliminate the link between the fate of a bank and small depositors. Deposit insurance system insured that the small depositor got their deposit from state agency in case their bank fails. Although deposit insurance has not been without cost or risk, it has provided stability in the payments system and given bank regulators greater flexibility in resolving individual bank problems.⁷

Protection of deposits and depositors is the primary reason for regulation and supervision of credit institutions. Over time, it was recognized that the regulation

⁵ Mishkin, Eakins, *op. cit.* note 4, p. 492

⁶ Spong, *op. cit.* note 4, p. 20

⁷ Spong, *op. cit.* note 4, p. 20

and supervision of an individual credit institution (microprudential regulation and supervision) is not sufficient. Regardless of how well the credit institution manage the risk, systemic risk can be transferred to a credit institution from other credit or financial institutions. And the instability that occurs in the system usually is transferred to all credit institutions. For that reason, another level of supervision and regulation of credit institutions is being developed. That is macroprudential regulation and supervision which primary goal is to preserve the stability of the whole financial system.

Table 3: Comparative representation of microprudential and macroprudential regulation

	Micprudential regulation	Macroprudential regulation
Proximate objective	Limit distress of individual Institutions	Limit financial system-wide Distress
Ultimate objective	Investor and depositor Protection	Avoid financial instability
Calibration of prudential controls	In terms of system-wide risk; top-down	In terms of risks of individual institutions; bottom-up

Sources: Bank for International Settlements (2008) *Addressing financial system procyclicality: a possible framework*. Note for the FSF Working Group on Market and Institutional Resilience, p. 4/17.

According to different researches consequently the main goals of regulation and supervision of credit institutions are: stability of credit institutions, protection of depositors and investors and the stability of the entire financial system.

3. BANKING UNION AND REGULATIONS FOR CREDIT INSTITUTIONS IN THE EU

In EU, the core principle of the Single Market for services is a freedom to establish a company in any EU country and a freedom to provide services in an EU country other than the one where the company is established. (Article 49. and 56. TFEU)⁸.

In accordance with these freedoms in 1989. *Directive 89/646/EEC on the coordination of laws, regulations and administrative provisions relating to the taking up and pursuit of the business of credit institutions* was adopted⁹. This Directive introduced freedom to provide banking services in whole EU. That means that a credit institution can be established in any EU member State with the license of the home

⁸ Articles 49 and 56 of Treaty on the Functioning of the European Union (OJ C 326, 26.10.2012.)

⁹ Directive 89/646/EEC on the coordination of laws, regulations and administrative provisions relating to the taking up and pursuit of the business of credit institutions (OJ L 386, 30.12.1989)

competent authority and to have a freedom to provide services in any other member State (single license/single passport rule).

The same rule applies also in Croatia; the credit institution established in Croatia with the license of Croatian National Bank can provide its services in any EU country. In addition, credit institution from another EU country can provide its services in Croatia without license from Croatian National Bank.¹⁰

According to ECB “Banking union is an important step towards a genuine Economic and Monetary Union. It allows a consistent application of EU banking rules”.¹¹ The Banking Union is based on a unified regulatory framework that applies to all credit institutions in the EU. That unified regulatory framework is called single rulebook and is divided into three key areas:

- Establishment and prudential requirements for credit institutions (CRD IV package),
- Recovery and resolution of credit institutions (BRRD) and
- Deposit Guarantee Schemes (DGS).

The Banking Union has three pillars: Single Supervisory Mechanism (SSM), Single Resolution Mechanism (SRM) and European deposit insurance scheme (EDIS).

The Single Supervisory Mechanism (SSM) refers to the system of banking supervision in the Eurozone. It comprises of the ECB and the national supervisory authorities. The ECB directly supervises the 118 significant banks of the participating countries. These banks hold almost 82% of banking assets in the euro area.¹² The Single Resolution Mechanism is the second pillar of the banking union which main purpose is to ensure the efficient resolution of failing banks with minimal costs for taxpayers and to the real economy. Central resolution authority in the Eurozone is Single Resolution Board. A Single Resolution Fund, financed by contributions from banks, will be available to pay for resolution measures.¹³ European deposit insurance scheme (EDIS) proposal builds on the system of national de-

¹⁰ Art. 74. to 89. of Credit Institutions Act, Official Gazette No. 159/13, 19/15, 102/15, 15/18

¹¹ Quoted from European Central Bank webpage:
[<https://www.bankingsupervision.europa.eu/about/bankingunion/html/index.en.html>]
Accessed 08.02.2018

¹² According to European Central Bank webpage:
[<https://www.bankingsupervision.europa.eu/about/thessm/html/index.en.html>] Accessed 08.02.2018

¹³ According to European Commission website:
[https://ec.europa.eu/info/business-economy-euro/banking-and-finance/banking-union/single-resolution-mechanism_en] Accessed 08.02.2018

posit guarantee schemes (DGS) regulated by Directive 2014/49/EU. This system already ensures that all deposits up to €100 000 are protected through national DGS all over the EU. EDIS would provide a stronger and uniform degree of insurance cover in the euro area. This would reduce the vulnerability of national DGS to large local shocks, ensuring that the level of depositor confidence in a bank would not depend on the bank's location and weakening the link between banks and their national sovereigns.¹⁴ EDIS would apply to deposits below €100 000 of all banks in the banking union. When one of these banks is placed into insolvency or in resolution and it is necessary to pay out deposits or to finance their transfer to another bank, the national DGS and EDIS will intervene.

4. ESTABLISHMENT OF CREDIT INSTITUTIONS AND PRUDENTIAL REQUIREMENTS FOR CREDIT INSTITUTIONS

The establishment of credit institutions, prudential requirements for credit institutions and prudential supervision of credit institutions in the EU are regulated by uniform set of rules called CRD IV package. CRD IV is composed of:

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 335, 23.12.2015).

- 10 Commission implementing regulation (ITS)
- 11 Commission delegated regulation (RTS) and
- 12 Guidelines

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 158, 27.5.2014.) and

- 18 Commission implementing regulation (ITS)
- 45 Commission delegated regulation (RTS) and
- 10 Guidelines

With this unique set of rules for credit institutions throughout the European Union has been regulate:

¹⁴ According to European Commission website:
[https://ec.europa.eu/info/business-economy-euro/banking-and-finance/banking-union/european-deposit-insurance-scheme_en] Accessed 08.02.2018

- **Establishment of credit institutions.** Credit institution is obliged to obtain authorization from supervisory authority before commencing their activities. Credit institution has to fulfill conditions to be granted authorization such as initial capital of at least 5 million EUR, suitable shareholder, sound and prudent management, personnel, organizational and technical conditions for providing services. Credit institution has to allow supervision at any time. Once credit institution obtain authorization, it can provide its services all over the entire EU (single passport principle). In Croatia, the supervisory authority is Croatian National Bank.¹⁵
- **Authorization for shareholders.** Shareholders who decided to acquire 10% or more shares of credit institution also has to obtain authorization from supervisory authority. Shareholders have to have a good reputation, financial strength and act in the best interest of the credit institution.¹⁶
- **Internal governance and risk management.** Members of the management body have to possess adequate knowledge, skills and experience. They have to act with honesty, integrity and independence of mind. Members of the management body also need to have authorization from supervisory authority.¹⁷
- **Capital requirements.** Regulation (EU) No 575/2013 sets the minimum capital requirements. Credit institutions shall at all times satisfy own funds requirements: Common Equity Tier 1 capital ratio of 4,5% of Risk-Weighted Assets (RWA), Tier 1 capital ratio of 6% of RWA and total capital ratio of 8% of RWA. Regulation (EU) No 575/2013 sets out in detail the method of calculating risk-weighted assets.¹⁸

In addition, Directives 2013/36/EU sets more capital requirements in form of capital buffers. There are five capital buffers: Capital conservation buffer of 2,5% of RWA, Countercyclical capital buffer that can be used to reduce negative effects of economic cycles, Systemic risk buffer that is used to protect a credit institution from systemic risks, global and other systemic risk buffers that can be used to protect systemic important banks.¹⁹

¹⁵ Article 8. of 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 335, 23.12.2015., further in the text: Directive 2013/36/EU

¹⁶ Article 22. of Directive 2013/36/EU

¹⁷ Article 88. of Directive 2013/36/EU

¹⁸ Article 92. of Regulation (EU) No 575/2013

¹⁹ Article 128. of Directive 2013/36/EU

Regulation (EU) No 575/2013 will soon sets a minimum requirement of 3% for the financial leverage Ratio.

- **Liquidity requirements.** Regulation 575/2013/EU sets the minimum liquidity requirements. Credit Institutions shall hold enough liquid assets to cover their net liquidity outflows. Moreover, Credit institutions shall ensure that long-term obligations are adequately met with stable funding instruments.²⁰
- **Limits to large exposures.** Regulation 575/2013/EU sets that credit institution shall not incur an exposure to a client or group of connected clients the value of which exceeds 25 % of its eligible capital.²¹
- **Supervision of credit institutions.** Each Member State shall designate a competent authority that shall supervise credit institutions and grant authorization to credit institution, its shareholders and its management body.²²

In Croatia, competent supervisory authority is Croatian National Bank and in the Eurozone competent supervisory authority is European Central Bank.

“The purpose of the Single Rulebook is to ensure the consistent application of the regulatory banking framework across the EU.”²³

Credit Institutions Act which entered into force on January 1, 2014, transposed Directive 2013/36/EU into Croatian legislation and set the rules for application of Regulation (EU) No. 575/2013/EU.²⁴ In addition to Credit Institutions Act, 35 Decisions as subordinate legislation have been adopted to further regulate capital buffers, suitability of management and supervisory board members, rules for shareholders, risk management, internal control system etc.

Credit Institution Act introduced Croatian National Bank as competent authority for credit institutions. That means that CNB has powers to issue and to revoke authorization for credit institutions, for shareholders and for members of management and supervisory boards of credit institutions. CNB has powers to supervise credit institutions and to issue supervisory measures. CNB can initiate misdemeanor proceedings in case of violation of the rules. The CNB is also designated

²⁰ Article 411. of Regulation (EU) No 575/2013

²¹ Article 395. of Regulation (EU) No 575/2013

²² Article 4. of Directive 2013/36/EU

²³ Quote from European banking authority website:
[<https://www.eba.europa.eu/regulation-and-policy/single-rulebook/interactive-single-rulebook>]
Accessed 08.02.2018

²⁴ Article 2. of Credit Institutions Act, Official Gazette no. 159/13, 19/15, 102/15, 15/18

as a macroprudential authority in Croatia and has powers to introduce macroprudential measures.²⁵

Credit Institutions Act introduced additional capital requirements so called capital buffers.

CNB has identified systemically important credit institutions in Croatia and we have 8 credit institutions that are systemically important: Zagrebačka banka d.d., Erste & Steiermärkische Bank d.d., Privredna banka Zagreb d.d., Raiffeisenbank Austria d.d., Splitska banka d.d., Addiko Bank d.d., OTP banka Hrvatska d.d. and Hrvatska poštanska banka d.d.²⁶

Credit Institutions Act has imposed penalties for minor offenses in case of violating the provisions of the Credit Institutions Act or Regulation 575/2013 ranging from HRK 50,000 to 10% of annual income.

5. RECOVERY AND RESOLUTION OF CREDIT INSTITUTIONS

Resolution and recovery of credit institutions are regulated by:

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. and

- 1 Commission implementing regulation (ITS)
- 15 Commission delegated regulation (RTS) and
- 12 Guidelines

With this unique set of rules for resolution and recovery of credit institutions throughout the European Union has been regulate:

²⁵ Article 11. of Credit Institutions Act, Official Gazette no. 159/13, 19/15, 102/15, 15/18

²⁶ CNB Notification on the review of the identification of other systemically important credit institutions in the Republic of Croatia. CNB website:
[https://www.hnb.hr/documents/20182/2293349/e-priopcenje-preispitivanje-sistemski-vaznih-ki-u-RH_22-2-2018.pdf/cb8b76ed-6aef-4a4d-aac0-defa83565ccd] Accessed 08.02.2018

- **Recovery plans.** Recovery Plan is a plan drawn up by the credit institution itself that provides measures to be taken by credit institution in case of financial distress. In this plan, the credit institution itself envisages measures to improve capital, liquidity and business stability.²⁷
- **Early intervention measures.** The supervisory authorities have additional powers (in addition to supervisory powers) which can be taken in the event of financial distress such as: require the credit institution to implement one or more measures from recovery plan or replace an individual member of the management, introduce a special administration, Write down of capital instruments to absorb losses, etc. All these measures may be taken as early intervention measures. Early intervention is a formal procedure that can be initiated by the decision of the supervisor. Formal decision on opening an early intervention has to be delivered to the deposit insurance system to prepare for deposit repayment.²⁸
- **Resolution plans.** Resolution plans are plans that resolution authority will draw up for each credit institution and that plan shall provide resolution actions which resolution authority may take in case of resolution of credit institutions.²⁹
- **Resolution** is a procedure in which resolution authority applies one or more resolution tools to protect depositors and clients' funds and to avoid a significant negative effect on the financial system.³⁰
- **Resolution authority.** Each Member State shall designate a resolution authority that will prepare resolution plans, manage resolution funds and apply resolution tools if necessary. In Croatia State Agency for deposit insurance and bank resolution is one resolution authority and Croatian National Bank another. In Eurozone, Single Resolution Board is a resolution authority for all credit institutions that are part of single supervisory mechanism.³¹

²⁷ Article 5. of 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), further in the text: Directive 2014/59/EU

²⁸ Article 27. of Directive 2014/59/EU

²⁹ Article 10. of Directive 2014/59/EU

³⁰ Article 31. of Directive 2014/59/EU

³¹ Article 3. of Directive 2014/59/EU

- **Resolution fund.** Resolution fund is financed by credit institutions and funds can be spent for resolution of any credit institutions.³²

Resolution of Credit Institutions and Investment firms Act which entered into force on February 2015, transposed Directive 2014/59/EU into Croatian legislation and set the rules for recovery and resolution of credit institutions.

Resolution of Credit Institutions and Investment firms Act introduced three resolution authorities in Croatia. Two of them Croatian National Bank for credit institutions and Croatian financial services supervisory agency for investments firm have powers before the resolution in the phase of preparing for resolution. Their powers include the power to prepare resolution plan, to monitor if the conditions for resolution has been met and to propose resolution. And the third resolution authority is Croatia State Agency for deposit insurance and bank resolution that carries resolution procedure if credit institution or investment firm is in public interest. DAB also maintains a resolution fund.³³

Since the Resolution of Credit Institutions and Investment firms Act we have had one credit institutions in resolution, Jadranska bank headquartered in Šibenik. DAB opened resolution procedure on Jadranska bank because Jadranska bank was failing and saving the failed bank was considered as a public interest. DAB applied resolution instruments and wrote down capital instruments to absorb losses, used money from resolution fund to cover remaining losses and prepare Jadranska bank for merging with another bank.³⁴

On other side on three banks: Nava banka d.d., Banka splitsko dalmatinska d.d. and Tesla štedna banka d.d. bankruptcy proceedings were initiated. Saving those banks were not in public interest because they were small banks.³⁵

6. DEPOSIT INSURANCE SYSTEM

Deposit insurance system is regulated by:

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, Further in text: DGS or Directive 2014/49/EU) and

³² Article 100. of Directive 2014/59/EU

³³ Article 8. of Resolution of Credit Institutions and Investment firms Act, Official Gazette No. 19/15

³⁴ Decision of initiation of resolution procedure on Jadranska bank:
[<http://www.dab.hr/novosti/>] Accessed 08.02.2018

³⁵ CNB list of credit institutions undergoing bankruptcy proceedings
[<http://www.hnb.hr/en/core-functions/supervision/list-of-credit-institutions>] Accessed 08.02.2018

- 4 Guidelines

With this unique set of rules for deposit insurance system throughout the European Union has been regulate:

- **Deposit insurance.** With this set of rules the same level of deposit insurance in the amount of EUR 100,000 was established in EU countries. Designated authority is obliged to repay insured deposits within 20 working days from the day that the deposits are determined unavailable.³⁶
- **Contributions to the deposit insurance system.** Credit institutions are obliged to contribute to deposit insurance fund on base of the amount of cover deposits and the degree of risk incurred by the credit institution.³⁷
- **Deposit insurance fund.** Each Member State shall designate an authority which administers a deposit insurance fund or deposit guarantee schemes. In Croatia designated authority is State Agency for deposit insurance and bank resolution. Deposit insurance fund should have enough money to repay insured deposits in case of deposits become unavailable. Directive 2014/49/EU set a minimum funds of deposit insurance fun at a level of 0,8% of all insured deposits.³⁸
- **Use of funds from deposit insurance fund.** Funds shall be primarily use in order to repay depositors but can also be used in order to finance the resolution of credit institutions and as alternative measures in order to prevent the failure of a credit institution.³⁹

Deposit Insurance Act which entered into force on July 2015, transposed Directive 2014/49/EU into Croatian legislation and set the rules for deposit insurance.⁴⁰ The Act designated State Agency for deposit insurance and bank resolution as designated authority for deposit insurance and for maintaining deposit insurance fund.⁴¹ Deposit Insurance Act has determined the minimum level of the deposit insurance fund, which is 2.5% of the insured deposits.⁴² As of 31 December 2016, in all credit institutions in Croatia there were about HRK 165 billion of insured

³⁶ Article 6. and 8. of Directive 2014/49/EU

³⁷ Article 13. of Directive 2014/49/EU

³⁸ Article 10. of Directive 2014/49/EU

³⁹ Article 11. of Directive 2014/49/EU

⁴⁰ Article 2. of Deposit Insurance Act, Official Gazet No 82/15

⁴¹ Article 3. of Deposit Insurance Act, Official Gazet No 82/15

⁴² Article 14. of Deposit Insurance Act, Official Gazet No 82/15

deposits.⁴³ This means that the minimum level of the deposit insurance fund is HRK 4,125 billion.

Credit institutions in Croatia are obliged to pay a premium for deposits insurance based on the insured deposits and the level of risk of an individual credit institution. This premium for each quarter is equal to 0.08% of insured deposits multiply with risk ranging from 50% to 150%.⁴⁴ This means that credit institutions in Croatia are obliged to pay contributions to deposit insurance fund in the amount of about 120 million HRK every three months.

7. HISTORICAL DEVELOPMENT OF BANK REGULATION IN CROATIA SINCE INDEPENDENCE UNTIL TODAY

7.1. The beginnings of banking regulation in modern Croatia

The Banks and Savings Banks Act (Official Gazette 94/1993) entered into force on October 28, 1993.⁴⁵ Prior to that, Banks and Other Financial Organizations Act from ex-Yugoslavia applied in Croatia. The Banking and Savings Act defines the bank as a financial institution established as a joint-stock company or as a limited liability company, whose business is performing all or only certain banking services. Banking services were then defined as: taking all kinds of deposits, granting credits, foreign exchange transactions, redemption of bills of exchange and checks, and provide payment services⁴⁶. This law has significantly changed the inherited institutional structure of banking regulation and introduced the banking system based on the free market. The main goals of new regulation were:

- establish a banking system on market principle without any influence from political factors or government bodies
- increase competition between banks and allow domestic and foreign entrepreneurs to participate as banks shareholders
- to strengthen the supervision of banks by the competent authority of the Croatian National Bank. The Act introduced supervisory standards using IMF guidelines.

⁴³ DAB publication: file://hnb.local/hnb/Users01\$/dhlupic/Downloads/DEPOZITI%2031122016%20(1).pdf

⁴⁴ Article 21. of Deposit Insurance Act, Official Gazette No. 177/04, 119/08, 153/200., 80/2013, 82/2015

⁴⁵ Banks and saving bank Act, Official Gazette No 94/93, 12/95, 24/96, 90/96, 98/96, 89/98, 161/98

⁴⁶ Article 1 and 3 of Banks and saving banks Act, Official Gazette No 94/93, 12/95, 24/96, 90/96, 98/96, 89/98, 161/98

By that Act, Croatia has adopted the European model of a universal, multifunctional bank. At the time, the financial sector was undeveloped and most of the financial sector was concentrated in the banks. In addition to collect deposits and grant loans, the law sought to encourage the development of providing other forms of financial services.

Since 1993 the banking market in Croatia was significantly liberalized and a large number of new banks were established. In 1990 in Croatia there were 30 banks and up to 1997, the number of banks was doubled and in 1997 there were 60 banks operating on the market.⁴⁷ However, many of the banks had financial problems and were unable to repay deposits, what affected the stability of the entire financial and economic system.

State Agency for deposit insurance and bank resolution was established in 1994, and the deposit insurance system has been established in 1998. Initially, the amount of the insured deposit was up to 30,000 HRK.

7.2. The regulator's response to the banking crisis

The 1998 Banking Act introduced restrictions to ensure better and safer banking operations. The Bank was defined as a joint stock company whose business is collecting deposits and granting credits and other placements. Since 1998 bank could only be established as a joint stock company, not as a limited liability company.

The 1998 Act introduced three types of authorizations and each of the authorization had a certain number of services the bank could provide. So the range of services that banks could provide was small, medium and large. The most important limitation was the limit on collecting deposit for the first three years. Newly established banks could not receive deposits in the first three years after its establishment.

The 1998 Act did not brought positive effects and the banking system remained unstable. Many of banks failed and the resolution was carried out on six banks, including the second-largest bank in Croatia Privredna banka Zagreb. The result was that the largest banks in Croatia, Zagrebačka and Privredna banka, were sold to foreign investors UniCredito and Intesa Sanpaolo. Many banks have ended up in bankruptcy, and some of the banks were merged with other banks. This has led to a reduction in the number of banks in the banking system from 60 banks in 1997, to the 41 in 2003, and that number continued to decrease.

⁴⁷ Draft of Banking Act from 1998

7.3. Harmonization with EU directives

The Banking Act from 2002 defined the bank as a financial institution that has been authorized by the Croatian National Bank. The definition was formal in a way that the bank is any financial institution that has received a CNB authorization. Banking services were defined as collecting deposits and granting loans from these funds for account of a bank as well as issuing electronic money.⁴⁸

Banks could also provide financial services.

The 2002 Banking Act implemented Directive 2000/12/EC relating to the taking up and pursuit of the business of credit institutions, which provided the freedom to provide services throughout the European Union. Restrictions from the previous Act have been abolished. Thus, a small, medium and large authorization was abolished and only one authorization was introduced. There were no limits on collecting deposit for the first three years.

The Act was amended in 2006 and the amendments introduced a savings bank as a “small” bank that can provide a limited range of bank services. The Banking Act was effective until 1 January 2009 when the Credit Institutions Act came into force.

Deposit insurance Act from 2004 increased the amount of insured deposit from 30.000 HRK to 100.000 HRK. In 2008 the amount of insured deposit increased from 100.000 HRK to 400.000 HRK. And from July 2013 amount of insured deposit is 100.000 EUR.⁴⁹

7.4. Complete implementation of EU regulation

Credit institutions Act from 2009 implemented CRD I into Croatian legislation and that was one of conditions Croatia had to meet to become the member of the EU.

Credit Institutions Act, which entered into force on January 1, 2014, transposed Directive 2013/36/EU into Croatian legislation and set the rules for application of Regulation (EU) No. 575/2013/EU.

Regulatory activities in Croatia and European Union brought us large number of rules and regulations. The graph shows the number of regulations that are supervised by the CNB, DAB and HANFA (whose responsibilities are to supervise

⁴⁸ Article 2. of Banking Act, Official Gazette No. 84/02, 141/06., 117/08,74/2009

⁴⁹ Article 4 of Deposit insurance Act, Official Gazette No. 177/04, 119/08, 153/200., 80/2013, 82/2015

non-banking financial sector: pension and investment funds, insurance companies, leasing and factoring companies, etc.).

8. CONCLUSION

Credit institutions provides socially important services collecting deposits from public and investing those funds to those who needs it. By providing that service, credit institutions collect a large amount of money. Managing those funds is in the public interest. To protect public interest, activities of credit institutions are strictly regulated and supervised. In this paper, we have elaborated the most important regulations that regulates activities of credit institutions and protect depositors.

Almost every aspect of credit institutions operations has been regulated. From the establishment, credit institution has to obtain license before commencing their activities, it has to have enough capital; it has to have sound business strategy, fit and proper management structure, etc. Accomplishing all of these required conditions, credit intuitions provide insurance for its depositors and can attract more deposits. On one hand by the fulfillment of required conditions, regulators can achieve stability and safety of credit institutions business activities. However, on the other hand, plentiful regulation can have negative effects; for example, it can be too expensive for credit institutions. Today we have a term regulatory cost, it is a cost that credit institution have to bare for complying with rules and regulation. Some of that cost credit institutions tend to shift to its customers in order not to reduce their profits. Looking from that angle, regulators have to be very cautious not to exceed with regulation, and regulate only major aspect of credit institution activities that are important for stability and safety of credit institutions.

In the future, it can be expected a lot of innovation in banking activities like enhance internet banking, mobile banking, instant payment etc. Those innovations will bring new types of risks and new types of frauds like stilling identity or stilling a credit card on the internet etc. The regulators will follow the trends and will try to insure the safety of clients of credit institutions in the future.

REFERENCES

BOOKS AND ARTICLES

1. Mishkin F.S, Eakins E.G., *Financial markets and institutions*, Mate d.o.o. 2005
2. Mishkin F.S. Eakins S.G., *Financial markets and institutions*, Eighth edition
3. Rose, P. S., *Commercial Bank Management*, 4th ed. Singapore: The McGraw-Hill Companies

4. Spong K., *Banking Regulation: Its Purposes, Implementation and Effects*. Fifth edition. Kansas City: Federal Reserve Bank of Kansas City

EU LAW

1. 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.)
2. Directive 89/646/EEC on the coordination of laws, regulations and administrative provisions relating to the taking up and pursuit of the business of credit institutions (OJ L 386, 30.12.1989)
3. 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 335, 23.12.2015)
4. 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.)
5. 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.)
6. Treaty on the Functioning of the European Union (OJ C 326, 26.10.2012.)

LIST OF NATIONAL REGULATIONS AND ACTS

1. Banking Act Official Gazette No. 84/02, 141/06, 117/08, 74/2009
2. Banks and saving bank Act, Official Gazette No 94/93, 12/95., 24/96, 90/96, 98/96, 89/98, 161/98
3. Credit Institutions Act, Official Gazette no. 159/13, 19/15, 102/15, 15/18
4. Deposit Insurance Act, Official Gazette No 82/15
5. Deposit insurance Act, Official Gazette No. 177/04, 119/08, 153/2009, 80/2013, 82/2015
6. Draft of Banking Act from 1998
7. Resolution of Credit Institutions and Investment firms Act, Official Gazette No. 19/15

WEBSITE REFERENCES

1. Bank for International Settlements (2008) Addressing financial system procyclicality: a possible framework. Note for the FSF Working Group on Market and Institutional Resilience [http://www.fsb.org/wp-content/uploads/r_0904e.pdf?page_moved=1] Accessed 08.02.2018

2. CNB Notification on the review of the identification of other systemically important credit institutions in the Republic of Croatia
[https://www.hnb.hr/documents/20182/2293349/e-priopcenje-preispitivanje-sistemske-vaznih-ki-u-RH_22-2-2018.pdf/cb8b76ed-6aef-4a4d-aac0-defa83565ccd]
Accessed 08.02.2018
3. DAB publication:
file://hnb.local/hnb/Users01\$/dhlupic/Downloads/DEPOZITI%2031122016%20(1).pdf
4. DAB Decision of initiation of resolution procedure on Jadranska bank:
[<http://www.dab.hr/novosti/3>] Accessed 08.02.2018
5. European banking authority on single rulebook:
[<https://www.eba.europa.eu/regulation-and-policy/single-rulebook/interactive-single-rule-book>] Accessed 08.02.2018
6. European Central Bank on banking union
[<https://www.bankingsupervision.europa.eu/about/bankingunion/html/index.en.html>] Accessed 08.02.2018
7. European Central Bank on supervision
[<https://www.bankingsupervision.europa.eu/about/thessm/html/index.en.html>]
Accessed 08.02.2018
8. European Commission on single resolution mechanism
[https://ec.europa.eu/info/business-economy-euro/banking-and-finance/banking-union/single-resolution-mechanism_en] Accessed 08.02.2018
9. CNB list of credit institutions undergoing bankruptcy proceedings
[<http://www.hnb.hr/en/core-functions/supervision/list-of-credit-institutions>]
Accessed 08.02.2018