



CHALLENGES FOR DEPOSIT INSURANCE AND FINANCIAL STABILITY IN EUROPEAN COOPERATIVE BANKS

Liliana Aurora CONSTANTINESCU

“Dimitrie Cantemir” Christian University, Faculty of Finance, Banking and Accountancy, E-mail: lilianaauroracon@yahoo.com

Abstract *In this article we highlight the main measures taken to protect depositors in the banking system and to strengthen the effectiveness of deposit guarantee schemes in the banking system. The global financial economic crisis has unveiled significant lows in the regulation and supervision of the international financial system. Cooperative banks wish to play a decisive role in consolidating the banking sector within the enlarged EU and to offer their clients services that are perfectly tailored to their needs. This article describes how credit guarantee schemes are being implemented in European Cooperative Banks and points to some of the problems faced, as well as the advantage of such schemes.*

Key words:

Cooperative banks,
deposit insurance,
financial stability,
crisis management,
economic crises

JEL Codes:

G01, G21, G23

1. Introduction

The economic crises reflects the difficulties of the economic activity, that is slowing down, stagnation as a serious fracture of the macroeconomic equilibrium especially of the equilibrium between production and consumption between demand and supply, between the extent to which the production factors are used and the level of employment, between the level of prices and the purchase power of the citizens etc. Financial crises reflect serious malfunctioning of financial system of all countries, which are the significant deficits of the public budgets. Financial crises may appear as a result of accidents (significant reduction of money collected to the budgets), unforeseeable shocks to the real economy due to hasty decisions of the management that trigger exaggerated expenses, thus ignoring risks, etc., as the case may be consequently, economic-financial crises are caused by crisis-generating elements that pertain to both categories and negatively influence, both fields of activity.

Crisis management is a very complex task involving both predictive capacity crisis, creation of scenarios for keeping control and solving them and the feedback when crisis appear. Their solution is achieved by identifying the causes, an important activity for any organization, because research helps, as a crisis is likely to recur.

The importance in resolving crises is a decision effectively and rapidly made and efficient communication. Because crises can change public opinion about the organization in a negative image, public relations experts must communicate with the

public so the organization can regain the place held in public opinion.

2. Deposit guarantee schemes and the banking system stability

In Europe and elsewhere in the world, the banking system is built and develops as an open system, which enables it to organise its activity through mobilising its own resources and to continuously adapting to market signals and economic developments, of which it is a cause.

The Cooperative Bank appeared in Romania in 2007. It was necessarily to change the organisational structure of credit cooperatives as soon as Romania joined the EU, in accordance with G.E.O. no 99/06.12.2006 on credit institutions and capital adjustment, approved through Law no 227/2007, with subsequent amendments. The implementation and transposition of European Parliament and Council Directive no 2006/49/CE of 14 June 2006, regarding the adjustment of the capital of investment companies and credit institutions, needed to be completed by the end of 2006 (a deadline established as part of accession negotiations). The procedure to pre-notify the European Commission of the entire legislative framework adopted was performed in the spring of 2007.

Within the EU, the European Association of Cooperative Banks is an important organisation with an intense and varied activity, involved in all European Commission activities regarding the cooperative banking system. As from April 2003, Romania has been

a part of the European Association of Cooperative Banks, alongside Austria, Belgium, Bulgaria, Cyprus, Switzerland, France, Finland, Greece, Germany, Italy, Hungary, Luxembourg, the Netherlands, Poland, Portugal, Spain and the UK. Congresses of the European Cooperative Banks take place annually, hosting debates on the following themes: financial markets, accounting and auditing, social responsibility, social and assisted development, banking legislation, payment systems, consumer protection and social affairs. The Congress is also the time for presenting the financial statement for the current year and the budget for the following year, as well as initiatives to increase the profile and to consolidate the position of the cooperative banks within the European banking system.

With specific characteristics, Cooperative Banks are recognised both by national and by European legislation. They are valued by all financial rating agencies and ranked as a real banking force.

Cooperative banks contribute to financing local economies and have the capacity of meeting the needs of co-operating members and of other clients. They are a moving force of cohesion and social integration and attempt to combat financial exclusion, so that all social categories in the demographic system may have access to financial services, without any discrimination. Cooperative banks equally play an essential part through their staff and collaborators, as the personnel of these banks accounted for 15% of all European employees over the last three years.

Furthermore, local and regional cooperative banks are the most important contributors to municipalities and local communities and also participate in regional economic development.

Starting with 2008, bankruptcies of the credit institutions in the United States generated a big financial crisis that has significantly affected the economy of the most countries of the world. To limit the effects of the crisis and restore confidence in the banking system, states have taken various measures, including providing substantial loans to banks in liquidity crisis, nationalization, as well as measures taken to increase the effectiveness of deposits guarantee schemes in the banking system have also been designed. Furthermore, different measures were implemented to reduce risk in the banking system, such as the strengthening of banking regulation and supervision, to avoid future situations similar to those in 2009.

Banking bankruptcy distorts capital allocation and, in most cases, lead to a decrease in the real economy.

There are several mechanisms that allow the banking system to cope with the phenomenon of

massive withdrawals from banks. The most effective of these is the deposit insurance.

Guaranteeing deposits provide depositors confidence that their guaranteed deposits are safe, which eliminates the panic, the main reason for the massive withdrawals from banks.

Guaranteeing deposits is seen primarily as a means to protect depositors of credit institutions, and secondly as a means of ensuring the stability of the banking system by preventing excessive withdrawals from credit institutions when the problems or suspicions public on the problems of one or more credit institutions.

Deposit guarantee schemes are set up and operated to meet specific goals, such as:

- a. protecting the interests of small depositors by providing the mechanism for reimbursement of deposits;
- b. encouraging sophisticated depositors to monitor banks and to impose market discipline;
- c. reducing government obligations and order banks to help solve the cost problem banks;
- d. increasing competition in the financial sector;
- e. creating formal mechanisms to resolve bank failures;
- f. avoiding financial crisis;
- g. promoting financial stability;
- h. encouraging saving and promoting economic growth;
- i. contributing to a disciplined system of payments;
- j. encouraging economic growth;
- k. reducing the effects of economic recession.

Analysing the literature, one can identify three main approaches in terms of complexity sought when establishing a deposit guarantee scheme. The easiest type is representing only one guarantee fund that can pay the guaranteed deposits (pay-box). A scheme like this is focused on targets reflected in points a) – d). The first three objectives are the starting point of any deposit guarantee scheme. The fourth objective, namely, increased competition in the financial sector, competes simultaneously with the first three because those deposits guarantee allow credit institutions, the smaller ones or the newly entered the market, to inspire enough confidence to depositors. In the absence of a guarantee scheme, depositors tend to choose bigger credit institutions from the market, and precisely because of their size, are considered more robust and, therefore, safer than the small ones. A more complex guarantee scheme, called guarantee fund with extensive powers, aims objectives related to liquidation of bankrupted credit institutions and financial crisis avoidance (see points e) and f)). Time seeking to reduce risks (minimize risks) – the deposit guarantee scheme will follow all the specific objectives.

Research shows that the most common type of guarantee scheme is a pay-box, while the objectives that lead to power monitoring, financial assistance and restructuring and liquidation of credit institutions are found in practice in a few countries (best known example being the FDIC -Federal Deposit Insurance Corporation, the agency that provides U.S. deposits).

Deposit guarantee schemes are created in order to strengthen the banking system stability. Numerous studies have shown that the establishment of deposit guarantee schemes has resulted in reducing the number of bank failures, and when they occurred, had less influence on other credit institutions in the system.

It is known that deposit insurance has also negative side effects, the most obvious of which is represented by moral hazard and adverse selection.

Some studies have looked at conditions in which to create and administer a deposit guarantee scheme which will lead to obtaining a higher degree of positive effects at its introduction and achieving low intensity side effects.

These studies have shown that deposit insurance is not a way to treat a banking system crisis. Setting up a deposit guarantee scheme can prevent a banking crisis, but once such a crisis broke out, deposit insurance involves high consumption of financial resources with modest results in terms of financial stability.

Guaranteeing deposits is an effective tool for ensuring stability of the banking system only if it is operated in conjunction with other specialized institutions, which form a financial safety net.

Creating new guarantee funds and the convergence of means they use, particularly in Europe, were strongly enhanced by the adoption of Directive 94/19/EC of the European Parliament and European Council of 30 May 1994 on deposit guarantee schemes.

The European Commission considered, however, that differences between EU countries in terms of deposit guarantee schemes parameters are too large and provide a different treatment of depositors in different EU countries, and, following consultations began in 2006, on 11 March 2009 adopted Directive 2009/14/EC amending Directive 94/19/EC as regards the coverage level and payment deadline. The new guarantee ceiling was set at (minimum) 50,000 euro per depositor, and since 2011, rising to 100,000 euro per depositor, and the deadline for payment was set at 23 working days.

Further, the European Commission provides the initiation of new amendments to the Directive on deposit guarantee, the main objectives being the following:

- a. simplification and harmonization of the scope of coverage;
- b. reduction of term of starting payments at 7 days;
- c. waiver to reduce the amount owed by the depositor with the amounts due to the credit institution;
- d. compulsory introduction of depositors signed forms with standardized information and information about DGF in the statements and advertisements;
- e. harmonization of financing arrangements of a DGF;
- f. setting target levels of FGD available resources;
- g. establishing the proportion between the ex-ante and ex post contributions to the DGF;
- h. introducing risk-based elements in the calculation of contributions of the credit institutions to the DGF;
- i. restricting the use of DGF funds for intervention in favour of banks with problems from which may benefit all creditors of a credit institution;
- j. the requirement that the DGF from the host country to act as sole contact point for depositors branches of other EU banks operating in that country.

The new form of a European directive on deposit guarantee and its final provisions will likely differ to some extent, against the stated objectives at the initiation of these changes.

In time of financial crisis, the negative effects of deposit guarantee, adverse selection and moral hazard, can be partly mitigated by measures to strengthen banking regulation and supervision, so that credit institutions with solvency problems to get quickly into special administration and to be restructured or closed down before their situation becomes very serious and affects heavily the banking system as a whole.

3. Conclusions

The European Union countries should learn from the experience of the global financial and economic crisis. We are stronger when we work together, and the success of getting out of the crisis depends, therefore, on a close coordination of the economic policy.

"The crisis has exposed fundamental problems and unsustainable trends which can no longer be ignored. Europe has a deficit of growth which puts our future in danger. We need to decisively resolve the vulnerability and fructify our many advantages. We need to build a new economic model based on knowledge, on an economy with low carbon and high labour employment. This battle requires a mobilization of all the stakeholders in Europe". (Barroso, J., M., 2010)

References

Liliana Aurora Constantinescu, *The global financial-economic crisis and the main priorities of the European*

Union for 2020, Bulletin of the Transilvania University of Braşov (2013);

Liliana Aurora Constantinescu, Adrian Constantinescu, *Challenges, opportunities and solutions in European banking system*, Knowledge Horizons-Economic, vol. 5, Issue 4. (2013);

Adrian Constantinescu, *European Cooperative Banks and contemporary economic crisis*, Knowledge Horizons Economics, Bucharest (2011);

Liliana Aurora Constantinescu, *Managementul financiar bancar*, Ed. Lux Libris (2010);

Willem, H. Buijter, *Good Banks Are the Cost Effective Way Out of the Financial Crisis*, The Wall Street Journal (February 2009);

Mugur Isărescu, *Criza financiară internațională și provocări pentru politica monetară din România*, Disertație susținută cu ocazia decernării titlului de Doctor Honoris Causa al Universității Babeş-Bolyai. Cluj-Napoca (2009);

Daianu, D., *What this financial crisis teaches us*, Europa Voice (2008).