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OVERVIEW OF THE FRAMEWORK FOR CRISIS MANAGEMENT IN THE FINANCIAL SECTOR OF BOSNIA AND HERZEGOVINA: STATUS QUO?

Dina Bajraktarević Pajević, PhD
Faculty of Criminalistics, Criminology and Security Studies, Sarajevo
E-mail: dbajraktarevic@fkn.unsa.ba

Marija Lučić – Ćatić, PhD
Faculty of Criminalistics, Criminology and Security Studies, Sarajevo
E-mail: mlucic@fkn.unsa.ba

Muamer Kavazović, PhD
Faculty of Criminalistics, Criminology and Security Studies, Sarajevo
E-mail: mkavazovic@fkn.unsa.ba

Abstract:

The research findings presented in this article aim at explaining the framework of crisis management in the financial sector of Bosnia and Herzegovina (B&H). This framework is supposed to ensure financial stability even in the circumstances of business failure of institution, which could cause systematic damage. Based on the critical analysis of market conditions and legal and institutional frameworks established in the B&H, and having in mind the supranational nature of the crisis in the financial sector, the authors argue that an adequate mechanism for a resolution of any crisis situation must be founded on the measures that ensure accountability, transparency and integrity of all participants in the financial system. Recent legislative initiatives in the EU financial sector have resulted with an innovative framework of crisis management and tremendously comprehensive integration in the field of financial law. For that reason this research includes also an evaluation of the extent to which elements of this modern European mechanism for dealing with crisis situations in financial sector are included in the legislative implemented in the fragmented legal and institutional framework of B&H.

Keywords: financial sector, financial stability, financial crisis, crisis management in banking

1. Introduction

Despite the noticeable increase of theoretical and practical interest for crisis and crisis management in the last couple of years, it can be generally concluded that only a superficial understanding of the phenomena has been achieved (Bundy et al., 2016:2). This is especially accurate when it comes to the crisis events and their treatment in financial sector. Namely, until the financial crisis in 2007, the crisis management had been hardly known in the context of the financial sector. Wessels (2015) refers to terra incognita, even within the banking sector, which is especially susceptible to crisis events. However, the great extent of the financial crisis' consequences, caught the attention of experts and academics, but also of legislators and tax payers. There was a general consensus that it is necessary to create effective mechanisms for crisis prevention and crisis management in the financial sector. Even though this standpoint was not ground-breaking, but rather a typical result of analyses after the crisis events, which usually occur in this sector regularly and mainly due to same or similar reasons (see: Cho, 2010; Agenor and Azenman, 1999; Singh and LaBrosse, 2012), for the first time coherent studies were developed on the basis of optimal approaches to the crisis events (prevention, management and remediation of the consequences) that cover all three levels of regulative interventions (global, regional and national) (Singh and LaBrosse, 2012).

The latest financial crisis indicated the need for improvement of the traditional apparatus, used so far by the key bodies of the so called financial security networks (such as, prudential regulation by supervisors, central bank interventions, deposit insurance systems, etc.). What was needed was an adoption of new and reliable tools that should be a product of the analysis of the best practices regarding prevention and control of crisis events within the financial sector. Even though the state activities undertaken during the last financial crises (such as: capital injections, guarantees of the assets and liabilities, liquidity support, etc.), achieved their goal - i.e. stabilization of the financial system, they also caused significant stress to the public finances and disturbed the equality of market conditions (COM 2010, 579). Systemic financial institutions, such as banks, were a core problem because they could not continue with normal functioning in state of insolvency, and their removal from the system meant an imminent cause of a significant system damage. The doctrine "too big to fail" (Huertas 2015, 3) proved unsustainable due to the damage caused to public finances, destruction of competition and promotion of risk behavior (COM (2010) 579:2; Huertas, 2015:3), and it was necessary to initiate a reform that would ensure solving of the problem of failed banks, and that will ensure that the entire burden of the negative economic consequences (expenses) caused by failure of the bank be covered by investors, not tax payers (Preamble para. (1); Article 34 of the Directive 2014/59/EU (OJ L 173/90/2014), while on other hand will make it possible for a bank in problem to continue with the performance of its vital functions during the procedure of its resolution. The emphasis in the regulation should be on prevention of risky situations that banks can encounter, and that are generators of a systemic risk, as well as to establish a regime that will reinforce the discipline on financial markets through reduction of implicit protection mechanisms that produce moral risk.

2. Crisis Management Framework in the Financial Sector of Bosnia and Herzegovina

In the financial sector of Bosnia and Herzegovina (B&H), the effects of the global financial crisis culminated at the end of 2010, when activities of commercial banks were stalled by weakening of domestic demand, and the system level losses were significant (Central bank of B&H, 2011). The wrong assessments of client quality and aggressive politics of lending in pre-crisis period caused increased reservation expenses. Nevertheless, despite the problems within certain banks, the banking sector as a whole, absorbed shocks and continued to perform its functions, while other financial intermediaries (leasing companies and micro crediting organizations) suffered the consequences of unregulated sector with unappropriated business politics, and all of that caused significant loss increase in business activities of those parts of financial sector (Central bank of B&H, 2011). Unlike the prior periods, the effects of reducing activities in the banking sector started in 2011 and spilled into the real and external sector of B&H's economy (Central bank of B&H, 2012). During this period, the credit risk was still dominant in the banking sector and its increase was caused by deterioration of macroeconomic conditions. In order to mitigate the credit risk, banks were undertaking significant activities that stabilized the banking system. However, the long-term effects of these activities were conditioned by the changes of inadequate credit policies of the banks in previous period. According to the Report on Financial Stability for 2011 (Central bank of B&H, 2012), a majority of the banks decided to implement a policy of reprograming of existing claims and their replacement with new credits with changed terms of repayment, activity that aimed at the improvement of possibility of servicing current debits. Other banks decided to transfer the part of credit portfolio to separate legal entities. From the reports of Central Bank of B&H on financial stability, it is obvious that development of the banking sector and credit activity significantly depend on financing from abroad, which is under influence of strategies that foreign banking groups are applying to its subsidiaries in B&H.

During the latest financial crisis, the financial sector maintained its stability, but the problems remained: increase of internal and external public debt, slow recovery of domestic consumption, continued low indicators of the living standard, and the lack of significant investment cycle in the country, continually represent significant threat for stability of B&H financial sector (Central bank of B&H, 2016; Central bank of B&H, 2017). Furthermore, the risk for financial sustainability is still present, due to expected pressures of external debt repayment in the following years, especially if one takes into consideration the lack of credit arrangements with international financial institutions. Due to the identified fiscal weaknesses and the political situation in the country, B&H rating, according to the assessment of leading rating agencies, is still in the zone of speculative credit standing with high credit risk (Central bank of B&H, 2017).

Prevention and control of risky situations in B&H financial sector represent a complex task, having in mind specifics of its political system where existence of two Entities indicates divide into two financial markets with separate institutional and legislative structure. Restricted apparatuses for dealing with the crisis events, which currently exist in the B&H, also reflects afore mentioned specifics, and its efficiency in maintenance of financial stability is questionable. Namely, Central

bank of B&H lacks functions which institutions of such nature usually have in financial sector. It does not have supervisory role, and it only can coordinate activities of banking agencies in the Entities, which are competent for issuing of banking licenses and conducting supervision of the banks within the Entities (Article 2(3) of the Law on Central bank of B&H). Restriction of B&H's monetary politics by currency board arrangement is manifested in a form of incapability to use basic instruments of monetary policy by the Central bank of B&H; it cannot lend to the state, in order to cover the budget deficit nor it can approve credits to commercial banks in order to protect liquidity of banking system – it does not have the role of the lender of last resort. Furthermore, Central bank does not get involved in any activities on money market, including the securities of any kind (Article 37 of the Law on Central bank of B&H); the only instrument of monetary politics that it has on its disposal are mandatory reserves (Article 36 of the Law on the Central bank of B&H). Therefore, this is institution that cannot be considered as the first line of defense in the case of crisis events (for comparison see Gabilondo 2015, 24).

Another traditional instrument of protection of stability present in financial sector of B&H is deposit guarantee system established on the state level, and managed by Deposit Insurance Agency of B&H („Official Gazette of B&H" no 20/02,18/05, 100/08, 75/09 and 58/13). It provides coverage to all eligible deposits in member banks (Article 3. of the Law on deposit insurance in banks in B&H). The highest amount of insured deposit, including the accrued interest, to be reimbursed by the Agency per depositor in member bank, is the eligible deposit in amount of BAM 50.000,00 reduced for the legal or contractual debt of depositor toward the member bank (Article. 4(1) of the Law on deposit insurance in banks in B&H). Membership in deposit guarantee system is mandatory for all banks licensed by the supervising banking agencies in the Entities and who fulfill all the membership requirements set by the Agency. This system is operating as so called „pay-box" and does not have additional monitoring functions. Since the establishment of this system, there have been two insured events in 2015 and 2016 (both occurred in the Entity Republika Srpska), where payment of insured deposits was requested: Bobar Banka and Banke Srpske. According to the information published on the official web page of the Deposit Insurance Agency of B&H, the procedure of payment of insured deposits started on 19 January 2015, in total amount of BAM 86.6 million for 21.400 depositors. On 28 June 2016, the total amount that was reimbursed was BAM 85.4 million (or 98.4% of insured deposits value) and to 14.500 depositors, (68% of total number of depositors). In the case of Banka Srpske, the procedure started on 23 May 2016. On 28 June 2016, the total amount that was reimbursed was BAM 49 million (88% of total amount of insured deposits) and to 8100 depositors (56% of total number of depositors). Since the process of liquidation started, the Agency has collected BAM 67 million in the case of Bobar Banka, and BAM 28 million in the case of Banke Srpske in the liquidation process, that is from the total required amount of BAM 142 million, the Agency collected BAM 95 million.

Having in mind aforementioned, it may be concluded that established system of deposit insurance is able to accomplish its main task, the protection of small depositors from losing their deposits within the banks, at least when it comes to minor banks. System performance proved to depositors that safety net is available, and relatively low level of insured deposit (per depositor)

reduces the possibility of moral hazard. However, exclusive role of the „pay-box"system does not contribute to better stability of the banks. The research studies showed that banking stability is better in the countries where systems have supervising authorities, as well as competence of intervening in banks that are in problems (Gerhardt and Lanoo, 2011:4).

B&H does not have single supervising and regulatory body and the functions of monitoring and supervision are performed by two agencies at the Entities level (Article 4 of the Law on Banking Agency of FB&H ("Official Gazette of FB&H", no. 9/96, 27/98, 20/00, 45/00, 58/02, 13/03, 19/03, 47/06, 59/06, 48/08, 34/12 and 77/12; and Article 4 of the Law on Banking Agency of Republika Srpska („Official Gazette of RS", no. 59/13 and 4/17). Both agencies were involved in process of developing new legislation in banking sector during the 2016 and first half of 2017, which should reinforce their supervision functions and stablish comprehensive framework for bank restructuring (Central Bank of B&H, 2017). Even though upgrade of regulatory framework was carried out with an intention of modernization and approximation of national legislation with legislation of EU and also improvement of business environment of financial intermediaries (Central bank of B&H, 2017:45), delays and fragmented approach in transposing the relevant acquis communautaire reasonably raise doubts in the real fulfillment of the objective of strengthening the stability of banking sector. From the perspective of crisis management, new regulations focused on risk management and bank capital are central. Drafting and adoption of these documents were partc of the activities towards upgrading the regulatory framework of the entity banking agencies in accordance with the strategies for adoption of "International agreement on capital measurement and capital standards" (Basel Committee on Banking Supervision 2009), and for accomplishing the goal of implementation of Directive 2013/36/EU (OJ L 176/338/2013) and Regulation 575/2013.

New banking legislation addressed the issue of risk management in banks. Regarding the risk management within the bank, importance should be given to the provisions of the new Law on banks in Federation of B&H (FB&H) contained in Articles 79, 80 and 81 and in Articles 89 and 90 of the Law on banks in Republika Srpska (RS). These provisions create specific legal framework for risk management. According to the laws, the banks are obliged to establish and implement risk management system in an efficient and reliable manner, proportional to the type, scope and complexity of business activities that are performed and to the risks inherent to its business model (Article 79 of the Law on banks in FB&H; and Article 89 of the Law on banks in RS). Every bank must establish comprehensive and efficient risk management or at least through its internal documents clearly and accurately define authorizations and responsibilities in risk management for all organizational levels (through strategy, policy and procedures for risk management), and to establish risk management processes and procedures (See Article 80 of the Law on banks in FB&H; and Article 89(1) of the Law on banks in RS). It is also provided that operationalization of these provisions will be achieved through adoption of bylaws focused on prescribing the elements of risk management system, as well as the procedures of internal capital adequacy assessments of the bank, which should cover all the risks in banks business activities (Article 80(5) of the Law on Banks in FB&H; Article 89(5) of the Law on Banks in RS). The risk management system has to be established in a way to cover all risks to which certain bank is exposed or could be exposed during

its business activities. Those risks should be defined in its strategy, policy and procedures for risk management, and at least following risks: credit risk, liquidity risk, market risks (position risk, currency risk, commodity risk and other market risks) operational risks, interest rate risk in banking book, country risk, compliance risk, concertation risk, settlement risk, settlement risk, strategic risk, reputation risk and other risks (Article 81(1) of the Law on banks in FB&H; and Article 90(1) of the Law on banks in RS). Consequently, Agencies adopted decisions on the risks management, which lay out quality requirements that bank is obligatory to apply in risk management, as an integral part of healthy corporative management and it is closely related to implementation of process of internal evaluation of adequacy of bank capital (Central bank of B&H, 2016:60). These decisions prescribe minimum requirements for managing the risks to which bank is exposed or may be exposed in its business and is an integral part of the general rules relating to the establishment and application of internal management system in the bank (Article 1 of the Decision on the risks management in banks of the Banking Agency of Federation of B&H; and Article 1 of the Decision on the risks management in banks of the Banking Agency of RS). Also, they prescribe general standards in risks management and special standards for management of individual categories of defined risks. Banks have obligation to establish and implement comprehensive, reliable and efficient system of internal management, which has to be proportionate to the type, extent and complexity of bank's business i.e. to the bank's risk profile (Article 4(1) of the Decision on the risks management in bank, Banking Agency of Federation of B&H; and Article 4(1) of the Decision on the risks management in bank, Banking Agency of RS). The internal management system must include: transparent organizational structure with clearly defined and consistent levels of responsibility; effective and efficient processes for determining, measuring/assessing, controlling, monitoring and reporting on risk exposure; adequate internal control mechanisms, which include clear administrative and accounting procedures; remuneration policies and practices that are consistent with assumed risks and which promote stable and efficient risk management; adequate internal capital adequacy assessment process and internal process of liquidity adequacy assessment; and recovery plans (Article 4(2) of the Decision on the risks management in bank, Banking Agency of Federation of B&H; and Article 4(2) of the Decision on the risks management in bank, Banking Agency of RS). Through adoption of their business strategies the banks have to set goals given its long-term economic interests and liquidity, undertaking and management of risks and amount, type and distribution of capital that is result of internal capital adequacy assessment process and regulatory capital which ensure coverage of bank's risks (Article 5(1) of the Decision on the risks management in bank, Banking Agency of Federation of B&H; and Article 5(1) of the Decision on the risks management in bank, Banking Agency of RS). On the basis of business strategy and objectives established by it, they also must adopt appropriate policies, procedures and other internal risk management documents. The bank's supervisory board adopts these strategies and policies proposed by banks management board and ensures that they are subject to and independent review by the internal audit. Implementation of these acts at all levels of decision-making and in all business activities of bank is entrusted to the management board (Article 5(3) of the Decision on the risks management in bank, Banking Agency of Federation

of B&H; and Article 5(3) of the Decision on the risks management in bank, Banking Agency of RS). The process of risk management involves regular and timely identification, measurement or evaluation, control, monitoring and risk control, including the reporting on the risks to which bank is exposed or could be exposed in business (Article 7 of the Decision on the risks management in bank, Banking Agency of Federation of B&H; and Article 7 of the Decision on the risks management in bank, Banking Agency of RS). This includes risks arising from the introduction of new services, products or systems, significant changes in existing services, products or systems, performance in new markets, trading with new instruments, or conducting similar transactions that the bank has not previously executed (Article 7(1) of the Decision on the risks management in bank, Banking Agency of Federation of B&H; and Article 7(1) of the Decision on the risks management in bank, Banking Agency of RS). The laws require that bank must provide independent assessment of the functioning of the risk management system by internal and external audit (Article 80(4) of the Law on banks in FB&H; and Article 89(2) of the Law on banks in RS).

Regulatory capital adequacy is concept in the focus of contemporary banking regulation and implies extent to which bank's assets exceed its liabilities (Posner 2014). The laws on banks prescribe obligation of the bank, depending on the risk profile and systemic significance, to ensure at any time amount of capital adequate to the types, scope and complexity of business that preforms and the risks to which it is exposed or could be exposed in its business. Regulatory capital of the bank represents the amount of resources of assets, which bank has to maintain for the purpose o safe and stable operations, that is fulfillment of obligations to creditors. Regulatory capital is a sum of basic and supplementary capital, after regulatory adjustments (Article 3(2) of the Decision on calculation of bank's capital of the Banking Agency of the Federation of B&H; Article 3(2) of the Decision on calculation of bank's capital of the Banking Agency of RS). The bank is obliged to meet at any time the rate of regulatory capital adequacy and at least at the level of 12%. The regulatory capital adequacy rate of the bank represents the ratio of regulatory capital to total amount of exposure to risk. The Banking Agency of FB&H has prescribed the characteristics and types of items that are included in the calculation of regulatory capital; the manner and scope in which the individual items are included in the calculation of individual parts of the regulatory capital; financial leverage rate; protection layers of capital and measures for the protection of capital of banks; and capital requirements and methodology for calculating capital requirements. The bank assesses the capital adequacy in relation to the type and level of risk it is exposed or could be exposed to in its business. Also, the bank is required to establish and implement adequate and comprehensive strategy and procedures for a continuous internal capital adequacy assessment process and is obliged to continually review them in order to ensure that they are comprehensive and consistent with the nature, scope and complexity of the activities it performs.

The process of internal evaluation of adequacy of bank capital is defined by separate legal acts (Decision on the internal process of capital adequacy assessment in the bank of the Banking Agency of the Federation of B&H, "Official Gazette of the Federation of B&H" no 81/17), according to which banks are obliged to assess internal capital requirements for other significant risks in business, which they will determine on the basis of their risk profile (Central bank of B&H, 2016:60).

During the procedure of internal evaluation of capital adequacy, banks must measure the risk using the quantitative methods, and if it is difficult to quantify it, they will evaluate significant risks using methodology and approaches that are the most suitable for bank's organization and business activities. The banks are obliged to adopt a capital strategy whose implementation will ensure an adequate, efficient and comprehensive capital planning that, in addition to the prescribed minimum regulatory capital, covers all other risks the bank is exposed to or may be exposed to in its business as well as continuous valuation procedures and maintenance of capital resulting from the implementation of internal assessment of capital adequacy procedure. In addition to the strategy, banks are obliged to adopt a capital management plan that clearly defines: strategic goals and deadlines for their realization, taking into account the macroeconomic environment and the economic cycle phases; capital planning and accountability procedures; the method of achieving and maintaining an adequate level of capital as a result of planning in the future period, and at least for the period of the next three years; action plan for unexpected situation that will define measures to maintain an adequate level of capital as a result of capital planning (e.g. the way of obtaining additional capital, limiting business activities, etc.); dividend policy, in line with the regulatory requirements for regulating capital and capital maintenance as results of internal assessment of capital adequacy procedure; and policy and practice determinants for determining and paying variable fees to the management and key employees of the bank that significantly influence the risk profile of the bank, with reference to compliance with the regulatory capital requirements. The banks are obliged, on a continuous basis, to establish and implement the appropriate documented procedure for establishing and securing adequate capital levels as a result of the of internal assessment of capital adequacy procedure and corresponding to the nature, scope and complexity of the bank's activities, taking into account the risk profile, risk management system and the techniques used to reduce the risk. When selecting a procedure for determining and securing an adequate level of bank capital resulting from internal procedure of capital adequacy assessment, the bank may also consider other factors such as market position, entry into new markets, capital availability and takeover of other companies, and other strategic goals. The impact of these factors on the amount of estimated capital as a result of the internal procedure of capital adequacy assessment has to be analyzed and documented by the bank.

Since 2016, the banks comply with the regulatory provisions of the decision on capital and capital protection banks (Decision on minimal standards for capital management and capital protection of the Banking Agency of the Federation of B&H ("Official Gazette of the Federation of B&H" no 46/14; Decision on minimal standards for capital management and capital protection of the Banking Agency of the RS, "Official Gazette of the RS" 57/14) in terms of the level and conditions for the recognition of supplementary capital items, as well as the requirements for the protective layers of capital to be fulfilled. Consequently, there have been changes in the structure of regulatory capital, which are reflected in an increase in the share of the base and the reduction of the supplementary capital, thus ensuring the improvement of the quality of regulatory capital (Central bank of B&H, 2017:49).

Although the financial sector in B&H has so far been able to overcome crisis events without significant threat to its stability, the previous brief overview makes it obvious that the established apparatus, which is at disposal of key players of banking sector, is limited even if compared with traditional forms of financial security systems. Financial security network of B&H cannot rely on system of deposit insurance. In order to ensure efficiency of system of deposit insurance, other elements such as strict prudential regulation and monitoring, adequate corporative management, legislation with efficient sanctions that are applied and correct accounting regimes and regimes of disclosure of relevant information, must be established as its support (Clarke, 2015:365). At the same time, all above mentioned elements are prerequisites for introductions of measures that will ensure accountability, transparency and integrity of all players within financial sector. Continued improvements of regulatory framework in both Entities are necessary, especially if we take into consideration the fact that establishment of an adequate framework of crisis management is the next step in the process of obligatory harmonization of national legislation with solutions implemented in European Union (EU) after the financial crisis.

3. EU concept of Crisis Management in the Financial Sector

Financial crisis indicated the problem of absence of appropriate instruments at the EU level that would efficiently solve the problem of unhealthy or failing financial institutions. The response of the European Union to the crisis was formulated through adoption of several quasi-legal and legal instruments. New EU framework focuses on three key areas of crisis operations: crisis prevention, crisis management and reparation of consequences and implied the intervention in a form of transfer of new regulatory and supervisory functions from national level to union level. These activities, at the end, resulted in stronger institutional players (such as European monitoring body for banking sector, European monitoring body for insurance and occupational pension funds and European board for system risk) and new legislations: Directive 2014/49/EU on deposit guarantee schemes (OJ L 173/149/2014) and Directive 2014/59/EU on bank recovery and resolution (OJ L 173/90/2014). Both legal instruments are tools of minimal harmonization. This means that member countries can pass or keep more strict rules or additional rules in comparison to rules determined by directives or delegated and implementing acts that are passed based on these rules, but the national rules cannot be contrary to the decisions within union acts.

Directive 2014/49/EU on deposit guarantee schemes is an upgrade of the system established by Directive 94/19/EZ (OJ L 135/5/1994) that was based on the principle of minimal harmonization, and due to this fact, there are numerous deposit insurance systems that are established within the Union, with very different characteristics (Preamble of the Directive 2014/49/EU, para. 1). In the recent financial crisis, uncoordinated increases in coverage across the Union have in some cases led to depositors transferring money to credit institutions in countries where deposit guarantees were higher. Such uncoordinated increases have drained liquidity from credit institutions in times of stress. The key elements of the framework established by Directive 2014/49/EU are:

- Establishment of coverage level for aggregate deposits of each depositor is EUR 100 000 in the event of deposits being unavailable (Article 6(1) of Directive 2014/49/EU);
- Gradual reduction of payment period during transitional interval until December 31, 2023;
- Better regulated system of financing deposit guarantee scheme. Deposit insurance schemes obtain financial means through contributions made by their members at least annually, with a possibility of financing from other sources (Article 10(1) of Directive 2014/49/EU). The Member States shall ensure that, by 3 July 2024, the available financial means of a deposit guarantee scheme shall at least reach a target level of 0,8 % of the amount of the covered deposits of its members (Article 10(2)). Financial means of deposit guarantee scheme can be used for: payment of depositors and financial resolution of credit institutions, according to Directive 2014/59/EU (Article 11(1) and (2) of Directive 2014/49/EU);
- Establishment of possibility of borrowing between deposit guarantee schemes within the Union, on voluntary basis (Article 12 of Directive 2014/49/EU);
- Enhancement of depositors' information. Credit institutions are obligated to make available to actual as well as to potential depositors the information necessary for the identification of the deposit guarantee scheme of which the institution and its branches are members within the Union and shall ensure that credit institutions inform actual and potential depositors of the applicable exclusions from deposit guarantee scheme protection (Article 16(1) of Directive 2014/49/EU). The fact sheet in the annex of Directive, should be submitted to depositor, at least once a year. Official web page of scheme should provide information that depositors need, especially information on provisions related to procedure and requirements of deposit insurance.

Directive 2014/59/EU establishing a framework for the recovery and resolution of credit institutions and investment firms, sets the rules and procedures relating primarily to subjects which have business establishment within the Union, and in accordance with special conditions, also to the branch offices of institutions with business establishment outside of the Union (Article 1(1) of Directive 2014/59/EU). The key characteristics of the new framework for the recovery and resolution are:

- Establishment of the bodies responsible for crisis management – national resolution authorities that are empowered to apply resolution instruments and exercise resolution powers (Article 3(1) of Directive 2014/59/EU). Directive is strictly stating that this should be public administrative authority/authorities (Article 3(2) of Directive 2014/59/EU), such as national central banks, competent ministries of finance or other authorities entrusted with public administrative powers (Article 3(3) of Directive 2014/59/EU) and only in exceptional cases it allows that resolution authorities are competent for supervision.
- Prevention and preparation measures. Institutions are obliged to create and implement their recovery plan with defined measures for restoring their financial position in the case of its significant deterioration (Article 5(1) of Directive 2014/59/EU). Reviewing of recovery plans regarding its implantability is performed by competent authority that especially assess fulfilment of the following criteria: whether the implementation of the arrangements

proposed in the plan is reasonably likely to maintain or restore the viability of regular business and financial position of the institution or of the group, given the preparatory measures that the institution has taken or has planned to take; and whether is reasonably likely that the plan and specific options within the plan are implementable quickly and effectively in situations of financial stress while avoiding to the maximum extent possible any significant adverse effect on the financial system, including the scenarios in which would lead other institutions to implement their recovery plans within the same time period (Article 6(2) of Directive 2014/59/EU). When assessing the appropriateness of the recovery plans, the competent authority shall take into consideration the appropriateness of the institution's capital and funding structure to the level of complexity of the organizational structure and the risk profile of the institution. Beside the competent authority, recovery plan is also evaluated by the resolution authority that is attempting to identify any measures or actions in it, which may adversely impact possible resolution of the institution. Resolution authorities are obliged, in consultation with competent authority, to prepare resolution plan for each institution that provides: resolution actions that authority may take if that institution meets the conditions for resolution, important potential impediments to resolvability (and if it is necessary and proportionate, indicates all relevant actions for how those impediments can be addressed), and an analysis of how and when an institution may apply for the use of central bank facilities and identifies assets which would be expected to qualify as collateral. Resolution authority in consultation with the competent authority, assesses the extent to which institution (or a group) is resolvable without assumption of possibility for: extraordinary public financial support, central bank emergency liquidity assistance, or central bank liquidity assistance provided under non-standard collateralization, tenor and interest rate terms.

- Early intervention. In the case when institution violates or will possibly violate, in near future, requirements stipulated in Regulation (EU) No 575/2013 and Directive 2013/26/EU, the competent authority has on its disposal several measures of early intervention: implementation of one or more arrangements or measures from the recovery plan; analysis of the situation, problem identification and establishment of specific measures for overcoming those problems, and development of action program to overcome problems; convening of shareholders assembly; dismissal or replacement of one more members of management, if it is determined that those individuals are not capable of performing their duties; development of plan for negotiation of debt restructuring with certain or all creditors in accordance with recovery plan; modification of business strategy of the institution; change to the legal or operational structure of the institution; collection of all necessary information that will be forwarded to resolution body in order to update resolution plan and prepare institution for possible resolution of institution and for evaluation of assets and liabilities of the institution. In situation when there is significant deterioration in the financial situation of institution or where there are serious infringements of law and regulations or of statutes of institution, or serious administrative irregularities, and when

previously mentioned measures of early intervention are not sufficient to reverse that deterioration, the competent authority can request replacement of senior management or management body of institution (entire body or individual members), as well as to appoint one or more temporary administrators of the institution.

- Measures and tools of resolution. Resolution tools are: the sale of business tool; the bridge institution tool; the asset separation tool; and the bail-in tool. State tools of financial stabilization in comparison to resolution tools have subsidiary significance, and they may be used as a last resort. Tools of financial stabilization cover: public equity support tools and temporary public ownership tool. Wide range of powers of resolution authorities encompasses: the power to require provision of any information from any person, which are necessary for making decision and preparation of resolution action; the power to take control of an institution under resolution, and exercise all the rights and powers conferred to the shareholders, other owners and management body of institution under resolution; the power to transfer shares or other instruments of ownership issued by institution under resolution; the power to transfer rights, assets or liabilities of institution under resolution to another entity, with consent of that entity; the power to reduce, including to reduce to zero, the principal amount of or outstanding amount due in respect of eligible liabilities, of an institution under resolution; the power to convert eligible liabilities of an institution under resolution into ordinary shares or other instruments of ownership of that institution or relevant parent institution or a bridge institution to which assets, rights or liabilities of the institution are transferred; the power to cancel debt instruments issued by an institution under resolution except for secured liabilities; the power to reduce, including to reduce to zero, the nominal amount of shares or other instruments of ownership of an institution under resolution and to cancel such shares or other instruments of ownership; the power to require an institution under resolution or a relevant parent institution to issue new shares or other instruments of ownership or other capital instruments, including preference shares and contingent convertible instruments; the power to amend or alter the maturity of debt instruments and other eligible liabilities issued by an institution under resolution or amend the amount of interest payable under such instruments and other eligible liabilities, or the date on which the interest becomes payable, including by suspending payment for a temporary period, except for secured liabilities subject to Article 44(2); the power to close out and terminate financial contracts or derivatives contracts for the purposes of applying Article 49; the power to remove or replace the management body and senior management of an institution under resolution; the power to require the competent authority to assess the buyer of a qualifying holding in a timely manner by way of derogation from the time-limits laid down in Directive 2013/36/EU and 2014/65/EU.
- Establishment of European system of financing arrangements which consists of: national financing arrangements; the borrowing between national financing arrangements; and the mutualisation of national financing arrangements in the case of a group resolution.

4. Implementation of EU Solutions in the Legal and Institutional Framework of B&H

Evaluation of the extent to which elements of modern EU mechanism for dealing with crisis situations in financial sector are included in the legislative solutions implemented in the fragmented legal and institutional framework of B&H requires detailed analysis that surpasses the acceptable scope of this paper and therefore only general conclusions will be presented hereinafter.

As indicated, B&H deposit insurance system established at state level in 2002 has not been modified for the last past five years and therefore no approximation with new EU framework established by Directive 2014/49/EU is undertaken. New solutions focused on financial stability such as: uniform level of coverage of insured deposits, gradual reduction of payment periods, detailed regulation of financing of the deposit insurance system and improvement of information mechanism of depositors have yet to be implemented in legal framework of B&H.

Recent legislative activities in banking sector conducted with, inter alia, intention of harmonization of entities' banking legislation with EU legislation, have resulted with adoption of new legal framework but adopted laws do not transpose Directive 2014/59/EU and only partial approximation through implementation of certain solutions has been achieved. New legislation provides specific provisions on recovery plans, measures of early intervention, measures and instruments of resolution. Funds for financing resolution of banks may be provided from Deposit insurance fund in accordance with legislation regulating insurance of deposits in banks in B&H. Additional financing may be provided from other sources such as loans and other eligible forms of support from banks and third parties (Law on banks in FB&H). However, these funds may be used only if shareholders and other creditors participate in coverage of loses and capital increase by reducing the value, conversion and in other manner in amount of at least 4%. Funds of extraordinary public financial support may be used only if previously mentioned funds are insufficient or if they couldn't be timely secured.

5. Conclusion

Currently, B&H does not have established contemporary mechanism of crisis management in financial sector, therefore the next step in improvement of financial safety network should be creation of legal framework, which will be based on measures that guarantee responsibility, transparency and integrity of all participants within the financial sector. The emphasis in the future regulatory activities should be on prevention and control of risky situations that primarily banks can encounter, and not on resolution of consequences of the crisis events. Afore mentioned requires establishment of regime that will improve supervision, discipline and transparency on financial markets. B&H has yet to implement solutions from EU legislation that governs the area of crisis management, and due to complexity of country's organization, it can be assumed that the process will be slow and long lasting.

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