Croatian pre/post crisis perspectives
(with some legal considerations)

Impact of Financial Reforms in the Euro- Mediterranean Area
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Content

- At the crossroad
- Pre – crisis / pre EU accession regulatory efforts
- Current standing (post Basel III / CRD IV)
- Proportionality
- Diversity – legal point of view
Croatia - a view from the crossroad

- Crossroad: Geographical, Political, Cultural

- The last country joining the EU – July 2013

- CRD IV package transposing Basel III in EU
  - 27 June 2013 published
  - 31 December 2013 transposition deadline

- Almost simultaneous - EU accession and CRD IV transposition
Economic environment before EU accession (pre crisis)

- Global environment:
  - financial liberalization
  - high global liquidity, low risk aversion
  - yield hunt

  - stable real economic growth generated mostly by personal consumption
  - low inflation
  - excessive growth of bank placements to domestic sectors
  - increase in external debt due to external borrowing of banks and growing number of enterprises borrowing directly abroad
  - widening of the current account deficit
Regulatory (MP) measures before EU accession (pre crisis)

Some important pre-crisis regulatory measures:

- credit ceilings - restriction on credit growth
  - 16% (2003-2004)
  - 6%-12% (2007-2009)
- minimum required foreign currency claims
- marginal reserve requirements (MRR) 24 – 55% (2004-2008)
- special reserve requirement (2006 - 2008)
- high level of general reserve requirement (GRR)
  - certain % of foreign currency reserve requirement to be allocated in domestic currency (HRK)
- increased capital requirements (risk weights) for currency induced credit risk (2006, 2008)
- increased minimum capital adequacy ratio of 12% (2010-2013 Credit Institutions Act)
MP measures were introduced early and tuned timely

Shaded areas represent periods when banks' credit growth was regulated with compulsory CNB bills.

Source: CNB
Croatia and CEE countries – an avant-garde in scope and intensity of pre-crisis MP measures in Europe ...

Source: Lim et al., 2011 (Data from IMF Financial Stability and Macroprudential Policy Survey, 2010)
Similarly, until 2008 EMs were global outliers of MP policies

- Developed countries intensified their use only after 2008
- In Europe, MPP mostly used by CEE
- Most frequently used MPP instruments – related to:
  - credit activity
  - liquidity
  - capitalization

Note: The y-axis shows the number of countries that use MPP measures and instruments. Source: Bank of England (2014) IMF Financial Stability and Macroprudential Policy Survey 2010
What was accomplished by pre EU/pre crisis MP policies?

- Higher resilience of financial system
- Slower accumulation of systemic risk
- Good preparation for the crisis – legacy of early CAR and liquidity requirements
- No failing banks as consequence of crisis
- Legal test of MP measures
  - satisfactory legal efficiency of instrument regulating MP measures
  - no notable challenges in court or before Constitutional Court
  - circumvention of MP instruments nevertheless attempted
  - foreign direct lending (to corporates) as consequence of introduction of MP tools not prevented
Current state of play in Croatia (end 2017)

- CRD IV package in full application
- Capital buffers
- Risk weights for exposures secured by mortgages on RRE and CRE
- Risk indicators arising under CRD IV:
  - CAR 23,2 %
  - LCR 186%
- Still to come: CRR II
  - leverage ratios
  - NSFR
  - MREL / TLAC

**Applied:**
- 1st January 2015
  - CCB 0-2.5%
    - ('normal' upper limit)
- 1st January 2016
  - O-SII 0-5%
    - ('normal' upper limit)
- 19th May 2014
  - SRB 0-5%
    - ('normal' upper limit)
- 1st January 2014
  - CONSERVATION BUFFER
    - (adjustment deadline till 2015)

**Effective buffer rate:**
- 0%
- 0.2% or 2%
- 1.5% or 3%
- 2.5%
- 8%

**Additional capital requirements**
- Minimal capital requirements
- CRR II
  - leverage ratios
  - NSFR
  - MREL / TLAC

**CRD IV package in full application**

**Capital buffers**

**Risk weights for exposures secured by mortgages on RRE and CRE**

**Risk indicators arising under CRD IV:**
- CAR 23.2%
- LCR 186%

**Still to come: CRR II**
- leverage ratios
- NSFR
- MREL / TLAC
So, institutions are well capitalised, liquid, risk managed... ... but what about proportionality?

- No special treatment under CRD IV with respect to size, type or other specificities of institutions

- Reporting perimeter under CRD IV changed for all institutions uniformly:*
  - Before CRD IV (31 Dec. 2013) - 102 reports
  - After CRD IV (31 Dec 2017) - 206 reports

- Regulatory cost undeterminable, but possibly progressive along with the increasing reporting obligations

- Number of licensed institutions in Croatia decreasing (bankruptcy, transformation into branches, mergers, liquidation):
  - end 2013 - 35
  - end 2017 - 29
  - two recently announced mergers will likely decrease the number to 27

* the measure and comparison only numerical - merely indicative, not precise in every respect
Diversity – from a legal point of view

- Simultaneous transposition of Basel III into legislation of many jurisdictions globally almost unprecedented event in recent legal history.

- Uniform set of Basel standards vs. non-uniform transnational transposition and local application

- How transposition of standards into local laws and their application works in various countries:
  - Absorption capacity for implementation of laws/rules setting out complex matters
  - How they fit within the system of existing laws and interplay with other laws (compatibility - supranational / national)?
  - How they fit into legal culture?
Absorption capacity

"Regulatory Tsunami" for EU credit institutions (and supervisors)

- CRD IV package:
  - CRD IV (Directive)
  - CRR (Regulation)
    - 51 RTSs (Regulatory Technical Standards)
    - 33 ITSs (Implementing Technical Standards)
    - 3 Delegated acts
- ESRB Recommendations
- ... 

- BRRD (Bank Resolution and Recovery Directive):
  - 7 RTSs
  - 4 ITSs
  - 5 delegated acts
- DGSD (Deposit Guarantee Scheme Directive)
  - ....
- SSM (Single Supervisory Mechanism)
Are laws implementing (Basel) standards in individual countries sufficiently comprehensible for all stakeholders, in particular:

- industry
- regulators
- judges
- supporting service providers

Is terminology consistent with related laws and other instruments to enable uniform application?

Will it contribute to legal certainty?
Absorption capacity (are judges macroeconomists?)
How the implemented laws fit with existing laws of countries?

- Every decision of competent authority may be challenged or subject to judicial review in respective country.

- Appetite for challenging raise usually at wrong moment – in situations of threats (risks) to financial stability.

- Typical grounds for legal challenges:
  - inconsistencies among and between different EU and state laws
  - alleged violations of constitutional principles in respective countries

- Other potential obstacles for smooth application of implemented laws:
  - procedural laws in respective countries
  - company, property laws, etc.
How implemented laws fit into legal culture of countries?

- Legal Culture - unclear concept usually describing differences between legal systems (common/civil law), historical influences, legal institutes/concepts

- Effectiveness of implemented laws depend also on the efficiency of national justice systems

- EU sources:

Time needed to resolve administrative cases (*) (1st instance/in days)

Source: CEPEJ study

(*) Administrative law cases concern disputes between citizens and local, regional or national authorities, under the CEPEJ methodology. Methodology changes in HR, HU and FI. Pending cases include all instances in CZ and SK. DK, IE and AT do not record administrative cases separately. DE: Data solely based on the statistics on the administration of justice published by the German Federal Statistical Office.
Number of incoming civil, commercial, administrative and other cases (*) (1st instance/per 100 inhabitants)

Source: CEPEJ study (*)

(*) Under the CEPEJ methodology, this category includes all civil and commercial litigious and non-litigious cases, non-litigious land and business registry cases, other registry cases, other non-litigious cases, administrative law cases and other non-criminal cases. Methodology changes in CZ, HR, MT, FI.
Rate of resolving administrative cases(*) (1st instance/in %)

Source: CEPEJ study

(*) Methodology changes in HU and FI. Reorganisation of the administrative court system in HR. Pending cases include all instances in CZ and SK. DK, IE and AT do not record administrative cases separately. DE: Data solely based on the statistics on the administration of justice published by the German Federal Statistical Office.
Number of pending administrative cases (*) (1st instance/per 100 inhabitants)

Source: CEPEJ study

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Judges participating in continuous training activities in EU law or in the law of another Member State (*) (as a percentage of total number of judges)

Source: European Commission, European judicial training report 2016(**)

(*) In a few Member States the ratio of participants exceeds 100%, meaning that some participants attended more than one training activity. AT data includes prosecutors, DK includes court staff.
Closing the circle ...

- Accomplished quest for stability - from stochastic and individual to systemic and multilateral
- Hopes for more proportionality (and less diversity)
- How far the regulatory pendulum will continue in the current direction?
- Opportunities for deregulation and simplification?
- Consequences of neglecting the opportunities
- Involving and raising awareness among remaining stakeholders
THANK YOU