

UDC 338

JEL Classification: E60, G21

*Yefimenko Alina***REGULATORY AND LEGAL PROVISION OF BANKING SECTOR CAPITALIZATION IN CONDITIONS OF MACROECONOMIC INSTABILITY****Sumy State University, Sumy, Ukraine**

The article summarizes the regulatory and legal provision of bank capitalization in conditions of macroeconomic instability using the example of Ukraine. The author systematizes the main approaches to determining the categories of legislation in the field of capitalization based on a review of publications by foreign and domestic scientists. The purpose of the article is to analyze the regulatory and legal provision of capitalization of the banking sector in the example of Ukraine and assess the existing gaps in the legislative framework. Within the framework of the article, a bibliometric analysis was carried out for the systematization of scientific works in the field of regulatory support of bank capitalization. The following research tools were used in the article: methods of analysis and synthesis, grouping, bibliographic analysis, comparison method, etc. The following categories of regulatory support for bank capitalization have been identified: the primary State Law, State Laws, the main Central Bank Law and regulatory acts developed in accordance with the specifics of the bank's activities. The article identifies the main gaps in legislation at various levels of banking activity. From the NBU's point of view, the level of capital adequacy is characterized by banks' compliance with the specified standards H1 and H2. At the international level, these indicators are covered in the standards of the Basel Committee on Banking Regulation (Basel I, II, III). Several external and internal factors affect banks' implementation of the specified regulations. Macroeconomic factors include social, geopolitical factors, technological factors and national indicators. This determines the need for banks to consider fluctuations in GDP and incomes of the population when developing a resource policy, as well as implementing national legislation. Also, banks need to develop and implement appropriate action plans for negative scenarios of economic growth and population impoverishment.

**Keywords:** banking system, capitalization, standards, regulatory and legal support, macroeconomic instability, factors.

**DOI:** 10.32434/2415-3974-2022-16-2-6-13

***Introduction and statement of the problem***

At the current stage, the size of the bank's capital indicates the level of its development, the ability to perform basic functions. Compliance with capital standards is one of the most important tasks of Ukrainian banks, which characterizes the degree of protection of depositors and creditors from financial and non-financial risks. In this case, the amount of capital is considered acceptable if it is at

least 10% of the bank's assets.

The basis of the bank's activity is the formation of a resource base that accumulates from various sources and is used for conducting active operations. Ensuring a sufficient level of capital is a primary task for every bank, which contributes to the financial stability and reliability of the institution.

In this case, regulatory and legal provision of bank capitalization is the foundation for the formation

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of a sufficient resource base. The presence of gaps in the legislation is a challenge to the effective implementation of the bank’s resource policy. That is why it is important to analyze the features of capitalization regulation and identify the main gaps.

***Analysis and research of publications***

Both domestic and foreign scientists dealt with the issue of capital regulation.

I.V. Drogorub considered the issue of regulatory provision of capitalization in the context of the legislation regulating the financial resources of banks. The author divides the regulatory framework into the following 4 groups: the basic law of the state (Constitution of Ukraine), laws of the state (Laws of Ukraine), subordinate regulatory acts of the central bank, the regulatory legal framework is developed by the specialization of banking institutions [1, p. 119].

Polishchuk O.A., Somchenkov O.A. and Kolesov O.S. in their work note that imperfect legal and regulatory support has a negative impact on the stability of the financial sector, which includes the banking system [2].

Kuznichenko Y.M. notes that the legislation of Ukraine must comply with the norms of international provisions, which include the Basel requirements, which contributes to the regulation of capital adequacy at the interbank level [3].

It is also important to note that foreign and domestic scientists characterize the more quantitative side of regulatory support for capitalization, which is especially important in conditions of macroeconomic instability. Orlando Hoaqui-Barandyka and others point out that one of the macroeconomic factors underlying bank profitability is the capital efficiency indicators: ROA and ROE [4].

Paul-Oliver Klein and Turk-Aris Rima note that banks with larger capitalization are more financially stable, and in crisis conditions they are able to support

lending to the economy, which restrains adverse macroeconomic consequences [5].

Thus, the analysis of researches and publications confirmed the relevance and importance of effective normative and legal support of the capitalization of the banking sector as the basis of the state’s financial operations.

***The purpose of the article***

The purpose of the article is to analyze the regulatory and legal provision of capitalization of the banking sector on the example of Ukraine and assess the existing gaps in the legislative framework.

***The main material***

The economy of any state is impossible without effective financial mechanisms supported by relevant legal acts. The banking sector, which is the main sector of state settlement operations, also depends on the effectiveness of the development and implementation of national legislation.

First of all, we will consider the challenges faced by the banking system of Ukraine in the conditions of macroeconomic instability. These problems of the banking system, which led to a critical decrease in the level of capital adequacy during the crisis of 2014-2017, are relevant today (Table 1). This contributes to a clearer demarcation of existing and potential gaps in national legislation, which depend precisely on external economic fluctuations.

Each of the presented problems poses a threat to the lack of profit and loss of capital by banks. For example, non-transparency of activities will lead to an increase in reputational risk, which directly affects the profitability of the institution.

These problems should also be taken into account when implementing legislation in the area of ensuring capital adequacy.

The main legal acts characterizing the main features of the bank capitalization procedure are the

Table 1

**Characteristics of the problems of the banking system of Ukraine and their impact on capital**

Problems of the ukrainian banking system	Impact on capital
The non-transparency of banks' activities, the non-transparent ownership structure	the effect on the adjustment of the bank's balance sheet and regulatory capital;
Low-quality loan portfolios of banks	a decrease in the total amount of capital due to possible losses;
Non-fulfillment of the main function by banks - credit and investment	reduction of the level of profitability of banks, which affects indicators of capital adequacy;
Growing mistrust of banks	reducing the amount of resources for the bank's operation;
Low level of risk management of most banks	possible losses of banks;
High concentration of capital in the group of the largest banks	decrease in capital adequacy indicators in other banks.

Source: compiled by the author based on [8]

following four groups:

- the main law of the state – the Constitution of Ukraine;
- laws of the state – Laws of Ukraine;
- Central Bank Law – Law of Ukraine “On Banks and Banking Activities”;
- normative legal acts developed in accordance with the specifics of the bank’s activities.

In accordance with Article 100 of the

Constitution of Ukraine, the Council of the National Bank develops the main principles of monetary policy and controls its implementation [9]. Thus, the central bank is responsible for the development of the main standards of banking activity, which are governed by the banking institutions of Ukraine. Also, in conditions of macroeconomic instability, namely: rising inflation, unemployment, disruption of the equilibrium level of unemployment, political factors,

Table 2

### Features of capitalization at various stages of banking activity

Stage of banking activity	Features of capitalization	Gaps in legislation
Creation of a bank	<ul style="list-style-type: none"> <li>– formation of authorized capital;</li> <li>– payment of cash contributions by bank participants of the value of shares, shares of the bank in the amount determined by the statute, absence of anti-crisis measures in case of force majeure (socio-political, economic, etc. factors) after payment of the authorized capital by the participants of the institution. Functioning of separate divisions of the bank, the minimum amount of registered capital of the branch at the time of its accreditation is at least 120 million hryvnias</li> </ul>	lack of anti-crisis measures in case of force majeure (socio-political, economic, etc. factors) after the payment of the authorized capital by the participants
Functioning of separate divisions of the bank	<ul style="list-style-type: none"> <li>– the minimum amount of registered capital of the branch at the time of its accreditation is at least 120 million hryvnias</li> </ul>	<ul style="list-style-type: none"> <li>lack of distribution of types of capital and personalities of their formation by division;</li> <li>lack of anti-crisis measures in the field of resource policy of the branch</li> </ul>
Conducting banking activities	<ul style="list-style-type: none"> <li>– distribution of regulatory capital into primary and additional capital;</li> <li>– the basic capital of the institution includes authorized capital and disclosed reserves, created or increased due to retained earnings, premiums to the share price and additional contributions of shareholders to the authorized capital, the general risk coverage fund, which is created for an uncertain risk when conducting banking operations, with the exception of losses for the current year and intangible assets;</li> <li>– availability of elements of additional capital and their clear regulation;</li> <li>– The National Bank of Ukraine has the right to establish requirements regarding the sources of formation of components of regulatory capital, which is relevant in the presence of destabilizing economic factors;</li> <li>– determination of the minimum amount of capital and the order of its formation and increase, etc.</li> </ul>	lack of detailing of possible measures of the National Bank of Ukraine regarding changes in the amount of regulatory capital
Bank management	<ul style="list-style-type: none"> <li>– determination of sources of capitalization and other financing of the bank;</li> <li>– making decisions regarding the creation, reorganization and liquidation of legal entities, the formation of branches and representative offices of the bank on the territory of other states, approval of their statutes and regulations;</li> <li>– presence of verification by the internal audit unit of capital adequacy assessment processes, etc.</li> </ul>	lack of clear standards regarding capital adequacy assessment in conditions of macroeconomic instability at various levels of bank management

Source: created by the author on the basis of [6]

etc., the National Bank of Ukraine carries out anti-crisis measures, among which is the adjustment of capital indicators of banking activity.

Among the laws of the 2nd group, the Civil Code of Ukraine, the Law of Ukraine “On the Protection of Consumer Rights”, the Code of Ukraine on Administrative Offenses and others can be distinguished. Each of the mentioned laws has different spheres of responsibility and influence both on banking activity and directly on its customers.

The main law of the 3rd group of normative legal acts is the Law of Ukraine «On Banks and Banking Activities», which clearly defines the features of attracting, replenishing, functioning of various types of bank capital [6].

Table 2 shows the features of capitalization according to banking processes and the main gaps at each stage of the bank’s operation in conditions of economic fluctuations.

Another group is normative legal acts developed in accordance with the specifics of the bank’s activities.

Such documents include the resolutions of the National Bank of Ukraine, which regulate various types of activities of institutions, namely: credit, deposit, settlement and cash, etc. Such laws include the Instruction on the Procedure for Regulating the Activities of Banks in Ukraine [7].

We will consider in more detail the basic norms of the above-mentioned Instructions. The purpose of its introduction is defined in the first section of the document “General Provisions”. The purpose of the creation of the Instruction on the procedure for regulating the activities of banks in Ukraine is to ensure the stable operation of institutions and their timely fulfillment of their obligations to depositors,

as well as to prevent improper allocation of resources and loss of capital due to risks inherent in the activities of banks. In our case, it is worth paying attention to the point about possible capital losses, namely: in which cases, how to counteract this, and what measures are possible to reduce this risk in conditions of macroeconomic instability.

Banks must comply with the following regulations:

- capital standards that have a direct impact on the efficiency of banking activity (Fig. 1);
- liquidity standards;
- liquidity coverage ratio (LCR) for all currencies (LCRBB) and in foreign currency (LCRIB);
- coefficient of net stable financing;
- credit risk standards;
- investment regulations [7].

From the NBU’s point of view, the level of capital adequacy is characterized by banks’ compliance with the specified standards H1 and H2. At the international level, these indicators are covered in the standards of the Basel Committee (Basel I, II, III).

It is worth noting that when developing capital standards and making changes, the National Bank takes into account changes in the regulatory acts of the Basel Committee on Banking Supervision, so it is important to also consider the evolution of the committee’s standards (Fig. 2).

A number of external and internal factors affect banks’ implementation of the specified standards.

External factors that have an indirect effect include the following:

- natural factors;
- geopolitical and geoeconomic factors;

<p>H2</p> <p>Norm of sufficiency (adequacy) of regulatory capital</p> <p>H2 - ratio of RK to the total book value of assets and off-balance sheet liabilities, weighted by the degree of credit risk.</p> <p>Must be at least 10%.</p>	<p>H3 (from 01.01.2019)</p> <p>The standard of capital adequacy is defined as the ratio of capital to the sum of assets and off-balance sheet liabilities weighted by the appropriate credit risk factors.</p> <p>Must be at least 7%.</p>
<p>H1</p> <p>The minimum amount of regulatory capital</p> <p>As of July 11, 2014, it is UAH 500 million.</p>	<p>Regulatory capital adequacy ratio in accordance with Basel II</p> $\frac{RC}{CR+MR+OR}$ <p>where RC - regulatory capital, CR - credit risk; MR - market risk; OR - operational risk.</p>

Fig. 1. Norms of bank capitalization

Source: created by the author based on [7]

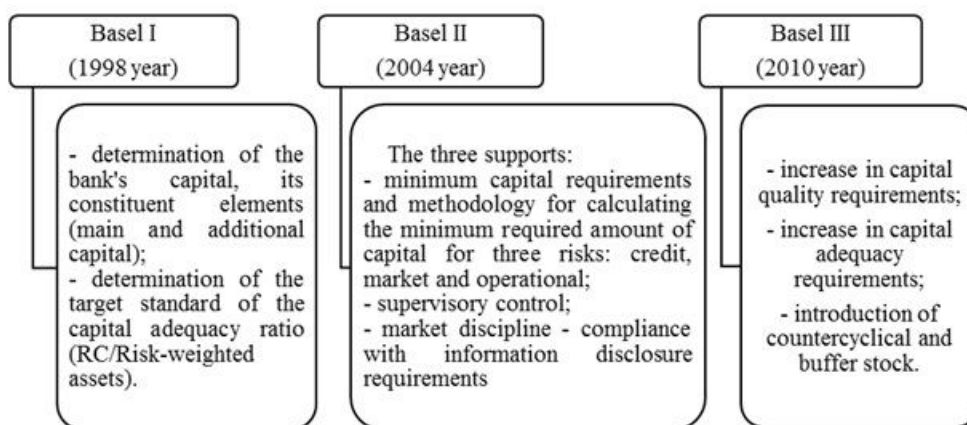


Fig. 2. Evolution of the Basel Capital Agreements

Source: compiled by the author based on [10–11]

– national indicators characterizing Ukraine's development (political, economic, GDP structure, level of public debt, state budget deficit, etc.);

– social (income level of the population, level of trust in banks);

– technological (level of innovative development of banks);

– the state of the banking services market (the level of development of the banking system, the main indicators of bank activity, the share of the largest banks, and others).

The external factors of direct impact on the bank's capital include:

– introduction of Basel III requirements by the National Bank of Ukraine;

– pressure from counterparties.

Let's take a closer look at the national indicators, since they characterize the level of development of any state.

One of the national indicators is the inflation rate, which characterizes the change in prices in the economy and is determined by the consumer price index. There is a direct connection between the rate of inflation and the level of interest on deposits and loans, which indirectly affects the volume of banks' capital. For example, with an increase in the inflation rate, interest on loans and deposits increases, while banks' profits decrease and the amount of capital decreases accordingly.

Another national indicator is the level of public debt. When this indicator increases for banks, the conditions of their functioning are also adjusted, namely: the increase in the amount of authorized capital is accelerated to avoid possible losses.

The structure of the gross domestic product also exerts an indirect influence on the capital of banks. Depending on which industry dominates the

country's GDP, the level of banks' profits also fluctuates, which depends on the structure of their loan portfolio.

Thus, the regulatory legal framework should take into account the fluctuations of these factors when developing relevant laws at both the national and international levels.

It is important to assess the influence of macroeconomic factors on changes in bank capitalization, which will contribute to the effective development and correction of regulatory acts and internal bank policies (Table 3).

Thus, the legal framework of Ukraine in the field of ensuring bank capitalization should take into account the possible fluctuations of these factors.

In the Instruction on the procedure for regulating banking activity, the procedure for calculating the bank's regulatory capital (RC) is defined, which is one of the most important indicators of banks' activity, the main purpose of which is to cover the negative consequences of various risks.

The factors listed in Table 3 can act as such risks and have both a positive and a negative impact on banking activity.

Risks in banking activity depend on the specifics of banking operations conducted under market conditions, and mean the probability of receiving revenues that are less than expected and a decrease in the value of assets. The increased level of these risks leads to significant financial losses and, as a result, to the bankruptcy of institutions.

When determining the real size of the RC, taking into account the risks in their activities, banks are obliged to constantly assess the quality and carry out the classification of active banking operations, as well as determine the size of the credit risk in order to reduce its possible negative impact.

Table 3

**Impact of macroeconomic factors on banking activity, namely capitalization**

Factor	Impact
Geopolitical factors: elections, change of authorities in the leading countries of the world, political actions, internal political events in the country	Deterioration of indicators of banking activity, which affects the profitability of the institution
National indicators: inflation rate	There is a direct connection between inflation rates and the level of interest on deposits and loans, which indirectly affects the volume of banks' capital.
National indicator: the structure of gross domestic product	Depending on which industry dominates the country's GDP, the level of banks' profits also changes, depending on the content of their loan portfolio.
Social factors	The level of public trust in banks and the level of income affect individual components of banks' capital.
Technological factors: the level of organization innovativeness	The introduction of innovations requires additional financing and capital investments. Most Ukrainian banks have a low level of innovation in their activities, as it is an additional expense.

Also, in accordance with Chapter 1, Section 4 of the Instructions on the procedure for regulating banking activity, the bank is prohibited from paying dividends or distributing the capital of the institution in any form, if such payment or distribution will lead or may lead to a violation of the standard of sufficiency (adequacy) of regulatory capital or its non-compliance. Another anti-crisis measure on the part of the NBU is the weighting of assets and off-balance sheet liabilities by the degree of credit risk when calculating the sufficiency (adequacy) standard of the RC.

Thus, in the normative legal framework, the regulator foresees possible actions of bank owners or fluctuations in the external environment that may negatively affect the institution's compliance with capital standards, and determines appropriate preventive measures.

**Conclusions**

The regulatory and legal framework is the basis for the functioning of any economic sphere. Compliance with legislative norms is special, which will contribute to the stabilization of economic, social and political processes in the country.

The banking sector is responsible for conducting financial operations of the state, and the main indicator of its stability is the adequacy of capital. Thus, the study of legislation in the field of ensuring capitalization in conditions of macroeconomic instability is important for any state.

The main regulatory legal acts characterizing the main features of the bank capitalization procedure are the following four groups: the main State Law - the Constitution of Ukraine, state laws – Laws of Ukraine, the Central Bank Law - the Law of Ukraine

«On Banks and Banking Activities» and normative legal acts, which are developed in accordance with the specifics of the bank's activities.

Among the legal acts developed for the specifics of banks' activities is the Instruction on the Procedure for Regulating Banks' Activity in Ukraine, the main purpose of which is to conduct stable activities of institutions and timely fulfillment of their obligations to depositors and creditors, as well as to prevent improper allocation of resources and loss of capital due to the risks inherent in the activity of banks. Also, this document defines the main capital standards, their features and the procedure for their calculation and further implementation by banks, taking into account the impact of various financial risks.

It is important to note that when making changes to the legislative framework, the state must take into account the influence of the following macroeconomic factors: geopolitical, social and technological factors, national indicators. These factors have a direct impact on banking activity, namely on capital adequacy and profitability of the institution, which are indicators of the stability of the institution.

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## НОРМАТИВНО-ПРАВОВЕ ЗАБЕЗПЕЧЕННЯ КАПІТАЛІЗАЦІЇ БАНКІВСЬКОГО СЕКТОРА В УМОВАХ МАКРОЕКОНОМІЧНОЇ НЕСТАБІЛЬНОСТІ

Єфіменко А.Ю.

У статті узагальнено нормативно-правове забезпечення банківської капіталізації в умовах макроекономічної нестабільності на прикладі України. Автором систематизовано основні підходи до визначення категорій законодавства у сфері капіталізації на основі огляду публікацій іноземних та вітчизняних науковців. Метою статті є аналіз нормативно-правого забезпечення капіталізації банківського сектора на прикладі України та оцінювання наявних прогалин у законодавчих базах. У рамках статті виконано бібліометричний аналіз для систематизації наукових праць у сфері нормативного забезпечення капіталізації банків. У статті були використані такі інструменти дослідження: методи аналізу та синтезу, групування, бібліографічний аналіз, метод порівняння тощо. Визначено такі категорії нормативного забезпечення банківської капіталізації: основний Закон держави, Закони держави, основний Закон центрального банку, нормативні акти, що розробляються відповідно до специфіки діяльності банку. У статті визначено основні прогалини у законодавстві на різних рівнях банківської діяльності. З боку НБУ рівень достатності капіталу характеризується виконанням банками зазначених нормативів Н1 та Н2. На міжнародному рівні зазначені показники висвітлюються у стандартах Базельського комітету з питань банківського регулювання (Базель I, II, III). На виконання банками зазначених нормативів впливає низка зовнішніх і внутрішніх чинників. До макроекономічних чинників відносять: соціальні, геополітичні та технологічні фактори, національні показники. Це обумовлює необхідність урахування банками коливань ВВП і доходів населення при розробці ресурсної політики, а також реалізації національного законодавства. Також банкам потрібно розробляти та впроваджувати відповідні плани дій за негативних сценаріїв зростання економіки та збідніння населення.

**Ключові слова:** банківська система, капіталізація, нормативи, нормативно-правове забезпечення, макроекономічна нестабільність, фактори.

Received 10.10.2022.

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**Keywords:** banking system, capitalization, standards, regulatory and legal support, macroeconomic instability, factors.

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