BAILING OUT FINANCIAL INSTITUIONS AS THE EPITHOME OF THE FINANCIAL SYSTEM TODAY

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Abstract: Financial institutions that are considered too big to fail are receiving increasing attention from government authorities today and they enjoy enormously privileged position in the modern financial system . The prime example of this is the financial crisis of 2008 where a lot of investment banks run with extraordinary rates of leverage were prime recipients of government aid . The reason behind this was the fact that these financial institutions are global and have a lot of counterparties, engage in critical transactions and manage money for a lot of individual investors and provide services to the world's largest institutional investors, so they are a threat to the financial system if they go bankrupt.

The most obvious solution from the financial and government authorities was to bail them out and limit the risk of the financial system as a whole.On the one hand, the logic is that bailing them out will help restore confidence in the financial markets and the financial panic will avert, but on the other side there are serious side effects from this.

One of the biggest effects in the allocation of funds into the hands of ineffective investors and lenders, which can cause ineffective allocation on the macroeconomic level, if a serious percentage of available liquid funds are allocated to weakening financial institutions . But the most serious problem is that large financial institutions take excessive risks only because they know that their significance is on a systemic level and that financial and government authorities will not let them go bankrupt without trying to get them out . The most detrimental effect is that they engage in transactions with excessive risk with a lot of counterparties and they engage in margin trading of complex financial derivatives with borrowed money . In the financial crisis of 2008, we saw a lot of complex positions that could not be efficiently evaluated timely even by experts from the FED and the Treasury of the USA . In the end we saw the biggest bailout in the history of the financial system with 700 billion dollars injected into the largest financial institutions in order to prevent systemic risk and failure of the global financial system.

Keywords: bailout, authority, counterparties

1. INVOLVEMENT OF THE FINANCIAL AUTHORITIES IN THE EXPECTATION OF THE LARGEST FINANCIAL COMPANIES

The largest financial sector companies can often count on the support of government agencies and financial authorities in charge of regulating them. The central role of central banks as financial authorities is to ensure the liquidity and solvency of the system.

Because of this, the central bank often helps major financial companies remain solvent in order to prevent a greater crisis. This can be seen in the example of large banks that were recipients of large financial resources by the Federal Reserve of Saddam. The largest financial companies such as Goldman Sachs, JP Morgan, Wales Fargo and others received individually tens of billions of dollars in order to be able to re-launch the lending process to interested parties.

The reason for this is the violation of the loan as the power of a major economy. We are aware that the disruption of lending and the reduction in the liquidity of the system leads to major problems.

If financial institutions are left with no money and can not carry out traditional and innovative credit operations, the system would remain without much of the liquidity and would come to a solvency margin. This means that financial institutions are an important link between the surplus categories of persons and the deficient categories of persons in relation to financial assets.

Effective and efficient capital allocation allows the financial system to work smoothly. But if a system appears in the place where the money "disappears " due to bad investments, market distortions immediately appear and the structure of the markets is disturbed. Therefore, the financial authorities are care about the state of the financial institutions and try to prevent their liquidity problems.

According to some estimates, with the reduction of the liquidity of a major financial institution and the disabling of transfers and credit operations, tens of billions of dollars of capital are being destroyed that could be used more effectively and effectively. This is because financial institutions are associated with a number of different If a problem occurs in one sector it will also mean reducing the opportunities of other sectors due to the reduction of the available funds.

Also, failure to fulfill obligations by financial institutions affects a large number of persons involved in financial transactions and impede effective and effective capital allocation.

This can be reflected on each level and needs to be taken into account because of the huge capital available to them and the number of transactions involving large financial companies have the potential to jeopardize the solvency of the system as a whole. Financial authorities have multiple roles in maintaining of the financial system :

- Monetary control
-Revision and control role
- Budget control
-More and estimate
- Implementation of policies

According to these roles, they must take care of the stability of the currency, the effective allocation of resources from the budget, performing audit, control and supervision of financial companies, conducting measurements and assessing the quality of the policies being implemented. For this reason, financial authorities must they affect multilevel financial institutions . They must ensure that these companies comply with the rules and regulations, in particular to those concerning their ability to borrow, their capital and debentures reserves.

Financial authorities and their actions to save privately owned financial institutions have become an everyday day in the financial system, and often, as in the case of the Croatian Agrokor, we see the influence of financial authorities in saving non-financial companies from essential significance and systemic risk.

It is important to understand that financial institutions are problematic for the system as a whole in a certain form and size, whereby financial authorities must resort to their redemption if they are not liquid in the face of financial recessions. We saw this at the big door in 2008 when primarily investment and commercial banks were affected by the crisis, but also monetary funds, investment funds in securities, private equity investment funds, etc. financial entities ... Then the government and financial authorities, and especially the latter, started with actions to relieve a large number of these entities that ended up with huge spending on taxpayers' money to save companies that had begun to borrow heavily before the crisis and then became companies of systemic significance.

Financial authorities often lack the ability to choose, because if they choose not to support systemically important companies, their decline would affect the solvency of the entire system. Larger financial institutions such as Lehman Brothers and Bear Stearns and their implosions in the markets have brought strict corrections that have suffered great number of other vital financial institutions. When regulating markets and deciding which are systemically important institutions, it is important to recognize the risks arising from the links of private institutionsproperty and other privately owned institutions and companies, the level of exposure to borrowings and the number and amount of unpaid liabilities.

An important parameter in which financial authorities make an effort is to include whether institutions applying for state aid have uncollectible (temporarily) claims against other companies that over time can be resolved, examining the solvency of their assets and the level of credit exposure. This is very important to understand why some institutions of great importance as Lehman Brothers were not relieved of state capital, and some of their competitors received state aid during the crisis.

There are several parameters used by financial authorities :

- Bonus of funds
- Subscribed claims
Credit depreciation
- Credit exposure credit obtained from lending to certain sectors of the economy
-Idiosyncratic risk of the fall of the institution
-System risk from the fall of the institution
-Important alternatives to the rescue of the institution
-A quantitative presentation of risk alternatives, etc.

These parameters serve the financial authorities to decide whether financial companies, and often others, are sufficiently systemically important to be rescued, whether there are no other alternatives, if there are no other risks if the transaction is carried out, etc. If the financial authorities evaluate all these parameters then decide which step to take.

Financial institutions that are of systemic significance often use this as their own advantage. In the progressive financial times they borrow and buy properties, and later in the crisis periods they receive relatively favorable loans from financial authorities that enable them to overcome this period without selling funds at depressed prices.

This freedom that financial companies have to be limited by the financial authorities, because in addition to threatening this phenomenon to ruin the financial system, it threatens to destroy democracy as a whole. The reason for this is the use of taxpayer money for saving certain financial companies, whether it is about giving loans (short-term and medium-term) or it is about capital injections by buying shares in companies that the state later sells. Nevertheless, then America managed to earn as a state by financing the largest financial institutions of systemic significance, however criticism was aimed at using the taxpayers' money to save companies that took over too much

2. POSSIBILITIES FOR THE PREVENTION OF SYSTEM RISK

There are several options for preventing systemic risk. One of the main options is increased controls on the capital positions of financial entities and their ability to borrow. Also, the regulation of complex financial derivatives that have hidden risks is one of the possibilities for prevention.

A good example of these derivatives is a contract of difference. If an institution wants to raise the price of its shares, it may decide to sell such contracts in difference.

He usually chooses an already proven investor and offers him to buy out these contracts for a fee, where in case the stock price rises, he pays a fee, but in case he falls then the investor pays the fee.

A good example of this is the case of the Anglo-Irish Banking Corporation, which in an agreement with the Quin Group agreed to create such a derivative. Since the bank was before the collapse, the stock price continued to fall. Because of this, the Quin Group, which had thousands of employees, problems, financial authorities had to react and rescue the Anglo-Irish Bank trying to save the depositors' money, but also the Quin Group, which had obligations to a large number of companies.

Due to the systemic importance of the Anglo-Irish Bank and the Quin Group, financial authorities had to rescue the bank during the crisis. There are many examples of these that point to the danger of leveraging and its permissiveness by financial authorities.

Financial authorities have to make financial institutions, in particular banks, to comply with the Basel rules. The financial resources of financial institutions are very important. Strong controls and supervision by the central bank is very important to be implemented.

Financial authorities have a large number of resources, including some of the greatest experts, cutting-edge technology, which can be used for quantitative analysis. If a good analysis is conducted, financial authorities can control the situation and try to reduce the systemic risk. The financial system today is filled with irresponsibility, due to the fact that systemically important companies are always considered too big to fail.

Therefore, they behave irresponsibly, inefficiently and inefficiently allocate capital and buy assets that do not have intrinsic value, and buy them only because of speculation and large debts.

According to the estimates, hundreds of billions of capital have been destroyed in the 2008 crisis because of investments in speculative derivatives. What financial actors need to worry about is the increase of criminality in relation to financial transactions.

Often, investment banks sold certain securities against which they later acquired "short" positions in order to profit from price differences. This meant abandoning the position of a fiduciary bond to care for its customers.

Financial authorities must respond to all opportunities for exploiting the rights of other market participants and punish and degrade irresponsible behavior. We are witnessing historical events where a few small financial institutions have been stripped of their licenses, and many of them they work on the brink of legality.

This alludes to the fact that financial criminality is also increased and that the number of financial irresponsible persons has increased. The number of people entering into financial transactions with major financial institutions is increasing every day. This prevents strong financial control by financial authorities because monitoring of a growing number of funds has to be monitored.

Due to this, there must be possibilities for limiting the entry into transactions with regard to the assets at the disposal of the financial institutions. It should not be allowed, as in the pre-crisis periods, large financial institutions with assets exceeding 30 times their capital . The largest investment banks, such as Lehman Brothers and Bear Stearns, were in charge of 35-1 and 31-1 leverage ratio, and could therefore support tens of billions of dollars worth of funds in the capital. Such cases must and isolated by establishing a larger capital controls by central bank authorities and financial authorities of the departments of finance and budgeting.

Of these negative examples, one should learn about what needs to be changed in the financial system, which is to replace deregulation with regulation and introduce tighter controls by financial authorities.

CONCLUSION

Financial authorities have to work hard to preserve the financial system primarily by reducing systemic risks. In today's world of automation of banking work, one must first take into account the risks that arise. A simple computer error can mean hundreds of millions of dollars of capital to be lost irrevocably. In such circumstances, we should not allow ourselves to allow any financial institution in private ownership to be of systemic significance.

We are witnesses to financial companies (in the form of holding companies) that manage assets worth billions of dollars. Often these funds are supported with very little own capital, so these companies are on the brink of solvency. But because of the complex number of transactions and their importance, financial authorities do not have much to do but save them with their own funds.

The financial crisis of 2008m went through financial aid to the institutions from an unprecedented scale. We are witnessing the destruction of hundreds of billions of dollars due to ineffective and ineffective allocation, which must not be repeated.

The lessons of financial crises should be the following:

-Reduction of systemic risk

-The division of large banks of multiple entities

- Limitations in terms of borrowing

- Restrictions in terms of assuming liabilities in relation to capital

- Determination of the rates of mandatory reserves that are higher

-Regulation of financial derivatives

If regulation and stage-by-stage implementation of measures are in place, the complete market action will be regulated over time. If other standards are set up as before, the systemic risk will not be prevented. It is necessary to regulate systemically important financial institutions, to reduce their scope, to divide the multiple companies and all to regulate.

Otherwise, we will see the episodes of the last financial crisis again. And it will be a repeat of events where major financial institutions are saved by taxpayer funds. And that means that financial companies will not learn from the mistakes of the past and will take over again big risks and will create new speculative markets.

The reasons for the recession appear to be always different, but the root is in the deregulation of markets started in President Reagan's time, and with the help of financial regulator Alan Greenspan who at the time was president of the Federal Reserve of Saddles. Therefore, it must be understood that re-regulation of markets is needed, it can help to allocate capital efficiently and focus on more conservative investments that have a lower yield in the short term, but which have long-term potential.

This would mean a change in the form of today's financial system as it would have changed from a system in which development and financial opportunities, as well as credit opportunities, are primarily an advantage of large financial institutions, and if a change is made, allocation to small businesses, start up companies, personal finance and the like.

If the approach is changed, more value would be generated, because small and medium-sized companies are the engine of society, and if they are financially responsible and there are greater capital controls, then they could grow organically without jeopardizing the system as a whole. Organic growth and neglect of adverse impacts on the system should be the new approach to the financial system as a whole.

Some steps have already been taken to limit the level of leveragedness after the crisis to a degree of 15-1, ie financial institutions can borrow from $ 15 to $ 1 capital, which is still too much, but far lower than the former 35-1 of Lehman Brothers which has implicated in the financial crisis of 2008.More efforts have to be made to influence the big institutions to direct their strategies towards reducing the borrowing, and the clear message from the financial authorities should be that there will be no use of state money to rescue financial institutions in the event of a crisis. These situations must be managed by early risk calculations, and financial authorities must perform good supervision.

Financial authorities are in charge of the "health " of the financial system and they must make more control and carry out more frequent audits of the operations of large financial institutions, using quantitative tools to address the risk of operating these institutions and prevent them from abnormally large levels of borrowing and risk occur.

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