PRACE NAUKOWE
Uniwersytetu Ekonomicznego we Wrocławiu

RESEARCH PAPERS
of Wrocław University of Economics

Nr 451

Finanse publiczne

Wydawnictwo Uniwersytetu Ekonomicznego we Wrocławiu
Wrocław 2016

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www.wydawnictwo.ue.wroc.pl

ISSN 1899-319
e-ISSN 2392-0041

ISBN 978-83-7695-618-3

Wersja pierwotna: publikacja drukowana

Zamówienia na opublikowane prace należy składać na adres:
Wydawnictwo Uniwersytetu Ekonomicznego we Wrocławiu
ul. Komandorska 118/120, 53-345 Wrocław
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www.ksiegarnia.ue.wroc.pl

Druk i oprawa: TOTEM

Spis treści

Wstęp

Publikacja *Finanse publiczne* została wydana w ramach Prac Naukowych Uniwersytetu Ekonomicznego we Wrocławiu. Poszczególne jej części stanowią dorobek pracowników naukowych najbardziej liczących się w Polsce ośrodków naukowych. Przedstawione opracowania odnoszą się do całego spektrum problemów naukowo-badawczych związanych z finansami publicznymi i polityką fiskalną. Poszczególni autorzy prezentują wyniki swoich badań teoretycznych i empirycznych w zakresie zarządzania dochodami i wydatkami budżetu centralnego oraz budżetów jednostek samorządu terytorialnego, w kontekście zarówno reformy finansów publicznych, reformy systemu emerytalnego, pomocy publicznej, jak i teoretycznych podstaw realizacji wyznaczonych celów przez narzędzia polityki fiskalnej.

Niniejsza publikacja jest adresowana do środowisk naukowych i studentów wyższych uczelni oraz osób, które w praktyce gospodarczej mają styczność ze stroną dochodową lub wydatkową polityki fiskalnej.

Poszczególne fragmenty książki były recenzowane przez profesorów uniwersytetów, w większości kierowników katedr finansów, katedr ekonomii oraz polityki ekonomicznej, którym chciałbym podziękować za rzetelne recenzje. Składam również wyrazy uznania pracownikom Katedry Ekonomii i Polityki Ekonomicznej Uniwersytetu Ekonomicznego we Wrocławiu oraz pracownikom Wydawnictwa za wiele wysiłku i zaangażowanie, dzięki któremu powstała ta publikacja.

Mam głębokie przekonanie, że książka *Finanse publiczne*, którą oddajemy w Państwa ręce, będzie inspiracją do dalszych badań i dociekań naukowych oraz do powstania równie inspirujących opracowań w przyszłości.

Jerzy Sokołowski

PRACE NAUKOWE UNIWERSYTETU EKONOMICZNEGO WE WROCŁAWIU
RESEARCH PAPERS OF WROCŁAW UNIVERSITY OF ECONOMICS **nr 451 • 2016**

Finanse publiczne

ISSN 1899-3192
e-ISSN 2392-0041

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DISINTERMEDIATION OF BANKS – CAUSES AND CONSEQUENCES

DEZINTERMEDIACJA BANKÓW – PRZYCZYNY I KONSEKWENCJE

DOI: 10.15611/pn.2016.451.21

Summary: In the age of financialization, i.e. since 1970s, in the financial systems of individual countries occurred many tendencies and phenomena influencing shape and functioning of financial intermediaries. The aim of the paper is to characterize one of the most important among them, namely the process of bank disintermediation, visible in financial systems of many countries. The process may be interpreted and analyzed in many dimensions. Its defining and understanding is of crucial importance when one assesses its consequences for the financial stability and access to financial services. In the paper disintermediation is considered in the context of diminishing trust in financial institutions and in connection with the process of financialization. After discussing definitions and features of disintermediation, there are characterized in details causes and consequences of the process. In final section some conclusions with reference to non-banking financial institutions are drawn.

Keywords: disintermediation, financial institutions, financialization, shadow banking.

Streszczenie: Począwszy od 1970 r., wraz z postępem finansyzacji, w systemach finansowych poszczególnych krajów wystąpiło wiele zjawisk i procesów wpływających na kształt i funkcjonowanie instytucji pośrednictwa finansowego. Celem artykułu jest charakterystyka jednego z ważniejszych, a mianowicie dezintermediacji banków, widocznej w wielu krajach. Zjawisko to można analizować i interpretować na wielu płaszczyznach. Zdefiniowanie i rozumienie dezintermediacji ma przy tym kluczowe znaczenie dla stabilności finansowej i dostępu do usług finansowych. W artykule dezintermediację rozpatruje się w kontekście malejącego zaufania do instytucji finansowych (głównie banków) i w powiązaniu z procesem finansyzacji. Po przedstawieniu definicji i cech dezintermediacji przybliżono przyczyny i konsekwencje tego zjawiska. W końcowej części sformułowano natomiast wnioski zarówno pod adresem banków, jak i niebankowych instytucji finansowych.

Słowa kluczowe: dezintermediacja, instytucje finansowe, finansyzacja, bankowość równoległa.

1. Introduction

In the age of financialization, i.e. since 1970s, in the financial systems of individual countries (especially those with mature market economy) occurred many tendencies and phenomena influencing shape and functioning of financial intermediaries. Some of them were the aftermath of specific decisions made by policymakers from different domains of the economic policy, whereas the others were caused, influenced and accelerated by market mechanisms.

As the most important among those processes one may consider globalization, deregulation and liberalization of financial activity, demutualization, privatisation, changes in structure and direction of activity conducted by banks or emerging new forms and types of money (see e.g. [Aliber 1987; Hübler et al. 2008; Kose et al. 2006; Janc 2004; Steuber 1977; Tomidajewicz 2013]. These phenomena influenced directly and indirectly individual segments of financial systems, enforcing – to some extent – changes in the regulatory frameworks as well as changes in principles, instruments and ways of conducting economic policy.

Considered processes occurred with different intensity and different frequency. What is characteristic and important here is the fact that these processes had, apart from purely economic, also significant social and cultural dimensions. They created specific climate, supporting financialisation attitudes and patterns among citizens in many countries, especially those with mature market economy [Epstein 2005]. Moreover, there were observed numerous interactions, interdependencies and feedbacks among individual processes. One may even argue that all the phenomena fed each other.

Preparation of precise, unambiguous balance of mentioned processes and tendencies is very complicated, not to say impossible. In different periods of time some countries, some branches of the economy, certain social groups or even individual economic agents benefitted from those processes, whereas the others – suffered in their aftermath. Moreover, the balance of costs and benefits changed from period to period.[1]

By no means, the group of entities especially involved – and at the same time extremely active – into discussed processes were banks. One might even say that banks have been pioneers of such processes as globalization and deregulation, playing important role in capital flows, entering foreign markets and contributing to faster transfer of technology, capital and "financialization" patterns of behavior. Of course such statement does not apply to all banking institutions – nevertheless, number of active "players" and participants of mentioned phenomena among banks significantly higher than companies from other branches of economy [Heffernan 2005; Janc 2004; Padoa-Schioppa 2001].

[1] However, it must be said that some groups of economic agents always benefitted and some were rather always on the "losers" side. Thus one might speak about specific subjective "bias".

Similarly to other participants of trends influencing financial systems worldwide, banks were both beneficiaries and victims of changes. On the one hand, opportunities for banks (especially for the largest ones, active also in foreign markets) emerged. They were connected with such factors as possibilities of expansion on new markets, developing scale of activity or cross-selling (see e.g. [Dembiński 2011; Heffernan 2005; Janc 2004, Jurek 2014]). But on the other hand, there occurred also negative factors, like e.g. increased risk and new types of risk emerged. Moreover, competition within financial systems increased significantly – banks, entering new areas of financial markets (insurance, securities markets, etc.) had now to compete also on their own field. Situation became even more difficult, as the competition appeared and intensified also from the side of non-banking financial intermediaries, entering market of bank products and services.[2]

Problems of banks intensified further in the aftermath of the Global Financial Crisis. The Crisis, starting in 2008, among other consequences, triggered changes in attitude towards banks (or, more broadly, towards all financial institutions) and revealed problems with effective surveillance over financial markets [Adrian, Shin 2009a]. The public in most countries perceived banks rather as culprits, not victims, without decomposition of the group on different types. Dramatic course and consequences of the crisis for the real economy and individual clients undermined confidence and trust in financial intermediaries – but especially in banks. The institutions were perceived as those who contributed to the crisis and then, thanks to bailouts, did not even suffer significantly.

In this context the problem of the so-called disintermediation has occurred. The aim of the paper is to characterize the process of bank disintermediation, visible in financial systems of many countries. Definition of disintermediation is discussed, then there are presented causes and consequences of this process and, finally, some conclusions are drawn with reference to financialization and financial supervision.

2. Definition of disintermediation

Disintermediationary tendencies were present in the financial systems worldwide already before the Global Financial Crisis [Heffernan 2005]. Disintermediation was, in a way, the answer for changing character of banking activity and banks themselves. In the face of growing inconveniences in relations with banks, problems connected with access to banking services on the one hand, and opportunities of making financial transaction via other financial institutions or transaction platform on the other, clients of banks – especially smaller ones, not interested in sophisticated financial

[2] Such phenomena constituted part of broader process of blurring borders between individual areas of financial market, products and entities, as possibilities of generating income and attracting new clients only through conducting "traditional" (strictly banking, insurance, etc.) activity by a given financial intermediary shrunk.

products or extremely high rate of return – started to limit their engagement in these institutions. Thus, as a general result of disintermediation one might perceive loss of banks' importance and weakening of their position.[3] They lose market share, clients and opportunities of gathering funds and making loans on behalf of non-bank or even non-financial agents or devices. In such context it is obvious that impact of disintermediation is rather negative, as it undermines competitive force of the banks.

Disintermediation, however, may be interpreted and analyzed in many dimensions. Its defining and understanding is of crucial importance when one assesses its consequences for the financial stability and access to financial services. Moreover, other entities are also involved in the process with not always clear role and incentives, connected with the so-called shadow banking [Adrian, Shin 2009b; Pozsar et al. 2010].

In general, disintermediation means just removing the middleman or intermediary from any transaction (or from flow of information). In the context of finance, the phenomenon may be investigated in two meanings. First, it can be understood as a decreasing importance of banks (mainly "traditional" ones, focused on deposits-loans operations) among financial intermediaries [Baka 2005; Miller 1998]. Accepting this approach, as the most basic measure of disintermediation scale and dynamics may be treated (decreasing) share of banking assets in the assets of the financial sector in general [Boyd, Gertler 1994].

Second, disintermediation may be perceived as withdrawal of funds from intermediary financial institutions, such as banks and savings and loan associations, in order to invest them directly. Thus, in such approach, the process is considered as more broad, as it implies diminishing role of the financial intermediaries at all. Participants of the market processes give up help and offer of financial entrepreneurs and make attempts to invest or raise funds directly on the financial market. Among their incentives is the will to avoid excessive costs of financial intermediation, limited access to financial intermediaries offer or even practical reasons.

In this context it is worthy to mention the concept of T. Rybczynski [1997]. According to him, the financial systems had gone in their development through three phases. In the first phase banks constituted the most important type of the financial intermediaries, as at this stage financing of the economy is based mainly on banks' loans. At the same time, the institutions raise funds for its lending activity only through the deposits of different groups of clients. The profit of a given bank is just a margin between received and paid interest. Thus, the phase may be treated as "canonical" stage in the development of banks.

In the second phase there appear some substitutes for banking services and the capital market develops more and more significantly. Under such circumstances, the banks are forced to change profile of their activity and to extend their offer. They

[3] One should take here into account differences in relative importance of banks in the Anglo-Saxon and European models of the financial systems (see e.g. [Sawyer 2013]).

are entering new domains (e.g. asset and risk management) and segments of the financial market (insurance, issuing of securities, etc.). But "traditional" products are still important and play significant role in generating banks' incomes.

Situation changes in the last, third phase. Banking loans become negligible and the involvement of banks into financing economic activity and investments shrinks. With time, banks are completely displaced as the source of funds and their offer is no longer competitive. The economic agents raise them directly from the market, mainly through issuance of various securities. In this situation banks focus rather on settlement and broadly understood investment banking. Main source of their profits are fees and provisions.

In consequence the importance of banks (and also other financial intermediaries) decreases, as the financial markets become mature and the needs of agents evolve. It seems that such chain of events describes well origins and progress of disintermediation, as well as changes in structure of financing investment in the real sector of economy. In the aftermath of this evolution, commercial banks become, as G.P. Miller [1998] puts it, "obsolete".

Nevertheless, the very concept of disintermediation and quoted definitions need some comments and further explanation. First, what is of special importance here, refusal of households and entrepreneurs to take financial intermediaries offer does not necessarily imply taking advantage of other entities. In contemporary economic life it is also possible – due to technological progress – to use various transaction platforms (so called *Business-to-Business* – B2B or *Peer-to-Peer* – P2P), operating on the Internet [King 2012; Tumin 2002].

Second problem that also needs more attention is the definition of the financial intermediary itself. Such definition changed and evolved over time and some types of entities were or were not included into this sector. The differences have been mainly the result of country-specific factors: binding legal frameworks, history, level of development, structure of society, etc. The definition of financial intermediary was broaden due to factors as: emerging of new instrument and entities operating on the financial market, changes in demand for financial services and increasing scale of settlements and liquidity needs in individual economies [Hosek, Zahn 1977; Allen, Santomero 1996, 2001; Gorton, Winton 2002; Klein 1996].

It must be stressed that such definitional consideration has not only theoretical character. Including a given entity into financial sector determines shape and structure of the domestic financial system, and thus – the range of the analysis. Moreover, only because of divergences in definitions, very similar institutions might have different legal status, different privileges and scope of activity and might operate on different legal basis. In some cases it may be beneficial for this entity, but in other – rather harmful. It also disrupts fair competition and may cause serious problems to supervisors. Considering topic of the paper, adequate definition of financial intermediary is also helpful in understanding scale and scope of disintermediation and thus – in precise assessing of this phenomenon.

Another controversial issue is connected with described problem of economic agents' classification. Namely, unclear is status of non-regulated entities conducting financial activity. Such agents offer services and products similar or even identical to those offered by "official" regulated financial intermediaries. In other words, question arises whether shadow-banking institutions could and should be treated as financial intermediary.[4]

3. Causes of disintermediation

Less controversial issue than definitions of disintermediation is pointing at its causes. In this context there are mentioned many different and quite diverse factors, some of them already mentioned in the Introduction. Among the main reasons of disintermediation one may point especially at globalization, deregulation, liberalization and technological progress – all factors strictly intertwined. They all made easier the creation of new entities or transactions platforms, which enabled to drive banks from their position. Opportunities to raise funds or invest money increased rapidly. At the same time, in the aftermath of mentioned processes, transactions costs – aside from liquidity issues and information asymmetry one of the main reasons of emerging and functioning financial intermediaries [Matthews, Thompson 2014] – decreased significantly, allowing individuals to conduct financial operation without any intermediaries.

With the latter factor closely corresponds another cause of disintermediation, namely development of brand new techniques (like securitization) and financial instruments which may constitute serious alternative for traditional products offer by banks and other "typical" financial intermediaries. Such new products and services would not have been created without technical possibilities given by computers and their increasing computing powers. It concerns mainly products exploited in advanced risk management (like derivatives). Their very construction and valuation demands technical devices not available earlier [Committee on Global Financial System 2002; Kroszner 2006].

Moreover, innovations in finance not only come down to new instruments, but also allow to use "old" services in a new way [Deloitte 2013; Levich et al. 1988; King 2012]. Thus clients in many countries gained better access to financial services, not only trough sometimes complicated and inconvenient procedures.

Another important source of disintermediation were changes in legislation in many countries, making conducting banking activity more difficult [Cobas et al. 2001; Trichet 2000][5]. They acted as specific obstacles, as they required for banks

[4] Of course, this problems vanishes when narrow definition of disintermediation is considered – in such case, the status of shadow banks is not relevant.

[5] As one of the first legal "obstacles", opening door to disintermediation, most frequently in the literature is the ceiling rate on time and savings deposits [Walker 1979].

fulfillment of some limits or introducing some rules. It was usually equal with higher costs of activity (e.g. in form of reserve requirements, collateral, etc.) or necessity to tighten loan policy (or, more generally, overall conditions of agreements). At the same time, non-banking institutions were not obligated to follow these regulations, thus, they were able to offer products and services on better conditions. Under such circumstances they started to undermine position of banks.

At two other premises of disintermediation points A. Sławiński [2006]. According to him, institutions of collective investments, due to investing their resources mainly in securities, have usually lower operating costs than the banks. The latter entities have to burden significant costs connected with assessment of clients' creditworthiness and include into their interest rates risk premium, by way of compensation default risk. Both elements force up costs of banking services. Such mechanism does not appear when one considers non-banking institutions, usually less (or even barely) regulated. For this reason they are able to provide products and services on terms more profitable than those offered by banks, struggling with increasing costs of intermediation and uncertainty.[6] Ultimately, lack of competitive – in terms of prices and other terms of financial arrangements – offer of banks (and other financial institutions) contributes to outflow of clients towards non-banking institutions or towards direct processes of lending-borrowing.

Second premise identified by this author is, in a way, exogenous with reference to financial sector. Namely, good economic situation in the 1960s and at the beginning of 1970s observed in developed countries and following this positive tendency growth of wealth of their citizens, resulted in significant increase in number of persons characterized by large financial capacities. They have been able to invest directly on the capital market, buying and selling securities – even those denominated in very high nominal values [Sławiński 2006].

Separate reason of disintermediation and avoiding financial institutions is lack of trust in these entities. In contrast with already discussed factor, this one has clear psychological blend, hard to quantification. Nevertheless, taking into account the very essence of banking and character of banks as the institutions of public confidence, this reason perhaps should be treated as the most important.[7]

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[6] It must be stressed, however, that in many cases high prices of banking services are not only consequence of high level of costs. They are also result of banks' policies and strategies, aimed at increasing profits. Thus, higher costs of banking services stemming allegedly from exogenous factors connected with burden of regulations or decisions from the domain of monetary policy (mainly referring to interest rates) are only official rhetoric of banks.

[7] Emphasizing the role of trust in sound and undisturbed operating of banks, N. Gennaioli et al. [2015] draw analogy between banking and medicine. Given information asymmetry, present in the both domains, it becomes clear that confidence is the condition *sine qua non* of mutual relations between bankers (doctors) and clients (patients), as the both parts differ in terms of information, knowledge and technical competence. Banks clients, like patient should have feeling that they are "in good hands" and trust is absolutely necessary to the final success (recovery/carrying out financial transaction).

The problems with trust and image of banks (especially the larger ones) were common already before the Global Financial Crisis. But since its outburst, the banks have experienced one of the worst crises of confidence ever. According to S. Lauteschlager [2015], this erosion of trust was triggered by many factors: the turmoil of years 2007–2010, increase of moral hazard in banks, connected with bailout procedures and programs (financed form taxpayers funds), actual impunity of many banks, even those which contributed to the crisis by conducting extremely risky operations (linked with huge bonuses for their CEOs even during the crises) or numerous scandals (manipulating LIBOR rates, large-scale tax evasion, the fraudulent behaviour of trades and dealers, misconduct in the selling of mortgages). All those things have undermined trust in banks which became to be seen – especially by common, ordinary clients – as greedy and unfriendly institutions, belonging to other, distant sphere of economy.

The shattered confidence of clients had to result in replacing banks and other financial institutions by other forms of lending and borrowing. In other words, lack of trust contributed to larger scale and faster pace of disintermediation process.

4. Consequences of disintermediation

Disintermediation, traditionally, is considered and analyzed from the commercial banks' point of view. It is the process especially strongly connected with these institutions and just to them its consequences are potentially (and actually) the most disastrous. Still, results of disintermediation and its influence may be also perceived with reference to other subjects and in many dimensions

First of all, detailed features, course and consequences of disintermediation will be disparate with reference to developed and developing countries. The both groups of countries differ, among others, in levels of development, pace of financialization, structure of ownership in the financial sector, patterns of individuals' behavior, demand on financial services and products, number of available alternatives to banks. All those factor determine scale and scope of disintermediation.

Moreover, disintermediation has an impact on the whole monetary and financial systems of individual countries, as it affects institutional basis of creation and regulation of money. First of all, as it was mentioned, the role and share of banks in the financial systems of individual countries decreases. Additionally, differences between banks and other financial intermediaries or even agents form other branches of the economy is blurring. Thus, it is hard to assess whether assets issued by those non-banking entities may serve as money. Moreover, banks constitute important chain in monetary policy transmission. Disintermediation, reducing role of the banks in the economy, in a way "breaks" the transmission, what makes conducting monetary policy onerous [Friedman 1999; King 1999; McCallum 2003].

What is characteristic, the process influences not only banks, but also other entities functioning in a given economy. Some of them are active parts in this process, while the others – only adjust to changes caused by disintermediation. It is not surprising, in the light of mentioned influence on monetary area and financial system – crucial parts of every contemporary economy.

Finally, disintermediation not necessarily should be linked only with threats and negative phenomena. There are also some advantages of the process, connected for instance with better and cheaper offer of financial services and products, development of the local communities or limiting scale of financial exclusion, by providing financial product on the more clear and friendly terms even for persons with low level of economic knowledge and those, who were not perceived by banks as profitable clients and thus were not offered satisfying terms.

Still, the most discussed in the literature problem are negatives and threats which disintermediation brings to the banks. First and foremost, it results (and also causes) in strong growth of competition from the part of non-banking (or sometimes even non-financial) intermediaries. The number of such agents has systematically grown. At the same time it is worth stressing that apart "traditional" competitors of banks, like investment funds, pension funds or insurance companies there emerged also brand new agents, labeled as *quasi banks* or *shadow banks*. As it was already signaled in the article, such name concerns all entities operating similarly to the banks, but without all the straightjacket resulting from supervisory and government regulations. On this account they are able to offer better conditions and have competitive advantage over "regulated" financial intermediaries.

The features of such institutions and consequences of their functioning have been widely discussed in the literature, especially from the critical point of view. It is stressed that such "shadow" (or parallel) banking may negatively influence financial stability, as it creates more uncertainty, promotes more risky behaviour of the involved agents and is not under financial supervisors' authority [Adrian, Shin 2009a, b; Dembiński 2011; Gorton, Winton 2010; Pozsar et al. 2010]).

Summarising, disintermediation brings along rather obvious negative consequences for banks. First of all, lesser are opportunities of generating profits – demand for banking services decreases and banks register outflow of clients. It concerns mainly typical "traditional" banking products – loans and deposits. Decreasing scale of these operations implies that banks lost to a large extent source of "cheap" money and, simultaneously, are confronted with shrinking possibilities of running the basic active operations.

Another consequence of intensified competition from the side of non-banking institutions is the need for extending the basic banking offer and attempts to entering new segments of the financial markets. The universal banks include into their offer also services connected with investment banking[8] and increase scale of the off-balance operations [Matthews, Thompson 2014; Heffernan 2005].

[8] It is worth noticing that combining both types of banking is at present rather not prohibited by law.

Such moves lead to blurring distinction between the banks and other financial intermediaries. Apart signaled already problems with definitions (which even deteriorated in the aftermath of these tendencies) it leads also to emerging of a new type of financial intermediary, combining “under the same roof” various forms and models of financial operations [Janc 2004]. Considering this tendency on the more general level, one may argue that disintermediation contributes to transformation of the universal (European, bank-based) model of banking system into the Anglo-Saxon one (market based).

Nevertheless, problems of the banks in the face of disintermediation are not identical with problems of the whole economy. As it was mentioned, disintermediation may have also some positive outcomes. Among them one may count emerging of the new institutional forms of financial intermediation and new methods of participation in the financial markets, the both elements potentially (and actually) limiting financial exclusion. Still, it must be remembered that some “disintermediated” entities, counted to shadow banking, could have been much more harmful to the economy than “ordinary” commercial banks. Moreover, these institutions at the same time also disregard small retail clients, not interested in speculative instruments, or offer them unfavourable terms and prices. Thus, specific dichotomy arises here between various forms of disintermediated entities – some of them may to some extent help to overcome banks’ shortages, while the other – make stability of financial system and situation of clients even worse.

5. Conclusions

Disintermediation has significantly changed competitive position and role of the commercial banks within the financial systems. It concerned especially systems of the European type (bank-based), but the diminishing importance of “traditional” banks was visible also in countries with financial systems based on the market. It is worth stressing that, among other factors, the important role in this decline of banking played the global financial crisis, contributing to growing distrust in financial institutions in general and in banks particularly. The customers, in part forced to this by credit crunch and tightening of banks’ policies and procedures, decided to limit their relations with banks. Still, both the households and small entrepreneurs needed to fulfil their financial needs and a natural choice as to turn to other institutions.

Thus, there emerged room for development of alternatives for commercial banking. Some of them were already well known institutions, like the cooperative banks or credit unions, while others – started to operate just in the last decade, like the social lending platforms. Their common future is more social character, as they function and operate closer to the clients, are more “friendly” for them and their offer is more convenient and transparent than the one in the large commercial banks. What is characteristic, this “alternative” institutions managed relatively well with the global financial crisis and its consequences, as they were perceived as less risky and more available for common clients.

Disintermediation may be thus perceived as a cause (and simultaneously result) of changes in the structure of financial systems. At the same time, it reinforced problems with supervision on financial institutions, increased uncertainty and level of moral hazard in the global economy and on the individual domestic markets. By no means, it was also conducive to spreading financialization processes, with all its negative consequences. Also conducting economic policy (especially monetary policy) became harder, due to ineffectiveness of many instruments, aimed at influencing private institutions (especially banks). The latter institutions have nowadays own sources of funds and liquidity are to a large degree independent of monetary authorities. They are also harder to supervise and regulate under current institutional conditions. It refers mainly to entities labeled as shadow banking.

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