

“Methodological background for integration of Ukraine’s non-banking financial services market into international financial environment”

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Methodological background for integration of Ukraine's non-banking financial services market into international financial environment

Abstract

The article demonstrates that the process of integration on the market of non-bank financial services is a special case of financial integration. It describes the emergence of new forms of integration on the financial services market – financial convergence. It presents a scientific approach to the classification of the forms of integration on the market of non-bank financial services according to the type of integration, its nature, the goal and level of management within the integration. The article offers a scientific and methodical approach to assessing the level of integration of Ukraine's non-bank financial services market into the global financial environment.

Keywords: integration, financial integration, financial convergence, non-bank financial services market, global financial environment.

JEL Classification: E44.

Introduction

Objective factors in the development of financial services in each country include the processes of globalization and integration on the international financial market, as well as the entry of financial intermediaries into the international financial environment. It contributes to cross-border mobility of capital, intensification of financial flows within the country, deregulation and liberalization of financial relations, development of advanced information systems, forms and methods of interaction among the market's participants, the emergence of new complex financial products. The experience of economic development of Eastern European countries shows a prominent role played in these processes by non-bank financial intermediaries as providers of long-term and low-cost funding.

The analysis of integration of the market of non-bank financial services into the international financial environment was carried out in many scientific works, including the studies conducted in Ukraine (V. Korneyev, V. Oparin, T. Vasylyeva, O. Kozmenko, O. Kuzmenko, I. Shkolnik, O. Boyko, V. Plastun, etc.).

Goal. The article's goal is generalization of forms and mechanisms of integration of Ukraine's market of non-bank financial services into the international financial environment.

The main results of the research. Integration is a social phenomenon, the result of human evolution and development of relations between individuals, communities and nations. Initially, the processes of internal integration provided preconditions for its external manifestation in the form of international and interstate cooperation. From an economic point

of view, integration is a system of economic relations between economic entities, the deepening of their interaction, the development of relations between them in order to achieve mutual benefits. It occurs between national economies of entire countries and between companies [9].

Within economic integration covering the totality of economic entities we will concentrate on financial integration, which is implemented through the formation of links between financial intermediaries. It involves both the processes of uniting the activity of the financial market's participants (banking, insurance activity, operations with securities, activities in the field of pension provision) and the formation of joint financial services – their types, composition, utility, and forms of provision and distribution [1]. Therefore, integration on the market of non-bank financial services is a special case of financial integration, which involves the formation of a system of economic relations between the subjects of the market of non-bank financial services in pooling their resources and capital, as well as the provision of financial services as a single financial product.

The current process of globalization contributes to the emergence of new forms of integration on the market of financial services – financial convergence. Financial convergence is realized on the basis of mutual penetration and assimilation of financial intermediaries, which manifests itself in the form of integration of banking and non-banking financial intermediaries.

Financial integration on the market of non-banking financial services can be represented as a horizontal consolidation of capital with the formation of internal relations within one group of market participants in one or several countries. Its goals may include growth of the market share, access to new segments,

withstanding the competition. Financial convergence is characterized by vertical integration of capital. It is based on the development of relations between different groups of financial intermediaries. Its strategic goal is to achieve synergy effects from offering converged services and products.

One of the components of the strategy of Ukraine's financial development is the deepening of integration of its financial intermediaries into the international

financial environment. The necessity of this is determined by two main factors: insufficiency of one's own financial resources and the need in innovative financial technologies. The problem of Ukraine's integration into the international financial environment is multifaceted and involves the solution of a number of problems outlined in [1]. Generalization of the above-mentioned approaches to the classification of the types of integration on the market of non-banking financial services is shown on Figure 1.

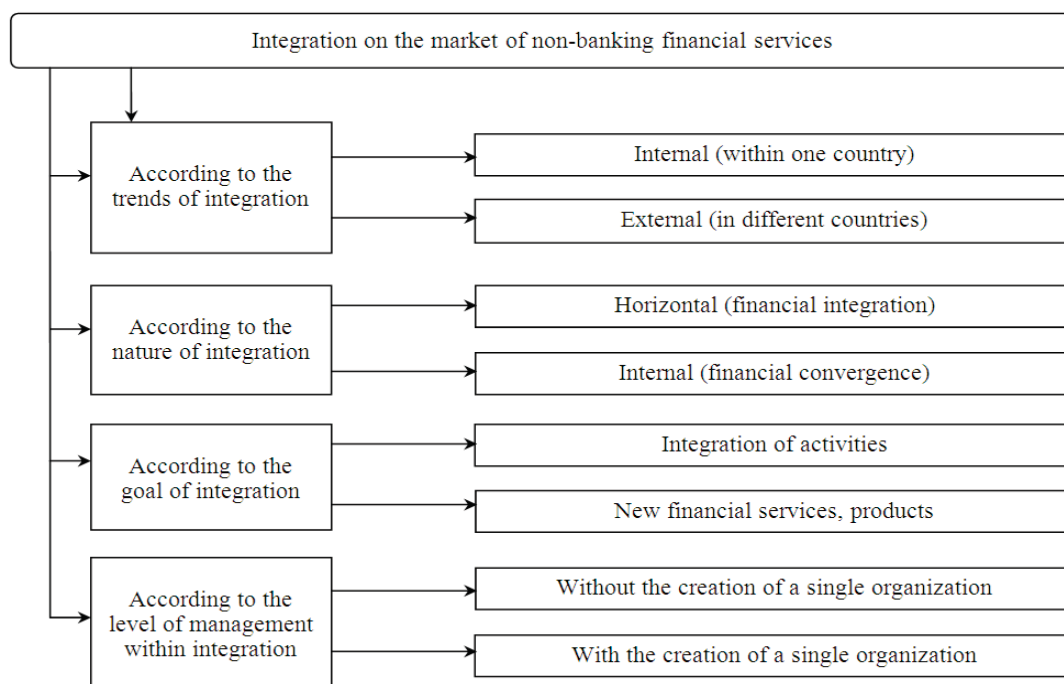


Fig. 1. Non-banking financial services integration on the market classification types

The theoretical foundations for the integration of the market of non-bank financial services of a country into the international financial environment are to be expanded. We believe that components for determining the level of integration should include:

1. The level of openness and development of the national economy in general and the market of non-bank financial services in comparison with other countries.
2. Comparison of the overall level of non-bank financial services market of a country with the development indicators for this sector in other countries.
3. The share of foreign capital on the domestic market of non-banking financial services.
4. The amount of foreign capital in the activities of participants on the market of non-bank financial services of a country.

5. The amount of domestic capital in the activities of foreign participants on the market of non-bank financial services.

The market of non-bank financial services is an integral part of the country's economy. Therefore, the degree of its openness depends on the general economic and socio-political situation in the country. Analysts of the European Bank for Reconstruction and Development have developed a methodology to evaluate the process of a country's transition to a market economy. It is represented by a set of Transition Indicators [14], which include integral assessments of the following areas (Table 1): the share of private sector in the country's GDP, %; openness of enterprises; openness of markets and foreign trade; openness of financial markets; infrastructure reforms.

Table 1. Indicators of structural changes in Ukraine estimated by EBRD for the period 2006-2012

| Indicators of structural changes | 2006 | 2007 | 2008 | 2009 | 2010 | 2011 | 2012 |
|---|------|------|------|------|------|------|------|
| Enterprises | | | | | | | |
| EBRD-privatization index of small enterprises | 4.0 | 4.0 | 4.0 | 4.0 | 4.0 | 4.0 | 4.0 |
| EBRD-privatization index of big enterprises | 3.0 | 3.0 | 3.0 | 3.0 | 3.0 | 3.0 | 3.0 |
| EBRD-index of reforms of enterprises | 2.0 | 2.0 | 2.0 | 2.0 | 2.0 | 2.3 | 2.3 |

Table 1 (cont.). Indicators of structural changes in Ukraine estimated by EBRD for the period 2006-2012

| Indicators of structural changes | 2006 | 2007 | 2008 | 2009 | 2010 | 2011 | 2012 |
|---|------------|------------|------------|------------|------------|------------|------------|
| Markets and trade | | | | | | | |
| EBRD-index of price liberalization | 4.0 | 4.0 | 4.0 | 4.0 | 4.0 | 4.0 | 4.0 |
| EBRD-index of foreign trade openness | 3.3 | 3.7 | 3.7 | 3.7 | 4.3 | 4.0 | 4.0 |
| EBRD-index of ensuring competition | 2.3 | 2.3 | 2.3 | 2.3 | 2.3 | 2.3 | 2.3 |
| Financial sector | | | | | | | |
| EBRD-index of changes in the banking sector | 2.3 | 2.7 | 3.0 | 3.0 | 3.0 | 3.0 | 3.0 |
| EBRD-index of changes in the non-banking sector | 2.3 | 2.3 | 2.3 | 2.7 | 2.7 | 2.7 | 2.7 |
| Infrastructure | | | | | | | |
| EBRD-index of infrastructure reforms | 2.0 | 2.0 | 2.0 | 2.3 | 2.3 | 2.3 | 2.3 |
| Average level of structural changes | 2.8 | 2.9 | 2.9 | 3.0 | 3.1 | 3.1 | 3.1 |

According to the EBRD methodology, a five-point scale is used for the analysis, in which “1” means an almost full adherence to the highly centralized planned economy and “5” is the attainment of standards of a pure market economy.

Thus, we can state that the average level of openness of Ukraine’s economy is about 60% of its potential. In the period from 2006 to 2012 it increased by only 11%. The best situation is observed in the sphere of privatization of small enterprises and liberalization of prices, while the worst situation is with the level of enterprise reforms and infrastructure reforms. The level of transformations in the sector of non-bank financial services is below average standing at about 54% of its potential.

In the context of using international indices as a factor of potential integration, an important role belongs to specific financial indices, such as The

Financial Development Index [13] prepared by analysts of the World Economic Forum.

The comparison of financial indicators of Ukraine’s development with other transition economies and economically developed countries reveals a significant gap. According to the general level of financial development it is the 59th position. However, on the positive side, we have development of the segment of non-banking financial services (34th position), although its level is two times worse than in Russia (Table 2).

Detailing of index values for the indicators of Ukrainian financial intermediaries shows that the best level of efficiency is observed with the indicators of securitization and mergers and acquisitions in the non-banking financial sector (26th and 29th positions), while the worst situation is with the banking sector’s efficiency (60th position).

Table 2. Comparison of components of the index of Ukraine’s financial development with other countries according to the data of 2012 (position/ranking)

| Components of the index | Country | | | | | | |
|--|---------|---------|---------|----------------|---------|---------|---------|
| | Ukraine | Russia | Poland | Czech republic | Germany | UK | USA |
| Institutional environment | 60/2.93 | 59/3.06 | 36/4.10 | 38/4.04 | 10/5.75 | 2/6.0 | 13/5.65 |
| Development of business climate | 52/3.57 | 32/4.50 | 36/4.40 | 35/4.42 | 11/5.61 | 8/5.75 | 13/5.58 |
| Level of financial stability | 60/3.14 | 41/4.19 | 40/4.31 | 11/5.19 | 18/4.93 | 43/4.12 | 38/4.36 |
| Development of banking financial services | 59/2.30 | 58/2.37 | 44/3.17 | 23/4.24 | 12/4.69 | 2/5.80 | 21/4.28 |
| Development of non-bank financial services | 34/1.95 | 8/4.09 | 20/2.68 | 50/1.56 | 16/3.06 | 3/4.85 | 1/6.11 |
| Development of the stock market | 53/1.40 | 35/2.05 | 43/1.75 | 52/1.41 | 13/3.80 | 2/5.44 | 1/5.86 |
| Level of financial openness | 56/2.66 | 50/2.83 | 34/3.43 | 31/3.51 | 16/4.40 | 12/4.51 | 5/5.06 |
| General | 59/2.37 | 39/3.30 | 37/3.41 | 35/3.49 | 11/4.61 | 3/5.21 | 2/5.27 |

We will make a comparison of the general development level of Ukraine’s non-banking financial services market with the indicators of this sector’s development in other countries. The analysis of the structure of assets of non-banking financial institutions in the countries with transition economies in Central and Eastern Europe and the developed countries makes it possible to draw the following conclusions:

- ◆ The Ukrainian market of non-bank financial services is inferior to other markets (in Ukraine

its total share is about 8% of the GDP while in Poland it is almost 41% and in Estonia – 28%).

- ◆ Participation of non-bank financial institutions in the economy is closely linked to the country’s level of economic development and its level of integration.
- ◆ The value of assets of non-bank financial institutions in these countries increased according to the rate of changes in the openness of the economy. Assets of insurance companies

in Poland in this period increased by 3 times, in Estonia – by 6 times, in the Czech Republic – by 1.5 times. Assets of pension and investment funds grew even faster. The reason for that was the high rate of integration.

- ◆ The developed countries own the biggest assets. In most countries the leading role on the market of non-bank financial services belongs to insurance companies (Germany, UK, Poland, Slovenia, and Czech Republic). In the United States and Hungary the main intermediaries are pension and investment funds.

According to the level of development, the highest level of integration is observed in the sector of insurance services. According to the League of Insurance Organizations of Ukraine [4] the amount of foreign capital on the insurance market remains

relatively unchanged. As of 2014, operating on the market are 112 insurance companies with foreign capital. That is 27% of all registered companies. The total volume of foreign investments amounted to 468.3 million Euros. According to countries of origin the capital is divided in the following way: Cyprus and the UK offshore territories – 43.6%, Austria – 15.6%, Russia – 9.8%, Kazakhstan – 5.5%, USA – 4.8%, Netherlands – 3.8%, France – 2.9%, Germany – 2.1%.

In spite of the relatively large volumes of investments into the non-banking sector on the part of some countries, the real investments that can be recognized as integration into the international financial environment are carried out as part of investment programs of the leading international financial conglomerates (Table 3).

Table 3. Investments of international financial conglomerates on the market of financial services of Ukraine [2, 8]

| International financial conglomerate (country of origin) | Financial intermediaries in Ukraine | | |
|--|-------------------------------------|---|---|
| | Banking sector | Insurance sector | Investment sector |
| Allianz (Germany) | - | Insurance company "Allianz", Insurance company "Allianz Life" | - |
| AXA (Belgium) | - | Insurance company "AXA Insurance", Insurance company "AXA Ukraine" | - |
| BNP Paribas S.A. (France) | "UkrSibbank" | Insurance company "Cardiff", Insurance company "Cardiff Life", Insurance company "AXA Insurance", Insurance company "AXA Ukraine" | JSC "UkrSib Asset Management", PLC "Ukrainian Leasing Company" |
| Generali (Italy) | - | Insurance company "Generali Garant", Insurance company "Generali Garant Life Insurance" | - |
| ING (Netherlands) | "ING Bank Ukraine" | Insurance company "ING Life Ukraine" | - |
| RZB-UNIQA (Austria) | "Raiffeisen Bank Aval" | Insurance company "Uniqa Life", Insurance company "UNIQA" | PLC "Raiffeisen Investment", PLC Asset management company "Raiffeisen Aval" |
| SEB (Sweden) | "SEB-Bank" (has left the market) | Insurance company "SEB LIFE UKRAINE" | Asset management company "SEB Asset Management Ukraine", Closed-end non-diversified corporate investment fund "SEB Stock Fund", Mutual interval diversified investment fund "SEB Money Market Fund", Mutual interval diversified investment fund "SEB Asset Balance Fund" |
| Petr Kellner (Czech Republic) | - | "Home Credit Insurance" | - |
| GRAWE (Austria) | - | "Grawe Ukraine", "Grawe Ukraine Life Insurance" | - |
| ERGO (Germany) | - | Insurance company "UTICO" | - |
| Ingosstrakh (Russia) | - | Insurance company "Ingo-Ukraine", Insurance company "PROSTO-insurance", Insurance company "PROSTO-insurance. Life and pension" | - |
| POCHO-Alians (Russia) | - | Insurance company "POCHO-Ukraine" | - |
| Rosgosstrakh (Russia) | - | Insurance company "Providna" | - |

The key targets for investment are insurance companies. Four conglomerates – BNP Paribas S.A. (France), ING (Netherlands), RZB-UNIQA (Austria) and SEB (Sweden) are present in various segments of the financial services market. Along with insurance they are actively developing the banking segment ("Ukr Sibbank", "ING Bank Ukraine", "Raiffeisen Bank Aval") and the market of investment management (JSC "UkrSib Asset

Management", PLC "Ukrainian Leasing Company", PLC "Raiffeisen Investment", PLC Asset management company "Raiffeisen Aval", Asset management company "SEB Asset Management Ukraine", Closed-end non-diversified corporate investment fund "SEB Stock Fund", Mutual interval diversified investment fund "SEB Money Market Fund", Mutual interval diversified investment fund "SEB Asset Balance Fund").

Given the leading position of the insurance segment and the highest level of its development (according to the Financial Development Index) relative to other non-bank financial intermediaries, we will analyze

active and passive operations of insurance companies, including reinsurance as a form of international cooperation between insurers in the sharing of risks and the transfer of financial resources (Table 4).

Table 4. Key indicators of reinsurance in Ukraine in the period 2003-2011. [3, 7]

| Year | Indicator | | | | |
|------|--------------------------------------|----------------------|-------------------------|--------------------------------|------------------|
| | Insurance premiums. mln. Hryvnias | Reinsurance premiums | | Premiums paid to non-residents | |
| | | Mln. Hryvnias | % of insurance premiums | Mln. Hryvnias | % of reinsurance |
| 2003 | 9135.3 | 5416.9 | 59.3 | 3175.9 | 58.6 |
| 2004 | 19431.4 | 11674.1 | 60.1 | 1907.2 | 16.3 |
| 2005 | 12647.0 | 6046.9 | 47.8 | 676.3 | 11.2 |
| 2006 | 13829.9 | 5621.6 | 40.7 | 561.1 | 10.0 |
| 2007 | 18088.2 | 6423.9 | 35.5 | 769.5 | 12.0 |
| 2008 | 24008.6 | 9064.6 | 37.8 | 1037.8 | 11.4 |
| 2009 | 20442.1 | 8888.4 | 43.5 | 1133.2 | 12.8 |
| 2010 | 23081.7 | 10745.2 | 46.6 | 1036.7 | 9.7 |
| 2011 | 22693.5 | 5906.2 | 26.0 | 1182.7 | 20.0 |
| 2012 | 21508.2 | 2522.8 | 11.7 | 1292.0 | 51.2 |
| 2013 | 28661.9 | 8744.8 | 30.5 | 2676.3 | 30.6 |

There are several stages in the interaction of the Ukrainian market with non-residents: till 2004 the share of premiums paid for reinsurance accounted for more than half of all premiums, with the share of non-residents exceeding 58%; in 2005-2011 there was a significant reduction in the volumes of reinsurance, with the share of non-residents fluctuating in the range of 10-16%; the period 2012-2013 was characterized by the significant

increase in the share of premiums paid to non-residents – up to 51%, although the level of reinsurance remained relatively low. We will determine the trends in the movement of insurance premiums relative to countries based on the fact that reinsurance is divided into active (the transfer of risks to other countries) and passive (assuming all reinsurance risks). The dynamics of active reinsurance is shown on Figure 2.

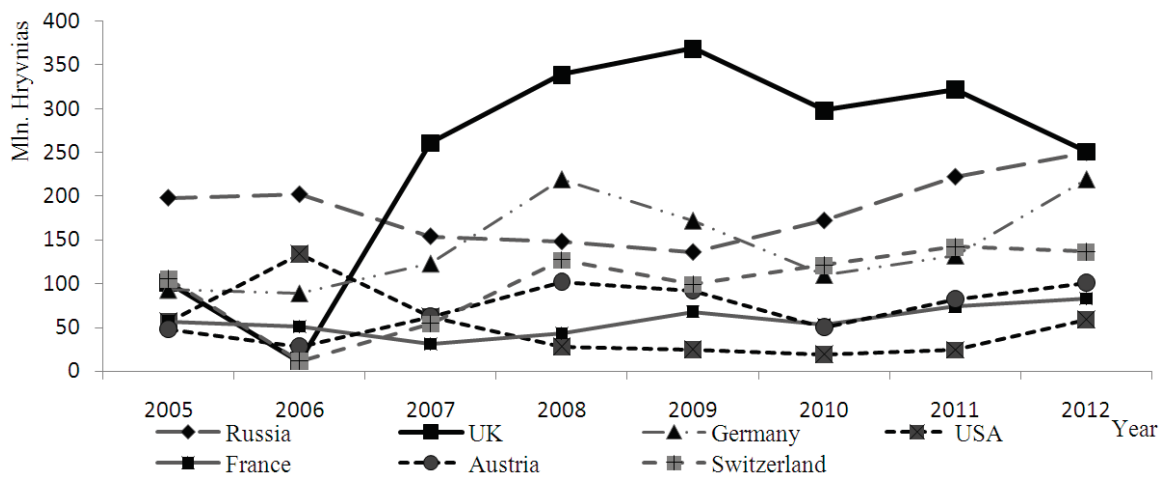


Fig. 2. Dynamics of active reinsurance by countries, 2005-2012 [3, 7]

The main countries for the transfer of reinsurance premiums of Ukraine are Great Britain, Austria, France, Germany, Switzerland and Russia. The major partners were Great Britain and Russia (by the end of 2012 their share amounted to 19% each). Other insurers had smaller shares: Germany – 17%, Switzerland – 11% and Austria – 8%. The dynamics of relationships with insurers demonstrates some differences in trends. For example, in the period 2006-2009 the dynamics of active reinsurance in Russia was decreasing, and in 2010-2012 it began to

grow rapidly. By contrast, in the developed countries the trend was generally reversed in the same period.

It is interesting to observe the comparison of the structure of active and passive reinsurance. The main partners who transfer their premiums to Ukraine are mostly the CIS countries with transition economies: Kazakhstan – 39%, Russia – 28%, Georgia – 3%, Uzbekistan – 2%. As an exception, France reinsured 11%, due mainly to activities of BNP Paribas S.A. group [3, 7].

The analysis of reinsurance has showed certain imbalances in the structure of active and passive reinsurance: Ukrainian insurers remit premiums mainly to the developed countries while receiving them from the CIS countries. This situation is the evidence of insufficient development of insurance and the level of its integration, the lack of opportunities to cover international risks.

Conclusions

Integration on the market of non-banking financial services is a special case of financial integration. A contemporary form of integration on the financial services market is financial convergence. The

components for determining the level of integration are: the level of openness and development of the national economy in general and the market of non-bank financial services in comparison with other countries; comparison of the overall level of the non-bank financial services market of a country with the development indicators for this sector in other countries; the share of foreign capital on the domestic market of non-banking financial services; the amount of foreign capital in the activities of participants on the market of non-bank financial services of a country; the amount of domestic capital in the activities of foreign participants on the market of non-bank financial services.

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