

FINANCIAL CRISIS: THE NEW STAGE OF INTERACTION BETWEEN BANKS AND INSURANCE COMPANIES IN UKRAINE

Oleg Pasko

The University of Banking of the National Bank of Ukraine (Kyiv)

Faculty of Economics, Department of Finance

1, Andriivska St., Kyiv

04070

Ukraine

e-mail: oleg@pasko.ws

telephone: +380 67 445 32 82

Abstract

Recently, Ukrainian financial market has been marked by a rapid development. Many global trends have manifested in Ukrainian financial market as well. One of such trends was an interaction between banks and insurance companies. The financial crisis resulted in certain changes in the financial institutions' activity all over the world, defining a new milestone of interaction between banks and insurance companies. The aim of the paper is to define the steps, that must be taken in field of interaction between banks and insurance companies in order to survive the crisis. Present conditions, previous events and theoretical studies helped us to get some results. Banks and insurance companies have faced certain challenges that resulted in the necessity to overview their approaches of alliances' formation and partnership establishment, to work out a new policy for advancing effectiveness and resisting unfavourable internal and external factors. Present financial market condition enables evaluation of taken measures efficiency and elaboration of new recommendations for improvement of the current situation in the context of an effective interaction between banks and insurance companies from the perspective of supervisors and companies themselves. It was defined that it is necessary to make improvements to the law base, business processes and implement mutual stability monitoring in banks and insurance companies. Synergy of these institutions and world experience with a consideration of local financial market may solve major challenges for banks and insurance companies during crisis.

Keywords: bank insurance; financial crisis; Ukraine; banks; insurance companies

JEL codes: G01

1. Introduction

Banks and insurance companies are major institutions of the financial sector and no wonder that they cooperate and compete when performing relevant activities. Their services are interconnected and their products are complemented and sometimes substituted. The

cooperation between banks and insurance companies resulted in contractual relationship in terms of selling products, creation of cross-sector strategic alliances, numerous merger and acquisition agreements. Thus, financial convergence in banking and insurance is a high priority topic for today's life and in the community worldwide.

Much has been written about the causes of the financial crisis. Financial crisis as known started in the US with the situation in the House Market in 2006, but the whole world faced its consequences in the fall of 2008. Ukraine faced them as well. Particularly, the financial crisis has seriously affected the national financial sector. Banks and insurance companies have got accustomed to that fact that the effective activity was not ready to new challenges.

Further, the effectiveness of activity and developing of new strategies on operations' optimization became of a special interest at this time. The existed procedures for cooperation of insurance companies and banks should be revised and modified. The measures, which had been already taken by various institutions are dominantly short term measures and are focused on settlement of minor current problems. This is why developing of new strategic tasks for banking insurance market sector and their accomplishment is a very essential aspect on the way of effective financial activity within the country and of searching for new solutions on improvement of current conditions.

2. "Pre-crisis" financial market in Ukraine

Before 2008, the Ukrainian economic has been rapidly developed. The growth of the real GDP was 7,9% during the 2007 and 2,1% during the 2008. Generally, the same situation on financial market - growing was not regular, but more rapidly.

Table 1 Ukrainian financial sector structure

<i>Assets</i>	<i>2007</i>		<i>2008</i>		<i>growth rates 2008/2007</i>	
	<i>mil. UAH</i>	<i>structure</i>	<i>mil. UAH</i>	<i>structure</i>	<i>%</i>	<i>mil. UAH</i>
<i>banks</i>	598300	93.1	927200	93.8	55.0	328900
<i>insurance companies</i>	32213	5.0	41930.5	4.2	30.2	9717.5
<i>credit unions</i>	5261	0.8	6064.9	0.6	15.3	803.9
<i>financial companies</i>	3274.6	0.5	6011.8	0.6	83.6	2737.2
<i>other non-banking financial organizations</i>	3701	0.6	7660,9	0.8	107.0	3959.9
<i>total</i>	642750	100	988868	100	53.8	346119

Source: State Statistics Committee of Ukraine, National Bank of Ukraine

The following indicators are used to show the long-term activity of banks and insurance companies: total insurance premiums increment and increment of credits that banks gave into national economic¹.

Table 2 Dynamic of banks and insurance companies' activity

	2003	2004	2005	2006	2007	2008
<i>insurance premiums</i>	97,5	100,4	-44,2	-4	13,6	11
<i>credits into economic</i>	80,6	-31,9	154,1	74	59,8	48,7

Source: State Statistics Committee of Ukraine

As we can see the development of banks and insurance companies is not stable, and it mainly due to rather shot history of Ukraine financial market. All transformations and events has been happening in a short term and as a result economic bubbles appeared

2.1 Interaction between banks and insurance companies

The process of the interaction between Ukrainian banks and insurance companies has been attended with tendencies. We can define some of them: creation of strategic alliances between banks and insurance companies, transition to customer-oriented model of business-processes, creation of financial supermarkets, provision of insurance and banking products and services by public distribution, creation of combined products and focusing on long-term savings (Pasko, 2008). As we can see these tendencies are similar to European ones (Voutilainen, 2006), but with some peculiarities. In the US and European countries and these processes developed through decades, while in Ukraine the development took several years, which resulted in many aspects and issues.

Unfortunately, there are no official macroeconomic statistics data concerning cooperation between banks and insurance companies in Ukraine. At least it was under development.

2.2 Known problems in interaction

As we can see banks and insurance companies have no commensurable assets. Banks domination and dictating terms to insurance companies appeared as a result from it. But this discrimination is not a profit-maximizing strategy (Block, Snow, Stringham, 2008). In Ukrainian practice banks choose insurance companies for accreditation (not vice-versa), they establish and buy insurance companies on a common basis. Thus insurance companies must

¹ real indicators in percent to the previous year with a glance of inflation rate

pay a great deal of commissions², deposit money to the bank account and make other unreasonable acts. If the client wanted to apply for a loan, unfortunately, he has no choice of insurance companies to insure the property. Thus banks wanted to promote their own insurance company. But today the customer is much more selective and exact.

Another major problem is the quality of banks and insurance company's assets. Unfortunately, the practice of pseudo-reserves formation on last reporting day is a common one. And it became the real problem in crisis period.

3. Banks and insurance companies in the period of crisis

Many negative events happened during the financial crisis in Ukraine³. The PFTS⁴ index lost more than 74% in 2008. In August - September prices on Ukrainian export products and a respective demand have decreased. It was a punch for the national export-oriented economy. Industrial production decreased by 0.5% for the first time since the beginning of current century. Prior to crisis the exchange rate of hryvnia was about UAH 4.70/USD and today⁵ it is about UAH 8.10/USD. The consequences of the financial crisis in Ukraine are obvious. As a result amount of GDP in the second quarter of 2009 was only 82.2 % comparing with 2008. Thus GDP decreased by 17.8%.

The financial sector is one of the major national activities to attract direct foreign investments (19% of total accumulated foreign capital). The share of foreign capital in the banking sector amounts to 37.2% of total capital, which exceeds the threshold of economic security established at 30%; in the insurance sector it approaches the threshold value, currently constituting 28.1%.

Crisis seriously affected the Ukrainian financial sector. The long-term lending market including mortgage lending was destroyed as well as consumers' credits. In 17 Ukrainian banks a temporary administration has been incorporated. In the first half-year of 2009 total insurance premiums decreased by 16%, some insurance companies appeared to be on the brink of the bankruptcy and their licenses were terminated.

² up to 40% of insurance premium in practice.

³ provided by State Statistics Committee of Ukraine, National Bank of Ukraine.

⁴ PFTS Stock Exchange is a registered by Ukrainian SEC stock exchange which is in operation since 1997 and currently is the largest marketplace in Ukraine.

⁵ The present date of October 2009.

3.1 Behaviour of companies

Transport and property insurance were largely dictated by current conditions and development of banking market. These types of insurance are related to banking channels. Though the growth of market for such types of insurance was terminated due to objective causes, certain market volume was gained. The objective of insurance companies is to preserve this volume under fast-changing conditions.

Due to decrease in paying capacity, banks apply practice of postponing of the principal, when only interest charges remain. Insurance companies understand the mentioned decrease in paying capacity of lenders as well. For sure the object of loan should be protected by insurance policy. In order to protect bank's and customers' interest, insurance companies applied the following scheme: decrease of insurance rate due to considerable increase of franchise – up to 10–20 %. Under such circumstances an insurance company should not recover numerous but minimal expenses of insurers, which enables the decrease of insurance premiums. Thus, insurance companies make their efforts to decrease the expenses.

One of the problem related to selection of insurance company to be a bank's partner, were incomplete requirements to determine the stability of insurance companies. Banks in the period of crisis are able to apply temporary administration, take operative measures on recovery of operations, while insurance companies have no such opportunity. Moreover, insurance companies are not required to approve their paying capability on a daily basis, they use a quarterly reporting. Insurance company should be capable of paying, meaning that they should be able to fulfill their actual and future obligations using their own assets. For this reason insurance companies should have quality assets not less than the volume of obligations of the company. In fact, banks are interested in high quality insurance coverage of the collateralized property.

In the current situation, it is practically impossible to evaluate the financial stability of insurance company from banks' perspective. Insurance companies are interested in banks' stability as well. Thorough integration of banking and insurance business means an increasing interdependence of these institutions. If one of the partners faces a serious problem, the other party is in unstable situation as well. Insurance companies have lost a considerable distribution channel due to termination of activities by banks.

3.2 Measures to be taken

Existing business processes should be more effective. Only under this condition the Ukrainian financial market can survive. One part of the optimization process is to increase effectiveness of bank and insurance companies' interaction. In our opinion this involves several steps:

developing a model with effective business-processes of banks and insurance companies alliance structures: official commission to banks as well as to insurance companies, right organization and effective cooperation between front- and back-offices;

mutual financial stability monitoring by partners on equal terms: only financial stable company can be an efficiency partner;

development of effective cooperation with legal assistance: making law with raising standards, especially for insurance companies.

4. Conclusion

Financial crisis revealed many weak points in the Ukrainian financial market, including scope of banks and insurance companies' interaction. Positive role of crisis is disclosing rotten business processes. It is means all economic bubbles is verifying by current events. Crisis makes insurance companies and banks act effectively. And if they will overcome the challenge, their future activities will be more effective.

Consequently the process of integration of insurance into banking sector should be more efficient. The mentioned financial institutions should consider each other as long-term strategic partners. Establishment of general partners enables accumulation of payments, activation of financial transactions, and an effective cooperation is required to overcome financial challenges. Such practice is on of the trends to increase the effectiveness of work during constant development of economy.

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