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THE PLACE AND ROLE OF INSURANCE COMPANIES IN INVESTMENT SECURITY OF ECONOMY OF UKRAINE

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Анотація. Досліджено місце страхових компаній в системі фінансових посередників. Визначено функції страхових компаній як фінансових посередників. З'ясовано, що страхові компанії виконують роль фінансового посередника шляхом здійснення інвестиційної діяльності в процесі використання сформованого ними інвестиційного потенціалу. Доведено, що в сучасних умовах сукупний інвестиційний потенціал страхових компаній не здійснює суттєвого впливу на інвестиційні процеси в економіці. Як перспективу, визначено поглиблення міжсекторної взаємодії між страховими компаніями та іншими фінансовими посередниками.

Summary. The place of insurance companies in the system of financial intermediaries is observed. The functions of insurance companies as financial intermediaries are determined. It is found out that insurance companies act as a financial intermediary by means of the investment activity in the use of formed investment potential. It is proved that

Аннотация. Рассмотрено место страховых компаний в системе финансовых посредников. Определены функции страховых компаний как финансовых посредников. Выяснено, что страховые компании выполняют роль финансового посредника путем осуществления инвестиционной деятельности в процессе использования сформированного ими инвестиционного потенциала. Доказано, что в современных условиях совокупный инвестиционный потенциал страховых компаний не осуществляет существенного влияния на инвестиционные процессы в экономике. Как перспективу, определены углубления межсекторного взаимодействия между страховыми компаниями и другими финансовыми посредниками.

currently aggregate investment potential insurance companies do not significantly affect on investment activity in the economy. In prospect, the intersectoral cooperation deepening between insurance companies and other financial intermediaries is determined.

Ключові слова: фінансове посередництво, фінансові посередники, страхові компанії, інвестиційний потенціал страховика, страхові резерви, активи, якими представлені резерви, інвестиційна діяльність страховика.

Ключевые слова: финансовое посредничество, финансовые посредники, страховые компании, инвестиционный потенциал страховщика, страховые резервы, активы, которыми представлены резервы, инвестиционная деятельность страховщика.

Key words: financial intermediation, financial intermediaries, insurance companies, insurer investment potential, insurance reserves, assets, represented by reserves, investment activity of insurer.

Statement of the problem. Investigating the specific features of insurance companies in the financial market the latter can be considered as financial intermediaries of contract and saving type, and the target (investment) funds.

Thus, special attention is paid to the exercise of

the investment function, indicating a special multifunctional role of insurance companies as financial intermediaries. A special role as a financial intermediary is played by insurance companies being in the process of using their investment potential, providing insurance services; insurance companies

are engaged in the movement of funds in the capital market.

This situation requires a grounded study of the place and role of insurance companies as financial intermediaries in the investment process as to ensuring national economic investment resources by means of creating conditions for sustainable economic development of Ukraine.

Analysis of recent research and publications.

The essence of investment activities, tools for its implementation and legal aspects of the insurance business are discussed in the scientific papers of V. Alenicheva, N. Nikulina, J. Fogelson, M. Yuldashev. The works of V. Bazilevich, A. Baranovsky, A. Wasylyk, A. Vasilenko, Y. Zhuravlev, V. Hrushko, K. Kovalenko, N. Tkachenko, T. Jaworska and others are dedicated to the clarification of the nature of insurance investments. Appreciating the contribution of scientists to the development of the institute of insurance relations it should be noted that the problem of determining the nature of insurance companies as financial intermediaries, their investment potential and important role in the reproductive system and impact on socio-economic development have not sufficiently investigated yet.

The purpose of the article is to study the practical aspects of the insurance companies as a financial intermediary by means of the investment activity in the process of using their investment potential.

Justification of scientific results. Possibility of the insurance companies as financial intermediaries in general and the investment activities performance, in particular, are defined by environmental conditions and their functioning:

- Availability of adequate market infrastructure, especially a functioning stock market;
- Development of institutional tools;
- Stability of the financial system in general and banking in particular;
- Presence of an effective system of financial law.

Taking into account that the current Ukrainian economy is in dire need of investment resources, the assessment of the investment potential of the insurance companies, opportunities, and its efficiency is now a rather urgent matter.

Thus, according to N. Tkachenko, «investment potential insurer» is a collection of funds that are temporarily and relatively free of obligations and they are used with the purpose of getting investment income [1].

The amount of insurance reserves and insurers' equity capital are the main sources of their invest-

ment potential and they are a major part of this amount in absolute terms.

The ability to accumulate significant cash flow and directing them to the economy turns insurance companies into powerful institutional investors. The criteria that give rise to attribute the insurance company to institutional investors are:

- A significant market share of investments;
- Participation in investment transactions on a regular basis;
- The nature of the investment intermediary activity [2, p. 196].

One of the most important indicators of the insurance market is the increase in capital of insurance companies (Figure 1.)

Differences in the nature of insurance risk, methods of forming insurance reserves and terms of insurance contracts define the specific investment policy of general insurance insurers and those insurers providing life insurance are summarized in Table 1.

Factors affecting the insurer's investment opportunities and, consequently, making influence on the formation of its investment potential can be combined into groups of direct and indirect ones, which in turn can be classified as major and adjusted factors. Direct major factors include: the amount of insurance reserves (life insurance reserves and other types of reserves than life insurance) and insurer equity capital (share capital and free reserves). Direct corrective factors consist of insurance premiums, accumulating by the insurer, the amount of insurance payments and insurance payments of compensation under insurance contracts, the structure of the insurance portfolio, the insurance agreements terms, the amount of insurer receivables, adequacy of insurance companies capital and return on equity.

Mediated factors affecting the value of the investment potential of the insurance company are: the number of insurance contracts entered into by the insurer, the total insurance amount (the amount of insurance liabilities), branch network of the insurer, the rating of the insurance company, the level of tax burden on insurance business, the rate of return of financial market, efficiency of economic sectors, living standards, the net income from investments and others.

Turning to foreign practice activities related to accumulation of temporarily free funds of economic entities by financial intermediaries it is revealed that insurance companies are serious competitors for banking institutions [6]. As to Ukraine, as of 01.01.2012, total assets of com-

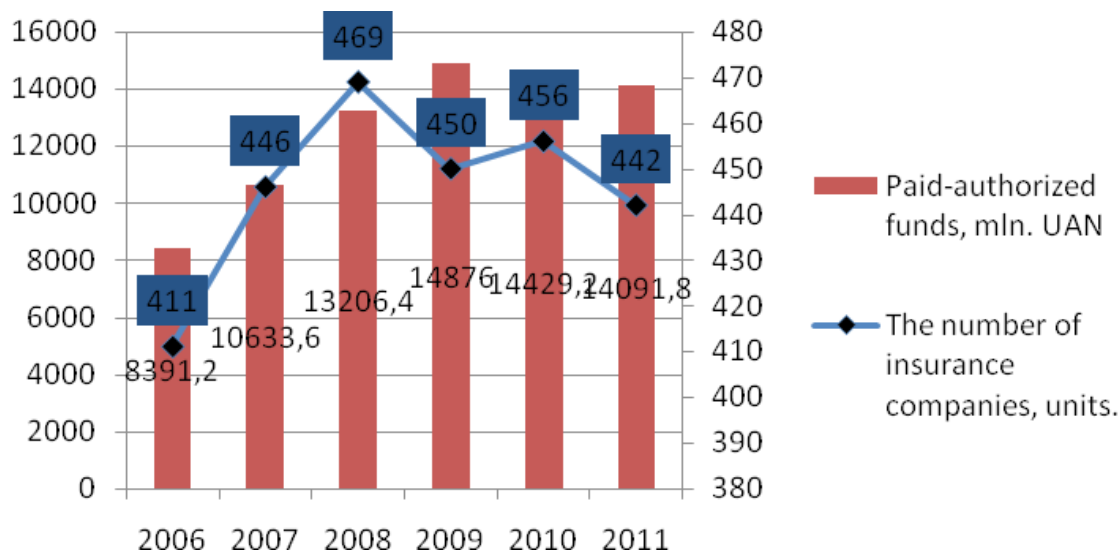


Figure 1. Change in the total number of insurance companies in Ukraine and the total paid-up share capital [3, 4]

Table 1

The comparative characteristics of investment activities via life insurance products and insurance other than life assurance [5, p. 301–302]

Comparative characteristics	Life Insurance	Insurance other than life assurance
Sustainability	Long-term	Short-term
Profitableness	It is necessary to obtain a stable income as profit from investment activities is included in determining the amount of insurance premium	Smaller yield versus liquidity investments
Liquidity	Does not play a significant role because the need for cash is covered by matching maturities with investment terms	There is an important principle of investment assets
Taking into account inflation processes	It is necessary to take into account inflation, as contracts are long-term	Under risk types of insurance the inflation can be ignored
Amount of investments	It is a significant one and is growing on account of capitalization	Investments amount is variable
Reconciliation of maturities	Maturity is often specified in the contract of insurance (insurance endowment)	Maturity is situational value. Necessary to consider the distribution of losses during the year on various types of insurance

mercial banks and non-bank financial and credit institutions (NBFCI) were – 941,3 billion UAH (117,81 billion USD), in return, banks own – 880,3 billion UAH (110,17 billion USD – 93,5 % of the total assets of the financial market) NBFCI own – 59,945 billion UAH (7,5 billion USD), including insurance companies own – 48,12 billion UAH (6,02 billion USD or 80,27 % of the total assets of NBFCI and 5,11 % of the total assets of the financial market) [4, 7].

The average size of assets per one company – 0,109 billion UAH, that is approximately 10,2 million Euro [3]. Despite the capital inflow in the insurance industry, the insurance market in Ukraine is considered as low capitalized. This problem is not only due to the insurance market but also it is a financial problem as a whole. The level of capitalization is critically low, that is not conducive to creating an attractive environment for capital inflows in the Ukrainian economy.

In order to assess the implementation of the investment function by Ukrainian insurers, we in practice will analyze the volume of generated by them insurance reserves and areas of their placement in profitable assets.

During the analyzed period against a background of growth in premium income a corresponding increase in assets and reserves of insurers also took place (Fig. 2).

At the end of 2011 the total volume of insurance reserves generated by insurers amounted to 11601 mln UAH, that is 947 mln UAH more than it was at the same period in 2010 (2008 – 10904 mln UAH, in 2009 – 10 141 mln UAH) (Table 2). As it is seen on Fig. 2 the total assets of insurance companies were growing much faster than the value of insurance reserves was. This situation may be due to revaluation of assets at the reporting date for the implementation of normative values.

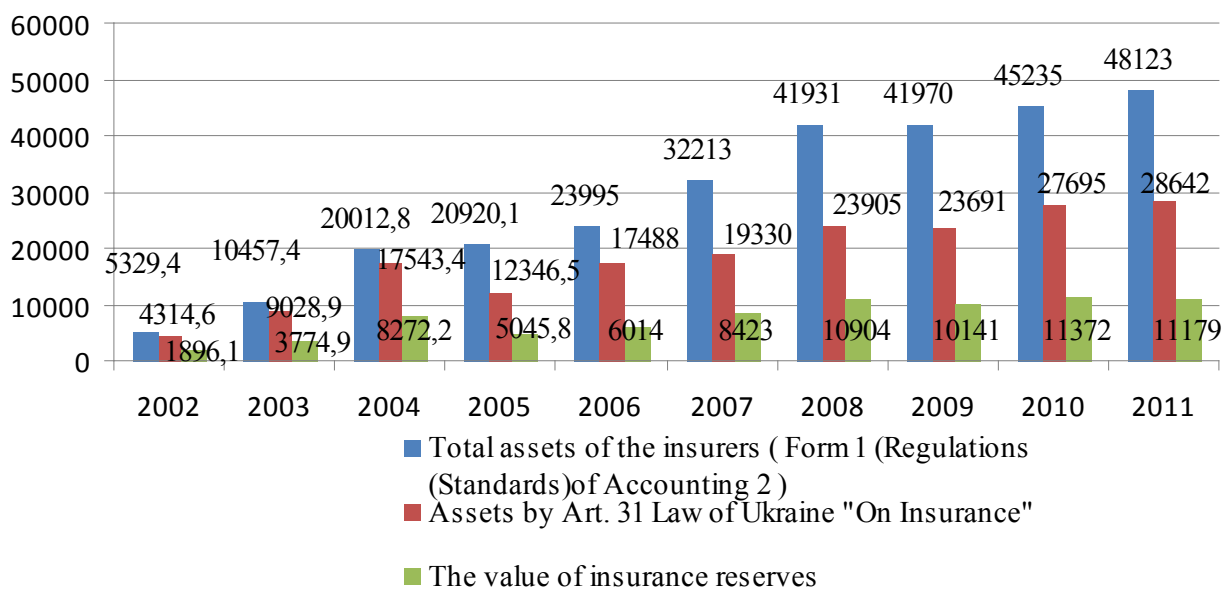


Figure. 2. Dynamics of assets and reserves of insurers during 2002-2011 [3, 4]

Table 2

Dynamics and structure of the existing insurance reserves of Ukrainian insurers over the period 2006–2011

	Technical reserves and reserves for life insurance											
	Pre-crisis period (stage)						Crisis and post-crisis period (stage)					
	2006		2007		2008		2009		2010		2011	
	mln. UAH	%	mln. UAH	%	mln. UAH	%	mln. UAH	%	mln. UAH	%	mln. UAH	%
Formed Insurance reserves, mln. UAH.	6014,10	100,00	8423,30	100,00	9903,40	100,00	9343,40	100,00	11371,80	100,00	11179,30	100,00
- Including technical reserves	5405,80	89,89	7432,00	88,23	9295,10	93,86	8352,10	89,39	9186,60	80,78	8515,50	76,17
- Including life insurance reserves	608,30	10,11	991,30	11,77	608,30	6,14	991,30	10,61	2185,20	19,22	2663,80	23,83

The above mentioned data in Table 2 show an increase in the share of life insurance reserves (mathematical reserves) in total insurance reserves formed by Ukrainian insurers. Primarily this is due to the increasing demand for storage contracts with elements of capitalization, which is the result of ongoing pension reform in Ukraine. Unfortunately, this increase wasn't caused by the state positive steps in this direction – tax benefits to pay income tax didn't occur, credit mechanisms to finance the construction or purchase of real estate weren't carried out, and vice versa – negative points of quality pension provision in the near future are expected.

In Table 3 the data describing the scope and direction of placement of technical provisions of Ukrainian insurers over the period 2006-2011 are presented. The table shows that the amount of financial resources mobilized by insurance companies is limited.

Throughout the analyzed period prevailing types of investments are bank deposits, the share of which in several years was ranged from 33,9 % in 2010 to 48,1 % in 2007. There is a large share of reinsurers – more than 20 % throughout the analyzed period an exception is the results of 2011 with the proportion of only 12,1 %, that Ukrainian assets dominate which are characterized by the highest liquidity in the investment portfolios of insurers.

Conditionally positive factor influencing on the increase in the possibilities of insurer investment a low level of loss insurance operations can be considered, which allows insurers to leave a lot of money after the insurance liabilities and financing costs of doing business.

The potential to increase the investment of insurance companies we guess an increase in the volume of insurance services for life insurance and it is in this area the government should introduce incentive mechanisms mostly of taxation character, that leads to the purchase of life insurance contracts both natural and legal persons (such mechanisms are widely used in developed countries).

Some differences are observed in the investment activities of insurers engaged in life insurance, so there has been a steady trend towards increasing the share of securities issued by the state of 7,59 % in 2006 to 30,8 % in 2011 to total assets, which are mathematical reserves (Table 3).

Trend in 2011 is a significant reduction in the proportion of claims to insurers – only 3,3 %. As a negative factor, it should be noted a sharp decline in the share of bond assets since 2009 from 9,21 % in 2008 to 2,4 % in 2011, corresponding to the

general market trends of investment. Generally, investment policy trends Ukrainian insurers, regardless of their specialization in terms of asset classes to cover insurance reserves, which are often used by insurers are bank deposits (deposits), bank account, and investing in securities, including securities issued by the government.

Noteworthy is the fact that the financial crisis has not absolutely affected the structure of investment directions of insurance reserves. In our opinion, this is due to the fact that the behavior of insurance companies as investors due to the peculiarities of the insurance system, including the duty to comply with the regulatory framework for the parameters and the proportions of the placement of insurance reserves. This aspect distinguishes the insurance company of the other financial intermediaries – activities to attract temporary funds of economic entities and activities as to their placement are strictly regulated and governed by the state.

The insurer, acting as an investor, not only generates additional revenue stream, but also he is influenced by a number of financial risks (depreciation of assets, non-return on assets placed in forms of insurance reserve funds), the implementation of which can lead to losses and throwing doubts on its ability to fulfill obligations under insurance contracts and, in total, having negatively impact on the financial stability of the insurer.

During the analyzed period the investment portfolio, as insurers of general insurance and life insurance companies is characterized by relative stability. The analysis of assets of insurers shows that the basic principle that Ukrainian insurers guided when placing funds – principle of liquidity.

Data concerning the investment of insurance companies in Ukraine indicate scarcity of investment insurance fund – it is about 0,09 % of the total investments of residents in the economy. [8]. As we see in Ukraine, despite the increase in the assets of insurance companies in the institutional structure of financial intermediaries they occupy a small proportion and therefore, to argue that Ukrainian insurance reserves of insurers being an important factor in investment is prematurely.

The reasons that determine the development of low insurance investment activities in Ukraine are:

- Underdeveloped stock market and limited effective and reliable financial instruments;
- Strict government regulation of the placement of insurance reserves;

Table 3

Directions of investing in technical reserves during 2006–2011

	Technical reserves											
	Pre-crisis period (stage)						Crisis and post-crisis period (stage)					
	2006		2007		2008		2009		2010		2011	
mln. UAH.	%	mln. UAH.	%	mln. UAH.	%	mln. UAH.	%	mln. UAH.	%	mln. UAH.	%	
Formed insurance reserves, mln. UAH.	5405,8	-	7432,0	-	9295,1	-	8352,1	-	9186,6	-	8515,5	-
Asset categories defined by Art. 31 of Ukrainian Law «On Insurance» for submission of insurance reserves, mln. UAH.												
Cash on current accounts and cash on hand	462,5	8,26	886,7	11,66	1205,8	11,54	994,6	12,46	966,2	10,3	1338,0	15,01
Bank deposits	2548,3	45,53	3661,3	48,13	3766,1	36,05	2790,0	34,97	3168,3	33,9	4098,4	46,0
Bank metals	н/д	-	н/д	-	60,5	0,6	54,1	0,7				
Real estate	323,7	5,78	518,8	6,82	810,0	7,75	595,7	7,46	673,5	7,2	590,8	6,6
Legal requirements for reinsurers	1130,1	20,49	1570,8	20,65	2447,3	23,42	1902,0	23,84	2549,9	27,3	1076,0	12,1
Investments in the economy of Ukraine in the areas defined by the Cabinet of Ministers of Ukraine	4,5	0,08	48,4	0,64	44,3	0,42	44,3	0,56	14,4	0,2	0,8	0,0
Other assets (bank metals and loans insured)	26,4	0,65	49,3	0,65	60,5	0,6	54,1	0,68	15,7	0,2	25,1	0,3
Securities, including:	1091,2	19,50	871,3	11,45	2112,9	20,22	1598,3	20,03	2777	24,06	2843,7	24,5
1) Shares	811,3	14,50	721,0	9,47	1867,4	17,87	1297,9	16,27	1246,6	13,4	1185,1	13,3
2) Bonds	144,9	2,59	62,9	0,82	177,1	1,7	102,5	1,28	107,9	1,2	197,6	2,2
3) Mortgage Certificates	1,6	0,03	0,0	0,00	0,3	0,00	0,0	0,00	0,2	0,0	0,0	0,0
4) Securities issued by the State	133,4	2,38	87,5	1,15	68,1	0,65	197,9	2,48	593,2	6,4	399,8	4,5
Loans to policyholders-citizens that are issued in the manner prescribed by competent authorities and agreed with the NBU	not investigated	-	not investigated	-	0,0	0,0	0,0	0,0	0,0	0,0	0,0	0,0
Long-term loans for housing, including individual builders used in the manner prescribed by Cabinet of Ministers of Ukraine	not investigated	-	not investigated	-	0,0	0,0	0,0	0,0	0,0	0,0	0,0	0,0
TOTAL	5596,6	100	7606,6	100	10446,9	100	7978,9	100	11541,8	100	11600,6	100

- Lack of state regulation of investment processes;
- Insufficient investment resources into a single insurer limiting investment opportunities;
- The lack of public information about potential targets;
- Limiting the investment activities connected to the demands of the founders' agreements with partners such as banks;

- Availability of high investment risks and low level of corporate governance;
- Lack of scientific research on improving the investment performance of insurance companies.

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