

JEL CLASSIFICATION: G34

FINANCIAL CONGLOMERATES: SIGNS OF IDENTIFICATION, PECULIARITIES OF FORMATION AND REGULATION IN UKRAINE

Nelya G. NAGAICHUK

Candidate of Economics, Associate Professor of Department of Finances and credit of Cherkasy Educational and Scientific Institute of the SHEI "Banking University"
e-mail: nagaichuk_n@mail.ru

Iryna V. TKACHENKO

Candidate of Philology, Senior Lecturer of Social Sciences and Humanities Department of Cherkasy Educational and Scientific Institute of the SHEI "Banking University"

Summary. The economic nature of financial conglomerates is considered. The features that allow to identify a financial conglomerate as an organizational form of integrated financial intermediary are revealed. The legal forms in which financial conglomerates can function in Ukraine are defined. Financial conglomerates are a new source of threat to national financial systems, and that requires the introduction of prudential supervision and creating a mega regulator.

Аннотация. В статье рассмотрена экономическая природа финансовых конгломератов. Выявлены черты, позволяющие идентифицировать финансовый конгломерат как организационную форму интегрированного финансового посредника. Определены организационно-правовые формы в которых могут функциониро-

Анотація. В статті розглянуто економічну природу фінансових конгломератів. Виявлено риси, що дозволяють ідентифікувати фінансовий конгломерат як організаційну форму інтегрованого фінансового посередника. Визначено організаційно-правові форми в яких можуть функціонувати фінансові конгломерати в Україні. Виявлено, що фінансові конгломерати виступають новим джерелом загрози стабільності національних фінансових систем, що вимагає впровадження системи пруденційного нагляду і створення мегарегулятора.

вають финансовые конгломераты в Украине. Выявлено, что финансовые конгломераты выступают новым источником угрозы стабильности национальных финансовых систем, что требует внедрения системы пруденциального надзора и создание мегарегулятора.

Key words: *financial intermediary, financial conglomerate, financial integration.*

Ключові слова: *фінансовий посередник, фінансовий конгломерат, фінансова інтеграція.*

Ключевые слова: *финансовый посредник, финансовый конгломерат, финансовая интеграция.*

Formulation of the problem. A modern economy, that is based on accumulation as a driving force of economic growth, needs the development of institutions that are engaged in the redistribution of savings. These institutions include financial intermediaries, which accumulate savings. Structural changes in the

economy cause changes in the needs of customers in financial services, which are becoming more diverse and complex. This, in turn, hampers their assignment to the traditional services of banks or insurance companies. Products of financial intermediaries are already considered as a part of a set of financial prod-

ucts and services, united by a common feature - price risk. Examples include insurance products that have features of deposits, certain derivative securities that have the characteristics of an insurance product, issuance of corporate bonds that are replacing bank loans and so on.

With the development of financial intermediaries we can see the modification of their structure from individual companies that operate in a specific segment of the financial market to integrated financial intermediaries - conglomerates. Foreign experience shows that a collaboration between various financial intermediaries led to the formation of financial conglomerates [1, p.166].

Analysis of recent research and publications.

The features of the origin and development of financial conglomerates and their role on the global financial markets were considered in the works by R. Levine, L. Laeven, H. Jakson, Y. Evlakhova. The functioning of financial conglomerates and their impact on the development of domestic financial markets were studied by V. Korneev, I. Shkolnik, A. Zemlyachova, A. Seleyman and others.

The aim of the article. Existing studies do not provide a complete picture of the features of the organisational forms of financial conglomerates, as well as the specifics of regulation and supervision of their activities in Ukraine, that resulted in the need for a better understanding of these issues.

Basic material. In the late 70s of the 20th century there appeared a situation on the global financial market that created favorable conditions for the alignment of banking and insurance businesses. Financial institutions were operating in conditions of easing state control, reforms in the financial sector, increased competition and rapid development of information technology. This was one of the reasons for the convergence and unification of banking and insurance businesses and these trends were characteristic of all developed countries.

In mid 1990s the need for structural changes in the global financial system to improve efficiency and financial sustainability of financial institutions became more topical. One of the ways of solving this problem was the consolidation of capital of financial institutions and the universalisation of their activities. The need to combine efforts of various financial institutions in developed countries was largely due to increased competition and falling profits of highly specialised segments of the financial market.

The key event was the adoption of the Gramm-Leach-Bliley Act (GLBA), also known as the Financial Services Modernization Act in 1999. It repealed

part of the Glass-Steagall Act of 1933, removing barriers in the market among banking companies, securities companies and insurance companies that prohibited any one institution from acting as any combination of an investment bank, a commercial bank, and an insurance company. With the bipartisan passage of the Gramm-Leach-Bliley Act, commercial banks, investment banks, securities firms, and insurance companies were allowed to consolidate.

As to the European financial market in the late 90's of the last century, it was characterised by inter-merger due to the advent of the single currency - the euro. At the same time, the European financial market was characterised by expansion of banks in the insurance segment, vendor financial services aimed at reducing costs through consolidation of financial institutions.

The trend of the late 90's was to improve the competitiveness and profitability of financial institutions through universalisation of business, or increasing specialisation through mergers and acquisitions of various financial institutions.

Thus the impetus for the emergence of financial conglomerates were the financial reforms that negated boundaries of individual segments of the financial market.

According to Y. Evlakhova, the main reasons for the emergence of financial conglomerates are: the need for more diverse and sophisticated financial services; finding new ways to increase profitability; the need to adapt to economic globalisation; distribution of financial innovation; deregulation; finding new ways to attract potential clients; and the need to protect the interests of the managers [2, p. 23].

A. Zemlyachova notes that the economic conditions for creating a financial conglomerate are: cheaper services provided by each of the participants; attracting new and retaining old customers by implementing an individual approach to customer requests with minimal time and effort; image forming groups that can solve all the problems of the client; creation of new products, combining the positive characteristics of a variety of goods (services) into a single unit; reducing the risk and improving control over cash flows within the group [3, p. 87].

First, we will discuss what a conglomerate is. In general, a conglomerate is a form of organisational integration of companies, which, in turn, brings together a network of diverse institutions under a single common control. The main feature that characterises a conglomerate is a combination of two or more corporations engaged in entirely different businesses that fall under one corporate group. A con-

glomerate, usually involves a parent company and many subsidiaries. Often a conglomerate is a multi-industry company. Conglomerates are often large and multinational. Their main goal is the creation of high returns in countries with low tax rates.

The term “financial conglomerate” can be used for any group of institutions that have a common property, and with their activities carried out in the financial sector. The minimal prerequisite of a financial conglomerate is that its members should include at least two institutions that represent a banking, insurance and / or investment sector.

From a larger perspective, based on the areas of financial intermediation, financial conglomerate is a market participant, whose work extends not less than two out of five areas: loans, deposits and cash management services; insurance; corporate finance, subscription and placement of securities; asset management, investment funds services or consulting; retail investment services.

Thus, for a financial institution to be a conglomerate, asset size is not a primary identification characteristic. But its presence in various segments of the financial market is taken into account.

According to Directive 2002/87/ EC “On the Supplementary Supervision of Credit Institutions, Insurance Undertakings and Investment Firms in a Financial Conglomerate”, adopted by the European Parliament and the Council in December 2002, a financial conglomerate shall mean a group which meets the following criteria [4]: a) a regulated entity (a bank, an insurance or investment company) is at the head of the group or at least one of the subsidiaries in the group is a regulated entity; b) at least one of the entities in the group is within the insurance sector and at least one is within the banking or investment services sector; c) the consolidated and/or aggregated activities of the entities in the group within the insurance sector and the consolidated and/or aggregated activities of the entities within the banking and investment services sector are both significant.

The regulators of some countries describe financial conglomerates in a more narrow sense. Thus, in the US a financial conglomerate is a union, which includes a banking institution that is not prerequisite in accordance with Directive 2002/87 / EC.

Taking into account all that has been mentioned above we can say that a key feature that allows us to define a financial institution from a financial conglomerate is its presence in various sectors of the financial market. The proof of this is found in the work of A. Seleyman [5], who defines a financial conglomerate as a group of organisations whose main activity

is financial and whose amenities include regulated business units operating in at least two of the following areas: banking, insurance and securities.

Let’s consider the feasibility of integrating financial intermediaries that are provided by Ukrainian legislation. In Ukraine the right of financial institutions to voluntarily merge their activities is legally enforceable. Types of groups that can be formed by domestic business entities are associations, corporations, trusts and consortia [6]. In other countries, the enterprises may be combined into trusts, syndicates, etc. due to national traditions and legislation.

The legal basis of the formation of integrated financial intermediaries in Ukraine is the Law of Ukraine “On Financial Services and State Regulation of Financial Markets”, which according to Chapter 1, Article 16 “Association of Financial Institutions” stipulates that financial institutions have the right to voluntarily integrate their activities if they are not contrary to the law on protection of economic competition and the requirements of the laws on the regulation of certain financial markets. Legal status, types, the establishment, operation and legal regime of the termination of the association is determined in accordance with the laws of Ukraine.

According to Ukrainian legislation, banks may establish banking groups and be a member of the financial, banking and financial holding companies. The bank holding company is a financial holding company in which the overwhelming financial institutions that are its subsidiaries and associated companies are banking institutions. The legal status of holding companies is defined by Article 126 of the Civil Code of Ukraine and the Law of 15.03.2006 “On Holding Companies” according to which the holding company is a public company that owns, uses and disposes corporate shares of two or more corporate enterprises.

The procedure for the creation, management and termination of the holding company is regulated by the Law “On Holding Companies.” It should be noted that since this law came into force in Ukraine, no holding company has been established in accordance with its provisions because it is supposed to create the Unified State Register of holding companies that are an integral part of the Unified State Register of Legal Entities and individual entrepreneurs. Moreover, according to Chapter 4, Article 3, a holding company acquires the status of a legal entity from when it is entered into the Unified State Register of holding companies [8]. A specially authorised body on state registration provides the State Register of holding companies in Ukraine. Today the State Committee of

Ukraine for Regulatory Policy and Entrepreneurship has this authority. However, maintaining the Unified State Register of holding companies of Ukraine has not been made part of the range of this Committee's powers, the order of state registration of holding companies was also not approved by The Cabinet of Ministers [9]. According to the Law "On Protection of Economic Competition", the creation of a holding company requires the prior authorisation of antitrust authorities or the Cabinet of Ministers of Ukraine.

One of the positive aspects of the formation of the bank holding company is that every bank that is a part of this entity, will be able to improve their financial situation by focusing unprofitable loans in a particular bank. An example of such a merger is when a large bank buys a small bank, with the required license and takes back a functional part of its assets and most importantly, the functioning of its liabilities, including customers. Debts and creditors remain within the old bank. In this case the bulk of the business is sound and customers won't suffer.

The next positive aspect of such an association within the banking sector is that if banks from different regions are merged within the group, it will be possible to extend the inter-relationships, turning them into intra-group that will solve the problem of the lack of a branch network. This will help to develop new geographical markets. This also increases the financial stability of the group. But in general, this model is difficult to consider effective in solving the basic problems of the banking system, since the degree of integration and centralisation of management in it are weak.

According to Article 1 of the Law of Ukraine "On Financial Services and State Regulation of Financial Services" it is possible to create financial holding companies and banks can be members of them.

A financial holding company is a legal entity whose main activity is participation in the authorised capital of legal entities, and activities of financial institutions that are its subsidiaries and / or associated companies.

The main aim of creating a financial holding company is to gain control over the assets of enterprises of different financial sectors to improve management at a group level. This form of business organisation allows to better adapt to the changing situation in the global financial markets - the accelerated development of the financial infrastructure and the removal of restrictions on banking activities provide an opportunity to increase competitiveness by reducing costs in the consolidation of financial institutions and the universalisation of services. In addition, it is

believed that with the emergence of financial holding companies the level of trust within the group is increased.

Functioning of financial conglomerates has both positive and negative traits. One of the advantages of this association is observed in the short term - improving the efficiency of the financial system. The emergence of financial conglomerates is the result of a conscious strategy for business owners, who are oriented on the growth of capitalisation based on networking, adjustment of conflict of interest with management and the use of tax benefits. The main advantage of the cooperation of financial institutions in the form of a financial conglomerate is expanding their market presence and increasing sales by reducing the cost of services and economies of administrative, marketing and technology costs.

The negative aspect is evident in the long run and is accompanied by cornering the market, which is characterised by a reduction in the number of participants or sectors, the rising cost of financial services to consumers and, ultimately, reduced competition in the financial market and reduced the effectiveness and efficiency of the financial system as a whole.

The problems that accompany the activities of conglomerates and can later cause their "death" are as follows:

- excessive diversification. This leads to the fact that the competitiveness of goods and services of a conglomerate is gradually reducing;

- suboptimisation. Though the technological similarities between the companies that make up the conglomerate are weak, the companies still try to gain intragroup cooperation relations, as manifested in the pursuit of each company to establish the most favorable price for a transfer, and as a result, the final product is expensive and uncompetitive.

Penetration of foreign financial conglomerates in the financial markets of other countries have both positive and negative traits. The positive points can include: accelerating the formation of financial markets in these countries; introduction of new technologies and management; development of relations with the international market and others. The negative points are: the displacement from the national market of resident financial institutions by foreign conglomerates; the possibility of losing the economic independence of the country.

The integration of financial markets of individual countries into global financial markets leads to synchronisation of national economic cycles with the world cycles, which can be viewed as a positive development i.e. a stabilising effect on the national econo-

my is being performed, that makes it possible to minimise the negative effects of local shocks as well as negative development - the crisis phenomenon can be imported. Thus, financial conglomerates reduce the national risks and increase the global ones.

Conclusions. From the results of the study a conclusion can be made that a financial conglomerate has not only become a new member of the financial market but a new object regulated by the authorities who are in charge of state supervision of the financial sector. The need for such regulation is due to the specifics of the formation (integrated financial intermediary): firstly, the financial conglomerate may include financial intermediaries that are already being regulated by the state by the established rules, and secondly, can include non-financial institutions that are not subject to state regulation.

Considering the first feature, regulators should consider the fact that the relationship between the companies that are a part of a financial conglomerate makes it easier for risk transfer between them and as a result, companies are at risk, not inherent for their activities in the financial market.

References:

1. Kremen V. Stratehiya konverhentsiyi yak suchasna model rozvytku finansovoho poserednytstva v Ukrayini // Svit finansiv: naukovyy zhurnal / Ternopil'skyi natsionalnyy ekonomichnyy universytet. Ternopil, 2009. – Vyp. 4 (21). – S. 165-173.
2. Evlahova Y.S. Regulyrovaniye deyatelnosti finansovykh konglomeratov // Rynoch'naya ekonomika i finansovo-kreditnyye otnosheniya: Uchonye zapiski. Vyipusk 14 / RGEU «RINH» - Rostov na Donu, 2008. - 175s.
3. Zemlyachova O.A. Ekonomichni ta pravovi zasady stvorenniya finansovykh supermarketiv bankiv's'kym ta strakhovym biznesom // Naukovyy visnyk: Finansy, banky, investytsiyi - 2012 – №4. – S. 85-90.
4. European Parliament and Council Directive 2002/87/EC of 16 December 2002 on the Supplementary Supervision of Credit Institutions, Insurance Undertakings and Investment Firms in a Financial Conglomerate and Amending Council Directives 73/239/EEC, 79/267/EEC, 92/49/EEC, 92/96/EEC, 93/6/EEC, 93/22/EEC, 98/78/EC and 2000/12/EC: <http://europa.eu/scadplus/leg/en/lvb/l24038c.htm>
5. Seleyman A. Motyvy stvorenniya finansovykh konhlomerativ ta kharakterni ryzyky yikh diyalnosti u suchasnykh umovakh / A. Seleyman // Stratehiya rozvytku Ukrayiny. - 2011. - № 2. - S. 183-188.
6. Pro finansovi posluhy ta derzhavne rehulyuvannya rynkiv finansovykh posluh: Zakon Ukrayiny vid 03.12.2008 r., № 2664-III. – [Elektronnyy resurs]. – Rezhym dostupu: www.rada.gov.ua.
7. Zakon Ukrayiny «Pro kholdynhovi kompaniyi v Ukrayini» . – [Elektronnyy resurs]. – Rezhym dostupu: <http://zakon2.rada.gov.ua/laws/show/3528-15>
8. Pro finansovi posluhy ta derzhavne rehulyuvannya rynkiv finansovykh posluh: Zakon Ukrayiny vid 03.12.2008 r., № 2664-III. – [Elektronnyy resurs]. – Rezhym dostupu: www.rada.gov.ua.
9. Komentar do Hospodarskoho kodeksu <http://legalexpert.in.ua/komkodeks/hku/85-hku/2679-126.html>