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## PROBLEMS OF THE UKRAINIAN INSURANCE MARKET DEVELOPMENT OF 2011

**Nelya G. NAGAICHUK**

*Candidate of Economics, Associate Professor of Department of Finances of Cherkasy Institute of Banking of the University of Banking of the NBU (Kyiv)*  
E-mail: nagaichuk\_n@mail.ru

**Olena O. MEKHANIKOVA**

*Candidate of Philology, Senior Lecturer of Social Sciences and Humanities Department of Cherkasy Institute of Banking of the University of Banking of the NBU (Kyiv)*

*Summary. In the article an analytical overview of the current state of insurance market of Ukraine condition is conducted with the purpose to identify problems hindering its effective functioning.*

**Key words:** *insurance, insurance market, market of insurance services, reinsurance, insurance premiums, insurance market concentration, insurance culture, financial literacy.*

**Problem setting.** Formation of the Ukraine's market economy, the development of its infrastructure, creation of effective mechanisms for managing of all market entities provides an objective necessity for the existence of insurance as a form of business, the search for adequate protective methods and reimbursement of losses both individuals and legal entities. Insurance industry and insurance market are essential for social and economic development of the national and international markets.

Insurance doesn't belong to the manufacturing sector, as a new value isn't created within insurance, but owing to insurance the loss is reimbursed upon the occurrence of adverse events, and it turns insurance services to one of the mandatory conditions of production process continuity.

The aim of the paper is an analytical review of the Ukrainian Insurance market in 2011 and identification of problems needed to be urgently solved ensuring a worthy place of insurance in the financial relations system.

**Proving of scientific results.** Current status and insurance development in Ukraine reflects the contradictory processes. The insurance market is heterogeneous, resulting in the growth of some segments in the stagnation of others. There is a disparity between the risky (general) insurance companies and life insurance companies, indicating a lack of long-term life insurance and private pensions. Excessive number of insurers in the market makes difficulties for monitoring and state controlling over their activities.

Indicators of insurance market concentration in terms of gross premiums collected by the end of 2011,

indicate the following: the first 3 insurance companies in the life insurance segment collect 51,3 % of all premiums, and 3 first insurers in the segment of general insurance captiveness – 13,7 %. The top 10 insurers of life insurance collect 87,1 % of all premiums, and the first 10 companies in the risk insurance segment accumulate 34,4 %. These first 20 companies in the life insurance market mobilize 96,7 % of gross premiums, we suggest the optimal number of life insurers have to be within 2025 companies, but the rest of 47 companies are the worthless stuff for the market [1].

As to the general insurance market, 92,1 % of all premiums are collected by the first 100 companies, then we make conclusion that the optimal number of companies serving this market sector – within 100150 companies, and the others are unproductive and minor players in the insurance market. In common 200 insurance companies or 42 % of their total quantity accounts for only 0,5 % of gross premiums. Normally, these insurers jeopardize system of state regulation and supervision. In addition, there are about 3035 insurers whose purpose is to conduct quasi-insurance operations only.

In 2011, the macroeconomic recovery of the insurance market was observed. Thus, in 2011 the gross insurance premiums share in terms of GDP was 1,7 %, which is 0,4 percentage points decrease compared with 2010 and by 0,5 percentage points less compared to the rate in 2009, while the share of net premiums written in terms of GDP for 2011 was 1,36 %, up 0,13 percentage points increase compared with the corresponding rate in 2010, however, by 0,02 percentage points less

compared with the corresponding rate in 2009 [1].

In 2011, the following aspects were decreased [1]:

- a) The number of insurance companies – by 14 units, including three life insurance companies.
- b) The amount of gross insurance premiums – by 1,7 % to UAH 22693,5 million.

But the amount of net insurance premiums was increased by 34,8 % to UAH 17,970 million. The reason is that the increase in net premiums of property insurance, financial risks and fire risks is observed. This result is the introduction of new tax rules (Taxation Code of Ukraine: Art. 138, 140), whereby opportunities to use insurance transactions optimizing taxes are limited.

Some positive trends in classic life insurance are supervised, especially active evolving of hull insurance and compulsory motor insurance (CMI). Also social insurance is presently spinning up: for instance, health insurance, compulsory motor insurance, life insurance.

The positive aspects of functioning of the insurance market in Ukraine include reducing of follows:

- a) reinsurance from non-residents;
- b) reinsurance in the total amount of insurance premiums received.

In 2012 the reduction of administrative costs are noticed, requiring optimization of insurers own business processes.

Ukraine is increasingly influenced by globalization of the financial markets and in particular by the insurance market. Such processes may have for Ukraine both positive and negative consequences that should weigh in making relevant decisions by the body supervising and regulating insurance business in Ukraine.

Among the positive results, the following is worthy to be noted:

- Inflow of foreign investment for the development of insurance infrastructure;
- Level increasing of domestic insurers capitalization at the expense of foreign companies;
- Introduction of innovative insurance technology;
- Expand the range of insurance services and improving their quality;
- Financial support of the foreign parent company in the event of financial difficulties.

And we can determine the following as negative:

- Placement of insurance reserves abroad, making the state supervision and control of insurance reserves and investment funds impossible;
- Lack of control over insurance market segments by excessive presence of foreign capital;
- Dumping prices for insurance services by large foreign insurers and their expansion strengthening in strategic sectors of the insurance market;

– Reducing the capacity of the state in the implementation of certain provisions of social policy relating to pensions and health insurance.

In general, problems of insurance market can be divided into the following groups of:

**1. Legislative nature:**

– An old version of the Law of Ukraine «On Insurance» requires to meet the international practice terminology. It is necessary to reinforce conceptual vehicle of insurance, establish classes of insurance in accordance with EU directives and determine the list of the insurance market members;

– Opacity in the insurer and the insured person interaction. The insured individual is in an information vacuum according to the insurer's reliability;

– Lack of the insurer duty legally defined to represent publicly the full financial statements (general and specialized);

– Lack of insurers legal regulation in the compulsory health insurance;

– Non-regulated activities of insurance intermediaries. Number of insurance brokers is 60, and their share of the insurance market is on unacceptably low level (less than 5 %). The insurance market employs over 35 thousand insurance agents-individuals who are not certified, but they account for over 25 % of the insurance market. Paying attention to the scope of the insurance agents, surveyors, adjusters, average commissioners which is not regulated properly, professional development should be one of the core values of present-day Ukrainian insurance market;

– Lack of effective safeguards for policyholders in the event of bankruptcy of the insurer.

**2. Infrastructural nature:**

– Excessive number of insurers in the market, which complicates their supervision and state control. The number of insurance companies (IC) as of 31.12.2011 amounted to 442, of which 64 Life Insurance Companies (LIC) and 378 IC that carried insurance other than life insurance («non-Life» IC). During 2011 the number of insurance companies was dropped to 14 IC.

– Disproportion between the risk (general) insurance companies and life insurance companies, in Ukraine the advantage of companies is prevailed in general insurance, indicating the lack of long-term life insurance and private pensions.

– Lack of an insurers' organizational form such as mutual insurance, but this one is provided by Ukrainian legislation;

– The existence of a large number of insurance groups, most of which do not perform the tasks for which they were created, such as Marine Insurance Bureau, the Ukrainian Medical Bureau. Some separate associations are absent, but the market is in need

of them, for example: Insurance Guarantee Fund, Insurance Education Fund, Insurance Obudsmen, etc. There are associations duplicating each other's functions, such as Ukrainian Actuarial Society and the Society of Actuaries of Ukraine;

- Excessive presence of foreign capital in the insurance market of Ukraine. In the insurance market of Ukraine there are 115 IC with foreign capital. The main group of insurers with foreign capital (nearly in number of 50) is presented by financial and insurance groups in Austria, Great Britain, Kazakhstan, Germany, Poland, Russia, Slovenia, the USA, France, Sweden and others. In 2010, they accounted for about 60 % of the real insurance market [3, p. 6].

- Future is expected to increase the impact of foreign capital in the insurance market of Ukraine. It should take into account the safety of the insurance market indicator – the presence of foreign insurers won't exceed 30 %.

- Poor development of national reinsurance market and the lack of market national reinsurer, such situation is leading to an outflow of premiums abroad. The key performance indicators data according to the reinsurance market are characterized by negative dynamics. In comparison of the previous period with the year of 2011, a total amount of premiums paid for reinsurance was decreased by 45,0 %, including decreased premiums transferred to reinsurers-residents by 51,6 % in comparison with year of 2010, and premiums transferred to non-resident insurers were increased by 19 % [1].

As to benefits compensated by reinsurers it is the opposite situation – an increase is observed up to 43,8 %, including non-resident reinsurers benefits – to 95,7 %, and the payments compensated by resident reinsurers are decreased by 24,7 %.

According to the incoming reinsurance share of premiums received growth from non-resident reinsurers is observed to 123,1 %, but at the same time, reduction of benefits, compensated by the Ukrainian reinsurers to non-resident reinsurers is noted to 68,5 %.

- The rising cost of reinsurance protection caused by the presence of catastrophic losses in 2011;

- Lack of diversification and asset quality insurance companies;

- The existence of imbalances between profitability expected and the compensation ability for the risks taken;

- The unreasonably large list of compulsory insurance services conducting mostly of which are uneconomical and unnecessary. Currently the mandatory insurance of certain categories of employees (police officers, authorized special departments, authorized central executive body on environment and natural resources, prosecutors, military personnel and military service, judges, members of the Verkhovna

Rada and other categories of authority) is carried out.

### **3. Common market character:**

- A significant proportion of bogus insurance operations;

- Lack of transparency of certain insurance companies related to the abuse of tax optimization;

- Lack of risks coverage;

- Low level of capitalization of the insurance market.

- Non-optimal insurer equity and debt capital ratio and as a consequence, most of the assets are financed by own funds but not from sources borrowed;

- Insurance market disproportion, prevailing amount of insurance operations are concentrated in the corporate property insurance sector;

- Delaying of compulsory health insurance. One of the priorities of the insurance market in Ukraine is implementing Compulsory Health Insurance (CHI), which in turn will contribute to the social protection implementing and state budget reducing at the same time. Lack of legal regulation of the insurers in this area and appropriate tax policy are hindering the implementation of this type of insurance. The main problem in health care is a mismatching of funds allocated to health care, financing current needs, which necessitates health care financing at the expense of the patients themselves, thus contributing to corruption, misuse and shadow medicine sector.

- The unsettling of definite range of issues and insurance companies non-admission to participate in the CHI not only reduces the investment attractiveness of our country, but also violates the Article 49 of the Constitution of Ukraine, guaranteeing the right of every citizen to health protection, medical care and medical insurance; material losses.

- Low level of insurance market penetration. Thus the proportion of insurance of buildings belonging to citizens in 2011 amounted to only 1 %, share of health insurance – 2 %, life insurance – 7 %, voluntary accident insurance – 7 %, travel insurance – 8 %, hull insurance – 8 % [3, p. 5]. These figures are much lower compared to other European countries;

- Limited (narrow) customer base;

- The lack of a wide range of safe financial instruments for insurance reserves investing. Weak development of the stock market (its speculativeness) and the use of securities as safe assets in insurance reserves aren't allowed by limited list of liquidity equity instruments. There are risks of reliability of financial instruments, which are almost always systematic.

- Economic instability in the stagnation of production and the corporate sector.

- The negative impact of the crisis. The inflation factor makes long-term implementation (funded) insurance in national currency irrelevant;

- captivity of IC and monopolization of the

market in favor of individual businesses, ministries or local authorities are taken place;

- insurance market underreservation occurs, characterizing by lack of funds of IC to fulfill its obligations to customers. The National Committee for the Development of Financial Markets (the NCDFM) doesn't assess the insurance risks, resulting to significantly debt increasing and going bankruptcy of IC.

- insufficient depth and disclosure of regular and special information given by insurers. Thus, firstly the Regulator's requirements aren't fulfilled specified by Law of Ukraine «On Joint Stock Companies». The resolutions of the National Committee for the Development of Financial Markets «On information disclosure by issuers of securities» under which issuers are required to disclose the results of the quarter and the year's information and, secondly, there is no minimum required information to make an balanced decision regarding to choice of insured person;

- Shortage of skilled and scientific personnel support of the insurance market;

- Low level of insurance population culture. Dominance of consumer nihilistic moods among citizens, low financial literacy of the population, misunderstanding of the nature and value of insurance – the spread of insurance experience is narrowed, which, in turn, financial literacy isn't promoted, predominance of dead-beaten behaviors is oriented towards consumers of insurance services to reach short-term economic interests;

- Little level of customer confidence in insurers;

- Low solvency and purchasing power, limiting revenues of sufficient premiums and insurers financial resources. Therefore, a promising direction is the micro-insurance development, focused on low-income citizens and small businesses;

- Insufficient level of consumers information about the content of insurance services, the need for and benefits of insurance. Insurance companies spend great money on advertising, but do not explain all the contracts aspects. Moreover, the failure of contracts «rebound» is negatively reflected in the market;

- Imperfect mechanism to protect the insurance consumers rights;

- Lack of clear division of powers of public authorities in the field of consumer protection;

- The deficiency of an effective mechanism for pre-conflict resolution;

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- Inadequate compensation mechanism caused to insured damage.

#### 4. Tax nature:

- Delay in insurance taxation to income tax transferring on general principles. This situation leads to the existence of tax arbitrage, for instance, the income transferring from the highest tax pressure sectors into the lowest insurance ones. Thus, tax revenue reduction in budget from the real economy is revealed and structure of insurance in Ukraine is distorted;

- The existence of possibility of using insurance market by entities to optimize taxation and capital outflow abroad;

- In the Taxation Code of Ukraine (TCU) concept of «profit insurer» is non-defined, such a state of affairs postpones the insurers transition on a common system of taxation. The current practice of insurer income taxing has got the characteristics of tax on turnover, that is an indirect tax and it isn't related to financial results of the main (operating) activities of the insurer. Thus, the current practice combines elements of both direct and indirect taxation, which are inherently distinct.

#### 5. Methodical nature:

- Delaying the introduction of new technologies and international standards and norms of accounting and financial reporting in the national insurance system of Ukraine.

- Lack of approved approaches to assess the solvency of the insurer's risk-based;

- Unresolved issues with the introduction of compulsory insurers rating. For a small number of institutions having gone through the ranking of authorized rating agencies and received an investment grade of credit rating, monopolization of the market is formed, leading to an underestimation of rates on bank deposits;

- The limited Regulator authority in the regulation of accounting and financial statements of financial institutions reported.

**Conclusions.** In general, the current state of the insurance market is characterized by many negative trends and significant imbalances that need urgent solution by grabbing attention from the government regards to the insurance sector of the financial services market.

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