

ASSESSMENT OF KEY MARKETS FOR INSTITUTIONAL INVESTORS IN UKRAINE IN THE CONTEXT OF WAR

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Abstract. The article is devoted to the assessment of key markets for institutional investors in Ukraine in the context of Russia's full-scale invasion. The *purpose* of this study is to assess the institutional investor market in Ukraine during the war. To achieve this goal, it is necessary to solve the following tasks: to study the legal status of an institutional investor in Ukraine and its types, to assess changes in the institutional investor market after the start of a full-scale invasion, to identify key risks that exist in the market now, and to provide proposals on the need to improve state regulation of the institutional investor market to protect citizen investors in times of war. The *methodological basis* of the study was formed by general scientific methods of cognition: the dialectical method of cognition of the phenomena of the surrounding reality and the comparative legal method for establishing the legal status of an institutional investor, methods of logic (analysis, synthesis, induction, deduction, analogy), economic analysis, absolute and comparative advantages and statistical methods for analysing the market of institutional investors and making proposals, mathematical methods for calculating the volume of the market of institutional investors. In accordance with the systemic and structural approach, the institutional investor market was assessed by each of the structural elements of this market. The authors propose to consider an institutional investor as a financial intermediary that attracts and accumulates funds of individual investors (consumers of financial services) and carries out investment activities in the interests of individual investors aimed at financing socially and economically important sectors of the economy for the state and society. The authors pay special attention to the concept of responsible business conduct, pointing out that today, socially responsible business conduct is extremely important for the activities of an institutional investor, which includes "responsible attraction (accumulation) of funds" and "responsible spending (investment) of investors' funds". The study found that the main markets for institutional investors in Ukraine – banking, insurance and private pensions – showed stability and a slight increase in key indicators, which is very positive for Ukraine today. However, in the long term, there are a number of risks that should be taken into account by the government when formulating the state policy on the activities of institutional investors in these markets to protect the interests of citizen investors. The article provides suggestions on the main areas of improvement of the legislation on the activities of institutional investors to minimise the risks of citizen investors.

Key words: investment activity, institutional investor, risk assessment, government regulation, banks, insurance companies, non-state pension funds.

JEL Classification: E22, E44, G24, K23

1. Introduction

The institutional investor market in Ukraine has been undergoing public administration reform in recent years, as evidenced by the adoption of the new version of the Laws of Ukraine "On Capital Markets and Organised Commodity Markets", "On

Insurance", "On Financial Services and Financial Companies", and was expected to become fully operational in 2024–2025. However, with the beginning of Russia's full-scale invasion of Ukraine in 2022, this market has undergone significant transformations, which necessitates, among other

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things, the improvement of state regulation of this market from the point of view of protecting citizen investors. The *purpose* of this paper is to assess the institutional investor market in Ukraine during the war. To achieve this goal, it is necessary to solve the following *tasks*: to study the legal status of an institutional investor in Ukraine and its types, to assess changes in the institutional investor market after the start of a full-scale invasion, to identify key risks that exist in the market now, and to provide proposals on the need to improve state regulation of the institutional investor market to protect citizen investors in times of war. The *methodological basis* of the study was formed by general scientific methods of cognition: the dialectical method of cognition of the phenomena of the surrounding reality and the comparative legal method for establishing the legal status of an institutional investor, methods of logic (analysis, synthesis, induction, deduction, analogy), economic analysis, absolute and comparative advantages and statistical methods for analysing the market of institutional investors and making proposals, mathematical methods for calculating the volume of the market of institutional investors. In accordance with the systemic and structural approach, the institutional investor market was assessed by each of the structural elements of this market.

2. Institutional Investor Concept

The study of the problems of institutional investors' functioning is devoted to the works of domestic scholars, namely: O. Baranovskyi, P. Bielenkyi, S. Biriuk, O. Vovchak, Yu. Havruk, I. Doronin, O. Druhov, A. Duk, S. Kozmenko, V. Kornieiev, V. Kremen, T. Kushnir, S. Leonov, A. Nikolaiev, H. Panasenکو, A. Peshko, L. Sysoieva, O. Tyvonchuk, O. Shevtsova, I. Shkolnyk and many others, while scholars have no doubt about the importance of the role of institutional investors in the development of the investment market and support of key sectors of the state economy, but opinions differ significantly on the essence of this category.

Scholars acknowledge that institutional investors act as financial intermediaries between individual investors, businesses that utilize invested funds, and the state. There is no denial of this fact. After all, on the one hand, the investment activity of an institutional investor is aimed at accumulating scattered cash flows of citizen investors, the so-called social capital (Verhun, Glukhova, & Humeniuk, 2023), in order to transform them into a powerful investment portfolio for investing them on more favourable terms for investors and for the development of the national economy. That is, on the one hand, it is about supporting the real sector of the national economy, and on the other hand, it is about meeting the socio-

economic needs of a specific consumer of services – a citizen investor – by offering him or her a variety of investment services.

Therefore, the activity of an institutional investor requires a high level of social responsibility, as its main goal should not be to maximise profits, but primarily to take into account the interests of investors who have entrusted their funds to it (Vazhynskyi, 2023; Toporetska, 2022). Investments should be low-risk and socially beneficial. In other words, the activities of institutional investors are aimed at assisting legal entities and individuals with free savings to turn them into capital working in the economy and invest in promising business areas, with parallel risk diversification (Kobushko, 2011).

In this context, one can speak of the socially responsible business of an institutional investor, which is divided into "responsible attraction (accumulation) of funds" and "responsible spending (investment) of investors' funds". For example, if an institutional investor invests in the production of weapons, tobacco, alcohol, gambling, chemicals or projects that harm the environment, it will certainly be a very profitable investment from an economic point of view, but from the point of view of social responsibility to investors, such investments will not be socially useful. Although in the current realities of the war, investing in arms production in Ukraine is highly debatable in terms of public harm or public benefit for Ukrainians.

Therefore, as part of corporate social responsibility, it is important for an institutional investor to ensure that funds are invested in socially important projects, or at least not socially harmful ones, but those that will become the basis for supporting key economic sectors that are important to the state and society. In this context, it is possible to talk about spending on high-tech production and innovation infrastructure (Stroiko, Rekhteta, & Burkun, 2023).

Responsible attraction (accumulation) and responsible spending of funds by an institutional investor generally builds public confidence (of citizen investors who are consumers of financial services) in investment activities through institutional investors. At the same time, there is a direct correlation between consumer confidence and real GDP growth in the euro area over the quarter (Borisov, 2022).

It is proposed to consider an institutional investor as a financial intermediary that attracts and accumulates funds of individual investors (consumers of financial services) and carries out investment activities in the interests of individual investors aimed at financing socially and economically important sectors of the economy for the state and society.

Key institutional investors include banks, insurance companies, pension funds, credit unions, CII (collective investment institutions) – mutual and corporate

funds and other funds, as they accumulate the largest amount of funds in Ukraine. Thus, today in Ukraine the most widely used instruments of accumulation of private savings (capital) are: 1) deposits in Ukrainian banks; 2) long-term accumulative life insurance; 3) non-state pension funds. Therefore, this paper will analyse each of these markets.

3. Evaluation and Changes in the Ukrainian Institutional Investor Market after the Start of the Full-Scale Invasion

Banking market. Putting money in bank deposits is the traditional and most common way for individuals to invest their money. Public confidence in banks is reflected in the indicator of household deposits attracted by Ukrainian banks. Despite the war, it has shown steady growth, and moreover, since the start of the full-scale invasion, the share of deposits has increased sharply, which is also due to people's fears for the safety of their savings. For example, in the Q4 of 2022, households' funds in foreign currency increased by 8.7% (-4.6% YOY). Retail time deposits in foreign currency increased by 20.8%. The most significant growth was in deposits in institutions with developed Internet banking, including PrivatBank (+51.4%) and selected private banks (+28% for the group). This was facilitated by the NBU's permission to buy foreign currency online for placement on deposits (Banking sector review, 2023).

Thanks to the consistent policy of the National Bank of Ukraine and international assistance, the banking system was able to maintain public confidence in banks and to keep the banking system stable during the war. All this was achieved by maintaining ample opportunities to invest in highly liquid assets. The shift to less risky instruments is a common response to the crisis, and in times of high interest rates, they also generate significant income. In addition, revenues from business lending remain resilient. Strong interest income allowed them to maintain high interest margins despite rising funding costs. Therefore, banks with private capital were not eager to change their business models after the outbreak of full-scale war. The role of state-owned banks has strengthened: they perform social functions, actively lend under government programmes, and are leaders in lending to state-owned enterprises. Their

market share is growing, which is typical in times of crisis (Financial Stability Report, 2023).

Thus, solvent banks earned 67.6 billion UAH in net profit in the first half of 2023, compared to a 4.6 billion UAH loss in the same period last year (The banking sector earned 67.6 billion UAH in profit in the first half of 2023, 2023).

Thus, the banking sector has been and remains a stable market for investment by individuals through institutional investors.

Life insurance market. This includes insurance companies that primarily provide life insurance services.

Since 01.07.2020, as of the first half of 2021, the insurance market has decreased by 46 insurers, or 21%. Of these, only 8 companies were forcibly withdrawn from the market as a measure of influence. The rest of the insurers surrendered their licences at their own request, with a significant number of them being subject to enforcement actions for violating regulations. As of 15.09.2021: 169 insurers are registered in the State Register of Financial Institutions (SRFI), of which 17 are life insurance companies. Life insurance premiums in the first half of 2021 increased by 0.4 billion UAH compared to the first half of 2020 and amounted to 2.7 billion UAH, but in the first half of 2022 they again decreased to 2.4 billion UAH (2020 level) (Insurance market overview for the first half of 2021, 2021). As of 01.09.2022, 140 insurers were registered in the State Register of Financial Institutions (SRFI), of which 13 were life insurance companies.

However, despite the overall decline in insurance companies' assets, life insurance assets showed growth dynamics. Thus, as of 01.01.2021, assets amounted to 15.9 billion UAH, as of 01.01.2022 – 17.5 billion UAH, and as of 01.07.2022 – 18.5 billion UAH (Overview of the Ukrainian insurance market in the first half of 2022 Supervisory activities of on-site supervision in February – September 2022 and priority areas of supervision under martial law in Ukraine, 2022). During martial law, life insurance companies accumulate liquidity by investing in military bonds.

Gross life insurance premiums increased by 9% in the fourth quarter of 2022. Overall, life insurance premiums decreased by 17% in 2022. Overall, payments under life insurance contracts increased by 7% for the year (Review of the non-banking financial sector, 2023).

Table 1
Household deposits at the end of the period, million UAH

Year	2015	2016	2017	2018	2019	2020	2021	2022	As of 01.06.2023
Household deposits at the end of the period, million UAH	410895	444676	495313	530250	576126	730317	794152	1045731	1091580

Source: (Financial sector statistics, 2023)

In the Q1 2023, life insurers' assets increased. Life insurance premiums traditionally decreased by 15% year-on-year in the first quarter. They also remained 13% lower than in Q1 2022, so this segment has not yet recovered. At the same time, life insurers' claims increased by 8% for the quarter and by 65% compared to Q1 2022. The ratio of claims to premiums in the life insurance segment has been growing for the fifth quarter in a row and has reached a record high over the past five years. Life insurers' investment income increased by 9% quarter-on-quarter. Over the past few quarters, companies have been gradually increasing the share of deposits in their portfolios. Therefore, income from deposits almost equaled income from investments in Ukrainian domestic bonds. Risk insurers posted profits in line with previous years and achieved a return on equity of 3%. Life insurers demonstrated the highest return on equity in recent years (10%) as a result of lower operating expenses and higher investment income.

Therefore, although the life insurance market in Ukraine has not recovered to pre-war levels, it is showing gradual recovery and growth, which indicates its stability and investment security for individual investors. Also, starting in 2024, insurers will be subject to new requirements after the new version of the Law of Ukraine "On Insurance" comes into force, which will help keep this market stable. Furthermore, the National Bank of Ukraine is also developing a new set of regulatory requirements for the insurance segment to comply with the requirements of this law, in particular, new requirements for insurer solvency will come into effect from the beginning of next year.

Private pension market. According to the National Securities and Stock Market Commission, as of August 2023, there were 119 non-state pension funds in the Register (Register of non-state pension funds, 2023).

As of 30.06.2021 and 30.09.2022, the State Register of Financial Institutions contained information on 63 NPFs (non-state pension funds), including 58 active ones, as well as 19 administrators of such funds. The total number of participants in the NPF in 2022 was 888.7 thousand people as of 30.09.2022, while as of 30.09.2021 it was 889.7 thousand people, while in 2020 it was 879.9 thousand. The number of pension contacts made increased from 93.4 thousand as of 01.09.2021 to 96.1 thousand as of 01.09.2022. The total value of assets formed by NPFs as of 30.09.2021 was 3,788.6 million UAH, and as of 01.09.2022 – 4,024.7 million UAH, which is an increase of 6.2% (Information on the state and development of non-state pension provision in Ukraine for the period..., 2022).

Thus, the number of NPFs has not decreased since the beginning of the war, but the same risks

and problems remain. Thus, in terms of investment, the majority of funds are invested in domestic government bonds (47.6%) and deposits (36.5%), with only 1.3% invested in equities and 2.7% in real estate, due to the underdevelopment of the stock market in Ukraine. Naturally, the purpose of investing pension assets is primarily to preserve the pension savings of citizens. The investment strategy of private pension funds is more conservative than that of other financial institutions.

In addition, the high cost of administering these assets remains a serious problem, making such deposits unprofitable for citizens. In the short term, given the time required to develop capital markets and reliable financial instruments for investing pension assets, the government should consider introducing tax-free, voluntary, automatic individual pension savings accounts in banks. Such accounts could be modelled on the simple Individual Retirement Account (IRA) system in the United States. For the purpose of providing reasonable and limited financial incentives (tax breaks) (Report "Private Pension Provision in Ukraine: Assessment and Recommendations". USAID Financial Sector Transformation Project, 2019).

4. Proposals for Improving the Legislation of Ukraine Regulating the Activities of Institutional Investors

As can be seen from the assessment of the main markets for institutional investors, the full-scale invasion did not seriously affect institutional investor activity in the short term. However, in the long term, it should be borne in mind that Ukraine's economy is currently completely dependent on foreign aid, and therefore the negative economic consequences of armed aggression may manifest themselves in the form of inflation, hryvnia devaluation, and investment market instability in the future. Global trade growth will remain low. Ukraine's economy is gradually recovering, but remains vulnerable to security risks, and consumer inflation is declining faster than expected. Public finances are in good shape, primarily due to international support. Today, it is challenging to estimate when hostilities will end and how much time it will take to reconstruct and revive Ukraine. Furthermore, approximately 9 million Ukrainians who fled at the start of military aggression have not yet returned, and it remains unclear whether they will, which could also significantly affect Ukraine's economic landscape.

Therefore, in formulating state policy on institutional investor activities, it is essential to consider not only the current positive market trends but also anticipate potential negative scenarios and establish safeguards to protect citizens' investments.

The banking market today protects the interests of depositors through the existence of the Deposit Guarantee Fund and the NBU's consistent policy of promoting the stability of the hryvnia. As a result, the banking system maintains high liquidity and profitability. Based on the results of the NBU's resilience assessment, the NBU will develop a plan to withdraw prudential easing and further implement regulatory requirements. The priority is to introduce new capital adequacy requirements, reintroduce deferred measures, and resume capital buffer requirements.

The guarantees of insurance payments will be strengthened after the new Law of Ukraine "On Insurance" comes into force on 1 January 2024, which establishes stricter financial requirements for insurance companies and a detailed procedure for their withdrawal from the market with a mandatory transfer of assets. Whether the efficacy of this system can be determined will require observation after a certain period of its application under the new law. As is known, the life insurance market was marred by a horrific event in 2015-2016 when five long-term insurers unlawfully halted their operations and vanished. According to the National Commission for the State Regulation of Financial Services Markets (Natskomfinposlug), they grabbed 316 million UAH and "tricked" 22,000 consumers (Why does the state not protect consumers in the life insurance market?, 2023).

Therefore, discussions are also underway to create a similar Deposit Guarantee Fund to guarantee insurance payments.

As for the private pension market, the reform is not yet complete. Currently, the Verkhovna Rada of Ukraine is considering the draft Law of Ukraine "On Accumulative Pension Provision" reg. No. 9212 dated 17.04.2023, which was developed with the participation of the National Securities and Stock Market Commission (NSSMC). The draft law proposes to create a single authorised pension fund that would assume risk guarantees for depositors.

The draft law stipulates that pension payments to participants of the authorised fund are guaranteed by the state. The issue of persons choosing non-state pension funds remains open. However, guaranteeing the payment of pension savings is one of the key issues that will determine the trust of citizens in institutional investors and the state as a whole. Therefore, the provisions on guarantees should be carefully considered when adopting this draft law.

In addition, it is necessary to strengthen the liability of institutional investors for any illegal actions that violate the interests of individual investors. It is not a question of negligence in the execution of a document or minor violations of labour or financial discipline, etc., but rather of deliberately committing actions that put the private interest of an institutional investor above the public interest of its depositors, as such actions are socially dangerous (Pohoretskyi, Serhieieva, Toporetska, 2019).

5. Conclusions

An institutional investor is a financial intermediary that attracts and accumulates funds from individual investors (consumers of financial services) and carries out investment activities in the interests of individual investors aimed at financing socially and economically important sectors of the economy for the state and society. For an institutional investor, socially responsible business conduct is extremely important, which includes "responsible attraction (accumulation) of funds" and "responsible spending (investment) of investors' funds".

The main markets for institutional investors in Ukraine – banking, insurance and private pensions – have shown stability and a slight increase in key indicators, which is very positive for Ukraine today. However, in the long term, there are a number of risks that should be taken into account by the state when formulating state policy on the activities of institutional investors in these markets to protect the interests of citizens-depositors.

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Received on: 04th of September, 2023

Accepted on: 19th of October, 2023

Published on: 17th of November, 2023