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REGULATION OF THE LENDING MARKET AND PROSPECTS OF FINANCIAL SECTOR STABILIZATION IN UKRAINE

Abstract. Current issues of non-bank lending by financial companies and the vision of the future regulation of their activities outline in detail the developments set out in this article. Changes in the volume of lending in the non-banking financial market are analyzed. The analysis of the concentration level of loans by the amount of concluded agreements is carried out. The future vision and mission of the financial sector of the economy are formed. Criteria for assessing the required degree of supervision of a credit company are defined. In the study, we used general and specific economic methods, as well as a basic research approach, which allowed us to determine the economic nature of the financial sector and the scope of lending to agricultural enterprises. The goals of realization of an economic growth strategy for the perspective period for the achievement of the European standards in the financial market are offered. Financial support for current activities and promising economic development in Ukraine still remains a significant problem. Expanding access to financial resources of agricultural entities may be one of the factors for the development of Ukraine's economy. The main goal of the National Bank is to introduce a risk-oriented approach in the licensing and supervision procedures of the non-bank lending market, which will allow it to develop and ensure compliance with the rights and interests of customers. It is proposed to maintain the procedure for agreeing significant participation for financial companies as a key element in

verifying the transparency of ownership structures and the impeccable business reputation of owners. The scientific novelty of the obtained results is represented by a set of theoretical and practical aspects of the study, namely proposals for the current state of lending and recommendations for supervision in the financial market of Ukraine.

Keywords: lending, financial sector, financial sector regulators, non-bank lending, stabilization.

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РЕГУЛЮВАННЯ РИНКУ КРЕДИТУВАННЯ І ПЕРСПЕКТИВИ СТАБІЛІЗАЦІЇ ФІНАНСОВОГО СЕКТОРУ УКРАЇНИ

Анотація. Актуальні питання небанківського кредитування фінансовими компаніями та бачення майбутнього регулювання їхньої діяльності детально окреслюють напрацювання, викладені в цій статті. Проаналізовано зміни в обсяги кредитування на небанківському фінансовому ринку. Проведено аналіз рівня концентрації кредитів за сумою укладених договорів. Сформовано бачення майбутньої візії та місії фінансового сектору економіки. Визначено критерії для оцінки необхідного ступеня нагляду за діяльністю кредитної компанії. Використано загальнонаукові та конкретні економічні методи, а також базовий дослідницький підхід, який дозволив визначити економічну природу фінансового сектору і сферу кредитування аграрних підприємств. Запропоновано цілі реалізації стратегії економічного зростання на перспективний період для досягнення європейських стандартів на

фінансовому ринку. Фінансова підтримка поточної діяльності та перспективного економічного розвитку в Україні досі залишається значною проблемою. Розширення доступу до фінансових ресурсів аграрних суб'єктів господарювання може стати одним із чинників для розвитку економіки України. Головною метою Національного банку України є впровадження ризик-орієнтованого підходу в процедурах ліцензування і нагляду на ринку небанківського кредитування, який дасть змогу йому розвиватися і забезпечить дотримання прав та інтересів клієнтів. Запропоновано зберегти процедуру узгодження значної участі фінансових компаній як ключового елементу перевірки прозорості структур власності та бездоганної ділової репутації власників. Наукова новизна отриманих результатів представлена сукупністю теоретичних і практичних аспектів дослідження, а саме пропозиціями щодо сучасного стану кредитування та рекомендаціями щодо нагляду на фінансовому ринку України.

Ключові слова: кредитування, фінансовий сектор, регулятори фінансового сектору, небанківське кредитування, стабілізація.

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Introduction. Both banks and financial companies that serve non-financial corporations and households without additional financial investments can afford the use of financial technologies [3, p. 45].

Existing administrative barriers and shortcomings in the current legislation complicate and significantly increase the time for non-banking institutions to enter the financial services market. In order to provide financial services, non-banking institutions need to go through a double procedure: enter information about the company in the Register of Financial Institutions and obtain a license to provide financial services. Non-bank lending in Ukraine and around the world is considered as an alternative.

Analysis of recent research and problem statement. Challenges financial sector of the economy is studied in articles by Lerner and Tufano (2011), Levine (2002), Llewellyn (2018), Shubalyi (2008). Yakubiv (2019). Thanks to their efforts, the credit market was analyzed, foreign experience and prospects for the introduction of new lending instruments in Ukraine were outlined. In particular, Onyshchenko [10] offers the author's position on the vision of the modern development of bank lending as a basis for financial intermediation in Ukraine. Shkliar [11] pays a lot of attention to the problems of credit markets. Many scientists focus on their research to solve modern problems of lending through special mechanisms, concepts, and more.

Despite the sufficient theoretical basis of research on financial technologies development, empirical works are presented fragmentarily and do not allow to determine the range of stimulators or dissimulators of financial sector development in terms of digitization. The need for credit market analysis and development remains in the field of view of researchers and analysts constantly. All this is of scientific and practical interest for further study.

The purpose of the article is to study the peculiarities of credit market regulation and prospects of financial sector stabilization in Ukraine.

Research results. The volume and structure of involved financial and credit instruments are also determined by the general financial and economic situation in the country taking into account the needs [1, p. 123; 2, p. 37; 4, p. 211] at a certain stage of economic development, which determines the importance of further research on the state and trends of financial and credit instruments for ensuring effective functioning of the residential real estate market in the conditions of Ukraine's economy development [5, p. 138].

The greatest effect on credit market have the instruments with the influence of which the banks have to work all the time that is instruments of open market operations policy REPO transaction rate and certificate-of-deposit rate) and the mandatory reserves policy rate of mandatory reserve) [10, p. 42].

The system of mortgage lending combines the real estate market and the financial market, therefore, it is characterized by the risks of these markets: market, credit and operational risks, as

well as liquidity and refinancing risks. In order to minimize the effects of their impact, it is expedient to develop a set of measures and methods for their minimization in terms of their species [13, p. 231].

The financial and banking systems effectively perform the function of financial intermediation. Ukraine has created a favorable business environment, in conditions of low inflation, economic growth is stable and high quality. GDP growth, expanded lending to the real sector of the economy, strengthening the solvency of private consumers contribute to macro-financial stability, increasing the capitalization of the banking system and the market of non-banking financial services. A legal framework has been created for the development of the secondary credit market, the definition of the principles of debt management activities, mechanisms for working with claims, the redemption of problem assets. The mechanism of securitization of financial and other assets has been introduced, as well as the mechanism of securitization of mortgage assets has been improved.

In recent years, measures have been taken to strengthen the protection of creditors' rights, in particular: at the legislative level, a mechanism for voluntary financial restructuring of corporate debts has been established; amendments to the tax legislation on an exemption from taxation of banks and individuals-borrowers for restructuring operations and forgiveness of foreign currency loans; the institute of the bankruptcy of individuals, establishment of the mechanism and conditions of restructuring of debts of individuals on loans in foreign currency was introduced; strengthened protection of creditors' rights in civil relations. The settlement of problem debts requires the emergence of a full-fledged secondary market of problem assets, the emergence of new entrants, and investments [14, p. 47].

At the end of 2019, 684 financial companies were operating in the Ukrainian non-bank lending market. The market is not very concentrated — the share of the largest twenty financial companies in the number of concluded contracts in 2019 was 57.5%, and in terms of amounts — 54.7%. The number of concluded contracts is shown in *Fig. 1*.

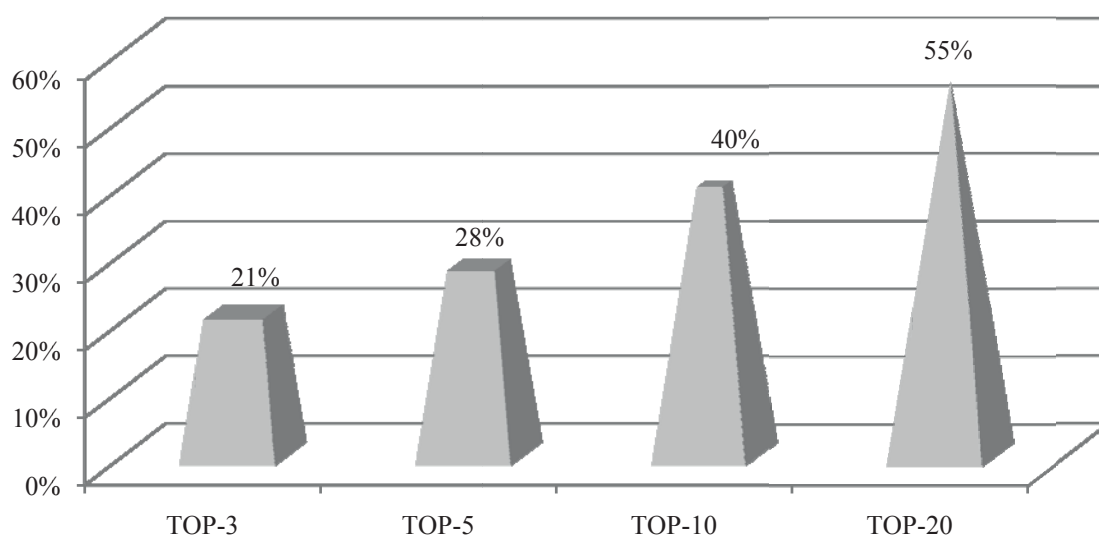


Fig. 1. The level of concentration on the amount of concluded credit agreements in Ukraine in 2019

Source: NBU Statistical Bulletin [9].

The Ukrainian market of loans provided by financial companies shows growth: in 2019, contracts worth UAH 79.2 billion were concluded, which is 52.5% more than in 2018 (UAH 51.9 billion) (*Fig. 2*).

The lending market for financial companies can be divided into two segments: lending to individuals and lending to businesses. As of the end of 2019, about 78% of all loans in the portfolio

were issued to legal entities. In new loans, the proportion is slightly different — more than half of the financing is provided to individuals and individual entrepreneurs, which is due to the significant turnover of such loans.

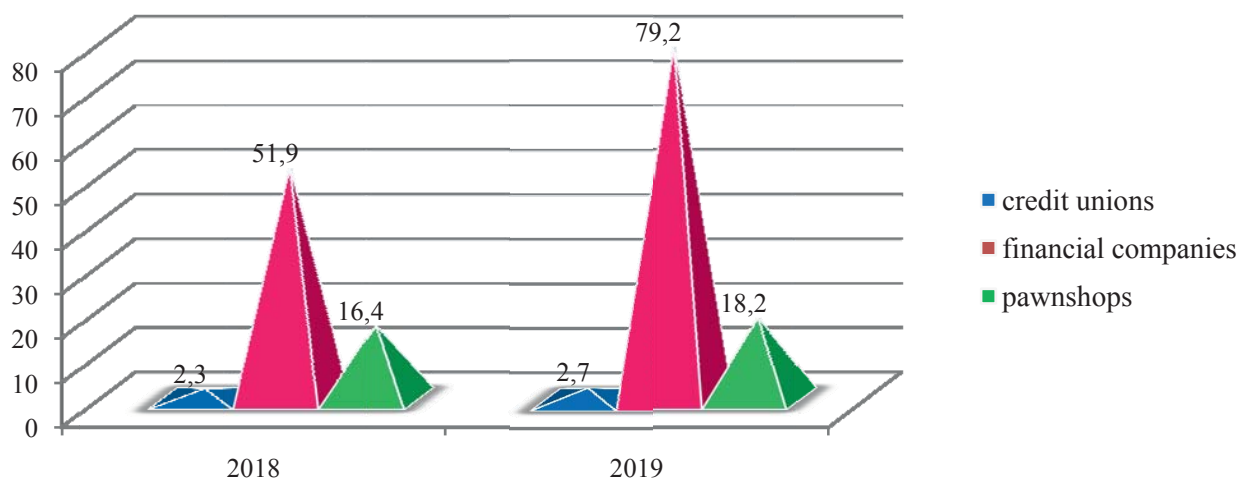


Fig. 2. Volumes of lending on the non-banking financial market in Ukraine for 2018—2019, UAH billion

Source: NBU Statistical Bulletin [9].

Representatives of the banking and capital markets sectors perceive the high rates of technological change as a threat to growth prospects [8]. Thus, 83% of traditional financial service providers believe that they are threatened by a loss of business that can go to competitors — companies in the financial technology segment. The greatest pressure from the financial and technological companies will be subjected to segments of banking operations and payments [11, p. 50].

Almost all banks that occupy leading positions in the market of banking services offer e-banking services, as it enables clients, without attending a branch of banks, to carry out a wide range of banking operations: to manage the volume of resources on their own account; exchange currency; make payments and transfers; pay for services of mobile communication, Internet, utilities, taxes, fines [15, p. 230].

The segment of non-bank lending to legal entities and natural persons-entrepreneurs also shows growth: in 2019, financial companies concluded agreements with legal entities and natural persons-entrepreneurs in the amount of 35.4 billion UAH (legal entities — 35.1 billion UAH, Physical person-entrepreneurs — 0,3 billion UAH; the average amount of the concluded agreement with legal entities was 50,230 UAH, and with Physical person-entrepreneurs — 30,461 UAH), which is 55.6% higher than the same indicator in 2018 (22.8 billion UAH).

A significant part of credit agreements with consumers is concluded via the Internet with the subsequent transfer of funds to the consumer’s bank card.

Contracts concluded remotely are usually signed using a one-time electronic identifier (sending the code by SMS to a telephone number provided by the consumer). Such methods of concluding a contract may not provide proper identification and verification of the consumer. The amount of loans granted is shown in Fig. 3.

The development of modern technologies contributes to a significant increase in the number of agreements: the ability to remotely enter into a loan agreement, passing a quick identification procedure, to receive funds on a bank card. In particular, due to this, the non-bank lending market began to grow actively in 2017. Contracts are concluded remotely, mainly for up to 30 days (Fig. 4).

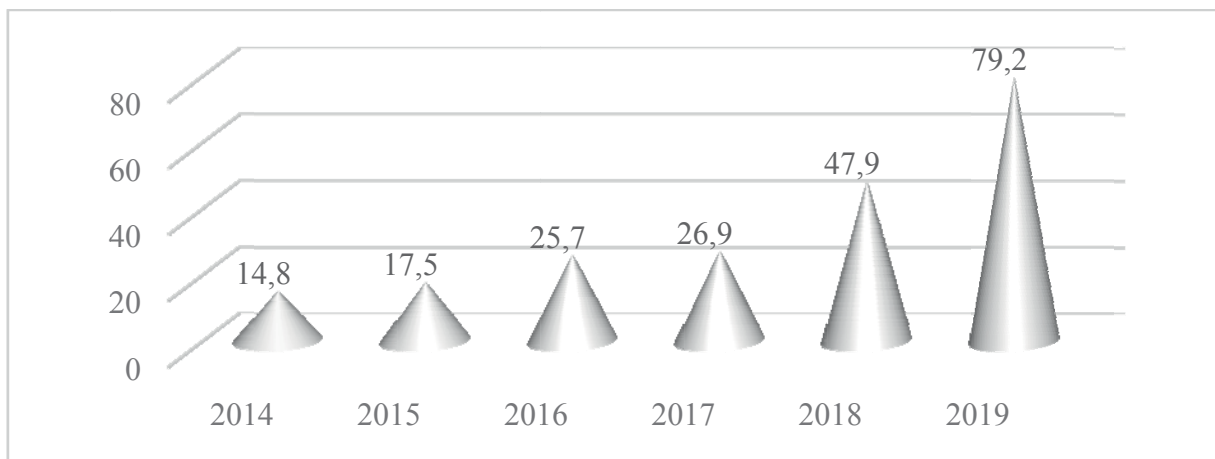


Fig. 3. The volume of loans granted in Ukraine for 2014—2019, UAH billion
 Source: NBU Statistical Bulletin [9].

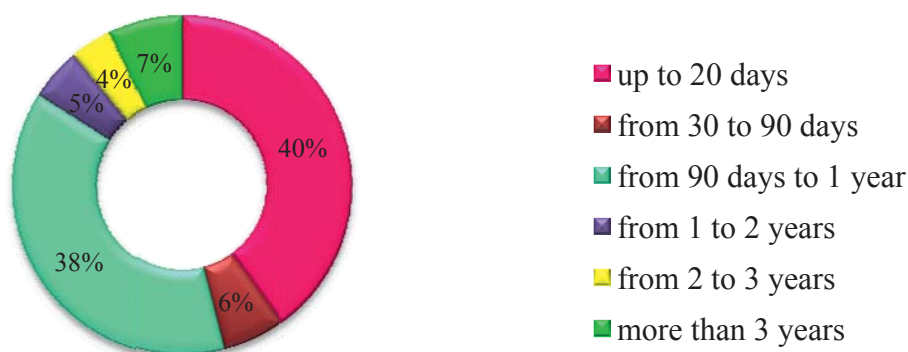


Fig. 4. Term of agreements concluded during 2019 in Ukraine
 Source: NBU Statistical Bulletin [9].

In the case of lending to legal entities and individual entrepreneurs, the target audience is small and micro-businesses that need additional funds — for operating activities or to cover unforeseen costs. Loans to small and micro-businesses are usually provided for a period of 90 days to one year or longer.

Financial companies often «attract» new consumers through a grace period during the first loan (usually up to a month) or the first soft loan, which provides for the payment of relatively low (soft) interest for a certain period or the entire term of such a first loan. At the end of the grace period, the loan fee increases significantly — the loan amount is charged high-interest rates (the amount of interest may be, for example, 2% per day) for the use of funds and commissions. In case of a violation of the payment schedule, the financial company charges high fines and penalties. Consumers are often unaware of the risks associated with loans, their value, do not distinguish between the types of financial institutions in which they borrow money, and therefore often unable to calculate their financial capabilities and repay such loans. Consumers often do not have sources of repayment of loans at their real value, and financial companies do not cut off such insolvent borrowers. Also, some financial companies may abuse the low financial literacy of consumers by not stating or hiding in advertising or on the website the true amount of interest and fees, and hence the amount of liability for the loan. High profitability of financial companies is ensured by a high fee on loans, consisting of interest on the loan, loan fees, weekly fees, monthly fees, etc., as well as through penalties for breach of the loan agreement.

Real interest rates on non-bank loans may exceed 700 percent per annum, and the number of payments made by the consumer in favor of the lender — the amount loan several times. In order to pay for one loan, the consumer often takes a new one, as a result of which his debt can quickly become uncontrollable.

The new model of regulating the activities of financial companies providing lending services should provide opportunities for a sustainable and harmonious development of this segment of the financial market in Ukraine, as well as ensure compliance of credit companies with the rules of good market behavior.

The National Bank considers it expedient to establish a single prudential requirement for financial companies — compliance with the minimum level of equity. Financial companies will maintain capital at 3 million UAH if only lending services are provided, or UAH 5 million if a financial company plans to provide two or more financial services.

This requirement will ensure the sustainability of companies and help create conditions for them to attract funding. At the same time, this will make it impossible for insolvent companies to operate in the market.

Approximately, the criteria for assessing the required degree of supervision of the credit company’s activities will include, in particular: book value of assets; market share of the credit company; a number of previous violations of the law.

Institutionally capable financial sector regulators apply common approaches and coordinate efforts for effective individual and consolidated supervision of the financial sector, regulatory influence, proportional regulation, transparency and stimulation of competition, and control of concentration in the financial market. The mission of the financial sector of the economy is shown in Fig. 5.

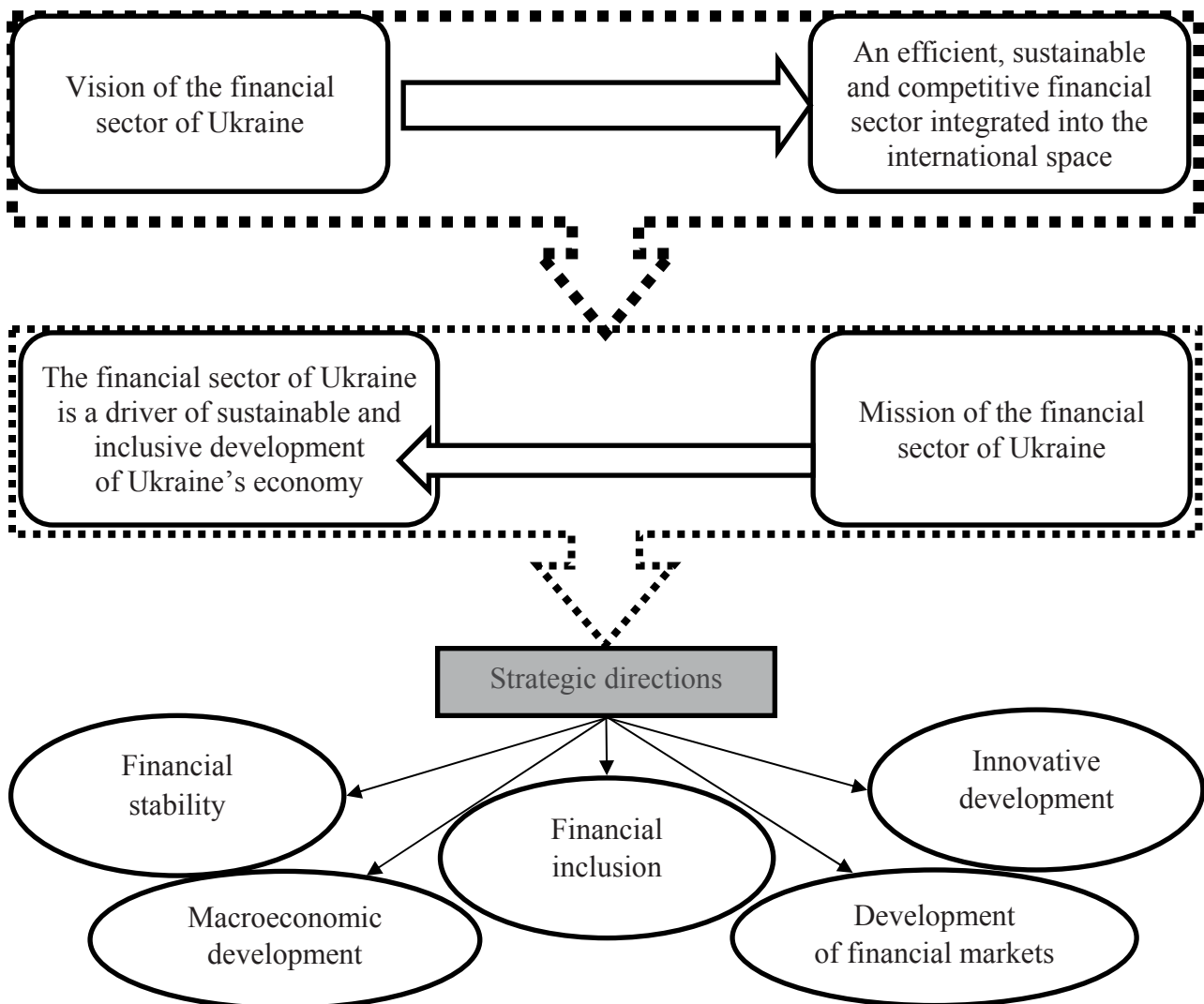


Fig. 5. Seeing of the future vision and mission of the financial sector of Ukraine’s economy

Source: created by authors.

Reforms have been carried out in all segments of the financial sector — in the banking sector, non-banking financial institutions, capital markets: all segments of the financial market have been cleared of troubled institutions, increased solvency of participants, strengthened financial system stability, restored customer confidence in market participants. Ukraine's financial sector is transparent, competitive, stable, high-tech, profitable, and diverse. Compliance with EU standards in terms of consumer protection, licensing, supervision, and control, restoration of a solvency of financial institutions, application of measures of influence, withdrawal from the market of troubled financial institutions is also ensured. The supervision of insurance market activities has been strengthened. Agricultural producers are provided with high-quality insurance protection, state planning and regular financing of subsidized agricultural insurance programs in Ukraine have been introduced. A transparent and stable market of mutual crediting was created, the directions of economic activity of credit unions were improved and expanded. In order to minimize risks in the financial markets and protect the rights of investors at the legislative level, the regulation of rating agencies and benchmark administrators is regulated in accordance with EU standards.

Construction of a new system of regulation and supervision should include:

- easy access to the market — minimum conditions are needed to enter the market to ensure the presence of honest players, but these conditions should not be unjustified obstacles to starting a business, developing competition or innovation;

- business plan for starting the activity — the basis of the activity and the main document for obtaining a license should be a business plan that will reflect the company's vision of its development in the future market and plans to attract customers and make a profit;

- new opportunities — expanding access to financing from third parties and allowing financial companies to carry out activities other than the provision of financial services, will create new opportunities for business development;

- transparency and impeccable business reputation — only those financial companies will operate in the market, the owners of which have significant participation and ultimate beneficial owners have been disclosed. Only owners and executives with an impeccable business reputation will be admitted to the market;

- consumer protection — the National Bank of Ukraine will exercise enhanced supervision over the observance of consumer rights, which are the main borrowers of financial companies;

- solvency — the requirement for the capital of a financial company will ensure the entry into the market of financially viable players, the stability of financial companies and make it impossible to operate in the market of insolvent companies;

- quality reporting — financial companies will compile and submit reports according to updated standards, which will allow to objectively assess the financial performance of financial companies.

Ensuring a transparent ownership structure of all financial institutions will be one of the key requirements of the new regulation. It is proposed to maintain the procedure for agreeing significant participation for financial companies as a key element in verifying the transparency of ownership structures and the impeccable business reputation of owners.

Conclusions. The goals of the strategy until 2025 are to promote the sustainable economic growth of Ukraine, ensure macrofinancial stability, increase the reliability and manufacturability of the financial system, achieve European standards in the financial market, increase confidence in the financial market, implement the EU — Ukraine Association Agreement and other international treaties.

One of the tasks of the National Bank should be to ensure effective protection of the rights of consumers of non-bank loans. At the same time, although individuals are the least protected, legal entities and individual entrepreneurs also need protection, as they may be subject to infringement by a financial company as a borrower or user of other financial services. Mandatory requirements for lenders should be introduced to indicate in the loan advertisement a warning about the risks associated with obtaining the loan (including in the event of late repayment). Establish specific requirements or restrictions that are preceded by a detailed analysis of real lending models.

Such analysis should include, in particular, an assessment of the return on assets of financial companies, the amount of problem debt, the amount of recovery on problem debt.

In carrying out their activities, financial companies must take into account the real financial condition of the borrower, its creditworthiness, and the ability to service debt. This will help improve the quality of the loan portfolio of financial institutions themselves, as well as protect the rights of borrowers.

During the development of regulations in the field of financial monitoring, the National Bank should form requirements and expectations for the construction of an appropriate internal system to prevent the use of the services of a credit company, the purpose of which is money laundering or terrorist financing. Regulations should contain risk criteria (increased areas of attention), which the financial company must take into account when building a procedure for proper customer due diligence, detection of suspicious transactions, etc. Supervision in the field of financial monitoring will be risk-oriented and with inspections only if necessary. This will avoid the over-regulation of the market and stimulate further development of this financial services sector.

Electronic identification and verification need special attention. Currently, remote verification and identification of the client during the conclusion of the loan agreement is mainly carried out using the BankID system using electronic signatures. Today, 14 banks are connected to the BankID system (the number of banks is constantly growing) and many non-banking institutions. Non-banking institutions will also be able to use data obtained through the National Bank's BankID to verify their customers.

The National Bank will also facilitate financial institutions' access to customer credentials in state registers. At the same time, the National Bank, as a regulator, must be aware of the risks inherent in remote verification methods, the biggest of which is fraudulent use of other people's data.

The new regulatory model will ensure the functioning of an efficient and transparent non-bank lending market by financial companies, as well as its harmonious development. The introduction of this model will help eliminate the negative factors that hinder the development of non-bank lending by financial companies, and will protect the rights of customers. Establishing rules of fair market conduct for all, without exception, financial institutions-creditors will ensure the avoidance of regulatory arbitrage and the protection of the rights of debtors in debt collection.

Credit companies will be able to raise funds from clearly defined sources of funding, which will improve the financial security of their activities. In addition, updating the standards of reporting and reporting will allow you to objectively assess the financial performance of financial companies, which could potentially increase the investment attractiveness of this sector. Transparent, informative and reliable reporting will also ensure effective supervision by the National Bank.

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