EFFECTIVNESS OF NON-BANK FINANCIAL INSTITUTIONS REGULATION: EVIDENCE FROM UKRAINE[49]

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Abstract: *NBFIs need effective regulation system, which provides the protection of financial services consumers and from other hand the uninterrupted activities of financial market. In this article, costs and revenues of National Commission for the State Regulation of Financial Services Markets in Ukraine (NCSRFSM) from have been taken from 2003 to 2012 for performing the analysis of regulation effectiveness. We attempted to find a correlation between costs and revenues of regulation body and number of NBFIs, which are regulated by NCSRFSM. After these recommendations, further development of NCSRFSM is presented here.*

Keywords: *financial institutions, financial market, regulation of non-bank financial institutions*

INTRODUCTION

The role of non-bank financial institutions in financing the investment process of the country gradually strengthens. With increasing their participation in investment projects must also change their approaches to their regulation.

There are different views on the organization of the regulatory process, i.e. the integration of supervisions on the financial market under a single mega regulator. However, there is also an opinion that the introduction of mega regulator is no actual issue for development of financial market, because non-bank financial institutions are on an early stage of development. And for the efficient operation still need a separate regulator, which would also protected the NBFIs from banks. Though, the issue of protection is quite important but has it effectiveness? We want to investigate it in order to know how tax payers' money NCSRFSM spends. And what they (as main beneficiaries) get from this regulation?

Objectives of the study are: 1. to compare costs and revenues of NCSRFSM in order to determine and evaluate its efficiency; and 2. to find a correlation between number of NBFIs and budget costs of NCSRFSM in order to determine suitability of its existence.

MATERIALS AND METHODS

The study is empirical in nature, which includes such indicators as costs of NCSRFSM (expenditures on development, expenditure on utilities, staff salaries, subsistence money), revenues of NCSRFSM (we took only penalties of NBFIs). We have considered all the absolute figures for the research. It is based on the data gathered from annual reports of NCSRFSM, National Bank of Ukraine (NBU), information from books, journals and online publications written by academicians. The investigation has been carried out by using the data between the periods of 2003 to 2013.

Major limitation of this study is insufficiency of accessible data; the main sources are the annual reports of the NCSRFSM. There is no the one standard of reporting of regulation body. That's why it was difficult to cumulate the data. These reports contain different data group's structure report, sometimes they were not full. Moreover, though there have been an ample number of researches regarding the regulation of bank sector's effectiveness but no substantial work has so far been done in Ukraine on the determinants of regulation effectiveness of NBFIs. So there is a scarcity of literature in this area.

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RESULTS

Financial support for regulation of NBFIs in Ukraine is from the general fund of the State Budget of Ukraine. Our research is based on the statements of operations NCSRFSM and analyzed the cost of maintaining the regulator from 2003 to 2012 (see Chart 1).

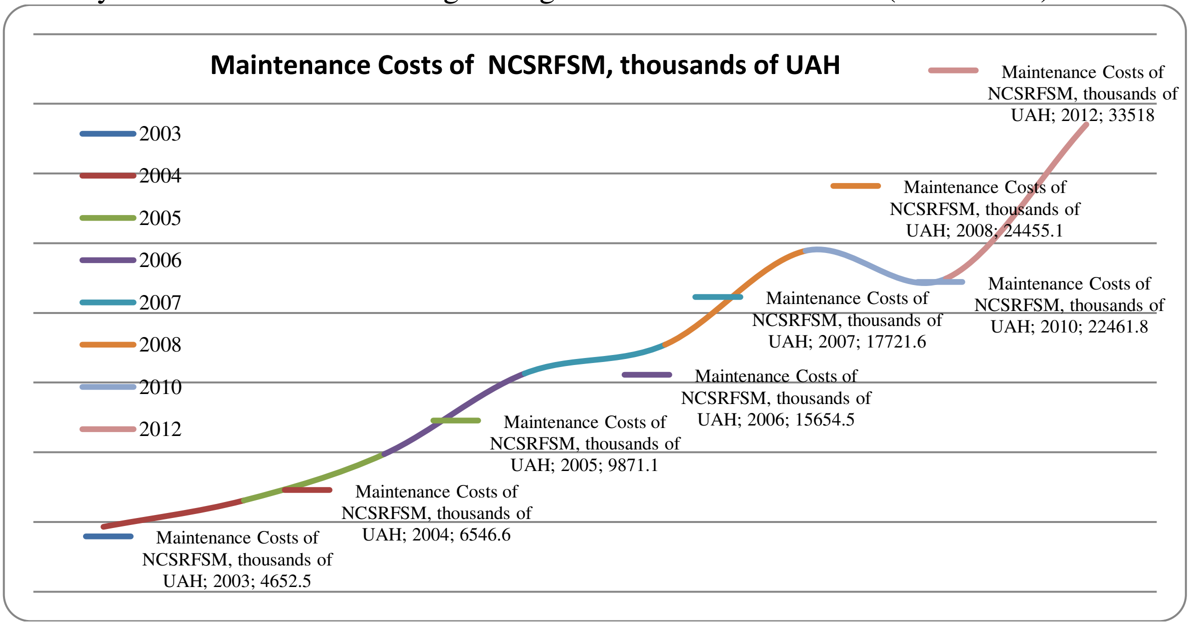

Chart 1: Maintenance Costs of NCSRFSM, in thousand UAH (2003-2012) [1-7]

As you can see, the cost of the foundation only increased. Only 2010 showed negative growth compared to 2009. This supports the argument that was put forward by us that under the difficult economic situation of the state begins to save on regulation – just when do not need. If we analyze the cost structure over the years, we will have the following:

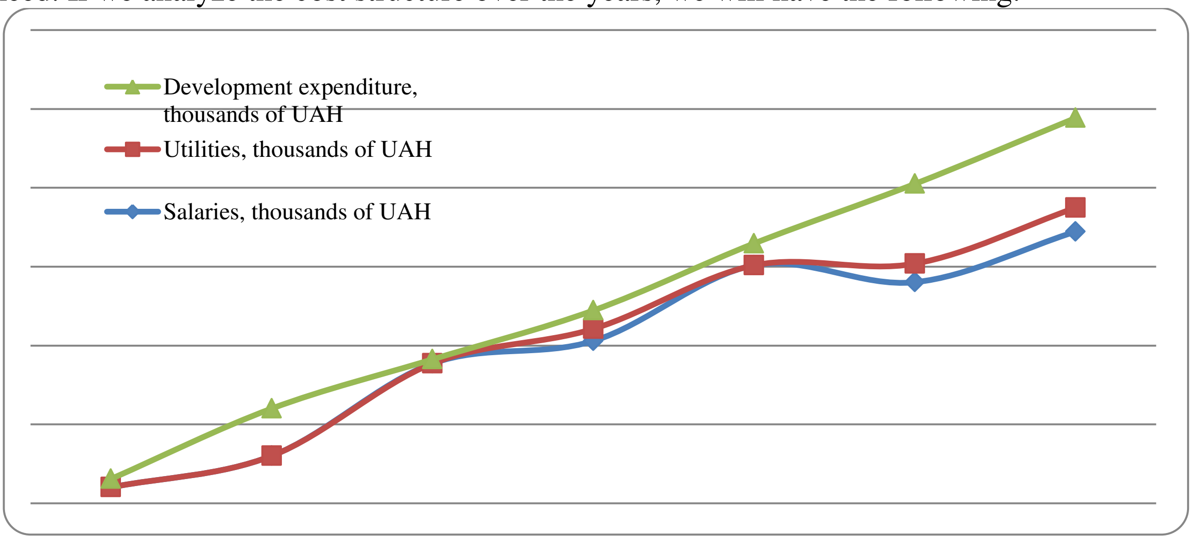

Chart 2: The cost structure of NCSRFSM [1-7]

However, funding NCSRFSM, although growing, but does not provide a full implementation of the commission's functions. Underfunding problem existed from the beginning of the creation of a regulatory body. However, it is not as deep as it seems. So, if you look NCSRFSM's report in 2012, the actual funding is nearly 95%.

In our opinion, the cost of regulation should be correlated with the increase in the number of NBFIs [10]. Is it true? To do this we need to analyze the corresponding period growth dynamics NBFIs and using methods of economic-mathematical modeling to determine the correlation and its strength.

The basis of cost NCSRFSM we took data from 2003 to 2012 (Table 1).

Table 1

Dynamics NCSRFSM costs and the number of NBFIs [1-7]

Indicators	2003	2004	2005	2006	2007	2008	2010	2012
NCSRFSM costs, in thousands UAH	4652.5	6546.6	9871.1	15654.5	17721.6	24455.1	22461.8	33518
Number of NBFIs	1589	1332	1612	1745	1913	2016	2008	2041

As shown in Table 1, the dynamics of these two parameters has a positive upward trend. Instead, only the data on compliance costs does not give us answers to questions about the effectiveness of regulation and supervision of public institutions. After analyzing data from 2003po 2012, we tracked the number of fines given NBFI (revenue in the budget of the NCSRFSM activities) and the number of fines imposed (Table 2).

Table 2

Penalties and earnings the Budget of regulatory and supervisory activities of NCSRFSM [1-7]

	2003	2004	2006	2007	2008	2010	2012
Earnings, in thousand UAH	122.5	No data	503.5	No data	661.84	4328.0	2500.0
Number of penalties to NBFIs	16	263	423	334	332	1456	434

However, this data is enough to carry out a full analysis of the effectiveness of the NCSRFSM. Nevertheless, in terms of limited statistical array, we, nevertheless, managed to build a graph which shows the revenues and costs of maintaining NCSRFSM (Chart 3).

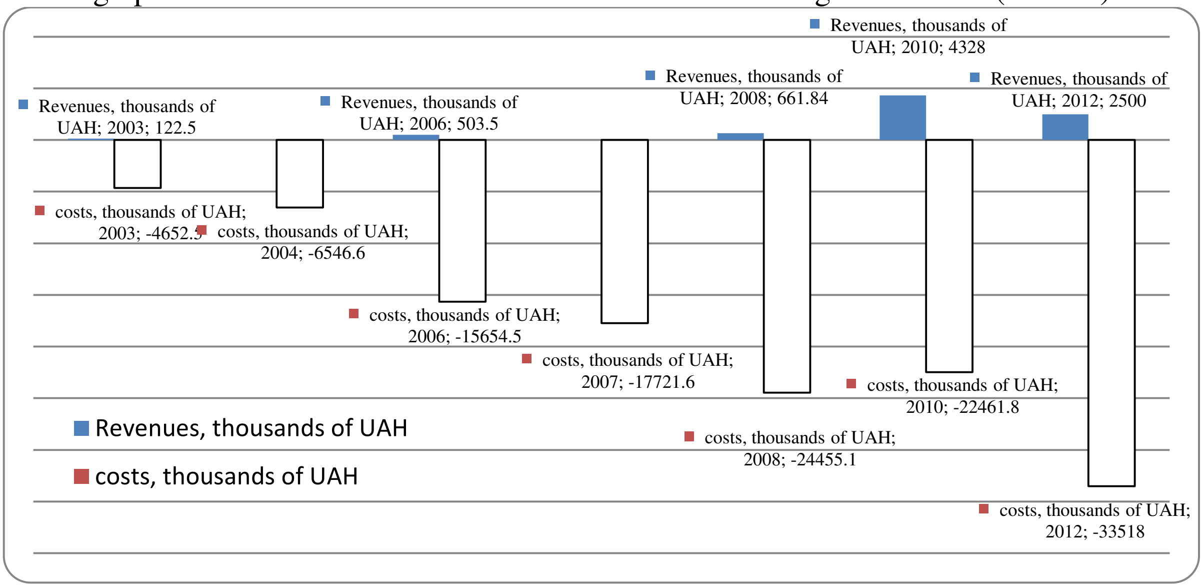

Chart 3: Costs and revenues from activities of the NCSRFSM [1-7]

So, for years of its existence, the maintenance costs of the regulator only increased against the meager revenue from fines for NBFIs (NCSRFSM does not other information on the flow of its activities). So some questions appear about its work. Among them are whether its activity is effective? Are the costs of maintaining the NCSRFSM accord to a number of financial institutions in this segment of the market; actually is there a need for such regulator body with incorrect reports?

Speaking of efficiency, we have determined that it is available when the costs of regulation are less than revenues as a result of this regulation [11]. As the chart 3 where we compare costs and revenues, there is no such effectiveness. Some may accuse us of unilateral attitudes to use only the quantitative approach. If we take into account other aspects of NCSRFSM, such as legislative, then, in our opinion, its performance, though difficult to measure, but in fact it is also low. Development and implementation of legislation often is a lengthy process, the benefits of which, unfortunately, difficult and sometimes even impossible to determine. Also we tried to answer the following question: compliance costs to the number of NBFIs. By using correlation models define the relationship between these indicators and their strength.

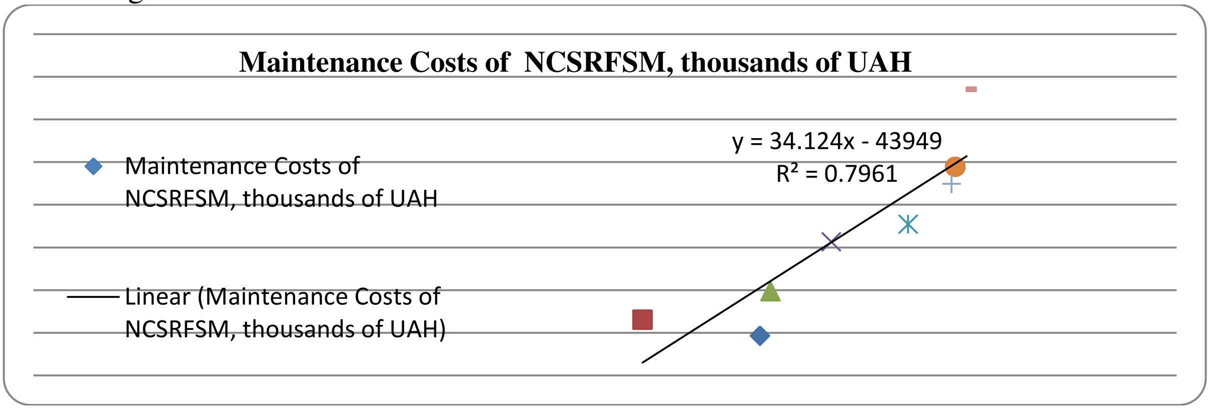

Chart 4: Compliance of the number of non-bank financial institutions to costs of NCSRFSM

Note that the relationship between these indicators exists, and it is quite strong, as evidenced by the fairly high correlation ratio (about 0.8). However, the calculated data do not give us information on compliance costs for authorized regulation body. By comparison, number of banks in Ukraine in 2013 was 180[8], while NBFIs 2074 [9]. The expenses of the National Bank 2,123 billion UAH [8], while for NBFIs 0.34 billion UAH [7]. We have a picture, the number of banks over smaller NBFIs nearly 11 times, and the cost of maintaining the NBU is higher than the cost of NCSRFSM up almost 63 times! Does the government is interesting to develop sector of NBFIs? We think no. Moreover, these disproportion costs of regulation of financial institutions may be the cause of low efficiency of NCSRFSM. Insufficient funding of the regulator device leads to staff lack of relevant departments. Workers simply have not time to cope with the flow of documents from market participants, and thus the regulator does not perform its functions.

DISCUSSION AND CONCLUSION

It is logical to conclude this study by telling about necessity of NCSRFSM. The above picture shows that the course is pessimistic, and could conclude the transferring NCSRFSM functions, for example, to NBU. But given the bias regulator of banks, it will lead to the actual destruction of financial institutions – banks' potential rivals – based on a loan: credit unions, pawnshops, leasing and other financial companies.

It can't be done as NBFIs fill the gaps at financial market which banks cannot or do not want to fill them. Therefore, in our view, despite this deplorable situation NCSRFSM should work independently and develop segments of the financial market for the benefit of society.

Then there is the issue of increasing the financial support of the regulator, the need for which is extremely critical. In countries such as Hungary, Poland, Austria, Canada, Australia, UK and others, regulators of financial services and additional funding by financial institutions, which, in turn, benefit from the provision of quality regulation.

The introduction of international best practice funding authorized body in the sphere of regulation of financial services through contributions in cash nonbank financial institutions supported by international financial institutions and ensures efficient operation of the regulator, stability and reliability of the financial services market.

However, implementation of these practices can significantly affect the very essence of market regulation of non-bank financial institutions.

Since the regulation is based on a commercial basis, may not be exercised in the public interest and in the interests of those who gives money. This, in turn, calls into question the feasibility of the existence of such a body.

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