

NATIONAL SECURITY & DEFENCE

№ 4
2000

Founded and published by:



THE UKRAINIAN CENTRE FOR ECONOMIC & POLITICAL STUDIES

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This magazine is registered with the State
Committee of Ukraine on Information Policy,
registration certificate KB No. 4122

Printed in Ukrainian and English

Circulation: 1500

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must refer to the
«National Security & Defence»

Photos:
cover, pp.14, 54 — UNIAN;
pp. 10, 15, 17, 23, 24, 27, 28, 34-38, 44,
45, 47, 50, 56-62 — IREX;
pp. 18, 55, 60 — "Novator" Foundation;
pp. 9, 25, 41, 51 — Corel Corporation;
p. 13 — Photo Saloon

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The publication of the journal is made
possible by financial support
of National Join-Stock Insurance
Company "Oranta"

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REFORM OF UKRAINE'S INSURANCE SYSTEM: CONCEPTUAL BACKGROUND

The insurance business is recognised throughout the world as one of the most important sectors ensuring the effective protection of the social and property rights and interests of individuals against different risks, and maintaining social stability and economic security of the state. Furthermore, it presents an important tool for the financial regulation of the national economy, and a potent means for accumulating significant funds for further investment into the economy.

In Ukraine, unfortunately, confidence in the insurance sector, as such, was seriously undermined: within a short period (1994-1997), the majority of Ukrainian insurance companies went bankrupt, and the state's mandatory personal insurance arrears are increasing. Some vital types of insurance are not developing; on the contrary, their share on the insurance market is decreasing. This refers, foremost, to life insurance: after 1994, the share of life insurance dropped more than 53-fold.

The state is annually spending around 20-25% of its budget expenditures on the population's social protection. At the same time, social payment arrears are increasing, and funds are often misappropriated. The establishment of effective social insurance mechanisms will, first of all, allow for solving the problem of reducing budget expenditures on social protection and improve their appropriation and, secondly, will encourage the accumulation of investment resources and expand long-term investment possibilities.

The state's regulatory function is particularly important during the insurance business establishment period, especially under economic crisis conditions now being experienced by Ukraine. However, in analysing the state's attitude towards the insurance business, one can conclude that the latter is not very interested in the establishment of civilised international rules of operation on Ukraine's insurance market. The Government has not adopted a single programme document setting conceptual fundamentals for the development of Ukraine's insurance business. Not a single comprehensive target-oriented programme has been developed, and plans for events proposed by separate agencies were never adopted. Furthermore, the state's policy in the insurance sector lacks transparency; this impedes the development of the insurance



market. State funds for separate kinds of insurance are being established, which significantly restricts the capabilities of insurance companies. Some insurance companies are established with the state's participation, and later, they obtain monopoly rights in separate segments of the insurance market without open tenders and bidding procedures. The problems of cumulative insurance taxation are not resolved.

The potential of Ukraine's insurance market is rather high. According to expert estimates, today only around 10% of risks are insured in Ukraine, while in most countries, this indicator is 90-95%. The share of Ukraine's insurance business in the European market of insurance services is only 0.05%, while Ukrainians make up 7% of Europe's population¹.

This report presents an analysis of the current status of Ukraine's insurance market and the factors that hinder its further development. We concentrated on reforming the kinds of insurance dealing with the population's social protection. Special attention is paid to the problems of relations between the state and insurance companies. The report consists of four sections.

The first section presents basic indicators describing the current status of Ukraine's insurance market. It shows that Ukraine's insurance market remains weak and insignificant, although it possesses strong potential for future growth.

The second section analyses the factors hindering the development of the entire insurance market, and its separate socially important segments: life insurance, pension insurance, third-party insurance, and obligatory state personal insurance. Special attention is paid to the unregulated problems of relations between the state and insurance companies.

The third section defines key directions for reforming Ukraine's insurance business. Measures are proposed, intended to improve the system of state insurance market regulation and separate types of insurance.

The fourth section sums up the proposals on reforming Ukraine's insurance market. It is proposed to begin reform with the development of a scientifically grounded, economically sound, and socially justified concept of the insurance business' development in Ukraine. It should serve as a basis for working out the State programme for the development of Ukraine's insurance market. Also of importance is the working out co-ordinated insurance draft regulatory-legal acts. We suggest that the developers should pay special attention to the delimitation of functions between the state and insurers, as well as elaboration of and legislative support for actions designed to protect the interests of insurance services customers, and raise the solvency and reliability of Ukraine's insurance companies.

¹ Koval S. The market is on the rise: Results of Ukraine's insurance market activity in 1999. — *Ukrainskaya Investitsionnaya Gazeta*, April 4, 2000, p.18.

1. THE INSURANCE MARKET SITUATION

In this section, UCEPS experts analyse the main indicators describing Ukraine's insurance market situation. Today, insurance remains one of the few sectors of Ukraine's economy where the basic indicators are rising for several years in a row. At the same time, the insurance market's aggregate value does not exceed 0.4% of the GDP², which points to the potential for its further development.

Unfortunately, some negative features can be observed on Ukraine's insurance market. This refers, above all, to the establishment of sectorised insurance companies actually holding monopolies in separate branches of the economy, and legal uncertainties in the issues regarding the presence of foreign companies on Ukraine's market.

VALUE OF THE INSURANCE MARKET

The total amount of insurance premiums obtained by Ukrainian insurers in 1999 amounted to UAH 1.16 billion, which is 48% more than in 1998.³ As in previous years, in 1999, the rate of insurance premium growth was much (twice) higher than the inflation rate. At the same time, considering the hryvnia's 1999 devaluation by 52%, as compared to 1998, it can be concluded that the *value of Ukraine's*

insurance market dropped last year by approximately 4.5% in real terms.

Despite the insurance market's nominal growth, this sector presently accounts for a very small share of GDP redistribution. Proceeding from the assumption that this sector should occupy a particular niche in Ukraine's financial system and be one of the driving forces behind the GDP's redistribution, it can be concluded that **today, Ukrainian insurance companies do not**

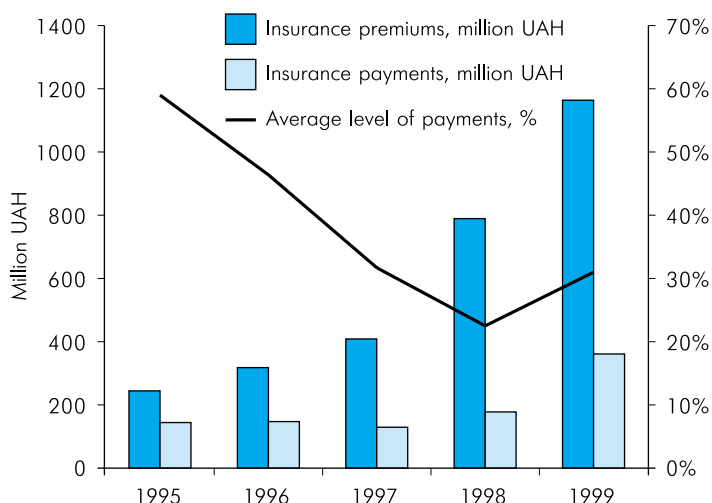
Ukrainian insurance companies indicators						
Indicators	1995	1996	1997	1998	1999	99/98
Insurance premiums, million UAH	244.4	317.8	408.4	789.2	1164.1	148%
Insurance payments, million UAH	144.3	147.3	129.2	177.8	360.9	203%
Level of payments (payment/premium ratio, %)	59	46	32	23	31	—
Formed insurance reserves, million UAH ⁴	65.2	92.7	159.8	447.7	537.0	120%
Amount of paid authorised funds, million UAH ⁴	22.6	64.2	118.7	150.6	327.9	218%
Number of valid policies, in millions ⁴	28.5	28.7	23.9	23.1	23.0	100%
Balance profit, million UAH	25.0	42.4	94.9	179.8	234.0	130%
Allocated on reinsurance, million UAH	38.3	55.5	63.1	238.5	451.2	189%
Of that, went to non-resident re-insurers	—	36.8	42.5	132.9	277.3	209%

² Similar indicator for the insurance sector in developed countries amounts to 8-12% of the GDP.

³ For comparison: German insurance companies annually accumulate around DM 200 billion; the "Ghroling" alone raises some DM 70 billion of insurance premiums a year.

⁴ As of the beginning of the year.

Dynamics of changes in insurance market financial structure



accumulate sufficient investment funds and exercise no significant influence on the gross domestic product redistribution process (Table "Ukrainian insurance companies indicators").

As the Table above makes clear, in 1999, the growth of insurance payments exceeded the growth of insurance premiums. As a result, the

dynamics of the average level of payments⁵, after decreasing for a long period (from 61.1% in 1994 to 22.5% in 1998), reversed: in 1999, the average level of payments amounted to 31% (Diagr. "Dynamics of changes in insurance market financial structure"; Table "Insurance market financial structure").

THE INSURANCE MARKET STRUCTURE

As the Table below shows, the services demanded most are those related to property insurance (61.6% of the total volume of insurance services), the least popular is life insurance (0.7%). In Ukraine, obligatory insurance accounts for a small share in the total volume of insurance services — 14.6% (of that, state insurance — 1.4%). For comparison: in Russia, this indicator amounts to around 40%. This shows that potential exists for the development of Ukraine's insurance market at the expense of obligatory insurance, first of all non-governmental.

It should be especially noted that Ukraine's insurance market is characterised by an extremely weak life insurance sector, showing a steady decreasing tendency since 1995 (Diagr. "1999 insurance premium structure").

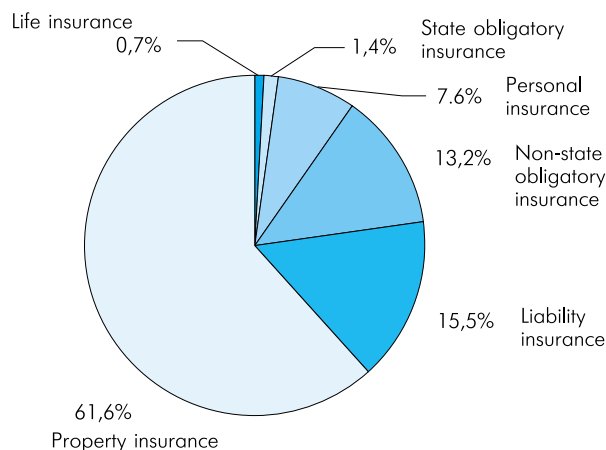
Insurance market financial structure, %

Types of insurance	Insurance premium structure					Insurance payment structure					Level of payments				
	1995	1996	1997	1998	1999	1995	1996	1997	1998	1999	1995	1996	1997	1998	1999
Voluntary personal insurance	38.0	29.1	16.7	9.2	8.3	59.7	46.8	37.0	29.3	32.8	92.7	74.4	70.2	71.5	125
Of that, life insurance	24.9	10.5	4.6	1.6	0.7	46.5	28.4	16.2	7.4	2.0	110.0	125.1	112.6	103.0	96
Voluntary property insurance	29.3	36.9	54.2	71.1	61.6	19.0	26.0	43.1	50.4	53.0	38.4	32.7	25.2	15.9	27
Voluntary liability insurance	10.5	9.0	7.4	8.9	15.5	12.6	13.0	8.0	10.1	6.9	70.4	66.4	34.0	25.6	14
Non-state obligatory insurance	16.4	20.9	17.8	8.7	13.2	1.9	5.7	0.5	1.0	2.4	7.0	12.7	1.0	2.5	6
State obligatory insurance	4.3	4.1	3.9	2.1	1.4	6.6	8.5	11.4	9.2	4.8	89.1	97.8	9.4	98.6	103
TOTAL	100	100	100	100	100	100	100	100	100	100	59.0	46.4	31.7	22.5	31

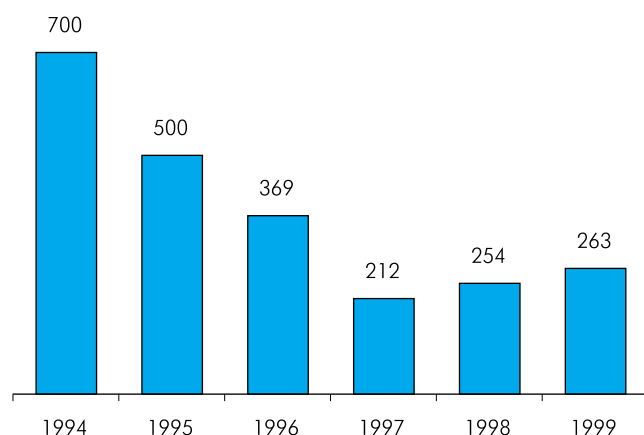
⁵ The average level of insurance premiums is calculated as a ratio of actual payments to collected premiums.

Every year, the specific weight of life insurance premiums in the general premium structure drops two-fold. Beginning from 1995, the total amount of life insurance premiums is also falling rapidly. The number of valid policies fell four-fold

1999 insurance premium structure



Number of insurance companies in Ukraine



between 1994 and the beginning of 1998. Meanwhile, in foreign countries this kind of insurance accounts for the lion's share of insurance premiums⁶, demonstrating a strong growth tendency.

According to the State Register of Insurers (Re-insurers) of Ukraine, as of January 1, 2000,

263 insurance companies were registered in Ukraine. Experts estimate the number of insurance companies active on the market in the previous year at around 200⁷ (*Diagr. "Number of insurance companies in Ukraine"*).

Compared to 1994, when more than 700 insurance companies were operating, their number fell nearly three-fold. However, this reduction had a positive effect, as it occurred due to the removal of insolvent companies and pseudo-insurance firms from the insurance market. It was partially conditioned by legislative regulation of the insurance business⁸, strengthening of state control over the insurance market, and tougher requirements to insurance company authorised fund amounts⁹. Such measures contributed to the sanitation and, to a certain extent, stabilisation of the insurance market.

Proceeding from specialisation in specific kinds of insurance, a group of companies engaged in obligatory insurance services can be distinguished. Furthermore, there is a tendency towards the establishment of sectorised insurance companies, which, behind the excuse of defending national interests or the population's social protection, monopolise some insurance market sectors.

Companies established by powerful industrial corporations or financial-industrial groups for servicing their own needs can also be distinguished. The sphere of their activity is usually limited by the founders' interests. At the same time, they bar competitor companies from the market.

Finally, we should name the group of, let's call them, classical insurance companies targeting the entire market and the broadest possible customer base. Such companies avoid engaging in a specific sector, and try bringing their entire range of operations in compliance with international standards.

Apart from the stabilisation of the number of insurance companies, Ukraine's insurance market is undergoing the process of establishing various insurer associations. Presently active are the League of Insurance Organisations of Ukraine and a number of insurance bureaus and associations (pools). For example, the Motor (transport) insurance bureau of Ukraine is a member of the

⁶ In the world's leading countries, this kind of insurance accounts for up to 60% of the total volume of insurance premiums.

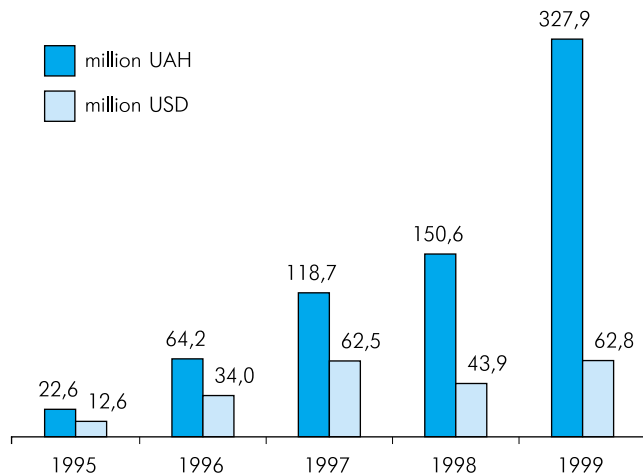
⁷ Cherniakhovsky V. Alien fear and risk: The tendencies of the insurance market's development. — *Kompanion*, No.12, March 20, 2000, p.32.

⁸ In March, 1996, the Law of Ukraine "On Insurance" was adopted.

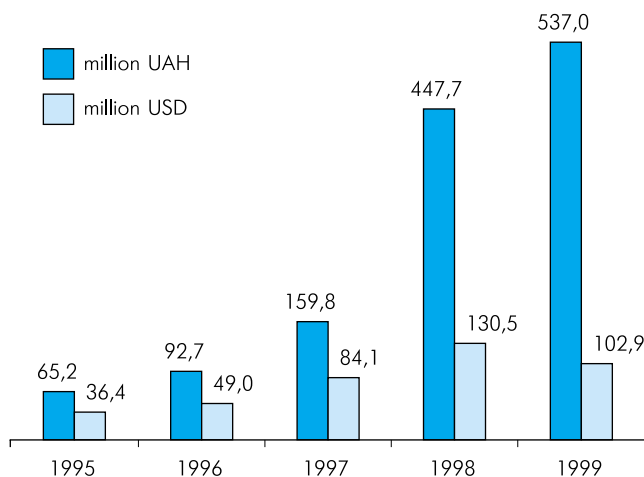
⁹ The minimum authorised fund was established as equal to 100 thousand euro.



The amount of paid authorised funds



Formed insurance reserves



indicator is only approximate for a number of reasons. First, the control over authorised fund compliance with state-established minimum norms was suspended. Second, at present, there are neither regulatory documents governing authorised fund use, nor control over its employment. Third, only 60% of a statutory fund is in cash, while the remaining 40% may consist of any assets, including illiquid. Fourth, there is no established correlation between the authorised fund amount and an insurance company field of activity; this issue is not regulated by licensing rules.

According to 1999 results, the total volume of authorised funds of all insurers rose by UAH 177 million, or more than two-fold. As of January 1, 2000, it amounted to UAH 327.9 million (*Diagr. "The amount of paid authorised funds"*). This growth was to a large extent achieved thanks to three companies: **People's Financial Insurance Company** (its authorised fund rose from UAH 1.3 million to UAH 24 million), **"Oranta" National Joint-Stock Insurance Company** (from UAH 960 thousand to UAH 22.3 million) and the **Ukrainian Oil and Gas Insurance Company** (from UAH 900 thousand to UAH 18.6 million).

In general, however, insurance company authorised funds remain low. **Ukraine's average paid insurance company authorised fund is approximately UAH 1.2 million.** More than two thirds of insurance companies have authorised funds below the established minimum amount, and only 60 companies (63%) have authorised funds exceeding UAH 1 million¹². This causes problems for Ukrainian insurers with risk reinsurance on the domestic market, and places the issue of the consolidation of domestic insurance capital on the agenda.

international "Green card" system¹⁰. The Bureau settles disputes arising with Ukrainian "Green card" holders abroad, and acts as a guarantor of insurance payments under obligatory civil liability policies on Ukraine's territory. Under this Bureau, a fund has been established to make payments to those who suffered in traffic accidents where offenders fled from the accident scene¹¹.

AUTHORISED FUNDS

The amount of the authorised fund is one of the objective indicators of the solvency of an insurance company. In Ukraine, however, this

INSURANCE RESERVES

Compared to 1998, in 1999, insurance reserves rose by 20% and reached UAH 537 million (*Diagr. "Formed insurance reserves"*). The growth of insurance reserves is a positive tendency, as it means the higher reliability and solvency of insurance companies. However, it is premature to speak about steady progress in the insurance business: **the total amount of insurance reserves of all insurance companies in Ukraine is lower than the equity capital of Ukraine's "Prominvestbank" alone** which, by 1999 results, totalled almost UAH 700 million.

¹⁰ Ukraine joined the international "Green card" system on May 1, 1998. Prior to that date, Ukrainian insurance companies were selling policies issued by foreign insurance companies.

¹¹ In 1999, 1311 such traffic accidents were registered. The Bureau settled 293 cases, the aggregate amount of payments totalled UAH 163 thousand.

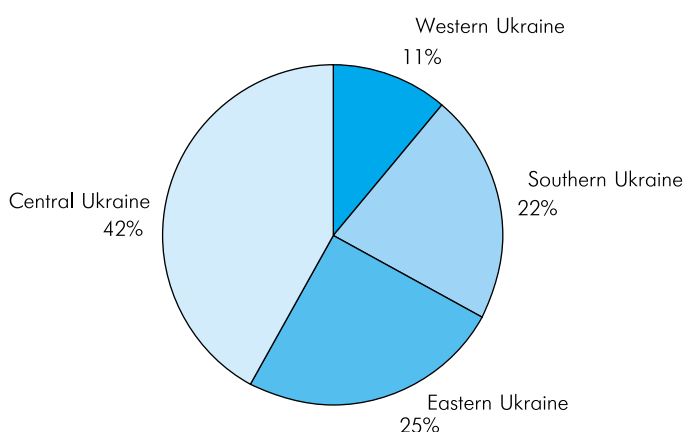
¹² Koval S. The market is on the rise: Results of Ukraine's insurance market activity in 1999. — *Ukrainskaya Investitsionnaya Gazeta*, April 4, 2000, p.18.



PROFIT

The balance profit of insurers in 1999 amounted to UAH 234 million (in 1998 — UAH 179 million). Profit from the insurance business was equal to UAH 192.2 million (UAH 128 million in 1998), from other activities — UAH 42 million. According to 1999 results, Ukraine's insurance companies paid more than UAH 50 million in taxes.

Insurance company distribution by Ukraine's regions

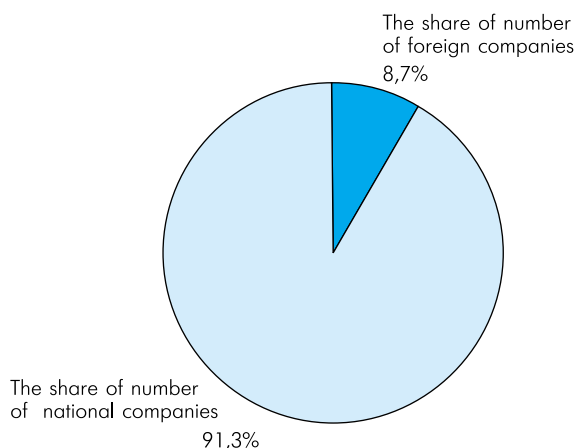


Today, more than half (55%) of all insurance premiums in Ukraine is concentrated in the 10 largest insurance companies, only 3.7% of their total number. The similar situation is observed in Russia where almost 50% of all voluntary insurance payments is collected by 10 biggest insurance companies. According to the latest data, 85% of all insurance premiums is collected by 50 insurance premiums, with the remaining 15% falling on 213 insurance companies¹³.

Almost two-thirds of Ukrainian insurance companies are concentrated in five cities: Kyiv (more than one-third), Odesa, Kharkiv, Donetsk, and Dnipropetrovsk. At the same time, in some regions (such as the Kherson and Sumy regions) there are no such companies. As the Diagram shows, the whole of Western Ukraine (nine out of 25 regions) has only 11% of all insurance companies (*Diagr. "Insurance company distribution by Ukraine's regions"*).

Considering the stagnant dynamics in the number of insurance companies in the last two years, the lowering of the business development expense share and its stabilisation at a level of 18-20% of all insurance premiums, one can assume that **today, there are no significant investments in the development of insurance company infrastructures.**

Foreign capital on Ukraine's insurance market



PRESENCE OF FOREIGN CAPITAL

Current laws provide only for the presence of foreign capital on Ukraine's insurance market in the form of foreign company participation in joint ventures (their share in the authorised fund is limited to 49%). At present, 23 insurance companies with foreign capital are active on Ukraine's insurance market. Six of them have a 49% share of foreign capital, one — 36%, two — 25%, and 14 — 19-21%, respectively (*Diagr. "Foreign capital on Ukraine's insurance market"*).

At the same time, after June 17, 1999, EU country insurance companies got a chance to work on the Ukrainian market directly. They were authorised to establish subsidiaries in Ukraine, 100% owned by foreign capital.

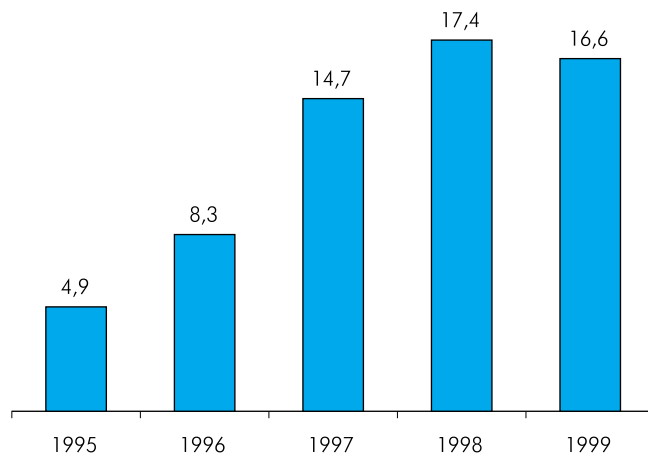
DEGREE OF CONCENTRATION

The performed analysis creates grounds for stating that **Ukraine's insurance market is highly concentrated, judging both by the index of the aggregate volume of insurance company insurance premiums, and from the regional point of view.**

This created a conflict of laws regarding the activity of foreign companies on Ukraine's insurance market, as the draft Law of Ukraine "Amending the Law of Ukraine "On Insurance" provided only a 49% foreign share in authorised funds of Ukraine's insurance companies. The draft does not mention the procedure for estab-

¹³ Ibid.

The insured amount of an insured object that may be taken by Ukrainian insurance companies without reinsurance, \$ million¹⁴



lishing companies with 100% foreign capital at all. On the other hand, even after the adoption of the aforesaid draft, Article 46 of the Law of Ukraine "On Insurance" will remain valid, providing that international treaties have a priority over domestic insurance legislation. Therefore, non-resident EU country insurers will be able to establish their subsidiaries in Ukraine, while those from other countries will, as before, content themselves with a 50% block of shares of Ukraine's insurance companies.

REINSURANCE

The volume of the reinsurance market is increasing. In 1999, reinsurance contracts earned UAH 238.5 million (11.5% of total revenues from all types of insurance), which is 90% higher than in 1998. UAH 262.8 million were paid to re-insurers, or 35.2% of total insurance proceeds.

Non-resident companies remained leaders on the reinsurance market. Due to limited Ukrainian insurance company authorised funds and the low capacity of Ukraine's insurance market, the lion's share of insurance premium amounts (which could potentially be used for domestic investment in Ukraine) goes to foreign reinsurance companies.

According to the Law of Ukraine "On Insurance", if the insured amount for a specific

insurer object exceeds 10% of the paid authorised fund and formed insurance reserves, the insurer is obligated to enter a reinsurance contract. Whereas the formed insurance reserves and the authorised funds of all insurance companies amounted to UAH 865 million in 1999, risks valued in excess UAH 86.5 million (or \$16 million, which is what an aeroplane costs) were to be reinsured abroad (*Diagr. "The insured amount of an insured object that may be taken by Ukrainian insurance companies without reinsurance"*).

For this reason, in 1999, 61.5% of the total amount of all reinsurance contracts was reinsured outside Ukraine. **Ukrainian insurance companies transfer up to 90% of insurance premiums for the insurance of air and marine risks to foreign re-insurers, up to 90% of premiums for health insurance of travellers abroad, up to 60% of "autokasko" premiums, and up to 50% of premiums of insurance of large property risks.**

Risk reinsurance abroad has both negative and positive consequences. The negative ones include the outflow of currency, and significant pressure on the hryvnia. On the other hand, foreign re-insurers have sufficient assets to reimburse large losses, and consciously fulfil assumed commitments. They successfully demonstrated this when reimbursing their share of damages after the "Zenit" rocket failure¹⁵.



At the same time, a group of market leaders may be distinguished among Ukraine's insurance companies, ready to provide reinsurance of significant risks and capable of expanding the range of such services. According to expert estimates, such companies include, among other, "Ostra-Kyiv", "Oranta", "Garant-AUTO", and "ASKA"¹⁶.

¹⁴ In accordance with the Law of Ukraine "On Insurance".

¹⁵ A "Zenit" rocket exploded during its launch within the "Global Star" project; re-insurer losses exceeded UAH 100 million.

¹⁶ Artsymovych I. "Absolute indicators cannot serve as a basis for determining reliability of an insurance company": Chairman of the Board of the "Nadra" Joint-Stock Insurance Company on nuances of insurance company selection. — *Kompanion*, No. 12, March 20, 2000, p. 37.

PRESENCE OF THE STATE ON THE INSURANCE MARKET

The state's regulatory functions on the insurance market presume the establishment of regulatory-legal fundamentals and control over their observance. This is to guarantee target-oriented use of funds for investors, profits for insurance companies, reliable sources of long-term investments for the national economy, and budget revenues for the state, at the expense of civilised taxation of the insurance business.

The state's regulatory role is especially important during the insurance business establishment period, particularly in the present critical situation being experienced by Ukraine. However, from the analysis of the state's attitude to insurance, one can conclude that the latter is not very interested in establishing civilised rules for Ukraine's insurance market, taking world experience into account. Over the entire period of economic reform in Ukraine, the Government has not adopted a single programme document setting conceptual fundamentals for the development of Ukraine's insurance business. Not a single comprehensive target-oriented programme has been developed, and plans for events proposed by separate agencies were never adopted.

Today, the state's role is becoming more important, especially in executing supervisory functions. According to the head of the former Insurance Business Control Committee I. Yakovenko, there is a real threat that the "trust" period will repeat itself. These words are being proven by the latest events in Dnipropetrovsk, Shostka and Kyiv, where thousands of individuals were deprived of mil-



lions of dollars. The economic mechanism of social insurance is similar to that of a "trust". According to Mr. Yakovenko, "Today, social insurance is closely related and merged with non-banking financial capital. This is normal. Around the world, non-banking financial markets interact with social insurance, but there is a relevant infrastructure there, regulating this process. In Ukraine, there is no such structure. That's why it is very important to solve the problem of the non-banking financial market together with social insurance in 2000"¹⁷.



¹⁷ The insurance market is on the rise. — *Ukrainskaya Investitsionnaya Gazeta*, January 18, 2000, p.27.



CONCLUSIONS

As of today, Ukraine operates a weak, underdeveloped and economically insignificant insurance market that accounts for the redistribution of only 0.4% of the GDP. This means that Ukrainian insurance companies are presently unable to accumulate sufficient volumes of investment resources and exert noticeable influence on the process of gross domestic product redistribution.

Most in demand are property insurance services (61.6% of the total volume of insurance services). Life insurance is the least important source of investment resources on Ukraine's insurance services market (0.7%), although in economically developed countries its share amounts to 50-60%. Moreover, the share of life insurance payments in the overall payment structure drops two-fold every year.

Ukraine's insurance market is characterised by a high level of concentration, both judging by the index of the aggregate volume of insurance company insurance premiums, and from the regional point of view.

Insurance company authorised funds remain low. Ukraine's average paid insurance company authorised fund is approximately UAH 1.2 million. This causes problems for Ukrainian insurers for the reinsurance of risks on the domestic market, and places the issue of the consolidation of domestic insurance capital on the agenda. Due to limited Ukrainian insurance company authorised funds and the low capacity of the domestic insurance market, foreign companies retain leading positions on the reinsurance market.

The lowering of the share of expenses spent on business development and its stabilisation at a level of 18-20% of all insurance premiums point to the fact that today, there are no significant investments in the development of insurance company infrastructures.

Ukraine's insurance market is now witnessing the process of establishing various insurer associations. Presently active are the League of Insurance Organisations of Ukraine and a number of insurance bureaus and associations (pools).

So far, the state does not display much interest in the establishment of civilised rules on Ukraine's insurance market, taking world experience into account. There is an urgent need for the working out a Concept and a State programme for the development of Ukraine's insurance market.

2. FACTORS IMPEDING THE DEVELOPMENT OF THE INSURANCE MARKET

The previous section presented the basic features of Ukraine's insurance market and made the conclusion of its unrealised development potential. This section presents an analysis of factors that hinder the insurance market's development, foremost those of economic, legislative, socio-economic and socio-psychological character.

Separately analysed are the aspects of the state's relations with insurance companies that have a negative impact on the insurance market's development. The monopolisation of separate segments of the market by companies established with the participation of the state is taking place. Furthermore, the state is creating a network of various state funds alternative to insurance companies.

Special attention is paid to the problems of the development of socially significant types of insurance — life, medical, civil liability and obligatory personal state insurance.

2.1. FACTORS OF AN ECONOMIC CHARACTER

Ukraine's economic crisis conditions a low demand for insurance services. Large mutual debts and the accumulation of non-payments¹⁸, losses¹⁹, a chronic deficit of cash with most enterprises²⁰ and citizens²¹, and the significant share of the shadow economy which, according to various estimates, amounts to 50-60% of the GDP — all of these factors interfere with the stable development of Ukraine's insurance business.

The present tax system and regulation of enterprise financial activities are not conducive to the goals of insurance. Only in a few types of insurance can insurance premiums be attributed to prime costs, while most of them are paid exclusively out of profit. For comparison, in other CIS states, a prime cost percentage is

established, out of which enterprises can direct costs for insurance²². A similar situation arose with payments of citizens. According to legislation, insurance payments paid to them are also taxed.

With approval of the Law of Ukraine "On taxation of enterprises" in 1997, a 30% tax on profits obtained by insurance companies from investing the funds of the population was established. But it is namely these profits that should be part of the commitments of insurance companies regarding payment of insurance monies per long-term types of insurance. Furthermore, in the Law of Ukraine "On Insurance" (1996), tough norms were established with regard to the possibility of insuring in hard currency equivalents. In this way, artificial barriers were created in order to get Ukraine's population interested in depositing their money into cumulative types of insurance.

¹⁸ The amount of accounts payable in enterprise settlements grew during 1999 by nearly one and one-half times, amounting to UAH 196.4 billion as of January 1, 2000.

¹⁹ 50% of enterprises ended 1999 with losses.

²⁰ In 1999, a part of monetary circulating assets within the structure of circulating assets of enterprises amounted to only 1.2%.

²¹ According to 1999 results, the average monthly per capital income of the population amounted to UAH 103.

²² For example, in Russia it is possible to charge insurance services to the account of prime costs in an amount of up to 1% of prime costs; this indicator is to be increased to 3% in the near future.



2.2. FACTORS OF A LEGAL CHARACTER

The legislative draft “On Amending the Law of Ukraine “On Insurance” has not been approved yet²³. An attempt was made in this document to take a more systematic approach to the problems of Ukraine's insurance market, and to the means of solving these problems.

The drawbacks of the existing legislation are not conducive for directing insurance reserves toward investments. During the second hearing of the Law of Ukraine “On Insurance” for its approval, provisions with respect to using insurance reserves for investment purposes were excluded. As a result, the approved law prohibits all insurers from investing, except for those that practice life insurance. But even under conditions of a legislative solution to this issue, **the necessary incentives and guarantees for investing insurers have not been worked out yet.** This refers to the working out of special investment projects, the issuance of relevant state securities, etc.

It is worth noting that in the draft law “On Amending the Law of Ukraine “On Insurance”, a number of propositions with respect to the insurance sector were included, among them:

- ❖ broader possibilities for insurers as institutional investors;
- ❖ the procedure for the reorganisation and sanation of insurers;
- ❖ enlarged authorised fund amounts up to 500 thousand euro, etc.

The inadequate Civil Code of Ukraine is impeding the development of the insurance market. In the first place, this relates to the development of civil liability insurance, inasmuch as the Civil Code does not envisage mandatory compensation of damages to third parties. The gradual introduction of such a norm, going in line with improvement of Ukraine's economic situation, would increase demand for insurance services on the part of the population, as well as provide for the better protection of citizens' rights.

2.3. FACTORS OF A SOCIO-ECONOMIC CHARACTER

The vast majority of Ukraine's citizens are not solvent. The average yearly per capita income of the population over the last ten years has been dropping steadily. While in 1990 it stood at \$3773, then in 1999, it was only \$318, or 12 times lower. According to data of the Ministry of Labour and Social Policy, 30% of Ukraine's population can be categorised as poor (half of them being at the absolute poverty level), another 15% of the country's citizens is on the margin of low income²⁴. The average wage in Ukraine is close to \$40 a month. Today in Ukraine, there are over 1 million families whose per capita income is under UAH 50 per month, in other 100 thousand families it does not even reach UAH 20²⁵.



The Program of the Viktor Yushchenko Government, named “Reforms for wellbeing”, envisages growth of citizen incomes by 1.3-1.4 times before 2004, i.e., the population's per capita income is to reach \$413-435 a year, or

\$34-36 a month. **The domestic market's palpable development, including that of the insurance market, appears rather problematic, given this income level.**

2.4. FACTORS OF A SOCIO-PSYCHOLOGICAL CHARACTER

Trust in insurance, as an institution of social protection, is one of the necessary pre-conditions for the development of the insurance business. Unfortunately, in Ukraine, trust towards the insurance branch has been, to a large extent, undermined. This is conditioned by the factors listed below.

- ❖ The inability to solve the problems regarding state compensation to citizens based on combined life insurance contracts (over UAH 3 billion), entered into during Soviet times.
- ❖ The state's financing of insurance payments for obligatory types of insurance

²³ The Verkhovna Rada adopted it in the first reading on May 20, 1999.

²⁴ Microdigest. — *Tovarishch*, No. 14, March, 2000, p.3.

²⁵ Realities and prospects of social policy. — *Uriadovy Kurier*, March, 4, 2000, p.10.

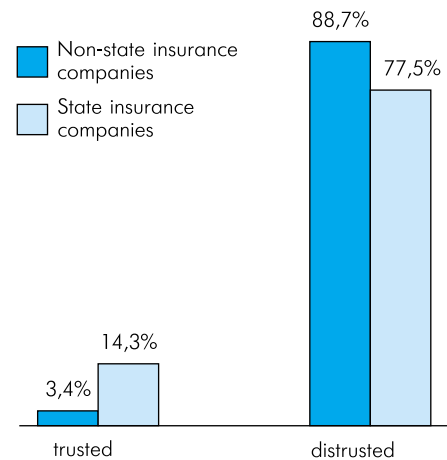
“according to the leftover principle”. This led to the situation where, as of March 1, 2000, the debt of 16 ministries and agencies of Ukraine with respect to obligatory types of insurance stood at UAH 58 million. The inability of citizens to receive insurance compensation, guaranteed by the state, for years undermines the reputation of Ukrainian insurers, although they are completely blameless in the present situation, inasmuch as they merely fulfil the role of the Government's agents with respect to the insurance payments.



- ❖ The bankruptcy of many Ukrainian insurance companies over a short period of time (1994-1997), especially those that were with impunity doing the “trust business” — “the play on inflation” (for example, specialised in so-called combined life insurance “with account of inflation”, etc.)²⁶.
- ❖ The absence of safety guarantees for the funds deposited into the insurance companies. Even information regarding the objects of investment of assets and insurance reserves, and the mechanisms protecting them from inflation, abuses, and risky transactions, was often unavailable.
- ❖ The absence of public information in the mass media regarding payments made by insurers. Even the lists of the 50 leading insurance companies published by the Insurance Business Control Committee over the last several reporting periods did not include information on the payment of monies by companies.
- ❖ The absence of highly professional specialised rating agencies and consulting companies which could perform objective analysis of the activities of insurance companies and create a positive image of them.

As a result, the population's trust in insur-

Population's level of trust in insurance companies



ance companies is critically low today. Based on the data of the poll conducted by the Sociological Service of the Ukrainian Centre for Economic and Political Studies in April, 2000, among financial structures, it is namely insurance companies that are the “leaders” in the category of social distrust. 77.5% of respondents doesn't trust state insurance companies, while the figure for non-state insurance companies is 88.7% (*Diagr. «Population's level of trust in insurance companies»*)²⁷.

2.5. NEGATIVE TENDENCIES IN RELATIONS BETWEEN THE STATE AND INSURANCE COMPANIES

The following negative traits characterise relations between the state and insurance companies:

- ❖ An increase in the state's presence on the insurance market through the creation of insurance companies with the participation of state structures; the monopolisation by them of different types of insurance (*Ukrinmedstrakh, Ukreximstrakh, Interpolis*);
- ❖ The state's creation of a network of various state funds alternative to insurance companies (*Accident Insurance Fund, Unemployment Insurance Fund, etc.*).

²⁶ According to information of the public human rights organisation *Investor*, over 17 million Ukrainian citizens were deceived by various financial brokers: Fandeyev O. Belief in “national capitalism” is buried in financial pyramids. — *Den*, August 14, 1999, p.5.

²⁷ For comparison: 17.5% of those polled trust in the state funds of social insurance, non-state - 3.6%, distrust - 70.2% and 85%, respectively. State banks hold on to the highest level of trust - 24.4%, non-state - only 7.8%, while 66.9% and 83.3% of respondents, respectively, distrust them.

Monopolisation of chosen segments of the insurance market by companies created with the state's participation

The mechanism for establishing monopoly by a company created with the state's participation is straightforward. First, a given type of insurance (or given set of insurance operations) is made obligatory. Later, for purposes of its implementation, a special insurance company is created whose majority share package is controlled by a state structure. The co-founders of the company are, as a rule, structures with non-state ownership forms, appointed without any kind of competition, tender or, at the very least, a preceding announcement. In this way, **the process for creating a company, in advance provided the status of monopolist on a given segment of the insurance market, is non-transparent and protective, limiting the possibilities of other competitors.**

The activity of the **Ukrinmedstrakh** insurance company, founded by the Ministry of Public Health of Ukraine, may serve as a demonstrative example of such monopolisation of a given segment of the market. In accordance with the decision of the Government²⁸, the government was granted a monopoly right for one type of insurance — the sale of medical insurance policies to foreign citizens upon entering Ukrainian territory. Starting with the autumn of 1997, foreigners crossing the border, or obtaining a visa according to the applicable rules, must have an **Ukrinmedstrakh** policy. Furthermore, the Government resolution states that the policies of foreign insurance companies that have no relevant agreements with **Ukrinmedstrakh** (regarding recognition on the territory of Ukraine) lose their validity at the border. To this point, **Ukrinmedstrakh** does not have any agreements recognising medical insurance policies issued by foreign companies. At the same



time, the policies of **Ukrinmedstrakh** itself are already legalised in several countries — Germany, Italy, Austria, Canada and Israel.

Another example is the **Interpolis** insurance company. With the State Administration of Railway Transport of Ukraine holding a controlling block of shares, among its founders, this insurance company services close to 45% of accident insurance contracts with respect to passenger train accidents²⁹.

The creation of state insurance funds

Aside from the tendency towards increasing the number of monopolist insurance companies, efforts on the part of the state to create new state funds for servicing different types of obligatory social insurance can be observed. Upsetting is the fact that the indicated tendency regarding the creation of funds is continuing even now. For example, it is planned to create a medical insurance fund under the Ministry of Public Health, which again will lead to increased state budget expenditures. The Law of Ukraine "On General Obligatory State Social Insurance for Unemployment"³⁰ also envisages the creation of a special state fund.

This tendency can lead to the appearance of a financial structure parallel to already present insurance companies. Moreover, for ensuring its activity, it is necessary to create an independent network, and provide it with appropriate means. For example, for the purpose of creating a Disability-related Industrial Accident and Occupational Disease Insurance Fund, *budget* expenditures in the amount of UAH 15 million are earmarked.

This kind of practice limits competition on the insurance services market, and introduces ineffective mechanisms for the insurance market operation, instead of removing the existing contradictions and artificial barriers on the path of increasing the payoff from the existing insurance structures.

2.6. PROBLEMS IN THE DEVELOPMENT OF SOCIALLY SIGNIFICANT TYPES OF INSURANCE

In this section, life (including pension), medical, civil liability, and obligatory state personal insurance are examined.

²⁸ Resolution of the Cabinet of Ministers of Ukraine No. 79 of January 28, 1997 and Resolution of the Cabinet of Ministers of Ukraine No. 1021 of September 17, 1997 "On Improvement the Procedure for Medical Assistance to Foreign Citizens Temporarily Staying on the Territory of Ukraine".

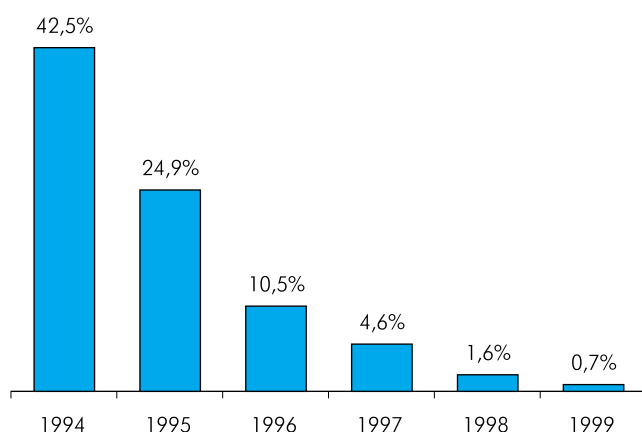
²⁹ Naumenko V. The fears of insurance. — *Kompanion*, No.3, January, 1998, p.12.

³⁰ Approved by the Verkhovna Rada on February 3, 2000.

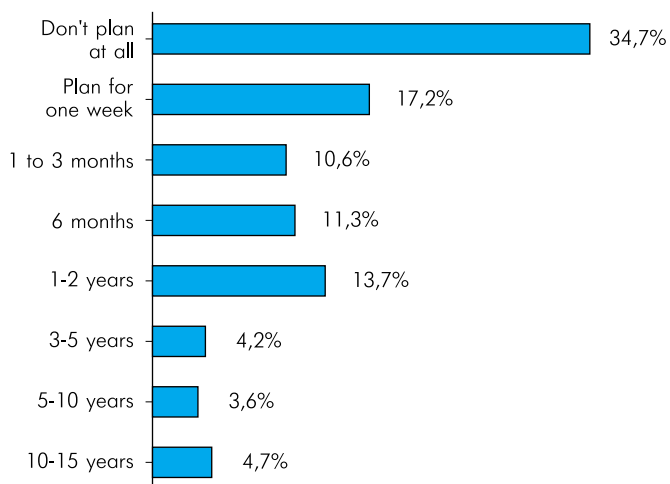
Life insurance

Today, only 12 Ukrainian insurance companies have licenses to conduct life insurance operations, but in reality, half of this number of insurers practise this type of insurance. At the same time, as a result of the illegal activities of foreign insurance companies practising life insurance, Ukraine, according to expert estimates, loses \$80-100 million a year³¹.

Portion of life insurance payments in the overall insurance payment structure



For what period do you plan your life?



In general, two main psychological reasons exist in Ukraine that cause virtually complete absence of life insurance (*Diagr. "Portion of life*

insurance payments in the overall insurance payment structure"), and interfere in the development of this type of insurance in the nearest future. The first one is the general reason for causing the Ukrainian population's distrust in insurance, as such. The issue in question is the loss by citizens of money paid according to insurance contracts entered into with the former State Insurance of the USSR at the beginning of the '90s. The second reason is the wave of various trusts and insurance companies that operated during 1993-1995 and turned out to be financial pyramids where the money of deceived depositors disappeared.

Aside from that, Ukraine's tax legislation does not stimulate the development of this type of insurance. Stimulating taxation applies only to contracts with over 10-year terms. A shorter-term contract is considered risky insurance which automatically leads to losses³².

Today, no requisite pre-conditions exist in Ukraine for the development of long-term types of insurance (including life insurance). It is necessary to ensure economic and financial stability, predictable inflation, steady economic growth, the population's confidence in the future, and the possibility for making long-term life plans. In Ukraine, the population is mostly occupied with the problems of survival and cares little about long-term prospects.

According to the poll conducted by the Sociological Service of the Ukrainian Centre for Economic and Political Studies in April, 2000, the vast majority of respondents either doesn't make life plans at all (34.7%), or limits their plans to one week (17.2%), 1-3 months (10.6%) or up to a half-year (11.3%). Only 4.2% of those polled plan their lives for 3-5 years, 3.6% — 5-10 years, and another 4.7% indicated long-term life planning of 10-15 years and more (*Diagr. «For what period do you plan your life?»*).

Pension insurance

The status of pension insurance system in Ukraine demonstrates that the existing solidary system, working under a divisional scheme, is incapable of performing its primary functions — ensure pension amounts at least at the minimum subsistence level and their timely payment. In 1999, the average pension was UAH 47. The practice of covering pension payments with goods became widely implemented: in 1999,

³¹ Koval S. Ukraine is on the threshold of an insurance products boom. — *Ukrainskaya Investitsionnaya Gazeta*, March 14, 2000, p.11.

³² In the developed countries, investment funds are not taxed, but it's just the opposite in Ukraine — they are taxed twice: when dividends are accrued, and when they are received from the insurance company as income, according to common procedure (that is, at a rate of 30%).

pensioners received UAH 311 million worth of goods in lieu of pension payments. Pension payment arrears stood at around UAH 1.8 billion as of February 1, 2000.

The crisis of the state pension is conditioned by a number of factors. First, this is the unfavourable demographic situation. Today, Ukraine has the highest ageing rate among the populations of all post-Soviet countries: for nearly 16 million working people, there are 14.5 million pensioners. Secondly, the level of filling the Pension Fund is critically low (as a result of lower production volumes, the overly high share of the shadow economy, the non-payment of wages). Thirdly, the principle of pension calculations is imperfect, when a person may choose, for pension calculation, any three years in a row when his wages were at their highest. In addition, information regarding wages is often falsified (overstated)³³. Fourthly, there are countless categories of privileged and early pensioners, and a general lack of order in pension legislation³⁴. And finally, the Pension Fund monies are part of the state budget, which makes possible their use for other than designed purposes.

Taking into account the indicated problems, the Government of Ukraine is initiating large-scale pension reform. The new pension system is planned to have three levels. *On the first level*, the solidary pension fund will be retained intact. It will be filled, as earlier, at the expense of employers (in the form of charges on the wage payment fund) and worker contributions. The solidary pension fund is to pay social pensions, first of all. It is planned to gradually decrease the share of charges remitted to the solidary fund, in favour of the second level of the pension system.

The second level is the introduction of a mandatory system of long-term accumulation of funds on individual (personal) employee accounts. Pilot projects for the implementation

of personal accounts are already active in 15 districts of the Lviv region. It is planned to open personal accounts for all working (employable) citizens of Ukraine in 2000, and in 2001 — to begin the transition to the new pension system. It has not yet been established which structures will be employed to manage the funds. Possibly, in the first stage of introducing the second level of the pension system, a relevant National Agency (within the executive power) will be created, while non-state pension funds will be involved in the second stage³⁵.



In general, the obligatory form of pension insurance is taking on the traits of social insurance. Insurance premiums paid by physical and legal entities are similar to a tax. That's why the obligatory form of insurance will probably be co-

ordinated by state structures. **UCEPS experts suggest that existing insurance companies should be involved in obligatory pension insurance on tender terms, with account of the size of authorised funds and experience of operation on the insurance market.**

Finally, *the third level* being proposed for the new pension system is the voluntary pension insurance, both individual and collective. **Namely on this level insurance companies will be employed to take part in the formation of long-term pension savings.**

Considering today's above-mentioned socio-economic realities, one should not hope for the noticeable animation of this type of insurance in the near future. The factors listed below are holding back the development of this type of insurance.

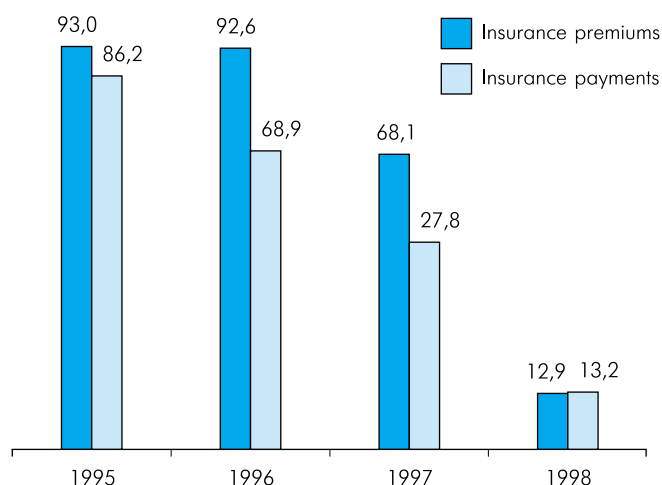
- ❖ Incomes of the vast majority of employed do not exceed the survival level, and in no way do they enable long-term savings.
- ❖ The Program of action of the Government of Ukraine provides for an

³³ According to the deputy head of the Pension Fund of Ukraine A. Bonislavskiy, wage data are overstated in every third case: Horban Yu. Hurry up slowly! — *Vlada i Polityka*, March 14, 2000, p.16.

³⁴ Today, the guidelines used for determining pensions (retirement age, amounts, calculation methods) are defined in 12 laws. Pension amounts fluctuate within parameters that are too wide — from UAH 27 to 1160. Nearly 6 million pensioners receive pensions in the amount of UAH 27-43. There are 11 categories of pensioners; in some categories, pensions are 4-5 times higher than the average wage, and more than 10 times higher than the average state pension.

³⁵ 98 non-state pension funds are registered in Ukraine of which 20 actually operate. The funds encompass around 20 thousand individuals. Deposits are made by enterprises; the amount of deposits is equal to 1 to 10% of profits; the amount of the additional pension — from UAH 7 to 300.

Insurance premiums and payments by private medical insurance companies, in millions of hryvnias³⁶



“increase in the charges collected into the Pension Fund”³⁷. If one takes into account that today this amount is already nearing 33% of the total fund of wages, its further increase will hardly be conducive to voluntary pension insurance.

- ❖ In our view, the hopes of supporters of the tri-level pension system in employers who would attract employees through voluntary pension insurance, are somewhat exaggerated. Unemployment in Ukraine is rising at a fast pace, which is ridding employers of their need to care for their workers.

Therefore, one can draw the conclusion that **the planned pension reform is opening new possibilities for involving insurance companies in the formation of long-term pension savings**. Nevertheless, it is necessary to provide for efficient mechanisms

for the real participation of insurance companies in the new sector of socially significant insurance business³⁸.

Medical insurance

In the former USSR, medical services of state healthcare establishments and medical-sanitary departments of enterprises were offered free of charge and were financed at the expense of the state budget and enterprise funds.

During the transition period, this system in Ukraine was complemented by a voluntary medical insurance system. However, the voluntary medical insurance market is too narrow. Furthermore, **in connection with the decrease in demand on this market, from 1996, it is gradually becoming smaller and is losing its significance** (Diagr. “Insurance premiums and payments by private medical insurance companies”).

Therefore, the sphere of healthcare is dominated by the old system of health protection funding mostly at the expense of budget. **Legislative acts have not yet been approved in Ukraine regarding the obligatory medical insurance of the population**, despite the active discussion of these issues by representatives of the healthcare system, insurance companies and state authorities. In other words, medical insurance, which is a part of social insurance and exists at the expense of obligatory contributions of the insured, is absent in Ukraine.

Civil liability insurance

As a rule, civil liability insurance (or third-party liability for unintentional damages) belongs to the category of obligatory insurance. **In Ukraine, this type of insurance with respect to individuals does not yet have a legislatively established obligatory character.**

That's why only a very small portion of Ukraine's citizens possesses civil liability insurance policies.



³⁶ Zuyeva A., Romanenko K. Are you insured? — *Biznes*, No. 14, 1999, p.18.

³⁷ Measures for the implementation of the Program of Action of the Cabinet of Ministers of Ukraine. — *Uriadovyi Kuryer*, March 21, 2000, p.4.

³⁸ Despite the fact that pension reform has already begun (if one is to consider the development of pilot projects, activities of non-state pension funds, and declarations by government officials), it is still premature to discuss the system for its conceptual foundation and necessary legislative grounding. The Program of Action of the Government of Ukraine presumes the development of draft laws “On General Obligatory State Pension Insurance” and “On Non-State Pension Funds”. One can draw the conclusion that new draft laws will be developed, rather than the Verkhovna Rada's quick review of the drafts developed by the Government and presented to Parliament back in July, 1997 (under the same names), will be encouraged.

According to the UCEPS Sociological Service, this group of the population amounts to only 2.1%. It is significant that only every fifth respondent indicated that he knew the essence of this type of insurance.

Again, the list of measures intended to ensure the implementation of the Program of Action of the Government of Ukraine contains no provision of the implementation of civil liability insurance³⁹. Therefore, civil liability insurance of individuals remains exclusively voluntary. Even in these conditions, experts observe the growth in the number of individuals who insured civil liability over the recent period, as well as the increase in amounts insured by the clients who insured civil liability earlier⁴⁰.

The Law of Ukraine "On Insurance" (article 6, paragraph 24) establishes the mandatory nature of insuring the responsibility of vehicle



owners, but the applicability of this rule is actually blocked⁴¹. And that's despite the fact that nearly 5000 people lose their lives each year in traffic accidents in Ukraine, while another 40,000 are injured.

Vehicle owners' mandatory civil liability insurance is performed in all European countries (except Russia) and the majority of countries the world over. In the former USSR, civil liability insurance is mandatory for the owners of vehicles and is strictly controlled in Estonia, Latvia, Lithuania, Georgia, and Kazakhstan. Starting

July 1, 1999, this kind of insurance was introduced in Belarus⁴².

European countries agreed on the mutual recognition of obligatory insurance policies via the creation of a unified International System of Auto Insurance, called Green Card. Ukraine's accession to this system has some specific features. Ukraine is the first CIS country which joined the Green Card system. Ukraine's specificity also lies in the fact that Ukraine is an important transit country which has a large fleet of registered vehicles. The development of this new form of insurance for Ukraine is complicated by the unfavourable economic situation, so, the obligatory civil liability insurance for vehicle owners should be introduced gradually.

Obligatory state personal insurance

This kind of insurance is regulated by the laws of Ukraine "On Insurance", "On Militia", "On Social and Legal Protection of Military Servicemen and their Family Members", "On the State Tax Service of Ukraine", "On the Status of Judges", "On the Procurator's Office", "On the Control-Revision Service of Ukraine", and other regulatory-legal acts, including applicable Government resolutions for every individual agency.

The situation which has developed regarding the implementation of obligatory state insurance is critical. As of March 1, 2000, ministry and agency insurance payment arrears stood at UAH 58 million. The issue of their repayment is not being solved, so, their amount is constantly growing. The delay in ministry and agency payments makes 1 to 2.5 years. It is worth noting that the term of delay, regarding payments of insurance compensation, is much larger today than the same period for wage, pension, scholarship, and other social payment arrears. The necessity for change in state policy regarding this form of social protection is obvious.

³⁹ This document refers to only the implementation of the Law of Ukraine "On General Obligatory State Social Insurance against Disability-related Industrial Accidents and Occupational Diseases".

⁴⁰ Shramko E. Risk on wheels. — *Kompanion*, No. 12, March 20, 2000, p. 39.

⁴¹ The corresponding changes proposed back in 1997 to the Law of Ukraine "On Traffic" have not been made.

⁴² Press release "TPL-insurance: state and prospects", Round-table "The insurance business in Ukraine: from the accumulation of problems to civilised competitive development", Kyiv, March 31, 2000.

CONCLUSIONS

Different segments of the insurance market are being monopolised by companies created with the state's participation. Creation of state funds for servicing different types of obligatory social insurance is continuing. This practice limits competition on the insurance market, and introduces ineffective mechanisms for its functioning, instead of removing barriers that hamper the effective operation of existing insurance structures.

There are no favourable pre-conditions for the development of long-term types of insurance (including life and pension insurance) in Ukraine. The population is mostly concerned with the problems of survival and cares little about long-term prospects.

The old system of healthcare funding mostly out of the budget dominates in the public health system; legislative acts regarding obligatory medical insurance for the population have not been approved. Medical insurance, which is an element of social insurance, and exists at the expense of mandatory contributions of insured individuals, is absent in Ukraine.

The development of Ukraine's insurance market is impeded by a number of factors of an objective and subjective character. In the first group, one can include those related with the economic crisis in Ukraine: economic instability, industry stagnation, and the decrease in the population's solvency; structural disproportion in the economy; the lack of funds; insufficient personnel; and the limited capacity of the insurance market. Subjective factors are conditioned by shortcomings in the management of economic processes, including processes of establishing the insurance market: the unfavourable tax system, the incomplete and fragmentary legislative base, ineffective control on the part of the state, state support for monopolisation, the absence of a developed support infrastructure, the lack of information on the possibilities of the market, and the low insurance culture of the population.

In general, the state of Ukraine's insurance market can be characterised as "expectant". It has a significant potential for development. As an important part of the overall state financial system and social protection system, the insurance market needs serious improvement within the framework of administrative, economic and legal reforms.

3. DIRECTIONS OF INSURANCE MARKET REFORM

Proceeding from the analysis of the status and factors that impede the development of the insurance market, this Section determines the possible directions for reforming Ukraine's insurance system. Most attention in this Section is paid to improving the state regulatory system and developing socially significant types of insurance.

The state annually spends around 20-25% of its budget for the population's social protection. At the same time, social payment arrears are increasing, and funds are often misappropriated. The establishment of effective social insurance mechanisms will, first of all, allow for solving the problem of reducing budget expenditures on social protection and improving their appropriation and, secondly, encourage the accumulation of investment resources and expand the possibilities for long-term investment into the national economy.

The main target of reforming the insurance system is improvement of the population's social protection and the creation of conditions for the steady development of the insurance market's competitiveness.

Reform should be based on such principles as foundation, consistency, phased structuring, and the social orientation of the intended results.

The main goals to be achieved after implementing the events stipulated in this Section are ensuring market stability and consolidating insurance companies; transparency of the state's relations with insurance companies; competition in the insurance business; establishment of efficient state and public control over the activity of insurance companies; restoration of public confidence in insurance companies; increasing investments into the economy; and decreasing the outflow of insurance company assets abroad.

3.1. IMPROVEMENT OF THE STATE REGULATORY SYSTEM

This sub-section proposes a number of measures for reforming the state's relations with insurance companies, regulating domestic insurer investment activities, foreign insurance company operations, and reform of the state control system.

Reforming the state's relations with insurance companies

While implementing new types of obligatory insurance, the state creates new funds for their servicing. **UCEPS experts see this as a faulty practice. Instead, tenders and bidding procedures**

among existing insurance companies should be encouraged, and European standards for selecting insurers observed.

The establishment of a new state fund requires money for the formation of authorised capital, creation of a regional network, etc. For instance, the 2000 budget earmarked around UAH 15 million for the establishment of the Disability-related Industrial Accident and Occupational Disease Insurance Fund. **According to UCEPS experts, it would be more acceptable to conduct an open tender (with clearly defined requirements and criteria) between existing insurance companies.** This would save state funds, that is taxpayer funds, and improve the quality of insurance services (*see comparative table*).

Establishment of a new state fund	Tender among existing insurance companies
Authorised fund formation at budget expense	Authorised fund already formed
Budget funding for creation of new regional representative office network	Operational network of regional representative offices in place
Lack of trained personnel	Specialists possessing practical experience

In order to achieve transparency in the state's relations with insurance companies, above all, the state's functions should be confined to supervision. Secondly, when implementing new types of obligatory insurance, existing companies should be involved on the basis of tenders and bidding procedures. Thirdly, the Government should examine all contracts between ministries (agencies) and insurance companies for the current year. Finally, before the end of 2000, tenders should be held among existing insurance companies to conclude contracts for 2001.

Regulation of insurance company investment activities

In developed countries, cash accumulated through insurance serves as a source for large-scale investments. In many countries, legislation stipulates the principles for using such resources *exclusively* for investing into the *national* economy. The nature of resources accumulated by insurance companies determines their priority use for long-term industrial investments through the securities market.

The majority of Western banks, using mainly short-term loans, doesn't have this kind of possibility. That's why insurance companies gradually conquer dominant positions on the national and world capital markets. Since cash proceeds obtained as insurance premiums and incomes from active operations normally far exceed the amount of annual payments to insurance policy holders, this enables insurance companies to increase investments into long-term securities with a fixed repayment term year⁴³.

Huge insurance company investment resources are turning those companies into influential external centres of financial control over industrial corporations⁴⁴.

In Ukraine, meanwhile, insurance company investment capabilities are relatively limited. As we already noted, the reasons for this include a limited set of investment mechanisms⁴⁵ and Ukrainians' mistrust in long-term investments.

One positive point is that the draft Law "On Amending the Law of Ukraine "On Insurance" suggests a significant expansion of possibilities for insurer investments into the national economy. In accordance with this document, the placement of insurance reserves is to be undertaken with the factors of safety, profitability, liquidity and diversification taken into account. They may be represented by the following asset categories:

- ❖ cash on settlement accounts;
- ❖ bank holdings (including deposits);
- ❖ real estate;
- ❖ interest-bearing securities;
- ❖ government securities;
- ❖ claims to re-insurers;
- ❖ investments in the form of financial and other contributions used for investing into Ukraine's economy, as determined by the Government;
- ❖ centralised insurance reserves;
- ❖ insurance guarantee fund;
- ❖ long-term investment credits.

⁴³ Foremost, into industrial corporate obligations, company shares and mortgages.

⁴⁴ Approximately one-third of US insurance companies' assets is comprised of corporate obligations and, together with corporate stocks and mortgages, accounts for 50% of total insurance companies' assets — close to \$800 billion.

⁴⁵ In accordance with the effective Regulations "On the Procedure for the Formation, Placement and Accounting of Insurance Reserves", *insurance companies may only invest in securities* (no more than 40% of reserves, and no more than 5% of total reserve amounts per issuer); *in real estate* (up to 10% of reserves); or into *bank deposits* (up to 30% of reserves per bank).

The problems of investments and their guarantees are rather complex. Therefore, this report concentrates on some of the possible solutions.

First of all, **it is important to restore the population's confidence in long-term deposit investments.** This will require invested fund repayment and accrued interest guarantees that are serious and understandable for potential clients. For instance, it may be advisable to use accumulated funds to complement only the National Bank's currency reserves, using state-owned real estate (under mortgage schemes), shares of profitable oil and gas sector enterprises, etc. to guarantee those funds.

Insurance companies should acquire institutional investor rights: be able to convert hryvnias into hard currency, and invest insurance reserves into housing construction and mortgages. A special fund could be established under the Ministry of Finance, or special "insurance" securities issued on terms similar to long-term life insurance obligations⁴⁶, etc. Perhaps international financial institutions could act as guarantors of life insurance investments. It may be expedient to examine the issue of the partial placement of the cumulative part of life insurance reserves outside Ukraine: this would help to solve the problem of investment for insurers and insured. One option suggests permitting insurers to invest into large (reliable) foreign companies involved in large-scale investment projects in Ukraine.

Regulation of foreign insurance company activities

As we already mentioned, today, the foreign insurance company activities on Ukraine's market are not sufficiently regulated by legislation. Furthermore, many experts fear that legislatively regulating the admission of foreign insurance companies to the domestic market will encourage the expansion of foreign capital, while Ukrainian insurance companies will be squeezed

out of the internal market, since foreign insurance companies have far greater capital and insurance market operation experience as compared to domestic insurers.

However, we consider those fears somewhat exaggerated. Foreign companies will come to Ukraine's insurance market, above all, to protect the property of foreign investors. Only then will foreign insurance companies expand the circle of their clients to involve Ukrainian nationals. Taking the current economic crisis into account, only companies prepared to act in extremely risky conditions will decide to enter the small and "divided"⁴⁷ Ukrainian insurance market. This conclusion is confirmed by the fact that until now, leading world reinsurance companies have not been represented in Ukraine. Furthermore, foreign insurance companies are frightened off by the low repayment of funds invested into the Ukrainian insurance market⁴⁸.

It becomes apparent that foreign competitors possessing significant capital and vast experience are not desirable for national insurance companies. Insurance company clients are, however, interested in the appearance of reliable, competent foreign insurance companies whose insurance reserves are counted in millions of dollars. It is up to the state to find a balance between the interests of Ukrainian citizens, domestic insurers, and their foreign partners.

Reforming the state control system

In market economies, the state strictly controls and regulates the insurance market. This is primarily caused by the fact that insurance possesses a special place in the national economy and in people's lives. Society is extremely interested in the successful and socially-oriented development of the insurance business. In contrast to deposits, **not a single state guarantees security policies.** However, developed countries have thoroughly designed legislation governing the insurance market and setting tough standards for insurance



⁴⁶ This approach was successfully employed in some countries, such as Israel.

⁴⁷ This especially refers to the segments where captive insurance companies are active.

⁴⁸ In accordance with studies performed by the Swiss Association of Re-insurers, if a foreign insurance company employing 10 persons entered Ukraine's market, it would spend some \$5 million over the first two or three years. It could expect real profit only in 6-7 years: Zuyeva A. One should not expect a mass advance of foreign insurers. — *Biznes*, No. 48, November 29, 1999, p.25.

companies. Those standards are meant to defend the interests of the insured and guarantee the unconditional fulfilment of contractual obligations by insurance companies.

As a rule, in the developed countries, the duty for insurance supervision is vested in special government structures on a ministry level. Those are powerful institutions whose role in the country's insurance market can only be compared to the role and significance of the Central Bank for the banking system. Their activity is governed by insurance control legislation.

Until recently, the duty of state control over the insurance business was assigned to the Insurance Business Control Committee. In March, 2000, the President of Ukraine liquidated this committee by his Decree on administrative reform. Its functions are to be assigned to chosen Ministry of Finance departments. In the opinion of UCEPS experts, this will weaken the efficiency of state control over Ukraine's insurance business, due to the lowered status of the state body responsible for the reliability of the insurance market and insurance companies.

In any event, a state institution for the control of Ukraine's insurance market must develop and implement a state policy in the insurance sector. This state body should exercise the following functions:

- ❖ make decisions on the issuance and revocation of insurance licences;
- ❖ exercise everyday supervision over insurance company activities by thoroughly studying quarterly insurer reports and complex insurance company audits;
- ❖ review complaints of the insured;
- ❖ regulate the insurance market by issuing orders and directives to prevent violations affecting the interests of the insured;
- ❖ render methodical and regulatory assistance by issuing manuals, instructions and other regulatory documents;
- ❖ introduce proposals concerning the amendment of insurance laws based on

an analysis of trends in the development of the world and national insurance markets;

- ❖ give explanations to the population;
- ❖ support an electronic database of all insurance companies in order to categorise them by degree of risk, premium amounts, etc.

In order to ensure the proper efficiency of such a state body in charge of state supervision over the insurance business, we consider it expedient to raise its status to, say, the State department level⁴⁹.

3.2. THE DEVELOPMENT OF SOCIALLY SIGNIFICANT TYPES OF INSURANCE

This sub-section proposes measures intended to encourage life insurance (including pension insurance)⁵⁰, medical insurance, and obligatory state personal insurance.

Life insurance

The main functions of life insurance are the population's social protection and the long-term accumulation of funds. In developed countries, insurance companies, along with pension funds, are the main investors in state securities and company shares⁵¹.

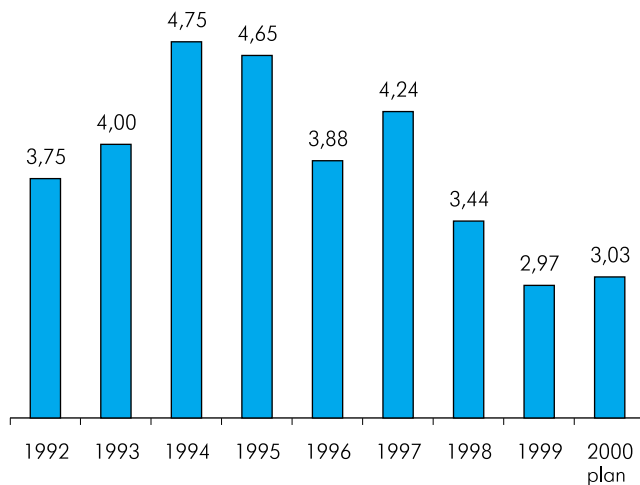
In order to stimulate the development of long-term insurance (such as life and pension



⁴⁹ That's what was done in neighbouring Russia. Moreover, the Insurance Business Control Department is intended to be taken out from under the subordination of the Ministry of Finance of the Russian Federation and be given more independence.

⁵⁰ Pension insurance is essentially a type of life insurance.

⁵¹ In Great Britain, the share of pension funds and life insurance companies in stocks of joint-stock companies comprises 55%.

State healthcare expenditures, % of GDP⁵²

insurance), the following steps should be made:

- ❖ insurance companies should be allowed to buy foreign currency against long-term reserves. This will strengthen the protection of insurance reserves against devaluation and be conducive to the restoration of the population's confidence in insurers;
- ❖ enterprises should be allowed to include expenses for employee insurance as part of their gross expenditures. This will stimulate the development of insurance and the social protection of workers;
- ❖ insurance payments should be excluded from the base of the aggregate income tax on individuals;
- ❖ taxation of revenues from insurance company investment activities should be cancelled if such revenues are channelled towards increasing the insured amount. This will be conducive to insurance company investments in Ukraine's economy.

According to UCEPS experts, implementation of the proposed measures⁵³ will create a positive impetus for the development of long-term forms of insurance. Of course, the fruitful cooperation of insurers with representatives of the legislative and executive branches is important for overall success. Without this, it will be difficult to restore the population's confidence in insurance, and guarantee the repayment of invested funds to

potential clients.

Medical insurance

The healthcare system of Ukraine is experiencing a long crisis, as the state is unable to ensure this sector's proper funding. Moreover, over the last three years, the share of state expenditures on healthcare decreased almost one and one-half times (*Diagr. "State healthcare expenditures"*).

The absence of proper funding, low medical worker salaries, the low quality of "free" medicine — all of these factors stimulate the shadow medical services market. That's why **the development of the concept and mechanisms for the implementation of obligatory medical insurance presents an important direction in the development of a system of the population's social protection.** There is also an urgent need to develop and adopt the Law "On Obligatory Medical Insurance". Ukraine's citizens must be certain that in the event of an insured risk, they will receive quality medical assistance and be provided cash to pay for prophylactic measures, at the expense of accumulated funds.

The system of obligatory medical assistance will be ineffective without competition. An attempt to create a monopoly system of obligatory medical insurance⁵⁴ would result in the deterioration of the quality of medical services and expendi-



ture increases. Nor should one expect an improvement in the quality of medical services under *state monopoly* in the field of medical insurance — the implementation of obligatory state medical insurance would, above all, increase administrative and service costs without noticeably improving public healthcare.

UCEPS experts suggest that obligatory med-

⁵² The concept of a new medical insurance system. — German advisory group at the Government of Ukraine, March, 2000, p.8.

⁵³ Along with other measures provided in the sub-section "Regulation of insurance company investment activities".

⁵⁴ Along with other options, today the Government is discussing the option of creating a State Fund for obligatory medical insurance.

ical insurance services must, above all, be provided by insurance companies, operating within a truly competitive environment. In the first place, they act as competent controllers of treatment. An insurance company will always make sure that a client is cured in the quickest and most effective manner, as the company's reputation depends on this. Secondly, competition will cause insurance companies to reduce insurance service prices. Finally, insurance company participation in the system of *obligatory* medical insurance will stimulate the development of *voluntary* medical insurance, as insurers will establish ties with medical institutions and gain experience in this field.

The state, in its turn, should provide supervision over the medical insurance system. The Ministry of Public Health should control the quality of operation and equipment of all medical institutions. Furthermore, the state, acting through insurance control bodies, should practise continuous control of all organisations and institutions engaged in medical insurance (both obligatory and voluntary).

After successful reform of the medical insurance system, the state will be able to cut healthcare budget expenditures: contributions of the insured will cover total medical service expenses, and the state will be able to contribute to the development of the public healthcare infrastructure.

Obligatory state personal insurance

There are two basic options for reforming the system of obligatory state personal insurance. **The first option** does not envisage radical changes; it is aimed at improving the regulatory-legal basis and existent system mechanisms.

The second option is more revolutionary. It is intended to turn the system of obligatory state private insurance into a *true system of insurance*, with a relevant division of functions and responsibilities, in the following manner: the state exercises overall control over the insurance business; employees and servicemen of corresponding ministries (agencies) are insured; insurers will be insurance companies granted relevant licences. Insurance tariffs need to be set for this type of state insurance. From the practical point of view, the first option seems more acceptable under present conditions.

Legislative support for relevant changes could be provided by **adopting a special basic**

Law of Ukraine "On Obligatory State Insurance in Ukraine"⁵⁵. This Law should set the procedure and terms for such insurance, categorise the insured, establish the procedure for insurance premium and damages payments, insurer responsibilities to the insured, etc.

After the Law of Ukraine "On Obligatory State Insurance in Ukraine" is adopted, relevant amendments should be introduced to all the laws governing this kind of insurance for separate categories of people ("On the Militia", "On the Procurator's Office", etc.)⁵⁶. Furthermore, **a new basic resolution of Ukraine's Government** should be adopted to regulate the procedure and terms of obligatory state personal insurance, and prior government decisions toward this end cancelled.

UCEPS experts propose the following changes to regulatory-legislative acts governing obligatory state personal insurance.

1. The contingent of the insured, the number of insured accidents, and the term of the state's responsibility should be limited. The state should renounce idle declarations not backed by resources, and only assume the commitments it is able to fulfil. Today, for example, the law does not set expiration term for obligatory state personal security commitments. At the same time, it is clear that the state is unable to pay insured sums indefinitely after an individual's dismissal or retirement. With age, an insured individual (just like anyone) accumulates illnesses affecting his health. However, medical-social expert commissions establish the total degree of disability as of the examination date and normally relate it to service duties⁵⁷. It is evident that the insured amount should be paid if the loss of capacity to work (category of disablement) was established during the work (service) period or a short time (a year, for example) after the dismissal (retirement).

2. The number of insured accidents should be reduced through their more accurate regulation. Existing insurance terms provide for repayment of the insured amount in the event of death and loss of capacity to work (from 1% to 100%). Such a repayment procedure, especially in view of the large budget deficit, seems unjustified. Today, the state can grant coverage only in connection with the consequences of injuries (diseases) that led to **disablement or death**.

⁵⁵ A similar basic law exists in Russia.

⁵⁶ Another approach is possible: amending the effective laws and resolutions of Ukraine's Government, without adopting a separate basic Law of Ukraine "On Obligatory State Insurance in Ukraine". In our view, this approach has more deficiencies than advantages.

⁵⁷ Therefore, if loss of capacity to work (category of disablement) is established for an insured person long after an injury, disease, dismissal or retirement, the degree of loss of capacity to work is overstated. This leads to an increase in the insured amount due.



Ukrainian laws contain different definitions of circumstances of insured accidents that influence the insured amount. Officers of the Ministry of Internal Affairs are entitled to the insured amount if an insured accident



occurred when on duty directly in connection with the protection of social order, public safety, and fighting crime⁵⁸; military servants — if injured during the service period⁵⁹; tax administration officers — when on duty⁶⁰; control and revision service⁶¹ and procurator's office employees⁶² — in connection with the execution of official duties; judges — in the event of mutilation or other long-term loss of health preventing him from further professional activities⁶³.

In order to work out a uniform state strategy of social protection and reduce budget expenditures, it is expedient to pay the insured amount only subsequent to injuries (diseases) related to the execution of official duties, as provided in most countries.

3. The insured amount should be unified; for military servicemen, its sum should be raised. The state should value the lives of servicemen (civilian employees), defending its interests, regardless of the posts they occupy or

their affiliation with any given ministry (agency).

In the event of the death of procurator office employees, officers of the Interior Ministry, customs service, tax administration, and other structures, the insured amount is normally defined as a salary for 10 years, and amounts to UAH 40-70 thousand. At the same time, for servicemen (of the Ministry of Defence, the Internal Troops, the Security Service, and other structures), the insured amount is determined as personal-average aggregate income multiplied 100 times, and only amounts to UAH 4,100⁶⁴. Therefore, the gap between insured amounts is ten-fold, and more! **UCEPS experts suggest that the situation must be corrected by raising the insured amount for servicemen. Furthermore, in order to protect the insured sum against inflation (in connection with significant payment delays), it should be calculated as of the payment date⁶⁵.**

4. A standard form for a typical obligatory insurance contract should be approved⁶⁶. In accordance with the Law of Ukraine "On Insurance", the form of a typical obligatory insurance contract should be approved by the Government. Until now, this form has not been developed or approved, although after 1992, many governmental resolutions regulating obligatory personal insurance were passed. The absence of agreements concluded between ministries (agencies) and the insured further complicates dispute resolution, especially in court.

5. The state budget should include a separate protected item "Expenditures on obligatory state personal insurance"⁶⁷. Furthermore, ministry (agency) budgets should also separately allocate insurance payments. This will allow for the supervision of timely and full payments, and subsequently encourage the target-oriented use of state budget funds⁶⁸.

⁵⁸ The Cabinet of Ministers of Ukraine Resolution No. 627 of November 19, 1992.

⁵⁹ The Cabinet of Ministers of Ukraine Resolution No. 488 of August 19, 1992.

⁶⁰ The Cabinet of Ministers of Ukraine Resolution No. 349 of June 3, 1994.

⁶¹ The Cabinet of Ministers of Ukraine Resolution No. 515 of July 5, 1993.

⁶² The Cabinet of Ministers of Ukraine Resolution No. 486 of August 19, 1992.

⁶³ The Law of Ukraine "On the Status of Judges".

⁶⁴ Present legislation has not produced a definition of personal-average aggregate income.

⁶⁵ Presently, the insured amount is calculated for officers of the Interior Ministry, procurator's office, customs service, and People's Deputies of Ukraine, as of the insured amount payment date, and for other categories of insured — as of the date of an insured event.

⁶⁶ Between insurers and ministries (agencies) whose employees are subject to obligatory state personal insurance.

⁶⁷ Correspondingly, expenditures should be reduced on the maintenance of the ministries (agencies) whose employees are subject to insurance, and expenses on payment of arrears accumulated in the previous years.

⁶⁸ For this purpose, an order of the Ministry of Finance of Ukraine introducing amendments to budget classifications is needed. That's how budget expenditures on indemnification repayment are provided in Russia. It is worth noting that in the Russian Federation, there are no arrears regarding the repayment of indemnification for this type of state insurance.



Resolutions of Ukraine's Government regulating obligatory state personal insurance should provide terms and procedures for remitting insurance premium arrears, depending on annual performance. Ukraine's legislation envisages repayment of arrears after the year-end, but the law does not specify the terms, procedures and fund sources for this purpose.

6. The procedure for the participation of ministry (agency) representatives in court proceedings should be specified. Relevant governmental resolutions contain a norm on considering disputes between the insured and insurers. At the same time, those documents don't require the obligatory involvement of the ministry (agency) as a defendant⁶⁹. The implementation of this proposal will enable reduction of state budget expenditures on obligatory state personal insurance, since courts provide for indemnification of not only material, but also moral damages in connection with delayed payment of the insured amount.

UCEPS experts suggest that the proposed changes in Ukraine's regulatory-legal acts will help to solve three important tasks: more effective and target-oriented use of very limited budget funds; more efficient social protection of representatives of socially important professions; establishment of benevolent relations between insurance companies and state agencies or, in general, contribute to the restoration of the population's confidence in the state.

CONCLUSIONS

In order to ensure transparency in the relations between the state and insurance companies, first of all, the state's functions should be mainly confined to supervision. Secondly, when implementing new types of obligatory insurance, existing insurance companies should be engaged on tender and bidding terms. Thirdly, the Government should review all contracts entered between ministries (agencies) and insurance companies for the current year. Prior to the end of 2000, tenders should be held among insurance companies to enter contracts for 2001. In order to raise the efficiency of the body in charge of state supervision of the insurance business, its status should be raised, for example, to the State department level.

In order to stimulate the development of long-term insurance (such as life insurance, pension insurance), the following steps should be made: insurance companies should be allowed to buy foreign currency against long-term reserves — this will strengthen the protection of insurance reserves against devaluation and be conducive to restoring the population's confidence in insurers; enterprises should be allowed to include expenses on employee insurance as part of their gross expenditures — this will stimulate the development of insurance and the social protection of workers; insurance payments should be excluded from the base of aggregate income tax on individuals; taxation of insurance company revenues earned from insurance activities should be cancelled, if such revenues are channelled towards increasing the insured amount — this will be conducive to insurance company investments in Ukraine's economy.

⁶⁹ This, in turn, violates the rights granted by the Constitution of Ukraine to legal entities regarding the protection and guarantee of their rights.



There is an urgent need to develop the concept and mechanisms of implementing obligatory medical insurance, which is an important direction in developing a system for the population's social protection. Attempts to create a monopoly system of obligatory medical insurance would only result in the deterioration of the quality of medical insurance and increase costs. UCEPS experts suggest that obligatory medical insurance services should be provided by insurance companies selected on the basis of open tenders or bidding procedures.

In order to work out a uniform state strategy of social protection, reduce budget expenditures, and prevent the further accumulation of obligatory state personal insurance arrears, appropriate changes should be made to applicable laws. In particular, it is advisable to strictly regulate insured accidents in order to reduce their number; standardise the insured amount for different categories of insured, and increase it for the military; include a separate protected item "Expenditures on obligatory state personal insurance" in the state budget, etc. Those changes will encourage a more effective and target-oriented use of limited budget funds, improve the efficiency of social protection of representatives of socially important professions, establish benevolent relations between insurance companies and state agencies or, in general, contribute to the restoration of the population's confidence in the state.

4. CONCLUSIONS AND PROPOSALS

The conducted analysis shows that the development of the insurance system presents a complex problem of nation-wide significance. It encompasses the interests of the majority of population, insurance companies, business entities, the state authorities, and Ukraine's foreign partners. First of all, annual social expenditures account for 20-25% of the state budget. Given limited budget funds, it is important to ensure their target-oriented and effective use, and guarantee the proper appropriation of social payments. Second, development of the insurance system would be conducive to accumulating internal long-term funds for investing in the national economy. Finally, the steady development of the insurance market will encourage the population's effective social protection and restore public confidence in the state, so necessary to Ukraine's Government during the period of deep social reform.

Today, Ukraine operates a weak, underdeveloped and economically insignificant insurance market, where only 0.4% of the GDP is redistributed. This means that today, Ukrainian insurance companies do not accumulate sufficient investment funds and exercise no significant influence on the process of gross domestic product redistribution. According to expert estimates, today, only around 10% of risks are insured in Ukraine, while in most countries, this indicator is 90-95%. The share of Ukraine's insurance business in the European market of insurance services is only 0.05%, while Ukrainians make up 7% of Europe's population. Therefore, Ukraine's insurance market has significant growth potential. Its realisation will depend on economic revival and the wellbeing of Ukraine's citizens.

At present, the most demanded services are those related to property insurance (61.6% of the total volume of insurance services), while life insurance is the least important source of reliable investment funds on the insurance services market (0.7%), whereas in developed countries, its share is 50-60%. Moreover, every year, the specific weight of life insurance premiums in the general structure of premiums drops two-fold.

Compared to 1994, when more than 700 insurance companies were operating, their number has fallen almost three-fold. However, this reduction had a positive effect, since it occurred due to the removal of insolvent companies and pseudo-insurance firms from the insurance market. It was partially caused by legislative regulation of the insurance business, strengthening of state control over the insurance market, and tougher requirements regarding the amount of

insurance company authorised funds. Such measures contributed to the sanation and, to a certain extent, stabilisation of the insurance market.

Ukraine's insurance market is characterised by a high level of concentration, judging both by the index of aggregate volume of insurance company premiums, and the regional point of view.

Insurance companies' authorised funds remain low. Ukraine's average paid insurance company authorised fund is approximately UAH 1.2 million. Over two-thirds of Ukraine's insurance companies have authorised funds below the minimum established level, and only 60 insurance companies (23%) have authorised funds exceeding UAH 1 million. This causes problems for Ukrainian insurers in the reinsurance of risks on the internal market and places the issue of the consolidation of domestic insurance capital on the agenda. Due to limited Ukrainian insurance company authorised funds and the low capacity of Ukraine's insurance market, the lion's share of insurance premium amounts (which could potentially be used for domestic investment in Ukraine) goes to foreign reinsurance companies.

The lowering of the share of expenses spent on business development and its stabilisation at a level of 18-20% of paid insurance premiums point to the fact that today, there are no significant investments in the development of the infrastructure of insurance companies.

Unfortunately, the state does not demonstrate a proper interest in the establishment of civilised rules on Ukraine's insurance market taking world experience into account.

The development of Ukraine's insurance market is hindered by a number of objective and subjective factors. The former include those related to Ukraine's economic crisis (economic instability, absence of economic growth and the population's stagnant solvency; structural disproportion in the economy; lack of funds; insufficient personnel; limited capacity of the insurance market). The subjective factors originate from deficiencies in economic management processes, including those pertaining to the process of establishing the insurance market: the unfavourable taxation system, an incomplete and fragmentary legislative basis, ineffective control on the part of the state, state support for monopoly, absence of a developed auxiliary infrastructure, lack of information regarding market possibilities, and the low insurance culture of the population.

The monopolisation of separate segments of the insurance market by companies created with state participation can be observed. New state funds are being created for providing separate types of obligatory social insurance. Such practice restricts competition on the insurance services market and encourages ineffective mechanisms for its operation, rather than removing barriers impeding the efficiency of existing insurance companies.

Today, there are no preconditions for the development of long-term insurance (including life and pension insurance). The population is mostly concerned with survival and shows little interest in long-term plans.

The healthcare system is dominated by the old scheme of budget funding; there are no laws on obligatory medical insurance for the population. Ukraine has no system of medical insurance at the expense of obligatory contributions of the insured, which is normally accepted as an element of social insurance.

In general, the status of the Ukrainian insurance market may be defined as "expectant". It possesses huge development potential. The insurance market, as an important element of the national financial system and social protection system, requires serious improvement within the framework of administrative, economic and legal reforms.

The main target of reforming the insurance system is the improvement of the population's social protection and the creation of conditions for the steady development of the insurance market on a competitive basis.

Reform should be based on such principles as

foundation, consistency, phased structure, and the social orientation of the intended results.

The main goals to be achieved after the implementation of the proposed events are ensuring market stability and the consolidation of insurance companies; transparency of the state's relations with insurance companies; competition in the insurance business; establishment of efficient state and public control over insurance company activities; restoration of public confidence in insurance companies; increasing investments in the economy; decreasing the outflow of insurance company assets abroad.

We propose starting reform with a preparatory stage, including the following steps: (a) developing a scientifically grounded, economically sound and socially justified Concept of the insurance business development in Ukraine; (b) on that basis, working out the State programme for the development of Ukraine's insurance market; (c) drafting co-ordinated regulatory-legislative acts on insurance, and changes and amendments of applicable laws of Ukraine. Implementing the State programme will give state policy more predictability, and allow for the consistent and complex reform of Ukraine's insurance market. The following steps are proposed for reforming Ukraine's insurance market:

1. Improving the state regulatory system. Special attention should be paid to the delimitation of functions between the state and insurers on the insurance market, as well as the elaboration of legislative support for actions designed to protect the interests of insurance service customers and raise the solvency and reliability of Ukraine's insurers. The state should also encourage competition on the insurance market.

The practice of establishing monopoly insurance companies (such as Ukrmedinstrakh and Interpolis), operating contrary to Ukraine's monopoly legislation, should be renounced.

In order to achieve transparency in the state's relations with insurance companies, the state's functions should foremost be confined to supervision. Secondly, when implementing new kinds of obligatory insurance, tenders and competitions among existing insurance companies (that possess extensive representative office networks, experience, and necessary capital) should be held, first of all, rather than establishing new state funds at the expense of limited budget assets.

Thirdly, the Government should examine all contracts between ministries (agencies) and insurance companies for the current year. Finally,

before the end of 2000, tenders should be held among existing insurance companies to conclude contracts for 2001. In order to raise the efficiency of the body in charge of state supervision of the insurance business, we suggest raising its status to the State department level, for example.

2. Restoration of the population's trust in long-term investment. This will require guarantees for the repayment of invested funds and accrued interest that are serious and understandable for potential clients. For example, it may be advisable to use accumulated funds to complement only the National Bank's currency reserves, using state-owned real estate (under mortgage schemes), shares of profitable oil and gas sector enterprises, etc. to guarantee those funds. Furthermore, a regular PR-campaign on insurance company activities should be waged, involving publicising payments made by insurers, and projects where insurance reserves and assets are invested.

3. Insurance companies should acquire institutional investor rights: be able to convert hryvnias into hard currency, and invest insurance reserves into housing construction and mortgages. A special fund might be established under the Ministry of Finance, or special "insurance" securities issued on terms similar to long-term life insurance obligations, etc. International financial institutions could possibly act as guarantors of life insurance investments. It may be expedient to examine the issue of the partial placement of the cumulative part of life insurance reserves outside Ukraine: this would help to solve the problem of investment for insurers and insured. One option suggests permitting insurers to invest into large (reliable) foreign companies involved in large-scale investment projects in Ukraine.

4. Development and implementation of incentives for the advance of long-term types of insurance (such as life insurance, pension insurance). For this purpose, the following steps should be made: insurance companies should be allowed to buy foreign currency against long-term reserves — this will strengthen the protection of insurance reserves against devaluation and be conducive in

restoring the population's confidence in insurers; enterprises should be allowed to include expenses on employee insurance as part of their gross expenditures — this will stimulate the development of the insurance market and social protection of workers; insurance payments should be excluded from the base of aggregate income tax on individuals; taxation of insurance company revenues earned from insurance activities should be cancelled if such revenues are channelled towards increasing the insured amount — this will be conducive to insurance company investments in Ukraine's economy.

5. Improvement of the legislative basis. The Law of Ukraine "On Amending the Law of Ukraine "On Insurance" should be adopted, providing for: expansion of insurer capabilities as institutional investors; the possibility for the placement of insurance reserves into assets less dependant on changes in the value of the national currency (hard currency assets, precious metals, etc.); raising authorised funds to 500 thousand euro in order to improve the reliability of insurance companies and encourage the concentration and accumulation of capital.

In order to work out a uniform state strategy of social protection, reduction of budget expenditures, and prevention of further arrears accumulation with respect to **obligatory state personal insurance**, appropriate changes should be made in applicable laws. In particular, it is advisable to strictly regulate insured accidents in order to reduce their number; standardise the insured amount for different categories of employees (servicemen); include a separate protected item "Expenditures on obligatory state personal insurance" in the state budget, etc. Those changes will encourage more effective and target-oriented use of limited budget funds, improve the efficiency of social protection of representatives of socially important professions, establish benevolent relations between insurance companies and state agencies and, in general, contribute to the restoration of the population's confidence in the state.

On the whole, implementing the proposed measures for reforming Ukraine's insurance business will allow for a reduction of budget-funded social expenditures and provide for their proper appropriation; further accumulation of insurance company investment resources; provide for transparency in the state's relations with insurance companies; encourage the efficient social protection of citizens and restore public confidence in the state, so needed for Ukraine's Government during the period of deep social reform.

In our opinion, the materials provided by the UCEPS analytical report may be used when drafting the Concept of the insurance business development in Ukraine and, later, the State programme for the development of Ukraine's insurance market.

PROBLEMS OF INSURANCE BUSINESS DEVELOPMENT IN UKRAINE

By Mykola SUNGUROVSKIY

The success of Ukraine's insurance business depends on the co-ordination of the interests of its main players: individuals and legal entities, as insurance service consumers and insurance premium payers; insurers (domestic and foreign), as "producers" of insurance services; and the state, as guarantor of the wellbeing of its citizens and the economy's efficiency.

UCEPS experts asked the insurance market players to assess its current status, and present their views on the possible ways of reforming Ukraine's insurance business.

Representatives of authorities, insurance companies and enterprises were invited to take part in the discussion. Our "round table by correspondence" welcomed:



Andriy Lytvyn,
Head, Financial
Institutions and
Markets Department,
Ministry of Finance
of Ukraine



Yuriy Lakhno,
President,
"GARANT-AVTO"
Ukrainian Joint-
Stock Insurance
Company



Halyna Tretyakova,
Board Chairman,
"ASKA-Zhyttia"
Ukrainian Joint-Stock
Insurance Company



Katerina Guzik,
Marketing Manager,
Connect Insurance
Services Ltd.



Serhiy Pereloma,
Deputy Financial
Director,
"Kryvorizhstal"
Integrated Plant

UCEPS experts asked the participants three questions:

1. What factors impede the development of Ukraine's insurance business?
2. What is your idea of the strategic directions for reforming Ukraine's insurance market?
3. What priority measures should be taken to improve the efficiency of Ukraine's insurance business?

Presented below are the answers to those questions, UCEPS' poll results reflecting public opinion on some insurance market problems, and conclusions based on the results of this "discussion by correspondence".

FACTORS THAT IMPEDE THE DEVELOPMENT OF UKRAINE'S INSURANCE BUSINESS

Andriy Lytvyn. Although the pace of the insurance sector's expansion produces one of the best indicators in Ukraine's economy, the insurance business' potential is far from being exhausted. The main reasons for this are: (1) absence of the state concept (and subsequent lack of predictability) of the insurance market's expansion; (2) insufficient transparency of the market; (3) its low capitalisation level; (4) a somewhat distorted sector structure; (5) factors unfavourable to cumulative insurance (tax pressure, the population's loss of confidence in the financial structures, etc.).

Halyna Tretyakova. Ukraine has a population of over 49 million, but voluntary insurance covers no more than 10% of that number, while in Europe, every third individual has a life insurance policy. In the former USSR, 20% of the population insured their lives; in Ukraine, that figure exceeded 30%. The state should be extremely interested in the development of insurance, especially life insurance, as "long-term" funds are accumulated in this sector. The expansion of privatisation and emergence of new real proprietors among Ukraine's citizens will be conducive to the development of the insurance business. Therefore, the potential of Ukraine's insurance market is relatively high, but today, the necessary conditions don't exist for its development. There are several reasons why.

First, the state does not have a clear idea of an efficient insurance system model, that is why

the insurance market's structure is fragmentary and developing mainly "from beneath". This trend is often based on incompatible interests, making it difficult to predict the main market development tendency.

Second, there are no legally fixed rules and mechanisms of the insurance market activity. For instance, legislation does not set the norms for indemnification of damages inflicted on third parties, nor does it provide a clear definition for different kinds of insurance; in the medical insurance sector, standards for illness and treatment methods require a clearer definition.

Third, state control mechanisms over the insurance business are unstable and ineffective. This is proven out by the liquidation of the Insurance Business Control Committee, with its functions being assigned to two divisions of the Financial Institutions and Markets Department at the Ministry of Finance of Ukraine. In my opinion, this leads to the lowering of the status (and, consequently, limitation of the powers and capabilities) of the only state body dealing with state policy formation in the insurance business and control over its implementation.

Fourth, the population has no insurance tradition. People lack information, that is why the demand for insurance services remains low.

Yuriy Lakhno. Throughout the world, the insurance system works efficiently not only for its primary purposes (i.e., for the protection against risks), but also as a means for accumulating investment funds. In Ukraine, this system doesn't even perform its primary functions, as the aggregate capacity of the insurance market does not exceed the capital of one large insurance company in Poland. In Ukraine, the investment situation looks paradoxical. On the one hand, annual foreign investments don't exceed \$700 million, and are unlikely to grow noticeably in the near future.

On the other hand, tens of billions of dollars are needed for investment, and the state has no way of filling this gap. Greece, whose population is five times smaller than Ukraine's, is a good example for showing what Ukraine is losing. In Greece, non-state insurance companies appeared on the market in 1989. In 1998, total insurance premium amounts reached 1.85% of the GDP (\$2.3 billion); insurance companies invested some \$4.2 billion into the national economy — an amount comparable to Ukraine's state budget.



What hampers Ukraine's insurance business? The reasons are many, but three of them deserve the most attention.

1) *delay in the improvement of the legislative basis.* Our estimates show that, due to imperfect laws and delays in adopting them, Ukraine fails in obtaining around \$200 million a year in the insurance sector alone. Meanwhile, a package of insurance business-related draft laws was present-



ed to the Verkhovna Rada for review quite some time ago, but its adoption is not in sight yet;

2) *inconsistent formation of legal regulatory base.* For instance, a government resolution on obligatory third-party liability vehicle insurance was adopted. However, it was not fully implemented, since no relevant changes were introduced to the regulatory documents defining the mechanisms for control by State Automobile Inspection officers;

3) Ukraine's insurance market is dominated by small companies: out of the present 263 companies, only five or ten are financially sound. *The limited competitiveness of small companies creates preconditions for the outflow of funds abroad* through reinsurance mechanisms, or encourages assets into the "shadow economy". The state is not interested in the agglomeration of insurance companies and the consolidation of insurance reserves.

Katerina Guzik. The growth of insurance premium volume by 30% in 1999 gives the reason for optimism. However the main problem remains that the majority of Ukrainians (both legal entities and individuals) do not consider voluntary insurance necessary. It is basically undeveloped and the majority of insurers are Western managed companies. Among Ukrainian insurers the focus is on voluntary insurance. There are more than 260 insurance companies in Ukrainian narrow market — sometimes it seems there are more fishers than fishes. This causes hard competition when insurance companies are

forced to use dumping tariffs which are sometimes of symbolic value. Therefore, it is not surprising that the companies are reluctant to acknowledge the fact of insurance accident and the sum of damages. The consumer's attitude towards such insurers' conduct is negative. This is a vicious circle which needs to be broken.

STRATEGIC DIRECTIONS FOR REFORMING UKRAINE'S INSURANCE MARKET

Andriy Lytvyn. Insurance reform's main directions are: (1) strengthening of competition on the insurance market according to civilised standards; (2) growth of the potential of national insurance companies; (3) development of cumulative insurance; (4) raising the insurance culture, confidence of business entities and individuals in financial institutions in general, and insurance companies in particular. These developments will lead to the insurance market becoming one of the main sources of investments into Ukraine's economy.

Halyna Tretyakova. The strategic goal of the insurance system reform is to implement the Western model while taking into account specific features intrinsic to Ukraine. I would divide the steps required for achieving this goal *into three directions: legislation, tax regulation, and strict delimitation of functions of the state and insurance market operators.*

Problems that need to be resolved *legislatively* include a methodological definition of the kinds, mechanisms, norms and standards of insurance, including life insurance. The Law of Ukraine "On Insurance", the Civil and Administrative Codes, and other regulatory legal acts need to be improved. Contradictions in the insurance regulatory-legal base lead to violations of insurance licensing rules which, in their turn, force huge sums of money into the "shadow" sector. While the capacity of Ukraine's insurance market stands at around \$250 million, today, actual insurance accounts for only \$80 million of that amount.

Ukraine's *taxation system* does not encourage the insurance business. A high tax (30%) on companies engaged in life insurance, and the uncertainty in matters of precious metals used in banking transactions, create a situation where insurance reserves are not covered by assets. This is directly related to insurance risks, and destroys confidence in insurance companies. Furthermore, the state's tax and preference policy creates unequal conditions for insurance market operators, artificially channelling cash through the

public sector, where the efficiency of its use is low. The situation could be improved by decreasing the above-mentioned 30% tax, improving the preference policy, and introducing the tender system for obligatory types of insurance.

The functions of the state and insurance company should be clearly delimited. The state should concentrate on obligatory insurance, involving budget payments, and exercise control over the insurance business. In Western countries, for example, state control is very tight, and the state can initiate the replacement of insurance company managers. In Ukraine, insurance companies could assume responsibility for those types of obligatory insurance where payments are not made from the budget, and for all types of voluntary insurance.

Yuriy Lakhno. The strategic directions for reforming Ukraine's insurance market are: (1) improving the regulatory-legal base; (2) perfecting the mechanisms for the establishment and operation of insurance companies; (3) improving the forms of the state's presence on the insurance market. Relevant measures should be all-inclusive. The main targets should be: growth of insurance reserves from the present 0.4% of the GDP to 2-3% of the GDP within 3-5 years, which could bring an additional \$100-200 million of investments into Ukraine's economy annually; estab-



lishing clear and uniform rules for all players in the insurance business; legislation support of Ukrainian insurance companies' competitiveness.

Katerina Guzik. The strategy has to take into account three factors. First, there is a need to attract more Western insurers into the Ukrainian market with their capital, management and experience on insurance market. Secondly, the minimum amount of authorised fund should be increased in order to support national insurers that reached both success and customer's trust. That will not lead to the misuse of capital concentra-

tion since it already exists. Thirdly, the support of insurance brokers and agents should be assured — in Western countries they provide for significant amount of insurance contracts entered. And last, but not least: all this should be based on a viable State programme.

PRIORITY MEASURES THAT WILL IMPROVE THE EFFICIENCY OF UKRAINE'S INSURANCE BUSINESS

Andriy Lytvyn. Liquidation of the Insurance Business Control Committee and the assignment of its functions to the Ministry of Finance of Ukraine marked a new stage in the development of Ukraine's insurance market. Tribute should be paid to the Committee for its role in the establishment of a control system over insurers, and the prevention of bankruptcies and financial collapses. Taking into consideration the Ministry of Finance's potential, not only will control over the insurance market be retained, but the institutional ability to influence the strategy of its development will improve.

The new stage should begin with the creation of a qualitatively new state concept of insurance. The prospect and concrete targets in the insurance market's development, the criteria and mechanisms for monitoring and regulating the insurance business should be defined. Furthermore, the insurance business cannot expand without the establishment of direct communications between the Government and insurance market players.

Halyna Tretyakova. The new draft Law of Ukraine "On Insurance" already accounted for the key proposals. This law should be adopted without delay. Regulatory acts should set the implementation stages of civil liability insurance, co-ordinate them with the results of economic reform and the advance of the living standards.

Yuriy Lakhno. First steps won't require significant amounts of extra funds, and will presume mainly organisational and legislative measures. The following can be considered priority steps:

1) *an increase in the insurance companies' authorised funds (to 0.5-1.0 million euro) and amendment of their licensing rules.* Provisions should be made that companies whose authorised funds exceed 1 million euro can apply for all-around insurance licences, while those with authorised funds between 0.5 and 1.0 million euro can receive licences for specific types of insurance only;

2) *encouraging the concentration of insurance companies' capital by eliminating excessive restric-*

tions on their acquisition of other companies' shares. At present, national insurance companies can acquire only a 5% share interest, while foreign insurers are entitled to 49-50%. This limits not only the activity of domestic insurance companies, but also their market competitiveness;

3) *encouraging the competitiveness of domestic insurance companies.* At present, 95% of life insurance premiums in Ukraine is collected by foreign insurance companies, and eventually returns to us in the form of interest-bearing credits. Furthermore, due to the operation of small companies, significant funds used for risk insurance also remain abroad (through the reinsurance mechanism), are laundered, or move into the "shadow" sector. The amount of funds flowing out of Ukraine totals \$80-100 million a year. This factor has become a threat to national security. The Government should adopt a resolution regulating the risk reinsurance process in order to provide for the placement of relevant funds on Ukraine's insurance market, and allow reinsurance via foreign insurance companies only where domestic insurers are unable to assume the risks;

4) *improving legislation to encourage insurance company activity.* Legislative definitions of different insurance types, and a division between obligatory and voluntary insurance would help in reaching this goal. Obligatory insurance should encompass: medical expense insurance; pension insurance; third-party liability vehicle insurance; extra professional risk insurance; state individual insurance of power-structures personnel. The Civil Code should provide for a third-party liability mechanism. This will ensure the protection of victims when the guilty person's solvency is limited, and encourage the demand for insurance services;

5) *regulating insurance company currency operations.* The ban on insurance companies' foreign currency reserves causes the outflow of capital abroad. Insurance companies should be allowed to keep their insurance reserves in hard currency. Insurance companies propose depositing such reserves in the National Bank of Ukraine on acceptable terms (LIBOR) in order to prevent taking currency out of circulation and the devaluation of the Hryvnia.

First of all, we should understand that without improvement of the economic situation, there will be no broad demand for insurance services from the population. Second, no economic revival is possible without investments, including those accumulated in the insurance sector. Third, Ukraine's insurance market already possesses the potential for investing in the national economy. No additional budget expenses are required for attract-

ing available resources: the only thing needed is legislation designed to stimulate the insurance business. According to expert estimates, implementing the above proposals will allow Ukraine to invest an additional \$400-500 million a year in its economy.

THE OPINION OF AN INSURANCE SERVICES CUSTOMER

Serhiy Pereloma. The issues of life and health insurance for employees are vital and simultaneously tortuous for every enterprise. The Law of Ukraine "On Taxation of Enterprise Profits" allows for charging expenses on insurance of fixed assets, enterprise property, goods, other commercial and financial risks to a prime cost account. However, payments made as per the employee life and health insurance policies cannot be charged to a net expenditures account.

In my opinion, the life and health of employees are no less important to an enterprise than the



safety of its fixed assets. It is normal practice throughout the civilised world to insure employees at enterprises' expense. Even company losses related to the deaths of their CEOs can be insured. Top priority, therefore, is attached to personal insurance. I think that the same approach should also be implemented in Ukraine. Proper conditions are required for this, and foremost, in the area of taxation. Should relevant changes be made in applicable Ukrainian laws, allowing for payment out of an enterprise's gross expenditures under an employee's private insurance policy, everyone will be in the money. *Employers will be able to allocate more funds towards insuring their workers, employees will get the required level of social protection, and insurance companies will increase their revenues from such important types of insurance as personal and life insurance. In general, the Ukrainian population's insurance culture will improve.*

The social aspect of this problem is also important. Quite often, a person's standard of liv-

ing does not allow him to earmark insurance expenses from the family budget. For many, it is problematic acquiring necessary medication and paying other medical expenses. An insurance policy will help to resolve this problem. *And when an employer is ready to assist in solving an employee's problems, doesn't he deserve certain preferences?* Permission to charge insurance payments to a net expenditures account will somehow stimulate such insurance. For instance, the "Kryvorizhstal" Integrated Plant employs around 45 thousand workers. At minimum tariff rates, their accident insurance will cost the works around UAH 500 thousand, given the insignificant amount of insurance liability (UAH 1000). Those are minimal expenses, but if medical insurance is involved, this amount will rise several dozen times. Such a situation is typical for any enterprise.

INSURANCE PROBLEMS: THOUGHTS OF UKRAINIAN CITIZENS

In order to determine the attitude of Ukrainians to the problems that are the subject of



this discussion, the sociological service of the Ukrainian Centre for Economic and Political Studies conducted a poll throughout all of Ukraine's regions¹.

The results of the poll demonstrated the *reluc-*

tance of people to use the voluntary pension insurance offices. At present, only 3.1% of those polled is ready to invest their money in this type of insurance. The main reasons for their refusal included mistrust in non-government pension funds (13.6%) and the certainty that the money will be stolen (18.2%). *More than 40% of individuals considers this question unimportant because of the lack of money.* A majority of those polled (over 63%) is not tempted to use insurance services, even if insurance companies are allowed to receive premiums and repay compensation in hard currency. It is not unusual, therefore, that *only 8.4% of those polled is now covered by voluntary insurance.*

The overwhelming majority of respondents does not trust any financial institutions, whatsoever. The "leaders", by level of mistrust, are: insurance companies — 88.7%; insurance funds — 85%; commercial banks — 83.3%. They are followed by state insurance companies (77.5%) and funds (70.2%). Most trusted are state banks: 24% of those polled is ready to invest in these structures.

Among insured individuals, most popular are state insurance companies (77% of those polled), only 8.2% of the insurance policies are executed with non-government insurance companies. And even in this category, not everyone is sure of the usefulness of insurance. Only 55.8% of respondents in this category cherishes the hope that the invested money will be repaid in either a smaller or larger amount.

According to 26.8% of those polled, the State Social Insurance Fund should become an independent entity, 25.2% supports the idea of transferring it under public administration, and only 17.4% is sure that the Fund's assets should be managed by the Federation of Trade Unions of Ukraine, as earlier.

One of the factors underlying the low demand for insurance services is the *Ukrainian population's low insurance culture.* Only 3% of those polled considers pension insurance their business, another 10.5% is ready to share this headache with the state, and some 80% of individuals is sure that this problem should rest solely with the state and the employer. 83.5% of individuals does not know what a joint pension scheme is. One-third (33.1%) of those polled is unaware that their enterprises pay wage and salary charges to the Pension Fund. 80% does not know what "third-party insurance" means. After this was explained, 68% of those polled said that they considered it expedient to provide this type of insurance in voluntary, rather than obligatory form.

¹ The poll was held between March 25 - April 5, 2000; 1012 individuals were polled.

CONCLUSIONS

The responses of insurance experts and the public opinion poll results make it possible to classify the problems of Ukraine's insurance market development and the possible ways for solving them.

Ukraine's insurance market possesses significant potential, but its employment is hindered by the absence of a state concept for developing this sector, an economic crisis, an imperfect regulatory-legal base, the low standards of living and, consequently, a low effective demand for insurance services. Other important hindering factors include the poor insurance culture of Ukrainians, and the low level of confidence in insurance companies.

The Government and representatives of leading Ukrainian insurance companies are ready to join efforts for the population's social protection and the investment of people's savings into Ukraine's economy. One of the factors impeding constructive collaboration is the parish pump, corporate interests aimed at preserving the state's insurance sector monopoly, and the establishment of stable and transparent insurance market rules.

According to the polled experts, the strategic directions for reforming Ukraine's insurance system, and the steps that would encourage its development, are the following:

1. Creation of a regulatory-legal base for the insurance market's development:
 - a) standard legislative definition of types, mechanisms, norms and standards of insurance, including life insurance;
 - b) legislative delimitation between obligatory and voluntary insurance;
 - c) amending the Civil Code in order to provide for a third-party liability mechanism;
 - d) immediate adoption of amendments to the Law of Ukraine "On Insurance" proposed by insurers.
2. Enhancing the efficiency of state insurance business regulation:
 - a) conceptual definition of the targets of the Ukrainian insurance market's development, the stages and mechanisms for its convergence to European standards;
 - b) removing departmental barriers on the insurance market, introducing the tender system to select operators for obligatory types of insurance;
 - c) easing tax pressure on life insurance, permitting enterprises to charge expenses on their employees' life insurance to a primary production cost account;
 - d) improving the population's paying capacity in order to encourage the development of cumulative types of insurance;
 - e) improving the efficiency of state control bodies supervising the insurance business; perfecting their operational procedures;
 - f) delimiting the powers of state and joint-stock insurance companies concerning obligatory and voluntary types of insurance.
3. Harmonisation of relations on insurance market:
 - a) permitting insurance companies to keep their insurance reserves in hard currency, and deposit them with the National Bank of Ukraine on acceptable terms;
 - b) raising the competitiveness of domestic insurance companies by removing discrimination against them on the reinsurance market;
 - c) encouraging the concentration of insurance company capital, improving their structure through the elimination of excessive restrictions on their acquisition of other insurance companies' shares.

According to the polled experts, such measures would result in better social protection of the population, and growth of insurance reserves from the present 0.4% of GDP, to 2-3% of GDP within 3-5 years, which could bring an additional \$100-200 million of investments into Ukraine's economy, annually.

MODELS OF STATE REGULATION OF THE INSURANCE BUSINESS: experience of Western European countries

By Andriy SAMOYLOVSKYI

Market transformations in the sphere of insurance in Ukraine can be seen in the gradual move away from state monopoly structures, and a decrease in the state-owned part of insurance companies. But this does not mean that the state should completely leave the insurance sector. The paradox of the insurance business lies in that its goal is the hedging risks, but it can itself be influenced by negative factors and can create risks for the insured. Dishonest or non-professional business of the insurer can cause substantial moral and material damages to clients, and undermine the faith of people in the institution of insurance, as such. In its turn, this leads to a decrease in the demand for insurance services and, in the end result - to a decrease in insurance funds, which could be invested in the national economy. That's why state regulation and control should be inseparable parts of the insurance market.

In the search for an acceptable mechanism of state regulation of the Ukrainian insurance market, it is worth referring to Western European experience which has worked out three basic schemes of control over the insurance business: tough, liberal, and intermediate. They differ in the extent of the regulation of the business of insurance companies, and the character and mechanisms of state involvement in their affairs. The specifics of the functioning of the system of insurance supervision according to the above-mentioned schemes can be viewed through the examples of the insurance markets of Germany, France and Great Britain.

THE EXPERIENCE OF GERMANY

The insurance business in Germany is the most tightly controlled. State control is executed by the Federal Agency for Insurance Supervision. Its main functions are management of the state system of insurance companies' admission onto the national financial market, and control over its activities.

One of the most effective mechanisms of the state's influence over insurance activity is its licensing policy. It involves the working out of individual (separately for each insurance company) programmes for the conduct of insurance operations which regulate the character and volume of permitted insurance operations in a very

detailed manner, proceeding from the financial possibilities of the companies contending for an insurance licence. In the event that the insurer veers from the programme, the Federal Agency for Insurance Supervision has the right to apply necessary sanctions, including suspension or cancellation of the licence.

Furthermore, with the goal of ensuring the protection of the interests of the insured, the Federal Agency for Insurance Supervision analyses insurance companies' compliance with policy provisions, and also undertakes a systematic monitoring of their solvency. The review of insurance companies' overall financial standing and sufficiency of financial reserves is done on a



yearly basis. Insurance company reserves are also strictly controlled. However, the financial standing of the re-insurers is not controlled. Insurance companies that exclusively practice reinsurance in Germany are not required to have a license for these operations and come under only limited insurance supervision.

THE EXPERIENCE OF GREAT BRITAIN

This country has the most liberal system of state regulation over the insurance market. The state conducts a policy of minimal interference in the insurance sector with the goal of ensuring maximum freedom of the insurance business. Although insurance operations come under licensing requirements, nevertheless, the main regulator of the development of the insurance market is, for the most part, the competition. The state does not interfere into insurance terms and conditions. Responsibility for supervising insurance activities is placed on the British Trade International. Only the financial state and the solvency of insurance companies come under control, as well as (as opposed to the German model) companies that practice reinsurance.

THE EXPERIENCE OF FRANCE

France has an intermediate (between the German and British) system of state insurance supervision. It has two bodies, which execute control over the insurance business. The first



one is the Commission of Insurance Control. Its functions include the review of bookkeeping operations, control of investments and technical reserves, analysis of the direct insurers' solvency. The second one is the Department of Economics, Finance and Industry whose sub-

branches conduct analysis of the terms of insurance contracts, the regulations of the insurance business, the issuance of licenses, and also the control of tariffs for life insurance. In this way, control over the solvency of insurance companies is placed on the Commission of Insurance Control, while licensing and other functions — on the Department of Economics, Finance and Industry.

In France, as in Germany, bodies supervising the insurance business control the policy terms. They can obligate the insurer to change contract provisions if they don't correspond to established requirements. The goals behind involvement in contract terms are (a) to protect the interests of the insured who are not sufficiently familiar with the specifics of insurance, and (b) to regulate contract terms at obligatory types of insurance. Financial control of the French supervisory bodies is geared exclusively towards ensuring the insurer's solvency for direct insurance.

GENERAL TENDENCIES

Analysis of the experience of insurance supervision in the developed countries of Western Europe makes it possible to determine definite similar traits characteristic of different systems of state regulation of the insurance market.

First, insurance supervision is normally conducted by special governmental structures of ministerial level. Their activities are regulated by insurance supervision legislation. These are influential institutions, whose role for the country's insurance market can be possibly compared to the importance of the central bank for the banking system.

Second, these institutions develop and implement state policy in the insurance branch. Their functions encompass: issue or refusal of licenses for practising the insurance business; study of quarterly reports of insurers and complex audit of insurance companies; sanation (if necessary) of insurance companies; review of complaints of the insured; regulation of the country's insurance market by issuing orders and directives; methodical and instructive work with insurers, educational work with the population; offering propositions with respect to necessary changes to insurance legislation; creating an electronic data base on insurance companies.

Third, institutional oversight of the insurance business normally presumes a central

administrative mechanism and a regional system of working bodies. They have the powers for fulfilling their functions, employ highly qualified staff, and have necessary technical capabilities¹.

In the process of the development of market relations, state regulation of the insurance business is taking on an increasingly liberal form. This is a dynamic process, and its important components are the constant improvements of laws and rules, and the creation of an association of insurance companies. At present, most EU countries focus their attention on the liberalisation of the system of state regulation of the insurance business. Even Germany, with the toughest system of state regulation of the insurance business in Europe, no longer tends to go into all the details of the insurance business, and has primarily focused on the control of insurance companies' solvency.

TRAITS INTRINSIC TO UKRAINE

World experience shows that the state's role in transition economies differs fundamentally from its role in societies with well-formed market relations, a stable legislative base, and a developed insurance market. **Under steady economic growth conditions, the state should create conditions for the optimal application of self-reg-**

ulatory mechanisms with an accent on the stability of economic ties. The state's job is the creation of such mechanisms during the transition stage.

In developed countries, fewer formal requirements with respect to insurer business increase the effectiveness of insurance activities, make it possible to achieve a better balance of proposal and demand and, finally, bring about a higher quality of service at affordable prices.

The development of the insurance business in Ukraine lags significantly behind that of developed countries. Ukrainian insurance companies worked under difficult conditions of an economic crisis, the absence of a market infrastructure, and the necessary legislative base. That's why not all state regulation mechanisms, applicable in the countries of Western Europe, will work in Ukraine.

The more acceptable strategy for Ukraine is the orientation on the German model of state regulation of insurance activities. Definite steps with respect to increasing the effectiveness of the insurance business should be "built-in" the national strategy of economic growth, otherwise the effect of innovations on the insurance market will be minimal.

CONCLUSIONS

The main task of state supervision over the insurance business is control over the solvency of the insurer in order to protect the interests of the insured.

State regulation of the insurance business is an inseparable part of a developed economy and has special significance for transitional economies, including Ukraine. Nevertheless, state regulation does not exclude self-regulation of the insurance business — these two components should always complement one another.

The attainment of the main goal of control over the insurance business by means of market mechanisms only is not possible. A state supervisory body with a sufficiently high status should act effectively in this sphere in Ukraine.

Reform of the insurance market in Ukraine is closely connected with reforms in other spheres of society and cannot be effective without key pre-conditions: economic growth and raising the standard of living of the population.

¹ A good example in this context is the Federal Agency for Insurance Supervision of Germany. The central apparatus of the agency has 350 employees. The agency includes seven divisions, and 43 sub-divisions. The agency employs 70 attorneys, 130 economists, 25 mathematicians with a higher degree, 100 workers with a specialty degree, and 25 employees working as technical personnel. The agency controls 714 insurance companies whose overall yearly earnings amount to DM 200 billion. The system's effectiveness is demonstrated by its ability to ensure the stable development of the insurance market virtually without insurance companies' bankruptcies.

PERSONNEL AND SCIENTIFIC SUPPORT FOR THE INSURANCE BUSINESS

By Semen OSADETS

World experience shows that one of the most important factors for the successful organisation of the insurance business is the employment of highly qualified personnel by insurance companies. **In countries with developed market, 1-1.5% of the able-bodied population works in the insurance sector. If such parameters were applied to Ukraine, this would mean the creation of additional 200-300 thousand jobs.**

Despite the huge economic problems, the insurance industry in Ukraine tripled the volumes of insurance services in the last five years, and raised the quality of insurance services. **If measured by the growth rate of insurance services, Ukraine occupies one of the leading positions in the world.** Domestic insurers have seriously strengthened their market positions and improved their image. In 1999, the volumes of insurance premiums have grown by 47.5% as compared to the last year's indicator. In our view, this should be attributed, among other things, to an improvement in the personnel policy of insurance companies. However, one should keep in mind that Ukraine lags far behind international and European achievements in the insurance business. **According to Swiss Re company¹, Ukraine, being second largest European country by territory (5.6%), and with 7% of the European continent's population, maintained 0.05% of Europe's volume of insurance services in 1998 (in the dollar equivalent).** In Hungary, this indicator was 4, in Poland — 12, and in Russia — 14 times larger. These factors determine the internal and external requirements to the personnel employed in Ukraine's insurance business.

THE STATE AND PROBLEMS OF PERSONNEL TRAINING

The establishment and development of the insurance market have created the need for new professions: qualified managers, underwriters, actuaries, commissioners, surveyors, and brokers. The specifics of the insurance business demand specialised bookkeeping, financial and legal services. A significant number of insurance employees and, foremost, those who hold key positions, should have a good base of knowledge in economics, finance, the law, and have a command of the theoretical principles of insurance and

state of the art experience in its organisation. Depending on the types of insurance, there exists a real *need to understand the basis of the technology of a given type of production, operation, or protection of objects*. There is a need to skilfully and promptly undertake all procedures related to identification and assessment of risks, determination of damages, and payment of compensation for damages to individuals and legal entities alike. That's why it's not unusual to see engineers, technical experts, agronomists, medics, and other specialists alongside of economists in the staff of insurance companies. Effective contacts of insurers with the existing and potential

¹ Insurance review — Moscow, *Strakhovoye Reviu*, Publishing House, No.1, 2000, pp.41-43.

insured are possible only if *the personnel has command of a certain minimum amount of knowledge of psychology and business communications*. The development of ties with partners from other countries, and the utilisation of information from abroad, including from the Internet, is not possible without *command of the international language for insurance — English*.

Over the last several years in Ukraine, as in other post-socialist countries, a real boom is observed in the preparation of bachelors and specialists with an economic background. Over 120 state and commercial colleges and universities in the country are involved with this matter. The vast majority of them prepare accounting specialists and bookkeepers. It was possible to solve one of the more important tasks — to introduce into educational plans obligatory learning of the discipline of “Insurance”, as part of any economic specialty, and the additional discipline of “Insurance services” — for the specialty of “Finances”. This factor positively influences not only the training of personnel for insurance organisations; it gives the impetus to the accumulation of insurance knowledge among the community of potential insured (industrial, trade, transport and other enterprises and organisations where tens of thousands of graduates of economic colleges and universities work).

Nevertheless, the base level of a higher economic and even financial education for managers and CEOs of insurance companies is insufficient. Bachelors did not have the opportunity to master subjects such as risk-management, the methodology of determining insurance tariffs,

underwriting in property and individual insurance, administration of reinsurance operations, insurer finances, accounting and audit of insurers, management of an insurance company, insurance law, and the like. To date, this combination of disciplines can be found in the only master's program in the country named “Insurance Management”, held in the Kyiv National University of Economics. During the four years of its existence, master's degrees (for full-time and correspondence students) were granted to 86 graduates, while 22 graduates acquired the qualification of insurance specialist.

The Ternopil Academy of National Economy also trains specialists for the insurance sector. Here exists the only insurance chair in the country, organised by the Ukrainian-Polish insurance faculty. However, the number of students studying the insurance business is limited to one academic group.

In general, state colleges and universities yearly graduate only 60-65 masters and specialists for the insurance industry in Ukraine. A still smaller number of experts in this field is trained at private establishments. The system of training of experts for agencies that provide social insurance is practically non-existent. At this scope of expert training, *insurance companies will long be unable to rely on graduates with a special higher education*.

Meanwhile, another serious problem is ripening, which will have a direct relation to the training of domestic experts in the insurance business. Removing restrictions on the entry of foreign companies to the Ukrainian market will



not only strengthen competition for insured, but will also cause *the outflow of highly qualified Ukrainian experts to foreign companies.*

DIRECTIONS FOR SOLVING THE PROBLEM OF PERSONNEL SUPPORT FOR THE INSURANCE BUSINESS IN UKRAINE

The following steps can be proposed in order to improve the situation in training personnel for the insurance branch.

First, it is necessary to work out and approve qualification standards for individuals



applying for a certain position. This is especially important for directors of insurance companies (funds), their deputies, directors of affiliates, and the state insurance control service. It is logical to assume that this category of officials should have a higher professional education. Corresponding requirements should be firmly set in the Law "On Insurance".

Second, it would be worth proposing to the League of Insurance Organisations of Ukraine and other interested organisations to inquire about the needs for insurance business personnel of various specialities and educational (qualification) levels by regions, and put forward proposals with respect to planning the graduation of specialists from corresponding colleges and universities.

Third, it is necessary to provide in the programmes of the relevant colleges and universities a separate speciality, like "Insurance Business" or "Insurance". This step will give the possibility to improve the selection of students for this specialty, fill the curriculum with disciplines that go to form the given trade, optimise the timetable of students and professors, strengthen the practical aspect in the training of experts with account of the requirements of insurers and other concerned entities. Experts should train for the needs of companies (funds) that provide social insurance services,

within the parameters of this specialty, but also taking into consideration the specifics of future work.

Fourth, masters and specialists of the insurance sectors should be trained at the expense of budget funds solely for the needs of state organisations. At the same time, insurers should pay more attention to the selection of talented youth for education on a contractual basis. This will make it possible to retain personnel where the situation requires.

Fifth, it is worth making wider use of the possibilities of education on conditions of acquiring a second higher degree (of the master or specialist level). A definite positive experience already exists. A master's program called "Insurance Management" in the Ukrainian Financial-Banking School is being successfully implemented. This educational structure was founded in 1994 with the support of the European Union (within the framework of a TACIS project). Presently, this school has the highest — fourth — level of accreditation. The school's structure incorporates the Ukrainian Centre for Insurance Business Education. After two years of learning, individuals who already have a higher education (non-economic), and after one year — those who enter the programme with a bachelor or specialist diploma in economics, acquire the master degree in insurance management. Presently, over 30 directors and CEOs of leading insurance companies are successfully learning at the school on a contractual basis, among them are three persons with a Ph.D degree. Such schools can give serious assistance to insurers in the raising of the qualifications of employees.

Sixth, taking into account that among young university and college graduates, and insurance business practitioners, there are many who speak English fluently and would like to acquire a certificate of one of the most prestigious educational establishments — the London Institute of Certified Insurers. Presently, it has affiliates and branches in 90 locations around the world. It is advisable to hold talks regarding the opening of one such branch of this institute in Kyiv. The possibility to receive necessary methodological background, consultations, and take exams without expensive trips abroad will make the named establishment accessible for Ukrainians. This kind of education will be especially advantageous for the training of lecturers in the insurance business and employees who practice the insurance of external economic risks and reinsurance operations on international insurance markets.

Seventh, there is sense in renewing the training of younger insurance specialists on the level of economic training schools. Their skills can be applied in the positions of insurance company operators and insurance agents as part of the staff of establishments that practice social insurance. This need will arise especially with increased sale of insurance products by phone, or through the Internet².

Eighth, a very important task is the publication of insurance handbooks and reference books for various professional (educational) levels of training. They should not only contain the necessary theoretical materials, but also be related with the actual needs of the practice inasmuch as possible. The process of effective learning requires the preparation of handbooks on selected business situations, forms of insurance documentation, etc.

In addition, one would like to see *a greater interest from insurers in strengthening student motivation in order to achieve a command of the insurance business*. This could be brought about by holding competitions for the best diploma or master's dissertations, articles on a specific subject, the establishment of insurance companies' scholarships for excellent students in need of financial assistance, and guaranteeing jobs to distinguished graduates.

SCIENTIFIC SUPPORT OF THE INSURANCE BUSINESS

Over 80% of scholars who conduct research in the area of insurance works in colleges and universities. Unfortunately, even the few existent research studies on insurance problems are being applied ineffectively.

Nobody is co-ordinating scientific research in the insurance business. The work done is not

appropriately appraised and its implementation in the companies' business is not encouraged. In order to remove these faults in the organisation of the scientific support for insurance, *it would be worth creating an academic council under the aegis of the League of Insurance Organisations of Ukraine*. This council would periodically discuss urgent problems, review the research results and, above all, the conceptual approaches to further development of the insurance market, draft legislative and regulatory acts, recommendations and methodology.

When the responsibility of state supervision over the insurance business is placed on one of the central economic bodies of the executive branch, namely the Ministry of Finance, more attention will be paid to the issue of the development of insurance business. It would be desirable that the Financial Research Institute under the Ministry of Finance of Ukraine sets the tone for the insurance business studies.

The press should play a more active role in informing insurers and other interested parties on the research results, and useful domestic and foreign insurance experience. *Ukraine has only one monthly publication, the "Finansovye Usługi" ("Financial Services")*, interesting by its form and contents. All Ukrainian insurance companies subscribe to this journal; there are many readers of this publication abroad. This journal made it possible for scientists to publish the results of their research. **Unfortunately, the Highest Attestation Commission of Ukraine did not include the journal on the list of professional publications, despite the requests of leading educational establishments, and the League of Insurance Organisations of Ukraine.** This not only significantly limits the possibilities of applicants for a scholastic degree to meet the Highest Attestation Commission's publication requirements, but also narrows the circle of experts where the research results would be spread.

The level of development of property, life, pension, third-party liability insurance business is the indicator of the economic and social security, on the individual, family, enterprise, and national level. Only professionals can improve this important matter by taking into account scientific achievements and the world experience. It is the mutual task of Ukraine's insurers and higher educational establishments to find and train such people.

² Author had a chance to visit one British insurance company specialising in twenty-four hour motor vehicle insuring over the phone. The company has significant profits because it was able to avoid commission costs to brokers and to employ over 200 operators trained at three-month courses for school graduates.

IS THE STATE CAPABLE OF GUARANTEEING THE SOCIAL PROTECTION OF ITS DEFENDERS?

By Volodymyr BONDAR

With the goal of providing for the social protection of different categories of Ukrainian citizens whose service duties carry a high degree of risk to their lives and health, the state has legislatively introduced *obligatory personal state*

*insurance*¹. In this way, the state has assumed the duty of social protection of the above categories of citizens and guaranteed them social payments.

For timely social payments to be made, ministries and agencies should transfer monies to the special account of the Board of the National Joint-Stock Insurance Company (NJSIC) "Oranta". According to a decision of the Government of Ukraine, this company should provide obligatory personal state insurance and payment of insured amounts at the expense of the state budget. Payments should be made *monthly* in the amount of 1/12 of the established yearly amount. Budgetary items of relevant ministries and agencies *are the only sources of such payments*.

However, beginning with the second half of 1995, the transfer of monies has not been timely and not in the necessary amounts. As a result of this, large payment arrears have accrued. Documents for the receipt of social payments are filled out daily, but the actual receipt of insurance payments occurs with significant delays. As a result, the debt amount is constantly growing. **As of March 1, 2000, the debt of ministries and agencies with respect to social payments stands at over UAH 58 million. This is nearly 2/3 of all NJSIC "Oranta's" assets.** The debt delay period is also constantly growing, amounting to 1-3 years.

At the same time, claims by citizens with respect to the receipt of the legally provided for payments are pouring into the courts. There are



¹ Entitled to such insurance are: servicemen of the Ministry of Defence, the Security Service, employees of the Ministry of Internal Affairs, judges, People's Deputies of Ukraine, employees of the Procurator's office, customs, the control and revision service, and others.

no reasons for disallowing these claims, and the courts are satisfying them by way of exacting insurance monies, state duties, legal fees and moral damages from all NJSIC “Oranta” accounts. A paradoxical situation is taking shape



where ministries and agencies (that is, the budget) are unable to pay, while the insurance company is forced to pay.

NJSIC “Oranta” must fulfil the decisions of the courts and make payments at the expense of its own insurance reserves intended to meet its insurance commitments for voluntary risk insurance to millions of insured individuals. Taking into account the arrears amount, *a real threat has arisen for the financial destabilisation of the largest insurance company in Ukraine with a state-controlled share package (78%), and not fulfilling its commitments with respect to payments of insurance monies to those insured who hold policies*

for voluntary property insurance against natural disasters and other risks.

In order to correct the situation, the Government of Ukraine has proposed a number of steps. They provide for the transfer of the insurance money payment functions directly to the relevant ministries and agencies (the main administrators of budget funds), whereby payments will be made at the place of residence of the insured. Payments should be made out of funds allocated by the Main Department of the State Treasury of Ukraine. NJSIC “Oranta” will only be responsible for the collection and processing of documents, determination of the insured amount, and their transfer to the relevant bodies of the place of employment of the claimant. The goal of such steps is to increase the responsibility of the ministries and agencies in providing social payments, terminate the exhaustion of NJSIC “Oranta’s” insurance reserves, and ensure the fulfilment of its commitments with respect to voluntary insurance.

These steps by the Government look like half-measures which will not be able to improve the situation. The inadequate regulation of this question means that the state budget of Ukraine and the budgets of various ministries and agencies (the insurers) **don't have an expense item** to carry out the plan. Funding of the above-mentioned form of social payments is carried out today according to the leftover principle, despite its nation-wide significance. As a result, there is a chronic under-financing of ministries and agencies for these needs, and significant state arrears have accrued, with respect to the payment of insurance monies to the insured, whose non-payment period is longer than for wage arrears, scholarships and pensions.

Unfortunately, it is now evident that the earlier mentioned categories of citizens will not receive money for obligatory social payments in the full amount for some time. Under such conditions, the state should either find reserves for providing obligatory insurance by allocating such expenses through separate state budget items, or retract from its obligations for some time (declare a social default). The proposed government steps in this instance are to protect NJSIC “Oranta”, as it is also responsible for other types of insurance.

INSURANCE IN UKRAINE: regulatory and legal background

By Olha HAMAKOVA

THE CRUX OF THE PROBLEM

It is the accepted practice the world over to categorise all insurance contracts into two large groups. One of those groups encompasses general insurance contracts entered into for a one-year term¹. These types of contracts provide for insurance protection for the insured, and the role played by this insurance goes no further.

The second group encompasses the insurance of life: contracts of comprehensive life insurance, insurance of children until their adulthood and marriage, insurance of additional pensions and annuity, infinite insurance, etc. Life insurance contracts are entered into with individuals, for the most part, and not with legal entities. Unlike general insurance contracts, these contracts are of a long-term nature: for five, ten, fifteen, twenty years, or more. According to such a contract, the insured makes his payments by instalments (during the whole life of the policy) at a rate that enables the insurance company to end up with the amount of money in its account as indicated in the contract at the expiration of the contract's term. At the end of the contract term, the sum paid into the contract is returned to the insured person with interest. If the insured individual becomes deceased, his or her heirs receive the entire insured amount, according to the contract, notwithstanding the sum of insurance premiums paid. In this way, **life insurance policies not only provide for an individual's insurance protection, but also become a form of investment on the part of the insured.**

In contrast to other financial-credit establishments, insurance companies that insure life can invest the surplus funds of the insured at a much smaller yearly interest rate, since this kind of investment is conducted on the basis of ensuring insurance protection. That's why insurers are in a more comfortable situation as compared to other financial-credit institutions. Life insurance contracts are entered into on a long-term basis, repayment commitments are further off in time, and they can be predicted with relative accuracy. That's why insurers can invest a significant portion of long-term payments as part of their own overall investments. **The particular investment possibilities of life insurance companies make their position on the capital markets a unique one: such companies (along with pension funds) satisfy a large part of the economy's requirement for so needed inexpensive long-term capital.**

Questions arise: is this kind of capital unnecessary for Ukraine? And if not, than is the life insurance sector of the insurance market, so important to the country's economy, sufficiently developed? If the first question is rhetorical, then the answer to the second one will not, unfortunately, be very encouraging.

In Soviet times (when insurance operations were monopolised by the state and conducted by one organisation — the GOSSTRAKH), the development of the insurance of life reached a very high level. According to official data², in 1990, within the structure of insurance payments of the GOSSTRAKH, 37.1% came from the national economy, while 62.9% — from the pop-

¹ They include contracts covering land, water and air transport, property, all types of liability, the insurance of life and health against accidents, etc. Insurance premiums, paid by the insured under these contracts, amount to a small percentage of the insured amount and are not returned to the insured at the end of the contract term. If an insured accident occurs, then damages are paid within the limits of the insured amount (as a rule, the amount of insurance damages paid out is far greater than the amount of the insurance premium paid by the insured).

² Government insurance in the USSR, 1991: Anniversary statistical almanac/Ministry of Finance of the USSR. — Moscow: *Finances and statistics*, 1991, pp.14,19,53,79.

ulation. Within the structure of the payments from the population, 90% of *payments were based on long-term life insurance contracts*. The vast majority of the employable population of the USSR (68.3%) had this kind of insurance. In Ukraine, this indicator was even higher — 71.4%. This level of life insurance gave the state a possibility of accumulating and utilising huge funds for investments and other needs. Reserve volumes of live insurance payments amounted to 74.9% of the overall state insurance fund amount collected by the GOSSTRAKH, and in 1990, stood at more than 34.4 billion Soviet roubles.

From the point of view of the unique investment possibilities of the life insurance market, the state should have used all means to encourage its development. Ukraine, unfortunately, was unable to maintain and multiply the positive experience from Soviet times. Over the last years, payments of insurance premiums under life insurance contracts have reduced drastically. In terms of overall insurance premiums paid in 1998, premiums for life insurance contracts made up 1.6% of that amount, and in 1999 — only 0.7%. These figures are difficult to compare with the 1990 indicators.

HOW DOES THE STATE CARE FOR THE PROTECTION OF ITS CITIZENS?

Such a drastic reduction in the life insurance volumes occurred for a variety of reasons. Among them — objective economic reasons, as well as reasons of a subjective nature related to the careless and unprofessional management of the insurance sector, including imperfect legislative, regulatory and methodical support.

The first step on this non-constructive path was the implementation by the Insurance Business Control Committee of the “Temporary methods for forming reserves for the life insurance”³. According to this document, life insurance policies were to cover only three types of insurable events from now on: survival of the insured until the end of the insurance contract term; death of the insured; attainment of retire-

ment age by the insured person (pension insurance). In this way, such important events as the *temporary* or *permanent* disability resulting from an accident during the insurance contract term were groundlessly excluded from the list of insurable events. The same document virtually eliminated the most popular during Soviet times *combined* form of life insurance, inasmuch as a very important psychological motive for insuring vanished, connected with the possibility of receiving partial payments resulting from temporary or permanent disability during the life of a long-term contract.



The GOSSTRAKH's legal successor — the “Oranta” National Joint-Stock Insurance Company, which until that time continued entering contracts for combined insurance, found itself in an awkward situation. At one end, there was ten year's worth of experience of operation on the life insurance market; provisions and rules for long-term cumulative insurance had been worked out, and the insured were used to them; there were contracts in force with just such broad obligations. At the other end, it was necessary to take into account the requirements of the above-indicated Temporary methods⁴ with the unconditional introduction of new standards.

NJSIC “Oranta” and other companies were forced to exclude from the life insurance rules guaranteed payments to the insured in connection with injuries and other accidents which led to temporary non-employability and permanent disability. This drastically lowered the popularity of life insurance contracts.

The mistake was corrected only in June of 1997, when the Insurance Business Control Committee approved new “Methods for forming reserves for the life insurance” (hereinafter — Methods), which is in force today. With respect to life insurance contracts, the Methods enlarges the list of insurable events to its past size. Therefore, **everything has fallen into place, but time was lost and, most important, potential insured were lost, too, inasmuch as insurance**

³ Brought into force October 27, 1995 by the order of the former Insurance Business Control Committee.

⁴ After registration in the Ministry of Justice, it took on the force of a regulatory-legal act.

exclusively in the event of survival or death is not attractive to people, especially in today's difficult socio-economic situation.

Ineffective state regulation of life insurance terms also found its further negative development in the sphere of taxation of the insurance business. In Ukraine, life insurance operations are not subject to a profit tax, but this provision applies only to life insurance contracts that foresee solely such insured accidents as the *death* of the insured⁵, *survival* by him to the end of the contract validity term, or attainment of the age indicated in the contract. Policies cannot provide for the possibility of partial payments until the end of their term, or before an insured event. If life insurance provides for other insured events (aside from survival and death), then the operations of the contracts do not qualify as operations for life insurance. Incomes from such operations are taxed just like sums accumulated under the general types of insurance, that is, at a rate of 3%.

It is very difficult to find the logic here. In foreign countries, life insurance contracts in next to all cases include additional insured events (aside from survival and death) and foresee partial payments — this does not get in the way of recognising them as life insurance contracts.

The differences between the requirements of the last Methods and the Law of Ukraine “On the Taxation of Enterprise Profits” don't end here. The most important problem remains unresolved: the term of the contract. The Methods indicate that life insurance contracts are entered into for a period of not less than three years, while the law — not less than 120 calendar months. Clearly, this kind of requirement is neither logical nor viable in our difficult times. It is

unlikely that a domestic insurance company wishing to practise life insurance can count on large amounts of money from the population on such terms.

The prohibition placed on domestic insurers to simultaneously practise general and life insurance has had a very negative influence on the development of the domestic life insurance market. The pretext for such actions on the part of the state was alleged concern for the protection of the citizens. Undoubtedly, financial management of a company practising life insurance differs from that of a company practising general types of insurance. The need to protect long-term savings of the insured under life insurance contracts places particular requirements on the insurers. As a rule, they are required to have a larger amount of authorised capital. A special procedure for forming insurance reserves is implemented, to be calculated separately for each contract, relying on the methods of actuarial mathematics. Such insurers should have a very careful and well thought-out investment policy, especially with respect to placing and investing insurance reserve funds. A special taxation regime is applied to such insurers. All of this is correct, but the time chosen for such an uncompromising division of insurers by specialisation in Ukraine was very inopportune.

The desire to be “on level with international standards” cannot be achieved at just any price. In the countries of the EU, the division of insurers who insure life and those who practise other types of insurance business, took place only in 1982. Until that time, the insurance markets of the EU countries took a long evolutionary path. Great Britain, for example, even today has so-called “composite” companies on its domestic insurance market, which practise life insurance and general insurance alike. Russia is demonstrating namely this approach. Ukraine, unfortunately, has taken another path which is difficult to call well thought-out.

DOES THE STATE PROTECT THE NATIONAL INSURANCE MARKET?

The problems of the Ukrainian life insurance market are not confined to the mentioned regulatory-legal aspects. **Unsolved remains the important problem of the protection of the payments of the insured, based on long-term insurance contracts, from the ruinous influence of inflation, especially if the limited capabilities of domestic insurers and the low level of trust of the**



⁵ Or a decision of the court regarding the announcement of his death.

population are taken into account. The solution to the situation is apparently evident; it even appeals to the insurers. The idea is that insurance contracts are entered with domestic (foreign) insurers in dollar equivalents, with further reinsurance by foreign re-insurers. This is what non-resident companies, that are already expanding their activities on Ukraine's life insurance market, are aiming to achieve.

There is also a threat of the loss of market for domestic operators, arising in connection with its openness for foreign insurance companies. Domestic insurers remain unprotected against the new competitors. Today, there are no

whatsoever limitations on transfer of collected premiums abroad via the reinsurance channels. Meanwhile, Russia's legislation provides that the insured risk of survival of the insured to the end of the term or the age indicated in the insurance contract is not eligible for transfer to reinsurance by non-residents of the Russian Federation.

For the rank-and-file citizen, reinsurance is, apparently, convenient. However, the state should make efforts to stop the outflow of big money abroad, find the balance between the interests of ordinary citizens, national interests, and the interests of domestic and foreign insurance companies on the domestic market.

IN CONCLUSION

After the opening of the Ukrainian insurance market on June 17, 1999, it became clear to EU member countries that life insurance is the most lucrative for foreign insurance companies. Competition (even of a symbolic nature) on the part of Ukrainian insurers is not a foreseeable reality at this time. There are no problems for the creation and registration of pseudo-Ukrainian insurance companies, which are actually 100% owned by foreign capital, on the territory of Ukraine. There are no legislative restrictions in Ukraine on the transfer of insurance premiums under life insurance contracts abroad via reinsurance mechanisms. But legislation does impose very tough conditions for the activities of insurers who operate on the life insurance market. These conditions are unaffordable for domestic insurers, but completely acceptable for foreign insurers. This makes the Ukrainian life insurance market attractive for the latter.

Life insurance in Ukraine does not yet have the required legislative support, which is impeding its development. On the one hand, Ukraine's citizens are not receiving the desired insurance protection. On the other hand, domestic insurance companies are not developing. Finally, a channel for the outflow of long-term savings of Ukrainian citizens abroad is being created. Under other circumstances, these monies would remain in the country and satisfy its needs for long-term capital.

PEOPLE OF THE HAPPY MEDIUM?

Sketch of a socio-psychological self-portrait¹

Liudmila SHANGHINA

How can happiness be measured? Possibly, it can be embraced, counted, poured into a glass, or listed according to the top five indicators. Happiness can also be measured in percentages if the topic concerns the feeling of a nation. Therefore, in accordance with the poll conducted by the Sociological Service of the Ukrainian Centre for Economic and Political Studies (UCEPS), 9.8% of our citizens feel happy. 22.7% is satisfied with their lives, while 52.4% is not. Finally, 7.5% of the population feels unhappy.

The emotional portrait of the Ukrainian nation can be drawn from these happiness and unhappiness percentages. What do the light and dark shades of this portrait depend on, what do we believe to be priorities in our lives, and what do we accept with calm or even indifference? How do we raise our children, and how do we spend our free time? What pluses and minuses do we give ourselves and our fellow citizens? These and many other questions were answered by two thousand individuals, 98.4% of whom are Ukrainian citizens, questioned by the Sociological Service of the UCEPS. The research undertaken may not be the ultimate truth, in the last instance, but it does give us a picture of the state of the single source for authority of the Ukrainian nation — the people. It is the people who choose the President and People's Deputies from among its ranks, and then later must live with their choice. In this connection, some data which were collected during this representational sociological polling allows for the unlocking of the secret of the Ukrainian phenomenon. While in Russia this phenomenon can be characterised as the enigmatic nature of the Russian soul, in America — as the material attainment of the American dream, then in Ukraine, especially under present conditions, the puzzle is the patience of the people. Let's look at everything in order. But first of all, the most important.

1. ON OURSELVES

Values

It appears that we are a very domestic and quiet people. Above all, and in the following order, we value health, family, the opportunity to get paid for work, wellbeing, and peace in the country. Everything else worries us less, and least of all — politics.

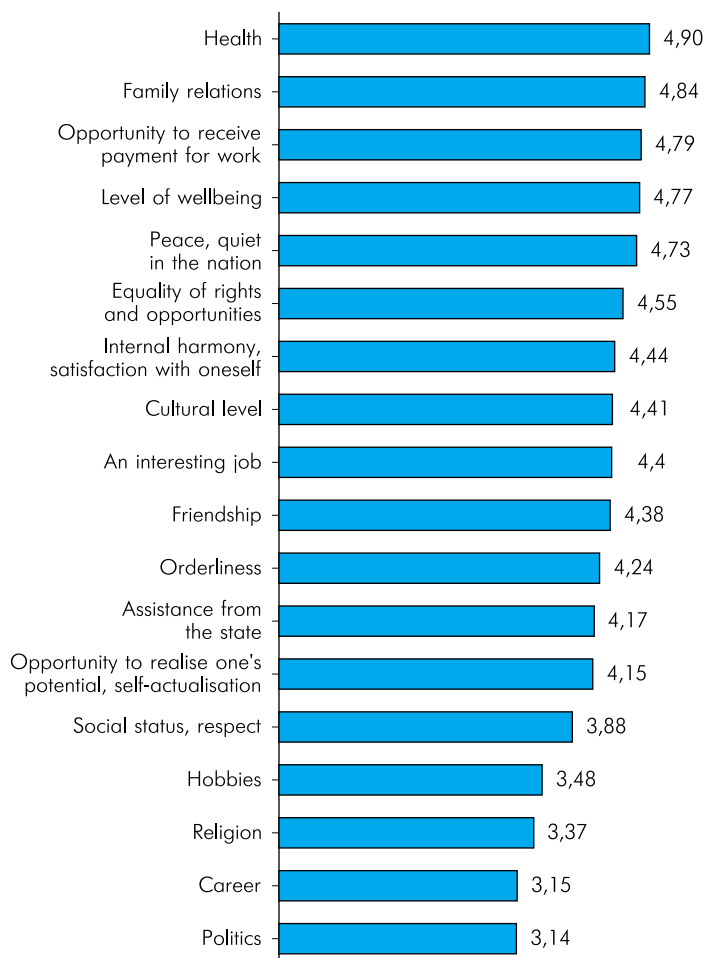
If one is to judge according to the average point value given by respondents to the level of importance of a given aspect of their lives (a 5 indicating the highest degree of importance on a five-point scale), then our system of values takes the following shape (*Diagr. "Life values rating of citizens of Ukraine"*).

Health

98.1% of respondents indicated the importance of this aspect of life by giving it the highest marks (4 and 5). But we shouldn't be too quick to draw the conclusion that we are overly concerned about a healthy lifestyle according to the American example. As it turns out, only 5.4% participates in sports activities on a daily basis, while nearly 70% is completely inactive in this respect. The more probable scenario is that we simply understand that healthcare is increasingly becoming an unattainable luxury, while health itself is turning into a condition for survival. That's why we place a high value on health without condemning those (and by the same token, ourselves) who smoke 10 or more cigarettes a

¹ The article was published on March 4, 2000 in newspaper *Zerkalo Nedeli*.

Life values rating of Ukrainian citizens



day, as well as those who drink themselves into a state of oblivion once a week. But in general, as the responses show, we drink very little: it appears that one-third, or 33.1%, doesn't consume alcohol at all, 4.6% never drinks wine, and nearly half (48.7%) doesn't care for beer.

The overall impression was that we were not



filling out anonymous questionnaires, but employment applications!!! However, this is not a reflection of alcohol allegiances, but rather, the level of honesty in answering the questions being the subject of public dispraise. But let us be charitable to respondents. Have you never sneaked a look at the answers on tests in order to see yourselves as the ones who have given the correct responses? You see, it is very difficult to admit one's drawbacks, after all.

Family

We, citizens of Ukraine, as unusual as it may seem, are consistent in our life priorities. Results recently obtained by UCEPS coincide completely with the data of the monitoring dynamic of the value of priorities conducted by the Institute of Sociology of the National Academy of Sciences of Ukraine and the Socis-Gallup service on the basis of polls taken in 1991, 1994 and 1997. Health firmly holds the first position in each of these polls. Next come prosperity, welfare of the children, family, favourable climate in the country and the creation of equal opportunities in society for everyone. There is one nuance which is worth mentioning. An increase in the average score for the priority of family has been noted: in 1991 — 4.44; in 1994 — 4.51; in 1997 — 4.71. It occupied third-fourth place behind prosperity and welfare of the children. According to UCEPS research, the importance of the family was valued by respondents at 4.84 points. Although no separate question was presented with respect to children's welfare, in 1997, it stood in second-third position behind "strong family". Despite all reservations regarding the admissibility of comparison of results of various research, it can be concluded that our life has become more centred on the family, as though shrinking into this natural, consanguineous cell as a means of sheltering oneself (at least for the time being?) from social problems and calamities.

That's why, perhaps, there is a decreasing number of those in Ukraine who ignore the priority of family. Only three out of one hundred citizens are decidedly single and value the level of importance of the family in the range of 1-3 points. The vast majority (97.2%) are individuals dedicated to family. The factor that distinguishes itself as the most important one underlying our daily behaviour is our sense of "duty to our close relatives" (according to 88.2% of respondents). All other factors are far less of a priority. For example, morality, as a very influential factor, was indicated by only 59.8% of those polled, the law — by 44.6%, and duty to country — by 20.3%. It's not even worth discussing political allegiances (10.3%).

As far as our understanding of "social envi-

ronment” is concerned, in all appearances, it has not changed much from the time of the “Kaydash family”, as the Ukrainian writer and poet Ivan Nechuy-Levitskiy saw it. This especially refers to parents. We sincerely believe that parents should be loved and respected independently of their positive qualities and drawbacks (85%). But we desire to live separately from them, as shown by 84.3% of those polled who indicated that living separately from one's parents is an important condition for one's own happy marriage.

Many factors determine our happy marriage. Above all, the presence of respect and mutual support between individuals (97.2%), then, children (96.8%), understanding and patience (96.7%), mutual faithfulness (96.4%), and the readiness to discuss problems that arise between the spouses (93.5%). Only later, and one notch lower, do the factors of living conditions (92.7%) and high incomes (91.8%) appear.

The old saying “Birds of a feather flock together” is not applicable, insofar as we are not concerned with social background as a factor that is important for a happy marriage: only 11.4% of respondents say that it matters. Religious convictions are also of little importance (14.3%), while the least role is played by agreement on political matters (7.3%) and whether individuals are of the same nationality (6.8%).

There is still hope for our yawning demographers and pension system reformers, for in today's difficult conditions, we are overwhelmingly concerned about sex (90.8%) as a condition for a happy marriage.

With respect to sex. Our attitude towards it is such that one would think that the spicy publications “Bulvar” and “Lel” are not written for us. That is to say, in the majority of instances, we believe that sex should be legally grounded. Other instances are seen as violations of the Seventh Commandment which we (74.2%) judge no less harshly than the Bible. We take a similar harsh stance towards extramarital sexual relations (67%) and the start of such relations prior to attaining adulthood (71.3%). We believe that even by our nature, our tendency towards sexual freedom is far smaller than towards faithfulness in marriage (14% versus 46%). Nevertheless, 40% could not say what was more characteristic of them (or of us). Probably they were all readers of “Lel”.

And now back to children. Thoughts with

respect to the time for ejecting them from the parental nest are divided. Nearly 55% of those polled believes that parents should do everything possible for their children, even at the expense of their own happiness. 34.7% doesn't accept this kind of infinite sacrifice, believing that parents have their own personal lives and cannot be required to sacrifice their happiness for their children's sake. One out of ten was undecided on the issue.

We are more uniform in how we value the most important qualities that a family should bestow on a child. In first position — industry (85.6%), followed by the sense of responsibility (70.2%), patience and respect regarding other people (58.6%), prudence (51%), and the ability to behave in society (47.4%). The last positions of 11 proposed qualities are held by — attention! — the ability to share (20.9%) and the degree of religious faith (10.8%). Only “imagination” was lower. Now, that's something to think about...



It's out of the question that the last and single largest family problem is divorce. With our high degree of dedication to family, our attitude to divorce is surprisingly realistic.

A significant number — 40% — could neither condemn nor justify divorce, one-third of those polled (32.3%) tends toward the belief that there are reasons justifying it, while only every fifth individual is quick to denounce it (21.8%). Against the background of a large number of divorces, it is no doubt comforting that nearly 76% highly value their degree of satisfaction in their family relations.

Work

We are hardworking and eager to work. Over two-thirds of those polled (69%) believe that our defining feature is the hardworking nature, while only every tenth individual believes that our defining characteristic is laziness. If salary does not meet with family needs, almost 40% is ready to look for a perquisite, while 26.9% would search for another job. And only 1.6% is ready to make money by breaking the law. We don't joke around with the law, even in an anonymous questionnaire.

We value an interesting job (average 4.4 points) and are indifferent to career (3.15). We value a job with a good salary rate (89.5% of respondents placed this condition in first place), while at the other extreme, we are prepared to be

satisfied with a guaranteed salary (second place, 46.3%). It is important for us to be surrounded by pleasant people in the workplace (23.2%), although “dealing with people” is important for a significantly smaller number of fellow citizens (17.5%). Far less significant for us are job characteristics as “not very stressful” (4.7%), and “a long vacation and a sufficient number of days off” (5.6%). 47% of those polled are fully, or most likely in agreement with the thought that work should always be in first place, even if there is less free time left as a result. We are content



with very little...

Employers of the world — unite in Ukraine! This is while we are still choosy in our choice of work and mostly believe (41.7%) that the unemployed should have the right to reject a job that they don't like. But the threat of unemployment has already taken fourth position in the category of problems that worry us (44.3%). And we are ready to fight for a working place with those who are like ourselves. Note, not competing, but simply limiting the access of outsiders to our city, village or location is what's needed, as nearly half of us tends toward the belief that competition awakens undesirable qualities in people. 72.2% of Ukraine's citizens completely, or most likely agrees that in the event of a deficit of working places, local inhabitants should be given priority. One-third (35.5%) agrees on doing away with women, inasmuch as they sincerely believe that in conditions of unemployment, the stronger sex has more rights. So where has our value hierarchy gone to? In sixth place, as the Diagram shows: equality of rights and opportunities, for which 89.9% of us voted for. So there you have it...

And the last thing regarding work: we are paid for it infrequently and not very fairly. Otherwise, how did late payments for work done presently or once done come into first position in

the list of problems: salaries, pensions, etc.? In what other country of the civilised world does not only work appear in the list of top values, but the “opportunity to receive payment for work done”?

Free time

Free time for us now, as in the past, is “cultural leisure”. First of all, we are not satisfied with our own level of culture: only every eighth individual saw it possible to give himself an “excellent” mark, every third person was unpretentiously satisfied with a grade of “good”, while a large number assessed their level of culture lower, including every seventh individual giving himself a “one”, on a five-point scale. And this is a wonderful description of ourselves, insofar as it bears witness to the characteristic of self-criticism.

What are we doing in order to raise our cultural level? The situation with positive characteristics looks a little different.

Above all, it appears that the classic question “Do you love the theatre?” lost its meaning and effect with respect to us. The overwhelming majority (79.3%) **never visits** the theatre. Only 18.5% visits it several times a year, while there are merely three out of one thousand theatre lovers that cannot live if they miss the theatre for even a week.

If the cinema remains the most important of the arts for us, as Lenin once put it, then we watch films on television. Because we **never go** to the cinema on an even greater scale than the theatre (83.6%). Only every eighth person (13.6%) sees films in the company of fellow citizens several times a year, while only two-plus out of one hundred — 1-2 times a month.

By contrast, nearly each of us can be confidently stopped at night in the street and asked “How can I get to the library?”. But not, what is the library like?! — the book market at Petrivka?

There is a basis for asserting that we would be able to show the way, because nearly every fourth individual reads books almost every day, every fifth — at least once a week, while only one in seven individuals (15.3%) will not be able to satisfy the interest of the midnight library seeker, because he **never reads** books.

Getting information on the “source of scientific literature” with our help is more difficult, since 42.6% of our citizens **never reads** special publications. A steady and systematic interest in it was noted on the part of only less than one-third of respondents, dedicating time to it if not on a daily, then at least on a weekly basis. And nearly one-third improves its post-graduate level from time to time — several times a month or year.

Ukraine has 2000 museums. But if a tourist who strayed from his group begins asking about



the nearest one, it will turn out easier for him to find out the location of a secret army unit. Because three-fourths of us **never visit** either museums or exhibitions. Only every fifth individual goes there several times a year, while there are



only five out of a thousand museum lovers among us. The tourist won't be that lucky.

He has ten times more chances finding a disco or night club, because nearly every fifth individual visits these places of cultural entertainment more or less frequently. But en masse — 79.5% — we **never go there**.

What we do most willingly in order to raise our cultural level is we listen to music daily (53%), with every tenth individual only **never listening to it**. By contrast, the situation regarding the independent playing of musical instruments is simply a disaster, and soon there will be no one to enter the conservatory. 85% of Ukraine's citizens never take an instrument into their hands. Only an incomplete six out of a hundred play music several times a year, while four do so once a month. In terms of prospects, the "singing rector" (M. Poplavskyi of the University of Culture) is left with no choice but to place his hopes on those two-three out of a hundred that play almost daily, or at least once a week.

Therefore, though we take a very critical stance towards our cultural level, we do little in order to raise it. Is it because we don't want to, or because we can't? It is difficult to answer this question directly. On the one hand, the conditions of our life don't make it possible, and the earning capacities don't provide for it. The currently unpopular Karl Marx was right when he affirmed that a hungry person demoralised by life's problems would be indifferent to the most beautiful sight.

But on the other hand. In the hierarchy of

qualities important in the raising of children, why is "imagination" — a quality so necessary for the understanding of beautiful things in art and in life — appeared in last place? Why did only eight out of one thousand people express their readiness to make donations in this area if it becomes possible to donate large sums, and only three out of a thousand promised to make such donations for the development of national arts?

And what we do not spare our earned, not won in a lottery, money on is presents for our friends. In this country it is not acceptable to visit people with empty hands, and we make calls on friends more often than go anywhere else. Every fourth individual visits friends or relatives at least once a week. This is probably because 78.5% of our fellow citizens are satisfied with their mutual relations with their friends.

Religion

We are religious in a strange way. We have already mentioned that in the hierarchy of our life's values, religion occupies one of the last places. Less than one-third of those polled (30.6%) gave it a "5", another 20.2% — a "4". In total, around one-half. And, notably, almost as many (49.6%) assume the level of satisfaction of their religious demands to be sufficient, also giving it 5 or 4 points. This is completely in line with the fact that in the list of problems that worry us most, inter-confessional conflicts and division of the church occupies 11th position out of 26. These problems worry less than one in ten individuals (9.7%).

More than half of those polled (52.2%) doesn't believe that similarity of religious convictions forms an important condition for a happy marriage. And finally, we remind our readers that religiousness occupies next to last place among the qualities that we want to bestow on our children. For the purpose of verifying — in the list attached to the form it was possible to indicate five qualities, rather than one. That is, we didn't simply give preference to being "hard-working" or, say, "having the ability to bear oneself in society". If the context of indirect questions on religion are taken into account, then the conclusion cannot be avoided: we are far from being worried about establishing the Law of God in the schools, or the institution of the chaplain service in the army, as may be believed from mass media debates. And we are far from convinced in the salutary nature of a religious upbringing.

As far as religious organisations are concerned, the attitude towards them is in a very exemplary fashion reflected in the answer to the question of how we would spend large sums of money had we the chance to donate them. While 71.3% is prepared to make donations foremost

on the needs of the sick, socially unprotected children and orphans — and this is to our honour — only 2.2% is ready to donate on the needs of religious organisations. Let us be forgiven for



a possibly incorrect stance, but statistics is an unemotional realm: a slightly greater number of people are ready to make donations to shelters for homeless animals (2.3%) than to religious organisations.

Politics

In the system of our life values, politics takes 18th place out of 18. Is there any sense in discussing it? If one is to believe the ancient Greeks, then politics is participation in the affairs of the state and society. It is only necessary to figure out what for us is the state, and what is society. And what is our country for us? For the Greeks, all those things meant the same, and that's why they were citizens. But what are we?

2. ON THE NATION AND THE STATE MACHINE

We love our country. In the form, a direct question was posed: “What feeling does the word “Ukraine” evoke, above all?” Polled individuals gave their various responses. Every fourth individual, 25%, expressed his feelings in a direct and deep word — “Homeland”. Every twelfth

(7.8%) — “pride”, every fifteenth — “sorrow, despair”. There were many descriptions: “pain”, “tears”, “humiliation”, “native home”, “I love it”, “Mama”, “warmth and light”, “holy”, “granary”... Is it necessary to comment on these descriptions? Generous and moving ones were in the majority. But there were others. “Place of residence”, “poverty”, “begging”, “fear”, “worry”, “shame”, “third world country”, “ruins”, “impending doom”, “desire to leave”. In truth, these descriptions are different only at first glance. Doesn't despair stand behind them, mixed with love, after all?

We are patriots of Ukraine. More than two-thirds see themselves as such (70.7%). In this space, 7.8% gave a categorical “no”. Well, every family has its black sheep.

The phrase “small Homeland” is not an abstraction for us. Nearly half of those polled (45.2%) believes themselves to be inhabitants, first of all, of their own town, region, village, and of Ukraine in general — 26.5%. Only two out of one hundred feel themselves to be Europeans. In contrast, 10.4% are “citizens of the world”.

How much feeling of pride in our country do we need in order to attain a comfortable feeling about ourselves? Here, thoughts were divided. 42.3% answered that in order to feel happy, one's own happiness is sufficient, while nearly as many — 43% — believes that it is necessary to be proud of their country. What would we like to be proud of most of all? A high standard of living, economic development, and the social welfare of the population (76.85; 67.85; 63.8%, respectively). We are willing to keep up with the Joneses.

Despite our love for the country, and the feeling of pride and pain for it, every sixth individual is not prepared to defend it in a hypothetical war situation. Every third individual expressed doubts that we would defend the Homeland in the same unselfish way as was done during the years of the Second World War. And every fifth individual drew a limit as to the extent of his sacrifice depending on what country it was necessary to fight. What is it with us? It is possible that our mostly warm attitude towards the country is shadowed by an antipathy towards the state machine.

We have our separate relationship with the latter. We don't like authority, for (remember the Greeks with their “politikh”) we don't participate in the affairs of the state. In order to participate in the affairs of the state, it is necessary to take part in the affairs of society, it is necessary to be a society, since our state is a “res publica” — a social, common affair.



3. ON SOCIETY

Think hard! Two-thirds of us (67.3%) believe that in relations with people, it is necessary to be very cautious, and only an incomplete one-third (26.7%) is ready to trust not everyone but, take note, most people in any case.

Truth be told, this strange lack of trust in no way saved us from trusts, investment funds and other pyramids. We are capable of placing our trust in almost any words announced from the rostrum, the television screen, or newspaper page.

But we do not believe one another. We do not believe those who are like ourselves - ordinary, rank and file compatriots. To the contrary, we have a tendency to suspect them for that which we ourselves don't do, but hold others in judgement for. Indeed, most of us (59.4%) believe that there is no justification for receiving government aid to which the recipient has no right. In addition to this, 78.9% believes that there are "many" (40.9%), or "some" (38%) who do just so. Similarly, not justifying tax evasion (50.4%), 76.6% suspects those "many" (50.7%) and "some" (25.9%) in doing just that. Approximately the same correlation exists in how we accept small and large sins — from the dis-



posal of garbage in public places and the unpaid-for ride on public transport, to lies in one's own interests and the acceptance of bribes — with the conviction that the majority of our law-abiding fellow citizens do so without any kind of shame. Why are we so convinced about this? This may

sound insulting, but it should be remembered that we normally judge others, according to ourselves. These are not strangers who throw whatever pleases them wherever, nor are they strangers who take bribes and don't pay taxes. They are "we".

But "we" separate ourselves from "them". "We" will never have a "common social affair" with "them". "We" — numbering up to 90% — take no part in any public associations, parties, movements and other common activities. Because we also don't trust common activities. We don't place our hopes in them, and await neither aid nor support from them.

In other words, "we" — is at most that very same family which we value so highly. Our "detached" house, or hut, has nothing to do with the neighbourhood. This saying about one's house took second place among those that most effectively reflect the defining traits of our character.

"We" — this is not society. We — this is each one by oneself. If Aristotle was alive among us today, it would never enter his head to state that man is a social animal. We are the descendants of Ukrainian philosopher and educator Skovoroda — society can chase us all it wants, but it is unlikely to catch us.

That's why, in returning to politics, "we" don't relate to the state, but to authority. Because it is authority that takes care of our "common affair". At least it should...

4. ON AUTHORITY

Today's active authorities we hate with a passion. But even with this, we don't lose our hopes and dreams, and like Alyosha Fedyashyn — the unfortunate client of Count Kaliostro, as depicted in a Russian film — we continue to dream of an ideal authority and demand that our sensual ideas become materialised.

In the ideal, authority should be responsible (so thinks 98.1%), honest (97.6%), competent (96.7%), democratic (83.9%), predictable (82%), and even authoritarian. Such high requirements, which even the founding fathers would be secretly startled by, are not explainable by our romantic nature, or the traces of a classical education. There are reasons for believing that everything is far more straightforward. Simply, "we", without relying on rank-and-file fellow citizens, have a great need for authority and clearly understand and accept our dependence on it.

Only every fourth individual (24.1%) believes that his personal influence on the direction of his own life is very significant, or at least significant to some extent. 44% assesses their

efforts somewhat more pessimistically, and another one-fourth (25.4%) could not decide, taking a middle position. More than three-fourths (76.8%) believe help from the state to be very important, only 13% is relatively indifferent to it, and only every tenth individual (10.1%) is prepared to acknowledge that it is not especially important.

Very interesting answers were received to the question “What would be the first thing you do if you won 100,000 hryvnias?” Notwithstanding all of our commendable care of what tomorrow holds in store and even fear of the future, only every sixth individual (15.9%) would risk starting his own business. Only 8.6% would spend the money on educating their children abroad, and nearly half (41.8%) would immediately take care of their urgent problems with home improvements, the purchase of expensive furniture, clothing, and other things. Almost 9% would live without sparing any expenses for some time, and a little over 1.5% would spend the win on a trip. Almost 3% would spend a large sum on a charitable cause. An affirmative response to “Would you give all of this money or a large part

of it to the state?” was given by 0.2%. And one should not doubt of the poll organisers' mental capacities. The questions are not accidental, since during the 1998 financial crisis, the citizens of South Korea donated their own valuables and expensive items en masse to the state banks with the goal of supporting their national currency. If the National Bank of Ukraine was to turn to the citizens of Ukraine today with the request to support the hryvnia in like manner, then 47% would “not give anything because they don't believe that their

donation would truly go towards supporting the national currency, but would be stolen”. 36% answered as follows: “I couldn't donate anything because I don't have any valuables”, 12.3% would not give anything, since they don't believe that protecting the hryvnia is their problem, but the state's. There were 2.7% devoted patriots who said that they would “definitely give all of their valuables, including family relics and wedding rings”.

And note: this is South Korea, not North, where one can become an altruist despite one's own will... Although many of us pine for the North Korean-like system. Meaning the Soviet Union. And this is taking place not because the

vast majority of those who so yearn were young then, as only 5.3% of those who wished to return to the past answered in this manner. What we yearn for is the feeling of confidence with respect to the future that used to exist (62.1%), the well-being (60.9%), and the high level of social guarantees during Soviet times (46.9%).

At the same time, there are no threats of a left-led revenge. Leader of Ukrainian Communists Petro Symonenko rest easy — the burden of state responsibility is unlikely to fall on his shoulders. 52.6% of Ukraine's citizens are completely uninterested in achieving such a goal. And for the 18.9% who wants this, there is 28.5% who would like a “renaissance” but understands that this is unrealistic under today's conditions.

But today's representatives of authority are not to our liking, despite the fact that they did not take the administrative buildings on Bankivska or Hrushevskoho streets by storm. We picked them ourselves, amicably voting at elections that were not held for the first time ever,



and which were, among other things, democratic. Not so? Not democratic? We are so infantile that even European observers defended us, ignorant people, saying that there was mass media and administrative pressure. Well, we are grateful for the defence. Indeed, there was pressure, and of an administrative nature. But are we not over 18 years old? Did we somehow participate in our elections, or were we just present there? And furthermore: who was in the administrative mechanism? We again.

We elected Parliament ourselves in 1998 and the President in 1999. Why? For 73.4% of the voters to immediately inform them that MPs and the President “are not patriots” or “are unlikely to be Ukrainian patriots”? This stance towards Ukraine's entire governing elite is held by all those polled. But there are also separate thoughts regarding every branch of power that we elected, as well as the ones appointed by those whom we elected.

Parliament is the leader in our negative attitude regarding present-day authorities. We may

take our ideal and place a “minus” sign next to every model quality that we desire. Only nine out of one hundred (8.8%) believe that Parliament is responsible (4 and 5 points on a five-point scale), seven times more (62.2%) gave it a mark “1” or “2” – “completely, or almost not responsible”; 11.3% believes it to be competent, while



those who think it is incompetent numbered four and a half times more (51.1%); one out of ten (9.9%) believes it to be predictable, while almost six times that number stick to the contrary view (54.2%); 17% assesses its actions as transparent, while those who don't believe them to be transparent number nearly three times more (46.7%); only six out of a hundred citizens (6.1%) gave the highest grade to the legislative branch for honesty, while almost 70% happily gave it “ones” and “twos”. With respect to Parliament's corruption, in our opinion, everything is as it should be: 59.9% believes this quality to be intrinsic to Parliament, while 13% holds the contrary opinion. Among us there are still some stubborn non-conformists.

The perception of the government — and



this should be noted — is a little softer, at least, there are less negative assessments. Most likely, that's thanks to Viktor Yushchenko, who has a sufficient reserve of national support at his disposal. There were almost 14% less strongly pessimistic assessments with respect to the responsibility of the Cabinet of Ministers for what happens than in the case of Parliament; 12% fewer negative marks for competence, nearly 10% — for predictability and honesty, 3% — for transparency of actions. But positive assessments did not veer far from the characteristics of Parliament. 54% of those polled voiced their belief that corruption is intrinsic to the government.

We were relatively tolerant with respect to the President. This demonstrates, among other things, that even under mass media and administrative pressure, we were thinking about what we were doing after all. We

extended Leonid Kuchma a new line of credit in trust. Or, if you will, restructured the old one.

The President received the highest number of votes in favour at assessment of his responsibility (30.3%), competence (35.2%), and honesty (23.4%).

Yet no one and nothing restructured the President's staff. The number of positive assessments of the staff's qualities is significantly lower than for the President himself, while nearly half of Ukraine's citizens (46.5%) believes his staff to be corrupt.

In the eyes of the people, local authorities are not far removed from the President's staff, but a little closer, in any case, than Parliament. Their corruption level collected 9% more votes than that of the presidential staff, but 5% less than Parliament.

But these marginal grades are on a five-point scale. In a situation of assessments of power structure qualities, we experienced a very interesting grouping. With rare exceptions, in the above-mentioned five-point scale, as a rule, near the three mark, a stubborn tendency of convergence in the “three” space was noted. That is to say, a given quality turned out to be not especially characteristic of a power subject, nor was it lacking. The middle — down the middle, so to speak.

Coincidence? It does not appear to be so if one considers that of 25 “threes”, 19 were occupied by a relative majority. We are almost firmly balanced around the three mark. A little to one end of the scale — the assessment is worse,

a bit to the other end — better. Not in a political sense, but in terms of prospects.

If the present, currently disliked but necessary, authorities were a little nicer to us, a little more honest and open, then we would be ready to give up the notion of the materialisation of our cherished ideas. But if not, then...

If not — then not. Nothing bad will happen. We have no plans to protest in the nearest future. Only one-fourth of those polled (26.6%) expressed their verbal readiness to take part in legally sanctioned protest actions, another one-fourth (25.9%) is inclined towards signing petitions. Only nine out of a hundred are willing to frighten authorities with unsanctioned actions, while an incomplete four individuals out of one hundred (3.7%) could devise taking over administrative buildings. In general, this even seems like a respectable number, with respect to declaring plans. But as it turns out, very few of us realistically participated in protest actions: 7.3% of citizens signed petitions, 5.5% participated in sanctioned activities, 1.4% — in unsanctioned activities, while 0.4% — in the take-over of various administrative buildings and enterprises.



In general, and on the whole, the majority of our protest actions depends, most of all, on the skills and abilities of television operators.

Because 84.5% of us will never take part in any movements, 77.4% — in unsanctioned actions, and more than half has no plans to sign petitions or to participate in legally sanctioned protest actions (53.7% and 56.2%, respectively).

And this is under conditions, let it be recalled, that the overwhelming majority of Ukrainians is unsatisfied with their lives, the authorities, their wages, etc. Can our difficult-to-comprehend love for peace and patience be

explained to the tourist who recently asked us where the museum is? No, they can't; it is not worthwhile, and one shouldn't try. He — a Frenchman, German or Pole — won't understand, in any event. He doesn't understand how it is possible to not receive wage payments for years — and to come out every spring for sowing, and in the fall — for harvesting; to not see money for months on end — and all the same, to enter the mines to dig out coal. And what will he say, if quoted the responses of one-third of those who were willing to protest and were asked the reasons behind such a long-term preparation period? Do you know the nature of their response? "There were no reasons for protesting". On a comparative scale of the effectiveness of such a response, only one other can compete with it: "I don't think that such actions are effective, because the authorities ignore them all the same". In other words, if the authorities continue to ignore my inclinations to protest, then I will increase my inclinations to do so all the more.

This kind of respectful attitude towards any form of authority is probably found among the individual traits of our character. We believe that such a submissive trait is more characteristic of Ukrainians than rebelliousness (48% of respondents versus 12%); the inclination towards obedience — greater than the ability to lead (37% versus 19%); conformity — greater than strength in convictions (42% versus 16%). If we add to all of this our well-known hardworking nature, then a portrait of a nation can be drawn which is ideal for the state and for authority. We are suspicious, and that's the reason for division; we tend towards submissiveness and impressionability; we are closed and that's why we don't admit even to our own faults, but also why we forgive them in others, including the authorities. Given that, we are obedient and hardworking.

If we were governed normally, then we could move mountains! An impression forms that we are not citizens of the country, but in the custody of the authorities. And if we take into consideration the priority qualities that we want to instil in our children, such as a hardworking nature, a sense of responsibility, and patience, then it can be predicted that the tradition of forming these character traits will continue, and the authorities will be able to take advantage of such convenient for them qualities for a long time to come. It's interesting whether it will ever enter the heads of the authorities to take advantage of them for the sake of our own wellbeing?

LIST OF PUBLICATIONS BY UCEPS' EXPERTS IN 2000

#	Author	Publication	Mass-media	Date of publication
1.	Volodymyr Saprykin	The "Trojan Horse" of Shah Deniz, or Happy New Gas, Azerbaijan!	"Region"	15/01/2000
2.	Leonid Polyakov	Conscript Service for One Year. When It Will Become Reality?	"Narodna Armiya"	26/01/2000
3.	Anatoliy Grytsenko	Should Ukrainian Army Perform the Internal Functions?	"Zerkalo Nedeli"	29/01/2000
4.	Oleksandr Manachinsky	Caucasus: the Second Chechen War	"Versiyi"	31/01/2000
5.	Leonid Polyakov	Term in Service Boots	"Ukraina Moloda"	09/02/2000
6.	Mykhail Pashkov, Igor Zhdanov	In Political Knock-Out	"Companion"	11/02/2000
7.	Leonid Polyakov, Igor Zhdanov	Crime... without Punishment	"Region"	12/02/2000
8.	Andriy Bychenko, Igor Zhdanov	Sociological Portrait of the Referendum	"Zerkalo Nedeli"	12/02/2000
9.	Viktor Skarshevskiy	Budget 2000: Absence of Deficit, the Way It Is	"Zerkalo Nedeli"	19/02/2000
10.	Volodymyr Saprykin	Chechnia Is Being Destroyed by Geopolitics	"Region"	19/02/2000
11.	Igor Zhdanov	Playing Outside	"Companion"	25/02/2000
12.	Liudmila Shanghina	Return to Power	"Companion"	25/02/2000
13.	Volodymyr Saprykin	Three Symptoms of Gas "Desease" of Turkey's Growth	"Region"	26/02/2000
14.	Oleksandr Manachinsky	Third World War: Information Warfare	"Chelovek i Zakon"	No.2, 2000
15.	Anatoliy Grytsenko, Leonid Polyakov, Mykola Sungurovskiy	Military Reform in Ukraine: Expert's Opinion Poll	"National Security & Defence"	No.2, 2000



16. Andriy Bychenko, Igor Zhdanov	UCEPS Opinion Poll: Nation, Power, Referendum	"National Security & Defence"	No.2, 2000
17. Oleksandr Razumtsev	Social Aspects of Armed Forces' Reform: the Spirit of Ukrainian Officers	"National Security & Defence"	No.2, 2000
18. Liudmila Shanghina	People of the Happy Medium? Sketch of a Socio-Psychological Self-Portrait	"Zerkalo Nedeli"	04/03/2000
19. Leonid Polyakov	Experience of Finland May Also Find Its Application in The Process of Development of Armed Forces of Ukraine	"Narodna Armiya"	14/03/2000
20. Liudmila Shanghina	The Liberal a la Ukraine	"Companion"	17/03/2000
21. Valeriy Chaly, Mykhail Pashkov	There Should Be Some Kind of Mystery in the Country	"Zerkalo Nedeli"	17/03/2000
22. Anatoliy Grytsenko	Government Program: Does Anything Like This Exist?	"Zerkalo Nedeli"	18/03/2000
23. Liudmila Shanghina	Unsecured	"Companion"	31/03/2000
24. Valeriy Chaly	International Image of Ukraine: Expert's Estimates	"National Security & Defence"	No.3, 2000
25. Valeriy Chaly, Mykhail Pashkov	International Image of Ukraine: View From Poland	"National Security & Defence"	No.3, 2000
26. Valeriy Chaly, Mykhail Pashkov	International Image of Ukraine: View From Russia	"National Security & Defence"	No.3, 2000
27. Liudmila Shanghina	Second Coming	"Companion"	07/04/2000
28. Oleksandr Manachinsky	Current Military And Political Situation And Some Issues of Ukrainian Military Security	"Arsenal XXI Veka"	No.1, 2000
29. Yuriy Bilous, Volodymyr Saprykin	The Main Issue Is Climate at Home...Made by IMF	"Zerkalo Nedeli"	08/04/2000
30. Igor Zhdanov	Reforms Are Impossible Without Creating the Majority in Verkhovna Rada	"Uriadoviy Kuryer"	08/04/2000
31. Valeriy Chaly, Mykhail Pashkov	The Opposite Side of Strategic Partnership	"Zerkalo Nedeli"	15/04/2000