

CONSIDERATION OF SPECIFIC FEATURES OF ACTIVITY WHILE IDENTIFYING RISK FACTORS OF BUSINESS FINANCIAL SECTOR

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Abstract. The article systematizes risk factors of the financial sector in Ukraine basing on the risk classification for the following groups: strategic, financial, legal, operational and reputational ones. It emphasizes that the financial sector risk factors are to be divided into those arising within bank and non-bank financial institutions, depending on their specific activity.

Keywords: risk management, financial sector, risk identification, risk factors.

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Introduction

Key issue of corporate form of ownership development today is the increased level of risk. Corporate risk management is a systematic process of risk management of corporate ownership entity, which goes along with the most effective management decisions at all levels of management aimed at both reduction or avoidance of possible losses and obtaining benefits upon the occurrence of adverse events. Corporate risk management must be integrated into the overall control system of the company and its organizational structure, is to be effective, flexible and corresponding to external changes.

Risk Factors Assessment for Banks and Non-Bank Financial Institutions

Numerous studies of corporate risk management have revealed the diversity of scientists' views on its stages. Thus, the researchers Khokhlov N.V. (Khokhlov, 2003) and A. Matviychuk (Matviychuk, 2005) distinguish the following stages: 1) risk analysis (identification, evaluation); 2) the choice of methods to influence the risk evaluating their comparable effectiveness; 3) decision-making; 4) influence upon risk (reduction, fixing, and transfer); 5) the monitoring and adjustment of results. At the same time Doba N.M. identifies only 4 stages: 1) the context of risk (determining strategic and tactical objectives); 2) risk analysis; 3) ranking and selecting risks; 4) influence upon risk (Doba, 2009). Mostenska T.L. and Skopenko N.S. offer more detailed research of risk management stages (Mostenska, Skopenko, 2010). They distinguish the following stages of risk management: 1) assessment of the economic situation, 2) problem diagnostics, 3) risks identification, 4) risk analysis, 5) determining the methods of influence upon risk 6) determining the methods of risk optimization, 7) the development of management decisions, 8) decision-making 9) influence

upon risk, 10) evaluation of the results.

The issue of distinguishing steps of risk management in financial sector is quite debatable. Thus, according to the methodology of National Bank of Ukraine there are four stages, Falyuta A.V. defines five stages (Falyuta, 2012), Kuzmak O.M., in his turn, considers seven of them (Kuzmak, 2011) and Makarenko J.P. studies only three (Makarenko, 2014).

The research of portfolio risk management in insurance deserves particular analysis. The process of the insurance of company risk management, according to Baranov A.L. and Baranova O.V., consists of the following stages: 1) risk identification; 2) risk assessment; 3) risk control (Baranov, Baranova, 2013). Osadets C.S. proposes the following sequence of risk management activities: 1) risk analysis; 2) risk control; 3) financing risk (Osadets, 2002). Sorokivska M.V. in her turn points out the necessity of recognising 5 stages such as forming setting goals, providing information support, identification and assessment, analysis of eligibility, choosing methods to neutralize risks (Sorokivska, 2012).

Summarizing approaches to the study of corporate risk management stages we should say that most scientists consider risk identification to be the first step because all further work will depend on its results. In its turn, the effectiveness of the results of risk identification is impossible without the systematization of its causes (factors).

Systematizing risk factors involves not only their classification according to types, but also defining interrelationship between them. In the process of identification of risk factors we assess conditions and causes of their occurrence, identify those activities of the economic entity which are potentially most risky. When identifying risk factors, special attention should be paid to the scope of their emergency, the degree of impact on the achievement of goals, the probability of the emergency of certain risk factors and their interrelationship. At the same time, interconnection and interdependence of different groups of risk factors determine the origin of the reasons that contribute to the risk exposures.

Risk management of financial sector differs significantly from risk management of other business areas. Therefore it is necessary to take into account their specific features (Yakimchuk, 2016). The scientists have made attempts to analyze risk factors in the banking sector (Falyuta, 2012; Makarenko, 2014) and insurance companies (Pikus, 2006; Bratyuk, 2014). In Ukraine the procedures of assessment and managing risk for banking financial institutions is determined by the existing legislature. Legal regulatory framework is the Guidelines on the organization and operation of risk management in banks of Ukraine approved by the NBU of 02.08.2004 number 361 and Guidelines for the inspection of banks' "Quantitative risk assessment system". Methodological guidelines number 361 provides the division into internal (endogenous) and external (exogenous) risk factors. It gives the opportunity to systematize groups of risk factors for banking institutions. Unfortunately, today there is no legal regulatory framework for classification of risks for insurance companies and other non-banking financial institutions in Ukraine. Thorough analysis of existing literature indicates the absence of a holistic approach to the classification of risk. It is difficult to use classifications proposed by scientists due to their complication and great number of subtypes. We believe that the comprehensive systematization of risk factors of the financial sector should take into account only the most important ones. Therefore, basing upon the studies for generalization and systematization of factors and sources of the financial sector risk of Sokolov D.V. (Sokolov, 2011), the author emphasizes the following groups as the most important: strategic, financial, legal, operational and reputational groups.

Banking institutions as leading subjects of the financial sector provide a wide range of financial services. Therefore, the risks are inherent to the very nature of their activities. Group

threats that can bring to the risk arising in banking are the following:

the strategic causes, which mean significant impact of public authorities on the conditions of activity; increasing competition among banks; unprofessional marketing policy of the bank; reduced demand for banking products and services; ineffective implementation of new banking products; frequent choice of inadequate conditions of the environment strategy of the bank; incorrect definition of the mission and goals of the bank; unsatisfactory state of implementation of strategic plans; the lack of an integrated approach to risk management; internal discrepancy between risk management and regulatory requirements; bad management;

the financial causes, meaning lower rates on the debt securities market; inadequacy and inconsistency of information exchange; unexpected fluctuations in exchange rates; change in intrinsic value of currencies; shortfall in income as a consequence of excess liquidity; borrowers' insolvency arising from failure to comply with the terms of the contract borrowing transactions with debt securities, etc; the failure of third parties to fulfil liabilities; large proportion of unsolved debts; the failure of banking institutions to fulfil their obligations; ineffectiveness of capital management; insufficient equity; not optimal dividend policy;

the operational causes, such as small size and scale of bank activity; early withdrawals of deposits; reducing balances on customers' current account; lower quality deposits; the change of the amount or time of payments on financial instruments on the part of a customer; speculative financial instruments; the increasing gap between assets and liabilities; adverse changes in the structure of bank assets; substantial reduction in the value of assets; asymmetrical revaluation rates for different types of assets and liabilities; inability to meet the needs of customers in cash; change in interest rates on term structure; interest rate policy of the bank; the wrong choice and evaluation of project; lack of confidence in the national currency; improper organization of operation procedures in contracting; imperfect system of internal control and internal fraud; the breach of health, safety and environment regulations; the disruption of functioning or safety of computer systems; inefficient processing of the bank; low capacity of the software systems of the bank; out-of-date software; interruptions in electricity supply; wrong staff policy; lack of staff motivation; errors caused by inattention, lack of concentration, wrong interpretation of information or lack of staff professional knowledge; external fraud;

legal causes, dealing with violating or not observing bank legal and regulatory activity; variability of legislation in the monetary and credit sphere; changes in tax laws; conflict between majority and minority of shareholders; non-notification or late notification of shareholders' general meeting; the change of the place and time of a general meeting after the official notification; imperfect internal procedures of registration and calculation of a quorum at a general meeting; limiting the rights of minority shareholders to obtain information as for activities of the bank;

reputational causes, such as non-transparent ownership structure; reducing the quality of customer service; ineffectiveness of Information Policy, the insolvency of the bank; lawsuits initiated by customers, shareholders and creditors; rumours, spreading negative information about the bank owners.

Insurance companies are financial institutions that face problems of managing numerous risks, which are divided into two groups. The first group is determined by the specific risky business environment, the second one represents deliberate taking responsibility for additional risks from other entities. The negative phenomena that generate the emergency of these risks are:

strategical, such as reducing real incomes; reduced demand for insurance services; the high level of competition; limited opportunities to conduct marketing research; inability or unwillingness to introduce new insurance services; unsatisfactory performance plans of insurance services; overstating profits in tariffs; imperfect investment strategy; poor management of the regional network;

financial, such as significant fluctuations in foreign exchange, credit and stock markets; undeveloped securities market; adverse changes in the financial condition of the insurance company regarding the violation of deadlines by customers or failure (partial execution) of obligations; volatility of cash flows; the insurers necessity to fulfil their obligations;

legal, such as changes of insurance licensing conditions; changes in the rules of insurance services; penalties from public authorities; ineffective control of public authorities; conflicts among shareholders; legal protection from access to customers' personal data;

operating, including lack of insurance operations; inability to launch proper agent network; faulty information flow; providing false information, concealing or distortion by customers; non-optimal tariff policy; overstatement of net rate; amateurish formation of risks portfolio; unreliable statistical basis for calculating tariffs; errors in the selection of underwriting risk; errors in the implementation of reinsurance policies; inefficient use of reinsurance mechanism; failure of reinsurers to fulfil liabilities; mismatch between capacity and structure of insurance risk portfolio; inaccuracy of calculating compliance of insurance reserves to taken obligations; the conflict between functional units of the company, in particular, the conflict between underwriter's and actuary's interests; unpredictable factors in the activities of third-party relationships; deterioration in asset quality; inefficient investment funds; limited choice of financial instruments in the portfolio; low quality front-office systems; errors in the staff activity (not making insurance payments received in cash by an insurance agent, etc.); the probability of risk for employees in calculating the tariff; dishonest personnel (espionage), psychological fatigue of employees; highly qualified staff reduction due to the optimization of management structure;

reputational, for example, the existence of negative information on the results of audits by the supervision and control; existence of facts of legalization or laundering the proceeds; lack of public information on the performance; rejection of insurance claims; low quality customer service; scandalous reputation of the owners; low corporate culture.

Activities of other types of non-bank financial intermediaries generate the appearance of risk, characterized by multidimensionality and multiplicativity. In Ukraine the activities of financial and investment intermediaries is carried out in high volatility. Potential threats to the risk groups are the following:

strategic threats, which include lack or decline of trust in these types of intermediaries; low level of financial literacy and investment culture of the population; decline in income per capita; economic conflicts with other countries, riots, acts of war, strikes; transparent competition; unfair competitors' behaviour; ineffective strategy development; lack of effective advertising campaigns; absence of prudence in the formation of investment strategy;

financial threats, such as depreciation of assets and investment income due to high inflation; high volatility in foreign exchange and stock markets; reducing the value of assets as a result of interest rates rising; decrease in the market value of securities, real estate; lack of reliable and liquid financial instruments; multiplicative factors (losses resulting from the deterioration of cooperating systems e.g. banking, insurance, stock market); for leasing companies it is lack of funds for the formation of reserves; low liquidity; reduction of long-term solvency;

legal threats, among them there are inadequacy and inconsistency of legislation (no clear mechanism for the transfer of pension assets from private pension fund to the insurance company or to the bank deposit account, insufficient regulation of pension savings accounts and pension life-long insurance contracts); lack of continuity of government in the implementation of certain types of financial intermediaries; inadequate legislation on preparation of investment returns; increase of administrative activity restrictions; insufficient legal protection of the market participants' interests; a significant number of regulatory and supervisory activities; for leasing companies it is imperfect legislative support mechanism for the securitization of assets; revocation or suspension of license;

operational threats, including profit shortfall due to the bureaucracy; incorrect practices on handling services, financial instruments, etc; discrepancy of product features and interests of customers; the lack of a broad network of investment services; dependence on the operation of third parties (asset managers, administrators, savers, consultants); failure of payment of investment income dividends; limited investment portfolio management; low investment diversification opportunities; incompetence of investment-making companies; errors in the analysis of trends and investment targets; inefficient operational management of the investment portfolio (incorrect economy and industry forecast, subject to price fluctuations of financial instruments); false definition of investment prospects; lack of control over volatility; investment in assets related entities; revenue shortfall due to the inability to perform obligations under the securities of mutual funds, numerous appeals demanding to repurchase securities of mutual funds, problems in the placement of pension reserves of private pension funds; late payment on private pension funds; suspension of work due to the software breakdown; disruptions in business operations and processes; wrong appreciation of candidates for the posts; conflicts between structural units of the mediator; inexperienced staff and lack of qualified professionals; lack of experience and knowledge of the staff; for leasing companies it is non-return or loss, damage and significant degradation of the leased object; full or partial insolvency of the licensee; impossibility of leasing object in the secondary market; lack of diversification of the portfolio of contracts; ineffective monitoring of the leasing object (no unscheduled inspections of leasing object, incorrectly folded schedule of inspections, etc.); unpredictable actions of third parties (intermediaries, insurance companies, banks, factoring companies, guarantors, etc.); fraud by participants of the leasing agreement; problems of vendor leasing object; early termination of the lease agreement; lack of enforcement of credit obligations by the licensee;

Reputational threats, first of all, the use of financial intermediaries in the informal economic circuits; fines, penalties charged by state agencies; damage to the reputation of the owners, the asset management company; lack of transparency and public information on the structure and efficiency of assets; default for customers (the existence of the facts of non-payment of investment income, non-return of accumulated pension funds, untimely redemption of investment certificates, failure to provide leasing facilities for use by a leasing company and claims of employees); negligence in meeting the obligations regarding customers; manipulative actions to guarantee the fund profitability; for a leasing company – loss of reputation of one of the leasing agreement participants; the spread of raider attacks; the conflict of owners' interest.

Conclusions and suggestions

At present stage of the Ukrainian financial sector development the improvement of risk

management requires considerable attention. In order to solve the practical problems of risk identification and assessment this article proposes the systematization of risk factors for the financial sector teams distinguishing strategic, financial, legal, operational and reputational ones. The detailed analysis of causal risk characteristics of financial intermediaries gives the opportunity to determine possible consequences more accurately and develop relative measures for managing it.

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