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## **INSTITUTIONAL STOCK MARKET TRADERS: PERFORMANCE APPRAISAL AND DEVELOPMENT BENCHMARKS**

### **Abstract**

In this article the essence and general features of institutional stock market traders are investigated. The activity of institutional stock market traders in the conditions of financial instability of the Ukrainian economy is analyzed. The problems that impede the successful functioning of stock market traders are identified. The directions of improvement of regulation of activity of institutional stock market traders of Ukraine are offered.

**Key words:** stock market, institutional stock market trader, securities, stock exchange, institutional investors, non-state pension funds, insurance companies, joint investment institutions, asset management companies, self-regulatory organizations, broker, dealer.

### **INSTYTUCJONALNI HANDLOWCY GIELDOWI: OCENA SKUTECZNOŚCI I WSKAŹNIKI ROZWOJU**

#### **Streszczenie**

W artykule badane są istota i ogólne cechy instytucjonalnych inwestorów giełdowych. Analizowana jest działalność instytucjonalnych inwestorów giełdowych w warunkach niestabilności finansowej ukraińskiej gospodarki. Identyfikowane są problemy, które utrudniają skuteczne funkcjonowanie handlowców giełdowych. Zaproponowano kierunki poprawy regulacji działalności instytucjonalnych inwestorów giełdowych na Ukrainie.

**Słowa kluczowe:** rynek papierów wartościowych, instytucjonalny inwestor giełdowy, papiery wartościowe, giełda, inwestorzy instytucjonalni, niepaństwowe fundusze emerytalne, firmy ubezpieczeniowe, instytucje wspólnego inwestowania, spółki zarządzania aktywami, organizacje samoregulujące, pośrednik, dealer.

## Introduction

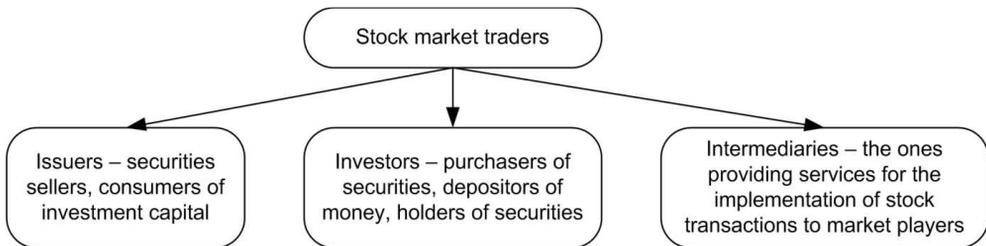
The stock market is one of the important elements of a modern market economy, and the financial system in particular. In connection with the dynamic development of the securities market and the ability to influence the country's economic development, there is a need to determine the efficiency of functioning of the stock market in the modern economy. Therefore, in order to accelerate economic development, it is expedient to create conditions for the rational use of the opportunities of stock market institutions and ensure maximum transparency and openness of the market.

In general, the effectiveness of the functioning of the stock market players is a comprehensive reflection of the final results of the financial resources of investors to meet the needs of all market players.

## Main part

In the scientific literature, the notion of "institutional traders" is regarded as legal entities that are not bodies of state legal regulation, in particular enterprises, institutions, societies, companies, foundations, corporations and other organizationally formed institutions acting on the basis of their statutory documents.

The players of the stock market are often divided into the following categories (Figure 1): issuers, investors, intermediaries.



**Fig. 1. Traditional classification of stock market traders**

Source: comprised by the authors.

Individual scholars divide stock market institutions into two groups: basic and infrastructural. In particular, V. Pasichnyk refers to depositors, registrars, self-regulatory organizations, audit firms, stock exchanges, consulting firms, trade and information centers<sup>1</sup>. V. Kolesnyk believes that the main traders include issuers, investors, intermediaries, regulators, special government bodies of the stock market<sup>2</sup>.

<sup>1</sup> В. Г. Пасічник, *Ринок цінних паперів: Навчальний посібник*, Центр навчальної літератури, Київ 2005.

<sup>2</sup> В. В. Колесник, *Введение в рынок ценных бумаг*, А.Л.Д., Київ 2011.

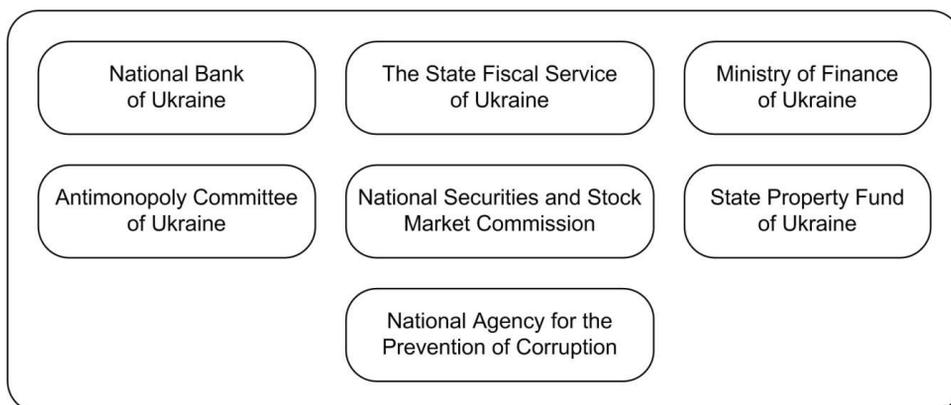
Scientists M. Kolisnyk, O. Maslak, E. Romaniv argue that the traders in the stock market should include:

- consumers (enterprises, authorities);
- suppliers (households, institutional investors);
- securities traders;
- players serving the market (auditing, consulting firms);
- regulatory bodies that regulate the activities of market actors<sup>3</sup>.

In Ukraine, securities issuers include state authorities, local administrations, and legal entities. The data of the participants can be considered as players of investment activity, who have the opportunity to carry out operations for investing their own, borrowed and attracted monetary, property, and intellectual property.

Functioning of stock market institutions is regulated by state authorities. Therefore, the National Securities and Stock Market Commission as the main link in the system of regulation of the domestic securities market and other authorized bodies are in close interaction and interconnection (Figure 2).

Considering the division of functions in relation to the regulation of the stock market among state authorities, it should be noted that the formation of state policy is entrusted to the National Commission on Securities and Stock Market.



**Fig. 2. Interaction of the National Commission on Securities and Stock Market with other state bodies**

Source: comprised by the authors.

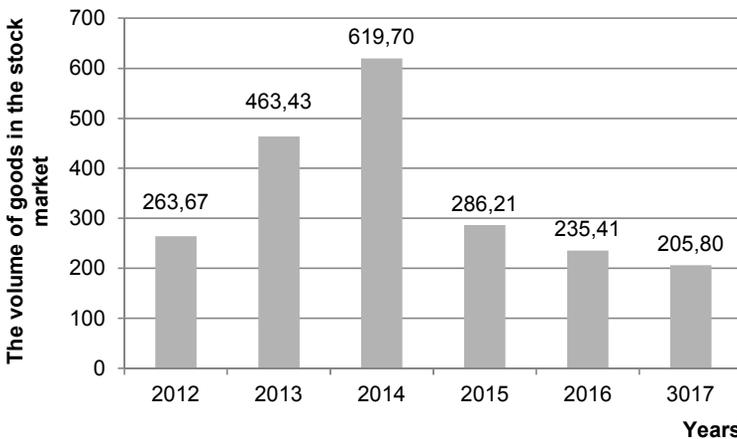
In the domestic stock market, in general, there are similar features, as in most major emerging markets. On the one hand, we are witnessing high rates of positive quantitative and

<sup>3</sup> М. К. Колісник, О. О. Маслак, *Фінансовий ринок: Навч. посібник*, Видавництво Національного університету «Львівська політехніка», Львів 2011.

qualitative changes; on the other hand, there are numerous problems that hinder its more effective development<sup>4</sup>.

It is worth noting the significant degree of backlog of the domestic stock market from the leading developed markets for certain categories of qualitative indicators (market liquidity, dividend yield). Obviously, the stock market is still performing one of its most important macroeconomic functions, namely, transforming investment savings, as more and more enterprises in the real sector of the economy begin to see it as an alternative source of resources to finance investment in fixed assets and Merger and Acquisition Agreements. In addition, since 2006, there has been an increase in the number of citizens investing in stock market instruments. At the same time, the domestic stock market is not yet the most attractive tool for accumulation of capital for the majority of the population and the source of investment resources for most enterprises, and, consequently, can not perform the full range of functions inherent in developed stock markets. Ukraine still has a very low share of private individuals and collective investment institutions in the aggregate structure of investors<sup>5</sup>.

The stock market in one or another country is characterized, first of all, by the volume of stock trading in securities, the number of securities traded on stock exchanges. According to the results of 2017, the volume of trades on the organized securities market fell by UAH 29.61 billion compared with the indicator in 2016, and amounted to UAH 205.8 billion (Fig. 3).



**Fig. 3. Volume of exchange contracts with securities on stock exchanges during 2012-2017, UAH billion**

Source: comprised by the author according to data (Пасічник, 2005).

<sup>4</sup> М. О. Кужелев, *Розвиток інфраструктури ринку цінних паперів: сутність та елементи*, „Збірник Наукових Праць Університету Державної Фіскальної Служби України” 2016, №2, с. 145-156.

<sup>5</sup> М. В. Стецько, *Фінансовий ринок України у контексті глобальної конкурентоспроможності*, [в:] *Економічний аналіз: зб. наук. праць*, ТНЕУ, Тернопіль 2016, Т. 25, № 1, с. 159-168.

The volume of stock exchange contracts with securities at trade organizers during 2012-2017 varies significantly. So, 2012-2014 is characterized by a positive trend, as the volume of stock exchanges significantly increases. In 2015-2017, the volume dynamics decreases. This dynamics is primarily caused by the loss of investors' confidence in the securities market, political instability, which has a very negative effect on the Ukrainian stock market.

The largest volume of trades on financial instruments at trade organizers during the specified period was fixed with government bonds of Ukraine – UAH 189.6 billion. (92.1% of the total volume of exchange contracts on trade organizers) (Table 1).

**Tab. 1. Volume of stock exchange contracts with securities on trade organizers with distribution by type of financial instrument in 2017, UAH million**

	<b>Stocks</b>	<b>Bonds of enterprises</b>	<b>Government bonds of Ukraine</b>	<b>Investment Certificates</b>	<b>Derivatives</b>	<b>Total</b>
January	133,88	213,66	13 677,22	1,79	357,42	<b>14 383,97</b>
February	115,93	348,47	20 986,12	1,25	186,28	<b>21 638,04</b>
March	175,26	78,89	22 236,97	2,31	196,50	<b>22 689,92</b>
April	166,91	96,09	14 135,68	3,05	565,98	<b>14 967,69</b>
May	133,93	145,92	13 240,81	4,06	268,63	<b>13 793,36</b>
June	111,22	795,29	10 437,38	6,67	305,18	<b>11 655,39</b>
July	130,52	547,38	12 579,80	4,41	195,39	<b>13 457,49</b>
August	3 221,15	750,20	14 899,74	7,72	355,89	<b>19 234,72</b>
September	224,97	638,65	14 137,07	1,77	363,75	<b>15 365,21</b>
October	216,33	440,75	16 610,28	4,16	331,35	<b>17 602,88</b>
November	168,16	902,16	14 085,60	3,10	1 152,48	<b>16 311,50</b>
December	253,30	1 162,63	22 528,34	11,54	740,14	<b>24 695,95</b>
<b>Total</b>	<b>5 051,56</b>	<b>6 120,09</b>	<b>189 555,01</b>	<b>51,83</b>	<b>5 018,99</b>	<b>205 802,50</b>

Source: (Пасічник, 2005).

Consequently, the organized market in the structure of trades in terms of financial instruments is in fact the market for the circulation of government bonds (90%). The volumes of trading with other securities remain at the minimum level and consist mainly of several issuers whose demand for securities is formed by a limited number of traders.

During 2017, compared with the data of the same period in 2016, the volume of exchange contracts with securities at trade organizers decreased by 14.4% (or UAH 38.1 billion) (January-December 2016 – UAH 235.4 billion).

The modern stock market is not attractive enough for its players, and therefore requires a gradual expansion. Reducing the share of securities in the assets of institutional investors negatively affects the economy as a whole, and in turn, it can lead to containment of the secu-

rities market development, the growth of the investment business shadowing, and the use of opaque investment schemes by traders.

A mixed stock market model has developed in Ukraine historically. In this market, both commercial banks that carry out the entire list of securities transactions and non-bank investment institutions participate simultaneously. Domestic stock market is a dynamic market with fast growing volumes of operations, as well as diversified financial instruments. The Ukrainian stock market has the same characteristics as most of the major emerging markets. Here, on the one hand, there is a high pace of quantitative and qualitative changes, and on the other – numerous problems that impede its development. The American model, which is aimed at most of the countries that are just shaping their markets, is considered to be more effective and deeply thought over. The American model differs from the European one, first of all, by the deep interference of the state in the regulation of the stock market. The differences between the European and American models are given in Table 2.

**Tab. 2. Comparative analysis of American and European stock market models**

Peculiarity of comparison	American model	European model
Possibilities of combining professional activity in the stock market	Banking institutions are prohibited from engaging in investment activities, and investment - classical banking operations. There are limitations on the combination of professional activity in the securities market	Banks are allowed to combine ordinary banking transactions with securities market operations. Securities market traders can combine several types of professional activities.
The role of banks in the stock market	Can only carry out custodial activities	Provide a full range of financial services, can carry out custodial activities
Type of system of accounting for securities rights	Distributed system	Centralized system, fixed by law
The presence and role of registrars	At the first level there are system registrars	No registrars
Degree of state regulation	Rigid regulation	Low level of centralization of supervision and control
The role of nominal holders	"Splitting" of securities secured by rights between the owner and the nominee holder	"Splitting" is not allowed. The owner is always listed in the register

Source: comprised by the authors.

The so-called self-regulatory organizations play an important role in the securities market in individual states. In different countries, they exist on the basis of certain factors, in particular: established traditions, norms of law, organization of the economic system, etc. Therefore, depending on these factors, the role of self-regulatory organizations can be significant or minimal. This situation is explained by the fact that, for example, in Germany, France, the main role is played by public authorities, so there is no need to create such entities. If we take into account such countries as the USA, Japan, Great Britain, then the state does not take much

participation in the regulation of the securities market, and accordingly, self-regulatory organizations are created.

Also, we should note that the US has a regulatory body – the Securities and Exchange Commission, which develops and verifies the implementation of laws relating to the stock market. Other regulators perform functions that are directly related to the protection of investors from financial losses. First of all, it is ensuring registration of all players of the securities market (candidates must have a minimum equity capital), as well as reporting full precise information to the traders.

In the UK, the power to regulate the stock market is transferred to organizations that have the appropriate rights. The Securities and Investment Board (SIB), which served as an observer and controller, was created, but it did not have the status of a self-regulated organization. By law, the SIB has the right to independently issue licenses for conducting investment activities in the securities market or may delegate these powers of the SRO, which has been practically done.

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Changes in tariff regulation should be a priority measure in the direction of improving the activities of institutional traders in the stock market. Infrastructure organizations should be customer oriented and their tariffs should be transparent, understandable and predictable for customer service.

Another logical step towards improving the activities of institutional stock market traders is the maximum possible refusal to exchange documents in paper form and the transition to electronic document circulation, working on common standard principles, using common encryption mechanisms and formats of documents transmitted. Actions in this direction will lead to accelerated settlement of transactions and significantly simplify the collection and processing of information on the operations performed.

One of the basic components of the stock market infrastructure is the accounting and calculation system, the fragmentation of which today leads to the fact that its risks and cost become unacceptable for professional investors.

For this reason, one of the most important tasks of the development of institutional stock market traders is to improve the procedure of delivery and accounting of securities rights by organizing their storage and easy access to them. The fulfillment of these priority tasks will

increase the level of trust from a wide range of investors to the national stock market and will determine the movement of investment from currency instruments in the stock<sup>6</sup>.

In our opinion, it is expedient to have such a model of the infrastructure of stock market traders, in which all institutions would work on the common goal of capitalization of the market and increase its liquidity. This requires a single strategic development center for an organized stock market, in close cooperation with the responsible government body.

In addition, the growing number and variety of financial instruments offered by the global stock market at the present stage of its development, a large number of factors affecting the change in their value, leads to the fact that the individual investor is often not able or willing to assess the entire set of risks, related to investing in specific financial instruments. The process of delegation of authority and responsibility for making an investment decision leads to the formation of a system of increasingly specialized financial intermediaries.

From our point of view, these tasks should be put on institutional investors, which will combine the functions of investment advisers and suppliers, to act as registrars and depositaries, protect investors from fraudulent actions of third parties, act as insurance organizations to minimize the risk of loss of investor funds.

In order to improve the efficiency of banks in the market of depository services, it is expedient:

- NSSMC is to provide legal authority for investigating all problems in the system of registrars and the application of necessary measures, the imposition of disciplinary sanctions, including the cancellation of the license of those registrars who violate the law and resell the registers. NSSMC should improve its oversight function by strengthening existing self-regulatory organizations by empowering them to eliminate such fraud for the sake of security and reliability of the system;
- to unify the interrelations among the members of the depository system and streamline the activities of its direct traders by introducing operational standards of professional activity based on modern financial and information technologies, with the provision of these traders with a single electronic document circulation.

Along with this, in our opinion, in order to improve the activity of institutional traders in the stock market, it is expedient:

- to strengthen and expand the system of state guarantees for loans to socially significant projects and types of economic activity, in particular – small businesses;
- to use the mechanism of partial or full nationalization by means of acquiring shares of problematic institutions at the expense of budgetary and other state resources;
- to modernize the system of mortgage lending by creating and including stable financial institutions with powers to guarantee mortgage and its regulation;
- to implement in practice the strategy of asset management using urgent market instruments;

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<sup>6</sup> Г. Яцюк, *Модернізація торговельної інфраструктури ринку цінних паперів*, В: *Фінансова інфраструктура України: проблеми та напрями розвитку*, Криниця, Київ 2013, с. 170-172.

- to increase the efficiency of work and interaction of state financial regulators and law-enforcement bodies for the implementation of state regulation, control and supervision of the stock market;
- to expand the state regulation and strengthen it in the part of banking and insurance business, overseeing the trading of securities, and arrange operations with their derivatives<sup>7</sup>.

In order to successfully develop the activity of institutional players in the stock market, it is expedient to introduce a single standard of professional activity for the safe transition of the majority of traders to complete automation of securities accounting, which will significantly improve the overall quality of the proposed software products and reduce their cost to the end user<sup>8</sup>.

In our opinion, self-regulated organizations play a key role in issues of licensing, the establishment of common standards for professional activities, supervision and reporting.

Therefore, we propose to introduce a model of the infrastructure of the self-regulated domestic stock market, which includes:

- active involvement of institutional traders in the development of the regulatory framework;
- development and introduction of common standards of professional activity for all traders of the stock market, as well as principles of corporate behavior;
- expansion of institutional traders in the spectrum of services provided with simultaneous reduction of their cost;
- organization of work on standardization of document circulation of institutional traders in the stock market;
- reducing the costs of state regulators for direct supervision of all professional stock market traders, licensing and reporting;
- modification of software in order to increase the efficiency of professional activity in the stock market;
- implementation of programs to reduce the level of risks accompanying the activities of institutional traders in the stock market;
- improvement of the quality of consulting services on all issues related to the implementation of professional stock market activities (reporting, certification, licensing);
- elimination of existing shortcomings of the infrastructure of the national stock market, and not only solution of problems in the short-term period;
- improvement of the internal monitoring and control system in order to increase the efficiency of the state regulation of the stock market.

Stimulation of investment in the stock market should be accompanied by improvements in taxation. Compensation and insurance schemes can be an important means of stimulating the play of retail investors in the stock market. Also, in order to protect investors, the issue of exclusion of stock market traders from among the participants in compensation schemes

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<sup>7</sup> В.М. Ячменьова, *Чинники, що впливають на рівень стійкості функціонування фондового ринку*, „БізнесІнформ” 2013, № 10, с. 328-336.

<sup>8</sup> Л.М. Алексеєнко, М.В. Стецько, Г.М. Кулина, *Фінансовий ринок: навч. посіб.*, Тернопіль 2016.

should be regulated. This system should be built on the principles of compulsory insurance, which provides, by analogy with the mechanism of insurance of bank deposits, standard deductions of funds by institutional traders in the stock market.

At the same time it is advisable to create effective legal regulation of the system of financial services offerings to retail clients. In particular, require clarification of the rules for the admission and execution of client orders, reporting. It is important to create rigid and effective legal and organizational barriers, to review the law enforcement practice of law enforcement agencies with the participation of self-regulatory organizations of the stock market, which impede the unlicensed activity of attracting funds to the population.

At the same time, we propose to unify the requirements for the consolidation of funds of the founders of trust management and their joint investment. Today, the pooling of funds can be made within the framework of investment, mutual funds, partially non-state pension funds, and also under special rules such association is carried out within the framework of general funds of bank management created by credit organizations. To increase the volume of collective investment instruments and increase their liquidity it is expedient to create a centralized system of clearing and calculation of transactions, issuance, exchange and redemption of investment shares.

The high level of development of institutional stock market traders today is a prerequisite for ensuring sustainable and dynamic economic growth. The implementation of the proposed measures will make it possible to strengthen supervision and control on the securities market and improve the effectiveness of long-term monetary and financial policies aimed at strengthening the stability of the domestic financial market and its institutional players.

## **Conclusions**

The dynamics of the functioning of the Ukrainian stock market remains disappointing: the volume of trade is decreasing, the symptoms of the unhealthy stock market worsen with a negligible share of stock trades with a steady tendency to further reduce the latter, the vast majority of stock market organizers are loss-making. Therefore, there is a noticeable reduction of institutions during 2012-2017. The total nominal value of securities owned by the securities holders and by types of individual stock market traders is analyzed, where it is observed that in legal entities-residents it is the highest in the general structure, the smallest share was recorded for individuals-non-residents and territorial communities. The analysis of world models of stock exchanges development on the example of the USA, Germany, France and Poland showed that each country has its own way of developing the stock market. The functioning of institutional traders of the stock market of foreign countries is substantiated. The main differences between the American and European models of the securities market organization are outlined. We considered the regulatory authorities of the leading countries of the world, the most influential stock exchanges, the specifics of the activities of self-regulated organizations. It is revealed that the main problems hindering the effective functioning of the traders in the Ukrainian stock market are: low level of protection of the rights of owners and

buyers of securities; imperfection of the regulatory framework; low level of information provision of market traders, resulting in shadow financial transactions with securities; the lack of equal conditions for all real and potential traders in the performance of operations related to the purchase/sale of securities; high degree of risk; lack of trust among market traders.

In order to improve the activities of institutional traders in the stock market, a number of complex measures can be proposed to create conditions for growth of real incomes of the population. The main constraints in accessing the private investors market are low income levels; to create conditions for the uniform distribution of financial flows within the country to stimulate regional stock markets and their infrastructure; to reduce the tax burden on standard securities transactions, which will undoubtedly trigger the activation of the stock market; to determine the unified order and rate of taxation of various financial instruments; to review priorities in the field of fiscal policy in the direction of growth of investment flows from the state; to improve measures to protect the interests of domestic and encourage long-term investments by foreign investors; to increase the attractiveness of the stock market by reducing political risks, a set of measures to protect the interests of business issuers.

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