COOPERATION AND COMPETITIVENESS IN FINANCIAL SECTOR

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MY CHALLENGE – C&C in Fin. sector
Outlining some specific cases of relations between C&C in fin. sector.

- cooperation
- competitiveness

The general question of ***Cause and effect*** may have some interesting reasons. Although, I saved my time to think over this question.

I MARKED 3 TASKS:

1) Hidden relationships;
2) Non standard relations on financial market;
3) Some modern tools transforming competition in to cooperation, without affecting negatively the market.

A KIND OF FINAL GOAL IS:
Directing a real salvations, in investors community, from conventional practice to contemporary tools and techniques.

- Setting the financial institutions and investors free from conventional possibilities and introducing a new appropriate techniques.

OBJECTS:

- insurance; credit market; capital markets.

SUBJECT OF RESEARCH:

- Reinsurance;
- Financial derivatives (SWAPS, Credit Derivatives ..);
- A **case of market acting** of Mutual Funds and managing the resulting **market risk**;
- Constructing an instrument for diversification a **liability risk** without loosing a key clients - big investors.

All these instruments **benefit Competitiveness through Cooperation**.

1. INSURANCE MARKET

- Insurance companies, Reinsurance – number, market volume – *proportion*;

The number of Insurance companies changes and generally rises, for 2007 figures are:
Life Insurance – 15 Ins. Companies, 1 Reinsurance company (DZI).
Common Insurance – 19 Companies, 8 Reinsurance companies.

Concerning Life Insurance, we may see the lack of competition and the monopoly in reinsurance, but it has understandable explanation, having in mind, the specifics of Insurance. The reasonable here is the established practice for managing the global insurance market risk, through cooperation and without loosing competitiveness.

2. BANK SECTOR, SPECIALLY A CREDIT MARKET

There was global tendency of consolidation of Bulgarian bank sector in the last year of the new millennium.

After the years of stagnation and conservative and cautious acting till 2000, 2001, credit market In Bulgaria assume aggressive behaviour and the volume have rise dramatically last 4 years.

Bulgarian credit market for 2007 the average mortgage credit size is rose with 48,5 % to 36.000 Euro.[1] The number of granted mortgage credits went up with 75 %.

There is many different relations and models of managing competition in bank sector through cooperation. The contemporary techniques are related with constructing a new forward and market instrument and tends to derivatives. Interest rate derivative, Credit Derivatives, Structured derivatives.

The first credit derivative is used by Merrill Lynch in 1991. Credit derivatives are submitted officially in 1992. In 1993 these instruments gets a pessimistic appraisal. Four years later in 1997 (after Asia finance crises) credit derivatives gets very fast popularity.

The base forms of credit derivatives may be grouped as follow:

1) Credit risk swaps: ***Credit Default Swap; Credit Event Swap****;*
2) ***Total Return Swap;***
3) ***Credit-Linked Notes*** *(known still as* ***Credit Default Notes****);*
4) Credit spread products: ***Credit Spread Forward; Credit Spread Option; Credit Spread Swap.***

In our days the most attractive instruments are so called Structured derivatives.

It is materially to mark here, that derivative instruments in fact slow down the risk on underlying assets and instruments, which is cooperation and in the same time making transaction prove competition between market participants. The speculative aspect, which is also very strong, is another side of the coin. The speculative trade proves the market liquidity and also benefits loyal competition. Dealing between both parts of derivative contract is in fact “Cooperation”. In above mentioned derivative contracts the parties changes not only risky positions, they changes a risky clients. The result is lower risk for bout sides (Bank institutions), lower market risk and in the same time higher competition (in credit terms).

[1] http://pazari.dnevnik.bg/show/449201/

3. CAPITAL MARKET

Official cooperation:

10 of April this year Vienna Stock Exchange started to calculate a new index for BG-capital market - ***Bulgarian Traded Index (BTX)***[2]. BTX excerpt includes 7 most traded companies, with biggest capitalization.[3]

The benefit is undoubted – for the short period of 2006-2007, after starting the mutual project with Romanian stock exchange there are invested over 270 million EUR in companies listed at ***Bucharest Stock Exchange***.
Isn't it a case for ***"cooperation over competitiveness"?***
And it is only a simple example. Venice Stock Exchange issues 22 indexes over national, regional and sector stock markets from Central and South-eastern Europe.

It is also very important to mark, that **BTX may be used as underlying instrument for standard derivatives**. (a short brackets: It happens in the same time, when Bulgarian investment community continues to scare of financial derivatives). And it is not the first derivative based over Bulgarian financial instrument. There is futures trading over SOFIX from the beginning of last (2007) year.

One of the last cases for not legal acting:
US Securities and Exchange Commission have lodged an action upon the London Hedge Fund "Headstart Advisers" by assertion of illegal securities trade. (13 Apr. 2008, by information of Daily Telegraph)[4].

A case of legal action, pushing the market to abnormal behaviour
In the end of 2007 Bulgarian Pension Fund "Allianz" draw out his all invested capital from the market. It was about 50 million BGN (Bulgarian leva). ItIt was extremely abnormal supply for BSE-Sofia. As a result the praises started to fall dramatically. It marked the categorical beginning of bearish market, which is continue already fifth month.
How the Cooperation and Competitiveness work here?

- At firs look: we can see all other market participants as grate losers (specially when we have not *short selling* possibilities).
- Second: the mutual funds are in competition between themselves for Pension Funds resources – *it is positive for the market in general*.

But in our case Allianz redirected his capitals from capital market.

There is another interesting question – concerning the evaluation method which is used for **value the price of fund shares**. It is very important for all market participants to have objective information.
Aiming to avoid market manipulations, the price of purchased stocks is used when the volume is at least 0,2 % of the issue. This price is averaged with the last closing Bid.

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[2] http://news.expert.bg/n155695/
[3] (Monbat; Chimimport Plc; Kaolin; First Investment Bank; Corporate Commercial Bank; Eurohold Bulgaria Plc.; Industrial Holding Bulgaria Plc.)
[4] http://pazari.dnevnik.bg/show/?storyid=484283

From our point of view, the two most crucial market players have really very interesting relations: **Investment mediators and Managing companies.**

- **Investment mediators**
    - IM – Exchange members and Not members.

The last part – the mediators who are not members of Stock Exchange, are functionally related with exchange members. Both categories are in the same time in competition and cooperation.

The number of BSE members is 70, from 85 Licensed Investment mediators.[5]

- **Managing companies** number 25, Established to Investment mediators.

Specific form of cooperation among Bulgarian Managing Companies, specially in a critical problems for the market, is the Good practice to convoke not formal meetings between themselves and with Government Supervision Commission. By opinion of the professional investors guild, this communication is very beneficial.

IPO (initial public offer) – the *Managing Companies* competes for IPO (purchase new issues). Of course, the most succeed Managing companies are these, which are founded to *Investment Mediators*. It's known there is bigger speculative potential (bigger profit for short period and parallel risk, of course). These circumstances generate a greater demand. It makes the procedure of satisfying the purchase offers very important. It is so called "Book-building".

The procedure of "Book-building" comprisesnsists one unclear stage. The technology of defining: Whom? and How many stocks to be written? – is a kind of "Black-box".

We can not missed here Integration and Convergence tendencies in capital markets, as it selves. Exchange integration itself.

<u>The role of science?</u>

To propose solutions, helping to optimize practice.

More concrete, in our case it may be:

- Developing the regulations;
- Constructing a new instruments;
- Developing the evaluation models.

In normal contemporary practice the market risk is hedged by forward, futures and other derivative instruments. classical techniques

By analogy of Credit Derivatives (specially Total Return Swaps)[6] it is possible to construct an instrument for restructuring investment portfolios.

Such instrument may be very useful for investment funds, specially when they whish to restructure them portfolios and massive sells will push the market down. Only the speculators whit short positions gain from the last. Probably it will be not so far the time, when the biggest funds (like pension funds) will choose different investment (mutual) funds and investment mediators. But changing a big shares in portfolio may be done by analogy of credit derivatives.

[5] http://www.bse-sofia.bg/?page=List+of+BSE

[6] Gregory, Jon. Credit Derivatives, 2003, 1-st ed. Publisher Risk Books.

In Conclusion we may outline the following findings:

The practice in financial market has created natural tools to sustain market risks and competition, to cooperate and to keep the market healthy. As classical example, we may mention: mergers, reinsurance, investment.

The newer sector – finance investments and capital market attracts bigger capitals and tends to create more dynamic instruments in derivative segments. Contemporary practice in financial sector develops in direction to construct hedging and speculative instruments, which are practically cooperation and prove the competition.

SUMMARY:

Development, Cooperation and Competitiveness in Financial Sector

With present paper the author makes an attempt to outline several patterns of contemporary development and specific cases of relation between cooperation and competitiveness in the financial sector. Generally it aims to outline some covert relationships; non-standard financial market relations, and some modern tools that transform competition into cooperation (without negatively affecting the market).

Further in this paper the author seeks to direct the managing pattern and real solutions in the financial sector (especially on the Balkan financial markets) from conventional practice to contemporary tools and techniques. It departs from reinsurance and bank limitations to financial derivatives (SWAPS, credit derivatives, etc.).

Following the deductive logic the paper focuses on a case of liquidity of investment funds (especially for limited capital markets) and the resultant risk management problem. As a solution we propose to construct an instrument for liability risk diversification without loosing key clients and big investors.

Finally, the author attempts to prove the assertion - ***These instruments develop the financial market, improving competitiveness through cooperation.***

KEY TERMS:

- investment funds;
- liquidity risk;
- derivative instruments;
- reinsurance.

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