SPECIFICATIONS OF THE SOURCES OF SECURING INSURANCE COMPANY'S FINANCIAL STABILITY

Mariia BALYTSKA[1]
Taras Shevchenko National University of Kyiv, Ukraine

Abstract. *The purpose* is to generalize the methodological concepts of domestic researchers in sources of insurance companies' financial stability provision. The need in developing and deepening both theory and practice upon the issues of improving financial stability of the Ukrainian insurance companies facilitated the following tasks: analysis of methodical approaches of native researchers concerning division of financial stability sources; highlighting the most important sources of securing financial stability for insurance companies; feasibility of the role and essence of each factor securing financial stability for insurance companies. *Methodology*. The study is based on the theoretical analysis of scientific works and practical activity of enterprises. Methodological basis of the article are methods of scientific cognition, which enable to expose basic conformities to the law of development of the insurance companies, priority ways to ensure their financial sustainability. Such methods are in particular used: analysis and synthesis – during research of financial stability of the insurance companies; systematizations – for revealing factors of maintenance of financial stability of insurers, their detailed analysis and definition of their interrelation; scientific abstraction – with the purpose of forming theoretical generalizations and conclusions. *Results*. The insurance sector plays an important role in the provision of critical financial services. But insurers are exposed to a number of risks and can become distressed or fail. The article examines the essence and importance of insurance company's financial stability as an important factor in the development and functioning of the insurance market. The economic essence of the general theoretical issues about the financial stability of insurance companies is reviewed and analysed. The main features of insurance companies and the factors that affect their financial stability are investigated. *Value*. The economic and social importance of insurance is such that the intervention of public authorities, in the form of prudential supervision, is generally accepted to be necessary. Not only do insurers provide protection against future events that may result in a loss, they also channel household savings into the financial markets and into the real economy. The intervention of public authorities has tended to focus on introducing the measures that seek to guarantee the solvency of undertakings or minimise the disruption and loss caused by insolvency. Therefore, the study of the legislative regulation of the factors of providing financial stability of insurance companies is of strategic importance towards creating a stable insurance market in Ukraine.

Key words: insurance company, financial stability of insurer, insurance company equity, reserves of insurer, reinsurance, tariff policy of insurance company.

JEL Classification: G200, G220, G280

1. Introduction

Insurance and reinsurance companies are an important and growing class of financial market players. They are becoming ever more significant investors and intermediaries in a wide range of financial markets across the globe, bringing innovative approaches to capital markets, providing insurance coverage for financial risks, mediating in the reinsurance market, as well as developing new tools that help bridge the gap between banking and insurance products.

In particular, the gradual blending of boundaries between the insurance and other financial institutions, especially in the over-the-counter derivatives market, entails the increasing role of the insurance industry for the systemic financial stability.

As a result, a stronger emphasis on the prudential supervision of the financial risks (as opposed to underwriting risks) will be important for ensuring financial stability.

Under market relationship, the prevailing task of analysing the company status shall be not only accounting monetary flows but also the research of its financial and economic status and financial stability. Financial stability is one of the most important features of any company status and behaviour in respect of external and internal changes.

Corresponding author:
[1] Department of Insurance, Banking and Risk Management, Taras Shevchenko National University of Kyiv.
E-mail: mari12197@yandex.ru

Security of the insurance company's financial stability is quite a complex process related to regular control of all the insurer's activities and prompt response of the company management to external and internal changes.

2. Research analysis and problem statement

Financial stability of the insurer and impact of various factors on its level have been displayed in numerous scientific researches of national and foreign scientists and practitioners, such as M.M. Aleksandrova, V.D. Bazylevych, V.D. Bigdash, E.N. Bochkaryova, N.M. Vnukova, N.B. Gryshchenko, N.M. Dobosh, M.G. Zhygas, O.M. Zaletov, A.A. Kudryavtseva, S.V. Lukonina, V.V. Maslenikov, O.P. Ovsak, S.S. Osadets, A.V. Palkina, V.A. Sukhova, Yu.N. Tronina, V.M. Filonyuk, O.F. Furman and many others.

Despite a variety of scientific opinions regarding essence, theory and practice of securing financial stability of insurance companies, such issues still remain not enough investigated.

3. Sources of the financial stability of the insurance company

Despite the large essence of financial stability of insurance company, the principal regulatory act upon insurance – the Law of Ukraine "On Insurance" has no definition of the essence of insurers' financial stability and its security terms; while only Section III of the Law of Ukraine "On Insurance" devoted to securing the insurer's solvency (in particular, Article 30) formulates basic terms to be complied with by the insurance company for the purpose of securing solvency, namely:

– Paid insurance fund for resident insurers or guarantee deposit for branches of non-resident insurers and the insurer's guarantee fund;
– Insurance reserves enough for further insurance payments and insurance reimbursements;
– Exceeding actual stock of the insurer's solvency over the estimated standard solvency stock (The Law of Ukraine "On Insurance", 1996).
– Meantime the concept of financial stability is quite broader than the concept of solvency; thus, apart from legislative provisions, the economic literature contains the larger list of sources serving as grounds for the financial stability of insurance companies.

In practice, apart from compliance with legislation, financial stability of the insurer is grounded on the following sources:

– Enough scope of the own capital;
– Grounded tariff policy;
– Balanced insurance portfolio;
– Enough scope of insurance reserves;
– Reinsurance.

4. Enough scope of the own capital as the basis of financial stability of the insurers

Grounds for the insurer's financial stability are fixed just in the process of its incorporation. At this stage, the essential terms are the amount and structure of share capital required for commencement of its activity, since for the first time insurance company has no funds but share capital for the purpose of fulfilment of its obligations under insurance agreements, while insurance investments at this stage are quite small. Both in Ukraine and abroad, share capital shall be formed in the manner and under the terms prescribed by the current legislation and constituent documents. The insurer's own costs shall be formed at the expense of founders' investments as well as by means of additional share emission. The own capital shall consist of share, additional, reserve capital and undistributed profit (Fig. 1).

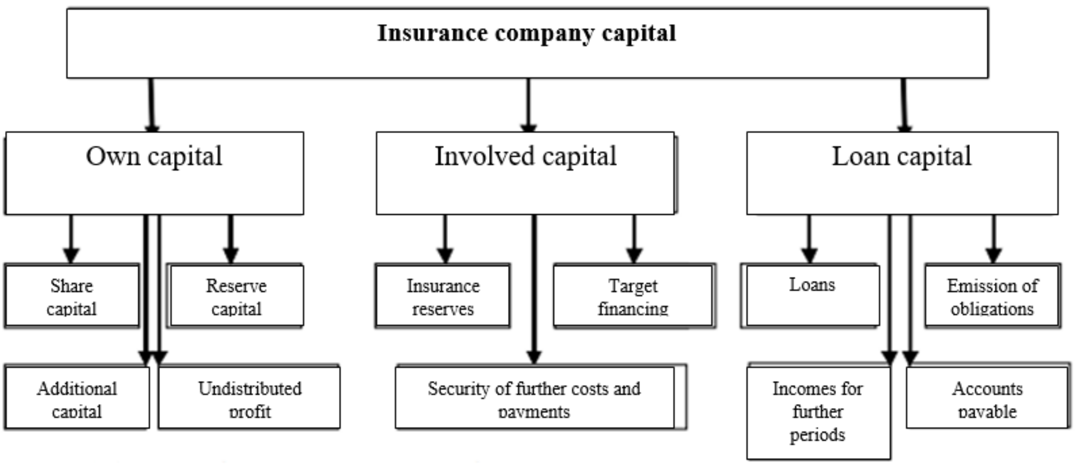

Fig. 1. Structure of the insurance company own capital

Source: made by the author based on (Bazylevych, 2008; Pikus, 2015)

Some authors believe that both own capital in general and share capital, in particular, have no essence for an insurance company, since, in order to fulfil obligations against insurants, the target insurance reserves shall be formed. In our opinion, such an approach is not correct enough. In order to secure the insurer's financial stability both in Ukraine and abroad, the law prescribes minimum share capital required for commencement of the business activity. From one hand, it concerns the fact that at the initial stage insurance company has no funds for a fulfilment of its obligations under insurance agreements, but share capital, since insurance investments are insignificant. From the other hand, a large amount of share capital facilitates more confident planning of the entity's market activity, quite large operations and the opportunity to gain competitiveness. Thus, in the process of forming the insurance organization, a principal attention shall be drawn to the amount and structure of share capital, i.e. the insurer's financial stability shall be based on the process of incorporating the company. The essence of both share capital and free reserves shall not decrease even when the insurer acts in the market for a long time. Their role in securing financial stability of the current activity is as much important as the role of insurance reserves since even the most accurate calculation of insurance reserves is a mere presumption, which even under the stable portfolio and reliable statistic grounds preserves a risk of loss fluctuation, which is unfavourable for the insurer. It may result from its unsuccessful tariff policy, undesirable changes in contract structure, devaluation of assets (stocks, real estate etc.) due to deterioration of the general economic situation, insurants' additional claims upon insurance payment the insurer deemed as settled etc. It may also occur so that the insurer, in order to support its market positions, will have to expand the range of its operation, which may result in additional risks not secured by the current insurance reserves covering obligations solely under the current contract portfolio (Slepukhyna, 2006).

Therefore, the insurer's own capital amount provides terms for optimal organization of the company's tariff, investment and reinsurance policy by means of securing the insurer's financial stability.

5. Reinsurance on the way of ensuring the financial stability of the insurance company

Another term facilitating financial stability of insurance operations and ordinary activity of any insurance company is reinsurance.

The Law of Ukraine "On Insurance" determined reinsurance as insurance by one insurer (assignor, reinsurer) under the contractual terms concerning the risk of a partial fulfilment of its obligations against the insurant at the other resident or non-resident (re)insurer having the status of insurer or reinsurer in compliance with legislation of its registration country (The Law of Ukraine "On Insurance", 1996).

Authors of The Interdisciplinary Glossary of Insurance and Risk Management determine reinsurance as financial operation upon assigning the insurer's risks accepted before the insurance to another competent (re)insurer in order to provide the balanced insurance portfolio as if it secured the insurance company stability and profitability (Pikus, 2015).

The main function of reinsurance is secondary market redistribution. It means that insurance company is able to provide to the insurant the insurance, which corresponds to its financial capacities. The insurer is unable to achieve such results by itself. The insurance company may fulfil its obligations by means of reinsurance, i.e. share risk between itself and another insurance company. Under reinsurance, reinsurer shall assume essential part of risk or guarantee, while the other part of risk imposed on assignor shall be treated as its own retention. Each reinsurer usually bears different shares of insurance cover; therefore, the insurer when assigning risks to reinsurer increases tenfold its abilities to accept risks.

In view of financial stability, reinsurance has at least two aspects. For the primary insurer, the ability to reinsure accepted risks shall mean strengthening its financial stability. Meantime it presumes also reinsurer's financial stability: being also the insurance organization rendering services to other insurers, reinsurer shall have enough solvency level in order to fulfil its obligations in case of insurance or reinsurance event.

Thus, reinsurance has a crucial impact on securing the insurer's financial stability.

1) First, each certain insurance type contains quite many large risks the insurer is unable to bear in full. Insurance company probably will defend itself in case of especially large risks by reducing its responsibility level as compared to accepted liabilities.

2) Second, the insurer's financial stability is under the threat of not only large risks but mass small claims. Reinsurance agreement concluded in case of catastrophic insurance event allows the insurer to avoid extreme losses. Reinsurance provides safe risk level for the company.

3) Third, reinsurance may adjust fluctuations in results of insurer's activity for several years. In particular, results of the insurance company's activity within one year may be subject to the impact of either essential loss due to numerous insurance payments caused by the single insurance event or negative results upon the whole insurance portfolio within one year. Reinsurance adjusts such fluctuations and facilitates stable results of the company's activity for several years, which is quite important for securing the insurer's financial stability.

Therefore, due to reinsurance, the insurer is able to bear most of the insurance risks. On these grounds, we may state that the more agreements the insurance company concludes the more balanced portfolio it obtains and the fewer fluctuations its financial results face. Reinsurance provides an opportunity for the insurer to expand the list of insurance risks it is ready to bear, to cover the greater range of insurance types and to defend its assets. Reinsurance allows the insurer to insure such objects whose value or risk level increases significantly its financial resources.

Today almost all the Ukrainian insurance organizations need reinsurance. Most of the insurers do not have enough funds and are unable to bear large risks. Having assigned partially their responsibility to reinsurers, insurance organization may guarantee fulfilment of its obligations against the insurants even in a case when several large insurance events occur. Reinsurer provides economic support to insurer: from one hand, it secures financial stability; from the other hand, it expands the insurer's scope of activity.

6. Enough scope of insurance reserves as the basis of financial stability of insurers

To make payments in case of insurance events, insurance organization shall have special monetary funds, i.e. insurance reserves. V.D. Bazylevych states that insurance reserves mean monetary assessment of further payments under the current insurance agreement, other than life insurance (Bazylevych, 2008).

Formation and use of insurance reserves, right and obligation whereon is imposed on insurance organizations according to the current legislation, serve as the basis for the insurer's activity and its financial stability. Financial stability, solvency of financial organization and its ability to fulfil insurance payment obligations against insurants under insurance events depend on correct calculation of insurance reserves with regards to non-fulfilled or partially fulfilled obligations.

Pursuant to Article 31 of the Law of Ukraine "On Insurance", in order to secure fulfilment of its obligations, insurance companies shall, in the manner and under the terms prescribed by the Ukrainian legislation, form insurance reserves from their insurance investments required for further insurance payments and insurance reimbursement depending on (re)insurance types.

As per the standard scheme of insurance reserve formation, each type of the insurer's obligations shall be covered by the relevant type of insurance reserve. Like in worldwide practice, the current Ukrainian classification detaches the following groups of insurance reserves:

– Under life insurance agreements (for accumulative insurance types);
– Under other than life insurance agreements (for risk insurance types);
– Preventive measure reserves (The Law of Ukraine "On Insurance", 1996) (Fig. 2).

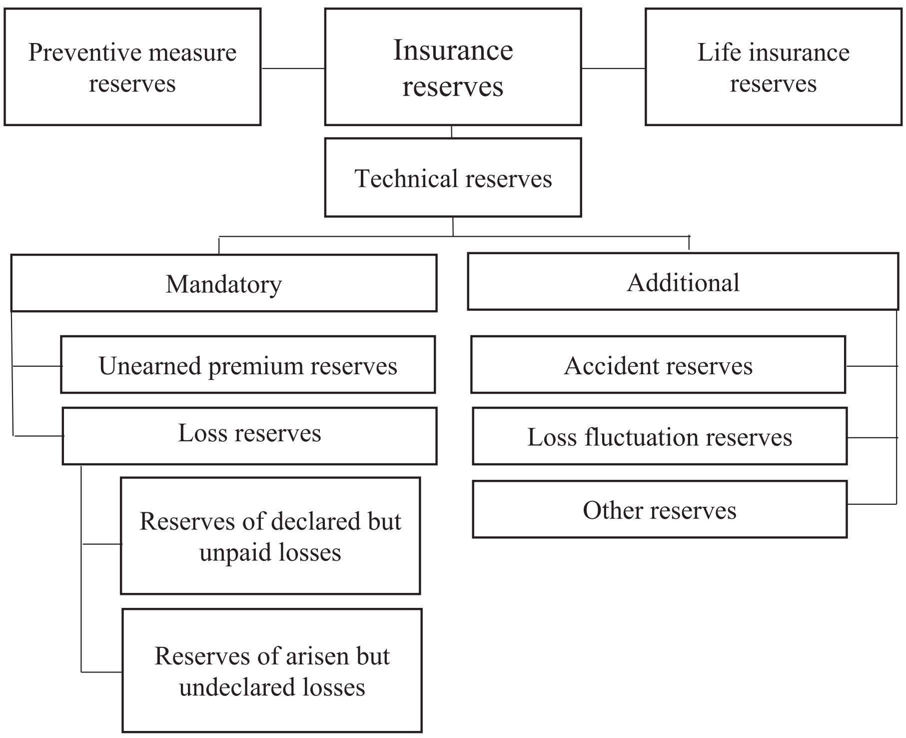

Fig. 2. Classification of the insurance company reserves

Source: made by the author based on (The Law of Ukraine "On Insurance", 1996; Resolution of The National Commission for State Regulation of Financial Services Markets of Ukraine " On Approval of the Required Criteria and Standards of Adequacy, Diversification and Quality Assets of the Insurer", 2016; Resolution of The National Commission for State Regulation of Financial Services Markets of Ukraine "On Approval of the Methodology of Formation of Insurance Reserves by Type of Insurance Other Than Life Insurance", 2016)

Insurance reserve distribution in life insurance and risky types of insurance is facilitated by a different content of insurance indemnity, risk nature, functions, tasks and methods of tariff calculation.

Insurance reserve amount, provided that they conform to obligations under insurance agreements, as well as their optimal placement and proportion conformity to the scope of own costs may show the insurer's financial stability. That is why the role of the state in determining methods of insurance reserve formation is a necessary factor for securing the insurers' financial stability.

Financial stability, solvency of financial organization and its ability to fulfil insurance payment obligations against insurants depends on the correct calculation of insurance reserves with regards to non-fulfilled or unduly fulfilled obligations. If a (re)insurance company has not enough insurance reserves for insurance reimbursement, it has to make payment at its own expense. Such own expenses will form the solvency stock over the solvency provided by the established insurance reserves.

EU member states highlight seven principal factors, which impact on the insurance reserve system formation:
- Insurance organization cycle inversion;
- Insurance portfolio stability;
- Insurance portfolio risk structure;
- Insurance company organizational structure;
- Insurance company investment activity;
- Reinsurance development market level;
- Inflation.

If the Ukrainian (re)insurers comply with such principal factors, they will be able to form insurance reserves, which would facilitate their financial stability in the insurance market and will fulfil promptly their obligations against insurants and other (re)insurance companies.

Insurance reserves consist of insurance premiums payable by insurants. Insurance payment amount shall facilitate not only insurance reserve formation but also the insurer's opportunity to settle all the insurance events, to cover case proceedings costs and to gain income, as displayed in the insurance tariff structure.

Under today macroeconomic conditions, insurance organizations face more difficulties in maintaining profitability level and securing financial stability, therefore tariff policy and expense decrease become prevailing management objects for insurers.

Today the standard insurer performing the large scope of various insurance types with a small portfolio under each one faces problems regarding risk assessment on the grounds of its own experience only. It is necessary to use either valid market rates or information of large insurance companies with a large portfolio under the certain insurance type.

7. Grounded tariff policy as the basis of financial stability of insurers

The insurer has a lot of risks to break the stable situation caused by errors in tariff application, e.g. tariff decrease under the loss increase under the certain insurance type, or incorrect choice of the insurance portfolio structure for the certain market under other equal conditions may cause decrease or loss of financial stability. Today when insurance is performed by different insurance organizations, the rate is one of the elements of competition constantly stimulating insurers to reduce tariffs, grounded with regards to client involvement but groundless with regards to the company's financial stability. If the insurer performs single agreements under any type of insurance, tariff amount is not essential as for impact of the insurance company's competitiveness, but in such a case, in order to secure financial stability, tariff shall take into account the market loss level for the purpose of this risk assignment to reinsurance without any problems (Sukhov, 1995).

Therefore, the insurer's tariff policy optimization is quite essential in the aspect of securing its financial stability. Insurance business prosperity is facilitated merely by the quality of calculations regulating financial relationships between the insurance subjects. Incorrect tariff calculation causes a decrease of the insurance company's financial stability. In order to optimize insurance policy, the insurer shall use mathematic and statistic methods for developing algorithms of the insurance portfolio structure formation and modification, which will facilitate a sufficient defence of the insurance company from the threat of bankruptcy.

8. Conclusions

The financial stability of insurance companies is the main condition, through which the institution of insurance can fully carry out its multifaceted role in the social reproduction process, since it is solvency that acts as one of the main criteria when potential policyholders select an insurer, and as the basis for the successful functioning and development of the said institution.

An adequate level of financial stability of insurers is, therefore, the main condition for:
– the provision of the insurance coverage for the social reproduction and for the maintenance of the standard of living achieved by the population;
– the full and timely compliance with insurance obligations;
– the efficient and competitive functioning of an insurer in the future;
– the development of the country's economy as a whole.

The economic and social importance of insurance is such that the intervention of public authorities, in the form of prudential supervision, is generally accepted to be necessary. The intervention of public authorities has tended to focus on introducing the measures that seek to guarantee the solvency of undertakings or minimise the disruption and loss caused by insolvency.

Thus, on the grounds of the above analysis we may conclude that financial stability of the insurance company depends on many aspects of the insurer's work organization, while their complex and simultaneous improvement may facilitate effective and stable activity of the company, which will become more confident among competitors and guarantee proper defence for its clients.

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Мария БАЛИЦКАЯ

ХАРАКТЕРИСТИКА ИСТОЧНИКОВ ОБЕСПЕЧЕНИЯ ФИНАНСОВОЙ УСТОЙЧИВОСТИ СТРАХОВОЙ КОМПАНИИ

Аннотация. *Целью работы* является обобщение методологических концепций отечественных исследователей на пути поиска источников обеспечения финансовой устойчивости страховых компаний. Необходимость развития и углубления теоретических разработок и практических наработок по вопросам совершенствования обеспечения финансовой устойчивости страховых компаний Украины обусловили постановку следующих задач: анализ методических подходов отечественных исследователей относительно выделения источников обеспечения финансовой устойчивости страховых компаний; выделить важнейшие источники обеспечения финансовой устойчивости страховой компании; обосновать роль и значение страховых резервов в обеспечении финансовой устойчивости страховой организации. *Методология*. Исследования проводится на основе теоретического анализа научных трудов и практической деятельности страховых компаний. Методологической основой статьи являются методы научного познания, позволяющие выявить основные закономерности развития страховых компаний, приоритетные пути обеспечения их финансовой устойчивости. В частности используются следующие методы: анализ и синтез – в ходе исследования финансовой устойчивости страховых компаний; Систематизация – для выявления факторов обеспечения финансовой устойчивости страховщиков, их детального анализа и определение их взаимосвязи; Метод научной абстракции – с целью формирования теоретических обобщений и выводов. *Результаты*. Страховой сектор играет важную роль в обеспечении критически важных финансовых услуг. Но страховщики, в свою очередь, тоже подвержены ряду рисков и могут потерять способность отвечать по своим обязательствам. В статье рассматриваются сущность и значение финансовой устойчивости страховой компании как важного фактора развития и функционирования страхового рынка. Экономическая сущность, общие теоретические вопросы о финансовой устойчивости страховых компаний рассмотрены и проанализированы. Основные характеристики и факторы, влияющие на финансовую устойчивость страховых компаний исследованы. *Значение*. Экономическое и социальное значение страхования такова, что вмешательство органов государственной власти, в форме пруденциального надзора, является общепризнанным необходимым

фактом. Роль страховых состоит не только в способности обеспечить защиту от будущих событий, которые могут привести к убыткам, а также перераспределении сбережений населения в финансовые рынки и в реальный сектор экономики. Вмешательство органов государственной власти, как правило, сосредоточены на внедрении мер, которые призваны гарантировать платежеспособность предприятия или минимизировать разрушения и потери, вызванные неплатежеспособностью. Таким образом, изучение законодательного регулирования факторов обеспечения финансовой устойчивости страховых компаний имеет стратегическое значение на пути к созданию стабильного страхового рынка в Украине.