Improving the Role of Reinsurance in Securing Financial Stability of Insurance Companies

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Annotation: *The article deals with the issues of reinsurance in the current reinsurance business and the main conditions of reinsurance. It also analyzes the features of managing the financial sustainability of insurance organizations, the development of reinsurance as a factor in managing the financial sustainability of an insurance organization, and the need to create a specialized reinsurance company.*

Insurance organizations are one of the main elements of the country's financial system, providing compensation for losses and stabilizing the sustainable development of the national economy and social sphere. At the same time, insurance companies are also subject to influence upon negative factors. The liability assumed by the insurer must be consistent with its financial capabilities in order to fulfill all obligations in full. Accordingly, the insurer might has a problem of managing financial stability and solvency in general. The main role in maintaining and strengthening the financial stability of a particular insurance company is assigned to the internal regulation of its financial resources. To ensure and improve the level of financial stability of insurance organizations in the current conditions of changing market conditions and to overcome the crisis, it is not enough to meet the requirements set at the state level. Therefore, there is an objective need to supplement the existing system of factors for ensuring financial

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stability, such as an effective risk management system through the use of reinsurance protection, as the basis for the financial stability of an insurer. The financial sustainability of an organization can be described through a set of indicators, which implies the possibility of formulating specified requirements as a set of parameters that an organization must meet in order to be financially sustainable.

The specifics of the activities of insurance companies necessitates the allocation of a system of certain indicators that characterize the functioning of insurers as financial institutions. In this paper, the systematization of indicators is proposed, in which all their diversity is presented in the form of two blocks: indicators for evaluating financial results and indicators for assessing financial condition (fig. 1). At the same time, for each indicator, a calculation algorithm is presented, its economic essence is disclosed, and the degree of influence on the complex (integral) risk indicator is determined.

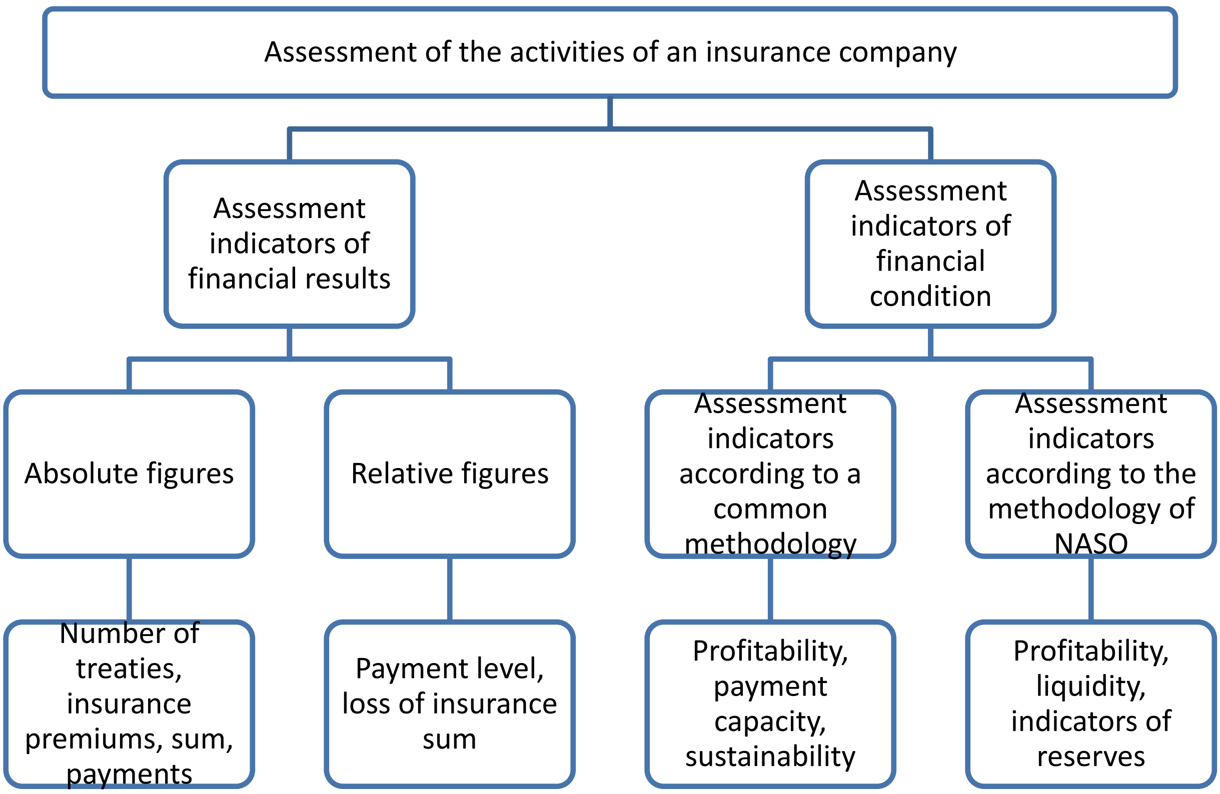

Fig. 1. The system of indicators for evaluating the activities of insurance organizations[1]

In this regard, traditional approaches to managing the financial sustainability of an organization are based on the following:

- coefficient analysis by developing individual coefficients and identifying relationships between them in order to select a specific set of criteria indicators of the financial stability of an organization
- financial and statistical analysis, during which the analytical coefficients of financial stability, calculated according to the financial statements of the organization, are compared with the normative, actual industry average or best values;
- constructing aggregated integral indicators of the financial sustainability of an organization, based on the relationship of particular indicators;
- the development of discriminant models built using the justification of a number of indicators in order to determine the probability of bankruptcy.

Important conditions for the effective management of the financial stability of an insurance organization are:

- linking target indicators with specific factors and parameters of financial sustainability;
- building a clear control system to compare the results with financial sustainability indicators.

For a quantitative assessment of financial stability and solvency, a number of indicators are used. One of the indicators characterizing the financial stability of an insurance organization is its own capital ratio (R), or property ratio:

$$r=(Ce+o)/100$$

[1] Kabantseva N.G. Insurance business. Tutorial. M .: Forum, 2008

where Ce - the equity capital of the insurance organization;
O - the total amount of the insurer's obligations.

The property ratio determines the fraction of equity capital (in percentage) in the total amount of capital according to the balance sheet.

The high level of the ratio (up to 100%) characterizes the financial independence, the stability of the insurer, guarantees that it fulfills its obligations to the insured beneficiaries) - by other creditors.

It should be noted that the essence of an organization's financial sustainability lies in the assessment of its financial position in the long term from the point of view of immunity to the effects of external and internal factors that violate its production function. Research methodology for assessing financial stability, concepts and entities are fully represented in the scientific literature and are deeply developed by authors such as Blank I.A., Rodionova V.M., Orlanyuk- Malitskaya L.A., Chernov G.V., Yuldashev R .T. and others.

It seems, according to the opinion of Orlanyuk-Malitskaya L.A., that financial sustainability can be viewed as the ability of a market entity to maintain the quantity and quality of its financial resources when the environment changes[2].

The specificity of the assessment of the financial stability of an insurance organization is due to the peculiarity of the formation of its financial resources, which are formed from three components - equity capital, raised as insurance premiums and borrowed capital. The attracted part of the capital, on the one hand, is considered as the liabilities of the insurer, and on the other - serves as a source of funds, while the liabilities largely prevail over their own capital, which contradicts the existing requirements for ensuring the financial stability of the enterprise. Reinsurance allows you to balance the risks of the insurance organization and the ratio of regulatory requirements for conducting activities to their execution. The

[2] Orlanyuk-Malitskaya LA On the concepts and factors of financial stability of insurance companies // Bulletin of the Financial Academy. - M., 1998. №1. with. 33—38

insurer, at its discretion, determines its own deduction under the insurance contract.

M.I. Braginsky believes that through reinsurance, the insurer is able to redistribute the risk lying on it between him and the reinsurer. For this purpose, the insurer in the contract of property, as well as personal insurance concludes a reinsurance contract with the reinsurer. In this regard, reinsurance is understood as a way to redistribute major risks in order to ensure the financial stability of insurers[3]. The mechanism of the effect of reinsurance on financial stability includes:

1. The formation of a balanced insurance portfolio. This means that an insurance organization has a fairly large number of insurance contracts for homogeneous objects that are not concentrated in a small area, with an identical range of insurance risks and with insignificantly different insurance amounts. Having a balanced insurance portfolio is very important because it increases the ability to be guided by the law of large numbers when conducting insurance operations. The essence of this law, which is the basis for calculating tariff rates and expected financial results in insurance, is that the cumulative effect of a large number of random factors leads to a result that is almost independent of the case under certain general conditions. With regard to insurance, this means that with an increase in the number of insurance contracts for homogeneous objects with identical insurance sums and insurance risks, the predictability of the future performance of the insurer increases. The insurer's lack of a sufficiently large number of insured homogeneous types of property or other objects, the inclusion in the number of insurance risks of events that could entail catastrophic losses, the concentration of insured objects in a small territory, the existence of insurance contracts with drastically different insurance amounts seriously violate optimal proportions ,

[3] M.I. Braginsky. Insurance contract. M. Statut, 2000

creating a basis for financial stability when carrying out insurance operations. This can lead the insurer to significant losses and bankruptcy.

2. Reducing the risk of insurer losses from carrying out insurance operations. Such losses arise due to the fact that the size of insurance payments for a particular financial year exceeds the amount of the insurance premium received. The main reasons that can lead to this excess:

a) the insurer's lack of a large and well-balanced portfolio of insurance contracts, which allows using the law of large numbers when calculating the size of tariff rates and expected insurance payments;

b) an unexpected increase in the number of insured events in the current year;

c) an increase in the size of insurance payments per one insured event, compared with average values for previous years;

d) the need to make insurance payments at the same time on many insurance contracts for the consequences of one insured event that is catastrophic and does not happen every year (for example, natural disasters), which is called in the practice of insurance cumulation of risks;

e) professional errors made, for example, when calculating the value of tariff rates.

In all such cases, reinsurance is one of the ways to help compensate for fluctuations in the size of insurance payments by year.

3. Increasing the insurer's ability to enter into insurance contracts for high insurance premiums. In order to ensure their financial stability, insurers cannot enter into insurance contracts for amounts exceeding a certain percentage of their own capital. If the capital at the disposal of the insurer does not allow him to assume all the obligations under insurance contracts, he can transfer part of them to reinsurance. This is especially important in the conditions of competition in the insurance market, when the insurer's ability to provide insurance protection to any

insured against those risks and the amount in which he is interested depends on the results of his activities.

4. Allows insurers to regulate the ratio between the size of their own capital and the volume of insurance operations. In order to ensure its financial stability, each insurer must have its own capital in an amount not lower than the established percentage of the obligations assumed by it under insurance contracts. If the value of the insurer's own capital does not meet the requirements, then it is obliged to either increase its capital or reduce the volume of insurance operations. It is not always possible to quickly increase the amount of capital, but the refusal to conclude new contracts and, moreover, termination of existing ones, leads to the loss of clients who may no longer return when the insurer can accept them for insurance. In such a situation, the transfer of a part of the insurer's liability to reinsurance reduces the amount of its insurance liabilities and, therefore, makes it possible to perform this ratio without refusing insurance contracts.

5. Allows insurers more boldly to engage in operations on new types of insurance. Carrying out such operations, the insurer, without having the necessary work experience and statistical base for calculating the size of tariff rates, runs the risk of incurring significant losses. Reinsurers, taking on a significant part of the insurer's obligations, reduce its potential losses, thereby allowing you to accumulate the necessary experience in conducting new types of insurance, which ultimately contributes to the development of insurance operations.

6. Reinsurers can provide insurers with various services needed to improve the efficiency of their activities. Such services may consist in helping to develop conditions for new types of insurance for the insurer, in providing the necessary information for calculating tariff rates, in evaluating the insured risk when concluding insurance contracts, in considering claims of policyholders and beneficiaries on insured events that have occurred and calculating the amount of

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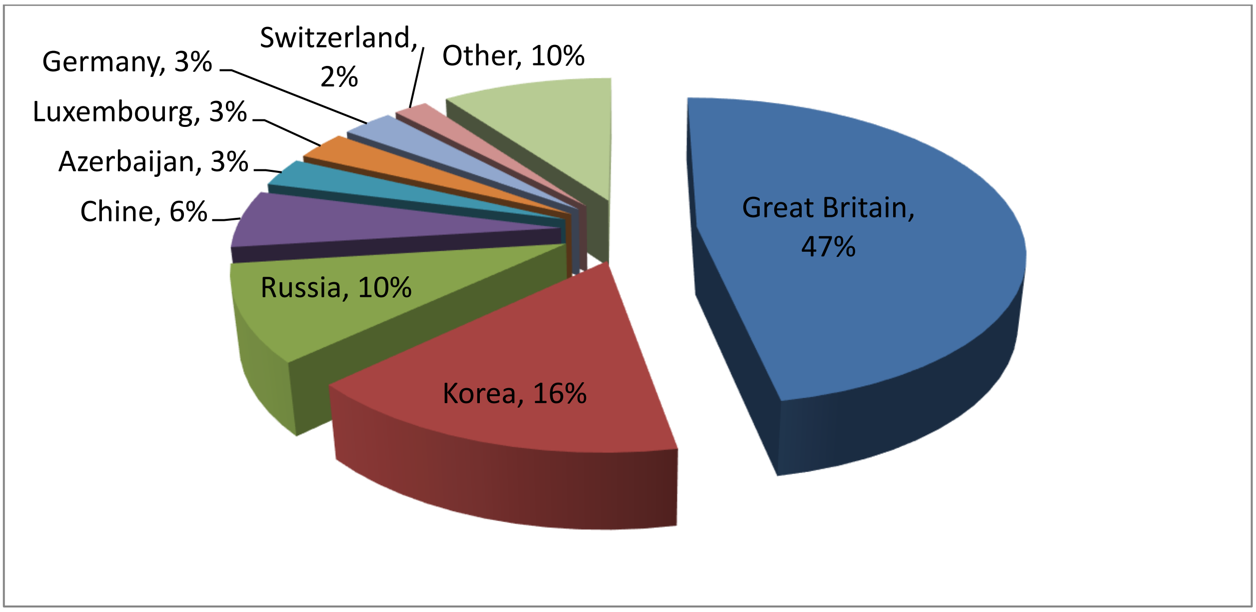
damage from them, in training. The possibility of providing such services by reinsurers is due to the fact that they, as a rule, have high-class specialists, have extensive experience in conducting insurance operations, and for many years accumulate the necessary statistical data. In addition, reinsurers are interested in the successful work of insurers, their partners in reinsurance contracts, since the results of the activities of the reinsurers themselves depend on it. Thus, a less balanced insurance portfolio requires the insurance company to use less competitive tariffs or additional reinsurance costs.

It should be noted that today in Uzbekistan there is no specialized reinsurance company, at the same time it can be added that six financially sustainable companies provide reinsurance services in the insurance market. In order to diversify the reinsurance portfolio, considerable attention is paid to the development of cooperation in the field of international reinsurance. According to the Regulation on the solvency of insurers and reinsurers (Reg. No. 1806 dated 12.05.2008), reinsurance of risks abroad is allowed only with an approved reinsurer, as well as solvent insurers with relevant international ratings. Domestic insurance organizations are entitled to transfer risks to reinsurance only to approved reinsurers. When reinsuring liabilities of foreign insurance organizations, the minimum amount of own deduction must be greater than or equal to 5% of the actual size of the insurer's (reinsurer's) solvency margin, with the exception of export contracts for insurance against political and commercial risks and insurance for persons traveling abroad. At the end of 2017, the liabilities are reinsured by insurance companies in the UK, Korea, Russia, China, Azerbaijan, Luxembourg, Germany, Switzerland, etc. (see figure 1).

Chart 1.

Structure of reinsurance activity by the end of 2017[4]

[4] http://www.Uzreport.com



The largest share of outgoing reinsurance obligations was transferred to countries such as the United Kingdom (47%), Korea, (16%), Russia (10%) and China (6%), while the share of countries with developed insurance markets in the aggregate was 21%, at the same time providing high guarantees of insurance payments to domestic policyholders. At present, such companies as Uzbekinvest, Uzagrosugurta, Kafolat, Temiryul sugurta, Alfa Invest, Gross Insurance, Ingo Uzbekistan conduct reinsurance activities in the national insurance market of Uzbekistan. The above mentioned companies are entitled to reinsure in parallel with their activities, as they have reached 30 billion soum authorized capital, established by the Decree of the President of the Republic of Uzbekistan dated 29.09.2017, No. 5197.

It should be noted that improving financial sustainability is possible by creating a national reinsurance organization. The creation of a state reinsurance company in Uzbekistan is not a rejection of the principles of market economy mechanisms, but one of the forms of private-state partnership in the insurance sector of the economy, aimed at solving the problem of sustainable development of the national insurance industry. Thus, a national reinsurance company would allow:

- guarantee the stable development of the insurance market;
- to increase the total capacity of the national insurance market;
- turn our country from a buyer to a seller of reinsurance capacities and minimize the leakage of currency through international reinsurance channels;
- strengthen the truly market trends in the development of the insurance industry in Uzbekistan on the basis of equal access for all insurers to compulsory types of insurance, all-round development of competition in the insurance industry, increasing the capitalization of insurers, quality and expanding the list of services provided by them;
- to become a mechanism for the implementation of social guarantees of the state to its citizens in the field of compulsory insurance, the initiator, the introduction of which is the state;
- to guarantee reinsurance of risks of civil liability of enterprises operating in closed mode;
- to promote public confidence in the insurance market of the country.

In addition, it should be emphasized that the creation of a national reinsurance company will undoubtedly strengthen the role of the state in the insurance sector of the economy, but at the same time it will allow to solve in the long term the problem of the sustainable development of the national insurance market in the area of direct state and public interests.

In conclusion, it should be concluded that, if in the current situation time is lost for making major changes in the reinsurance market, then further events could turn into a large-scale crisis, which will seriously affect the financial condition of economic entities, most national insurers, and accordingly, on the market behavior and reliability of reinsurance companies.

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