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Ensuring The Financial Sustainability of Insurance Companies

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Abstract: This article studies the important conditions, principles and target indicators for ensuring the financial stability of insurance companies, analyzes the coefficients for quantitative assessment of the solvency of insurance companies and the system of relative indicators for determining financial stability and efficiency, and develops scientific proposals and recommendations for increasing the solvency of insurance companies and ensuring financial stability.

Key words: financial stability, solvency, financial resources, reinsurance, investment capacity, liquidity.

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Introduction

In an innovative economy, the financial stability of insurance companies is an important factor determining the effectiveness of their activities, the development of the insurance system, and the growth of confidence in the insurance business. The stability of a company is understood as its ability to maintain its normal state even as a result of large and small random changes in its activities .

One of the priority areas for the development of the insurance market in Uzbekistan is to increase the financial stability, solvency and capitalization of insurers. This includes the following:

to increase the volume of the national insurance market, promote the development of co-insurance and reinsurance mechanisms by creating insurance funds for the organization of insurance against large, rare and new risks;

creation of necessary conditions for the rapid development of reinsurance activities and increasing the capacity of the country's insurers regarding their obligations, as well as minimizing the volume of reinsurance going abroad from the national insurance market;

implementation of modern corporate management methods aimed at increasing the efficiency of insurance and investment activities of insurance companies.

Literature review

The financial stability of insurance companies is closely related to their solvency. These concepts are quite conditional and do not have strict boundaries, which is why a number of authors interpret

them differently. Accordingly, M.S. Abryutina, V.V. Grachev argue that “the financial stability of an enterprise is nothing more than its solvency, guaranteed by hope...” [1]. They also indicate that the main sign of financial stability is “...the presence of net liquid assets, which are determined as the difference between all liquid assets and all short-term liabilities at a given time” [1].

A.V. Grachev believes that financial stability depends on the efficiency of the use of working capital, which is characterized by the turnover rate (turnover) of working capital. The more efficiently the use of not only working capital, but also all the resources of the enterprise, the more stable its financial condition is [2].

M.N. Kreinina emphasizes that “it is necessary to ensure the solvency, liquidity and creditworthiness of the organization. This is the lower limit of its financial stability, otherwise it is threatened with bankruptcy” [3]. Thus, assessing the financial stability of an economic entity consists in assessing its future financial condition. If such characteristics as its solvency, profitability and business activity are not taken into account when assessing the financial stability of an organization, then such an analysis will not be sufficiently complete.

One of the authors states that the financial stability of insurance companies is understood as their ability to maintain the existing level of solvency for a certain period of time under possible adverse external and internal influences on financial flows [4]. Financial stability analysis is carried out to determine the solvency of an insurance company. Insurance companies do not produce anything while operating in the financial sector, therefore, assessing the financial stability of insurers has a number of features.

By financial stability of an insurance company, the author means “... improving the activities of insurance companies, developing new types of them, as well as effectively organizing insurance operations and ensuring a certain level of solvency at any time through own funds and equivalent funds, the amount and structure of liquid assets, property and financial condition” [5] understands.

The concept of financial stability, according to N.V. Kirillova, can be explained as follows: Financial stability is a state of financial resources that contribute to the development of insurance companies, their distribution and use in such a way that risk transfer, unconditional fulfillment of obligations to policyholders, taking into account changes in the economic situation, and a stable positive financial result are ensured [6].

Methodology

The scientific views of researchers devoted to theoretical and practical problems of ensuring the financial stability of insurance companies were studied. The experiences of advanced foreign countries in ensuring the financial stability of insurance companies were studied. The collected materials were based on the financial reports and statistical data of the National Agency for Promising Projects of the Republic of Uzbekistan, the National Statistics Committee of the Republic of Uzbekistan, insurance companies. The scientific proposals and practical recommendations developed within the framework of the study serve to enrich scientific views on ensuring the financial stability of insurance companies .

Analysis and results

The concept of solvency of an insurance company expresses the ability to fulfill the obligations assumed by them under insurance and reinsurance contracts, even in the presence of unfavorable conditions. The conditions for ensuring the solvency of the insurer are the existence of the charter capital formed in the amounts determined by the law, the creation of insurance reserves sufficient for future insurance coverage, the actual amount of the insurer’s solvency exceeding the normative amount.

To assess financial stability and solvency, insurers must adhere to the normative ratio between their assets and assumed insurance obligations, i.e. the normative solvency margin, established by the insurance supervisory authority. The solvency margin can be included in a synthetic indicator that summarizes a number of aspects of the insurer's activities. However, this indicator is not considered comprehensive, since it does not take into account many aspects of the insurer's activities. Therefore, this indicator is used in conjunction with other indicators that characterize the insurer's solvency and ensure its financial stability. The actual amount of the insurer's solvency margin is calculated as the sum of the authorized capital, additional capital, reserve capital, undistributed profit for the reporting period and previous years, reduced by the amount of uncompensated losses in the reporting period and previous years, shareholders' debt to the authorized capital for contributions, own shares repurchased from shareholders, intangible assets, and overdue receivables. The standard amount of the solvency margin of an insurer operating in the general network is formed on the basis of the data on insurance premiums and coverages for insurance, co-insurance and reinsurance contracts and the calculation of two indicators, the larger of which is multiplied by the correction factor.

The choice of theoretical approaches to ensuring the financial stability of insurance companies has an important theoretical and practical value as it has a direct impact on its results. From the point of view of modern financial theory, ensuring the financial stability of an insurance company is formed on the basis of:

- selection of quantitative indicators describing the factors of financial stability of the insurance company;
- change of factors of financial stability of the insurance company using strategic management tools.

In the framework of this theory, ensuring the financial stability of the insurance company should be based on the following principles:

- flexibility, since the dynamics of changes in the external and internal environment justify the change in the factors characterizing the financial stability of the insurance company and its indicators. In this case, external factors that belong to the uncontrollable category affect the internal ones, changing their quantitative expression. At the same time, the optimal model for managing the financial stability of the insurance company depends on the selection of quantitative indicators that reflect important internal factors and target objectives. The system for ensuring the financial stability of the insurance company should take into account the possibilities of changes in external and internal factors, operating conditions and the results obtained;
- partiality (polyelement). The effectiveness of ensuring the financial stability of the insurance company is the result of the interaction of several important factors that reflect the main directions of activity;
- hierarchy. Important factors combine the influence of lower-order factors, resulting in a hierarchical, multi-level system of financial stability of an insurance company;
- balance. The interdependence of financial stability factors determines the need for balancing and refinement as a single system of ensuring the financial stability of the insurance company;
- continuity. Ensuring the financial stability of an insurance company is continuous and represents a stable process for all its levels.

Thus, the main parts of the proposed approach to ensuring the financial stability of an insurance company are:

- setting strategic goals and sub-goals, taking into account the analysis of the external and internal environment (development of acceptability and final selection);
- determining the factors of financial stability of the insurance company and establishing their hierarchy;
- selection of indicators describing factors of financial stability of insurance companies;
- evaluation of the results of practical activities to achieve the set goals, control and change them.

Ensuring the financial stability of an insurance company represents a process aimed at achieving a system of financial relations with the ratio "profitability - risk - liquidity" established within the framework of its main strategic goal. Accordingly, the established ratio is considered as a target task, and a set of specific issues for ensuring the financial stability of an insurance company is interpreted using selected quantitative indicators of profitability, risk and liquidity. At the same time, the main role in ensuring and strengthening the financial stability of a particular insurance company is played by internal regulation of its financial resources. In order to ensure and increase the level of financial stability of insurance companies in changing market conditions, it is not enough to fulfill the requirements established at the state level. Therefore, in addition to the existing system for ensuring the financial stability of the insurer, it is necessary to introduce an effective risk management system using reinsurance protection. The financial stability of an organization can be expressed in a number of indicators, which implies the formulation of the established requirements as a set of parameters necessary to ensure financial stability. Important conditions for ensuring the financial stability of the insurance company are as follows:

- linking target indicators to specific factors and financial stability indicators;
- create a clear monitoring system to compare results with financial stability indicators.

A number of indicators are used to quantitatively assess financial stability and solvency. One of the indicators characterizing the financial stability of an insurance company is the equity ratio (K). This ratio determines the share of equity in the total volume of capital on the balance sheet in percent. A high level of the ratio (up to 100 percent) indicates the financial independence and stability of the insurer, guaranteeing the fulfillment of obligations to all policyholders, beneficiaries and other creditors. At the same time, business entities are trying to attract funds at an acceptable level in order to increase the efficiency of using their funds. In the practice of foreign companies, it is normal for the equity ratio to be in the range of 60-70 percent.

The debt capital ratio of the organization can also be used in the analysis and evaluation of the financial condition of the insurer. This ratio represents the share of debt (raised) funds in the total capital in percentage and is the inverse of the ratio of own funds. In foreign practice, it is considered normal for debt to be in the range of 30-40 percent. Comparison of the actual amount of free assets with the normative amount is also a method of quantitatively assessing the financial stability of the insurer. The following coefficients are used to quantitatively assess the solvency of the insurer:

- C clr – total (current) liquidity ratio;
- C tl – term liquidity coefficient;
- C er – equity ratio.

The total (current) liquidity ratio is calculated according to the following formula:

$$Cclr = Ac / Lsht \quad (1)$$

where, *Ac* – current assets of the insurance company (total amount of sections II and III of the balance sheet assets);

L sht – short-term (up to 1 year) liabilities of the insurance company:

- insurance reserves for high-risk insurance contracts with a term of up to one year;
- insurance reserves for life insurance contracts with a term of one year or more;
- short-term loans and debts;
- other short-term debts.

The total (current) liquidity ratio *Cclr* characterizes the level of provision of the insurance company with working capital to cover its short-term obligations in the current year. If this indicator is less than 1.0, this indicates an insufficient level of working capital to cover short-term obligations, a low level of solvency.

The following factors threaten the low level of liquidity:

- non-compliance by the insurer with the ratio of its assets and liabilities;
- insurance of high-risk objects without sufficient research and as a result the loss of the insurance amount;
- improper development of the tariff policy and insurance tariffs;
- receivables and other factors.

In foreign practice, the current ratio is in the range from 1 to 2.

Term liquidity ratio (*Ctl)* determined by the following formula:

$$Ctl = Ahl / Lt \quad (2)$$

here, *Ahl* - highly liquid assets of the insurer (cash, government securities, bank deposits, other assets that turn into quick money that make monthly and quarterly payments of the insurance company);

Lt - term liabilities of the insurance company for a quarter or month: current insurance coverage; repayment of loans and debts; settlements with reinsurers and co-insurance participants, budget and non-budgetary funds, and other creditors.

The short-term liquidity ratio determines whether the insurance company is fully provided with highly liquid assets to meet its obligations. *A Ctl* value of more than 1.0 characterizes the insurance company as fully provided with highly liquid assets and has a high level of solvency. *Ctl* of a ratio of less than 1.0 indicates a lack of funds to meet obligations, which indicates a low level of solvency and a risk of bankruptcy. The standard range for the short-term liquidity ratio is between 1 and 2.

The coefficient of own working capital adequacy (C*wca*) of the insurer indicates its financial condition and ability to meet the demands of creditors and must not be less than 0.5. If C*wca* > 0.5, the insurer is not at risk of bankruptcy and is able to fulfill all its obligations. If C*wca* < 0.5, there is a possibility of insolvency and bankruptcy.

In general, the characteristics of ensuring the financial stability of an insurance company are economically based:

- insurance tariff is an insurance premium rate determined in relation to the insurance amount, and this feature of ensuring financial stability may depend on the factors of the external financial environment that directly affect it (for types of compulsory insurance), as well as on the factors of the internal environment (in voluntary insurance);
- insurance reserves, i.e. sufficient funds intended to fulfill obligations under insurance, co-insurance, reinsurance and mutual insurance contracts. This feature of the financial stability of

an insurance company is associated with the formation and placement of insurance reserves. It should be emphasized that insurance reserves are debt obligations of the insurer. Therefore, their placement in proportion to the sources of its own funds and at an acceptable level determines the insurer's compliance with its obligations and indicates the company's financial stability;

- the source of own funds depends on the direct influence of the external financial environment (fulfilment of the requirements for the formation of the minimum size of the charter capital) and the influence of internal environmental factors (profit distribution);
- reinsurance refers to the internal financial environment and is considered an important factor in ensuring the financial stability of the insurance company.

Indeed, the adequacy of solvency in an insurance company not only increases its potential, but also stimulates long-term cooperation with its clients and the flow of potential clients. Despite the regulatory requirements for the use of reinsurance established in regulatory documents, insurers do not prefer to use such a mechanism. They are "forced" to transfer obligations that exceed their financial capabilities to reinsurance only at the request of the insurance supervisory authority. Below is a system of relative indicators for determining financial stability and efficiency in order to ensure solvency and achieve financial stability in insurance companies (Table 1).

Table 1. System of relative indicators for determining financial stability and efficiency of insurance companies[1]

№	Indicators	Determination procedure	Explanation of symbols	Stats	Interpretation
1.	Total liquidity ratio	$\frac{C_w}{L_{sht}}$	In this case: C_w - working capital of the insurer; L_{sht} - short-term liabilities of the insurer	< 1	It describes the level of current assets available to cover the insurance company's short-term obligations in the current year, and if it is less than 1, it indicates a low level of solvency.
2.	Fixed term liquidity ratio	$\frac{A_{hl}}{L_t}$	In this case: A_{hl} - highly liquid assets of the insurer; L_t - term liabilities of the insurer	< 1	It indicates that the insurance company is provided with highly liquid assets to meet its obligations, and a ratio of less than 1 indicates a low level of solvency and a risk of bankruptcy.
3.	Working capital ratio	$Cwca$	In this case: $Cwca$ - the insurer's working capital adequacy ratio	< 0.5	there is a possibility of insolvency and bankruptcy.
4.	Ratio of reinsurance tariff to insurance tariff	$\frac{RI_{tr}}{DI_{tr}}$	In this case: RI_{tr} - reinsurance tariff rate; DI_{tr} - direct insurance tariff rate	< 1	It assumes the efficiency of the use of reinsurance and the provision of solvency.

[1]Developed by the author.

Indicators analyzed above, a number of other indicators also indicate the use of reinsurance by insurers. In particular, the ratio of the insurer's assets to insurance liabilities greater than one indicates the adequacy of the solvency margin and the financial stability of the company. The fact that the volume of liabilities assumed by the insurance company under one contract is equal to the amount of the share retained by itself also reflects the adequacy of the company's solvency, and also implies the use of a reinsurance mechanism with a deep analysis of the nature of the risks. That is , in dangerous risks, in the above situation, it is advisable to transfer a certain part of the liabilities to reinsurance, if the probability of the risk occurring is low, solvency is maintained even if it is left to itself.

If the amount of the obligation assumed under a single contract exceeds the share retained by the insurer, it means that a part of the obligations that exceeds the company's financial capabilities must be re-insured. Otherwise, a single large payment may have a serious negative impact on the company's financial stability.

Conclusion

A careful development of the tariff policy in insurance companies ensures their capital adequacy. The tariff policy should be developed in such a way that setting high rates does not cause customers and potential customers to move away from the company, and, conversely, the use of low rates should not prevent the sufficient formation of insurance reserves. From this point of view, insurance companies should carefully determine the tariff rate even when transferring risk to reinsurance, while it is very important to pay attention to the preservation of the solvency of both the direct insurer and the reinsurer. There is another point worth noting, namely, the direct insurer incurs a number of expenses when concluding a contract with a client, these are: brokerage fees to the insurance agent, fees for surveyor services, contributions to insurance reserves, paper costs, etc. Therefore, the tariff rate offered to the reinsurer should be somewhat lower than the rate accepted from the client, otherwise the direct insurer may have a negative impact on financial stability due to the lack of insurance reserves. In this regard, the lower reinsurance tariff than the insurance tariff implies the efficiency of the use of reinsurance and the provision of solvency.

In all of the above-mentioned cases, the use of the reinsurance mechanism is effective and ensures that the solvency of the insurance company increases and financial stability is achieved .

The application of this system developed by the author in insurance companies will further increase the effectiveness of reinsurance. In general, there are a number of factors that can help insurance companies maintain solvency and ensure financial stability, among which the use of the reinsurance mechanism is the most appropriate method, which, most importantly, increases the potential not only of the company, but also of the country's insurance and reinsurance market.

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