

THE IMPACT OF THE CRISIS ON THE FINANCIAL PERFORMANCE (RESULTS) OF ROMANIAN INSURANCE COMPANIES*

CRISTINA MIHAELA NAGY, BOGDAN COTLEȚ, DUMITRU COTLEȚ, MARINA UHER
WEST UNIVERSITY OF TIMISOARA
cristinanagy2009@yahoo.com, toldo_bogdan@yahoo.com, dumitru.cotlet@feaa.uvt.ro,
uher.marina@yahoo.com

Abstract:

The evolution of financial results reported by Romanian insurers to the commission for supervision of insurers in the context of the financial and economic crisis has spotlighted the fact that the insurance industry hasn't been immune to the crisis. A number of 28 insurers have reported losses during the peak of the crisis in Romania, i.e. 2008, their number decreased to 23 insurance companies in 2010, this being due to companies practicing mainly life insurance, because the number of companies which registered profit had increased from 8 companies in 2008 to 13 companies in 2010.

Key words: insurance industry, financial results, losses,

JEL classification: M41, G22

1. Defining specific financial results of insurance companies

Economic and financial results represent the favorable or unfavorable effect of the effort made by the entity and determined at any given time. Effects, expressed in value, reflect the amount collected from the sale of goods, works or services rendered in their own activities. The developer's effort expresses the interaction and use of production factors that are consumed in the form of production and circulation costs.

“In accounting terms, the result of the exercise (financial result) is the difference between total revenue during the reporting period and the total expenses incurred. If the revenue is greater than the expenses of the exercise (financial year), the financial result is reflected as a profit, while the reverse situation, it takes the form of losses.”¹

Specific for insurance companies² is the deduction of technical reserves from the gross profit before taxation, and after applying the tax rate, the net profit will be distributed by Shareholders' General Assembly, according to the law. The annual financial results are presented for approval by the Board of Directors of the company to the Shareholders' General Assembly, after previously having been audited by an external auditor.

In accordance with the provisions of Law No. 32/2000 on insurance companies and insurance supervision, with subsequent amendments and additions, one of the

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¹ Robu Doina Maria – *Contabilitate generală*, available at <http://www.scribd.com/doc/15897192/Contabilitate-in-comer-i-turism>, p. 208

² Bogdan Decebal Manole - *Mecanismul gestiunii financiare în societățile de asigurări*, Editura Casa cărții de știință, Cluj Napoca, 2005, p. 180-181

obligations of the insurer is to analyze the technical results per insurance classes, in order to determine whether the activity is profitable or not.

The financial results of insurance companies depend in great measure of random, unforeseen factors such as: number of contracts concluded, insurance premiums established and in time cashed, assumed commitments for the insured amount, probability that the risk is produced, extent of the damages, cash flow and its evolution over time, the level of reserves constituted and their evolution, placement and usage of reserves and other cash availability, operating and management expenses, taxation.³

The financial results are highlighted in the following documents⁴:

- the budget of income and expenditure;
- trial balance;
- profit and loss account;
- Balance sheet.

The economic activity of insurance companies is achieved to obtain a profit as higher as possible, this being carried out through: obtaining income from the sale of insurance products; financial investments; the rational use of the insurance fund in paying compensations for damages, meaning only the amounts that need to be paid.

Profit calculation is not possible at the level of the company's branches, since they do not record the full technical reserves and don't draw up a balance sheet.

Profit and loss account is a synthesis financial accounting document on the basis of which the result of the activity is determined for one calendar year.

It is specific for insurance companies to divide the profit and loss account in 3 separate accounts, namely:

- The *general insurance technical account* will be drawn up for the direct insurance fields and the reinsurance corresponding fields and it present the technical result of general insurance (profit or loss).
- The *technical account of life insurance* will be drawn up for areas of direct insurance and the corresponding field of reinsurance and it presents the technical result of life insurance (profit or loss).
- The *non-technical account* includes the results of general insurance and life insurance, and also the non-technical incomes and expenses (from investments), extraordinary incomes and expenses, the gross result, ending with the determination of the exercise's net result

The insurers whose activity consists entirely of reinsurance operations will draw up the general insurance technical account for all transactions. This provision will also apply to the companies that practice direct general insurance activity and therewith reinsurance⁵.

The technical results obtained by insurance companies will be recorded separately for the general insurance activity and for the life insurance activity. In obtaining the financial result registered in the on the market besides the technical results of the two categories of insurance the non-technical results contribute as well. Non-

³ Cistelean Lazar; Stefan Daniel; Decebal Manole Bogdan; Udrea Marcel - *Coordonate ale managementului financiar în Societățile de asigurări* – Annales Universitatis Apulensis Series Oeconomica, volumul 2, Nr. 8/ 2006

⁴ Bogdan Decebal Manole - *Sistemul informațional în societățile de asigurare*, Editura Antet, București, 2003, p. 179

⁵ ORDIN nr. 3129 din 21 decembrie 2005 pentru aprobarea reglementarilor contabile conforme cu directivele europene specifice domeniului asigurărilor, Anexa – art 49 (ORDER nr. 3129 from December 21, 2005 on approval of accounting regulations in accordance with the European directives specific for the insurance industry, Annex-article 49)

technical results include income from investments, expenses on investments, as well as income and expenses arising from the management activities of voluntary pension funds.

The significant losses recorded in the results of the companies may be caused by a number of factors, such as:

- increasing the amount of gross indemnities paid;
- increasing indemnity payments, especially in car insurance (mandatory and optional);
- increasing the amount of the technical reserves as a result of the obligation to comply with rules issued by the ISB regarding the calculation method of certain reserves;
- increasing losses registered on the capital market which decreased the value of investments made by insurers;
- increasing acquisition and management expenses, reinsurance expenses.

For reducing the current losses and those accumulated from previous years, insurance companies have on hand a series of measures such as:

- restructuring the insurance portfolios;
- adequate monitoring of the assumed risks;
- diminishing administration expenses;
- efficient management of the evaluation and payment of damages activities,
- recovery of the claims from intermediaries, etc.

The **insurance result** and the **subscription result** are specific for insurance companies⁶.

The insurance result measures the financial performance of insurance companies in activity carried out in the previous period, and is calculated by the following formula:

$$\text{Insurance Result} = \text{Premiums} - \text{Damages} - \text{Expenses} + \text{Financial income}$$

Financial income represents the income from investments generated by investing technical reserves.

The subscription result shows us how the earned premiums for the financial year are greater than the damage and expenses incurred in the same financial year, and is a measure of the subscription activity unfolded by the insurer in a financial year, and is defined and calculated by applying only the principle of exercises' independence and can be gross or net, according to the consideration of the reinsurance operations. The subscription result is calculated according to the following formula:

$$\text{Subscription result} = \text{Cashed premiums} - \text{Incurred damages} - \text{Incurred expenses}$$

2. Analysis of the results obtained by insurance companies

In order to study the impact of the financial crisis on the financial performance of the Romanian insurance companies we will analyze the results of the financial exercises at the level of the entire market in the 2007-2010 period, according to data provided by the ISB.

We can observe from the figure above that throughout the analyzed period (2007-2010) the highest profit was achieved in 2009, and the smallest in 2007.

Analyzing the data in Figure No. 1 we can also observe that in the field of insurance the highest peak of the crisis was in 2008 when the biggest loss in the history of the Romanian insurance has been registered (about 850 million lei), but this situation was rectified in 2010 compared with the period 2007-2009, when losses were approximately 277 million lei, with approximately 141 million lei less than in 2009 and with around 572 million lei less than in 2008.

⁶ Negoită Ion - *Aplicații practice in asigurări si reasigurări*, Editura Etape, Sibiu, 2001, pag 549-551

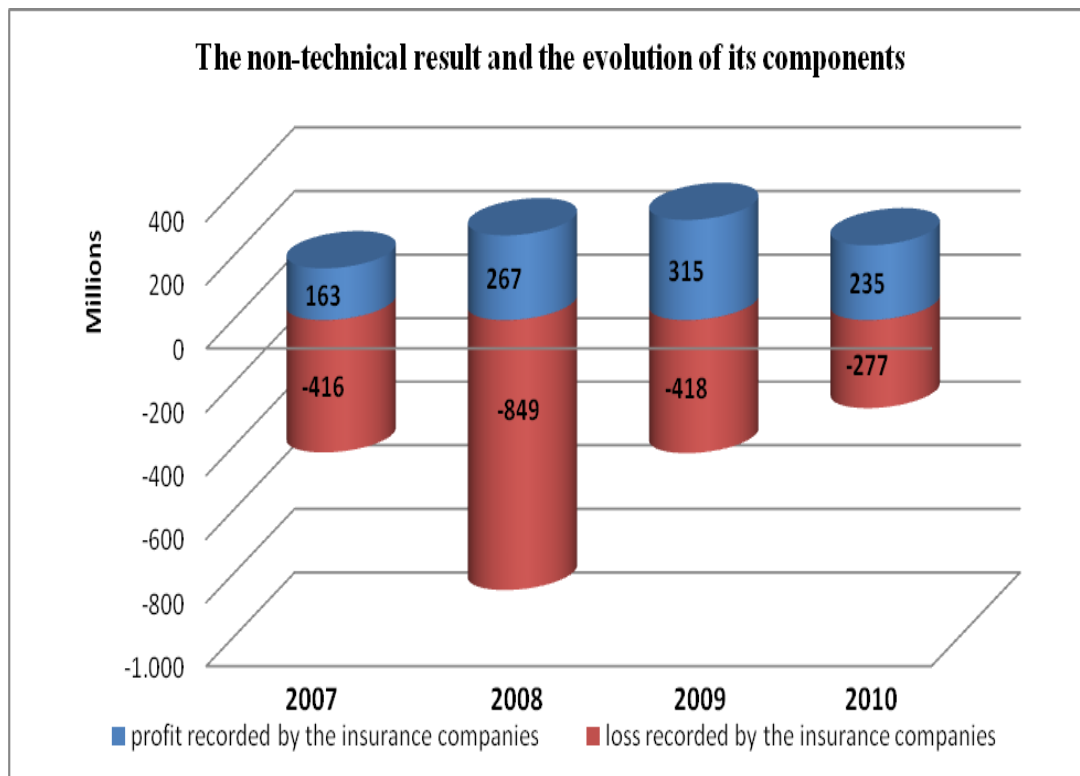


Fig. 1. The non-technical result and the evolution of its components, i.e. financial result

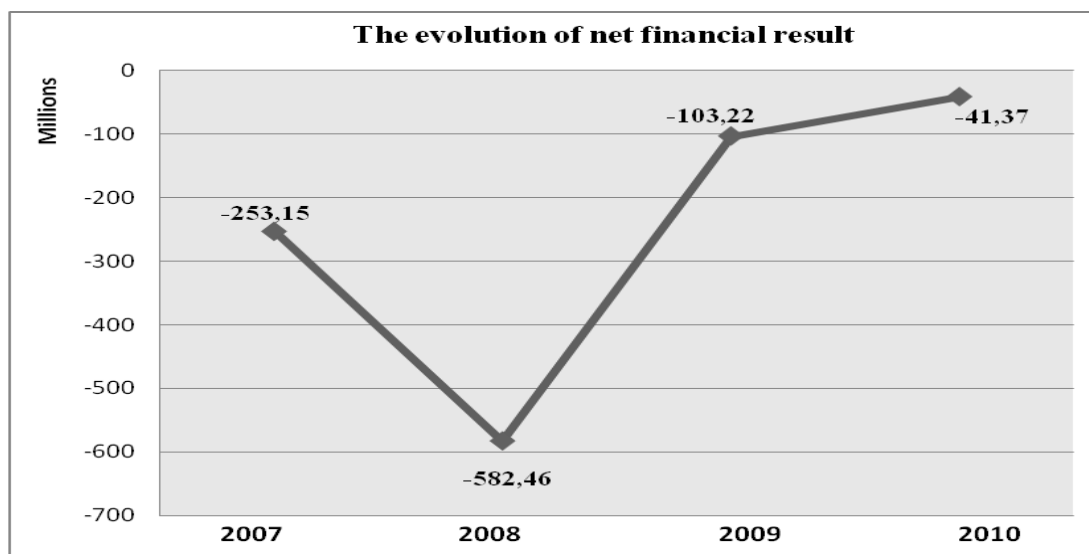


Fig. 2 The evolution of net financial result

In the figure above we can observe that in 2010, the Romanian insurance market has registered the lowest negative net result (determined as the difference between profit and loss) of the entire analyzed period, 41.369.241 lei, compared with the year 2009 when its value was 103.215.754 lei, and in 2008 its value was the highest, respectively 582.457.431 lei. This means that in 2010 compared with 2009, losses were reduced by 33.86%, while compared to 2008 with almost 93%, this actually taking place due to the insurance companies which made their activities more efficient. The negative net result registered in 2010, is 2.5 times lower than the net loss recorded in all insurance companies in the previous year and 14 times lower than the net loss for the financial year 2008.

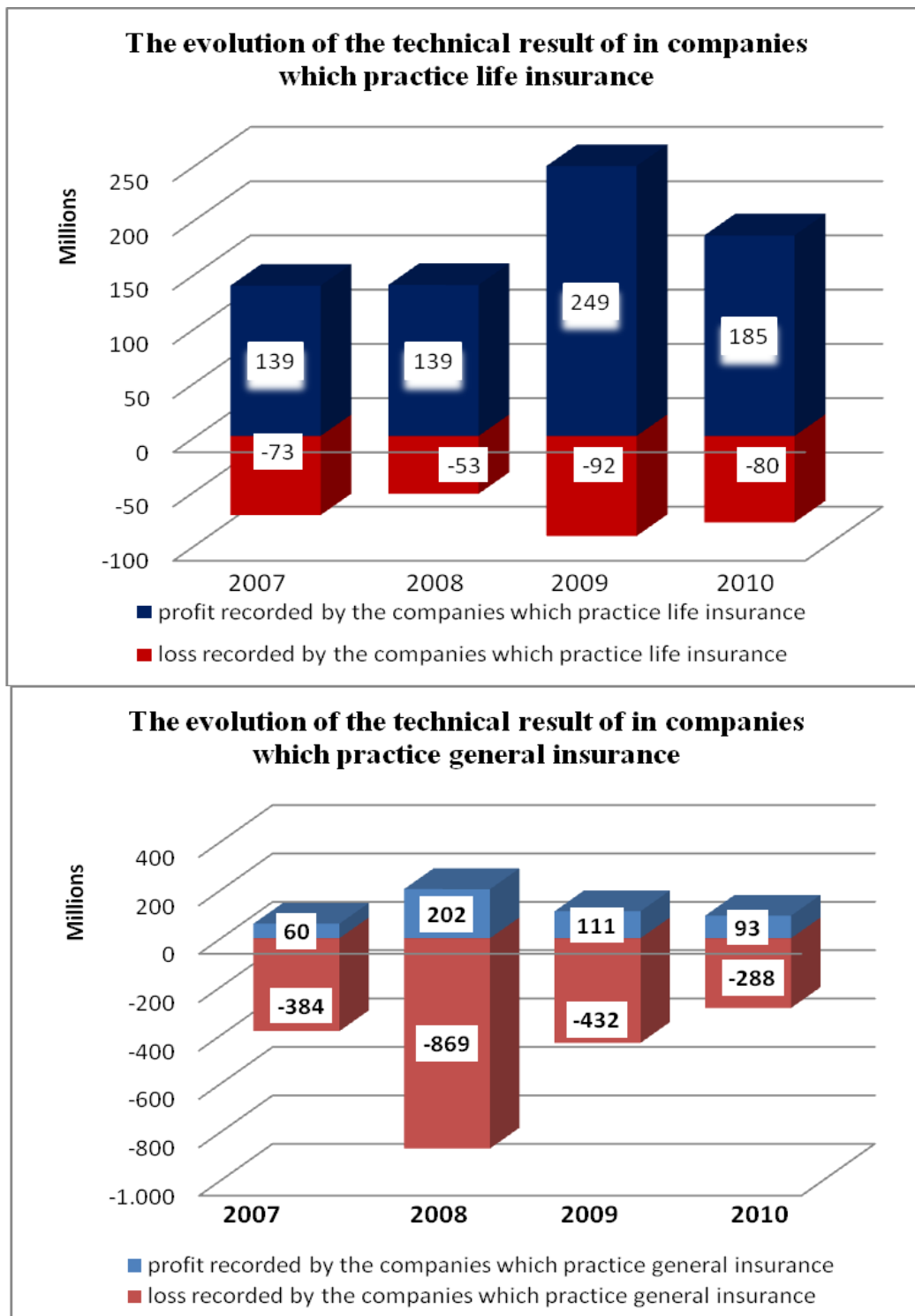


Fig. 3 The evolution of the technical result of in companies which practice general insurance and companies which practice life insurance

Regarding the technical results obtained by insurance companies, we can notice that throughout the analyzed period the most profitable is that of the insurance companies that practice life insurance. We observe that in these companies the highest profit was achieved in 2009, its value being 248.736.055 lei, while the smallest value in the year 2007 when companies that practiced life insurance have registered in their technical account a profit of just 138.512.010 lei, while in 2008 their profits grew by only 0.5%. In 2010, compared with the previous year, the technical result corresponding to life insurance activities fell by 63.887.048 lei, which is by about 25%.

The loss registered in the technical account of life insurance was 72.814.941 lei in 2007, in 2010 there was registered a technical loss in the amount of 79.565.673 lei, i.e. only 9% higher than at the beginning of the analyzed period.

We can also observe in Fig. 3 that in the general insurance sector the cumulative value of the technical profits from general insurance reached the highest value in 2008, its value being 202.485.080 lei, about 3.4 times higher compared with the previous year, the technical result related to the general insurance activity was in 2007 just 59.755.820 lei, while in 2010 the insurance companies recorded a technical profit worth 92.969.443 lei, which is by 55% higher than at the beginning of the analyzed period.

The loss value from the technical account of general insurance has also reached the peak in 2008, the loss being in the amount of 868.933.428 lei, diminishing until 2010 with approximately 67%, i.e. a technical loss of 288.052.643 lei.

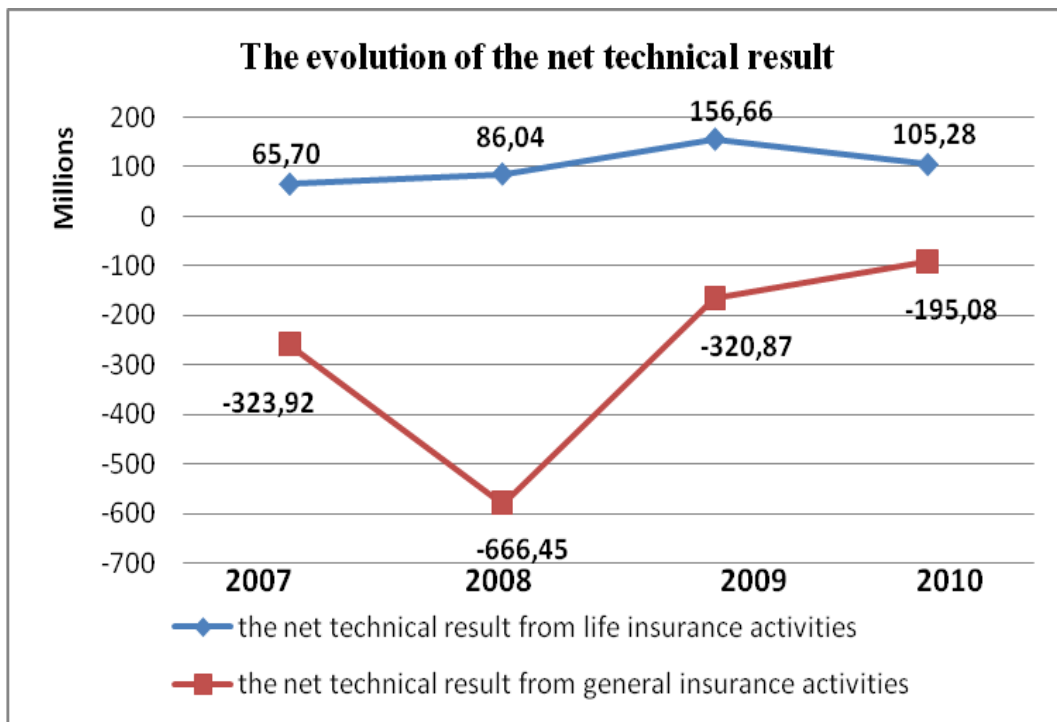


Fig. 4 The evolution of the net technical result

We observe that the highest net profit from life insurance activities was achieved in 2009, i.e. 156.657.196 lei. In 2010 a net technical result from life insurance activities was obtained in the amount of 105.283.334 lei. Compared with the previous year, the net technical result from life insurance activities decreased by 51.373.862 lei, respectively with 33%, but compared to the beginning of the analyzed period, respectively 2007, the net profit has increased by 60%.

In 2010 on the entire market, life insurance activity has generated a negative technical result (loss) of 195.083.200 lei.

However, it should be noted that compared to the technical result recorded in 2009, which was also negative (minus 320.870.559), the net technical loss in 2010 is about 40% less (i.e. 125.787.359 lei).

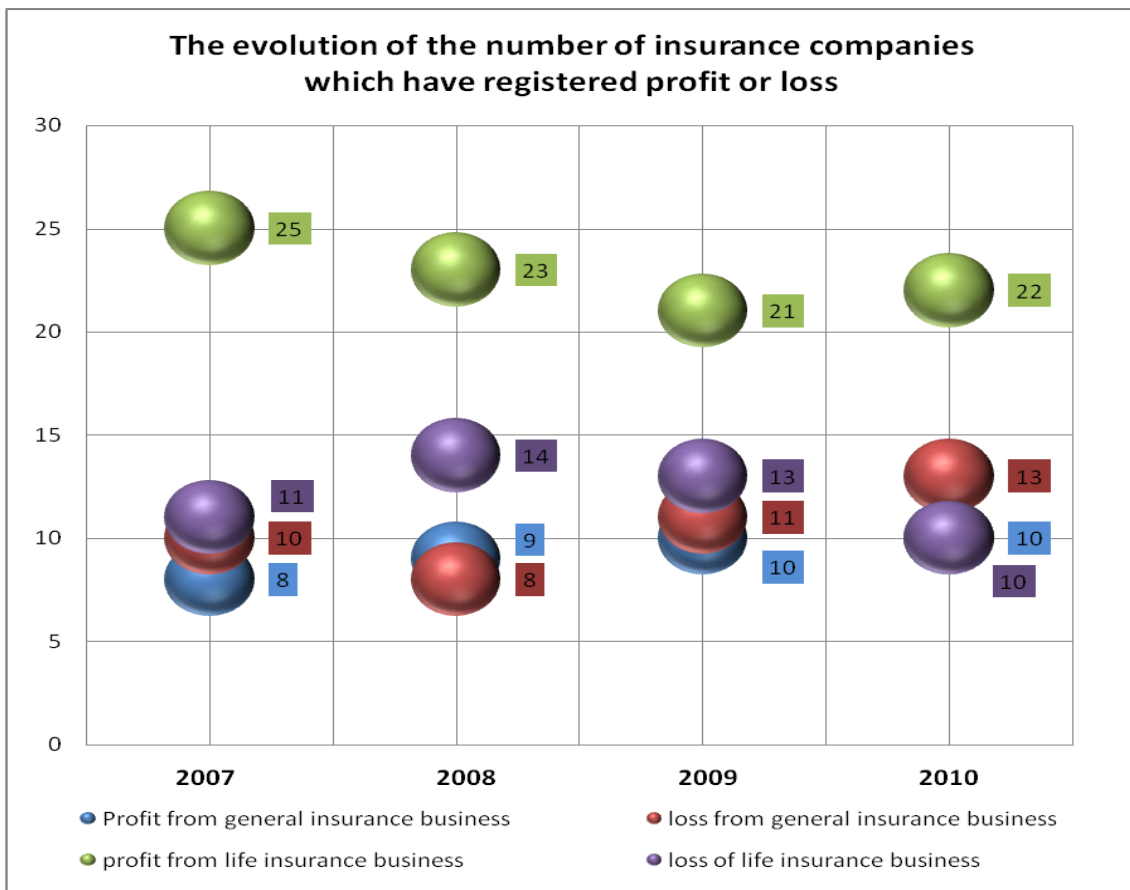


Fig. 5 The evolution of the number of insurance companies which have registered profit or loss

In the figure above, we can observe that throughout the analyzed period most of the companies registered loss (i.e. negative net technical result) however their number has diminished from 25 companies in 2007 to 22 companies in 2010.

CONCLUSIONS

The economic crisis has led to a decline in the financial performance of the Romanian insurance companies being influenced by a number of factors. According to the data published by the Directorate for Driving Licenses and Vehicle Registration in 2010, the number of new cars registered in Romania dropped by 18.5% compared to the previous year. Moreover, the number of vehicles with an inveteracy less than 5 years, which were most likely purchased through a lease contract or a bank loan, which implicitly means that they have Casco insurance, has decreased in 2010 by 6% compared with the previous year and by 8% compared to 2008 when the economic crisis started. The financial crisis has been felt most acutely in the life insurance sector, this being due to the increase of unemployment and the decrease of the income for consumers of insurance products.

However, one of the factors that have had a significant influence on the sector was the psychological one, because fear and uncertainty regarding the financial safety of consumers have led to an increase of contract cancellations and repurchase agreements, as well as to the postponement of the intention to purchase life insurance policies.

In crisis conditions insurers must seek the most effective ways to optimize costs and to use systems adapted to new market needs.

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