

THE ABILITY OF ROMANIAN INSURERS TO COVER TECHNICAL RESERVES UNDER PRESENT CONDITIONS*

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 insurance companies are required to cover gross technical reserves with permitted assets in accordance with the legal regulations in force, namely prudential rules issued by the Insurance Supervisory Commission in accordance with the European directives on the matter, and the coverage of the gross technical reserves, is an important indicator in the insurance sector because it reflects the ability of companies to honor their obligations to the insured.

Key words: insurance companies, the gross technical reserves, permitted assets,

JEL classification: M41, G22

1. Introduction

Technical reserves are established for each line of insurance as special funds so that the stability and solvency of insurance companies are not affected.

Technical reserves are estimates of future payments for risks produced in the past (for general insurance) or for those that will occur in the future (for life insurance) and the value of technical reserves should allow the insurer, at any time, to honor its commitments arising from the insurance contracts¹.

Efficiency or “the ability to do things right” is a type of effect/effort concept. An effective manager is person who attains effects (results) measured through the undertaken effort (labor, materials, time). Managers who are able to minimize the cost of the resources needed to achieve the goals of the entity are efficient managers.²

In order to assess the effectiveness of the activity that is carried out in insurance companies we can compare on the one hand, the effect obtained in relation to the effort, and on the other hand, there will be done an analysis of the actual financial results obtained.

For the insured the effect obtained as a result of the insurance activity is represented by the compensation granted by the insurer and which allows the creation of those conditions favorable to the economic activity's continuity, maintaining the property's integrity, strengthening and adopting some additional precaution measures and saving provisions, while *for the insurer, the effect* is given by its own financial results that he obtains and that guarantees his further functioning in conditions of maximum security. *The efforts made by the insured* consists in paying the insurance

* "This article is a result of the project “Creșterea calității și a competitivității cercetării doctorale prin acordarea de burse”. This project is co-funded by the European Social Fund through The Sectorial Operational Programme for Human Resources Development 2007-2013, coordinated by the West University of Timisoara in partnership with the University of Craiova and Fraunhofer Institute for Integrated Systems and Device Technology - Fraunhofer IISB.”

¹ Nagy Cristina Mihaela, Trif Viorel – “Particularities of the financial statements at insurance companies”, „Anale. Seria Științe Economice, Timișoara” Volumul XVI, Editura Mirton, 2010, p. 604

² Dalotă Marius-Dan – *Management: Elemente fundamentale, ediția a 3-a, revizuită și adăugită*, Editura Orizonturi Universitare, Timișoara, 2003, p. 10

premiums, and the *insurer's effort* consists in activities such as leadership, management and organizing the funds established and/or placed in various financial operations.³

To meet the obligations under the concluded insurance contracts, insurance companies must permanently manage and monitor both the subscription and the investment placements activities, so as to obtain positive technical and financial results.

The structure of the portfolio of assets should be correlated with the assumed obligations, both in terms of the currency in which they are expressed, and from the point of view of the maturity dates or periods of maturity, but taking into account the legislation in force, in particular that relating to assets used to cover gross technical reserves for the insurer which practices general insurance or life insurance activities, the assets' dispersion permitted to cover gross technical reserves.

2. Defining the assets admitted to cover technical reserves

The assets of insurance companies include tangible assets, current assets, and financial assets. There are insurance companies operating in a classic system with fixed territorial structures (offices, cars, furniture and other equipment) belonging to the tangible and intangible assets' category, but the current management prefers a mobile structural organization without owned offices, and the spaces in which it operates are mostly rented and the means of transport are used through lease agreements.

The insurance companies are required to cover gross technical reserves with permitted assets in accordance with the legal regulations in force, namely prudential rules issued by the Insurance Supervisory Commission in accordance with the European directives on the matter.

Eligible categories of assets admitted to cover the technical reserves of the insurer, dispersion of investments rules, as well as the liquidity coefficient which is determined by the rules, at their development the categories and classes of practiced insurances are taken into account. So, in order to cover gross technical reserves investment must be made taking into account the type of activity carried out by the insurance company, in order to ensure efficiency, safety and investment tradability, ensuring the dispersion of those assets.

Insurance companies must cover their gross technical reserves with matching assets in accordance with the provisions of the legislation in force. The categories of assets eligible to cover the gross technical reserves of insurer that practices general and life insurance activities starting with July 1, 2011 are as follows:⁴

● Investments:

- State securities and Treasury bonds issued by the Member States;
- securities issued by local public administration authorities;
- bonds and other money and capital market instruments, treated as such, traded on a supervised market;
- shares and other variable efficiency participations, treated as such, traded on a supervised market;
- units in collective placement bodies in transferable securities and other investment funds;
- current accounts and deposits in credit institutions;
- lands, constructions in the companies' property;

³ Monea Mirela – Asigurări comerciale, Petroșani, 2008, p. 80

⁴ Ordin nr 9/2011, privind activele admise sa acopere rezervele tehnice brute pentru asiguratorul care practica activitatea de asigurari generale, dispersia activelor admise sa acopere rezervele tehnice brute, precum si coeficientul de lichiditate, Publicat in Monitorul Oficial, nr. 325 din 11 mai 2011, Anexă - art.4 (Order No. 9/2011, on assets permitted to cover gross technical reserves for the insurer that practices general insurance activity, the dispersion of assets permitted to cover the gross technical reserves, as well as the liquidity coefficient, published in Monitorul Oficial, nr. 325 on 11 May 2011, annex, art. 4)

- **Receivables:**
 - receivables from insurers and intermediaries resulting from direct insurance operations and reinsurance acceptance;
 - the technical reserves relating to contracts ceded in reinsurance;
 - receivable interest for assets permitted to cover gross technical reserves.
- **Others:**
 - carried forward acquisition costs;
 - available funds in cash-office.

The assets permitted to cover the gross technical reserves will be assessed by respecting some conditions and criteria, at the net value, i.e. without excluding acquisition costs, on prudential basis, taking into consideration any future failures.

Shares, bonds and other instruments of the capital market must be listed on an official stock exchange for securities, being valued at market value, which is the value established at the end of the financial year, and when the end of the financial exercise is not a stock exchange trading day it will be taken into account the last trading day before that date.

Shares, bonds and other instruments of the capital market traded on a regulated and supervised market, as participation securities to collective placement bodies in transferable securities and other investment funds, may represent 50% of the total of the technical reserves, provided that the securities issued by the same entity does not exceed 5% of the technical reserves.

Bank deposits in lei are evaluated on the basis of nominal value, which represents the amount of the deposit without interest and liquidity in foreign currencies, constituted as fixed-term deposit according to the contracts concluded with the banks and liquidity in foreign currency held in current accounts will be assessed at the exchange rate of the currency market established and communicated by the National Bank of Romania at the end of the financial year.

Liquidity and deposits at credit institutions can not exceed 90% of the total reserves, but not more than 10% of the gross technical reserves in one credit institution.

Available funds in cash-office can represent 3% of the gross technical reserves.

Land and buildings are accepted as cover for gross technical reserves only to the extent that the insurer provides proof of ownership and they are free of charges. Construction will be insured against all risks to which they are exposed, at least at the value considered to cover gross technical reserves, based on a separate insurance with another insurer or auto-insurance, provided that the reinsurance is risk transferred in a proportion of at least 70%, for external re-insurers.

For this category of assets a value higher than 10% of the gross technical reserves for a single land or building or in a number of lands or buildings close enough to each other to be considered effectively as one investment; the investment made in several lands or buildings can not exceed 40% of the total technical reserves.

The claims admitted to cover gross technical reserves shall be calculated on a prudential basis, taking into account any future losses. The claims from the insured and intermediaries resulting from direct insurance and reinsurance acceptances operations may be accepted as cover for gross premium reserves, up to their level and only to the extent that they are not outstanding for more than 30 days from the due date stipulated in the contract.

Carried forward acquisition costs may be accepted as cover for technical reserves only to the extent that the calculation method is compatible with the calculation of premium reserves.

Other assets could be admitted to represent technical reserves only with the Insurance Supervisory Commission's approval, at a value determined based on an analyses, performed for each particular case.

Regarding assets admitted to cover gross technical reserves, others than the ones mentioned previously, for which maximum limits were not provided, at their investment the insurer will comply with the following regulations:⁵

- the assets covering the gross technical reserves must be diversified and dispersed so that there isn't an excessive use of a particular category of assets, of an investment market or an investment;
- investments in certain types of assets, which presents a high risk either due to the nature of the asset or due to the condition of the issuer, must be restricted to a prudential level;
- the limitations in certain categories of assets must take into account consideration the treatment of reinsurances in calculating technical reserves;
- if the assets held represent an investment in a subsidiary that manages integrally or partially the insurer's investments in his name, the assets of the subsidiary will be taken into account, the treatment of the assets from the insurer's other subsidiaries is similar.

3. The evolution of assets admitted to cover gross technical reserves and their coverage

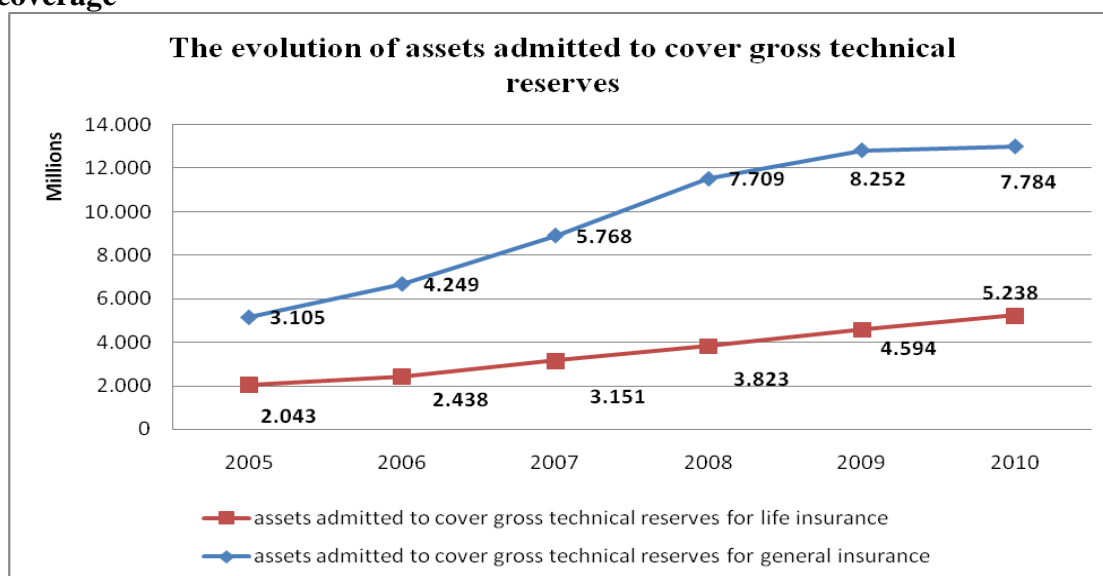


Figure no. 1. The evolution of assets admitted to cover gross technical reserves

In Figure no. 1 it can be seen that the value of the assets admitted to cover gross technical reserves established for the general insurance activity is higher throughout the analyzed period than the value for the life insurance activity, their value increasing from 3.104.996.270 lei in 2005 to 7.783.772.071 lei in 2010, i.e. an increase of 2.5 times that is also valid in the case of assets admitted to cover gross technical reserves established for the life insurance activity, but their value increased only from 2.043.186.966 lei to 5.238.415.318 lei.

⁵ Ordin nr 9/2011, privind activele admise sa acopere rezervele tehnice brute pentru asiguratorul care practica activitatea de asigurari generale, dispersia activelor admise sa acopere rezervele tehnice brute, precum si coeficientul de lichiditate, Publicat in Monitorul Oficial, nr. 325 din 11 mai 2011, Anexă - art.7 (Order No. 9/2011, on assets admitted to cover gross technical reserves for the insurer who practices general insurance activity, the dispersion of assets admitted to cover gross technical reserves, as well as the liquidity coefficient, published in Monitorul Oficial, nr. 325 on 11 May 2011, Annex - art. 7)

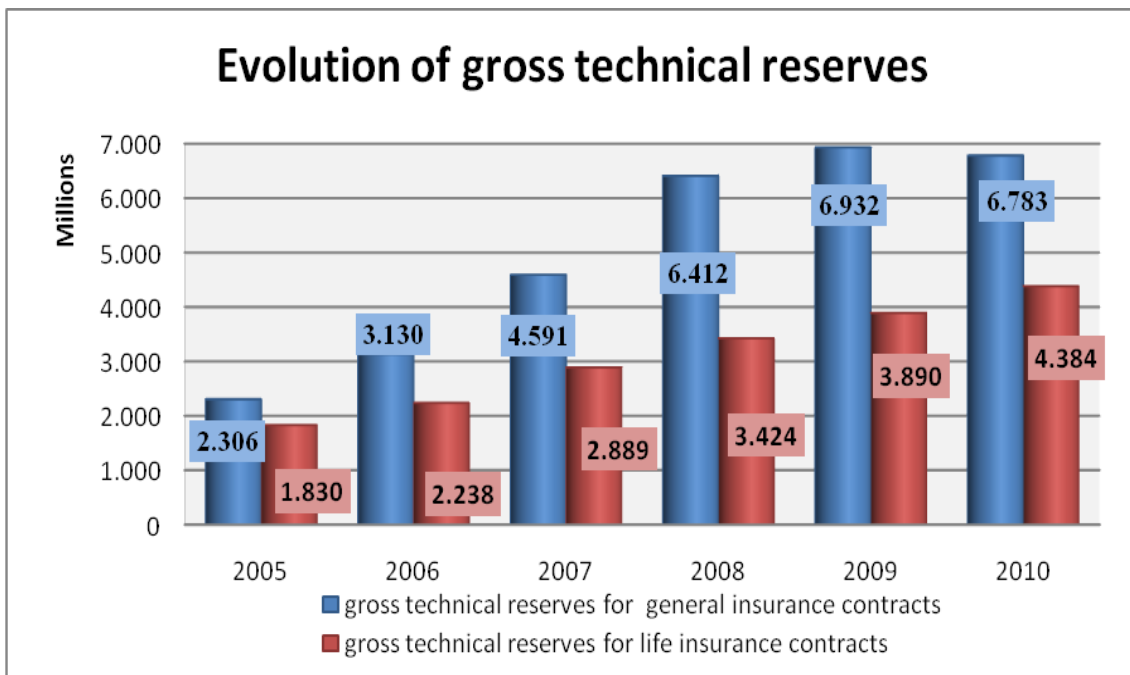


Figure no. 2 Evolution of gross technical reserves

In Figure no. 2 it can be seen that for contracts concluded by insurers which are engaged in the general insurance activity, the total gross technical reserves formed was 2.305.645.336 lei in 2005 and has increased annually, reaching in 2010 an amount of 6.782.629.538 lei, the increase compared to 2005 is approximately 295%.

For contracts concluded by insurers which are engaged in the life insurance activity, the total gross technical reserves formed was 1.829.665.245 lei in 2005 and 4.383.572.919 lei in 2010, the increase is over 239%.

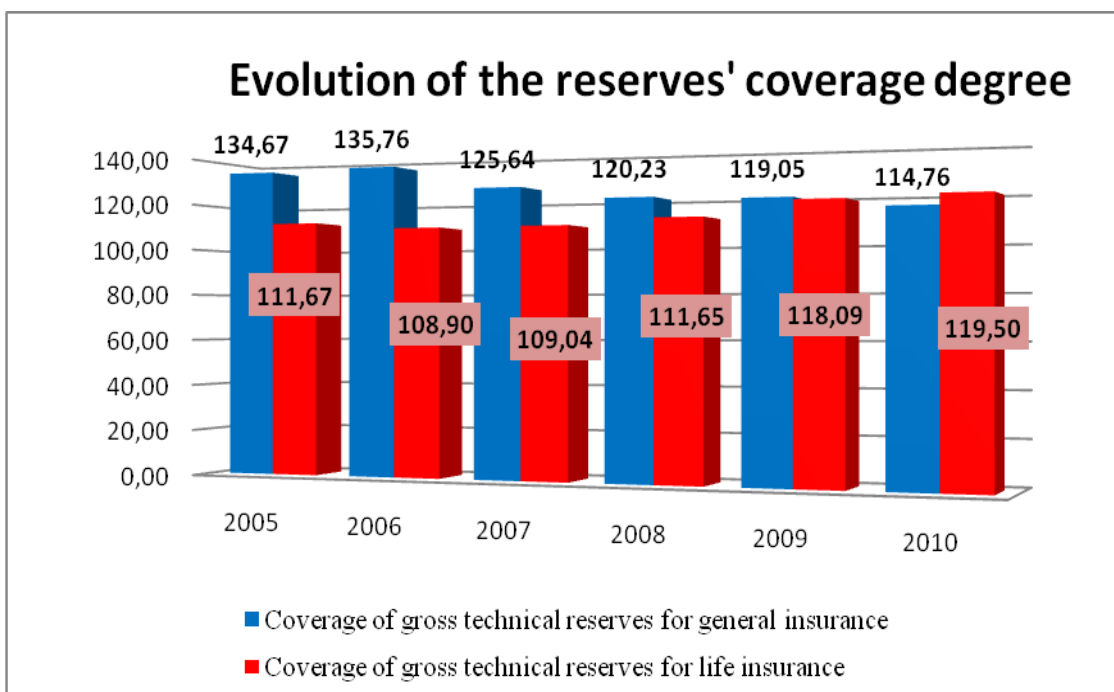


Figure no. 3 Evolution of the reserves' coverage degree

Coverage of gross technical reserves for life insurance through admitted assets grew by almost 8 percents, from 111.67% in 2005 to 119.50% in 2010; instead the coverage of gross technical reserves for general insurance has decreased by 20%, from 134.67% in 2005 to 114.76% in 2010.

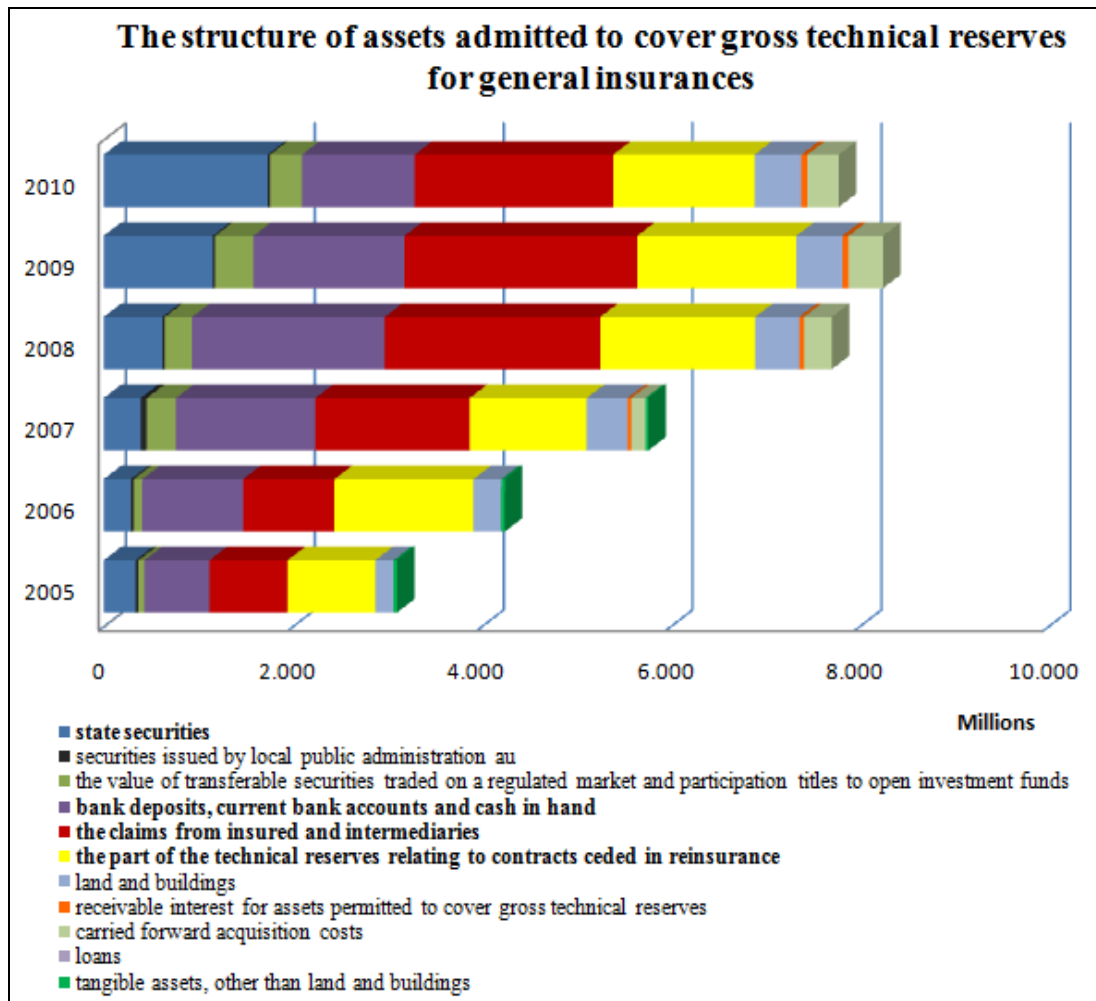


Figure no. 4 The structure of assets admitted to cover gross technical reserves for general insurances

In Figure no. 4 we can observe that throughout the analyzed period in the structure of assets admitted to cover gross technical reserves for general insurance, the largest share was represented by three types of admitted assets, respectively *the claims from insured and intermediaries*, *the technical reserves relating to contracts ceded in reinsurance* and *bank deposits, current bank accounts and cash in hand*, the exception appeared in 2010 when *State securities* took the place of *available funds in deposits, current accounts and petty-cash*.

Throughout the entire analyzed period the structure of assets admitted to cover technical reserves for this category of insurance was as follows:

- *claims from insured and intermediaries* with a share of 27% in 2005 and in 2010, the highest share was registered in 2008 and 2009;
- *the part of the technical reserves relating to contracts ceded in reinsurance* with a share of 30% in 2005 decreased by 10% by the end of the period (2010);
- *bank deposits, current bank accounts and cash in hand* decreased by 7%, from 22% in 2005 to 15% in 2010, this decrease was in favor of the *State securities*, which registered a growth from 21% in 2005 to 22% in 2010.

Changing the assets' portfolio by reducing the amount of bank deposits can be explained both by large compensation payments made by insurance companies, but especially by the fact that companies have oriented to other investments with a higher efficiency.

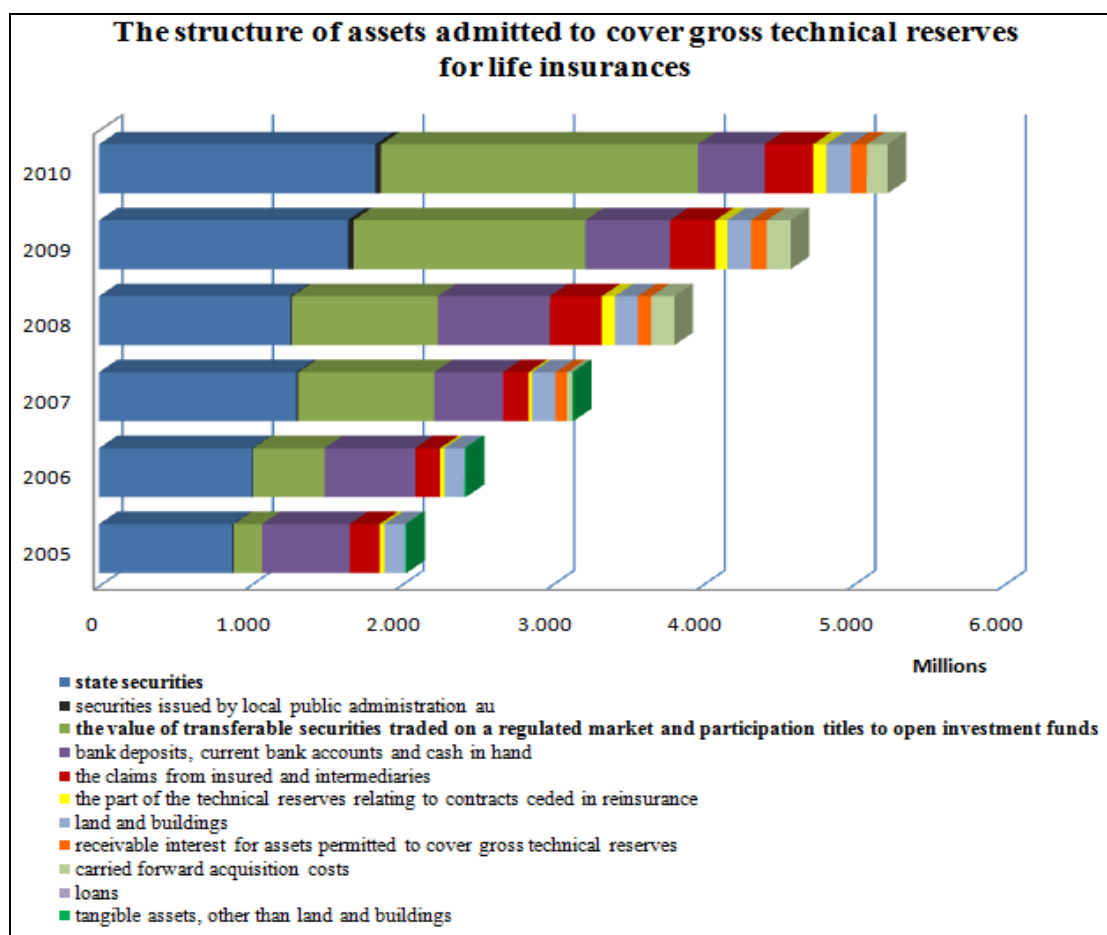


Figure no. 5 The structure of assets admitted to cover gross technical reserves for life insurances

In Figure no. 5 we can observe that in the period 2005-2009 in the structure of assets admitted to cover gross technical reserves for life insurances, the largest share was held by *State securities* that have had a share between 36% and 42%, this being due to their stability and safety. *The value of transferable securities traded on a regulated market and participation titles to open investment funds* have registered a spectacular growth from a rate of 9% in 2005 (188.925.363 lei) to 40% in 2010 (2.102.656.334 lei) of the assets admitted to cover gross technical reserves for life insurances, the increase value being 11 times higher.

The bank deposits, current bank accounts and cash in hand, reported as an asset admitted to cover gross technical reserves, had a value of 582.599.977 lei at the beginning of the analyzed period (2005) and at the end of the analyzed period (2010) the value of these assets was 444.842.492 lei, only their share in the total assets admitted to cover gross technical reserves for life insurance decreased from 29% to 9%.

Conclusions

The value of State securities and Treasury bonds issued by the Member States have had the highest share in the structure of assets admitted to cover gross technical reserves for life insurances, but also for general insurances, which means that insurance companies have oriented their investment policy towards assets that provide increased efficiency and safety.

We observe that most of the assets covering gross technical reserves for insurance are represented by instruments with low risk and can be converted into liquidity in a short time, so we can say that insurance companies may honor their

obligations assumed to the insured, since technical reserves are covered even up to their gross value, so the market remains stable.

BIBLIOGRAPHY

1. Dalotă Marius-Dan – *Management: Elemente fundamentale, ediția a 3-a, revizuită și adăugită*, Editura Orizonturi Universitare, Timișoara, 2003
2. Monea Mirela – *Asigurări comerciale*, Petroșani, 2008
3. Nagy Cristina Mihaela, Trif Viorel – “*Particularities of the financial statements at insurance companies*”, „Anale. Seria Științe Economice, Timișoara” Volumul XVI, Editura Mirton, 2010
4. *** Ordin nr 9/2011, privind activele admise sa acopere rezervele tehnice brute pentru asiguratorul care practica activitatea de asigurari generale, dispersia activelor admise sa acopere rezervele tehnice brute, precum si coeficientul de lichiditate, Publicat in Monitorul Oficial, nr. 325 din 11 mai 2011 (Order No. 9/2011, on assets permitted to cover gross technical reserves for the insurer that practices general insurance activity, the dispersion of assets permitted to cover the gross technical reserves, as well as the liquidity coefficient, published in Monitorul Oficial, nr. 325 on 11 May 2011)
5. *** Ordinul nr. 3129 din 21 decembrie 2005 pentru aprobarea reglementarilor contabile conforme cu directivele europene specifice domeniului asigurărilor (ORDER nr. 3129 from December 21, 2005 on approval of accounting regulations in accordance with the European directives specific for the insurance industry)
6. Rapoartele Comisiei de Supraveghere a Asigurărilor 2007-2010 (Insurance Supervisory Commission reports 2007-2010)