INFLUENCE OF ADJACENT INSURED RISKS UPON THE MANAGEMENT OF INSURANCE COMPANIES

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1. Adjacent risks

Besides technical and investment risks, other risks can be identified, with own traits and implications that cannot be ignored. We speak about the risk of participation, the risk regarding guarantees in favor of tertiary, risk regarding loss because of tertiary, general business risk and managerial risk.

The risk of participation is the risk that an insurer assumes when he is a share holder in other companies. It is known that companies can have financial difficulties that are felt by the share holders. As a result any capital subscription to another company has to be done prudently.

The risk regarding guarantees given in favor of tertiary makes its effect felt if the insurer that guarantees has to pay a guarantee for a promise made to a tertiary person. Such payments affect the financial capacity of the insurer, reason for which such guarantees must not be done with easiness, but very prudently.

The risk of having loss because of tertiary can appear when tertiary persons do not respect obligations regarding the insurer. These kinds of obligations appear in the case of reinsurance contracts, coinsurance or intermediary ones.

The general risk of business when it evolves in a certain legal framework, major changes that it encounters (for example, ones referring to taxation) can affect the profitability rate of business. Also, changes that could occur economical or socially, here being included the cyclic character of economy, can determine mutations in the profile and structure of business and the dimension of obtained financial results.

The managerial risk refers to the risk that an insurer could confront, when the management activity is not attained by competent people or when among them are people inclined to cheat. Because of the importance of this risk some detailing is necessary.

As it is known, management in a complex activity that implies among others, managers with special professional training, initiative, devotion, courage, responsibility, and sobriety, sufficient knowledge of psychology and sociology and futurology. This is how it is explained why sometimes the managerial activity hasn't got sufficient people able to lead to performance. Thus, along objective factors we can talk about subjective factors as well, that are related to human emotions and that can determine a managerial risk in the insurance activity. This risk includes:

- Willingly settling lower premium tariffs to gain or maintain an important segment of the insurance market;
- Practicing reinsurances that do not have sufficient guarantee in achieving the proposed goal, because: completed reinsurance contracts don't take into consideration all the characteristics of the risks cession in reinsurance; an optimum dispersion was not pursued, having an insufficient number of reinsurers in order to be representative;

- The existence of a distribution network (of placement) that does not comply with exigencies because: a stable insurance portfolio hasn't been reached yet, the profitability degree of business is inadequate, because agents lacking necessary qualification and experience are being used and commissions fixed with agents do not take into consideration the quantity and quality of the contracts;

- Practicing a passive control regarding the retrieval of sums owed by debtors. It's about debts regarding mortgages, loans and sums to retrieve from reinsurers;

- Internal control is not made at necessary quality parameters in order to avoid inefficient operations that lead to high administrative costs;

- The expertise that has to be made regarding damage payments has deficiencies, thus facilitating the payment of some ill-founded damages or even cheating that take place with the involvement of some employees of the insurance company.

The above mentioned aspects regarding managerial risk mark out the relationship between the risks we have spoken earlier; this is a reason why clearly defining managerial risk is difficult. So, it means that a management of a doubtful quality creates aggravating circumstances for the risk we already referred to.

The agents that determine the apparition of "other risks" and the effect propagated by these factors is presented in the diagram below:

Table 1. Agents that generate "other risks"

AGENTS APPELLATION	THE EFFECT PROPAGATED BY THESE FACTORS	OTHER RISKS
Market economy and its specific laws (competition, insolvency)	Adopting group strategies Apparition of some financial difficulties in companies where the social capital was subscribed	Participation risk
Market economy and its specific laws (competition, insolvency)	Appearance of insolvability state in some partners	The risk related to guarantees given to tertiary person
Unsecure financial markets Cyclic character of economy	The demand is dropping in the insurance market Some insurance policies are annulled	General business risk
Shortage in educational system The diminish of attention given to ethical values	Reduction in the quality of professional training The diminish of responsibility spirit and showing lack of confidence	Managerial risk

Source: the Bureau of surveillance for insurance activities, Study regarding surveillance in insurances, internal use, Bucharest 1997, page 6

Taking into consideration the particular importance that actions in process have in preventing different global risks, the existence of a legal framework is necessary in order to supervise the insurer's activity, which endorses their maintenance and support.

The goal aimed by establishing such a legal surveillance framework of insurers is to prevent and limit risks. In this line according to the law, basis

coordinates are settled which define managerial strategies. So surveillance pursuits that an insurer has the capacity in every moment to execute its obligations to his insurance holders, assumed in insurance contracts.

Regarding the above mentioned the problem of establishing methods that prove to be the most suited in risk prevention and limitation is raised. These rules, like prevention methods too, in a large amount are not the privilege of the insurers' management, but are settled in surveillance regulations, sometimes quite precisely.

Of course, differences between surveillance systems can be encountered, concrete regulated domains or general rules (through suggestions or indications) being different from a country to another, some don't even have a precise regulation.

In what follows we will present some of the regulations common to all surveillance systems, which are practiced in the European Union in order to prevent or limit global risks.

a)For technical risks

Table 2.Prevention and limitation regulations and measures for technical risks which are applicable in the European Union.

PREVENTION AND LIMITATION MEASURES	SURVEILLANCE REGULATIONS THAT ARE POSSIBLE TO APPLY
1) regarding premiums tariff settlement: -prudently calculating premiums; -modification clauses of premiums; -extra fee for special risks; -offering bonuses in the case of no damages	-calculation methods compulsory for insurance premiums; -existence of legal stipulations for premiums modifications; -definition and utilization mode of statistic data in premium calculation; -share holder responsibility
2) referring to conditions at the base of the insurance policies: -the existence of stipulations for cost limitation; -possibility of excluding some risks; -the possibility of annulling the policy by the insurer.	Insurance contract regulation.
3) regarding the strategy of closing the insurance contract: -establishing the risk groups -the possibility of closing the contract for diverse risks (diversity of risks) -risk dispersion	Stipulations regarding risk limiting in a contract.
4) concerning technical reserves: -prudency principle; -establishing reserves for volatile risks (balance reserve)	Compulsive calculation methods for technical reserves. Compulsiveness of presenting a report.
5) regarding profit control	Profitability has to be proved by an actuary.

Source: Surveillance office of insurance activity, Study regarding surveillance in insurances, internal use, Bucharest, 1997, page 6

b) For investment risk:

Table 3. Prevention and limitation regulations and measures for investment risks, applicable in the European Union.

PREVENTION AND LIMITATION MEASURES	SURVEILLANCE REGULATIONS THAT ARE POSSIBLE TO APPLY
-prudent evaluation; -respecting requirements regarding the making of the evaluation; -risk diversity and dispersion; -carefully choosing currency	Rules referring to investments; Rules referring correspondence between currency and debts for tertiary; Accounting regulations for insurances
-matching assets with the obligation types for tertiary -adequately using financial instruments -contract cancellation tests	Regulations regarding the use of financial market instruments the compulsiveness of the actuary to test different scenarios

Source: Surveillance office of insurance activity, Study regarding surveillance in insurances, internal use, Bucharest, 1997, page 6

c) For "other risks"

For what concerns these risks, excepting the general risk of business and managerial risk, the prevention action can be realized by avoiding exposure to them. It is about not buying shares from other companies unless the certainty that the business has no unacceptable risks exists and if according guarantees in favor of other companies is not involved.

Against general business risk establishing some concrete measures to prevent it is quite difficult. As for managerial risk, usually an insurer should have the capacity to establish on its own prevention methods.

Regarding the above mentioned, possible regulations that could be taken into consideration in supervising other risks are:

Table 4. Prevention regulations for other risks, applicable in the European Union

RISK TYPE	POSSIBLE SURVEILLANCE REGULATIONS TO APPLY
1. Participation risk	-prohibition of capital subscription to other companies; -first approving capital subscription; -shares representing subscribed capital cannot be used as assets afferent to technical reserves of solvability margin
2. Risk regarding guarantees given to tertiary persons	-forbidding the giving of such guarantees
3. Risk of not cashing in debts from tertiary persons	-establishing provisions for such risks
4. Managerial risk	-honorability and competence rules for significant members of the insurer -control that has to be done to significant share holders -rules referring control inside the company -rules regarding share holder's responsibilities -rules regarding qualification and agent preparation

Source: Surveillance office of insurance activity, Study regarding surveillance in insurances, internal use, Bucharest, 1997, page 6.

In dedicated literature we meet other tackles regarding the risks that insurance companies' management could have in mind. It is about seeing the relationship between manifested risks in the insurance company, systematic risks (those manifested at the level of the entire industry of insurances) and systemic risks (those manifested in the entire economy).

In what follows, we will present these three categories of risks based on the grouping presented in the mentioned magazine.

Risks that are manifested in an insurance reinsurance company.

Table 5. Risks in an insurance reinsurance company.

NAME OF THE RISK	MANIFESTATION FORM IN LIFE INSURANCES	MANIFESTATION FOR IN GENERAL INSURANCES
Subscription	Increased volume and frequency of risks as a result of death and longevity indexes modification	Increased volume and frequency of damages determined by the changes regarding different natural catastrophes.
Subscription management	Shortcoming subscription determined by a wrongful selection of risks and an inappropriate projection with the reality of the market.	Same with life insurances. Plus here could appear losses determined by an unreal dimensioning and quota of reserves, managerial development decisions, lack of experience and important loss concentration.
Credit	Investment risks and weak collection of the premiums from intermediary.	Same with the ones in life insurances, plus the inability to recuperate sums from reinsurances (main factor of credit risk).
Reinsurance	Less felt in life insurances.	A reinsurance program that does to cover sufficiently. The re insurer hasn't got the capacity to promptly honor assumed obligations.
Operational	Fraud, products that cannot be sold, IT problem, work or control inadequate procedures and managerial failure.	Same with the life insurance ones.
Investments	Poor investment output as a result of insufficient investments reported to the share market (for example, excessive concentration of assets on some types of investments). An important part of the investment risk is supported by the insurance holder.	Same as life insurance, here we mention that a great part of the investment risk is supported by the share holder.
Liquidity	Impossibility of transforming some assets in liquidities at a given time or at estimated value.	Same as in life insurances.
Correction (adequate)	Inadequate assets with assumed responsibilities as a result of the cash flow, risk synchronization or monetary adjustments.	Short periods for which contracts are made makes this risk not so important in general insurances.
Expenses	Great periods for which contracts are made, raises the possibility of exceeding the cost volume initially estimated.	Same as the ones mentioned in the previous risk.
Reserves	Unreal dimensioning of reserves can create the impression that the financial situation of the company is better in reality; this could lead to arbitrary management decisions.	

Risk management that is manifested in the insurance company has a great importance, because frequently the idea is accredited that efficiency of an insurer is mostly conditioned by the way in which internal risk managed, money (insurance premiums) are being the instrument thorough which external risks become internal ones.

Accepting the idea that external risks are risks that the insurer assumes

from the insurance contract, then we can state that usually (in a less important degree in compulsive insurances) he assumes them after making a selection whose coordinates are established in his strategic development plan. Thus said, the insurer accepts only some categories of risks or imposes restrictive conditions in the contracts regarding the acceptance of a certain risk.

As a result, the insurance contract, allows the control of the insurer's exposure level, and contract stipulations, clearly and without any doubt expressed, eliminate the possible misunderstandings with the insurance holder regarding the nature and dimension of the insured risk.

What has been presented above proves once more, why the efficiency of an insurer is influenced by the quality of the management and the way of administrating internal risks. The insurance activity practice on international level certifies that internal risks which create problems and that had lead to insolvability of some insurers are: operational risks (incompetent or lack of experience management, fraud cases, poor transactions involving entities of the same financial group); subscription risks(loss caused by a high rate of development, reinsurance politics inadequate, high operational risks); investment risk (financial investments with a structure that has not taken into consideration the report and characteristics of the investments in mobile and fix assts).

For what concerns systematic risks, meaning the ones that could appear in the entire industry of insurances, these are presented in the table below.

Table 6. Risks concerning the insurance industry.

RISK NAME	MANIFESTATION FORMS IN LIFE INSURANCES	MANIFESTATION FORMS IN GENERAL INSURANCES
Jurisdictional and legal	Changes of the legal framework from this field and collateral ones that could affect the activity of insurance companies.	Same as in life insurances, plus the implication of legal forums decisions that affect the level of responsibility (especially in civil liability insurances)
Market changes	Implications of the changes occurred in consumers' attitude and in competitors' attitude	Same as in life insurances, plus the implications of going over the insurance cycle- "soft" market that could influence insurer in accepting insurances which are in their disadvantage.

Identifying in time the systematic risks, taking into consideration the conditionality existent between them and the risks that manifest in the whole insurance company is an important task of risk management.

In this way the relationship between external and internal risks can be monitored, which could prove useful for realizing general management objectives in order to get competitive results.

Referring to the third category of risks, risks that occur in the entire economy (systemically risks), these appear under the next forms.

Table 7.Economy risk

RISK NAME	MANIFESTATION FORMS IN LIFE INSURANCES	MANIFESTATION FORMS IN GENERAL INSURANCES
Fluctuation of mobile values market	Decrease in market value of investments	Same as in life insurances.
	In insurance products that have an investment component, the risk consequences are supported in a great deal by the insurance holders.	The consequences of the investment risk are the share holders.
Environmental changes	Larger payments with death or health compensations as a result of natural catastrophe occurrence or mortality rate increase.	Increased costs with compensations as a result of growing frequency in natural phenomena with catastrophe character.
Socio political changes	Changing in mortality rate as a result of appearance of new diseases and major demographical changes	Increase in the volume of damages determined by the social behavior change (criminality, thefts, vandalism). Change in the belief of insurance holders regarding compensation requests addressed to civil liability insurers.
Economic cycle	In recession the number of annulled policies could grow because insurance premiums are impossible to pay.	Growth in the number on unemployed could lead to the increase in damages as a result of criminality rate increase. There could be a decrease in the premium quota because of recession.
	Negative impact upon investments	Same as in life insurances
Inflation rate	Affects the payments for long time policies, especially if the benefits are actualized with inflation	Growth of costs with compensations' payment and in general a negative impact on expenses
Interest rate	Variation in the interest rate affect the evaluation of assts and insurers' responsibility	Talking about contracts made on short periods, the interest rate does not manifest as a major risk for general insurances
Currency rate	Having some loss if there are great responsibilities in a given currency, and when investing assets monetary adjustment was not taken into consideration	Same as in life insurances
	In products that have an investment component the risk is supported a great deal by insurance holders.	Consequences of foreign currency risk are supported by share holders
Technological changes	Possible growth of obligations to pay by insurers as a result of rising the average life expectancy or risks of making incurable diseases	The failure in implementing new technologies could rise the number of damages. The efficiency of insurance distribution channels could be affected
	A possible collapse in IT system has an impact upon operational risks.	

The existence of many risk categories that could influence the good progress of the insurers' activity has made measures taken by them through management politics to be of a great variety. The factors that determined this variety are, in general, the specific and dimensions of the activity, corporate culture, objectives considered of imminent importance to management. If we take into consideration statistic data made public by insurers from different countries, then we will see that some risks are explicitly taken into consideration in the vast majority of models used in time by insurance companies with tradition and results as well, internationally recognized. It is the case of risks associated to subscription and investment operations, credit risks, inflation rate, interest rate, currency rate. On the other hand, risk mostly linked to changes occurred in the social and economical environment in which insurers develop their activity are taken into consideration in an implicit way.

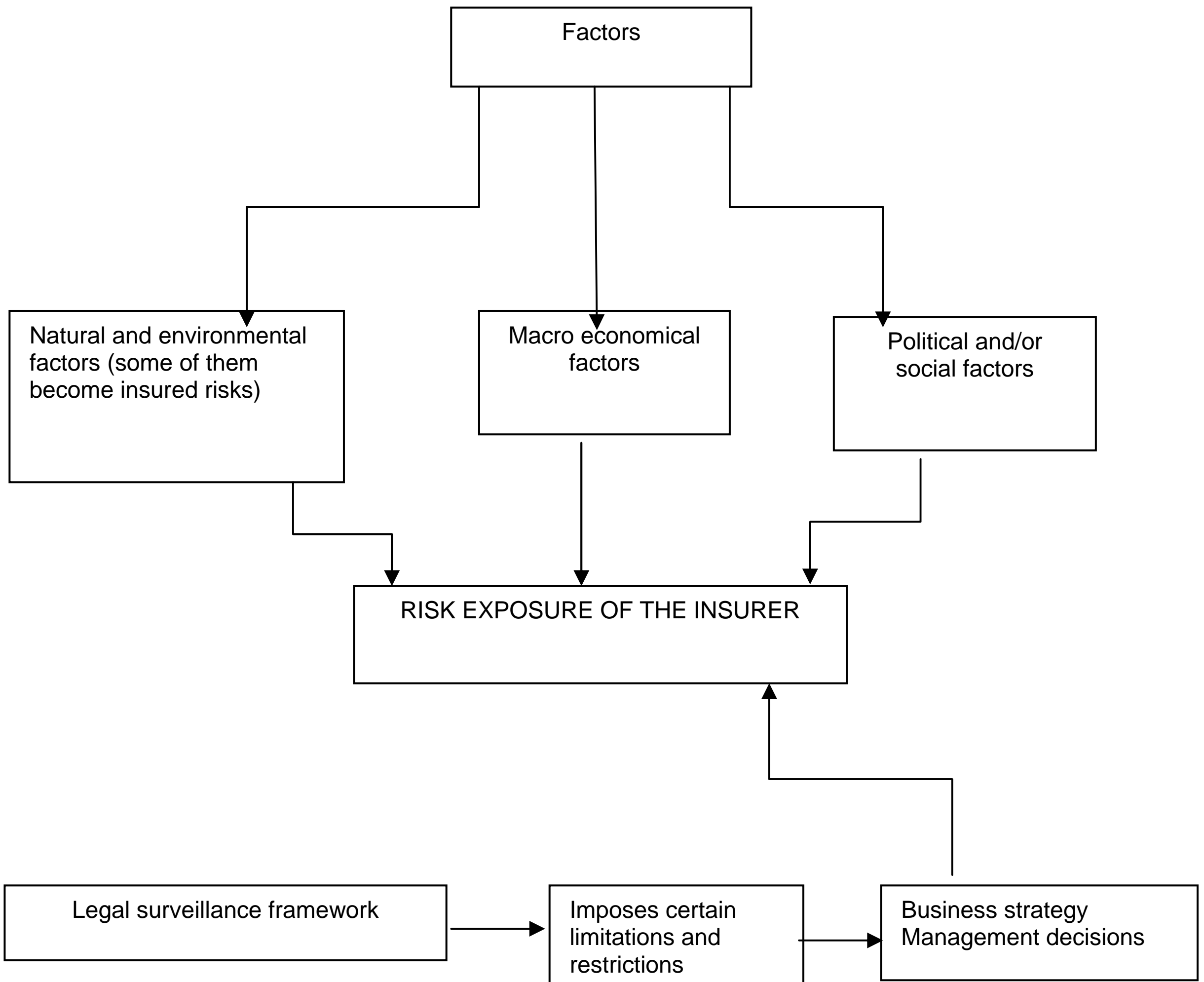
In these models we find fewer risks, like: subscription management quality (maybe as a result of the omnipresent preoccupations for raising the market rate), liquidity and others.

We can conclude that for insurance companies that operate in a socio-economical environment undergoing a changing process and where the insurance market has not reached yet maturity, management and especially risk management are a very difficult mission. As a result, and in Romania the most, risk management has to be the responsibility of every employee. This requirement is based on the fact that risks are not fragmented in separate compartments, thus risk management can't be fragmented.

It is important that employees realize the fact that uncertainty is acceptable. But this acceptance has to be based on identifying and evaluating the risks in advance. This way a favorable environment can be created that allows risk managers to work in an environment that is not strict and predetermined. On the contrary, they have to have the chance to think (build) before making a strategic decision, bald scenarios but based on rigor and having all the factors that influence in a way or another the company's activity.

As a conclusion, risks (and risk factors) to which an insurer is exposed can be presented in this diagram:

Figure 1. Factors that expose insurers to different risks:



Our suggestion is that the actors on the insurance market sustain the improvement of some persons in the analysis and solving the problems with basis and adjacent risks, thus to prevent and limit their effects upon insurance holders, and implicitly upon the trust of insurance holders and potential ones in them.