

WAYS TO ENSURE FINANCIAL STABILITY IN INSURANCE ORGANIZATIONS

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Abstract: This thesis examines the formation of capital adequacy in insurance organizations based on a risk-adjusted differential approach as one of the key factors in ensuring financial stability.

Keywords: insurance organization, financial stability, capital adequacy, risk-adjusted approach, capital burden, reinsurance, underwriting policy.

Ensuring capital adequacy and optimizing capital burden in insurance organizations, especially under conditions of high-risk portfolios, serves as the “central link” of financial stability. In practice, many insurers consider compliance with statutory capital and equity requirements sufficient; however, the institutional limitation of this approach lies in the fact that regulatory standards are generally designed for an “average” risk profile and do not fully reflect sensitivity to changes in risk concentration within the portfolio, variability of losses, reinsurance coverage, and the risk profile of assets.

As a result, on the one hand, insurers with high-risk portfolios may face insufficient capital buffers to cover actual liabilities and extreme loss scenarios; on the other hand, in organizations with low-risk portfolios, excessive capital may remain “frozen,” reducing the efficiency of financial resources, limiting investment potential, and negatively affecting competitiveness. Therefore, within the framework of this research, it is proposed not only to rely on regulatory requirements in capital formation, but also to introduce a risk-adjusted differential approach. The scientific essence of this proposal lies in interpreting the capital adequacy criterion not as a “static norm,” but as a “dynamic management parameter” directly linked to the actual risk profile of the portfolio and requiring continuous reassessment.

In this regard, the differential approach primarily envisages determining capital requirements based on indicators such as the structure of insurance risks (sectoral risks, regional concentration, contract duration, limits and deductible policies), the dynamics and dispersion of losses, the share of loss-making segments within the portfolio, as well as the actual level of reinsurance protection (net retention, cession rate, reinsurer credit quality). In other words, the “required level” of capital is adjusted according to the extent and form in which the insurer retains risk within its own balance sheet: as net risk exposure increases, the capital buffer should also expand, while the distribution of risks through reinsurance enables optimization of capital burden.

The practical advantage of this approach is that it transforms capital into an active instrument of risk management rather than restricting it to a “minimum regulatory requirement.” Through strategic decisions such as reducing exposure to risky segments, strengthening reinsurance coverage, and tightening underwriting standards, insurers gain the ability to manage capital requirements as well. Thus, capital adequacy is viewed not as a “result,” but as a “manageable process,” which deepens the concept of financial stability.

A risk-adjusted differential capital approach requires viewing both the asset and liability sides of an insurer's balance sheet as a unified system, since the transformation of a capital buffer into real financial stability also depends on the quality of assets. If an insurer formally increases capital while concentrating assets in high-risk, illiquid, or highly volatile instruments, the apparent growth in capital does not guarantee stability. Therefore, within the framework of the differential approach, the risk profile of assets must also be taken into account when assessing capital requirements. Factors such as the share of liquid assets, the quality and repayment discipline of receivables, market risk within short-term investments and securities portfolios, sensitivity to interest rate fluctuations, concentration risks, and the availability of alternative liquidity sources directly determine the required level of capital.

For example, when the share of receivables is excessively high, "paper assets" may increase, while actual liquidity decreases; under such conditions, both the capital buffer and liquidity cushion should be reconsidered with greater prudence. Consequently, the proposed differential approach integrates capital formation with underwriting policy, reinsurance, and asset allocation strategy. This scientifically substantiates that, in ensuring the financial stability of insurance organizations, priority should be given not to fragmented decisions, but to a unified risk-management architecture.

The issue of optimizing capital burden represents the second and practically most significant outcome of the differential approach. In the insurance business, capital is an expensive resource: its value is determined by dividend expectations, alternative investment costs, regulatory requirements, reputational risks, and market confidence. Therefore, both excessive capital retention and capital deficiency may lead to strategic losses. Excessive capital reduces profitability and slows market expansion, whereas insufficient capital puts pressure on solvency, increases the cost of reinsurance arrangements, and negatively affects the confidence index.

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