ROLE OF INSURANCE COMPANY AS INSTITUCIONAL INVESTITORS[1]

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Abstract

Insurance company as institutional investor is very important participant in financial market, especially in Capital Market. They have very important role in contribution to make stronger competition on financial market, stimulating financial innovation, to make stronger corporative governance, to affect in integration in market, on supporting to regulative. In European financial market insurance company are the largest institutional investor with e 8,5 trn. of assets under management as of 31 December 2012. Structure of these assets in 2011 was: 64% government or high-rated corporate bonds and 15% were equities. Investment strategies and asset allocations depend on: prudential regulation, taxation, collateral rules for derivatives. On other hand, investment is core to the provision of insurance products: protection products, life products with investment features, annuities and other products, products with profit-sharing provisions. Aim of this work is to show how insurance companies make their investment strategy and how they make investment decision. This work wants to prove that a range of regulatory developments have the potential to create framework conditions that affect insurers' ability to continue providing long-term funding to the economy.

Key words*: insurance company, investors, asset, strategy, financial market, regulatory.*

INTRODUCTION

The financial market is the environment in which to create and transform financial claims, and realize the supply and demand for financial instruments. It is a special institutional mechanism at the basis there are financial institutions that provide the performance of its functions and its effectiveness.

Financial institutions are the main participants in the trade financial instruments. Their main role is to mediate between the provider and user of accumulation. This

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they perform their function by collecting reservoir through their own credit financial instruments and perform its routing credit or purchase of financial instruments borrower. Financial intermediaries are divided into:

1. Traditional institutions (banks, savings banks, etc..)
2. Institutional investors (insurance companies, pension funds, financial companies, endowments, etc..)
3. Collective investors (investment companies, mutual funds, broker-dealer institutions and stockbrokers).

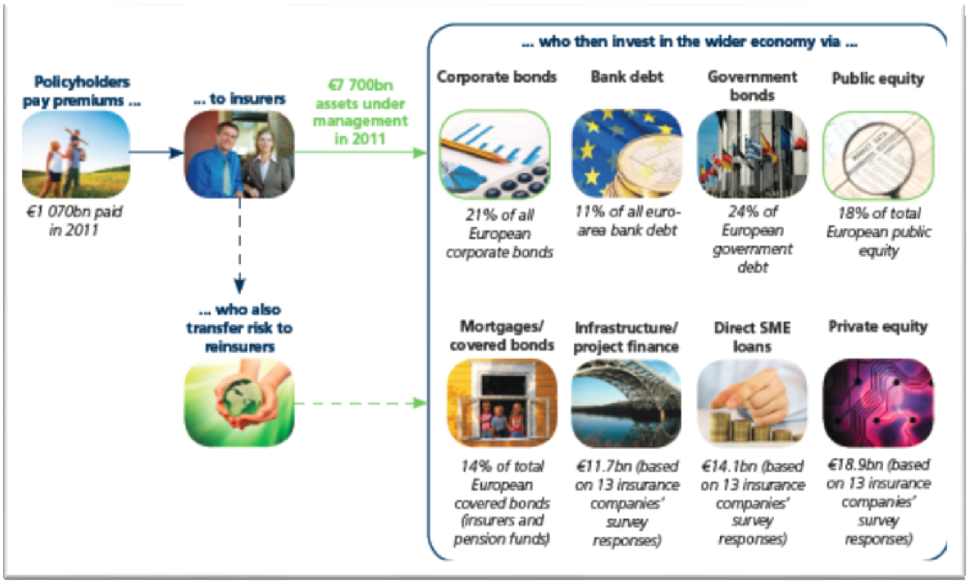
As institutional investitures, insurance companies are very important participants in the financial market, especially in the capital market. They have a very important role as they contribute to the strengthening of competition in the financial market, stimulate financial innovation, strengthen corporate governance, contribute to increase market integrity, pressure for modernizing market infrastructure, encourage the development of regulations, which primarily stems from their long-term business horizon.

The importance that the insurance companies have on the capital markets, investment principles that are applied, and the sources of funds available to it will be suggested below. Modern financial markets are characterized by internationalization, globalization and deregulation, and the emergence of new institutions and instruments. Standard banking institutions are increasingly giving way to institutional investors, whose role in the financial market is becoming increasingly important.

Due to increased risk of devastating natural disasters and terrorism, which is now the dominant influence on the insurance sector, in the global market there is integration of insurance companies in the form of acquisitions and mergers. This leads to the formation of market giants who have huge resources expressed in billions of euros. Thus, they become key players in the global capital markets and have a huge impact on price movements within these markets.

The importance of insurance companies, as well as one of the most important institutional investors, is the fact that in the United States by assets in front of them, only commercial banks. Also, the enormous importance of the insurance companies in the financial market indicates the fact that the investments of insurance companies in the capital market in the United States amounted to $ 5.343 billion in 2004 (of which $ 4.160 billion of waste in investments of life insurance companies).

Picture 1. Insurers' investments in the wider economy



Sources: "Insurance companies and the financial crisis", OECD, March 2010; Bank for International Settlements; EIOPA; Eurostat; Economist Intelligence Unit; ECBC; Insurance Europe and Oliver Wyman analysis

Importance of the activities of insurance companies carries out the activities in the financial markets, reflected in the following:

1) Insurance provides financial stability and reduce uncertainty through indemnity all those who have suffered loss. In this way it reduces the effect of mass bankruptcies that could have catastrophic consequences on production, employment, state tax revenues, and the state of an economy in general.

2) Voluntary pension insurance as one of the most important types of insurance in terms of investments of these funds on financial markets provides security for future pensioners that their retirement based on their payments be paid out monthly is stable until the end of their lives.

3) Growing of small amounts of money collected in the form of premiums, insurance companies are able to finance large investment projects and thus positively affect the economic growth of the country.

4) Insurance provides effective risk management and transforming evaluating risk. when investing, insurance companies thoroughly investigate the creditworthiness

of the borrower, which allows other investors in the market to obtain information about the characteristics of other firms in the environment when making investment decisions.

5) Conducting international trade between partners who are not sufficiently familiar with is often conditioned by the existence of certain types of insurance. Thus ensuring encourages the development of international trade.

6) Granting discounts in premiums, and preventive measures to protect against fire, injury at work, etc., insurance companies affect the prevention and reduction of losses of the insured or of society as a whole.

1. PRINCIPLES OF INVESTMENT INSURANCE COMPANY

Since the primary function you have homeowners insurance, which refers to the protection of the insured, they have to allocate a sufficient amount of reserves based on actuarial estimates. Another requirement for the protection of policyholders and their timely compensation in the form of payment of compensation or payment of the sum insured is the security and profitability of reserves.

During the placement of available funds, insurance companies must seek to make a profit at least equal the average interest rate earned on the capital market. Placements of insurance companies can be implemented in one of the following categories:

1) Real estate or the granting of mortgages and other loans,
2) Purchase of securities
3) Deposit funds with banks and other financial institutions.

Each investment of insurance company based on two basic principles:

1) Providing a high level of protection against the risk of its insured,
2) Achieving the highest possible return on invested funds.

Table 1. Division of assets of insurance companies according to the degree of risk

Conditionally risk-weighted assets	Banking deposits State Bonds Long-term bonds of state companies
Risk assets	Corporative and municipal bonds
High risk assets	Stocks, corporate bonds without rating Financial derivatives

To these two conditions have been satisfied, developed the three principles on which the investment policy of the insurer:

1) The principle of security,
2) The principle of profitability and
3) Principle of liquidity.

The specificity of the position that insurance companies take the financial market, is reflected in the requirement that they must fulfill. This requirement is an obligation to policyholders, which is a timely, must comply and which determines the structure of the portfolio of insurance companies.

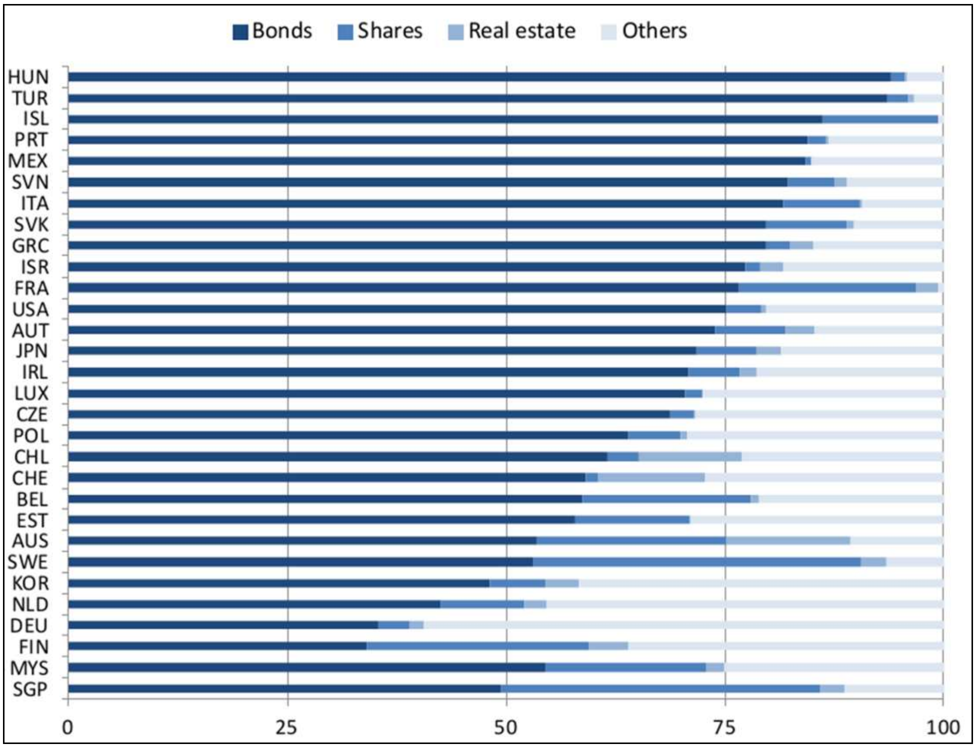
Therefore, when making investment decisions in the types of assets will qualify for the funds, portfolio managers must take into account the safety of those investments. If the insurance companies own the remaining funds invested in high-risk assets would be uncertainty about the fulfillment of their basic functions, and that the payment of compensation to the insured amount. For this reason, insurance companies have to sell their assets primarily in low risk assets. This primarily applies to companies engaged in life insurance, since it is long-lasting quality sources of funds to qualify for long-term needs and to align the maturity structure of funds from the placement of assets and liabilities of insurance companies. [2]

To ensure the solvency of insurance companies, precisely for this reason it is necessary for the state to determine what types of assets in which a percentage of the insurance companies can invest their funds.

Growth of premium and accumulation of funds on the basis of life insurance products has led to the fact that insurance companies are the biggest institutional investor in Europe. At this point the data drain for the year 2012, where it can be observed that the Insurance Companies occupy 51% of the finance market as the largest investor.

[2] Kočović J. Šulejić P: Insurance, Ekonomic faculty, Belgrade 2006, p.391.

Graphic 1. Structure of investment portfolio of life Insurance Company in the OECD countries



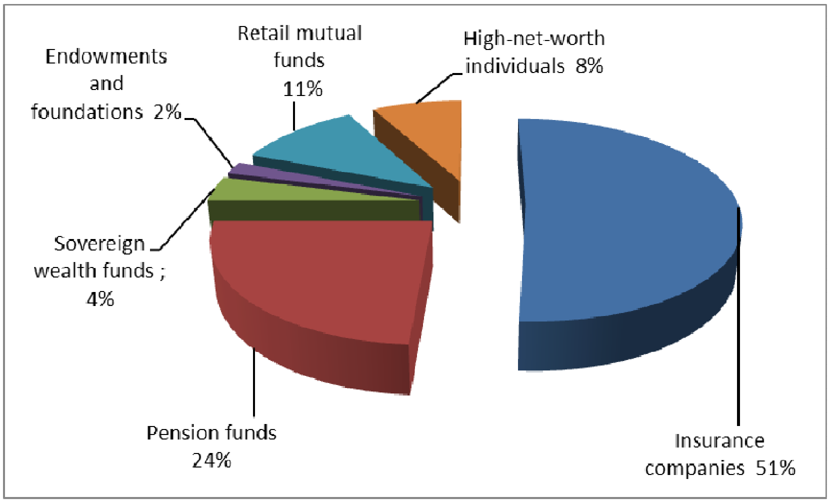
Source: Insurance activity indicators, OECD Insurance Statistics (database), www.oecd-ilibrary.org

Models and patterns for investment in individual securities are determined by the limited nature of their duties, liabilities. How are life insurance at present a permanent long-term sources of funds, it is natural that the insurance companies involved in life insurance invest primarily in capital markets, primarily in government bonds and mortgage deed. It is essential that there is a coincidence of time maturities investments and commitments.

Unlike life insurance, property insurance and face a basic form of investment is in shares and corporate bonds. It is caused by the fact that their reserves less and less stable, and the potential damage to large.[3]

[3] The financial Services Fact Book, 2006, www.financialservicesfacts.org

Graphic 2. Insurers are the largest institutional investors in Europe



Source: OECD; IMF; EFAMA; Insurance Europe; Philanthropy in Europe; Foundation Center; ECB; FSB; Oliver Wyman analysis

This principle determines the requirement to maximize return on investment while minimizing risk. Portfolio managers at insurance companies are required to in the asset management of reserves, ensuring return on investment that provides at least to preserve the real value of invested assets. Such rates therefore should be at least equal to the average interest rate on the capital market.

Insurance companies would have effectively and with minimal risk to invest resources while maintaining the current liquidity. Given that the primary function of ensuring the protection of the insured, safety should be the basic principle of investing and much more important than profitability. It is therefore a necessity to diversify the investment portfolio and thus ensure the realization of returns with an acceptable level of risk.

In order to ensure the safety of investments shall be the division of assets of insurance companies according to the level of risk:

The principle of liquidity assumed such investment structure that guarantees that at any time a sufficient amount of liquid assets or liquid securities that can be easily and at low cost can sell the financial market before their maturity.

Given the need to respect this principle, the insurance company is extremely important to comply with the funding sources of the maturity structure of the same rank. The main characteristic of the non-life insurance is to have duration of one year, therefore it is a short-term sources and short term obligation, and the investment should be focused on short-term securities, liquid assets such as commercial paper, treasury bills.

2. WORLD PRACTICE OF INVESTMENT FUNDS INSURANCE COMPANY

As institutional investors, insurance companies are among the most important participants in the financial market, especially in the capital market. One of the important factors that determine the structure of investments of insurance companies in the world, certainly are the level of development of financial markets in a country. As the capital market is more developed, there are more high quality paper and as more investors to invest in it, be sure that such a market insurance companies provide many more opportunities for adequate investment.

Compared with the structure of investments in companies engaged in life insurance, it is evident that in the non-life insurance companies much smaller share of bonds. From participation in this type of bond insurance, short and dominated by corporate bonds.

Table 2. The structure of investment placements

	Nonlife insurance	**Life insurance**
Premium	Determinated	Determianted
Claim/Insured sum	Stohastic	Predcitable
Maturity funding sources	Short term	Long term
Maturity of liabilities	Short term	Long term

The share of real estate has decreased, while the commercial paper and borrowings at approximately constant levels. As the conclusions that could be drawn from the structure of investments in securities (shares) in the global markets, perform the following:

1) For a life insurance risks are easier to predict and no major unexpected events that could endanger the liquidity of the business and is planning more likely. Therefore, insurance companies dealing with this type of insurance can invest in long-term government bonds, shares of good companies or real estate.
2) In the non-life insurance potential liability for payment of claims and the amount paid is more difficult to predict. Therefore, it is necessary to

provide part of liquid instruments that can quickly be converted into cash in the case of unforeseen expenses.

3. IMPACT OF THE FINANCIAL CRISIS

High exposure to property insurance companies the impact of the financial crisis stems from their significant role in the financial markets of developed countries. Of the total value of assets of institutional investors in the European market, 42% relates to insurance companies and 30% of the pension funds.

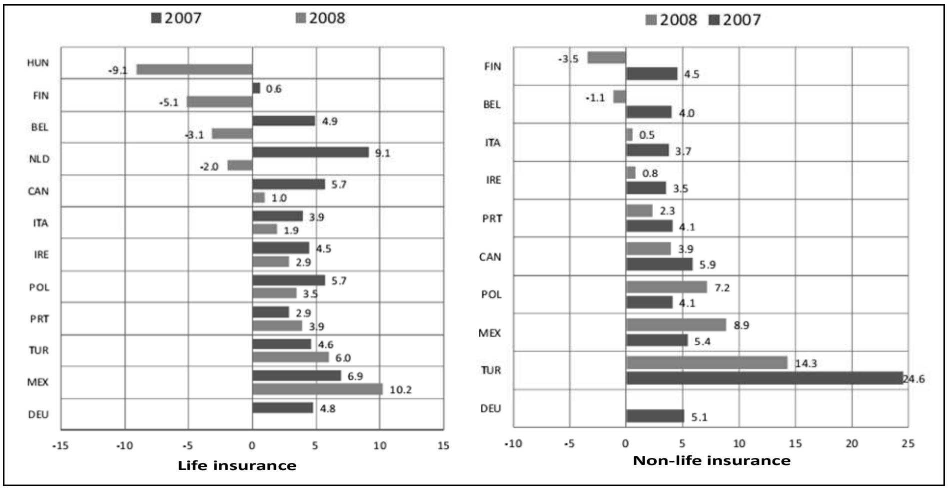
On the basis of a portfolio of securities of companies life insurance in developed countries, it can be argued that those in general most of its assets are invested in bonds, as well as securities that are characterized by lower yields, but also lower risk compared to equity instruments. In order to maximize security investments and the realization of certain tax incentives, these companies are particularly interested in investing in government bonds.

Companies in the field of non-life insurance, on the other hand, a relatively larger share of their assets held in cash, cash equivalents and short-term securities (primarily commercial paper and treasury bills). In addition, these companies invest relatively more in stocks compared to life insurance companies. The financial crisis is affecting insurance companies in five ways:

- direct influence of the sub-prime mortgage loans at risk through exposure to the assets of insurance companies sub-prime loans,
- impact on portfolio insurance companies through specific exposure to risk falling prices of certificates of deposit, bonds and other securities of banks that were hit by the financial crisis,
- impact overall meltdown of the financial markets as measured by the decline in stock prices and rising interest rates in the capital markets,
- impact of the crisis on the business of underwriting,
- valuation (price) of insurance companies.

The direct impact of the crisis on insurers is manifested through investment losses due to the drop in the market value of their investment placements, as well as due to non-fulfillment of the obligation to pay principal and / or interest by the issuer of a debt instrument. Riskiness of assets increased due to the direct impact of "sub-prime" mortgage loans, but also the risk of banks affected by the crisis, and with whom they associate by insurers to hold deposits and investment in their securities. In 2008 compared to 2007, insurers in most OECD countries recorded a significant decline in average net return on investment, both in the field of life, and life insurance, while in countries such as Hungary, Finland, Belgium and the Netherlands provide returns become negative.

Graphic 3. Insurance activity indicators in OECD country



Source: Insurance activity indicators, OECD Insurance Statistics (database), www.oecd-ilibrary.org

In response to the collapse of financial markets, insurers as a rule reduce the share of stocks and increase participation (government) bonds and short-term investments in their investment portfolios. The above tendency is manifested after the 2000-2001 crisis. year, and after the onset of the economic crisis of 2008. However, even government bonds as safe traditional instruments, in terms of the current debt crisis are a source of credit risk for insurers! Therefore, in recent years there is a tendency unusual decrease in the share of bonds and increase the proportion of stocks in the portfolios of insurers. Despite growing uncertainty and increasing regulatory requirements, the role of stocks in the investment portfolio of insurers should not be underestimated. Because of the need for harmonization of property forms with fluctuations in the value of liabilities of insurers and for exploiting effects of risk diversification, owning shares can contribute to reducing the overall risk to the insurer is exposed as an investor.

One way to alleviate the effect of inflation risk may be allocating a relatively large part of the assets of insurers in real assets. Although reducing exposure to inflationary action and provide returns comparable to equity instruments, investments in real assets are characterized by low liquidity and high volatility, which reduces their attractiveness to insurers. As suitable investment alternatives under conditions of high expected inflation affects short-term government bonds and bonds indexed to inflation.

4. INVESTMENT OF INSURANCE COMPANY IN SERBIA

Insurance companies in Serbia is very difficult to manage their portfolio, in addition to limitations in the law they have a "shallow" and "narrow" financial market. It is essential that insurance companies change approach to investment policy. To insurance companies reckon they deserve in the financial markets, it is necessary that the following conditions are met: increase in volume of business, increasing competition and the type of insurance the concentration of capital in the branch, forming pools and insurance associations, integration of insurance and banking products, expanding its investment assets .

Restrictions which are given by the Insurance Act are necessary because they provide stability and do not allow insurers to invest in projects with a high risk long-standing instability and lack of transparency of the insurance sector is the result of poor control and management weaknesses insurance companies. Strengthening the regulation and control is of great importance to the strengthening and development of the capital market. [4]

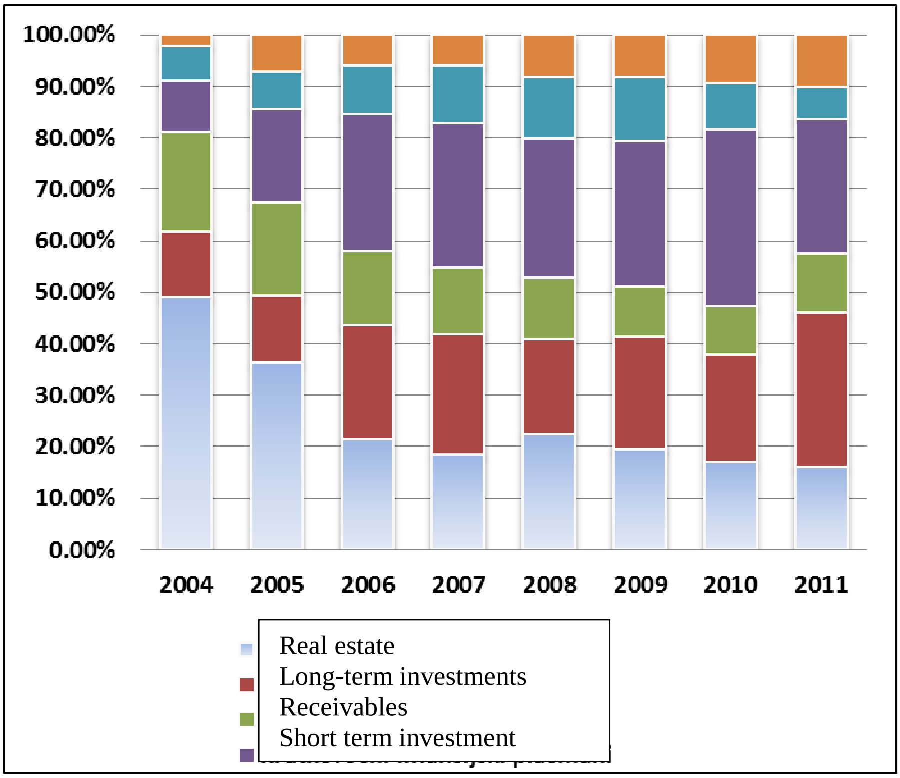
Based on the analysis and review of data in the previous section of this paper, it is proposed that the investment policy should be concentrate the effective investment of resources with minimum risk, maintain liquidity, diversification of the investment portfolio at the end of the realization of return on investment. To achieve the efficiency of investment required is a detailed financial analysis, identifying the factors that could negatively impact.

Investment and business in Serbia is exposed to a large extent, credit risk and market risk. Credit risk is primarily from investments in banks. What could be seen from the preceding analysis is that the insurance company in Serbia does not adhere to the policy of equalization of long-term assets and long term liabilities. This creates a problem of an appointment of their rating. The reason is that there are no relevant long financial instruments in the financial market, as well as management decisions to maintain liquidity significantly affects the portfolio. Investments must be matched by size and maturity structure of liabilities of insurance. However, an earlier target insurance company was the first place maintains liquidity without taking into account the matching of assets and liabilities by maturity. It did not manage assets, because securing liquidity. The adoption of the new Insurance Act, which ordered alignment of assets and liabilities, many insurance companies that operated on the principles mentioned above, have lost their license to operate. During the placement of funds in the financial market, insurance companies may be faced with a rise in interest rates,

[4] Balaban M., Insurance in modern world, monograph, Cikos, Belgrade 2007.

which can lead to fall of value of their investments. Ill-formed portfolio will provide sufficient rate of return. Therefore, it is necessary to establish an implementation of investment portfolio, which will enable with minimum risk and maximum return rate at the same time guarantee a certain degree of liquidity of the insurer in case of an increased number of payments on behalf indemnity damage.

Graphic 4. Structure of investment of Insurance company in Serbia for period 2004-2011



To ensure a normal investment climate is necessary to strengthen the capital market, otherwise any investment in this type of securities investors at risk. The function of institutional investors, and therefore insurance companies in the securities market are facing the problem solving the budget deficit, which is negative. Insurance companies, through the development of life insurance should be available to mobilize savings and that is directed towards productive investments, which will raise the level of its economy activity. in shares and corporate bonds. Investments in government bonds are useful, but should not be the only role of insurance companies. In addition, it is necessary to provide adequate flow and accuracy of information from the financial markets to be able to make appropriate decisions. Status of investor requires not only skilled personnel, but also the operational procedures for making decisions on investment, the ability to report on this work and effective internal control.

Although limited, the effects of the global economic crisis on the investment activities of insurers in Serbia can be identified in the area of coverage of technical reserves prescribed types of assets, as well as in the domain structure of the investment portfolio of the company.

Table 3. Coverage of technical reserves of insurance companies in Serbia prescribed types of assets

Year	2007	2008	2009	2010	2011
Coverage of technical reserves prescribed types property	96,4%	90,4%	94,2%	100,29% (nonlife) 101,74% (life)	99,35% (nonlife) 101,51% (life)

On the basis of capital gains, the coverage of technical provisions prescribed types of assets has deteriorated at the time of a crisis. Although below the period achieved notable improvements, the problem of providing quality forms of property in accordance with the appropriate secondary legislation is still pronounced, especially in the field of non-life insurance. In an effort to avoid capital losses and increase the safety and liquidity of its investments, the insurance companies are reorganize structure of own investment portfolio, according to the resultant crisis conditions. In the countries of the region there are certain investment limitations for insurance companies.

Table 4. Investment limitation for insurance company in Serbia, Croatia and Slovenia

	SERBIA	CROATIA	SLOVENIA
Securities which are not traded on a regulated market	10%	10% for nonlife	10%
Deposits at banks	35% life 40% nonlife	30%	30%
Real estate	30% life 20% nonlife	30%	30%
Foreign investment	20% capital	No limit in EU and OECD	No limit in EU and OECD

CONCLUSION

Insurance companies as a non-deposit taking financial institutions are an important part of the institutional infrastructure next investment, which in a competitive game participates in the transfer of savings from lenders to defective economic units, and which almost surpassed the bank as a depository financial institution. In practice, insurance companies and pension funds Investment funds collected from its customers. By purchasing an insurance policy, an individual benefits from insurance, because the insurance company assumes the risk in favor of his client. Insurance companies and pension funds, many individuals use it as their primary investment avenues. That raised funds of their clients; insurance companies and pension funds are channeled to various profitable investment alternatives.

OECD data show that the insurance sector is the highest source of investment for the growth of any economy, which is a real challenge for these institutional investors. Therefore, it is essential that economic policy makers ensure climate that will provide insurance companies the security for their investment.

As a novelty in the field of regulation of investment funds of insurance companies, the concept of Solvency II introduces a method of prudential regulation (Prudent person principle), abolishing the existing quantitative restrictions on investment.

... "Member states should not require insurers and reinsurers to invest in specific property types, because such a request is not in accordance with the freedom of movement of capital ..." (Solvency II Directive, Article 72)
... "The entire property, especially one that serves the coverage of SCR and MCR, should be invested in a manner that ensures the safety, quality, liquidity and profitability of the entire portfolio. Assets used to cover the technical reserves should also be invested in a manner that is consistent with the nature and duration of the liabilities of insurers "... (Solvency II Directive, Article 132)

Only exceptionally, Solvency II allows EU Member States the possibility to impose quantitative limits investments exclusively for those who are already investing risks are not adequately covered by the standard formula calculation of the SCR.

There is a lot of room for growth of the insurance market in Serbia, the fact is that the insurance companies are doing less to promote their activities than banks, and that is on them at their competitive struggle to branch out to the market in Serbia. The economic crisis has slowed down the development of the insurance market, but there is room for development, for example, in 2012, in Slovenia insurance premiums reached two billion euros in Croatia billion, while in Serbia just half a billion. But certainly need the support of the state in terms of amendments to the Insurance Act, and the introduction of tax incentives for all insurance companies that want to invest in the economy. On the other hand, insurance companies need to work on educating and raising awareness about insurance, but also the creation of products that are acceptable to the existing standard of living in Serbia. Only this way will ensure that the vast free resources insurance company put on economic development, through different forms of investment.

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