CONSIDERATIONS ON EFFECTIVENESS OF INSURANCE ACTIVITY

CONSIDERAŢII PRIVIND EFICIENŢA ACTIVITĂŢII DE ASIGURARE

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Abstract*: The current paper presents the main aspects regarding the effectiveness of insurance activity from the point of view both of the insured and the insurer. Discussions are on more frequently efficiency indicators, such as: damage ratio, relative cost of insurance activity, net income ratio, coverage ratio, growth ratio, damage coverage ratio, risk coverage ratio, renewal rate ratio, solvency ratio, liquidity ratio, promptness of claim settlements, claims rejection ratio.*

Key words**:** *insurance, effectiveness, damage ratio, net income ratio, coverage ratio*

INTRODUCTION

Generally speaking, economical effectiveness express company's performances comparative with their efforts of achieving these performances.

In order to evaluate the performances of an insurance company and to assess the effectiveness of insurance activity we have to take into consideration not only the financial results and the ratio between effects and efforts, but also the insurer success to satisfy the needs of their insured persons.

Effectiveness of insurance activity has to be discussing from the point of view both of the insured interests and the insurer managing their activity through economical and financial principle.

For insured:

- the effects obtained through insurance policy are represented by indemnity and compensatory damages awarded by the insurer;

- the efforts consist on payment of insurance premiums;

- insurance effectiveness from point of view of the insured is even greater as compensatory damages received are higher and insurance premiums paid are lower.

For insurer:

- the effects are represented by own financial performances which warrant further maximum financial security;
- the insurer efforts consists on organization and management in proper conditions of the insurance funds in various financial operations;
- insurance activity from the point of view of the insurer is more efficient as their total expenses are lower (including there indemnities, insurance cover and compensations, and those related to manage insurance funds).

MATERIALS AND METHODS

In order to achieve the objectives of the present paper, we used information from various national and international publications related to insurance activity. Discussions on efficiency indicators help us to understand the effectiveness of insurance activity.

Effectiveness insurance activity it has to be based on data from the insurance company's information system. A first step in analyzing and establishing the effectiveness of insurance activity is to study financial performances due to economical and financial practices.

Main goal of any company, including insurance companies is to obtain profit, so that to cover their expenses from incomes and achieve an excess. Analyzing insurance efficiency is necessary to take into consideration that in this industry meets an original-unique phenomenon, the insurer "to sell" before "to produce", so before knowing "the cost of goods sold".

RESULTS AND DISCUTIONS

For an objective assessment of the efficiency of insurance activity we will take into discussions an adequate indicators system. The choice for these efficiency indicators is made in accordance with several criteria such as: the aim for specific objectives, level assessment activity, legal requirements for insurance industry, insurance classes. Each of the selected indicators underlines some side of insurance activity, neither of these being considered more important than others.

The main important and useful indicators are:

- damage ratio;
- relative cost of insurance activity,
- net income ratio,
- renewal rate ratio;
- solvency ratio;
- liquidity ratio;
- growth ratio;
- risk coverage ratio;
- damage coverage ratio
- promptness of claim settlements;
- claims rejection ratio;

Damage ratio is used to assess the financial performances of an insurer, and shows the proportion between compensations paid by the insurer and earned premiums.

$$Damage\ Ratio = \frac{Compensations}{Earned\ \Pr emium} \times 100$$

This ratio is expressed as a percentage and ratio level could be lower, equal or higher than 100%. The indicator is relevant in case of non life insurance and liability insurance; in the specific case of life insurance we speak about sum insured not compensations, the insurer pay to the insured person or beneficiary an indemnity or sum insured not damages.

Relative cost of insurance activity is calculated as a ratio between total expenses and total revenues (premium and other incomes)

$$Relative\ cost\ of\ insurance\ activity = \frac{Expenses}{\mathrm{Re}venues} \times 100$$

Usually, the relative cost of insurance activity is lower than 100%. When this indicator level is higher than 100% the insurer could not cover the total expenses from total revenues.

Net income ratio shows how profitable insurance activity is, reflecting the quality of management and the viability of the insurance activity.

$$Net\ Income\ Ratio = \frac{Net\ Income}{Earned\ \Pr emium} \times 100$$

Renewal rate ratio is used to measure the proportion of those clients that renewed to those that could potentially renew their term coverage.

$$Renewal\ rate\ ratio = \frac{Number\ of\ \text{Re}newals}{Number\ of\ Potential\ \text{Re}newals}$$

This ratio shows the condition of marketing and distribution and reflects the satisfaction of the clients, being indicated to be measured per product.

Solvency ratio is related to assets and liabilities, reflecting the quality of management and the viability of the insurance activity.

$$\text{Solvency ratio} = \frac{Admitted\ Assets}{Liabilities} \times 100$$

Liquidity ratio shows the insurer capacity to pay claims and its expense obligations. It is indicate that the ratio level to be at least 1.

$$\text{Liquidity ratio} = \frac{Available\ Cash}{Short-term\ Payables}$$

Growth ratio shows the growth of insurance activity from one period to another.

$$Growth\ ratio = \frac{\Delta\ Number\ of\ Insured}{Number\ of\ Insured\ in\ the\ previous\ period}$$

Δ *Number of Insured = Number of Insured in the current period – Number of Insured in the previous period.*

Risk coverage ratio is used to measure the proportion between sum insured and the fair market value of the goods insured. It is significant only if is calculated separately for each particular good, being specific for non life insurance.

$$Risk\ coverage\ ratio = \frac{Sum\ insured}{Goods\ Fair\ Market\ Value} \times 100$$

Damage coverage ratio show the percentage between compensations paid by the insurer and the damages caused to the good insured. This ratio is influenced by the coverage principle applied by the insurer.

$$Damage\ coverage\ ratio = \frac{Compensations}{Damages} \times 100$$

Promptness of claim settlements indicates the average time spend on settling benefits, or reflect time in days for a policy holder to receive a

payment after the occurrence of an event. This ratio measures the percentage of claims paid within each time interval (ex. less than 14 days, between 15-30 days, between 31-90 days, more than 90 days, etc.)

Claims rejection ratio indicates the proportion between number of claims rejected and total claims reported.

$$Claims\ rejection\ ratio = \frac{Number\ of\ Claims\ rejected}{Total\ Claims\ reported} \times 100$$

CONCLUSIONS

Increasing effectiveness of insurance activity, regardless of class of insurance, insured risk, the relationships between insurer and insured depends on the size of incomes and expenses.

Size of incomes depends on gross premium received from total number of insurance policies and incomes received from other specific transactions. While gross premiums are influenced by insurance demand, the other incomes are dependent on financial market. Generally, insurance company take into consideration to decrease the average premium for an insured risk in order to influence increasing of insurance demand, increasing of insurance policies and goods insured and to achieve risk dispersion and reduce relative compensation level.

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