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SUPERVISION OF INSURANCE ACTIVITIES OF ENTERPRISES

Nosirov Jasur
International School of Finance Technology and Science (ISFT)

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Abstract:
There is a general agreement that insurance supervision is a fundamental requirement for the sound development of insurance activities. The principle of State intervention has been adopted in almost all countries but it would not be realistic to expect a general agreement on the methods or extent of State intervention.

Keywords: State intervention, insurance supervision

INTRODUCTION

Two reasons for classifying insurance as a public-interest business are 1) insurance companies sell complex promises, not immediate performance, and 2) the insurance business has considerable potential for discrimination and abuses against customers. Professor Kimball has divided the goals of insurance regulation into two groups: internal and external.4 Internal goals include solvency of insurance carriers and equity and fairness of insurance operations. The primary reason for regulating insurance goes beyond the traditional market failure reasons. The purpose is to guarantee that contracts entered into are valid and will remain valid. External goals include local protectionism to protect the interests of domiciled companies, socialization of the loss costs to make insurance more affordable and encourage the spreading of insurance, capital accumulation in the interest of the national economy. While internal goals are widely accepted around the world, external goals are subject to much criticism. The protectionism which has developed in most countries should be viewed as a decision to produce internal insurance as opposed to importing external insurance services. In many countries, public enterprises were considered a macroeconomic policy tool and as such used by Governments to produce not only insurance services but also social and macroeconomic objectives such as employment, source of funds for priority investments, or increased foreign exchange. Many developing countries have considered insurance institutions locally incorporated to be not only an essential element of their economic and political independence but also the main driving force in the supply-leading causality pattern to their development.5 The "infant industry" argument has justified particular efforts directed towards the protection of local markets. The infant-industry argument remains a well-respected legitimization of temporary protection if the existence of a competing foreign sector contributes to the inability of the local industry to establish itself. Recognizing the particular nature of the insurance business, the British Government created the function of the Registrar of Insurance. The activities of the Registrar, copied in many other countries in the world, where primarily designed to prevent fraud by obliging the registered companies to publish yearly audited accounts. The principle of freedom of trade was based on competition with full information and publicity. The principle known as "substantive supervision by the State" was applied in a large number of countries in western and northern Europe. A specific supervisory office or insurance commission was established either within a Ministry, or as a separate Government Agency called the Supervisory Authority. In the most restrictive form, all insurance operations, from the granting of a license, approval of policy terms and conditions, to special circumstances such as transfers of portfolios and mergers, are subject to supervision. In more "liberal" countries, financial supervision constitutes the focus of insurance supervision. The concept of solvency is applied to assess ex-post the financial efficiency of the insurance companies. A mixed-system is to be found just about everywhere nowadays. Nearly all aspects of insurance are regulated, starting with the formation of a company and ending with its liquidation. Criteria and standards for policy provision, rates, expenses limitations, valuation of assets and liabilities, investment of funds, and the qualifications of sales representatives are established and provided by the supervisory authorities. Regulation is more complete and sometimes more complicated for some forms of insurance than others. However, the degree and extent of supervision differ across countries and especially when protectionism is taken into consideration.

LITERATURE REVIEW

The Board supervises and regulates companies that control one or more banks (bank holding companies) and companies that are not bank holding companies that control one or more savings associations (savings and loan holding companies, and together with bank holding companies, depository institution holding companies). Congress gave the Board regulatory and supervisory authority for bank holding companies through the enactment of the Bank Holding Company Act of 1956 (BHC Act).The Board's regulation and supervision of savings and loan holding companies began in 2011 when provisions of the Dodd-Frank Wall Street Reform and Consumer Protection Act (Dodd-Frank Act) transferring supervision and regulation of savings and loan holding companies from the Office of Thrift Supervision to the Board took effect. Upon this

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transfer, the Board became the federal supervisory agency for all depository institution holding companies, including a portfolio of firms significantly engaged in insurance activities (supervised insurance organizations). The Board has a long-standing policy of supervising holding companies on a consolidated basis. Consolidated supervision encompasses all legal entities within a holding company structure and supports an understanding of the organization's complete risk profile and its ability to address financial, managerial, operational, or other deficiencies before they pose a danger to its subsidiary depository institution(s). The Board's current supervisory approach for noninsurance depository institution holding companies assesses holding companies whose primary risks are largely related to the business of banking. The risks arising from insurance activities, however, are materially different from traditional banking risks. The top-tier holding company for some supervised insurance organizations is an insurance underwriting company, which is subject to supervision and regulation by the relevant state insurance regulator as well as consolidated supervision from the Board; for all supervised insurance organizations, the state insurance regulators supervise and regulate the business of insurance underwriting companies. Additionally, instead of producing consolidated financial statements based on generally accepted accounting principles, many of these firms only produce legal entity financial statements based on Statutory Accounting Principles (SAP) established by states through the National Association of Insurance Commissioners (NAIC).

RESEARCH METHODOLOGY

The final insurance supervisory framework adopts the core elements of the proposal with certain modifications to address comments received. Consistent with the proposal, the final framework consists of a risk-based approach to establishing supervisory expectations, assigning supervisory resources, and conducting supervisory activities; applies tailored supervisory ratings; and describes how Federal Reserve examiners will rely to the fullest extent possible on the work of state insurance regulators to limit supervisory duplication.

The final guidance has been modified from the proposal to include additional clarity in various sections, including with respect to the complexity classification and applicable guidance. The final guidance also includes additional references to incorporating the work performed by state insurance regulators and allows for noncomplex supervised insurance organizations to be rated up to every other year.

Results and Discussion

In the proposal, the terms "risk profile," "complexity classification," and "risk assessment" would have been used to describe the Board's approach to aligning its supervision with the risk of a firm. Under the proposal, an organization's risk profile would have depended on its products, investments, and strategy and would have been assessed independent of supervisory opinions or approach. The complexity classification would have been the Federal Reserve's preliminary view of the organization's risk profile and would have been used primarily to determine the level of supervisory resources needed to effectively supervise an organization. A supervised insurance organization would have been classified as either complex or noncomplex when the organization initially became subject to Federal Reserve supervision and only re-classified if the organization's risk profile significantly changed (typically the result of a major acquisition or divestiture). The risk assessment would have been an exercise typically completed annually by Federal Reserve examiners to support a discussion of the organization's material risks, ensuring that supervisory activities planned for the following year were risk-focused and did not duplicate work done by other regulators. Commenters requested clarity on the differences between these three terms as used in the proposal. The final guidance maintains these terms and their intended definitions, but the text has been adjusted to clarify how they will be used.

COMPLEXITY CLASSIFICATION

Under the proposal, supervised insurance organizations would have been classified as either complex or noncomplex based on a list of characteristics. The complexity classification would have been the initial driver for the assignment of supervisory resources, with complex supervised insurance organizations being assigned a dedicated supervisory team. The complexity classification would have also been a driver for the application of supervisory guidance. Organizations with over $100 billion of consolidated depository institution assets or that are designated as an internationally active insurance group (IAIG) would have automatically been classified as complex. Commenters requested additional transparency regarding the factors considered when making the complexity classification and suggested additional factors for consideration, such as the source of funding for non-insurance operations. Commenters also suggested removing the $100 billion consolidated depository institution asset threshold, removing the automatic complex classification for IAIGs in exchange for a materiality view of international exposure, attaching specific weights to the factors listed in the proposal, and providing organizations the opportunity to appeal or request a review of the complexity classification.

To ensure that organizations with similar sized banking operations are supervised consistently by the Federal Reserve, the final guidance retains the $100 billion consolidated depository institution asset threshold as proposed. The automatic complex classification proposed for IAIGs has been removed from the final guidance and instead the materiality of an

insurance organization's international operations will be considered as part of the complexity classification decision. While weights were not added to the factors in order to preserve the flexibility needed to properly classify organizations of differing business and risk profiles, the factors in the final guidance are sequenced in order of expected relative priority. The Board believes that these factors are broad enough to cover the additional factors suggested by commenters. In response to the comments, and to promote transparency, the complexity classification work program used to support the complexity classification decision made by the Board will be published on the Board's website. The work program provides additional clarity regarding the information leveraged to make the complexity classification and several of the factors suggested by commenters are included in the work program as questions related to a listed factor. The final guidance also clarifies that an organization can request a review of its complexity classification if it has experienced a significant change to its risk profile.

SUPERVISORY ACTIVITIES

Under the proposal, supervisory activities would have focused on material risks to the consolidated organization and leveraged the work performed by the firm's functional regulators. Additionally, under the proposal, ratings examinations would have been performed annually for all supervised insurance organizations, including those classified as noncomplex. Commenters requested that supervisory activities focus on material risks not subject to oversight by other regulators and that, where appropriate, Federal Reserve examiners coordinate the timing and scope of supervisory activities with other regulators to avoid duplication. Specifically for noncomplex supervised insurance organizations, commenters requested that Federal Reserve examiners align periodic rating examinations with the frequency used by other regulators and limit the frequency of examinations to every other year, as described in SR letter 13-21,"Inspection Frequency and Scope Requirements for Bank Holding Companies and Savings and Loan Holding Companies with Total Consolidated Assets of $10 Billion or Less".

CONCLUSIONS

Based on the description in the discussion section that has been described in the previous chapter, the authors then draw the following conclusions, the Financial Services Authority can take necessary actions including appointing a statutory manager, the appointment is made if the management of the insurance company is deemed detrimental to consumers so that management is needed that can represent the interests of the OJK and consumers. One of the tasks of the statutory manager is to save the wealth of the insurance company. The statutory manager is responsible for all his actions and decisions while managing the insurance company. The statutory manager ends if OJK judges that it is no longer needed. In addition, the financial services authority as an independent institution has the duty and authority to supervise the insurance industry. Supervision is carried out periodically and/or at any time. In supervising the insurance industry, OJK carries out a type of risk-based supervision. OJK has the right to appoint other parties to carry out part of its authority to other parties. The scope of OJK supervision is all aspects of the insurance business operator or certain aspects of the insurance business activity

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