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THE IMPORTANCE OF INSURANCE IN STABILIZING THE ACTIVITIES OF COMMERCIAL BANKS BASED ON THE WORLD STANDARD

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Abstract: This scientific and practical article is devoted to some proof analysis on how necessary is insurance today to stabilize the activities of commercial banks based on the global standards. Insurance companies can be important for the stability of financial systems mainly because they are large investors in financial markets, because there are growing links between insurers and banks and because insurers are safeguarding the financial stability of households and firms by insuring their risks.

Key words: modern insurance, stabilizing the commercial banks, world standards of stabilizing.

The world we live in is full of uncertainties and dangers. Individuals, families, businesses, properties and assets are exposed to various types and levels of risk. These include the risk of loss of life, health, property, property, etc. Although it is not always possible to prevent unwanted events from happening, the financial world has developed products that protect individuals and businesses from such losses by covering them with financial resources. Insurance is a financial product that reduces or eliminates the consequences of loss or damage caused by various risks.

In addition to protecting individuals and businesses from many potential risks, the insurance sector contributes significantly to the overall economic growth of the country by ensuring the stability of business operations and generating long-term financial resources for industrial projects. Among other things, the insurance sector encourages the virtue of savings among individuals and provides employment to millions of people, especially in a country like India where savings and employment are important.

As the main argument of this article straightly relates to the international standards of financial support stability of the banking system, we find out that we had better discuss this concept first. Ensuring

financial sustainability of the banking sector is connected with effective system development of crisis management and regulation at the micro-, macro- and mega-levels. The main reasons for the development of crisis management systems for ensuring sustainable development of the banking sector are:

- ⊕ the extreme complexity of the mechanism of the international banking system and the use of a significant number of new financial instruments;
- ⊕ variety of operations and the movement rate of financial capital;
- ⊕ financial globalization and integration, that enhance the effects of systemic risks on the process of extrapolation from the banking sector to capital and derivative markets;
- ⊕ the availability of information asymmetry in the financial market;
- ⊕ the process of introducing common standards in the field of bank management;
- ⊕ improving the management of banking activities, particularly anti-crisis management, based on the harmonization of international and national regulatory systems. [1,2,3,4]

Insurance companies can be important for the stability of financial systems mainly because they are large investors in financial markets, because there are growing links between insurers and banks and because insurers are safeguarding the financial stability of households and firms by insuring their risks. This special feature discusses the main reasons why insurance companies can be important for the stability of the financial system. It also highlights the special role of reinsurers in the insurance sector and discusses some of the key differences between insurers and banks from a financial stability point of view.

The insurance sector has traditionally been regarded as a relatively stable segment of the financial system. This is mainly because most insurers' balance sheets, unlike those of banks', are composed of relatively illiquid liabilities that protect insurers against the risk of rapid liquidity shortages that can and do confront banks. In addition, insurers are not generally seen to be a significant potential source of systemic risk. One of the main reasons for this view is that insurers are not interlinked to the same extent as banks are, for instance, in interbank markets and payment systems. The insurance sector can, however, be a source of vulnerability for the financial system, and the failure of an insurer – an event that has occurred from time to time – can create financial instability. In addition, the traditional view that insurers pose limited systemic risk can be challenged, however, because it does not take account of the fact that interaction between insurers, financial markets, banks and other financial intermediaries has been growing. It is important, however, to recognize that insurance companies, given their role as mitigators of risk and their often, long-term investment horizons, often also support financial stability.

Methodology

Insurance is an essential component in stabilizing the activities of commercial banks based on world standards. Commercial banks are exposed to a wide range of risks that could lead to financial losses, and insurance serves as a means of mitigating these risks.

One of the key risks that commercial banks face is credit risk. This risk arises from the possibility of borrowers defaulting on their loans. Banks typically manage this risk by diversifying their loan portfolios, setting credit limits, and conducting credit analysis. However, even with these measures in place, there is always a chance that a borrower will default. In such cases, insurance can provide a safety net for the bank by covering the losses incurred as a result of the default. [5,6,7,8]

Another risk that banks face is operational risk. This risk arises from internal processes, systems, and human error. Examples of operational risks include fraud, errors in transaction processing, and system

failures. Insurance can provide coverage for losses resulting from operational risks, thereby stabilizing the bank's activities.

In addition, insurance can also help commercial banks manage other risks such as market risk, liquidity risk, and reputational risk. By providing coverage for losses resulting from these risks, insurance can help stabilize the bank's financial position.

Furthermore, insurance is also a regulatory requirement for commercial banks in many jurisdictions. Regulatory bodies require banks to have insurance coverage to ensure that they are adequately protected against risks that could lead to financial instability. [9,10,11]

Insurance companies, especially composite and life insurers, are large investors in financial markets since they invest insurance premiums received from policyholders. Most of the time, given their, often long-term investment horizons, insurers are a source of stability for financial markets. However, because of the sheer size of their investment portfolios, reallocations of funds or the unwinding of positions by these institutions has the potential to move markets and, in the extreme, affect financial stability by destabilizing asset prices. The largest asset class in which euro area insurers invest is debt and other fixed income securities. On average, large euro area insurers have about half of their bond holdings in corporate bonds and half in government bonds. Because of these large government and corporate bond investments, the investment behavior of insurers has the potential to affect long-term interest rates and pricing in the secondary markets. Furthermore, it makes insurers important for the provision of financing to both governments and firms. For example, around 20% of the debt securities issued by euro area governments are held by euro area insurers and pension funds

Researches and analysis

Below, we will supply some graphical statistics of number of FDIC-insured commercial banks in the United States from 2000 to 2021 (Figure 1¹).

¹ <https://www.statista.com/statistics/184536/number-of-fdic-insured-us-commercial-bank-institutions/>

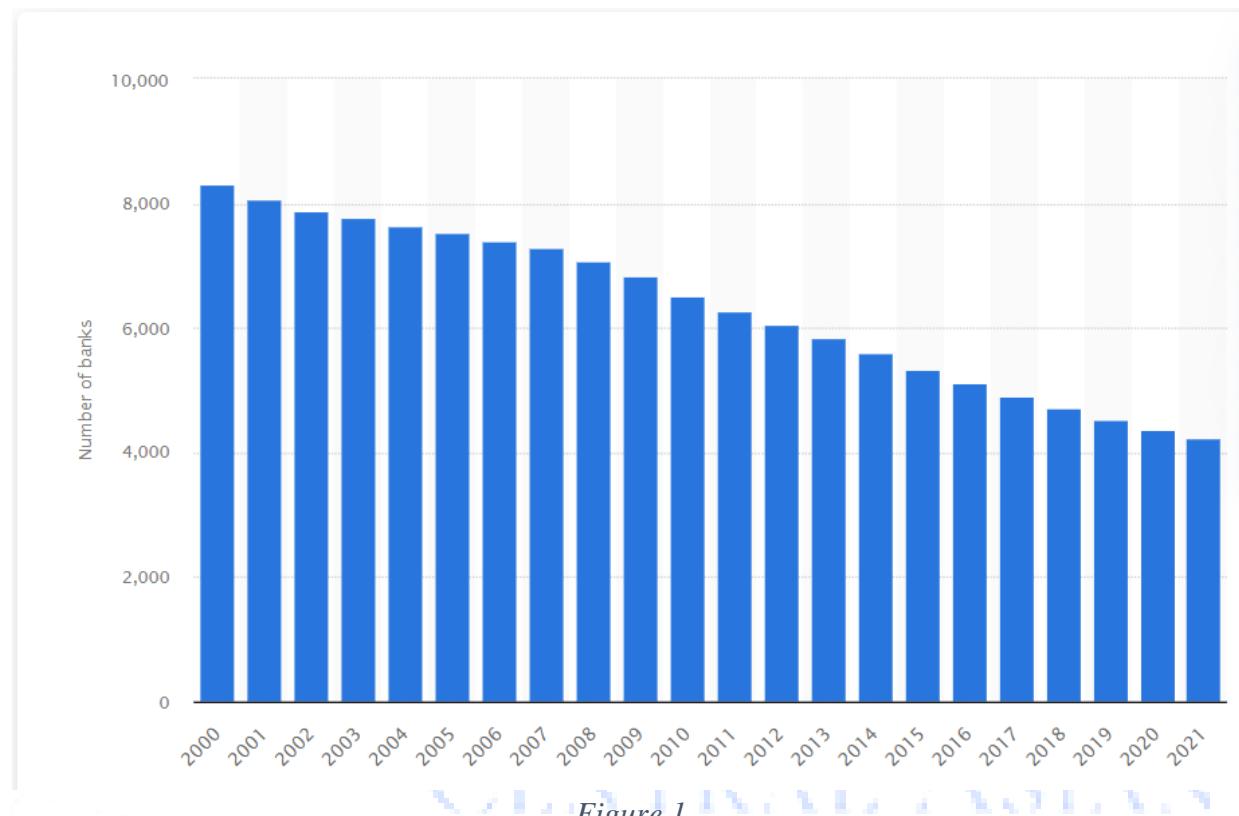


Figure 1

To give some detailed information, we should notify that FDIC-insured commercial banks include the following categories of depository institutions insured by the FDIC: national banks, state chartered banks and trust companies (except savings banks), commercial banks, either national or state chartered, insured by the FDIC, other financial institutions which operate under general banking codes, or are specifically authorized by law to accept deposits and in practice do so or the obligations of which are regarded as deposits for deposit insurance. [12,13]

The statistic does not include figures for Guam, Puerto Rico, Virgin Islands, and all other United States territories and possessions.

Insurance companies as promoters of financial stability among households and firms:

By ensuring risks that households and firms are confronted with, insurance companies contribute to the stability of the balance sheets of these sectors. However, the links between insurers and non-financial sectors can occasionally give rise to potential financial stability concerns. For instance, the default of an insurer – an event that has occurred from time to time – can cause financial distress in these sectors. This occurred, for example, in Australia in 2001 when the failure of HIH – the second largest non-life insurer in the country – led to the bankruptcy of some companies that had purchased insurance cover from HIH.¹¹ The default of an insurer or withdrawal of insurance coverage can also make it impossible or very difficult for firms to conduct certain business where insurance coverage is needed. Insurance companies can also be of similar importance for households. For example, insurance policies on houses, cars and other physical assets protect households from large losses. In addition, life insurers are increasingly important for euro area households.

The expected increase in the proportion of retirees in the population, and pension reforms underway in many euro area countries designed to encourage people to shift from public to private life insurance

schemes, has increased the role played by life insurers in the economy. The amount of euro area households' assets invested in life insurance and pension funds has increased from €2.5 trillion at the beginning of 1999 to almost €5 trillion at the end of 2008 (see Chart E.4).¹² As a share of households' total financial assets, life insurance and pension fund investments has increased from 23% to 31% during the same period. The important role insurers play for households and firms is the main reason why insurers are supervised. The prudential supervision of insurance companies and pension funds aims at promoting a sound and prudent management of these institutions also with a view to protecting policy holders and investors. In addition to providing insurance coverage for firms and households, insurance companies sometimes also finance their investments. As already mentioned, insurance companies are large buyers of corporate bonds, but in some cases, they also extend loans to both firms and households.

The special role of reinsurers:

Although the reinsurance sector is much smaller than the primary insurance sector, it can still be seen as important for financial stability for two main reasons. First, reinsurers provide safety nets for primary insurers, and a reinsurer's financial difficulties can significantly affect the primary insurance sector. For example, if a reinsurer experiences financial stress, the problems could spread to many primary insurers if their reinsurance hedges were to fail to perform as expected. In this sense, reinsurance is a credit risk for primary insurers. It could also lead to a reduction in the availability of reinsurance coverage, which might force primary insurers to cut back on their underwriting, withdraw from capital markets and bolster solvency positions by other means. Second, because the business of reinsurers is to protect against extreme events, they are usually more exposed than primary insurers to rare and unexpected catastrophic events, such as natural disasters and terrorist attacks, the likelihood of which is difficult to quantify accurately. The potential for a reinsurer to cause a systemic event within the primary insurance sector has increased in recent years, due to consolidation in the reinsurance sector. The global reinsurance sector is dominated by a handful of very large companies. For example, the four Euro area reinsurers that are regularly monitored in this FSR have total combined assets of about €290 billion and they account for about 30% of total global reinsurance premiums written. What is more, the reinsurers themselves are interlinked as they distribute reinsurance exposures among one another (called retrocession). In retrocession markets, large and unique risks can be spread around the global reinsurance market to allow primary insurers to also reinsurance risks that are too large for a single reinsurer.

Discussions

Insurance is a critical aspect of stabilizing the activities of commercial banks, and it is essential to maintain the stability of the financial system. Commercial banks play a crucial role in providing financial services to the economy, including deposit taking, lending, and payment services. However, they are also exposed to various risks, including credit risk, market risk, operational risk, and liquidity risk.

Insurance helps to mitigate the impact of these risks on the operations of commercial banks by providing protection against unexpected losses. By ensuring their assets, commercial banks can reduce the likelihood of insolvency in the event of a significant loss. Insurance can also help to stabilize the overall financial system by reducing the potential impact of systemic risk. [14,15]

The importance of insurance in stabilizing the activities of commercial banks is recognized on a world standard. For example, the Basel Committee on Banking Supervision, an international organization that provides guidance on banking supervision, recommends that banks maintain adequate insurance coverage

to mitigate the impact of risks on their operations. Additionally, many countries have regulations that require banks to maintain insurance coverage for various risks.

The difference between Banks and Insurance Companies:

Banks have a special role in the financial system on account of their central role in the transmission of monetary policy and their participation in payments systems. The interconnections between banks in interbank markets and payment systems can also cause problems faced by one bank to spread to others. Banks are therefore of particular importance for financial system stability. This importance is exacerbated by the fact that banks' assets (such as customer loans) are mostly long-term in character, whereas their liabilities (such as deposits) are of shorter-term duration. This leaves the banks vulnerable to depositor runs that can result in liquidity shortages. Insurers on the other hand, unlike banks, generally have liabilities with a longer maturity than their assets, which makes them less vulnerable to customer runs. In addition, insurers' liabilities are usually less liquid than bank deposits, as the possibility of withdrawing savings is restricted in most insurance contracts and is also more costly for customers. [16]

Although insurers can contribute to financial stability on account of both their capacity to reallocate risks in the economy and their often, long-term investment horizons, they also have the potential to destabilise the financial system. In particular, a problem confronting an insurer could affect not only households and firms that have bought insurance, but also financial markets – via insurers' investment activities – and banks and other financial institutions – via direct and indirect links. All this warrants a regular analysis and monitoring of insurers' financial performance and assessments of their risk by central banks, international organizations and other bodies that cover countries/regions where the insurance sector plays a significant role. In addition, given that the banking and insurance sectors have become increasingly interlinked, financial stability assessments should avoid an approach that is too sector-oriented and should take into account the linkages between these different parts of the financial system. [17,18,19]

Conclusion

In conclusion, insurance is an essential tool for stabilizing the activities of commercial banks and maintaining the stability of the financial system. By providing protection against unexpected losses and reducing the potential impact of systemic risk, insurance helps to ensure the continued provision of financial services to the economy.

Last but not least, insurance is a critical component in stabilizing the activities of commercial banks based on world standards. It provides a safety net for banks by mitigating risks and covering losses, thereby ensuring the stability of the bank's financial position. Additionally, insurance is a regulatory requirement for commercial banks in many jurisdictions, further highlighting its importance in the banking industry.

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