

Evaluation of Insurance Sector in Azerbaijan

Azer Shiryev

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Approval of the Institute of Graduate Studies and Research

Prof. Dr. Elvan Yılmaz
Director

I certify that this thesis satisfies the requirements as a thesis for the degree of Master of Science in Banking and Finance.

Assoc. Prof. Dr. Salih Katirciođlu
Chair, Department of Banking and Finance

We certify that we have read this thesis and that in our opinion it is fully adequate in scope and quality as a thesis for the degree of Master of Science in Banking and Finance.

Assoc. Prof. Dr. Nesrin Özataç
Supervisor

Examining Committee

1. Assoc. Prof. Dr. Salih Katirciođlu

2. Assoc. Prof. Dr. Bilge Öney

3. Assoc. Prof. Dr. Nesrin Özataç

ABSTRACT

The purpose of the thesis is to evaluate the developments of methodological bases of effective management on investment activities of the insurance companies. It is also important to point out to promote the satisfaction of requirements of national economy in investment resources and the solution of strategic problems of development of insurance business. The urgency of the chosen subject is defined by an increasing role of insurance in providing national economic system with investment resources for the successful solution of a problem of sustained economic growth, and also value of investment activity for ensuring profitability and financial stability of insurance business.

The study is carried out to investigate the volume and the structure of investment resources of insurance companies of the Republic Azerbaijan, and also the experience of state regulation of placement of means of insurance reserves; structures of investments, principles and results of investment activities of domestic and foreign insurers; to develop recommendations of the enhancement of state regulation in regard to management of investment resources of insurance companies.

Keywords: Insurance Company, Development, Azerbaijan.

ÖZ

Tezin amacı yatırımların olumlu etkilerini belirleyen faktörleri incelemek ve, yatırım kaynaklarının sigorta iş geliştirme stratejik problemlerinin çözümünde ulusal ekonominin şartlarına uyumunun teşvik edilerek sigorta şirketlerinin yatırım faaliyetinin etkili yönetim metodolar geliştirme, sigorta şirketlerinin yatırım politikası olanakları ve özelliklerini ortaya koymanın yanında, sigorta yatırımları devlet düzenlemesi önceliklerinin tanımı; hacim ve sigortacıların yatırım kaynaklarının yapısının değerlendirilmesini ortaya koyabilmektir.

Tezin ana hedefleri ise ; sigorta fonu organizasyon ve kurumsal yatırımcı formları gibi sigorta şirketinin faaliyetleri, ekonomik içerikleri ve özelliklerinin incelenmesi; ilgili faktörleri araştırmak ve koşulları sigorta şirketlerinin yatırım politikası ve yatırım olanakları ile özelliklerini tanımlayan Azerbaycan Cumhuriyeti'nin sigorta şirketlerinin yatırım kaynaklarının yapısının üzerine bir değerlendirme yürütmek; sigorta rezervleri sayesinde yerleştirme devlet düzenlemesi, iç ve dış deneyim analizi yürütmek için yatırımlar, prensip ve sonuçları ortaya koymak ve de yerli ve yabancı sigortacıların yatırım faaliyetlerini kapsamlı bir şekilde değerlendirmeyi içermektedir.

Anahtar Kelimeler: Sigorta Şirketi, Azerbaycan Cumhuriyeti, Sigorta Rezervleri.

To My Family

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TABLE OF CONTENTS

ABSTRACT	iii
ÖZ	iv
DEDICATION.....	v
ACKNOWLEDGMENT.....	vi
TABLE OF CONTENTS.....	vii
LIST OF TABLES	ix
LIST OF FIGURES	x
LIST OF ABBREVIATIONS.....	xi
1 INTRODUCTION	1
1.1 Theoretical Bases of Investment.....	2
1.1.1 Essence of Investment Activity of Insurers	2
1.1.2. Investment Risk	5
1.1.3. Investment Policies	8
1.1.4. Investment Principles.....	11
1.1.4.1. Safety Principle, or Recurrency	11
1.1.4.2.Profitability Principle.....	11
1.1.4.3. Liquidity Principle	13
1.1.4.4.Diversification Principle.....	14
1.1.4.5. Principle of Unoriginality (subordination).....	15
1.2. Rules and Regulation of Insurers.....	21

2 ANALYSIS OF INVESTMENT ACTIVITIES	28
2.1 Assessment of Investment Potential of Insurers of Azerbaijan	28
2.1.1 Attracted Capital	33
2.1.2 Insurance Reserves.....	39
2.2 Analysis of Efficiency of the Investment Activity of Azerbaijan.....	43
3 IMPROVEMENT OF INVESTMENT.....	53
3.1 Main Directions for the Improvement of Investment Activity Azerbaijan.....	53
3.1.1 Problems with the Realization of Investment Potential Azerbaijan	53
3.1.2 Ways of Improvement for Investment Activities Azerbaijan	64
4 CONCLUSION AND SUGGESTIONS.....	77
4.1 Conclusion	77
4.2 Suggestions	78
REFERENCES	854

LIST OF TABLES

Table 1: Dynamics of the Size of Equity.....	31
Table 2: Comparative characteristics of investments.....	36
Table 3: Total amount of created insurer reserves.....	40
Table 4: Data on sizes of authorized capital of insurance companies.....	44
Table 5: Investment income of insurance reserves by insurance companies.....	48
Table 6: Profitability of investments by insurance companies.....	49

LIST OF FIGURES

Figure 1: Dynamics of equity capital for 2007-2011.....	32
Figure 2: Changes of authorized share capital in equity.....	32
Figure 3: Dynamics of the insurance fees for direct insurance and joint insurance.....	34
Figure 4: Inflation Rate of Azerbaijan.....	37
Figure 5: Structure of an insurance portfolio.....	38
Figure 6: Dynamics of the ratio of insurance reserves created.....	41
Figure 7: Investment of mathematical reserves by insurers.....	46
Figure 8: Investment of technical reserves by insurers.....	47
Figure 9: Interest Rate of Azerbaijan.....	50

LIST OF ABBREVIATIONS

CA.....	cash assets , usd
CA.....	cash assets , usd
EC.....	equity capital, usd
IA.....	investment assets , usd
IN.....	investment income , usd
Net IR.....	insurance reserves – net ,usd
SCir.....	sufficiency of covering insurance reserves by investment assets

Chapter 1

INTRODUCTION

In modern economy insurance acts as the most important stabilizer of public reproduction process. Constant increase of accumulated public wealth and complication of technological, economic and social hazards menacing to its preservation and enhancement demand creation of effective and large-scale system of insurance funds intended for timely compensation of unforeseen material damage. Economic meaning of insurance is not only settled by its guarantee and compensating functions. Financial resources accumulated in insurance funds are an essential source of investments into economy. In developed countries insurance companies by capacity and size of investments compete to universally recognized investors like banks and investment funds (Shakhov, 2003).

Investment activity of insurers acting as one of the main factors of ensuring effective functioning of an insurance company, is as important at micro level.

First, investment activity defines possibility of providing insurance services at the expense of ensuring formation of sufficient insurance fund. First of all, this concerns those types of insurance where planned profitability from investments is considered when calculating tariffs (life insurance) or when obligations of the insurers are expressed in monetary units different from those in which insurance funds are formed.

Secondly, well organized investment activity ensures quality of provided services and defines market position of the insurer. Investment activity influences on the main

characteristics of an insurance product, first of all, on its cost and on the actual performance of the insurer's obligations.

Thirdly, investment gives a chance to owners of an insurance company to develop their business and to run it independently. At the expense of investment of insurance funds there is an accumulation of means for increase in own means without attraction of external investments. This is extremely important because of gradual increase of requirements to the minimum sizes of authorized capital of insurance companies.

The practical importance of the thesis is the possibility of application of received conclusions and recommendations in practice of investment activity of the Azerbaijani insurers.

1.1 Theoretical Bases of Investment

1.1.1 Essence of Investment Activity of Insurers

One of the features of insurance activity consists in so-called inversion of the operational cycle essence of which is the following. Unlike the production sphere where the producer at first bears costs of output, and then compensates them at the expense of sales proceeds, insurers at first accumulate funds in the form of insurance fees, creating necessary insurance reserves, and in the sequel when an insured accident happens, they bear expenses connected with insurance payments. As a result insurance companies have an opportunity to use the funds received from insurers during a certain (sometimes quite a long) period of time.

Besides the involved funds, insurance companies can also use their own funds - an authorized capital received from shareholders and founders - and also unused profit. The

funds at insurance companies' disposal represent a set of resources intended for insurers to fulfil their obligations when an insured accident takes place, and also for ensuring financial stability of insurance company. These kind of resources include both the current receipts, and various funds available to insurers (formed both at the expense of their own, and the involved funds), which are also intended to be used during next years.

Financial resources of insurance companies are constantly moving and in temporal aspect represent financial streams concerning formation of the insurance fund intended for compensation of a damage (Hankishiyev, 2006).

It predetermines a possibility and a need of implementation of investment activity by insurance companies. Insurance companies act as the largest investors and creditors in the financial markets and accumulating huge amounts of money in the form of reserves.

The financial capacity of an insurance company is forms of two main parts – own and involved capital. In developed countries the involved part of the capital substantially prevails over the own. Base of the involved capital is the cumulative insurance premium received by an insurance company minus loading, which covers expenses on business conduct. Cumulative net - premium represents insurance reserves of the company intended for payments of insurance compensation (Holt,1998).

According to Azerbaijani legislation, activities of an insurer as for an investment of insurance reserves in securities, real estate, precious metals and other property in an order established by the legislation, and also on other capital investments not forbidden by the legislation for receiving profit (income) are meant by investment activity.

Income from investments are formed of interest of securities, receipts from participation in authorized capital stock of other organizations, percentage of bank

deposits, income of leaving of fixed assets, intangible assets and other long-term assets, percentage of depot of awards at reinsurers, percentage of investments in real estate and other receipts. Investment income is an important source of insurance companies' income (Romesh Veytilingem, 2001).

Accumulative types of life insurance in a form of insurer's participation in profit of and target investment of insurance reserves' means are funded at the expense of this source. In countries with a developed stock market investment income allows to block negative results of insurance operations in risky type of insurance. Besides that, a part of the investment income can be used at insurer's own discretion, for example on development.

Investment activity is the second as for priority source of income of insurance companies after insurance fees. This statement is prevailing in national literature. However, there is another point of view which, in our opinion, responds to the essence of insurance. Investment activity is the main source of obtaining profit for insurance companies.

At "fair" calculation the profit of insurance activity should be very insignificant. Otherwise, the principle of equivalence of payment streams gets broken. According to this principle in foreign practice the volume of insurance payments is more than 90 % of collected premiums. But in our country the level of payments is 60 % (56,6 % in 2011) on the average, i.e. in essence the Azerbaijani insurers are overestimating risks taken. High share of the remaining premium allows not seek for options of profitable and reliable placement of assets.

Not only insurer's income, but also his solvency, i.e. ability to pay for liabilities, depend on efficiency and reliability of placement of temporarily available funds. In

connection with this, placement of insurance reserves is under rigid governmental control.

Thus, investment activity of an insurance company – the process of placement of insurance reserves and own free assets for obtaining the investment income. Quite big insurance funds caused by receipt of numerous, though small contributions on the one hand, and periods during which these means of insurers are being accumulated in insurance companies, turn insurance companies into powerful financial credit institutions and, as a result, insurance becomes a strategic sector of economy.

Performing investment operations and receiving income as a result insurers appear substantially dependent on a situation in the monetary and financial markets, bearing investment risk at the same time. This compels them to carrying out sufficiently careful investment policy.

Investment risk of the insurer – uncertain possibility of deficiency of the investment income caused by a possibility of loss of assets or deficiency of the income from them, which can lead to violation of financial stability of the insurance company and, consequently, to non-fulfilment of insurance payments obligations by the insurer (Bazanov, 2009).

1.1.2 Investment Risk

The following may be attributed to the main investment risks of the insurer, connected directly or indirectly with investment activity of the insurance company:

- the risk of an inadequate assessment of assets arises when investments were overrated and consequently incorrect, and the insurer mistakenly considers that available shares will provide a higher income above, than they will actually;

- the risk of depreciation of assets occurs in case when objects of investments lose their cost because of changes in the capital market when a shift of currencies occurs, etc.;
- the risk of discrepancy of assets to obligations is caused by a ratio of assets and obligations, and can occur in case obligations assume one profitability and liquidity of assets, and actually available assets – another, not meeting obligations;
- risk of illiquidity of assets. Influence of this type of risk is especially essential for risky types of insurance with short-term contracts and implementation of obligations is connected to limited time period. For personal insurance the risk of illiquidity first of all affects the possibility of implementation of insurer's obligations on the redemption amounts;
- the risk of standard of profitability is connected with a divergence between real market standard of profitability and the one that is provided by formed investment portfolio of the company. Risk can arise, for example, if in an investment portfolio securities with fixed standard of profitability has big unit weight, considerably smaller than market;
- the risk of participation caused by the fact that the insurer owns somebody else's shares and consequently can depend on difficulties of the company whose shares he owns. Example: a risk connected to participation of the insurer in subsidiary company;
- risk of use of financial instruments – derivative securities (futures, swaps, options, etc.). Use of derivative financial instruments is connected to potential risk of wrong assessment of credit, market risks and risks of liquidity. Besides that, the insurer's inability, insufficient work experience connected to financial instruments can also strengthen possible negative influence of use of derivative securities factor;
- risk of legislative changes affecting results of an investment activity of an insurance company. This risk is caused by a possibility of adoption of standard act at a

governmental level, directly or indirectly, or contradicting to the purposes of investment activity of insurance business, or limiting possibilities of investment activity of insurance companies;

- temporal risk caused by a divergence between time of obtaining income from investments and time of implementation of insurance obligations;

- risk of the management concept of the insurance company, connected with a choice of the management concept which can increase investment risk;

- risk of marketing strategy which can negatively affect investment activity of insurance company (Dorfman, 2001).

Existence of mentioned above investment risks means for insurer possibility of loss of certain types of assets and decrease in possibility of obtaining the investment income from them. It leads to a direct increase of insurer's breach of duty risk in terms of the part of investments which corresponds to insurance reserves. It also leads to indirect increase of breach of duty risk in terms of the part of investments which is connected to own available funds of the company.

The assessment of loss of funds risk because of insolvency of the organizations in which insurers' funds are invested has fundamental value during implementation of investment activity. For implementation of such estimates techniques of solvency analysis and also expert estimates of specialists which should be based not only on the current situation, but also on prospects of its change.

The list of possible objects for investment is created on the basis of the conducted analysis. This list covers their characteristics including assessment of investment risk degree which forms the insurer's investment portfolio.

The choice of investment objects should be carried out by insurance companies depending on terms on which means can be placed, and in their turn, in many respects are defined by forecasts of terms of emergence of requirement for means for implementation of insurance payments. For creating such forecasts on the basis of available statistics insurers build models of distribution of probability of insured accident occurrence time and the amount of insurance payments on different types of insurance contracts which are negotiated by them. On the basis of implemented calculations the ratio between long-term, medium-term and short-term investments is defined so to provide high profitability in a combination with reliability and flexibility of investments (Spletuhov, 2009).

1.1.3 Investment policies

Relation of an investor to risk is strongly connected to mentality of his investment behaviour. Mentality of investment behaviour of the insurer means prioritized policy of the insurer in relation to investment activity caused in the first place by his inclination to risk.

Generally mentality of investment behaviour of any investor can reflect conservative, moderate (moderate and aggressive) and aggressive investment policy.

Conservative investment policy assumes that investor chooses types of investments by criterion of minimization of loss possibility of corresponding assets or deficiency of the income that could be gained from them. Investor is in the first place interested in reliability of investments and therefore risks of loss of the chosen assets or deficiency of the income that could be gained from them are, as a rule, lower than market average but also level of the income expected from them also can be essentially lower than market average. Conservative strategy is usually used by those investors

aimed at protection of the capital. This strategy ensures obtaining stable income at maximum decrease of investment risk.

Moderate investment policy assumes that investor chooses types of investments using criterion of approximate compliance risk of loss of assets or deficiency of the income that could be gained from them as well as level of the expected investment income from these assets to market conditions. Moderate investment strategy is used by those investors, whose purpose is achievement of profitability of their investments exceeding (or equal to) profitability of tools with the fixed interest rate. When using this strategy means are partially allocated in tools with fixed profitability (corporate and municipal bonds), partially – in highly liquid corporate shares. On the one hand, that allows to lower risk level essentially, on the other hand, that allows calculating on obtaining high dividends per capital.

Aggressive investment policy assumes that investor chooses types of investments using criterion of maximizing investment income. Investor is in the first place interested in profitability of investments. Therefore, though level of the investment income that could be gained from the chosen investments is higher than market average, loss risk of the chosen assets or deficiency of the income that could be gained from them are also higher than market average. Aggressive investment strategy is implemented by those investors allowing high investment risk and aimed at obtaining profitability which is considerably higher than average stock market profitability. In case of a choice of this strategy all means of the investor are usually allocated in the market of shares. The main part of the portfolio is made, as a rule, of the most liquid shares of stock market, and the rest is the share of strongly underestimated shares of fast-developing companies with average level of liquidity.

In general, the insurer should be an investor who should not be inclined loss of assets risk or deficiency of the income that could be gained from them even if growth of risk level can be compensated by additional investment income. This can be explained by the fact that the main part of resources invested by him are means of insurance reserves and a part of own means of the insurer which are used for fulfilment of insurance engagements.

When an investor is involved in an investment activity corresponding to fulfilment of insurance engagements, he should not strive to receive high profits at any cost in the first place, but he also obliged to allocate means so to provide safety of investments and to receive not a big, but guaranteed income.

As an investor of means of insurance reserves and a part of own funds corresponding to fulfilment of insurance engagements, (guaranteeing solvency of the insurer) insurance company should not be inclined to risk. Reliability of investments should be the main principle of the insurance company's investment activity, and the company's behaviour in the process of allocation of the named means should not be aggressive. In regard to means of insurance reserves and a part of own funds corresponding to fulfilment of insurance engagements (adherence to solvency of the insurance company), the insurer can and should behave as a conservative investor or at least as a moderate investor.

In its investment activity the insurance company should be guided by certain principles and rules adherence to which will promote financial stability of the insurance company and solution of the main objective of the insurer – to fulfilment of insurance engagements.

1.1.4 Investment principles

Investment activity of the insurer will promote providing guarantees of fulfilment of insurance engagements in case it is based on adherence to principles of safety (recurrency), profitability, liquidity and diversification (Northcott, 1998).

1.1.4.1 Safety Principle, or Recurrency

Adherence to it means providing maximum possibility of safety of investments, i.e. means minimizing of risk of loss of an asset.

Unfortunately, in practice of investment, insurance companies do not always resort to difficult methods of investments safety analysis.

Nevertheless, world practice shows that any state securities belong to a number of the reliable and safe investments. Also, bonds of large corporations that established a good reputation are rather reliable. Shares of young science intensive companies are the most risky.

Because along with the safety guarantee insurer is interested in acquiring profit, the investor hopes for compensation in the form of higher profit at higher risk of investments, i.e. at a lowered guarantee of safety of investments.

1.1.4.2 Profitability Principle.

Adherence to this principle in terms of a certain type of assets means possibility of receiving income from investment activity by insurance company.

In whole, the rate of return expected by the investor (insurer) can be presented as a sum of standard profit rate (by non-risky type of investments) and additional profit rate, which plays a role of an award for increased safety risk by this type of investments. However, it is worth mentioning that there is a possibility of not receiving additional

profit as a compensation for high risk of non-compliance with a principle of safety for a certain type of investments.

Besides, it is also important to remember that a certain level of profitability is promised to insurer on long-term types of insurance the insurer and it is considered during creation of a tariff rate. Due to this fact discounting of an insurance tariff demands real profitability of investment operations not to be less than the profitability standard put in a tariff. For the specified reason insurance companies that carry out long-term insurance, always show heightened interest in highly profitable long-term securities.

During the creation of an investment portfolio the insurer in the first place should think of his obligations on insurance payments. Therefore, though for him adherence to profitability principle is not the main thing, it is important as well as for any other branch of economy. It is worth mentioning that realization of this principle in insurance has its peculiarities.

First peculiarity of realization of this principle in insurance becomes apparent in that the investment profit gives insurer a chance to suffer a loss on their insurance operations. Excess (if it exists) of investment income over the size of loss on insurance operations saves competitiveness of the insurer.

Second peculiarity is connected to that on long-term types of insurance the insurer "promises" to the insured a certain standard of profitability through discounting of an insurance tariff. Due to this fact, the insurer is interested in the highly profitable investments providing real standard of profitability which is not lower than the one considered during discounting insurance tariffs.

Third peculiarity is connected to the fact that insurer uses a part of the received investment income for his own purposes, in particular on development of the company.

The principles named above have different priority for the insurer. Safety principle should be the priority for the insurer because insurance is an institution of financial protection, i.e. is initially intended for decrease of financial losses connected to economic risk. Due to this fact when choosing a concept of financial management insurers are first of all focused on ensuring a certain level of safety. After this level is ensured insurers are focused on achievement of other purposes: receiving profit and ensuring liquidity of assets. This concept, assuming a priority of safety principle, is called “Safety First”.

1.1.4.3 Liquidity Principle

For holder adherence to this principle means a possibility of fast and non-defective conversion of assets into money.

In insurance business liquidity of assets means a possibility of operative conversion of assets into cash means of payment for paying off obligations of an insurance company.

When defining the level of liquidity they usually take into consideration time during which it is possible to turn these financial resources into money as well as the expenses connected to it. As is generally known, only cash possesses of absolute liquidity. Written orders on account demand temporal expenses. Moreover, liquidation of securities besides temporal expenses also demands payment of the services of a mediator, for example, broker. Except for expenses at urgent sale of securities, for example shares, additional losses connected to decrease of their price can arise.

Peculiarity of usage of liquidity principle in insurance consists in liquidity requirement differ depending on the risks making up an insurance portfolio. If the company carries out long-term accumulative types of insurance, it can provide a high degree of accuracy of when and how much money it requires for payments of insurance amounts. In case it is involved in risky types of insurance, for example responsibility insurance, sea, aviation, insurance of ecological, financial risks etc., it might need to settle accounts with its insurers in a very short period of time. Due to this, this kind of insurance companies needs to be made more rigid demands for adherence to liquidity principle.

In general, principles of safety, profitability and liquidity generally contradict one another. So, the safest investments are, as a rule, less profitable and liquid, and vice versa. Compromise between the investment purposes adhering to named principles, can be reached by adherence to diversification principle.

1.1.4.4 Diversification Principle.

Adherence to it assumes implementation of the requirement about distribution of capitals between various objects of investments for the purpose of decreasing risk of possible losses of both the capital, and the income from it.

Need of adherence to this principle when allocating insurance reserves is explained by the fact that means of insurance reserves are intended for implementation of obligations on insurance payments. Due to this fact, it is necessary to have guarantees of recoverability of means, liquidity in obtaining income not from one, but from several directions of investments.

It is worth mentioning that the part of investment risk which can be avoided at the expense of creation of a well diversified investment portfolio is called specific

diversified risk. The rest of the investment risk cannot be avoided or removed by creation of a diversified investment portfolio is called non-diversified investment risk. Existence of this risk is related to the factors influence of which on this business is almost identical and caused by the state of the economy as a whole (inflation, change of interest rates etc.).

The investment portfolio corresponding to adherence to safety principles (recoverability), profitability, liquidity and diversification is called balanced investment portfolio.

This definition of the balanced investment portfolio is lawful for any financial institution working with investments.

However, for the insurer, who in the first place should guarantee fulfilment of obligations on insurance payments to insured, this definition has an additional condition caused by the following factor is imposed.

Investment activity in an insurance company is of the major importance, but is of a subordinated character with respect to insurance operations. Subordination of an investment activity to insurance operations represents the fifth principle of an investment portfolio creation (Chernov, 2005).

1.1.4.5 Principle of Unoriginality (subordination)

Adherence to it means that investment activity should ensure that companies obtain investment income in the place, size and during the time which are agreed with fulfilment of insurance obligations.

Fulfilment of obligations on insurance payments will favour adherence to all principles of investment activity of the insurer.

This is how adherence to safety and diversification principles will favour preservation of assets, profitability principle – implementation of requirements about necessary volume of insurance payments, liquidity principle – fulfilment of obligations in the necessary volume, in the fixed term, a subordination principle – fulfilment of insurance obligations.

Capabilities of insurance company in participation in investment process are determined by participation by its investment potential. It is necessary to understand set of money as investment capacity of insurance company, it is temporary or rather free from insurance obligations and used for investment for the purpose of obtaining the income.

The investment potential makes up the part of financial potential which remains after deduction of expenses on business operations, debt funds and insurance payments. If volumes of the specified deductions are being increased more than growth of insurance fund volume and equity capital, there can be a situation when financial capacity of the insurance company increases but its investment potential decreases. In practice there are organizations which have high financial potential but small investment potential (Shcherbakov, 2009).

Realization of investment capacity of insurance company is a process of investment of insurance fund and equity capital. Investment potential is influenced by a set of factors:

- volume of collected insurance premiums;
- structure of an insurance portfolio;
- unprofitability or profitability of insurance operations;
- conditions of state regulation of creation of insurance funds;

- terms of insurance contracts;
- volume of own funds.

The system of indicators is used for assessment of investment capacity of a particular insurance company:

a) Sufficiency of covering insurance reserves (SCir) is determined by investment assets using the following formula (1).

$$SCir = \frac{IA + CA}{Net IR}$$

Where :

SCir – sufficiency of covering insurance reserves by investment assets ;

IA – investment assets , usd ;

CA – cash assets , usd ;

CA – cash assets , usd ;

Net IR – insurance reserves – net , usd.

Indicator of level of covering net insurance reserves by investment assets reflects the extent of placement of funds (at the expense of which obligations of an insurance company are being covered) in investment assets and cash assets. Investment assets and cash assets should correspond or exceed the size of insurance reserves. Existence of an opposite tendency might mean placement of funds in illiquid assets or in high risk assets (accounts receivable, intangible assets, equipment and materials).

b) profitability of investments (PI) is calculated by the following formula (2)

$$PI = \frac{PIA}{VI} * 100$$

Where:

PIA – profit from investment activity , usd;

VI – volume of investments , usd .

This factor is used for assessment of efficiency of investment activity.

c) share of investments in equity capital (SIEC) reflects amount of income goes to each usd of invested own funds. It is calculated by the following formula (3).

$$SIEC = \frac{IN}{EC}$$

Where :

IN – investment income , usd;

EC – equity capital, usd.

Concentration of considerable financial resources by insurers can turn insurance into the most important factor of the economic development by realization of effective investment policy.

At micro-level the investment potential characterizes possibilities of a separate insurance company stably execute guaranteed payments on insured accidents. Therefore, except for general indicators characterizing investment potential, it is reasonable to allocate the specific indicators assessing usage of this potential for insurance purposes.

First, successful investment activity gives insurance company a chance to use a part of received investment income for covering negative financial result of direct insurance operations in cases of increase of un profitability at uneven distribution of risk or occurrence of catastrophic risks as well as at a high competition and dumping of tariffs in the insurance market. In this situation assessment of investment potential should be given using an indicator of a ratio of insurance payments and awards (volume

of net premium). If value of this indicator is higher than one, it is the evidence of investment income being used for covering losses at a higher level than insurance tariffs allow. Accordingly, the more this indicator is higher than one, the more effectively investment potential is realized.

Secondly, investment activity allows insurer to attract those insured to take part in profit through a system of charge of bonuses or return of a part of an insurance fee. In this case the role of investment potential is characterized by indicator of investment percent size charged on insurance amounts of coverage on contracts of life insurance , and an indicator of the size of the returned part of an insurance tariff.

Thirdly, investment income can be a source of increase of equity capital of insurance company which is also used in emergency situations for covering insurance obligations. In this case the investment potential will characterize an indicator of a share of financial profit directed on increase in equity capital.

Thus, at macro-level investment activity is necessary and useful for national economy, but at micro-level it is necessary for each insurer as it increases his financial stability, solvency and competitiveness (Yurchenko, 2001).

Realization of investment potential in specific investment projects means formation of insurer's investment portfolio which represents a set of financial instruments received by the insurance company during investment of cash assets.

Formation of an investment portfolio is carried out in line with the investment policy accepted in the insurance company and taking into account rules of placement of the insurance reserves set by the legislation. The investment portfolio characterizes the sizes and structure of capital investments in particular reporting period and is constructed taking into account purposes of each insurance company. As it was

mentioned before, for investment insurance company can only use a part of available cash assets which include insurance fund and equity capital. At the same time, insurance fund (before it is used on insurance payments) is cash assets that are temporarily free from insurance obligations. Taking into account this feature of insurance fund, it makes significant impact on change of investment potential of the insurance company depending on existence and volume of insurance payments. Equity capital is cash assets relatively free from insurance obligations which can be used for insurance payments in case of insufficiency of means of insurance fund. Its size with high degree of probability is planned , and influences change in investment capacity of the insurance company much less.

Thus, investment activity of insurance companies is not connected directly to insurance. It is based on use of contributions of insurers as a source of financial investments. Being at the disposal of the insurer during a certain term, insurance premiums according to the established rules are invested in profitable assets and bring the investment income into insurance company.

Investment activity of insurance companies is an important element of social and economic development of society. Social value of investment activity of insurers is inseparably linked with savings function of insurance when collective funds managed by professional insurance companies are formed of numerous individual contributions necessary for covering of possible damages. To provide accuracy of formation of such funds and efficiency of their placement, and consequently, safety of protection of financial interests of their participants – the most important task of insurance companies. Considerable share of private savings is invested via insurance companies, which differ from other institutional investors. An essence of distinctions that insurance companies

implement two functions at once for their clients: guarantee connected to risk compensation and investment consisting in a capital increase.

Concentration of capital and consequently significance of investment activity of insurance companies resulted in importance of regulation of investments of insurance companies both on micro, and at macrolevel. The purpose of microeconomic regulation – achievement of the situation at which placement of assets of insurance company on volumes of investments and income received from them on time, place and space was agreed with obligations of insurance company, and first of all with obligations on insurance payments .

The purpose of macroeconomic regulation of investment activity of insurance companies – restricting insurance investments by the sphere of national economy, and also ensuring implementation of requirements caused by a role of insurance as an institute of financial protection and, thus, demanded from investment activity of all insurance companies of the country.

1.2 Rules and regulation of insurers.

For protection of those insured against losses which they can incur in case of insolvency of insurers, state authority of insurance supervision carry out regulation of investment activity of insurance companies and first of all supervise investment of insurance reserves funds. State regulation of investment activity in the Republic of Azerbaijan is carried out using definition of requirements to formation, placement, use of insurance reserves and other funds providing financial stability of insurance companies.

The president of the Republic of Azerbaijan establishes procedure of investment and placement of funds of insurance reserves. Council of ministers of The Republic of Azerbaijan in the framework of their competence and in agreement with the President of the Republic of Azerbaijan approves the procedure of investment and placement of funds of insurance reserves (Insurance Decree, 2007).

In particular, the procedure of implementation of investment activity by insurance companies in the Republic of Azerbaijan is regulated by the Investment code of the Republic of Azerbaijan and the Decree of Council of Ministers «About the affirmation statement of the Procedure of investment and placement of funds of insurance reserves by insurance companies».

If there is nothing else provided by Republic Azerbaijan legislative acts, sources of investments are the following:

- own funds of investors, including reserve for depreciation, profit remained after payment of taxes and other compulsory payments, including funds received from sale of shares in authorized capital stock of the legal entity;
- borrowed current assets and obtained funds including the bank credits and non-bank financial intermediary credits, loans of founders (participants) and other legal entities and physical bodies, bonded debts (<http://pravo.az/>. October, 2012).

According to the resolution of the Council of Ministers of the Republic of Azerbaijan insurance companies invest and place funds of insurance reserves on the terms of recoverability, profitability, liquidity and diversification. Funds of insurance reserves of insurance companies – state legal entities or legal entities in which authorized capitals more than 50 percent of shares (common (ordinary) or other voting shares) are in a property of the Republic of Azerbaijan and (or) its administrative and

territorial units, can be invested in the state securities , securities of National bank , securities of local executive and administrative organs.

At the same time investment is carried out on the basis of contracts with state banks of the Republic of Azerbaijan. And also in securities (excluding shares) of state banks of the Republic of Azerbaijan; in precious metals (except for their breakage and waste) and placing them in state banks of the Republic of Azerbaijan. Insurance companies are forbidden to invest funds of insurance reserves in objects of investment other than those set by Order; to act as a guarantor at the expense of funds of insurance reserves and objects of investment as well as to provide these funds as collateral.

When investing funds of insurance reserves, insurance companies are obliged to adhere to the following ratios:

1) types of insurance related to life insurance (in percentage of the sum of insurance reserves):

- not less than 40 percent – in government securities;
- not more than 10 percent – in securities of National bank;
- not more than 20 percent – in securities of banks of the Republic of Azerbaijan, excluding shares;
- not more than 10 percent – in securities of local executive and regulatory authorities;
- not more than 20 percent – in securities of legal entities of the Republic of Azerbaijan (excluding shares and bills);
- not more than 15 percent – in real estate (excluding residential buildings) and capital expenditures in real estate objects (excluding residential buildings);
- not more than 10 percent – in precious metals, except for their breakage and waste;

2) on types of insurance other than life insurance (in percentage of the sum of insurance reserves excluding share of reinsured people in insurance reserves):

- not less than 35 percent – in government securities;

- not more than 15 percent – in securities of National bank;

- not more than 25 percent – in securities of banks of the Republic of Azerbaijan, except actions;

- not more than 15 percent – in securities of local executive and regulatory authorities;

- not more than 25 percent – in securities of legal entities of the Republic of Azerbaijan (excluding shares and bills);

- no more than 20 percent – in real estate (excluding residential buildings) and capital expenditures in real estate objects (excluding residential buildings);

- no more than 15 percent – in precious metals, except for their breakage and waste.

The maximum total cost of securities of one bank of the Republic of Azerbaijan, one local executive and regulatory authority, one legal entity should not exceed 10 percent from the sum of funds of insurance reserves on the types of insurance related to life insurance and on the types of insurance other than life insurance – 15 percent of the sum of funds of insurance reserves, excluding share of reinsured people in insurance reserves.

The maximum cost of one object of investment – real estate (excluding residential buildings), one object of capital investments (excluding investments in construction of residential buildings) should not exceed 10 percent from the sum of funds of insurance reserves on the types of insurance related to life insurance and on the types of insurance

other than life insurance – 20% of the sum of funds of insurance reserves, excluding share of reinsured people in insurance reserves.

An insurance company should have not less than 10% of total amount of insurance reserves on accounts of banks of the Republic of Azerbaijan. For those insurance companies which are carrying out types of insurance other than life insurance, the specified size is estimated without a share of reinsured people in insurance reserves. At the same time, an insurance company cannot place more than 50% of the specified sum in one bank (Ministers of the Republic of Azerbaijan, 2007).

Insurance companies – state legal entities in which authorized capitals more than 50% of shares (common (ordinary) or other voting shares) are in a property of the Republic of Azerbaijan and (or) its administrative and territorial units, place own means and means of insurance reserves in the state banks.

At the same time, own funds can be invested in the government securities, securities of National bank, local executive and regulatory authorities only through state banks or organization department of National bank as well as in securities of the state banks and real estate objects (Insurance Decree of the President of the Republic of Azerbaijan, 2007).

Insurance company independently defines its investment strategy for placement of own funds and insurance reserves. When choosing investment objects it is necessary to consider interdependence of risk and income, i.e. to adhere to diversification of investments principle. It is possible to invest a part of funds in low-profitable and low-risk assets, and the other part — in highly remunerative with high level of risk. As a result the investment risk will be distributed among different types of investments. That will provide financial stability of insurer's investment portfolio.

The correct placement of investment resources — is first of all a possibility of insurance company to keep the real cost of the involved funds of insurers. Existence of effective investment activity also allows using considerable sums of reserves which bring significant income in the organizations. And as a result, the insurer gets an opportunity to provide clients with insurance services for a lower price which results into improvement of relations between the insurance company and clients, increase of portfolio of voluntary insurance contracts and growth of insurers' trust to the organization with which obligatory contracts of insurance are signed. Successful investment policy not only provides stability of insurer's activity, but also promotes increase of its financial stability in the conditions of the market.

Thus, when considering this matter we made the following theoretical conclusions. Investment resources of insurance companies — are their own funds (authorized capital stock, capital reserves, surplus and retained income) and involved funds in form of insurance reserves created of collected insurance premiums. The peculiarity of use of the investment capital of insurance company is its main source are insurance premiums of insurers. Own funds replenishment depends on insurer's income, and formation of insurance reserves depends on earned premium and obligations under existing contracts of insurance.

On the other hand, with respect to insurance obligations equity capital of the insurer is a guarantee of their timely execution in full. At the same time, the order of placement of funds of insurance reserves of insurers is established by relevant standard acts and is rigidly supervised by insurance supervision agencies.

Placement of insurance reserves is regulated by government so to minimize investment risk. Governmental regulation of investment activity in the Republic of

Azerbaijan is produced by defining requirements to formation, placement, usage of insurance reserves and other funds providing financial stability of insurance companies in concordance with «Procedure of investment and placement of funds of insurance reserves by insurance companies» decree approved of Council of Ministers of the Republic of Azerbaijan .

Being at the disposal of the insurer during a certain period, insurance reserves in concordance with established rules are invested in profitable assets and bring investment income to the insurance company. From the point of view of a possibility of obtaining investment income reserves on long-term life insurance possess of the greatest appeal as they are at the disposal of the insurer for a long time.

The main requirements to which the investment policy of insurance companies should correspond are reliability and profitability. On the one hand, loss of funds invested by insurer can lead to failure to implement his obligations under contracts of insurance and to bankruptcy. On the other hand, the insurance company is interested in receiving the biggest possible income of invested funds. At the same time, as a rule, high income accompanies low level of reliability. Therefore, the insurer should harmonize the specified purposes, this is reached by implementation of actuarial optimizing calculations. At the same time, principles by which insurers should be guided by at implementation of investment activity are diversification, recoverability, profitability and liquidity.

Chapter 2

ANALYSIS OF INVESTMENT ACTIVITIES

2.1 Assessment of Investment Potential of Insurers of Azerbaijan

During the intensive development period of Azerbaijani economy when the need for short-term and long-term investment resources increases, the special urgency is required for financial resources of insurance sector. Economic value of investment activity of insurance companies is caused by large volumes of their investment resources. Experience of the western countries incontestably testifies to the leading role of insurance companies in investment processes of the developed states, which cannot be observed in Azerbaijan.

For an assessment of investment capacity of insurance companies of the Republic of Azerbaijan it is necessary to analyze a number of indicators characterizing condition of resource base of insurers at the present stage, and also to track their dynamics for a number of years.

All the funds that participate in a turnover of an insurance company are classified into 'own' (equity) and 'attracted'. 'Equity' capital represents the settlement size consisting of the sum of funds and reserves of the insurer, free from future obligations, except for the rights of demand of property owners (founders, participants). For calculation of the size of equity capital, the data from the accounting (financial) reports of the insurer is used.

Equity capital includes the sum of authorized capital, the additional and reserve capitals, retained earnings of last years and fiscal year minus uncovered losses.

Authorized capital is formed when an insurance company is established, in the form of contributions from the founders. The minimum requirements for authorized capital are established by the Decree No 519 of the President of the Republic of Azerbaijan, as of 2007.

Authorized capital is defined as the difference between the size of authorized capital reflected in accounts of the balance sheet under the heading "Authorized capital", and its parts reflected in accounts of the balance sheet under the heading "Unpaid part of authorized capital", "Owned shares (shares in authorized capital)".

Sources of the additional capital are:

- Resources received as a result of revaluation of the main assets (non-current assets);
- Emissive income from the placement of shares;
- Gratuitous receipts.

The additional capital is defined as the difference between the size of the additional capital reflected in the account of the balance sheet under the heading "Additional capital", and the size of the additional capital as the gain (revaluation) in the value of real estate, acquired by means of insurance reserve resources, and other funds, created by insurance companies for the settlement of their obligations.

The order of formation of the reserve capital of insurance companies has no branch specifics. Creation and usage of this reserve is based on the legislation for joint-stock companies. The reserve capital is formed by annual deductions from the net profit until the size established by the charter is reached. The reserve capital is intended for the

coverage of losses, and also for repayment of liabilities and acquisition of the shares when there is a lack of other means (Shakhov, 2003).

For the calculation of equity capital, the reserve capital is defined as the difference between the size of the reserve capital reflected in the account of the balance sheet under the heading "Reserve capital", and the size of a reserve fund for salary payment.

The retained earnings (uncovered loss) correspond to the sum of the sizes reflected in the account of the balance sheet under the heading "Net profit (loss) for the reporting period" and "Retained earnings (uncovered loss)".

Let's consider the size and structure of equity capital of insurance companies of the Republic of Azerbaijan for a number of years. For this purpose it is necessary to familiarize with the accounting reports of insurance companies and to compare indicators of aggregate balance sheets of the insurers provided by the administration of Insurance Supervision of the Ministry of Finance of the Republic of Azerbaijan. The data is provided in Table 1.

It is necessary to note that earlier insurance companies were obliged by legislation to form accumulation and consumption funds from the retained earnings. Since 2010 this legislation has been cancelled, and funds of special purposes may be formed by the organizations voluntarily according to their accounting policies. For a more precise reflection of data, we included the funds of special purposes created in 2007-2009 in the indicators of retained earnings for the corresponding years.

Table 1: Dynamics of the size of equity of insurance companies of the Republic of Azerbaijan, in thousand USD.

Indicator title	The sum of the created resources, in usd.				
	01.01.2008	01.01.2009	01.01.2010	01.01.2011	01.01.2012
Authorized capital	58,314	407,261	552,029	567,690	596,738
Reserve capital	2,305	1,434	1,669	2,133	25,168
Additional capital	33,804	41,847	50,556	74,112	200,489
Retained earnings	8,518	12,730	21,437	18,572	83,155
Equity capital	101,006	460,979	623,347	659,697	900,512

Note - Source: developed based on: (Data General Directorate of Insurance Supervision, 2012)

As at 01.01.2011 equity capital of insurance companies of the Republic of Azerbaijan was 900ml USD, and increased in comparison with established prices of 2010 for 240.8ml USD, or for 36%. Cumulative authorized capital is 569.7ml USD, or 66,3% of the equity.

When an insurance company is formed, the initial element of formation of equity capital is authorized capital. Further replenishment of equity capital during company's operation period is due to various resources, such as profit, investment income, etc. The insurance company should possess a certain volume of equity capital, the size of which is regulated by normative acts of the Ministry of Finance of the Republic of Azerbaijan.

The minimum size of authorized capital is defined in the Decree No 519 of the President of the Republic of Azerbaijan and established as the equivalent of:

- 1 ml euro, - for the insurer who is carrying out types of insurance, not related to life insurance;
- 2 ml euro, - for the insurer who is carrying out types of insurance, related to life insurance;

- 5 ml euro, - for the insurer who is carrying out exclusively reinsurance activities.

Dynamics of this indicator for 5 years are presented in Figure 1. Changes of authorized capital share in equity are shown in Figure 1.

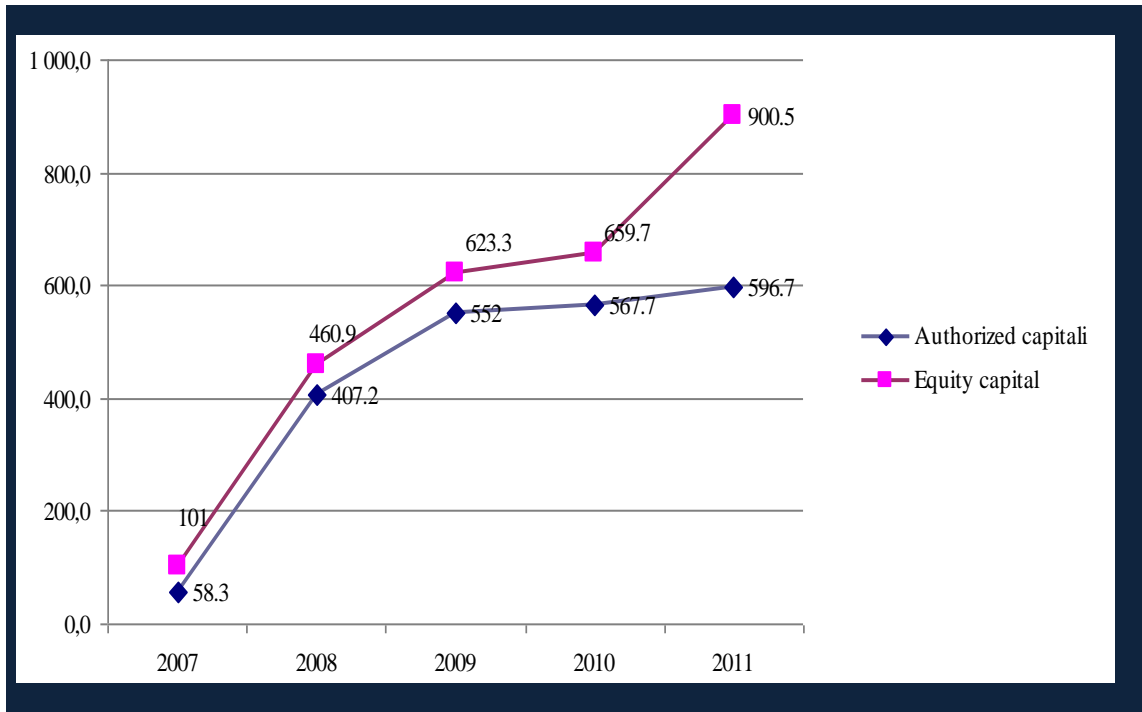


Figure 1: Dynamics of equity capital for 2007-2011, in thousand USD.

Note - Source: developed based on: (<http://www.gov.az> November, 2012)

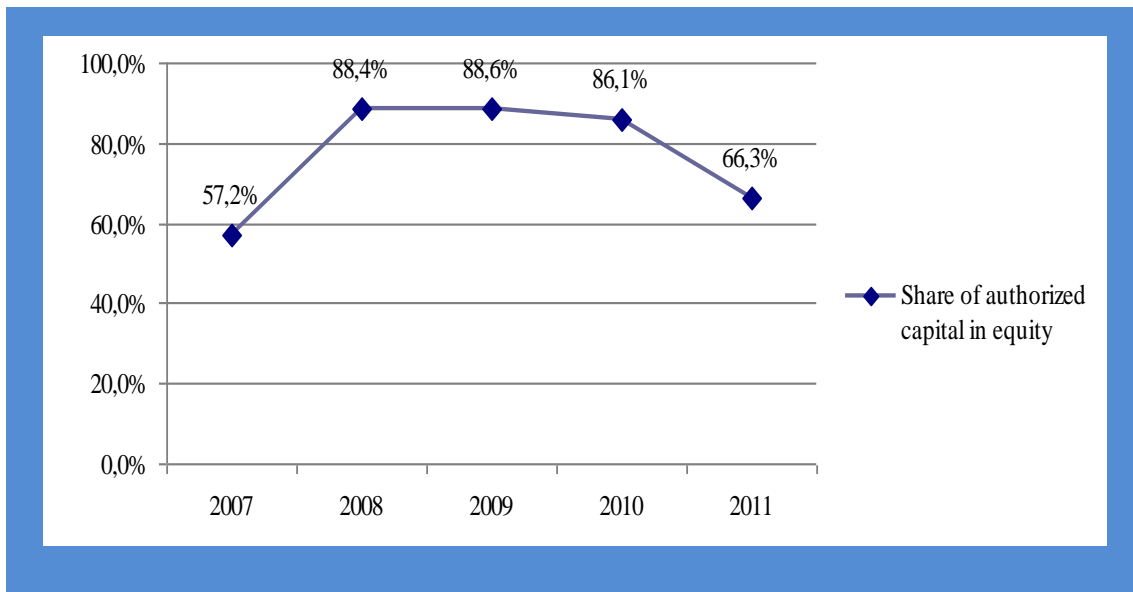


Figure 2: Changes of authorized share capital in equity, %.

Note – Source: developed based on: (<http://www.gov.az> November, 2012)

Every year the size of equity capital of insurers increases, which is an important factor in determining the investment capacity of the insurance market of Azerbaijan.

The gradual increase in equity capital not only strengthens the financial stability of insurers, but also creates possibilities for expansion of their investment activities. Additionally, each year the share of authorized capital in equity capital decreases, which leads to believe that the increase of equity capital is due to other components of equity.

As a part of the equity, one of the main sources of financial investments is the retained earnings. The size of this indicator, in turn, depends not only on the efficiency of current (main) operations of insurers, but also on financial and investment activities.

2.1.1 Attracted capital

Financial resources of insurers of the Republic of Azerbaijan are substantially dependent on the attracted capital. It is formed, initially, due to the accumulation of insurance fees under insurance contracts.

The structure of the attracted capital of the insurer also includes elements that can be confidently called 'loan capital': accounts payable (for example, for compensation) and bank loans that are included in the structure on a purely conditional basis (Mamedov, 2003).

Bank loan is not a significant element of attracted capital. Insurance companies rarely resort to bank services, for instance if there are insufficient current assets available. The accounts payable include sum of debts to suppliers for the goods and services, based on issued bills; advance payments received; settlements of the budget and off-budget funds; and remuneration.

Thus, it is possible to judge about the financial resources of the insurance sector of the Republic of Azerbaijan based on the volume of collected insurance fees. It is

known that the volume of collected insurance premiums defines the resource base of insurers, therefore speaking about the investment potential of insurers, it is necessary to analyze the dynamics of this factor.

During 2011 active insurance companies of the Republic of Azerbaijan have collected 788.5ml USD of direct insurance and joint insurance fees. The increase in receipts for 2011 in comparison with 2010 was 341.2ml USD in terms of established prices, or 76 %. The increase in receipts for 2010 in comparison with 2009 was 75.6ml USD in terms of established prices, or 20.3%.

The annual increase in receipts of insurance fees is the main precondition for growth of investment potential of the insurers of Azerbaijan.

Dynamics of the insurance fees in terms of established prices for a number of years can be tracked in Figure 3.

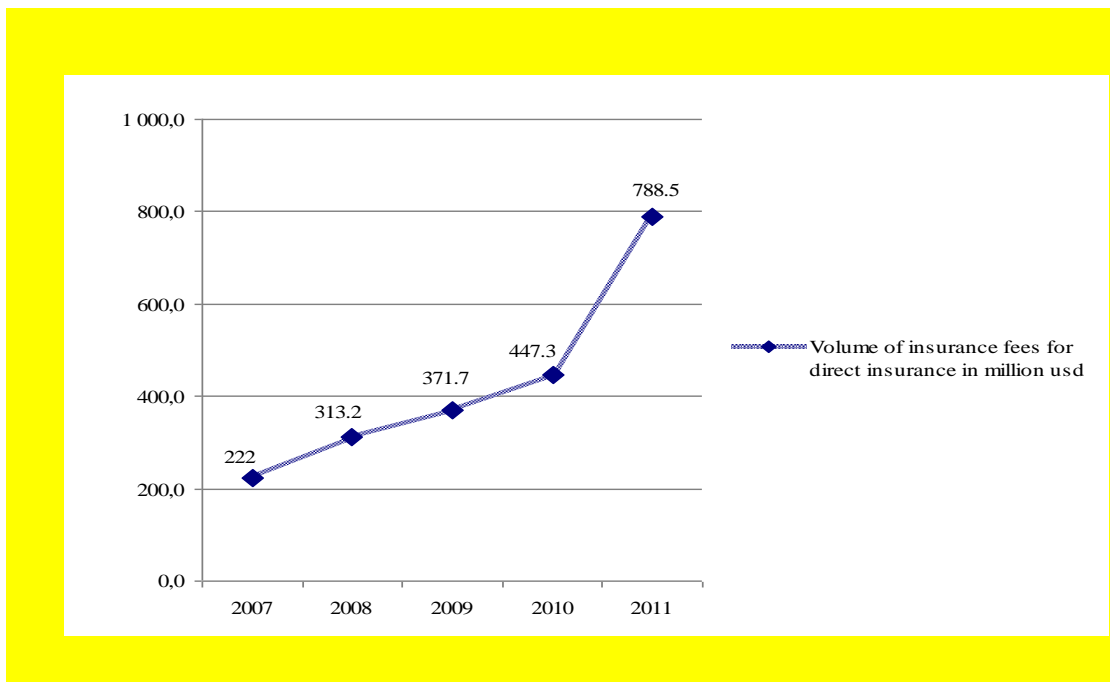


Figure 3: Dynamics of the insurance fees for direct insurance and joint insurance for 2007-2011, in million USD.

Note - Source: developed based on: (<http://www.gov.az> November, 2012)

It is noteworthy that insurance fees of 2011 in comparison with the results of 2010 have increased by almost 4 times. This fact causes interest and needs a more detailed consideration. The analysis of the change of received insurance fees in 2011 showed that the reason for such considerable change is due to sharp fluctuations in the exchange rate of foreign currencies.

It is nevertheless necessary to note that positive dynamics of insurance fees in the insurance market of the Republic of Azerbaijan is also due to other factors, such as the number of the signed contracts and the average insurance fee; which is an indicator of gradual development of the domestic insurance market and predetermines favorable conditions for realization of investment potential.

Essential influence on the investment activity of the insurer is rendered by the size and structure of insurance portfolio on types of insurance, size of the accumulated reserves and terms of using them. Characteristics of investment activities of the insurance companies engaged in life insurance and other types of insurance are substantially different.

Table 2: Comparative characteristics of investment activities of life insurance and insurance other than life insurance.

Nature of investment	Life insurance	Non-life insurance
Duration	Due to long-term insurance contracts long-term investment processes can be applied.	Due to relatively short-term insurance contracts (annual) investment processes are usually short-term.
Profitability	Stable income is a necessity, due to the fact that income from investment activities is taken into consideration for determining the insurance premium.	Fewer requirements for profitability as compared to liquidity of investments.
Liquidity	Is not very relevant – the need for money is covered by matching payment periods with investment periods.	Is the most important principle of investment.
Consideration of inflation process	It is necessary to take inflation into consideration, since the contracts are generally long-term.	Inflation influence may be not taken into consideration for most types of insurance.
Volume of investments	Substantial, increases regularly due to capitalization.	Volume of investments is transient.
Agreement of payment periods	Payment period is often defined in the insurance contract (survival insurance).	Payment period is variable; it is necessary to take into consideration the distribution of losses during the year for various types of insurance and the length of regulation for large insurance cases.

Note - Source: (Insurance Decree of the President of the Republic of Azerbaijan, 2007)

In particular, for the insurance companies engaged mainly in types of insurance other than life insurance, the most important principle of investment activity is liquidity; the principle of profitability has a smaller value. Due to short-term character of investments the inflation factor is virtually not taken into consideration. On the contrary, for the management of reserves under life insurance contracts the profitability is the most important principle, and liquidity does not play a significant role due to the fact that the contracts are long-term and payments periods are matched to the investment terms.

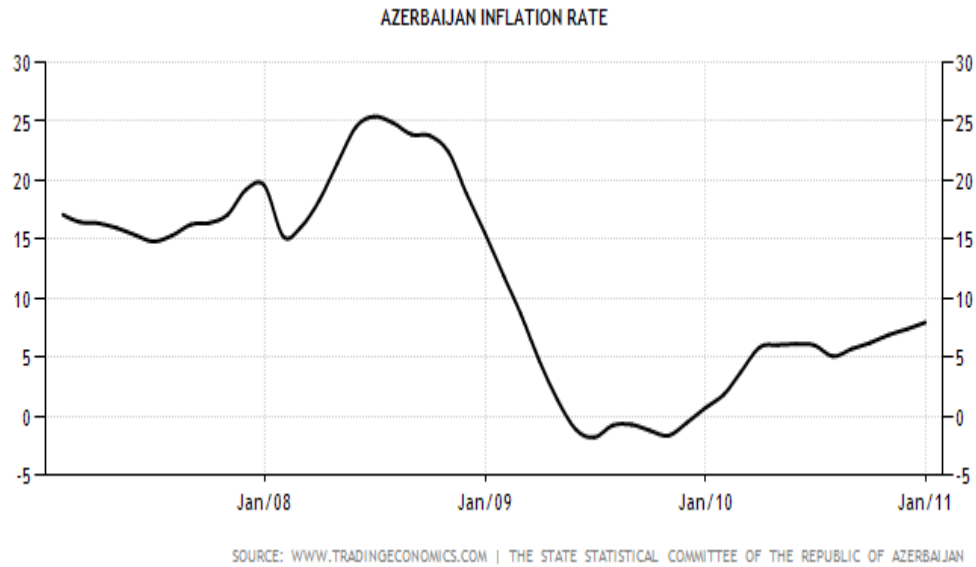


Figure 4: Inflation rate of Azerbaijan from 2007 to 2011.

Note - Source: developed based on: (<http://www.gov.az> November, 2012)

The second investment characteristic of the attracted financial resources is defined by the structure of the insurance portfolio. Contracts for types of insurance other than life insurance are mainly for the duration of one year. Therefore, technical reserves should be considered as financial resources for short-term investment.

Accumulative types of life insurance promote formation of insurance reserve, which is retained for the insurer until the expiration of the respective contracts; therefore the duration of the contract period defines the period for the investment of analyzed resources.

Based on the analysis of the structure of insurance portfolio of the Republic of Azerbaijan for the types of insurance relating to life insurance and other than life insurance, it is possible to draw a conclusion that short-term financial resources prevail in Azerbaijan insurance market.

The percentage ratio of the types of insurance relating to life insurance and other types for 2011 is represented in Figure 5.

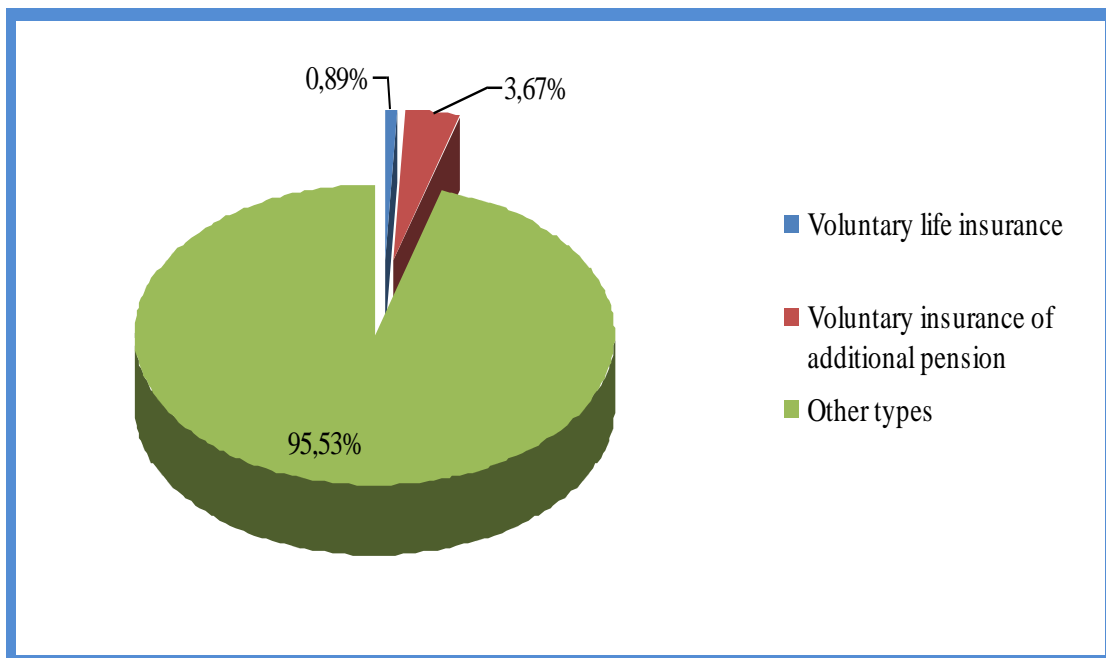


Figure 5: Structure of an insurance portfolio as at 01/01/2012

Note – Source: developed based on: (<http://www.gov.az> November, 2012)

During the period of intensive development of Azerbaijani economy, when the need for long-term investment resources increases, the special urgency is required for the types of insurance relating to life insurance.

In 2011 the volume of receipt of insurance fees for types of insurance as voluntary life insurance and voluntary insurance of additional pension were 7ml USD and 28.9ml USD respectively. Payments for these types of voluntary life insurance were 11.7ml USD. In 2010 the volume of receipt of insurance fees for these types of voluntary insurance was 26.3ml USD, including insurance premiums for life insurance in amount of 4.1ml USD, and voluntary insurance of additional pension in amount of 22.1ml USD. Payments were 4.9ml USD.

The growth of insurance fees for types of insurance relating to life insurance was 9.6 ml USD or 37% as compared to 2010.

This segment substantially defines the prospects of development for the national insurance market. It is confirmed by modern global practice, as 59% of the accumulated insurance is the gross collected insurance fees. In Republic of Azerbaijan this indicator was 4,6% for 2011 and 5,6% for 2010.

2.1.2 Insurance Reserves

To ensure the settlement of insurance obligations, the insurance organizations form insurance reserves from the collected insurance fees, for insurance types relating to life insurance (mathematical reserves); for insurance types not relating to life insurance (technical reserves); for obligatory insurance types for occupational accidents and occupational diseases; for obligatory insurance types with the state support of yield for agriculture, cattle and poultry (a special insurance reserve).

The order and conditions for creation of insurance reserves are defined by the Ministry of Finance. Insurance reserves are calculated in AZN or foreign currency, in which the insurance company has received contributions or accepted obligations for the corresponding types of insurance (reinsurance). Placement and accounting for the tools of insurance reserves are carried out on separate special accounts opened for this purpose in the servicing banks.

Insurance reserves reflect the size of current unsettled obligations of the insurer under the insurance contracts signed with the insured, and by characteristics they are classified as loan capital (Holt, 1998).

Total amount of insurance reserves created by insurance companies of the Republic as at 01/01/2012 is 578.3ml USD and increased in comparison to results as at 01/01/2011 by 234.9ml USD or 68,4 %.

Insurance reserves for types of insurance other than life insurance are 456.3ml USD, and 122ml USD for types of insurance relating to life insurance (254.7ml USD, and 88.7ml USD respectively, as at 01/01/2011).

Let's review the insurance reserve amounts, created by the insurance organizations of the Republic of Azerbaijan. Data on the size of technical and mathematical insurance reserves for 5 years is provided in Table 3.

Table 3: The total amount of created insurance reserves, in thousand USD.

Year	Total amount of insurance reserves	Insurance reserves for types of insurance other than life insurance	Insurance reserves for types of insurance relating to life insurance
2007	146.1	113.5	32.5
2008	215.5	168	47.4
2009	285	219.5	65.5
2010	343.4	254.7	88.7
2011	578.3	456.3	122

Note – Source: developed based on: (<http://www.gov.az> November, 2012)

Implementation of investment function of insurance is defined by the size of insurance reserves created by insurers from the received insurance fees for the reporting period. Formation and use of insurance reserves are the main aspects of the activities of insurance companies.

It is visible from the table, that total amount of reserves grows every year due to the growth of both technical, and mathematical reserves.

Based on the estimates of insurers, the biggest reserve of the market is in accumulative segment, as well as life and health insurance segments.

Growth of mathematical reserves indicates an increase in demand for these types of insurance by the insured, which creates a precondition for the creation of investment resources. However, it is still early to talk about sufficient level of these reserves in Republic of Azerbaijan, since technical reserves still prevail in the structure of insurance reserves.

Let's consider the structure of insurance reserves of the Azerbaijani insurers and its dynamics for a number of years.

Figure 6 shows the volumes of created technical and mathematical insurance reserves and their percentage ratios for 5 years.

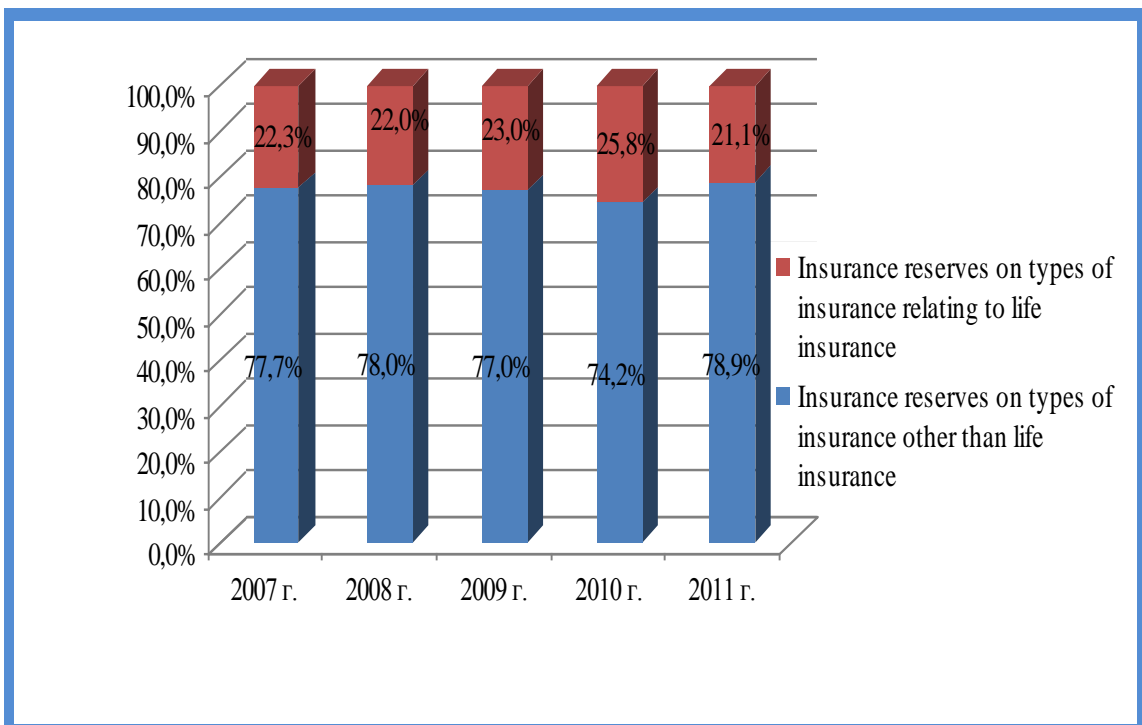


Figure 6: Dynamics of the ratio of insurance reserves created by insurance companies of the Republic of Azerbaijan for 2007-2011.

Note – Source: developed based on: (<http://www.gov.az> November, 2012)

It is noteworthy that in comparison to the previous years, when the share of mathematical reserves in total amount of the created insurance reserves was 22 %, in 2010 this share increased by 3,8 % and was 25,8 %, which indicates an increase in share of long-term financial resources of insurers. However, in 2011 the share of mathematical reserves fell to 21,1 % which was caused by a sharp leap in the size of technical reserves. This growth of technical reserves in AZN, as well as growth of contributions, was mainly related to fluctuations in exchange rates.

Despite the change in the ratio of technical and mathematical reserves, the size of the created insurance reserves in the Republic is steadily growing in nominal expression. This means that it is possible to speak about the sufficiency of financial resources of insurers for the realization of investment function of insurance.

The investment capacity of insurance companies of the Republic of Azerbaijan is an integral part of financial potential, which in turn depends on the capacity of the insurance market as a whole.

The assessment of the current trends of development of the insurance market in the Republic Azerbaijan testifies about the growth of its role in the socio-economic system and financial relations, the need to further increase the level of providing citizens and enterprises with insurance protection; and the realization of the mechanism guaranteeing stable economic growth regardless of adverse economic conditions, natural and techno-genic catastrophes.

2.2 Analysis of Efficiency of the Investment Activity of Insurers in the Republic of Azerbaijan

As at January 1, 2012 there were 25 insurance companies, including 4 which were carrying out types of insurance relating to life insurance, in the insurance market of the Republic of Azerbaijan. Controlling shares for 8 insurance companies operating during 2011 belonged to the State, and 2 insurance companies were founded with 100% foreign-owned capital.

During 2011 insurance companies continued to carry out their activities in accordance with the State priorities for the development of insurance market, one of which is the accretion of financial assets.

For this purpose the activities of insurers for the past years have been directed at the constant increase of the income from the primary activity, development of new types of insurance, and increase of the client base. All this inevitably leads to the accretion of investment potential and is a precondition for the implementation of a more effective investment activity of the insurance sector of the Republic of Azerbaijan.

The investment potential of Azerbaijani insurance sector is rather high. However, the policy adhered to by the insurance companies in the field of investments is insufficiently effective due to lack of full and complete analysis in this direction.

For the assessment of efficiency of investment activity of Azerbaijani insurers it is necessary to calculate a number of indicators. However, it is also necessary to consider some features of the structure of investment resources of the insurance sector in the Republic. Insurance companies of the Republic of Azerbaijan have formed the sizes of their authorized capital in accordance with the Decree No 519 of the President of

Republic of Azerbaijan. Data on the placement of sources for the minimum authorized capital by insurance companies in the accounts of Azerbaijani banks as at 01/01/2012 is presented in Table 4.

Table 4: Data on sizes of authorized capital of insurance companies in the Republic of Azerbaijan as at 01/01/2012, in thousand USD.

No.	Name of insurance company	Authorized capital
1	AzerSigorta	224,530
2	AzSigorta	1,161
3	Ateshgah	3,779
4	AXA MBASK	8,670
5	Beynəlxalq Sığorta Sirkəti	151,554
6	Pasha Hayat	3,584
7	İpek Yolu Sığorta	3,823
8	Standard Insurance	2,763
9	Xalq Sığorta	1,875
10	Ateshgah Hayat	1,737
11	A-Qroup	1,350
12	Pasha Sığorta	1,973
13	Azərbaycan Sənaye Sığorta	2,301
14	Qarant Sığorta	1,569
15	Qala Hayat	1,420
16	AtaSigorta	1,870
17	Bakı Sığorta	1,520
18	Alfa Sığorta	1,439
19	Basak İnam	1,488
20	Era Trans Sığorta	159,234
21	Revan Sığorta	2,523
22	Chartis Azerbaijan	5,722
23	Azerqarant Sığorta	2,720
24	Temz Sığorta Qrupu	4,933
25	Amrah Sığorta	3,200
Total:		596,738

Note – Source: (developed based on Data General Directorate of Insurance Supervision, 2011)

Besides, according to administration of Insurance Supervision it is necessary for insurers to have funds on their bank accounts, providing coverage of the minimum size of authorized capital as required by the legislation. It means that possibility of investment of resources for authorized capital in other financial assets is practically non-

existent. Therefore, for the implementation of investment activities insurance companies can currently use resources mainly from insurance reserves.

Based on the analysis of data about investment activities on objects of investments, it follows that during 2011 in the Republic of Azerbaijan insurance reserves in amount of 455.3ml USD were invested in risk types of insurance, including 19,8 % in state securities, 9,3 % in securities of the banks of the Republic of Azerbaijan excluding shares, 0,37 % in securities of local executive and administrative bodies, 59,7 % in bank deposits, and 10,5 % of resources were placed in settlement, currency and special accounts. 122ml USD of resources in insurance reserves were invested in accumulative types of insurance, including 11,43 % invested in state securities, 1,8 % real estate, 83,2 % bank deposits, and 3,5 % were placed in settlement, currency and special accounts.

The investment structure of insurers in the Republic of Azerbaijan is created generally in favor of bank deposits. Placement of resources in bank accounts yields minimum returns; however is almost completely risk-free. The second most popular investment destination is state securities that with a well-thought, rational financial policy may be the safest investment method.

Investments into these financial instruments allow placing a considerable volume of resources. An important feature of the state securities is their liquidity, and the stable income at a low risk level. Appeal of the state bonds is also caused by factors such as preferential taxation, and the possibility of acquiring these securities in primary market by various methods. However, such channelized investments do not allow insurers to fully realize the principle of investment profitability (Khankishiyev, 2006).

Let's consider the structure of investments for mathematical and technical reserves of insurance companies in the Republic of Azerbaijan for 2007-2011.

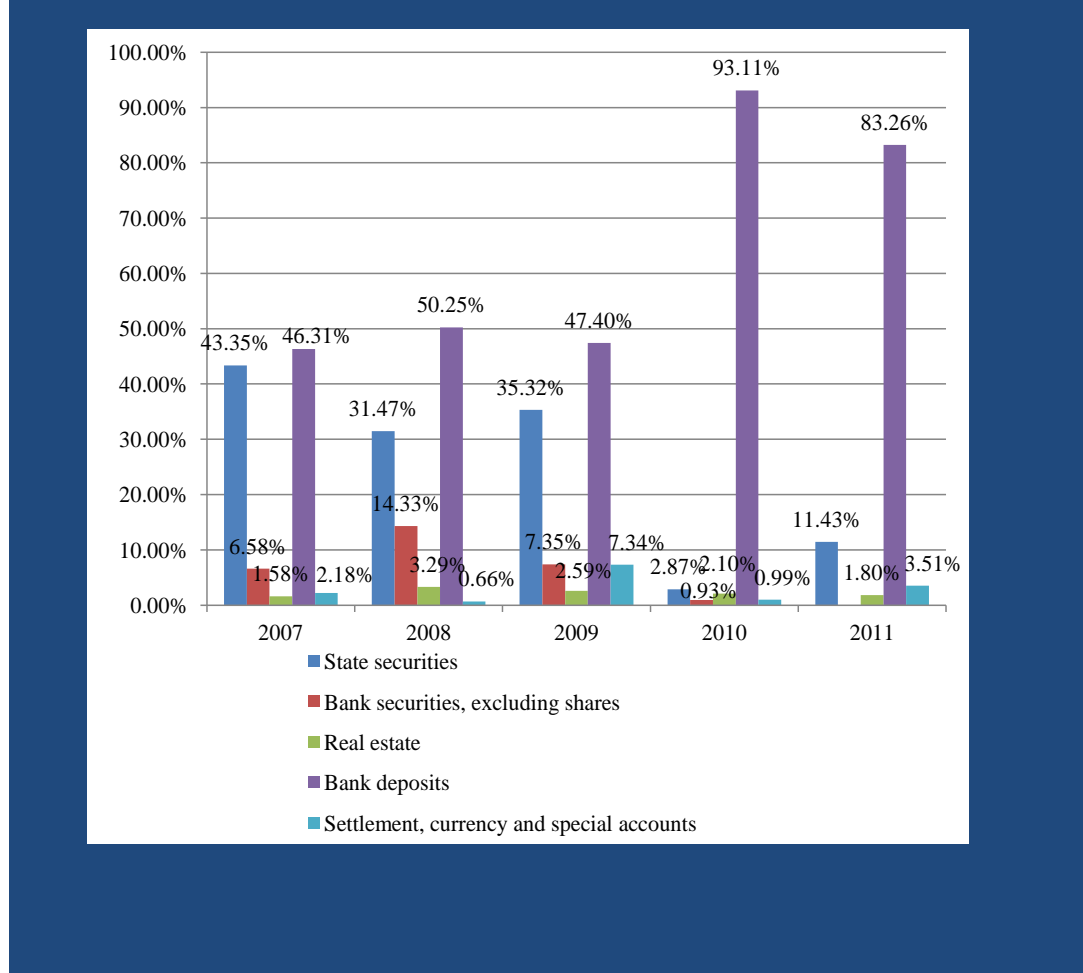


Figure 7: Investment of mathematical reserves by insurers in the Republic of Azerbaijan for 2007-2011.

Note – Source: (developed based on Data General Directorate of Insurance Supervision, 2011)

It can be observed that insurers place the biggest share of reserves in bank deposits, and this figure is increasing from year to year. On the contrary, the share of investments in the securities is decreasing. It is noteworthy that insurers do not make use of the exhaustive list of objects for the investments, as established by the legislation. Mathematical reserves are not invested in the securities of Central Bank of Azerbaijan, in securities of local executive and administrative bodies, in securities of legal entities

and in precious metals. This means that the above-mentioned financial assets are not attractive for local insurers.

Technical reserves occupy a bigger portion of insurance reserves and are invested by insurance companies in a wider spectrum than mathematical reserves.

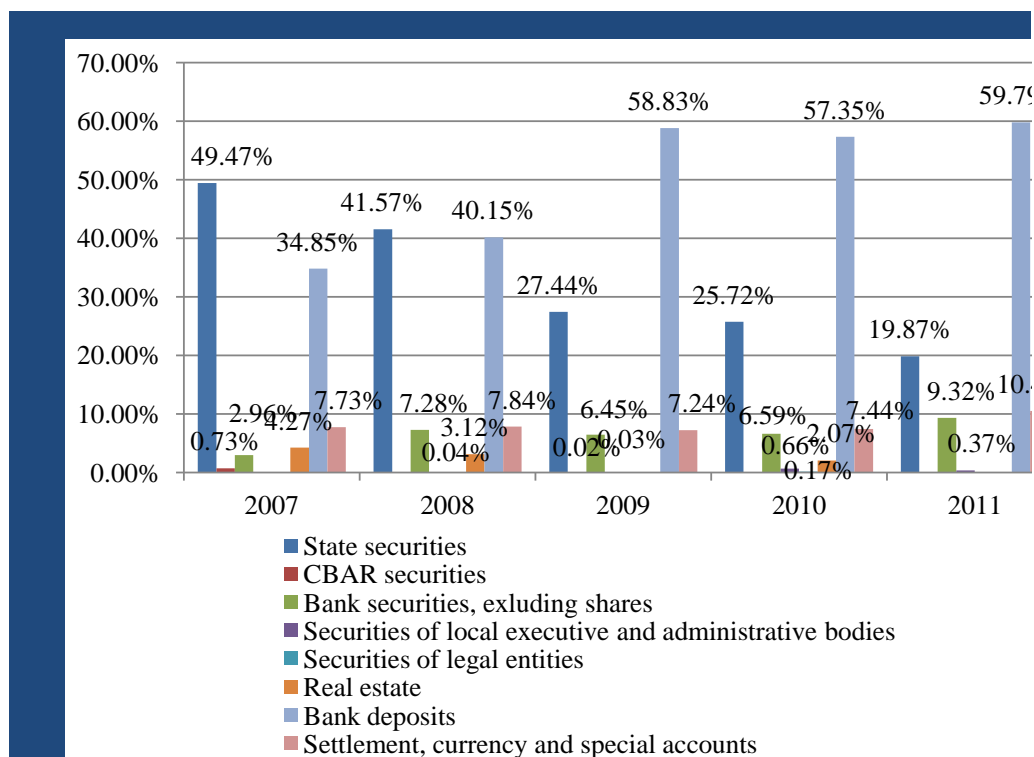


Figure 8: Investment of technical reserves by insurers in the Republic of Azerbaijan for 2007-2011.

Note – Source: (developed based on Data General Directorate of Insurance Supervision, 2011)

The investment structure of resources from insurance reserves is one of the main characteristics of efficiency of investment activities by insurers, however for complete coverage of the matter it is necessary to analyse profitability of these investments. Results of the profitability analysis of insurance reserves for 2007-2011 are generalized in Table 5.

Table 5: Investment income of insurance reserves by insurance companies in the Republic of Azerbaijan, in thousand USD.

Investment destination of insurance reserves	Income				
	2007	2008	2009	2010	2011
State securities	5,747	8,236	8,512	8,880	11,089
CBAR securities	68				
Bank securities, excluding shares	338	1,202	2,796	2,397	5,274
Securities of local executive and administrative bodies				670	211
Securities of legal entities				14	36
Real estate	280	399	303	369	57
Placement in bank accounts	4,679	7,544	19,088	25,069	51,396
Total:	11,112	17,381	30,699	37,399	68,063

Note – Source: (developed based on Data General Directorate of Insurance Supervision, 2001)

The largest income in 2007 was received by insurance organizations from the investment of insurance reserves in the state securities, in amount of 5.7ml USD (51 %). Placement of funds in bank accounts yielded return in the amount of 4.6ml USD (42 %). An insignificant amount of income was yielded from investment in bank securities and real estate. The total investment income of insurance reserves in 2007 was 11.1ml USD. In 2008 a similar tendency was observed.

In 2009, unlike 2007, the largest income was received by insurers of the Republic of Azerbaijan from the placement of insurance reserves in bank accounts (19ml USD, or 62 %), the second most profitable return on investments was from the state securities, 8.5ml USD or 28 %. Total investment income received by insurance companies has been 30.6ml USD.

In 2010 total investment income of insurance reserves received by insurance companies was 37.3ml USD. The main portion of income, 25ml USD, or 67 % was

received from the placement of reserves in bank accounts and deposits; the income received from investing in state securities was 8.8ml USD, or 23.7 %.

The profitability analysis of investments of insurance reserves revealed that for 2011 total amount of income received from investment of insurance reserves was 68ml USD. The main portion of the income, 51.3ml USD , was due to placement of insurance reserves in bank accounts (75.5 %). Investment in state securities yielded income in the amount of 11ml USD (16.3 %), investment in bank securities excluding shares yielded income in the amount of 5.2ml USD or 7.8 %, and 0.4% in other financial assets.

Based on this information, it is possible to define the efficiency of investment potential realization of Azerbaijani insurers. For this purpose we will calculate profitability of investment of insurance reserves for a number of years. Data is provided in Table 6.

Table 6: Profitability of investments by insurance companies, in million USD.

Year	Volume of the created insurance reserves	Investment income	Profitability, %
2007	146.1	11.1	7.6
2008	215	17.3	8.1
2009	285	30.7	10.8
2010	343	37.4	10.9
2011	578.3	68	11.8

Note – Source: (developed based on Data General Directorate of Insurance Supervision, 2011)

It can be observed from the table that positive dynamics of the investment income is caused not only by the growth of insurance reserves, but also by their effective placement/investment. The increase of 11.8 % in 2011 in profitability of investment activity is an indication of this.

The Deposit interest rate (%) in Azerbaijan was last reported at 11.64 in 2010, according to a World Bank report published in 2012. Deposit interest rate is the rate paid by commercial or similar banks for demand, time, or savings deposits. This page includes a historical data chart, news and forecasts for Deposit interest rate (%) in Azerbaijan.

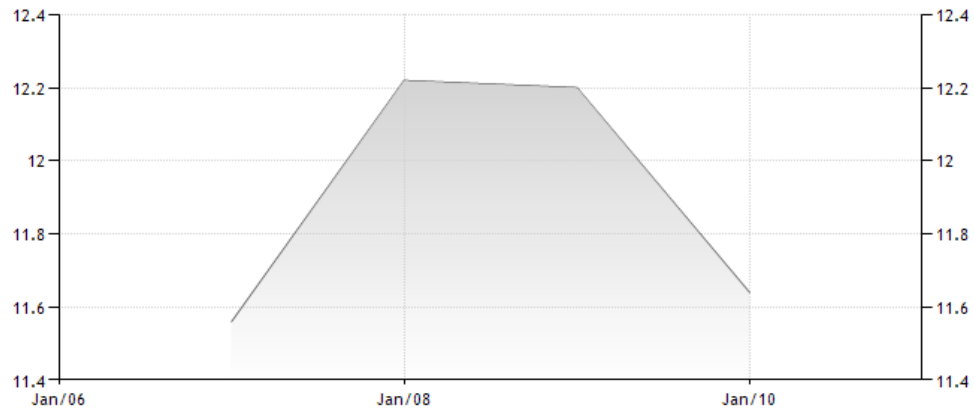


Figure 9: Interest rate of Azerbaijan for 2007-2010.

Note – Source: developed based on: (<http://www.gov.az> November, 2012)

Accumulation of monetary resources within insurance reserves of insurance companies puts insurance businesses in the list of most effective investors in various sectors of national economy.

Investment activity of insurance company is conjugated with the possibility of various investment risks, therefore correct management of investments at the corporate level is important for the overall financial stability.

The designated purpose of investment activity by insurance companies stipulates the necessity for the formation of a balanced investment portfolio, based on application of the basic principles of investment activities.

Compliance with the investment order and placement of insurance reserves by insurance organizations suggests a choice of directions for the investment of insurance

reserves, and fulfillment of requirements, which are applicable to their structure. It provides financial stability and compliance with the principles of reliability, profitability, liquidity and diversification.

Compliance with the principle of subordination is realized by the insurer at the stage of formation of the real investment portfolio, providing the realization of the investment income, coordinated in the place, time and size with possible insurance payments.

Thus, analyzing the efficiency of implementation of investment activities by insurers of the Republic of Azerbaijan, we have come to the following conclusions.

Insurance companies of the Republic of Azerbaijan have a rather high investment potential for modern level of economic development. Financial resources of insurers have a steady tendency of growth. The constant increase in receipts of insurance fees allows insurers to create large amounts of insurance reserves that they can subsequently use for the realization of investment income.

For the implementation of investment activities, insurers generally make use of insurance reserves; equity capital is necessary for the maintenance of financial stability and solvency. In the insurance market of the Republic of Azerbaijan short-term investment resources prevail, which can be observed based on the structure of insurance portfolio.

Based on the analysis of the investment destination of the insurance reserves, it is possible to draw a conclusion that insurance market of Republic of Azerbaijan is insufficiently effective considering the current stage of development. This is explained by the investment portfolio of the insurers of Republic of Azerbaijan. Insurance companies mainly invest in bank deposits, according to the local legislation, which

substantially decreases the amount of income which could be much higher if invested in other financial assets. State securities take the second place based on the volume of investments of insurance reserves. Other directions of investment, as defined by the state, have an insignificant share in the total investments of insurance reserves. Low investment activity doesn't allow to fully realize the investment capacity of the insurance market of the Republic of Azerbaijan.

Chapter 3

IMPROVEMENT OF INVESTMENT

3.1 Main Directions for the Improvement of Investment Activity of Insurers in the Republic of Azerbaijan

In this chapter main directions of the investment activity of insurers in the Republic of Azerbaijan will be presented.

3.1.1 Problems with the Realization of Investment Potential of Insurers in the Republic of Azerbaijan

The purpose of an insurer's investment activity is in many respects defined by the features of their primary activity – insurance. First of all, it is necessary for the insurer to organize the investment process so that the companies obtain the investment income in the same place, size and period as their insurance obligations. It means that the structure of investments should be coordinated with the structure of insurance obligations. Besides, it is necessary to remember that apart from subordination to the insurance investment activity, investment process should also be based on compliance with other basic principles – recoverability, profitability, liquidity, and diversification.

Another purpose of an insurer's investment activity, as well as any other economic production unit, is yielding income. It can be used in different directions – for the settlement of insurance obligations, as well as for the development of business.

Therefore, formation of investment portfolio must comply with the main objectives of the insurer's investment activity. Its main aim should be to settle the

insurer's obligations, however at the same time the investment portfolio should provide the insurer with an income that can be used at the insurer's discretion.

In countries with a well-developed insurance market, insurers earn profit mainly due to the effective use of investment tools. The income is used not only for the expansion of business, but mainly for the coverage of negative financial results of insurance operations (Balabanov, 2003).

The economic mechanism of insurance is provided by creation and usage of various organization forms of insurance funds. One of the most important of these is the fund created by investing temporarily free financial resources in various projects.

The analysis of the investment activity of insurance companies of the Republic of Azerbaijan has revealed that the insurance investment fund constitutes only a small share of all investments of Azerbaijani enterprises in the economy of the country.

Consequently, it is still too early to consider insurance reserves as an important investment factor; however the speed of development of the insurance market in the country gives a reason to hope that in upcoming years insurance reserves will take their relevant place as it is observed in global practice. In developed countries up to 70% of all domestic investments are investments carried out by insurance companies, additionally the biggest share of these investments are reserves accumulated due to long-term life insurance.

Insignificant investment injections of domestic insurance companies in the economy are not only related to low investment appeal of investment tools and insufficiency of the state guarantee mechanisms, but also to the inability of insurers to optimally manage their investment potential. Investment income in foreign insurance companies constitutes 20% to 30% of the general income items, which allows

considering investment as an essential component of insurance business, whereas for Azerbaijani insurance companies this indicator is still too insignificant, which testifies about the poor development of this type of operations by the national insurers.

The investment potential of insurance in many respects depends on types of insurance carried out; it is particularly dependent on the development of pension and accumulative life insurance. This specific insurance segment constitutes the overwhelming part of insurance investments in other countries. Terms of contracts on property and responsibility insurance, as a general rule, are for less than a year, therefore investments corresponding to the risky liabilities of these types of insurance are also mostly short-term.

According to Insurance Information Institute, in USA about 30% of long-term loans are provided by the insurance companies specializing on long-term life insurance, and assets of these companies exceed the assets of the insurers carrying out more risky insurance operations approximately by 3 times. Hence, investment income of insurance companies in the USA specializing on life insurance amounted to USD 164 billion in 2010. In Great Britain the share of the companies specializing on life insurance constitutes about 80% of the cumulative insurance investments. Insurance companies of Great Britain own more than 20% of the share capital of all joint-stock companies registered at London stock exchange; a significant number of real estate in London; as well as other liquid assets. Unfortunately, the share of contributions under the contracts relating to life insurance in the Republic of Azerbaijan constitutes only 4.6% of all the contributions for overall contracts of insurance, joint insurance and reinsurance (Shakhov, 2003).

By the estimates of insurers, the biggest reserve of the market is in the accumulative segment, as well as life and health insurance. Dynamics in this direction considerably advances all the other segments. There is a high-quality profile range of insurance services in Azerbaijan, and the necessary infrastructure is already created, hence the next step to be taken is to find consumers. The solvency demand of consumers at this stage of economic development is not high. According to the economic estimates, monthly income of people who make deductions for pension insurance exceed \$ 1000, and those constitute only 10-12 % of the population in our country.

However, the main obstacle that hinders the development of accumulative insurance is the banking sector. The main objective of all banks is to build up deposits from the population, which usually happens due to absence of alternative methods. The stock-market in Azerbaijan is virtually non-existent, and mutual investment funds are still not created. In short, accumulative insurance is in fact a competitor for the banks over the financial resources of the population. This competition is deepened by the fact that Azerbaijani population allocates only 4.5% of their income for the accumulation.

Paradoxically, the additional pension, life and health insurance segment is one of the main sources of replenishment for the resource base of banking sector. This is due to the fact that insurance companies are required by law to deposit their resources in bank accounts. However, the resources that are deposited in the bank accounts by insurance companies are classified as deposits by legal entities, and for the banks this will jeopardize the accuracy of performance forecasts for the attraction of the population resources (www.maliyye.gov.az. September, 2012).

Unless life insurance does not become a popular method of accumulation tool in the Republic of Azerbaijan, the investment potential of the insurance sector will remain low – both in relative as compared to other institutions of cumulative investment and absolute terms as in cumulative investments into the national economy.

This "unpopularity" is related to: first, low insurance culture of the population in this area, i.e. insufficient knowledge of advantages of this type of insurance; second, fall in the solvency demand which is typical for the current crisis phenomena in the economy. Demand, in turn, depends on the current state of economy, on the level of population income, and on the price of insurance services.

Another problem for the realization of investment potential of insurance companies in the Republic is that currently insurance organizations are physically incapable of applying the established normative ratio for investing insurance reserve resources in the state securities; this is mainly caused by the limited quantity of issued state securities circulating in the secondary market.

As a result of this, a legal collision occurs. On one hand, State does not issue sufficient number of securities, and on the other hand it obliges insurance organizations to comply with the normative requirements established by the legislation on investment of insurance reserves in the state securities. In case of a violation of the established normative requirements, the organization will be held liable.

To date, almost all insurance companies, in order to avoid huge penalties for non-compliance with standards of investment have practically stopped any investment activity. At the same time, as the global practice shows it, it's the insurance organizations that contribute to the development of securities market by investing their insurance reserves.

The foundation of insurance investments, as established by the legislation, is based on state securities and bank deposits. The state, representing itself or banks as the most reliable and effective investment intermediaries, are in fact solving the issue of attracting 'cheap' money.

Investment of insurance reserves in bank securities allows sufficiently realizing the principles of guarantee and liquidity only for short-term insurance risks, since banks do not engage in long-term attraction of funds with sufficient guaranteed income. Besides, this type of channelized investments doesn't allow insurers to fully execute the profitability principle of their investments. These investments are equally inefficient for the economy of the country as a whole, since they are being carried out through the most expensive intermediaries – banks. It is specifically due to high costs of credit resources that banks mainly engage in short-term financing of trade and commercial operations, as well as different levels of budgeting and therefore, cannot satisfy the needs of industrial enterprises for long-term low-cost investments.

Investments by insurance companies in the quoted securities do not satisfy any investment principles considering the current condition of the stock market in our country. Due to the significant profile narrowness of stock market in terms of both traded securities and number of participants, the recoverability, liquidity and profitability of insurance reserves invested in the stock market in practice do not only depend on the economic state of a certain issuer, but on the behavior of all the significant participants of the stock market, including government.

The list of investment objects is still rather narrow. This is related to the development stage of state securities of the Republic of Azerbaijan, as well as strict regulation by the government. This fact is also evident if we compare with the possible

investment directions for insurance reserves of Russian Federation, where the government's approach is more liberal. According to the Order No. 100 of the Ministry of Finance of the Russian Federation from 2006, «Statement of rules for the investment of insurance reserves» insurance reserve are enabled to cover the following: federal securities, state securities of subjects of Russian Federation, municipal securities, shares, bonds except for those relating to federal securities, state securities of subjects of Russian Federation and municipal securities), bills of organizations, shares, housing certificates, deposits in banks, mortgage securities, monetary cash, reinsurer's share in insurance reserves, and so on (Romesh, 2001).

Given such a large number of diverse investment objects, it's much easier for the insurance companies of Russian Federation to comply with the principle of diversification. This principle requires distribution of investment risks into different types of investment, which serves to reduce the level of general risk, consequently increasing the stability of the insurer's investment portfolio.

According to Azerbaijani legislation, in order to ensure the liquidity of investments and to settle current liabilities of insurance operations, it is necessary to have at least 10% of insurance reserve resources in the settlement bank account. In Russian Federation for the coverage of insurance reserves in this direction only 3% is sufficient, consequently insurance companies of Russian Federation have a bigger amount of temporarily available funds that they can invest and receive income on.

In order to ensure recoverability and liquidity of investments, as well as prevention of capital outflow from the Republic of Azerbaijan and attraction of additional investments into the national economy, local legislation stipulates obligatory placement of insurance reserves only within the territory of the Republic. On one hand,

it is a substantial disadvantage for the investment policy of the insurer, since it deprives the insurer of the possibility of receiving income with more favorable conditions; however on the other hand, the resources are not subject to a high investment risk.

Compliance with the conditions for investments, as required by the legislation, is obligatory for all insurance organizations of the Republic of Azerbaijan irrespective of the types of insurance carried out.

To sum up the afore-mentioned points, we should return to the legislation of the Republic of Azerbaijan and compare it with the above-mentioned Order No. 100 of the Ministry of Finance of Russian Federation, “Statement of rules for the investment of insurance reserves”.

The first and, perhaps, the most important point for comparison is the mechanism of regulation of investment activities by insurance companies. If the domestic legislation directly obliges the insurance companies to allocate insurance reserves in fixed directions, Russian legislation only defines the requirements that should be satisfied by the assets accepted in provision of the insurance reserve. According to those requirements not any assets can be included to cover insurance reserves, but only a limited number called ‘allowed assets’. Additionally, the total value of assets included in the coverage of insurance reserves cannot be less than the monetary value of insurance reserves.

In other words, Russian insurance company can get, for example, more short-term government commitments than it is established by the rules, but only the part allowed by the normative documents will be used for the coverage of insurance reserves. This applies to all types of assets.

Overall, the total amount of parts of the ‘allowed assets’ as calculated in the proportions established by the Rules should not be less than the amount of the insurance the reserves created by the insurance company. Otherwise they will be considered unsecured, with the respective consequences arising based on this implication.

The second point of comparison which requires attention is that the list of permitted investment objects in Azerbaijan is much narrower. Thus, for instance, if Russian insurer has 19 investment objects, Azerbaijani insurers will only have 8, including 4 for state-owned insurers.

Third point for comparison would be the above-mentioned limitation of ‘not less’ to be invested in bank accounts and state securities. Therefore, even at the legislation-approved normative level a dangerous structure of investment of insurance reserves will be observed, where only bank deposits or short-term government commitments will prevail (this is in fact currently happening).

The conclusion is obvious. Currently, the placement order of insurance reserves by the insurance organizations of the Republic of Azerbaijan does not comply with one of the main investment activity principles – diversification of investments.

The listed shortcomings of the current regulation of investment activity of insurers compel insurance companies to use two ways of complying with the rules of investment of insurance reserves as established by the state. This is either a formal compliance with rules of investment only for a certain reporting date, which introduces additional complications to the insurer’s work, or actual compliance with the rules of investment, which restricts the interests of the insured, since the insurer cannot use the full investment potential of insurance reserves, thereby providing the insured with lower prices for insurance services and a better insurance coverage.

It is necessary to note, that the success of investment activity in any segment of financial market is mostly defined by macroeconomic conditions. Hence, the main challenges of insurance companies in the Republic of Azerbaijan related to the investment activity are caused by extreme instability of the domestic financial market, and the absence of a developed stock market. Problems with investment choices are coming up due to these reasons.

On one hand, there is a limitation of offers in the financial market, and on the other — the necessity to take into consideration the risk of investing without sufficient information. There is a rather high risk in Azerbaijan stock market, which makes the forecasting of investment incomes quite difficult for the investors.

Along with the objective conditions, the reasons for financial difficulties of insurers may also be lack of skills for the formation and management of investment portfolio.

Also it is possible to call a factor of economic instability inflation. It has a significant impact on the financial stability of insurance organizations.

Inflation distorts all economic calculations, makes the development prospects uncertain, and strengthens the risk related to new investments. Growing uncertainty and lack of sufficient reliability in forecasts for the price dynamics causes the rejection of long-term projects by economic subjects. Inflation influences each side of insurance business, including the condition of insurance reserves and their investment.

First of all, the coordination of insurance reserves with the insurance liabilities of the insurer is influenced. At first sight, amortization rates both for liabilities and insurance reserves are the same, and this helps to keep the maintained ratio. However, a more detailed review will show that the stability of liability to reserve ratio also depends

on the structure of insurance portfolio and types of determined risks, considering inflation. For different types of insurance the ratio of liabilities to reserves may be subject to change, since the impact of inflation on the valuation varies.

Second, inflation has a significant influence on the investment of resources of insurance reserves. Overall, inflation serves the insurance companies the same challenges as it serves to any other financial company. Rate of return on investment does not depend on the current level of inflation as such, but rather on its rate of change and expectations of these changes. The gap between the expected percentage and real percentage can represent a serious problem for an insurance company, since insurers are to some extent obliged to invest a considerable share of the assets in 'safe' securities with a discount rate defined in advance. Increase of interest rates causes a reduction in the prices of those securities, and the portfolio of the insurer loses value.

One of the specific characteristics of investment activity of insurance organizations is that, investment of insurance reserves is subject to regulations. The issue of reasonable borders for the regulation of investment of insurance reserves is considered to be very important, since in inflation conditions a rigid regulation, which will always lag behind the rapidly-changing market conditions, can cause certain damage.

Third, inflation influences the investment income of insurance companies as a basis for indexing of obligations. Rates of inflation are difficult for estimating in advance with sufficient accuracy. As a result of this, the real profit of the insurer on investment operations may be negative. Furthermore, nominal growth of the investment income in the conditions of inflation leads to a growth of taxes; hence increased tax 'absorbs' not only the real income, but also a share of equity capital. As a consequence

of this, the more an insurer works and the quicker his nominal income grown, the more his equity capital diminishes.

Therefore, insufficient development of investment activity of insurance companies in the Republic of Azerbaijan may be explained by the following reasons:

- First, unlike western insurance companies, Azerbaijani insurance companies do not yet possess considerable volumes of resources which enable the investment activity. Small volume of real long-term life insurance and pension insurance also don't contribute to the increase of investment activity.

- Second, insufficiency of state regulation of investment processes, a consequence of which is an unstable investment climate in the country.

- Third, stock market in Azerbaijan is still insufficiently developed, and the choice of reliable funding tools is limited. The guaranteed profitability and liquidity is only provided by state debt instruments, and securities of financial institutions with state participation.

- Fourth, shortage of scientific researches on the issue of efficiency of investment activity of insurance companies is still perceptible.

3.1.2 Ways of Improvement for Investment Activities of Insurers of the Republic of Azerbaijan

Expediency of the increase in efficiency of investment activity of insurance companies is dictated by the necessity for rejection by the insurer to receive profit on insurance operations which, in turn, gives the insurer a chance to reduce insurance tariffs and, as a result, will contribute to the competitive edge in the insurance market.

Only in the presence of the corresponding economic conditions investment activity of insurers will bring notable economic effect both for certain participants, and for the market as a whole.

It is necessary to attribute the following to the investment activity of insurance organizations:

- Existence of adequate market infrastructure, including securities market;
- Development of investment tools;
 - Stability of national financial system (including banking);
- Effective insurance legislation (including tax);
- Other macroeconomic conditions providing a sustainable development of market economy (www.maliyye.gov.az. September, 2012).

The insurance company as a subject of the market cannot efficiently carry out its activities, including investment activities, if the other subjects of the market are absent and there is no effective mechanism for their interaction. Besides, if there is absence of attractive investment tools in the market, which would allow performing investment operations profitably and with a low degree of risk, investment activities of insurance companies will not yield the expected desirable effect. Additionally, existence of corresponding financial instruments isn't a sufficient basis for the investment by insurers in the conditions of an unstable financial system. This means, that lack of reliable financial instruments and/or their limitations do not contribute to the development of investment activities. All of the conditions listed above are mainly defined by the rules of the market, as established by the legislation.

Investment activities of insurance companies are extremely important for any national economy, including both macro-, and microeconomic levels. On one hand,

mobilization and concentration of funds of citizens and administration subjects by insurers, and the consequent investment of temporarily available parts of those funds in certain circles of financial assets contribute to the interests of the national economy as a whole. On the other hand, investment activities are the most substantial source of development for insurance organizations, as well as source of income, provision for the settlement of liabilities, and coverage of losses as a result of operational activities.

Furthermore, it is obvious that investment risks should not lead the insurers to bankruptcy and threaten the payments to the insured, thereby worsening the situation.

Hence, as the state aspires to protect its citizens and administration subjects, investment activities of insurance organizations are regulated by legislation for the following purposes:

- For the increase of reliability of insurance sector as a whole, and the prevention of destruction of the insurance companies as a result of participation in doubtful projects in pursuit of higher profits;

- For the restriction of leakage of the resources of insurance organizations abroad, and satisfaction of capital investment requirements of the national economy;

- For the direction of investment resources of insurance companies into certain fields of production, service sector or others, which need to be developed in certain regions or during a certain period of time (Kakora, 2007).

As a result of these, minimum and/or maximum amounts for the investment of insurance reserves in different directions are established by the legislation. Various limitations, restricting investment of these resources are defined.

Additionally, in conventional global practice fundamental principles for the investment of insurance reserves are established, consisting of compliance with recoverability, liquidity, diversification and profitability of investments.

In other words, the state should create conditions so that insurance companies could provide a high recoverability for their investments in managing them, allowing maintaining the value of investments during the whole investing period, and in case of necessity, could turn acquired assets into cash easily and quickly.

Independently existing features of investment activity of insurance companies lead to the realization of those features in practice. To ensure actual efficiency of the investment it is necessary to apply the following optimization technique. Owing to a number of general, as well as private reasons, questions regarding the optimization of investment activity of insurers were practically never mentioned in scientific literature, and those researches where the matter was brought up, were, in our opinion, insufficiently complete and didn't consider the specifics of insurance activity in necessary details.

First, it's common to narrow the problem of building an investment model of insurance companies to the problem of allocation of insurance funds only in the resources of insurance reserves. However, as it was shown in our research, resources of insurance funds are not the only investment resources of an insurance company. There are still 'owned resources' of the insurance companies not directly related to insurance liabilities. A share of these resources is also used for investment purposes.

Second, for the assessment of an investment portfolio's volume the indicator of "insurance reserves" is often used. In our opinion, this isn't always justified, as the analytical indicator of "insurance reserves" has a rather conditional character, and its

size depends on the chosen method of calculation. As a result, insurance reserves may sometimes not correspond to the size of liabilities, so the use of this indicator for the assessment of investment portfolio of insurance companies may lead to erroneous conclusions.

There is also a third aspect which is not considered in the works on the optimization of investment activities of insurance companies. There is only one type of restrictions imposed on investment activities which is considered practically everywhere, i.e. regulation of investment of insurance funds, specifically insurance reserves, by the state. However, there is at least one more type of restrictions related with the nature of insurance. Insurance reserve resources are resources that are temporarily available. They correspond to liabilities and may be 'withdrawn' at any time. The possibility, the size and time of the withdrawal may be casual, depending on the probabilistic nature of insurance liabilities. This factor can only be assessed based on the analysis of the insurance portfolio. Therefore, the optimization model should consider this reality.

Insurance companies should make use of expert services (investment organizations, investment banks, trust organizations), which conduct a thorough analysis of financial instruments, markets and are capable of accurately assessing the risks, during the formation of the investment portfolio. This may considerably reduce the work of insurers during the formation of a balanced investment portfolio, and satisfy the investment goals of the insurance organization.

A correct allocation of investment resources is, first of all, a possibility to maintain the real value of funds obtained from the insured. Existence of effective investment activity allows exploiting a considerable share of the reserves within the personal

interests of the insurance company, to earn a notable income. As a result, the insurer gains an opportunity to offer insurance services to the clients at lower prices, which leads to a better relationship between the clients and the insurance organization; a bigger portfolio of contracts for voluntary insurance; and gain of trust from the clients who only have contracts for obligatory insurance. A successful investment policy not only provides stability of activities of the insurer, but also promotes the increase of its financial stability in any market conditions.

One of the main methods of increasing capital is investing reserves of insurance companies in the securities. According to the legislation defining activities of subjects of the domestic insurance market, the use of such financial instruments is admissible, and their potential efficiency is high. The global practice is a confirmation to this, showing that in all developed countries insurance organizations belong to the main institutional investors in securities market. It's the investment income specifically which comprises the basis for the profits of foreign insurance organizations. In Great Britain, for instance, more than 50% of total transactions in the securities market are the share of insurance organization and non-state pension funds. In developed countries, where the competition in insurance sector is fierce, and the loss ratio reaches 90-95%, a profitable and reliable allocation of temporarily available resources of insurance companies is an issue of utmost importance. An effective use of available financial instrument by the insurers is also becoming relevant for Russian markets.

Main financial instruments comprise bank accounts, bonds and shares. Derivative financial instruments include depositary certificates, bills, forward and future contracts, options and their combinations. Despite this variety, all of the financial instruments are subject to the same general characteristics that define the level of their appeal to the

investors. First of these characteristics is the price (rate), then profitability, liquidity and risk.

If the characteristics of financial instruments did not change randomly, then working with these securities would become trivial. However, the conjuncture of financial markets is constantly changing; therefore, the appeal of securities is changing as well. As a result of this, the choice of the investment object by the insurance organizations becomes a responsible and complex challenge. Allocation of available insurance reserves has to comply with a number of conditions, legislation requirements being the most important of them. Chosen financial instruments have to be reliable, possessing the minimum risk of the loss of invested resources. Apart from that, they have to provide a real growth of invested capital, exceeding the inflation rate. Due to the fact that insurance organizations may need resources at any time for the settlement of their liabilities, the financial instruments have to be liquid as well. However, existence of financial instruments complying with all the listed conditions at a maximum degree is impossible. For instance, securities with fixed income (state and municipal bonds) are liquid and safe, however they yield low income.

Corporate bills promise a rather high income but have a number of shortcomings (for example, possibility of acquisition of a false bill, limitation in the choice of similar tools with low face value), besides, the majority of bills are of low liquidity level. Most of the financial analysts consider corporate bonds to be the most preferable type of investment for insurance organizations. They possess smaller operational risks, a higher income and higher repayment speed, as compared to bills. The main advantage of these investments is their rather high liquidity and low par value. Profitability and maturity dates known in advance allow the investors to perform financial planning, by organizing

the timely settlement of their liabilities and thereby increasing profitability of assets as much as possible.

Today the main objective of insurers in the insurance market of the Republic of Azerbaijan is to involve the savings of population, considerable share of which is stored at their houses in cash form, into the investment process on profitable terms. The problem of the market of long-term insurance is closely interconnected with the regulation of investment activity of insurance companies.

It is necessary to create a system of incentives for the development of long-term life insurance, including pension insurance (privileges in taxation for individuals, etc.). A number of Azerbaijani companies already operate in this segment of the market, increasing sales volume. However, scanty volumes of real long-term life insurance and pension insurance do not influence the financial condition of the insurance company as a whole, using these resources as investment. The general tendency of investment policy of insurance companies in the developed countries during the last decades has been the increase of long-term investments and decrease of short-term and risky investments. It is the sector of pension and accumulative life insurance that provides the overwhelming part of investments of insurers in the developed countries.

The analysis of experience of long-term life insurance in foreign countries allows drawing the conclusion that for the expansion of its implementation in the Republic of Azerbaijan it is necessary to undertake a number of measures:

- To introduce a number of changes in legislative and regulatory bases, so that possibility to license new types of insurance products arises;

- To carry out investments in the industry of life insurance (as well as to compensate the amounts under long-term contracts of life insurance and contracts of additional pension, concluded in the ‘Soviet’ period);

- To actively use instruments of insurance marketing: to carry out explanatory work about features of acquired policies as not only insurers may not earn any additional income, but also they may lose the invested resources due to the deterioration of the market conjuncture.

Application of these measures will allow using life insurance investments as a source of long-term investments.

It is necessary to provide Azerbaijani insurers with the possibility to invest their insurance reserves in such financial instruments as mortgage bonds. The paperless form of release, implementation of the income taxation on mortgage bonds in the same order as for the state securities, flexible term of usage – all of these makes mortgage bonds a safe and profitable instrument for the investment of resources of insurers. Insurance companies have the capacity of making a significant contribution to the formation and development of the market of mortgage securities. The share of the attracted insurance capital (insurance reserves), given favorable economic environment, will grow at quick pace. Mortgage securities of various categories are very suitable for allocation of available funds and assets, especially for reserves under long-term contracts of accumulative insurance.

If we turn to international practice, we will note that investments in mortgages reach considerable sizes in the markets of developed countries. In the investment portfolio of American insurers the main share (74% of ‘mortgage section’) is occupied by commercial, industrial and institutional mortgages, which assumes delivery of credits

for the construction of malls, offices, workshops, as well as medical centers. Additionally, 97% to 99% of all mortgage loans were regularly served, i.e. the overwhelming part of borrowers regularly paid debt on their mortgage loans (Khankishiyev, 2006).

It is therefore possible to conclude that insurance is penetrating the national economy deeper. Insurance companies thus increase their investment possibilities. Hence it is necessary to expand the list of allowed directions for the allocation of insurance reserves, by the corresponding state regulation.

In our opinion, as the insurance markets develops in the Republic of Azerbaijan, not only the investment income of Azerbaijani insurers will increase, but also the management of investments will become more effective. Optimal allocations of resources of insurance companies contribute to the increase of investment income and provide the insurers of the Republic of Azerbaijan with a stable activity. Additionally, investment income can be a source of growth of the equity capital, which may be used for the settlement of insurance liabilities in exceptional circumstances. During the formation of investment portfolio the investor has to consider its optimization on one hand, and provision of reliability and minimum risk on the other. Achievement of the target goals depends on the structure of portfolio. For a definition of optimal investment portfolio it is necessary to use the grading methods for the investments, highlighted in economic literature.

Today, new approaches to formation and investment of the insurance capital are necessary, since investment activities of insurance companies make positive impact both at micro level, as well as at the level of economic system as a whole. The state should create maximum favorable conditions for the formation and investment of insurance

capital, providing the flow of national capital and population savings into the insurance sphere; participating in support of basic innovative directions for the investment of resources; strengthening the legislative base; and improving the information and staffing of this process.

Development of optimal structure of an investment portfolio of the insurer, along with creation of favorable investment climate in the Republic and a possibility of effective allocation of accumulated insurance reserves; integration of bank and insurance businesses, not only by mutual participation, but also creation of joint financial and insurance products – all of these make insurance sector an important financial source for the development of national economy. This approach to the management of insurance capital of insurance companies to increase the importance of insurance in the economy of the country and increase cumulative insurance reserves, may have a significant impact on the development of production and provide insurance organizations with financial stability.

The condition of the competitive environment in the insurance market causes the promotion of improvement of quality of insurance services, decrease in their prices, and active introduction of new insurance products. For development of the competitive environment in the insurance market implementation of the actions directed on creation of equal opportunities for the state and private insurance companies, and also expansion of the presence of foreign capital in the domestic insurance market is expedient.

Formation of the competitive environment is a complex task and assumes realization of the following measures:

- Stage-by-stage liberalization of national system of insurance and reinsurance;

- A higher level of transparency of information about the activity of insurance organizations.

Development of the insurance legislation should be carried out by creation of uniform system of acts in the sphere of insurance, definition of accurate conditions of interaction between the insured and insurance companies, and granting possibilities to protect their rights to all subjects of insurance relations equally.

The main development task of the insurance supervision, providing increase of financial stability of the insurance market is the expansion of system of the requirements defining admissible parameters of risks, accepted by insurance companies.

By reviewing this subject we have come to the following conclusions. The main problems of investment activity of insurers of the Republic of Azerbaijan are the small volumes of resources of the investment insurance fund; insufficient development of long-term types of insurance; imperfection of the legislation; instability in the domestic financial market; insufficient development of securities market; and also the absence of necessary skills of domestic insurers to form and manage an investment portfolio.

The investment policy of insurance companies is directly dependent on state regulation, development level of economic system, development level of stock market, investment climate which has developed in the country, and macroeconomic situation as a whole.

With a view of improvement of investment policy of the insurer legislation improvement, both insurance, and tax is necessary, development of mechanisms which can use in the best way insurance reserves and prevent them from depreciation, develop the mechanism of investment of free money in medium-term and long-term types of securities.

For the solution of existing problems of investment activities of insurance companies in the Republic of Azerbaijan, we offered the following actions:

a) To create a system of incentives for the development of long-term life insurance and additional pension;

b) To expand the list of allowed directions for the allocation and investment of insurance reserves;

c) To exclude all established bottom limits for the investments of resources ('not less'), and replace them with top limits ('not more');

d) To provide Ministry of Finance of the Republic of Azerbaijan with the rights for development, confirmation and change of rules for the investment of insurance reserves.

Chapter 4

CONCLUSION AND SUGGESTIONS

4.1 Conclusion

For the purposes of improving the current situation in the Republic of Azerbaijan implementation of following actions would be advisable:

To substantially increase the list of permitted directions for the investment of insurance reserves. Azerbaijani economy, as compared with Russian economy, does not feature a wide array of financial instruments which could be used for the investment resources of insurers, due to the underdevelopment of stock market. Simultaneously, circle of assets included in the provision of insurance reserves could be enlarged, to include receivables from the insured, re-insured or insurance intermediaries; convertible foreign currencies in the bank accounts (regardless of the insurance type); real estate (for state organizations); etc.

To exclude all established bottom limits ('not less') for the investment resources, by replacing them with top limits ('not more'). This measure will allow avoiding the dangerous prevalence of one type of assets over another type, thereby considerably reducing investment risks.

Analogically to Russian Federation, to provide Ministry of Finance of Azerbaijan with an immediate right of development, confirmation and improvement of the position about the investment of insurance reserves by insurance organizations. Having a whole staff of professionals at the department of insurance supervision, Ministry of Finance

could influence the investment policy of insurance companies more effectively and flexibly, depending on the economic situation of the country, and keeping the interests of the state as a priority.

Considering modern conditions, the state regulation of insurance funds requires, according to our opinion, introduction and compliance with additional principles of investment of insurance reserves. This is a principle of control (submission to control) of investments by the insurers. It means providing the insurance companies with a real possibility to control the invested reserves by means of participation in board meetings of enterprises, in which the resources were invested; obtaining regular information about the decisions taken by the board; obtaining regular information about the financial situation, and so on. Insurers currently do not have the possibility of choosing, or somehow influencing the efficiency of their investments.

The principle of ‘submission to control’ of investments is particularly relevant considering the conditions of a developing economy and the absence of a stable stock market. Viewing the main goal of regulation of insurer’s investment activities as a way of maintaining the solvency of insurers to meet their liabilities before their clients, legislators do not pay attention to applying the rights of insurance companies as investors.

4.2 Suggestions

Summing up all of the above-mentioned points, it is necessary to carry out work in the following directions for further improvement of the investment policy:

Legislation improvement (insurance – in the field of directions for allocation of insurance reserve resources, establishment of allocation limits; tax – in the field of

granting tax privileges to the individuals or entities signing accumulative insurance contracts)

Study of the efficiency of allowed directions for investments of the organizations and preparation of offers that will allow making them more flexible;

Development of various mechanisms, for the use of insurance funds in the best way and for the protection of insurer's monetary resources from devaluation;

For the development of life insurance market, which would consider possibilities for the satisfaction of long-term savings interests of citizens, as well as interests of the state on accumulation of considerable financial resources, it is necessary to develop the mechanism of investment of available monetary resources in medium-term and long-term types of securities, to provide minimization of risk and return;

Implementation of strict accounting for the use of long-term resources that should be viewed as a source of domestic investments into the economy. The state has already taken some measures for the improvement of insurance activity for the nearest future.

During the conduct of this research we studied theoretical bases of investment activities of insurers in details, carried out the analysis of the efficiency of investment activities in the Republic of Azerbaijan; and reviewed the problems of realization of investment capacity of the insurance market of the Republic of Azerbaijan. Results of the research allow drawing the following conclusions and estimates:

Investment resources of insurance companies are their own resources (authorized capital, reserve capital, additional capital and retained earnings), and the attracted funds, i.e. insurance reserves formed by collected insurance premiums. The main feature of the use of investment capital of insurance companies is defined by its source, i.e. insurance premiums of the insured. Replenishment of the resources depends on the income of the

insurer; and the formation of insurance reserves depends on the collected insurance premiums and liabilities under existing insurance contracts. On the other hand, equity capital of the insurer represents a guarantee in relation to the liabilities of the insurer, providing their timely settlement.

Investment of insurance reserves is regulated by the state with a consideration of the minimization of investment risk. State regulation of investment activities in the Republic of Azerbaijan is executed by means of requirements for the formation, allocation and exploitation of insurance reserves and other funds, providing the financial stability of insurance organizations.

Being at the disposal of the insurer for duration of a certain term, insurance reserves are invested in profitable assets and yield investment income for the insurance organization. From the point of view of possibilities for obtaining investment income, reserves on long-term life insurance possess the greatest appeal as are at the disposal of the insurer for a long time. Retained earnings, as part of equity resources of an insurance organization, are the major source of capital investments.

The main requirements that the investment policy of insurance companies has to comply with are reliability and profitability. On one hand, loss of resources invested by the insurer, may lead to unsettlement of liabilities under insurance contracts and lead to bankruptcy. On the other hand, the insurance company is interested in receiving as much income as possible on invested funds. At the same time, as a general rule, high income investments are accompanied by low level of reliability. Therefore the insurer should harmonize the specified purposes, and that is achieved by optimizing calculations. Additionally, insurers should always use the following principles as guidance in the

process of any investment activity – diversification, recoverability, profitability and liquidity.

Insurance companies of the Republic of Azerbaijan have a rather high investment potential for modern level of economic development. Besides, despite the crisis phenomena in economy, financial resources of insurers have a steady tendency for growth. The constant increase in receipts of insurance fees allows insurers to form large sums of insurance reserves which they can use for obtaining investment income. For the implementation of investment activity insurers generally use resources of insurance reserves; equity capital is necessary for them for the maintenance of financial stability and solvency. Additionally, short-term investment resources prevail in the insurance market of the Republic of Azerbaijan, which is clearly visible from the structure of investment portfolio.

Analyzing the directions of investment of insurance reserves, it is possible to draw a conclusion that at this stage of development of the insurance market of the Republic of Azerbaijan it is insufficiently effective. This is explained by the structure of the investment portfolio of insurers of the Republic of Azerbaijan. To comply with the legislation, insurance companies allocate insurance reserves mainly on bank deposits, and that reduces the possibility of obtaining higher income if those reserves were invested in other financial assets. State securities take the second place for the investments of insurance reserves. Other directions of investments defined by the state have an insignificant share in the sum of investments of insurance reserves by the insurers. Low investment activity doesn't allow fully realizing the investment capacity of the insurance market of the Republic of Azerbaijan. One of the main factors having a negative impact on the investment resources is inflation.

Insufficient development of investment activity of insurance companies in our country is explained by the following reasons. First, unlike the western insurance companies, Azerbaijani insurance companies do not yet have considerable volumes of resources which make it possible to carry out investment activities. Small volumes of real long-term life insurance and pension insurance also do not contribute to the increase of investment activity. Second, insufficiency of state regulation of investment processes, a consequence of which is an unstable investment climate in the country. Third, stock market in Azerbaijan is still insufficiently developed, and the choice of reliable funding tools is limited. The guaranteed profitability and liquidity is provided only by state debt securities, and securities of financial institutions with state participation. Fourth, shortage of scientific researches about the problems of increase in the efficiency of investment activities of insurance companies is still intact.

The main problems of investment activities of insurers in the Republic of Azerbaijan are small volumes of resources for the investment insurance fund; insufficient development of long-term types of insurance; insufficiency of the legislation; instability in the domestic financial market; insufficient development of securities market; and absence of necessary skills for the formation and management of investment portfolio by domestic insurers. For the improvement of investment policy of the insurer the following is necessary – improvement in legislation, both for insurance and tax; development of mechanisms which will allow the most optimal use of insurance reserves and will prevent their devaluation; and development of mechanisms for the investment of available monetary resources in medium-term and long-term securities.

The correct allocation of investment resources is, first of all, a possibility to maintain the real value of attracted funds from the insured. Existence of effective

investment activity allows exploiting considerable sums of the reserves which yield notable income for the insurance organization. As a result, the insurer has an opportunity to offer insurance services at lower prices to their clients, to improve relations with the clients, to increase share of voluntary insurance contracts in the portfolio and to gain trust of the clients with obligatory insurance contracts. The successful investment policy not only provides stability of activities of the insurer, but also promotes increase of its financial stability in any conditions of the market.

For the solution of existing problems of investment activities of insurance companies in the Republic of Azerbaijan, we offered the following actions:

- a) To create a system of incentives for the development of long-term life insurance and additional pension;
- b) To expand the list of allowed directions for the allocation and investment of insurance reserves;
- c) To exclude all established bottom limits for the investments of resources ('not less'), and replace them with top limits ('not more');
- d) To provide Ministry of Finance of the Republic of Azerbaijan with the rights for development, confirmation and change of rules for the investment of insurance reserves.

Along with improvement of regulations for the investment activities of insurers at legislative level, development and adoption of regulations of the Government of the Republic of Azerbaijan directed at the stimulation of capitalization growth and financial stability of insurance companies, integration and concentration of the insurance capitals, preservation of real value of the insurance capital and quality of insurance protection, it is necessary to take measures for inflation restraint.

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