

## Regulatory Compliance Risks in The Insurance Market of the Republic of Uzbekistan

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### Abstract

The relevance of the topic is conditioned by the necessity of further development of insurance legislation in the context of compliance risk avoidance. The problems of the current state and prospects of insurance development and certain aspects of insurance use as an element of the risk management system of individuals and legal entities have been reflected in the works of Western and national scientists.

The works of a number of Uzbek scientists and practitioners have been devoted to analyzing the issues of insurance development and certain aspects of insurance practice in Uzbekistan. Scientists from foreign and neighboring countries have been dealing with separate issues of insurance. The problem of regulatory compliance risks in the insurance market of the Republic of Uzbekistan has not been practically considered in the available works of national and foreign authors.

This paper considers the main regulatory compliance risks in the insurance market of the Republic of Uzbekistan.

The results of the work include the definition of the main compliance risks in the activities of insurers in the insurance market of Uzbekistan. The article concludes that the realization of regulatory compliance risks is associated with potential significant losses of national insurers, but until recently the insurance companies of the republic did not concern about the creation of compliance control service.

In the course of this work we applied such research methods as analysis and synthesis of available information in the field of regulatory risk compliance in Uzbekistan and internationally, expert assessment, scientific abstraction and others.

The results of the research may be used by insurance companies, as well as state authorities to assess the state of affairs and prospects for further development of insurance legislation.

**Keywords:** compliance, compliance control, compliance risks, insurance

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## Introduction

Problems of the current state and prospects for the development of insurance are reflected in the works of Western scientists, such as: Cipra Tomas, Bom Patricia, Richter Andreas, Ch. Bernstorff, F.-J. Ermert, D. Famy, R. Koch and others (Thomas et al., 2010) [1].

Uzbek specialists R.S. Azimov, I. Abdurakhmonov, M.T. Askarova, B.B. Ashrafkhanov, T.M. Baimuratov, S.B. Imamov, T.K. Iminov, K.M.Kuldashev, M.A.Mirsadykov, S.A.Umarov, B.R.Shamsuddinov, H.M.Shennaev and others (Wilson, 1993; Larsen, 1974; Romanon, 1998) [2] have devoted their works to analyzing the issues of insurance development and certain aspects of insurance practice in Uzbekistan.

In the economy of the republic, insurance firmly occupies the place of a necessary tool that ensures socio-economic stability and security, the development of entrepreneurship, effective protection of the property interests of citizens and organizations from natural, technogenic, economic and other risks, and the implementation of state policy of socio-economic protection of the population. Insurance is one of the most dynamically developing areas of domestic business. The volume of insurance transactions in this market is steadily growing, and insurers are playing an increasingly significant role in the economy of the republic (Azimov, 2021) [3]. The main reformer of the insurance market of the republic was the state and remains, with the main emphasis being on the rapid development and improvement of insurance legislation (Resolution of the President of the Republic of Uzbekistan, 2019) [4].

In accordance with Solvency 2, the compliance risk management system is an integral part of an effective internal control system of an insurance organization, which carries out: informing the management of the insurance organization about the insurance company's compliance with the requirements of legislation, regulations and other acts; checking the compliance of internal documents of the insurance company with legal requirements; assessing the impact of future legislative changes on the business processes of an insurance organization; identification and assessment of the risk of regulatory non-compliance (regulatory risk) (Solvency II Directive (2009/138/EC)).

## Relevance of the research topic

Currently, in the domestic insurance market there is practically no legislative definition of the concepts "compliance control" and "compliance risks"; in our article, compliance risks in insurance are understood as the risks of an insurance company experiencing financial or reputational losses resulting from unintentional or intentional violations of the law, requirements of internal regulatory documents and standards for the provision of insurance services, ethical business standards relating to the conduct of insurance activities.

The main function of compliance risk management in insurance is regulatory, i.e. ensuring compliance by the insurance company and its employees with established standards and current

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legislation. The goal of compliance risk management in insurance is to prevent possible risks and losses for the insurance company due to violations of certain rules and regulations.

**The purpose of the study** is to analyze regulatory compliance risks in the insurance market of Uzbekistan and, on this basis, develop appropriate proposals and recommendations.

## **Research methods.**

The general methodological principle of the present study was a system-structural analysis of regulatory compliance risks in the insurance market of the Republic of Uzbekistan. The study used methods of system, factor and comparative analysis, mathematical modeling and statistical processing (Azimov, 2021) [5]. The reliability of the research results is ensured by: the use of a comprehensive approach, allowing to study in interrelation the main aspects of the research object; the use of a reliable and extensive information base, including official state, as well as regulatory and instructional documents, scientific and educational materials, articles from periodicals, statistical data; the choice of effective methods of analyzing information, corresponding to the goals and objectives of the study.

## **Main results of the study**

The reason for the occurrence and realization of compliance risks related to insurance legislation may be the following unresolved problems:

- well-known archaic and contradictory norms related to the protection of interests and rights of policyholders under the insurance contract;
- framed nature of the legislative norms in the life insurance industry in terms of endowment insurance (there is no concept of "endowment life insurance contract", the subject of the endowment life insurance contract is not defined, the main insurance risks under the endowment insurance contract are not disclosed, the procedure for termination of the endowment life insurance contract and payment of the redemption amount is not specified);
- there is no clear definite description of the subject matter of the civil liability insurance contract, including professional liability, and entrepreneurial risk insurance contract;
- the procedure for determining the "actual" value of property is not specified, which leads to disagreements between the parties when concluding an insurance contract; the procedure for reflecting the insurance compensation received under the insurance contract by the insured in its accounting reports is not specified, which may lead to problems during tax audits;
- the concepts of "insurance risk" and "insured event" given in the national legislation do not allow to clearly qualify an insured event as a fact of realization of an insurance risk;
- the legislation of the republic contains only six essential terms of property insurance contract and five essential terms of personal insurance contract, which causes certain difficulties in qualification of insurance contracts.

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In connection with the fact that the national Civil Code contains only one article - Article 960 "Mutual Insurance", regulating mutual insurance relations, and the new version of the law "On Insurance Activities" does not contain any norms concerning the organization of this type of insurance, serious compliance risks may arise when introducing Muslim insurance and commercial types of mutual insurance into the practice of insurance companies in Uzbekistan (R. Azimov. Insurance in Uzbekistan: history, current state, challenges in the process of development, insurance of foreign economic activity. -T: "TURON-IQBOL", 2021, 168 p.).

In Uzbekistan at the stage of establishment of insurer there is no verification of origin and actuality of funds contributed to the authorized capital. The legislation prescribes only the minimum amount of the insurer's authorized capital, which is set differentiated depending on the intended areas of insurance activities. The licensing procedure specified by the legislation includes control:

- compliance of the amount of the formed authorized capital with the established minimum amount;
- compliance of the head and chief accountant of the license applicant (licensee) with the established qualification requirements;
- when obtaining a license to conduct compulsory insurance - verification of the presence in the Republic of Karakalpakstan, all regions and Tashkent city branches of the insurer, authorized to conclude contracts of compulsory insurance, consideration of claims of the victim (his heir or legal successor) on insurance payments and making insurance payments.

In addition, the applicant for a license for compulsory insurance of civil liability of vehicle owners is checked for the existence of a membership agreement with the Payments Guarantee Fund, and the applicant for a license for compulsory insurance of civil liability of carriers - the existence of a joint activity agreement between insurers entitled to carry out this type of compulsory insurance.

The insurer may only operate in the classes (types) specified in the license, while the structure of classes in the general insurance industry and life insurance industry generally complies with the EU Insurance Directives.

It should be noted that for life insurance the EU Directives contain a detailed structure of insurance activities, in respect of which different requirements for solvency and financial stability are applied. In its turn, the legislation of the republic contains only the definition of "life insurance", which makes it difficult to exercise subsequent control over insurance activities both on the part of supervisory authorities and other state executive bodies (tax authorities, currency regulation and currency control).

A serious disadvantage of the existing licensing system is the lack of possibility for the supervisory authority to control the origin of capital, the real availability of funds and assets contributed to the authorized capital of the insurer, the reputation of the top management of the insurance company at the stage of its establishment.

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Current monitoring of the insurer's activity is carried out by the supervisory authority, moreover, in accordance with Article 14 "Rights and Obligations of the Insurer" of the Law "On Insurance Activity" "the insurer is obliged ...annually to undergo a mandatory audit and at least once a year to engage an actuarial organization to provide actuarial services in accordance with the procedure established by the authorized state body" (Law of the Republic of Uzbekistan dated 23.11.2021 No. LRU-730 "On Insurance Activity").

In Uzbekistan, the functions of the authorized state body for state regulation of insurance activity are assigned to the Ministry of Economy and Finance of the Republic of Uzbekistan. The authorized state body monitors the activities of insurers on the basis of submitted financial statements, and the requirements for the composition and form of financial statements are adapted to the conditions of the Republic and, in general, correspond to the requirements established by the relevant EU directives. According to the legislation, insurers ... "must disclose information related to the state of own funds, fulfillment of capital requirements, liquidity, amount of risks and other key indicators (norms) ... The annual financial report of an insurer (reinsurer) ... shall not be subject to publication without an auditor's report" (Law of the Republic of Uzbekistan dated 23.11.2021 No. LRU-730 "On Insurance Activity").

In Uzbekistan, when national insurers carry out reinsurance on the international reinsurance market, they accept obligations under insurance contracts on the local market in national currency, and the foreign reinsurer accepts obligations and forms corresponding reserves in hard currency. In such a situation, national insurers with outgoing foreign reinsurance are forced to convert the insurance premium, which, given the volatility of the foreign exchange market, can lead to problems with the solvency of the insurer.

Based on the results of the control of the authorized state body, depending on the severity of the violations, orders are issued, in the manner prescribed by law, the license is limited, suspended or terminated, in addition, the authorized state body has the right to impose sanctions such as fines on violators.

The efficiency of remote monitoring of insurers' activities is determined by the following parameters:

- timeliness, reliability and completeness of reporting information submitted by insurers to the supervisory authority;

- promptness and sufficiency of sanctions imposed by the authorized state body in case of detection of violations. According to these parameters, the activity of the authorized state body in supervising the insurance market of the republic is not efficient enough. This state of affairs can be explained by:

- insufficient level of insurance legislation - the basics of insurance legislation have been formed in the republic, systematic work on its development and improvement is necessary, in particular, on specifying the functional capabilities of the authorized state body;

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- understaffing, insufficient level of professionalism of the authorized state body employees, low attractiveness of work in authorized state body for highly qualified insurance specialists in terms of labor compensation;

-practical absence of digital channels for transmission, processing and analysis of reporting information, which significantly reduces the authorized state body's ability to promptly respond to identified violations.

Compliance risks in the field of administrative law may arise when:

- initial control over insurance conditions and insurance rates when creating an insurance company (in most EU countries, such control has been abolished and the main thing is remote monitoring of the financial stability and solvency of the insurer);

- justification of methods and selection of procedures for the formation of insurance reserves, reserve and insurance funds and rules for their placement, especially in the life insurance industry;

- choosing methods for calculating the solvency margin (calculating the standard ratio between the assets and liabilities of the insurer);

- establishing forms and deadlines for submitting accounting and statistical reporting to the relevant supervisory and statistical authorities;

- maintaining registers of insurers and insurance agents;

- restriction or suspension of validity and termination of the license.

The State Law of the Republic of Uzbekistan, based on general civil and special insurance legislation, includes issues of the creation and functioning of a state body authorized to regulate the activities of professional participants in insurance activities and protect the rights of policyholders.

The effectiveness of supervisory procedures is determined by:

- stability and predictability of authorized state body development directions;

- sufficiency, accessibility and transparency of the legislation necessary for the implementation of the activities of the authorized state body;

- sufficiency of functions, modern methods of supervision and structure of the authorized state body to solve the assigned tasks;

- the effectiveness of joint work to improve insurance and general civil legislation;

- legality and proportionality of the application of sanctions for violation by the insurer of established legal and economic norms.

Compliance risks in the field of public law arise when the authorized state body carries out the following types of activities:

1. Licensing of insurance activities of insurers (reinsurers) and insurance brokers. Risks arise due to insufficient elaboration of issues of regulatory and departmental support for this function.

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2. Ensuring transparency regarding the financial position of the insurer. The reason for the emergence of regulatory risks in this case is the lack of standards for providing such information.

3. Strict compliance with legislation and maintaining law and order in the industry by supervising strict compliance with contractual relations by participants in the insurance business. The authorized state body conducts routine inspections of the activities of insurance companies and, if violations are detected, has the right to take measures provided for by law against violators. However, to date there are no regulatory or departmental documents defining the rights and obligations of the parties, as well as standards for conducting inspections.

Insurers, policyholders and the state, when determining the composition of costs, determining the tax base of insurers, calculating and paying taxes and obligatory payments, are guided by the norms of financial law. To do this, refer to the following acts of legislation:

- “Regulations on the composition of costs for the production and sale of products (works, services) and on the procedure for generating financial results” (Approved by Resolution of the Cabinet of Ministers of the Republic of Uzbekistan No. 54 dated 02/05/1999);
- “Tax Code of the Republic of Uzbekistan” and individual departmental acts.

## Discussion

As the example of countries with a developed insurance market (USA, Germany, France, etc.) shows, the transition to remote monitoring in the implementation of financial control can significantly increase the efficiency of supervision by identifying at an early stage insurer with deteriorating solvency and financial stability and promptly taking necessary measures against them. In this case, remote monitoring, as a rule, is carried out on the basis of an index approach (coefficients of change in receipts of insurance premiums, costs of operating an insurer, loss ratio of the insured amount and insurance premiums, etc.).

A significant disadvantage of financial control when using remote monitoring based on reporting information is that it is carried out with a frequency of at least three months, that is, between successive checks of the financial condition of insurance, a significant period of time passes, during which the financial stability and solvency of the subject of supervision can change in a negative way, the actions of the State Administration to protect the rights of policyholders (beneficiaries) and insured persons may be late.

Almost all national insurers have republican banks among their founders, and in some cases cross-ownership of each other's shares is allowed. As foreign experience shows, such ownership of shares can lead to a significant decrease in the solvency and financial stability of both participants, therefore such cases should be the subject of careful financial control.

The insurance market is essentially inclined to monopolization of insurance activities, therefore the provisions of financial law on demonopolization of the insurance market are especially relevant. Unfortunately, at the present stage of development of insurance activity in the

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legislation of the republic there are no separate norms aimed at limitation and suppression of monopolistic activity in the insurance market. In connection with the above-mentioned, we consider it advisable to study and adapt to local conditions the foreign experience of antimonopoly regulation of insurance activity with regard to establishment of monopolistically high rates of insurance premiums through insurers' agreements and use of administrative resources and other opportunities by the insurer to occupy a monopolistic position in a particular type of insurance services (accumulation by the insurer of more than one third of insurance premiums for this type of services).

The absence of unified rules for the formation of insurance reserves and standards of independent actuaries' activity in the life insurance industry may lead to problems with the validity and sufficiency of reserves formed by insurers.

The insufficient level of development of the country's financial market leads to problems in the placement of insurance reserves, therefore it is necessary, based on the basic principles of the insurer's investment activity - diversification, liquidity, repayment and profitability, to significantly expand the permitted objects of investment of temporarily free funds of the insurer.

## Conclusions

In the existing works of national and foreign authors, the problems of regulatory compliance risks in the insurance market of the Republic of Uzbekistan were practically not considered. As a result of the study, it was determined that compliance risks in the field of financial law in the insurance market of the Republic of Uzbekistan are mainly associated with the following procedures:

- formation, placement and use of insurance reserves;
- determining the composition of costs, determining the tax base of insurers and the financial results of the insurer's activities;
- preparation of the insurer's financial statements and their submission to the relevant supervisory authorities;
- taxation of insurers and insureds in insurance and reinsurance operations (Azimov, 2021) [6].

As follows from the above-mentioned, realization of regulatory compliance risks is associated with potential significant losses of national insurers, however, until recently insurance companies of the republic have not been concerned about creation of compliance control services.

Most insurers believe that the main reason for insufficient development of compliance control services in insurance organizations is related to the lack of regulatory requirements on this issue. Other factors obstructing the development of compliance control services in the insurance organizations of the republic include: high costs of establishment and functioning of compliance control services; practical absence of compliance control specialists in the



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insurance organizations of the republic; insufficient supply of computer programs for automation of compliance control in domestic insurance companies.

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