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PRUDENTIAL SUPERVISION AS A LEGAL INSTRUMENT FOR ENSURING THE FINANCIAL STABILITY OF INSURERS

ПРУДЕНЦІЙНИЙ НАГЛЯД ЯК ПРАВОВИЙ ІНСТРУМЕНТ ЗАБЕЗПЕЧЕННЯ ФІНАНСОВОЇ СТІЙКОСТІ СТРАХОВИКІВ

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The article examines prudential supervision as a key legal instrument for ensuring the financial stability of insurers. It establishes that the legal regulation of insurance activities serves as the foundation for the stability of the insurance market and a safeguard for policyholders' rights. At the same time, it highlights the numerous challenges currently facing the domestic insurance sector, including the insufficient solvency and liquidity of certain insurers, inadequate risk management practices, and the low level of professional qualifications among insurance company employees.

Additionally, the study identifies fraudulent activities within the insurance market as a significant concern, including the failure to pay insurance claims, money laundering, and other financial violations that erode customer trust.

The author emphasizes that effective state oversight is a crucial mechanism for maintaining insurers' financial resilience, while prudential supervision remains an essential legal tool for safeguarding financial stability. The National Bank of Ukraine, as the primary regulator of the domestic insurance market, plays a vital role in introducing modern supervisory and regulatory approaches in line with European standards.

The study pays special attention to prudential supervision, which ensures insurers' solvency and mitigates systemic risks. It concludes that a risk-based approach to insurance regulation should adhere to key principles such as proportionality, early problem detection, and legal certainty. Implementing these principles is expected to enhance market stability, protect the rights of insurance service consumers, and create fair, non-discriminatory conditions for all market participants.

Key words: insurance market, prudential supervision, state oversight of insurance activities, financial stability, National Bank of Ukraine, risk-based approach to insurance regulation, protection of insurance service consumers' rights.

У статті аналізується пруденційний нагляд як важливий правовий інструмент забезпечення фінансової стійкості страховиків. Встановлено, що правове регулювання страхової діяльності є основою стабільності страхового ринку та гарантією захисту прав страхувальників. При цьому, зауважено, що на сучасному рівні розвитку вітчизняного страхового ринку спостерігається чимало викликів, зокрема, недостатня платоспроможність та ліквідність деяких страховиків, недостатній ступінь управління ризиками та невисокий рівень кваліфікації працівників страхових організацій. Також серед негативних проявів сучасного страхового ринку можна відзначити здійснення страховими компаніями шахрайських операцій, включаючи невиплату страхових відшкодувань, легалізацію незаконних доходів та інші фінансові правопорушення, що підривають довіру клієнтів.

Автором наголошено, що ключовим механізмом забезпечення фінансової стійкості страховиків є ефективний державний контроль, а важливим правовим інструментом забезпечення фінансової стабільності страховиків є пруденційний нагляд. Характеризуючи Національний банк України як основний регулятор вітчизняного ринку страхування, зазначено, про його роль у впровадженні сучасних підходів до нагляду та регулювання страхового ринку відповідно до європейських стандартів. У дослідженні особливу увагу приділено пруденційному нагляду, який забезпечує платоспроможність страховиків та зменшення системних ризиків. Констатовано, що ризик-орієнтований підхід до регулювання страхової діяльності передбачає дотримання таких принципів, як пропорційність, раннє виявлення проблем, правова визначеність. Зроблено висновок, що провадження названих принципів сприятиме підвищенню стабільності ринку, захисту прав споживачів страхових послуг та створенню рівних, недискримінаційних умов для всіх учасників.

Ключові слова: страховий ринок, пруденційний нагляд, державний контроль за страховою діяльністю, фінансова стійкість, Національний банк України, ризик-орієнтований підхід до регулювання страхової діяльності, захист прав споживачів страхових послуг.

Effective legal regulation of insurance activity establishes transparent mechanisms of oversight and protection of policyholders' rights, which constitutes the foundation of trust in the insurance system. However, as of today, the development of the insurance market is hindered by a number of factors, including issues of solvency and liquidity among several insurance companies, the absence of a clear business model, and generally low levels of risk management and corporate governance.

The analysis of the activities of certain operating insurance companies suggests that the primary business objective of some insurers is not the provision of insurance services per se, but rather engagement in fraudulent denial of insurance claims, capital diversion, legalization of illegally obtained income, tax evasion including through the conversion of non-cash funds into cash and maintaining insurance reserves that do not reflect actual risks. These practices render the insurance market imperfect and uncompetitive.

The aforementioned systemic issues in the domestic insurance sector are primarily the result of insufficient regulatory oversight. The urgent need for mechanisms to prevent such adverse phenomena as inadequate insurer solvency and the mismatch between insurance reserves and actual risks necessitates the establishment of an effective framework for state financial control. Through the application of robust financial management tools – particularly internal and external control and supervision over insurance operations – it becomes possible to assess the adequacy of prospective financial plans, promptly respond to emerging negative trends, and, consequently, avoid future difficulties in determining the financial stability of insurance companies.

Concerning the optimal management system for the insurance business in Ukraine – one that would stimulate the development of the insurance market it should be noted that various approaches have been proposed in academic circles regarding the identification of its elemental, methodological, and institutional components. Notable contributions on this topic can be found in the works of M. Bodnaruk, I. Hladii, A. Kryventsov, Ya. Krupko, L. Popova, M. Tymchak, A. Rudkovskyi.

The domestic insurance market has evolved from a phase of chaotic risk insurance particularly in the context of loan default risks through insurance cooperatives to the current stage, which features well-developed insurance programs aligned with international standards. By its very nature, insurance is a risk-based activity. The probabilistic process of accumulating insurance reserves and their subsequent use to ensure compensation and indemnity payments creates opportunities for uncontrolled operations aimed at money laundering and insurance fraud. Moreover, the placement of insurers own funds and attracted reserves into investment assets is not always guided by a rational strategy. The financial stability of an insurance organization is a key indicator of its overall financial soundness, expressed through the equilibrium between its own capital and assumed liabilities. In other words, it is a fundamental metric of institutional performance.

Insurance companies are entrusted with a crucial societal function protecting against various threats to stability and risk. Fulfillment of obligations by insurers, both to policyholders and to the state, contributes to the establishment of a well-thought-out system of effective financial control. Financial control serves as an integral component of insurance business management and, simultaneously, as an effective instrument of financial management both from the standpoint of governmental oversight and internal administrative supervision over insurance activities.

The Purpose of Analyzing Financial Control over the Solvency of Insurance Companies. The primary objective of conducting an analysis of financial control over the solvency of insurance organizations is to assess their compliance with the requirements of insurance legislation, as well as to identify those companies whose performance indicators may suggest potential violations of regulatory norms.

To date, neither regulatory frameworks nor specialized academic literature have established a clear distinction between the concepts of «regulation», «supervision», and «control». This conceptual ambiguity regarding institutional mechanisms inevitably complicates the effective execution of the functions assigned to the financial megaregulator. Currently, these functions are carried out by the National Bank of Ukraine, which serves as the financial megaregulator and oversees the activities of all participants across various segments of the financial market.

Although numerous methodologies exist for evaluating the financial stability of insurance businesses, given that the activities of insurance companies are regulated by the National Bank of Ukraine, it is crucial to prioritize those indicators specifically established by this institution.

The National Bank of Ukraine promotes sound insurance practices at both the micro and macro levels [2]. At the macro level, it pays particular attention to measures that foster favorable conditions for the effective functioning of the insurance sector. This includes stimulating demand for insurance services and ensuring a stable socio-economic environment in which all market participants can operate on an equal footing. Furthermore, the National Bank of Ukraine integrates into its regulatory decisions a wide range of measures aimed at protecting the interests of consumers namely, policyholders in the insurance market.

The National Bank of Ukraine is officially recognized as the primary regulatory and supervisory authority in the insurance sector. It possesses the most comprehensive regulatory mandate within this domain, exercising its powers in monitoring and ensuring insurers compliance with solvency requirements from a financial and economic standpoint [6, p. 243]. The overarching goal of this financial regulator is to establish a solvent, resilient, and competitive insurance market in Ukraine, with robust protection of consumer rights.

To this end, the National Bank of Ukraine has introduced a new regulatory model for the insurance market, which incorporates the provisions of European Union directives, as well as global best practices in insurance and reinsurance market regulation and supervision.

In describing the functions of state regulation and supervision over insurance market activities particularly the establishment of prudential requirements and the monitoring of their compliance it is essential to highlight several key responsibilities of the National Bank of Ukraine as the country's principal financial regulator.

Firstly, this includes setting solvency and capital requirements for insurers, encompassing the determination of the minimum authorized capital and the procedures for its formation. Secondly, the National Bank establishes mandatory standards and requirements concerning the formation of insurance reserves to ensure insurer solvency and to protect the interests of policyholders.

Moreover, the National Bank of Ukraine periodically updates the regulatory standards and methodologies related to the calculation of insurance reserves and insurers solvency. These updates aim to strengthen the financial stability of insurance undertakings and uphold policyholder rights. For instance, one such initiative involved launching a public consultation on proposed amendments to the methodology for forming insurance reserves and the requirements for calculating the surrender value.

In this way, the National Bank of Ukraine endeavors to ensure that insurance companies maintain adequate reserves necessary for the fulfillment of their obligations to policyholders.

In many European countries such as Germany, France, and Italy where a centralized model of legal regulation of insurance activity had long been applied, a strategic shift has occurred in favor of prudential supervision [1]. This approach reflects the increasing significance of risk-based state oversight, emphasizing the assessment and mitigation of risks inherent in the operations of insurance market participants, with a primary focus on ensuring the solvency of insurers.

The analysis of international practices in jurisdictions where the state guarantees insurance payouts, regulates insurance tariffs, and controls the conditions for their application allows for the identification of key characteristics of prudential regulation in the insurance sector:

1. Unified regulatory approach across all financial market sectors, aligned with national policy objectives;
2. Legislative determination of parameters for calculating insurance premiums for each type of compulsory social insurance, including state-defined premium rates differentiated by the probability of risk occurrence;
3. Optimization of the tax burden and the creation of favorable conditions for investment activities;
4. Integrated financial market supervision, enabling the coordinated regulation of insurance alongside other financial institutions – including investment funds, private pension funds, securities markets, and banking institutions – thus facilitating the establishment of a unified financial megaregulator within the system of state governance;
5. Provision of adequate resources to governmental supervisory bodies to ensure the effective execution of their mandates in overseeing insurance companies;
6. Enhanced policyholder protection, including guarantees for indemnity payments through the establishment of compensation funds in the event of insurer insolvency. This also includes the development of early-warning mechanisms to prevent potential bankruptcies and mandatory transfer of portfolios from distressed insurers to financially stable entities.

Such principles constitute the foundation for modern prudential regulation, aimed at ensuring the stability, transparency, and integrity of the insurance sector within a broader financial ecosystem.

The value-oriented role of prudential supervision lies in its contribution to the development of effective risk management strategies and the mitigation of potential crisis phenomena within the insurance sector. This primarily entails stimulating demand for insurance services and creating a favorable and stable socio-economic environment that ensures the smooth functioning of the market and equal opportunities for all its participants. To this end, measures must be in place to ensure the protection of consumer interests within the insurance services market.

Effective regulation of insurance companies requires a balanced approach one that combines robust state oversight with the promotion of innovation in insurance products. This synergy ultimately supports the overall stability of the financial system. Minimizing systemic risks and enhancing the insurance market's resilience to macroeconomic challenges is achievable through the implementation of a risk-based supervisory approach [4, p. 137–138]. The execution of this approach is grounded in several key principles [8].

1. Proportionality – Regulatory requirements and the intensity of supervision are determined based on the size, significance (i.e., the company's impact on the market and economy), complexity of the business model, and the institution's risk profile .

2. Forward-looking perspective – Supervision is conducted with an emphasis on understanding the company's business plan, future outlook, and potential risks, rather than solely assessing historical performance.

3. Early warning and timely response – This involves the identification and assessment of potential risks at an early stage, enabling timely communication or appropriate intervention before adverse outcomes materialize.

4. Professional judgement – Evaluations are based on motivated and well-substantiated conclusions derived from expert knowledge and experience, as well as a comprehensive and multidimensional analysis of relevant information.

5. Legal certainty – This principle calls for the establishment of clear and understandable requirements through a coherent framework of legislative and regulatory acts, including defined timelines for aligning the activities of financial institutions with newly adopted standards [3].

The implementation of the prudential regulation concept within the domestic insurance market necessitates the refinement of standards for assessing insurer-specific risks, revisions to accounting and reporting rules, and the availability of appropriate supervisory tools to monitor the «absolute solvency» of insurance companies.

In addition to overseeing regulatory solvency compliance, insurance reserve calculations, and investment practices, supervisory authorities must also evaluate the reliability of insurers management systems. This includes the quality of accounting practices, the effectiveness of risk management frameworks, and the robustness of internal control mechanisms.

Successful implementation of prudential regulation demands an integrated approach that combines financial monitoring with the assessment of organizational resilience and risk governance. Such a comprehensive supervisory model enables the early identification of vulnerabilities and fosters the long-term sustainability and stability of the insurance sector.

Thus, prudential regulation of insurance activity should be understood as a form of organization and functioning of the insurance system in which the state's key financial regulator holds a monopoly on establishing rules and standards within the financial services market. Under this framework, public authorities ensure the protection of policyholder rights and support the effective development of the national insurance market.

The core objectives of legal regulation in the field of state insurance include the prevention of unscrupulous entrepreneurial practices in the insurance market particularly those associated with risk coverage and other insurance operations and the establishment of requirements that ensure the financial stability of the insurance industry.

Within the framework of prudential state supervision, regulatory mechanisms not only facilitate the creation of an effective risk management system for insurers but also contribute to the long-term reliability and sustainability of the insurance market.

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