World Applied Sciences Journal 31 (6): 1188-1190, 2014
ISSN 1818-4952

DOI: 10.5829/idosi.wasj.2014.31.06.93

Insurance as a Way for Reducing the Market Risks Level Associated with the Collective Investments

[1]Bulat R. Khismatullin and [2]Firdaus I. Kharisova

[1]CJSC "Energy Consulting Audit"
[2]Kazan Federal University

Abstract: This article focuses on the need to introduce an insurance mechanism in the implementation of investment funds in the Russian economy. Management companies in order to obtain high profits try to buy securities with high risk level. However in conditions of financial crisis and recession of the share market only highly liquid securities can keep money of shareholder. Moreover, any mutual fund possesses the important feature - if rigidly not to control a structure of its portfolio, it becomes superprofitable, but superrisky. Due the scale of collective investment market any error of management company, which operates with money resources of investors, can lead to serious consequences. There is a kind of insurance like - double insurance. Double insurance occurs when the object is insured against the same risk in the same period of several insurance companies and insurance claims for all contracts, taken together, exceed the cost of insurance. In this article the authors substantiate the need for a mechanism of double insurance. This insurance system, in our opinion, will reduce the level of risk in implementation collective investments, but, despite a slight decrease in the profitability of funds, it will increase investor interest to mutual funds.

Key words: Insurance · Market risk · Mutual Fund · Management Company · Collective Investments · Net Assets

INTRODUCTION

The recent global financial crisis has exposed the weaknesses of the Russian market for collective investment. After a series of failures of management companies, as well as a significant drop in value of shares revealed the problem of insufficient protection of investors (shareholders). For example, in 2009 the market of collective investment left the oldest Russian management company CJSC "Pioglobal Asset Management". It is important to note that, in accordance with Article 32 of the Federal Law of November 29, 2001 ¹ 156-FZ «On Investment Funds» in the event of a mutual investment fund holders of investment shares are in fourth place in priority in the distribution of money resources constituting the Mutual Fund and entered into it after the sale of the mutual fund assets. [1]. In this regard, the question of insurance mutual funds becomes particularly relevant. Management companies in order to obtain high profits try to buy securities with high risk level. However in conditions of financial crisis and recession of the share market only highly liquid securities can keep money of shareholder. Moreover, any mutual fund possesses the important feature - if rigidly not to control a structure of its portfolio, it becomes superprofitable, but superrisky.

MATERIALS AND METHODS

The system of strict supervision and control procedures, that currently exists, allows you to manage non-market risks. It helps reduce the risk of fraud, lack of professionalism in the management company. But the market risks that are associated with investing in securities can not be reduced.

Due the scale of collective investments market any error of management company, which operates with money resources of investors, can lead to serious consequences. In connection with the foregoing, to investigate this problem, we propose the part of assets of funds collected by the management company in the formation of mutual fund, transfer like insurance premiums

Corresponding Author: Bulat R. Khismatullin, CJSC "Energy Consulting Audit"

to insurance companies, which, if necessary, will carry out compensatory payments. At the same time, due the scale of collective investment market and the involvement of a large number of shareholders, in our view, it makes sense to establish a procedure, according to the compensation should be paid in bankruptcy as a management company and if occurs significantly reducing the value of shares.

In insurance practice distinguishes between repeated and double insurance. Repeated or additional insurance occurs when insured the same interest against the same dangers for the same period of time in several insurance companies so that the total sum insured for all contracts will not exceed the cost of the insurance. Repeated insurance is not prohibited by law.

Double insurance occurs when the object is insured against the same risk in the same period of several insurance companies and insurance claims for all contracts, taken together, exceed the cost of insurance. In this situation, insurers are responsible within the insured value of the insured interest and each of them is responsible in proportion to the sum insured by an insurance contract made. This means that the insurance case insurance claims due from insurers, will exceed the total amount of damage. Double insurance is often deliberate and is carried out with the purpose for illegal enrichment while substantially reducing the value of shares [2].

It should be noted that since the double insurance can be used to enrich, the law in many developed countries contain special restrictive rules. In the Civil Code of Russia in Article 951 «Consequences of insurance excess insurance cost» found that if the sum insured specified in the contract or business property insurance risk exceeds the insured value, the contract is null and void in that part of the insurance amount that exceeds the insured value. Where the sum insured exceeds the insured value as a result of security of the same object from two or more insurers, the insurance indemnity is payable by each of the insurers is reduced proportionally to the reduction of the original sum insured under the contract of insurance [3].

In collective investment market the object of insurance is property interests related to the with responsibility of management company to compensate the losses to investors as a negative result from asset management. At the same time the cost of insurance is the value of assets raised by the management company in the mutual fund.

In order to assess the extent of the activities of mutual funds, we consider it necessary to compare the amounts of borrowed funds by mutual funds with net assets of insurance companies. Net assets, as is known, the estimated value determined by deduction from the total amount of assets the total amount of liabilities.

Table 1: Net assets of the largest insurance companies (ths. rub.)

	Reporting dates		
Name of insurance company	December 31, 2012	December 31, 2011	December 31, 2010
OJSC “SOGAZ” [1]	30348 451	22743 024	17742 860
INGOSSTRAKH OJSIC [2]	21485 659	19414 833	16052 448
OJSIC “Reso-Garantia” [3]	11964 295	9898 635	11470 767
Soglasie Insurance Company ltd.[4]	9627 612	6430 302	5274 999
OJSC IC “Allianz” [5]	9211 016	7146 932	6950 047
OJSC “Rosgosstrakh” [6]	9208 127	2126 288	1613 586
AlfaStrakhovanie PLC [7]	8729 355	7439 949	6886 611
OJSC “VSK”[8]	7516 814	5759 465	5412 207
VTB Insurance, Limited [9]	6492 876	4311 384	2196 900
CJSC “MAKS” [10]	3179 526	2708 952	2636 045
CJSC IG “UralSib” [11]	3489 807	3359 542	2572 959
OJSC ZHASO [12]	2767 601	2792 389	2574 388
Zurich Insurance Company Ltd [13]	2177 907	1992 874	1895 019

[1]SOGAZ Insurance Group http://www.sogaz.ru
[2]Open Joint-Stock Insurance Company Ingosstrakh http://www.ingos.ru
[3]OJSIC "Reso-Garantia" http://www.reso.ru
[4]Soglasie Insurance Company ltd. http://www.soglasie.ru/
[5]OJSC IC Allianz http://www.allianz.ru
[6]OJSC "Rosgosstrakh" http://www.rgs.ru
[7]PLC AlfaStrakhovanie http://www.alfastrah.ru
[8]OJSC "VSK" http://www.vsk.ru
[9]VTB Insurance, Limited http://vtbins.com
[10]CJSC "MAKS" http://www.makc.ru
[11]CJSC IG "UralSib" http://www.uralsibins.ru
[12]OJSC ZHASO http://www.zhaso.ru
[13]Zurich Insurance Company Ltd http://zurich.ru

Table 2: Amount of borrowed funds in mutual funds in 2011 and 2012 [14]

No	Name of management company	Name of mutual fund	Amount of funds raised, ths. rub. in 2012	in 2011
1	Trust Investment Company LLC	OMF “Reserve”	9 839 330	73
2	MC "BIN Finam Group" LLC	CMF “Finam – Capital Investments”	7 782 910	1 449 968
3	JSC "MC " TransFinGroup"	CMF “Spectrum”	4 403 258	3 033 299
4	Region Development LLC	CMF “Business Real Estate”	4 210 220	-
5	REGION Portfolio investment LLC	CMF “Commercial Real Estate”	3 099 545	-
6	MC "Montes Auri" LLC	CMF “Montes Auri Mountain”	1 494 648	1 299 233
7	Region Development LLC	CMF “Region Commercial Property”	1 390 494	-
8	MC "GeoKapital" LLC	CMF “Golden Spike”	1 238 904	26
9	MC "Eurotrust" LLC	CMF “Agrocapital”	843 574	1 717 728
10	MC "NRC-capital (AM)" LLC	CMF “Savvinskaya Chamber”	-	1 640 488
11	Veles TRUST LLC	CMF “ATRIUM”	4	1 063 616
12	JSC "MC "TrustUnion-Real Estate Funds"	CMF “TrustUnion – Podmoskovny”	842 559	1 008 157
13	MC "Mikhailovskiy" LLC	CMF “Mikhailovskiy – Rental”	929 302	18
14	Trinfiko Property Management LLC	CMF “Russian field”	857 669	431 324

[14]Nonprofit Partnership «Nationalnaya Liga Upravlyayuschih» http://www.nlu.ru

The need for such comparisons is that any payment of insurance value leads to a decrease in net assets of an insurance company. Therefore, it is logical that the amount of insurance indemnity if the insured event would happen, did not exceed the amount of the insured value or cost of funds in a mutual fund.

We analyzed the value of net assets of largest insurance companies. We get the data for the analysis from the annual financial statements, which confirmed by audit conclusions (Table 1).

The largest amounts of borrowed funds by mutual funds in 2011 and 2012 are presented in Table 2.

RESULTS AND DISCUSSION

Analysis of the data shows that the volume of assets, attracted by management companies into mutual funds, is comparable with value of the net assets of large insurance companies. Consequently, the need for double insurance related with saving of sustainable state of insurance market and preventing large drawdowns and increasing if the insured event would happen as a result of activity of management companies. In addition, the mechanism of double insurance provides investors more assurance in getting back earlier investments to property of mutual fund.

Such insurance system, in our opinion, will reduce the level of risk in implementation collective investments, but, despite a slight decrease the profitability of funds, it will increase investors interest to mutual funds.

As already noted, collective investments related with interests of many private investors. The audit of accounting (financial) statements of management companies of mutual funds is the statutory audit, because of the high public importance of it. However, despite the significance of the institution of collective investments, legal acts are not fully developed the proper organization and methodology of the audit of investment funds. The task for the audit of investment funds is complicated by the fact that their activities are regulated by the numerous requirements from the former Federal Financial Markets Service (now - the Central Bank of the Russian Federation), but these requirements are not systematized for audit purposes. Without developing the organization and methodology of audit funds it is impossible to provide quality audit services. Systematization the requirements for investment funds for providing high quality audit can increase user’s confidence to the auditor's opinion about accounting (financial) statements of management companies and thus can improve the quality of management decisions in general.

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