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INNOVATIONS IN TRANSFERRING INSURABLE RISK TO CAPITAL MARKETS - INSURANCE-LINKED SECURITIES (ILS) APPLICATION BY THE NON-FINANCIAL COMPANIES

Abstract:

In this paper we focus on financial innovations that have emerged as a result of the convergence of the capital market and insurance market. These new solutions called Insurance-Linked Securities (ILS) were created in 1990s. by insurers and reinsurers in order to improve the liquidity of insurance market by providing the opportunity to transfer insurable risk to capital market. However, nowadays the application of ILS have been extended beyond financial sector. In particular, the application of ILS in the new, different way by the non-financial companies is regarded here as innovations.

The prime purpose of the paper is to justify a statement that in recent years, capital market innovations within transferring insurable risk to capital markets (ILS) have grown on diversity. Our objective is to critically analyze the innovative solutions within transferring insurable risk to capital market, and assess their potential for the use by non-financial companies. We address the limitations and possible consequences of these solutions.

To achieve the expected results we use the document analysis and select important information in order to provide systemized characteristics of Insurance-Linked Securities. Our intention is also to initiate a debate on the possible use of insurance-linked securities in non-financial sector, focusing on their potential advantages and positive consequences for the non-financial companies as well as on potential limitations and obstacles.

From the analyzed group of insurance-linked securities available on the capital market, we have selected these solutions that can be applied by the non-financial companies, i.e.: cat bonds, insurance-linked derivatives (including weather derivatives) and contingent capital structures. These innovations may be applied in order to improve the integrated risk management process in the non-financial companies in two ways: (1) as an alternative (substitute) to traditional risk management instruments (e.g. insurance policy) conditional upon their efficiency (similar protection at lower costs or better protection at comparable costs); (2) as a complementary solutions to traditional instruments, if they provide access to tools and mechanisms not available directly by the application of traditional solutions.

However, there are many constraints, both on the supply and demand side of the ILS market that limit their application by non-financials. Further research may be focused on the analysis of the solutions that can be applied in order to overcome these problems and improve the development of the ILS innovations offered to non-financials.

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Keywords:

management, financial innovations, non-financial companies, insurance-linked securities, cat bonds, insurance derivatives, weather derivatives, contingent capital

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