

# Insurance in the banking system of the Kyrgyz Republic

## Seguros en el sistema bancario de la República Kirguisa

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### Abstract

This article discusses the current state of the insurance system in the banking sector of the Kyrgyz Republic. The weakness and underdevelopment of the insurance market of Kyrgyzstan does not contribute to the effective insurance of major banking risks, therefore, closer interaction between the banking and insurance communities is necessary to develop effective tools for insurance protection of banking risks, except for those that are directly established and implemented by the National Bank of the Kyrgyz Republic.

**Keywords:** Insurance, credit system, banking system, banking risks

### Resumen

Este artículo analiza el estado actual del sistema de seguros en el sector bancario de la República Kirguisa. La debilidad y el subdesarrollo del mercado de seguros de Kirguistán no contribuyen al seguro efectivo de los principales riesgos bancarios, por lo tanto, es necesaria una interacción más estrecha entre las comunidades bancarias y de seguros para desarrollar herramientas efectivas para la protección del seguro de los riesgos bancarios, a excepción de aquellos que son directamente establecido e implementado por el Banco Nacional de la República Kirguisa.

**Palabras clave:** seguros, sistema de crédito, sistema bancario, riesgos bancarios.

## 1. Introduction

In the formation and development of economic relations, one of the most important roles is played by the banking system, which is a combination of various types of commercial banks, financial and credit institutions, individual economic organizations, as well as their interaction. The largest share of risks in the banking system is associated with active operations - lending and with obligations - attracting deposits (deposits) from individuals and legal entities. Regarding the protection of depositors, a deposit protection system operates, which is managed by the Deposit Protection Agency. In order to guarantee to domestic entrepreneurs a part of the

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required loan amount in case of insufficient collateral for loans in banks and leasing agreements, the Guarantee Fund OJSC was created. It is well known that the stability of the banking system is the basis of the general economic security of the state. One of the instruments contributing to ensuring such stability is insurance, which is traditionally divided into two types: general and insurance directly against bank risks. At the same time, the need for insurance protection is experienced not only by financial institutions, but also by business entities, citizens involved in banking services and activities.

The functioning of the banking sector belongs to the category of economic activity where the presence of risk in the relationships between entities is permanent. At the same time, as already noted, the bank's losses (additional costs) associated with the loss of property as a result of natural disasters; unlawful actions of third parties, other events not associated with banking operations, and banking risks themselves are subject to differentiation. The latter, in the opinion of a number of researchers, are characteristics of the bank's activities, expressed in cost terms, which, when banking operations are carried out, show uncertainty regarding future cash flows, the likelihood of losses or an increase in costs (loss of revenue), compared with projected data [Kozlova, 2014]. For example, the National Bank of Kyrgyzstan refers to bank risks such types as: credit, market, price, interest rate risk, currency risk, country risk, including transfer risk and sovereign risk, as well as operational risk, liquidity loss risk, loss reputation, compliance risk, concentration risk, risk of FTD / LPD, risk appetite.

The purpose of this study is to determine the role and need of the insurance system in the banking sector.

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## 2. Methodology

In the course of the study, we applied general research methods of scientific abstraction, logic and system-based approaches, methods of comparison; analysis, synthesis, we also analyzed and took into account the extensive experience of developed economies. The analysis method has already been partially implemented in relation to the issue under study since there are several studies that specifically refer to the private potentials constituting the insurance. However, the problem of fragmented results of these works remains unsolved; therefore, they require further systematization, correction, and generalization

### 2.1. Materials

The works devoted to the development of the insurance system in the banking sector, risk assessment, its use and development at the regional, national and international levels, as well as our own data obtained during the research results, served as the primary source materials for this study.

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## 3. Results

Due to the fact that a significant part of the resources in the banking system is formed by customer deposits, the issue of protecting the latter from risks seems relevant for any state, especially during times of crisis. In the Kyrgyz Republic, relations on the formation and operation of a system of mandatory protection of deposits of depositors in commercial banks, the organization and use of the Deposit Protection Fund, and the payment of compensation in the event of warranty cases are regulated by the Law of the Kyrgyz Republic "On the Protection of Bank Deposits (Deposits)". To achieve the above objectives, the Government of the Kyrgyz Republic established the Agency for the Protection of Deposits, which is an independent non-profit organization. Here we must immediately emphasize that in world practice such terms as "insurance" and "guarantee" are used. As part of a subsequent study of this issue, the concepts of "deposit insurance" and "deposit protection" will be considered by us as synonyms.

Upon the occurrence of a warranty case, i.e. commencement of compulsory liquidation of the bank, each depositor, who is an individual who has a deposit in this financial-credit organization, or an individual

entrepreneur who does not have the status of a legal entity and who has placed his money in bank accounts in connection with the activity, is paid compensation within 200 thousand som in aggregate, which includes interest on deposits. The level of insurance protection of Kyrgyz depositors as defined by law seems to be minimal and significantly lags behind not only the world, but also, for example, the standards of the member states of the Eurasian Economic Union (EAEU), of which the Kyrgyz Republic is a member.

It should be noted that the approaches to determining the optimal amount of insurance compensation for deposits are based on the principle of congruence of the size of this compensation to the level of economic development of the country and incomes of the population, which as a result contributes to the effective implementation of its basic functions by the insurance system. After the global financial crisis of 2008, in many states there was a tendency to increase guarantees on deposits as a preventive measure to maintain the stability of the banking sector. With an increase in insurance, the financial market and society receive, in general, a positive signal - the banking system is reliable and safe. At the same time, in some foreign studies, full reimbursement of deposits is considered as a temporary measure necessary in the face of acute banking crises, and a phased transition to a limited amount of compensation is recommended [Demirgüç-Kunt, et al., 2015]. In connection with the foregoing, we believe that one of the existing problems in the development of a client deposit insurance system in the banking sector of Kyrgyzstan is finding the optimal limit for compensation payments to depositors.

As a number of researchers indicate [Kononenko, 2018; Oskolkova, 2016], another of the significant principles of the deposit protection system is the speed of compensation payments. In the Kyrgyz Republic, the payment of compensations must begin no later than 30 calendar days after the occurrence of the warranty case. In the event of a trial regarding a warranty case, compensation will not be paid until a final decision of the court is issued, which is not subject to further appeal. Payment of depositors' funds may be suspended if there is a criminal case against the latter regarding the legalization (laundering) of proceeds from crime and / or the financing of terrorist activities until the criminal case is terminated or the court makes a final decision.

Note that according to the Fundamental Principles for effective deposit insurance systems, states should strive to provide investors with access to their funds within 7 business days from the occurrence of the insured event. Currently, these countries include: USA and Canada (1 business day), Brazil (3 business days), Argentina (5 business days), South Korea, Australia (7 business days). For example, in Russia, the law establishes a three-day period of compensation payments from the day the depositor submits the relevant documents to the Deposit Insurance Agency, but no earlier than 14 days from the date of the insured event. Individuals in the Republic of Belarus have the right to apply for insurance payments no earlier than 14 days and no later than two years from the date of formation of such an obligation with the Agency for guaranteed reimbursement of bank deposits (deposits). In connection with the foregoing, we believe that in Kyrgyz legislation, you can find options for a significant reduction in the terms of compensation payments and optimization of the procedure for the latter.

Thus, the analysis of bank deposit insurance in Kyrgyzstan makes it possible to conclude that, given the current state of the national economy and the banking sector, a quite workable system has been developed to protect the population's investments in financial and credit organizations. At the same time, a number of areas for improving the latter should be highlighted.

1. An increase in the total amount of insurance compensation. In many world states, one of the most common recommendations is to increase insurance coverage. The Ministry of Economy is already introducing amendments to the Law of the Kyrgyz Republic "On the Protection of Bank Deposits (Deposits)" for public discussion regarding the increase of compensation to depositors of commercial banks up to 300 thousand som, while leaving the previous amount of 200 thousand som to MKF clients. However, as mentioned earlier, the amount of insurance compensation in Kyrgyzstan is significantly lower than in the member countries of the

Eurasian Economic Union. Therefore, in our opinion, a more harmonized innovation would be to determine the limit of compensation payments of 500 thousand som for commercial banks, and 300 thousand som for IFC and HBC, regarding deposits in national currency, leaving the previous level of 200 thousand som for deposits in foreign currency. In this case, annual indexation of the maximum amount relative to the inflation level should be provided.

We believe that the above will contribute more to the growth of the deposit base of financial and credit organizations, increase the degree of protection of depositors and will have a positive impact on public confidence in the country's banking system. Moreover, the current level of adequacy of FZL funds is currently gradually approaching the standards of the EAEU.

2. Differentiation of insurance premiums of participants in the deposit protection system. An increase in the amount of guaranteed compensation on deposits (deposits) will encourage bank customers to place their funds in financial and credit organizations that offer higher interest on deposits than competitors. In order to balance the banking system, it is proposed to establish a differentiated scale of contributions for banks depending on the risk level of participants in the deposit protection system, the size of the organization (small, large), interest rates, and also the structure of deposits in correlation with their amount and placement periods. An approximate range of contributions may be equal to 0.2-1.0% of the total guaranteed deposits of this subject of the banking system.

3. Providing guarantees on the repayment of deposits (deposits) using alternative mechanisms to insurance. Many authors consider it possible to use such an alternative mechanism as the bail-in procedure, which was carried out in some European countries (Cyprus, Portugal, and Greece) during crisis periods [Kononenko, 2018]. This procedure involves converting the placed funds of the bank's customers into bonds or shares and shifting the burden of saving the credit institution to the shareholders and creditors of the latter. A number of works by Russian and foreign scientists substantiated the need for the introduction of a bail-in system [Kornilova, 2016], which has already been tested in practice in the USA and the EU. The use of the bail-in mechanism in Kyrgyzstan will provide an opportunity to protect the interests of large investors, since when you revoke a license from a financial-credit organization, only 200 thousand som will be returned. Presumably, it is worth determining the distribution of bail-in on deposits of more than 10 million som. It seems that in a critical situation in the context of insufficient funds to pay compensations to bank customers, one of the compromise options may be to replace the requirements for a fixed-rate bond loan.

4. Expanding the authority of the Deposit Protection Agency. The implementation of directions for improving the system of protection of deposits (deposits) requires the provision of ADA with additional powers and functions. Thus, the Agency for the Protection of Deposits should receive the right to directly supervise the activities of financial and credit organizations, independently verify and apply sanctions regarding its field of activity, and participate in decisions and procedures for liquidating insolvent banks. At the same time, for the adoption of certain regulatory legal acts, the National Bank of the Kyrgyz Republic will need approval with the AZD. The functioning of the Agency for the Protection of Deposits (Deposits) should be as transparent as possible, and the official website - more informative.

Regarding the issue of introducing insurance cover for legal entities, which has been discussed for a long time in the scientific community and among experts from EAEU countries [Gorovec, 2015], we consider this proposal to be premature, especially in the current economic conditions in the Kyrgyz Republic. As some researchers correctly note [Urazova, 2017; Chelyuskin, 2019], medium and large business entities are not vulnerable when entering into certain financial and economic relations. It is understood that they have the ability and ability to quite realistically recognize, evaluate and predict entrepreneurial, including financial, risks in accordance with

their own criteria. A special point is that, as a rule, the main risk of medium and large business lies outside the banking sector - in the relations between manufacturers, sellers, buyers and other market participants.

One of the main risks that accompany banking is credit risk, which is the possibility of loss of a bank's financial asset as a result of a borrower's default on credit obligations. It should be noted that the country's commercial banks have achieved some success in the field of credit risk management and its reduction, [Gorovec, 2014] using various methods and tools. In addition to the RPPU established by the National Bank of the Kyrgyz Republic, this method acts, first of all, collateral for the loan, especially when providing large sums of money. This method is quite popular not only in the banking environment of Kyrgyzstan, but also throughout the world, since collateral (mainly immovable and movable) to the maximum extent reduces the risks for a financial institution, and the bank, in turn, can obtain a loan for more interesting and favorable conditions. However, with collateral there are own risks, among which there are:

- risks associated with the value of the subject of the pledge (inadequate assessment, the effect of depreciation, cost reduction over time, etc. factors);
- risks associated with the complete or partial loss of the subject of the pledge or its properties, reliability (physical loss, difficulty in monitoring, legal errors and other factors);
- risks associated with the liquidity of the pledged item (decrease in demand, changes in the market cycle, etc. factors) [Tishchenko, 2018].

A special place in the banking risk management system, including credit, is insurance, the essence of which is that upon occurrence of an insured event and non-repayment, for example, to a bank of credit by an unscrupulous borrower, and also the inability to recover funds from the latter, insurers compensate financially credit organization losses in accordance with the existing credit risk insurance contract.

Today, in Kyrgyzstan, credit risk insurance of banking system entities is not widespread due to a number of reasons, among which the main ones are: reluctance of commercial banks to incur additional insurance costs (a rather expensive way), weak national insurance market, low capitalization of insurance companies relative to banking sector, as well as the lack of potential insurers full information about the creditworthiness of a borrower. As a rule, when providing consumer loans, commercial banks oblige to insure the life of the borrower. Some credit organizations provide such insurance as bonuses. For example, Bank of Asia CJSC offers its customers, upon lending, free life or car insurance (CASCO). OJSC "Bakai Bank" includes the auto-acquired auto + insurance or real estate, guarantee in the provision of a car loan. Kyrgyzkommertsbank OJSC establishes compulsory car insurance + a pledge of the movable property itself (at the expense of the client) when providing a car loan. When mortgage lending within the framework of the Government of the Kyrgyz Republic Affordable Housing 2015-2020 Program is subject to mandatory annual insurance, the subject of a mortgage loan, which acts as housing, is provided by the State Insurance Organization OJSC in accordance with the Law of the Kyrgyz Republic "On Compulsory Insurance of Residential Premises from Fire and Natural Disasters". For affordable conclusion of insurance contracts, the State Insurance Organization has entered into agency agreements with such financial and credit organizations as: Aiyl Bank OJSC; OJSC "Bakai Bank"; Bank of Asia CJSC; CJSC Companion Bank; Dos-Credo Bank OJSC; OJSC "Capital Bank" OJSC "RSK Bank".

One of the specific forms of credit insurance in the banking system of Kyrgyzstan, in our opinion, is the provision of guarantees to domestic entrepreneurs on bank loans and leasing agreements for part of the required loan amount in case of insufficient collateral. To this end, in 2016, the Guarantee Fund (hereinafter - the Global Fund) was established, the activities of which are regulated by the Law of the Kyrgyz Republic "On Guarantee Funds in the Kyrgyz Republic", as well as the regulatory legal acts of the National Bank of the Kyrgyz Republic.

The guarantee fund assumes responsibility for non-fulfillment or improper fulfillment by the bank client of the obligation secured by the guarantee in a subsidiary form in the amount specified in the guarantee agreement. At the same time, in terms of payments by the client of interest, penalty, , commission, the Global Fund does not provide guarantees. There arises the liability of the guarantee fund for the fulfillment of the client's obligations to the credit institution in case the latter violates the terms for repayment of financing. After confirming the fulfillment of the conditions defined by the current legislation, the Global Fund repays the debt under the terms of the guarantee agreement at the expense of this fund. When a guarantee fund repays customer debt under a financing agreement, it acquires all the rights of a financial and credit organization under a financing agreement in the amount of fulfilled obligations. The guarantee fund also receives the right to demand from the borrower the reimbursement of the amount of money paid to the financial and credit institution in fulfillment of the obligation under the guarantee agreement, in recourse, in accordance with the civil legislation of the Kyrgyz Republic. In this case, one can observe a significant discrepancy between the activities of the Global Fund and insurance in its classical sense.

For 2017-2018 this Guarantee Fund has demonstrated the effectiveness of the guarantee system for insufficiency of collateral

**Table 1**  
Key performance indicators of JSC "GF" for 2017-2018.

Name of indicator	2017	2018	growth rate
The number of guarantees, units	234	656	2.8 times
Volume of issued guarantees, million som	246,0	755,0	3.1 times
Volume of issued loans, million som	966,0	2752,0	2.8 times
Refundability of guarantees provided, %	99,9	99,9	100
Created new jobs (units)	486	1225	2.5 times
Supported by existing jobs (units)	1251	5887	4.7 times

Source: <http://gf.kg/about/godovoj-otchet/>

At the initial stage of its existence, this guarantee system allows attracting additional banking resources to the real sector of the economy, generally positively influencing both the banking system and the activities of small and medium-sized businesses. At the same time, despite a certain similarity between the functioning of guarantee funds and insurance activities, the latter cannot and should not replace the concept of "credit risk insurance".

For the Kyrgyz banking system, this policy is not common. Domestic financial and credit organizations prefer not to disclose information on internal business processes and cash flow, which is necessary for the insurer to determine the cost of the BBB policy. Other reasons for the unclaimed demand by banks of the above comprehensive insurance may be the relatively high price of insurance and the development of bank insurance, which enables banks to earn money on the sale of insurance products and shift insurance costs to their customers. An example is, as already mentioned, the life insurance of a borrower that accompanies a loan agreement (consumer, etc.).

Different types of insurance of operational risks are offered by such few insurance companies of the Kyrgyz Republic as:

- CJSC IC “Kyrgyzstan” (insurance of financial and commercial risks);
- CJSC IC Jubilee Kyrgyzstan Insurance Company (comprehensive banking insurance Bankers Blanket Bond);
- Insurance company NSC CJSC (insurance of financial risks);
- CJSC IC ATN Policy (comprehensive insurance of banks);
- CJSC IC Arsenal-Kyrgyzstan (insurance of commercial and financial risks).

Insurance companies of the republic provide insurance coverage against only a small part of banking risks, a large share of which is regulated by the National Bank of the Kyrgyz Republic through its various regulatory requirements. For example, to minimize currency risk, financial and credit organizations establish a mandatory requirement to comply with the open currency position limit, and instant, current and long-term liquidity ratios are communicated to commercial banks to reduce liquidity risks.

So, according to the reports of the National Bank of the Kyrgyz Republic, the results of the “reverse” stress testing of liquidity risk, interest rate and currency risks show that:

- the real volume of liquid assets of the banking sector is capable, as of the end of 2018, of covering the outflow by an average of 31.9% of the total volume of deposits and non-financial enterprises;
- in the banking sector there is a slight sensitivity to interest rate risk. Decrease in the average level of interest rates on loans by 15.3 percentage points may reduce capital adequacy to a threshold of 12%. The banking sector has a low level of interest rate risk;
- the domestic banking industry has a low risk of revaluation of assets and liabilities, confirming the presence of low sensitivity to currency risk, the impact of which the country's commercial banks are able to withstand.

Thus, at present, credit risk insurance in the banking system of the Kyrgyz Republic is in its infancy and determines the need for closer interaction between the banking and insurance communities to develop effective tools to protect banking risks, except for those that are directly established and implemented by the National Bank of the Kyrgyz Republic.

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## 4. Conclusions

Speaking generally about the development of insurance in the banking system of the republic, we can state certain successes in improving the efficiency of the deposit (deposit) protection system, in introducing a special instrument to guarantee the insufficiency of collateral, as well as in developing bank insurance, i.e. transferring part of the functions of the insurance company for the sale of insurance products to a commercial bank as an intermediary, which is especially evident in consumer insurance. At the same time, the weakness of the insurance market in Kyrgyzstan does not contribute to the effective insurance of major banking risks and, therefore, to the **improvement of the activities of banking institutions.**

The progressive movement of the banking sector of the national economy is impossible without the introduction of insurance market instruments that contribute to meeting the insurance protection needs of not only financial and credit institutions, but also of citizens, business entities, other legal entities and the state, as well as the accumulation of long-term investment resources for the development of the state economy generally.

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