

Discussion on Internal Control of Insurance Companies

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Abstract. In recent years, insurance institutions have gradually increased, their business structures have become increasingly complex, and their underwriting coverage has continued to increase. The insurance industry's function of boosting the economy and ensuring social stability has been continuously enhanced, which has prompted insurance companies to better implement new development concepts and explore high-quality development paths. However, in the development process of the insurance industry, some companies have neglected internal controls in order to maximize their business scale, leading to a sharp increase in the probability of risk occurrence. This article analyzes the current operational characteristics of insurance companies, points out the problems existing in insurance companies, and provides corresponding suggestions to improve the effectiveness of internal control. It emphasizes the necessity of internal control for the development of insurance companies, and hopes to help them improve their governance level and achieve healthy, stable and positive development.

Keywords: Insurance Company, Internal Controls, Risk Management.

1. Introduction

With the further deepening of China's economic reform, enterprises and residents are gradually increasing their risk awareness while investing towards diversification and specialization. Although the rapid growth momentum of the national economy has slowed down, due to the significant gap between China's insurance density and depth and the world average, the development potential of China's insurance market is great.

However, during the development process of major insurance companies, market fluctuations, the introduction of relevant national documents, and insufficient internal construction of enterprises may hinder the pace of insurance company development, exposing more risks and hidden dangers. Insurance companies should analyze the effectiveness of internal control from their own perspective and propose targeted suggestions to improve the overall governance level of the company.

2. Necessity Analysis of Internal Control in Insurance Companies

2.1. The Meaning of Internal Control

Internal control refers to the establishment of management methods through the establishment of a series of systems. It appears in the daily operation and management activities of enterprises to strengthen management and reduce the occurrence of risks through a series of behaviors. Internal control is a series of top-down evaluation, supervision, and control schemes implemented by enterprises to achieve business management goals, ensure asset safety and integrity, ensure legal and compliant business management, and improve efficiency of business management. In 2008, the Ministry of Finance of China, together with the China Securities Regulatory Commission, the National Audit Office, the China Banking Regulatory Commission, and the China Insurance Regulatory Commission, formulated the Basic Standards for Internal Control of Enterprises in accordance with the COSO reporting system. This standard combines the actual situation of enterprises in China, integrates the development ideas of internal control, and elaborates on the meaning of internal control. It refers to a series of activities jointly implemented by the board of directors, management, and all employees of the enterprise, with the aim of ensuring the achievement of operational efficiency and effectiveness, the authenticity, reliability, and completeness of

enterprise management information and financial reports, and the safety and completeness of assets. Comply with relevant national laws, regulations, and regulatory requirements. In 2010, the China Insurance Regulatory Commission issued the "Basic Guidelines for Internal Control of Insurance Companies", which is an authoritative document targeting the insurance industry, with the aim of strengthening internal supervision of insurance companies and improving their operational efficiency.

2.2. The necessity of implementing internal control management in insurance companies

There are four principles and five objectives for internal control of insurance companies. The four principles are: unity of comprehensiveness and focus, unity of checks and balances and collaboration, unity of authority and adaptability, and unity of effective control and reasonable costs; The five major goals are: behavioral compliance goals, asset security goals, information authenticity goals, operational effectiveness goals, and strategic security goals. This standard provides detailed explanations and regulations on the four principles and five goals based on the operational characteristics of the insurance industry itself, and the core of the continuous operation of the insurance industry is to protect the legitimate rights and interests of insurance companies, shareholders, insured persons, and other stakeholders.

According to the relevant data of the insurance industry released by the China Banking and Insurance Regulatory Commission, the balance of insurance fund utilization in 2022 was 25.05 trillion yuan. As of the end of the first quarter of 2023, the balance of insurance fund utilization in China's insurance industry was 26.02 trillion yuan, which has shown a significant growth compared to the entire year last year. This indicates that there is great room for development in the future market of China's insurance industry. It is worth studying whether insurance companies can timely improve their internal control systems in accordance with regulations in the fierce market competition to prevent risks and improve enterprise efficiency. However, the theory of internal control in China lags behind practice, but the path of exploration has been ongoing. At present, the theoretical research on internal control in foreign countries has a century of history, and the research is relatively mature. There are also many case studies that can support the internal control of insurance companies. On the contrary, in China, research on the effectiveness of internal control has only gone through more than thirty years, and the theory is not yet mature and in a few cases. If enterprises want to achieve healthy and sustainable development, the role of internal control cannot be ignored. Especially in the insurance industry, a special industry with risk management as its business process, the three major links of sales, underwriting, and claims settlement are highly prone to internal control risks. In order to prevent risks during the insurance process, insurance companies need to strengthen the management of internal controls.

3. Analysis of the Current Situation of Internal Control in Insurance Companies

3.1. Incomplete internal control environment

The insurance industry has been developing in China for more than 30 years. Over the past 30 years, the country has introduced relevant policies to regulate the behavior of the insurance industry, but there are still some enterprises that excessively pursue rapid development, pay more attention to premium income and the market size they occupy, and neglect compliance in the insurance transaction process. The internal control system is relatively chaotic. This is manifested in two aspects: firstly, the division of responsibilities between the company's management and employees is not clear enough. Conflicts between departments may arise between businesses and projects for their own interests, and some department employees may need to accept dual leadership, which may lead to inadequate information dissemination, low work efficiency, and lengthy work processes. Secondly, the cultural level and comprehensive quality of internal control personnel in the insurance industry are not uniform, and their understanding of the new rules of insurance internal control is vague, which

is not conducive to enterprise management. The quality of managers is directly related to the future development prospects of enterprises. If the quality of management is not high, it may lead to decision-making errors and thus lose the effectiveness of internal control guarantees.

3.2. The risk management process is not sound

Although most insurance companies have established risk management systems and departments related to risk management, there is still a lack of systematic risk management methods. Financial risk, credit risk, operational risk, legal risk, etc. will change with changes in the political and economic environment, which are unforeseeable and cannot be ignored. Moreover, the internal audit department did not evaluate the probability, triggering factors, and impact of risk occurrence, lacking quantitative indicators.

3.3. Inadequate execution of internal control activities

The control activities of insurance companies are mostly concentrated in three aspects: sales, underwriting, and claims processing. For the sales process, the behavior of enterprise management and sales personnel should be further strictly required in accordance with the laws of the market and industry norms. Otherwise, it is easy to induce illegal behavior towards customers, such as introducing false products to mislead customers to purchase insurance, signing contracts on behalf of them, illegally encroaching on customer compensation, etc., which can easily cause insurance disputes and have a negative impact on insurance companies. In the underwriting process, some agent sales personnel may not conduct excessive investigation of customer information during underwriting in order to achieve higher performance, and may accept customers who do not meet the standard underwriting or conditional underwriting as normal underwriting customers. This potential risk may cause financial losses and reputation losses to the insurance company. In the claims process, some sales personnel, in order to retain key customers for their own performance, give concessions to claims applications that are not within the scope of claims, increasing the cost of claims and causing losses to the company. Insurance companies may still have insufficient prevention measures for major and difficult cases, lack targeted identification standards, division of responsibilities, and handling methods, which may result in false claims or claims being rejected.

3.4. Incomplete supervision mechanism

In order to better operate the internal control system, insurance companies need to implement effective internal supervision measures. The internal control effectiveness evaluation and supervision mechanisms established by the internal audit departments of some companies have not been effectively implemented, resulting in untimely and inaccurate identification of internal control risks. The overall management work of the company is slow, and the accountability mechanism is not coherent and in place. Moreover, the internal audit and supervision departments of insurance companies lack sufficient personnel and professional internal control management skills, resulting in repeated violations and inadequate rectification.

4. Suggestions for Insurance Companies to Improve Internal Control

4.1. Optimizing internal control environment

The optimization of the internal environment and a reasonable organizational structure are particularly important. From management to employees, they should clarify their job responsibilities, adhere to the principle of incompatible positions, maintain independence between each position, and prevent the occurrence of fraud. Clear responsibilities of each position can improve employee work efficiency, enhance management efficiency, and promote the implementation of corporate strategy.

The managers of enterprises have the right to make management decisions, and their ideas determine the cultural atmosphere and development direction of the enterprise. Company managers

should learn new internal control theories, transmit a corporate culture that emphasizes the construction of internal control systems and risk management from top to bottom, improve the scientificity and execution of internal control, and guide management and sales personnel to reasonably avoid and manage risks. Provide systematic training to the company's internal control dedicated personnel to improve their overall quality and enhance their awareness of internal control and risk management. In addition, insurance companies can hire technical experts related to internal control to provide professional and standardized technical guidance

4.2. Building a comprehensive risk warning system

When conducting risk assessment, more professional and rigorous methods can be considered. For example, hiring a professional team to provide more professional suggestions for the core and technical depth of the internal information system of an insurance company can help risk management department personnel better evaluate risks. Design an internal control effectiveness evaluation questionnaire, and determine the standard value and reasonable range of each early warning indicator for its survey indicators. Relevant personnel will analyze the results through quantification to prevent subjective assumptions about internal control risks and truly discover and effectively prevent risks. When the risk warning system sends signals, specific response measures should be developed for each different risk.

4.3. Standardizing business processes

Building an associated application between financial and business systems can enable managers to better grasp the financial and business conditions of the enterprise, achieve information exchange between financial and business departments, and share data to ensure good information communication for internal control. The specific measures are as follows: Firstly, upgrade and transform the internal system, strengthen the connection between the two, and make information transmission smoother. Secondly, the finance department and business department hold regular meetings to communicate and exchange opinions on major issues.

For the sales process, insurance companies should strictly comply with national policies and regulations, collect premiums according to standard ratios, and need to raise the entry threshold for insurance sales personnel, improve their quality, and strictly regulate insurance sales behavior through systematic training. For the underwriting process, a comprehensive internal audit and evaluation mechanism should be established to conduct sufficient research on the true information of policyholders. Secondly, relevant departments should combine the actual insurance cases in China to improve and optimize relevant laws and regulations, providing guidance for the development of the insurance industry. For the claims process, insurance companies should strictly follow the contract agreement to make compensation and conduct accident investigation and evidence collection. If necessary, third-party organizations can be introduced to conduct accident investigation to ensure the authenticity of the results.

4.4. Improving the supervision mechanism before, during, and after the event

Establish and improve the internal audit work mechanism, clarify the relevant responsibilities of internal audit department staff, promote the fair performance of internal audit personnel in accordance with industry regulations, and improve the quality of supervisory department personnel to improve the quality of internal audit. At the same time, we will optimize the accountability mechanism, strengthen the punishment of violations, and never be soft on accountability for violations. We will link violations with performance and assign responsibility to specific individuals, so that the internal control system can be effectively rectified.

5. Conclusion

The essential business model of insurance companies belongs to high debt operation, and the company's operational problems are not only financial problems, but also financial risks that the company will face. This is also the key reason for the difficulty of internal control management in insurance companies. Therefore, by analyzing the problems in internal control, responding to risks reasonably, possessing scientific management methods and business models, continuously deepening internal control reform, improving business management level, and enhancing one's core competitiveness, the entire insurance industry can be urged to develop towards a healthy and orderly direction.

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