TRENDS IN THE REINSURANCE SECTOR IN THE CONTEXT OF FINANCIAL INTEGRATION

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Abstract: The article deals with the problems of insurance integration processes in the EAEU. The strategic directions of state regulation of the reinsurance market of the Republic of Belarus have been identified. It is determined that there is no a single legislative act regulating reinsurance activities in Belarusian legislation. State regulation of reinsurance relies on the current insurance legislation. The analysis of financial stability in EAEU is based on the Solvency I criteria.

In the EU countries the risk-based approach to financial stability for the insurance sector is offered. However, neither of these approaches can be fully applied in the Republic of Belarus due to the methods of the analysis, which are based on hypothetical scenarios of market developments and may have a high degree of unreliability. It is determined that in reinsurance, it is necessary to assess the reliability of a reinsurance organization not only on the basis of an analysis of financial indicators, but to

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make a complex study of the financial stability of a reinsurer. It was concluded that the above methodology makes it possible to objectively analysis of a reinsurer reliability and can help to develop a set of measures aimed at raising it.

Keywords: State regulation, reinsurance, financial stability, reliability rating of reinsurers, integration, reinsurance development

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Introduction

In modern economic conditions, insurance becomes the determining instrument for the state development in terms of protecting the interests of society and the economic and production activities of business entities from adverse events of various kinds. In turn, during the insurance period most companies do not have the opportunity to create a balanced portfolio of risks that would exclude the possibility of minimizing the potential losses. In order to equalize the scope of liability for the insured risks and ensure financial stability of the insurer, reinsurance operations are applied. The reinsurance market is an important part of the financial system and serves as a financial stabilizer designed to ensure the sustainable development of insurance companies and the country's economy.

As an international business in its essence, reinsurance along with the equalization of insurance portfolios by the size and geography factors provides additional capacities for accepting especially large and dangerous risks. When the international activities of reinsurance companies appear to be at odds with the national security, it is extremely important to organize the effective control over the actions of reinsurers. There are certain difficulties here, because when a company starts working in several countries, it works and is institutionally organized, based on two opposite principles: the centralization of financial resources and the decentralization of the functional management in the territorial aspect in order to take into account local characteristics and market conditions.

In 2014, the Eurasian Economic Commission (EAEU) made the introduction of a common system of reinsurance in the EAEU as a priority direction. This idea was further developed within "The concept of the reinsurance capacity creation in the EAEU and the removal of barriers for cross-border reinsurance". This document assumes the creation of a state reinsurance organization or a cross-border company on the basis of several public-private partnerships and a pool of commercial participants in the insurance market. Such a reinsurance organization will accept risks, reinsurance of which within each state is impossible or inappropriate. The concept of building a common system of reinsurance in the Eurasian area was approved by the professional insurance associations of the Republic of Belarus, the Republic of Kazakhstan and the Russian Federation. Thus, the creation of a single reinsurance capacity is a paramount aspect of the integration of insurance markets at the moment.

1. The reinsurance market regulation in the Republic of Belarus

State reinsurance regulation is a mechanism of targeted impact of the state on the variety of the economic relations that arise between the subjects of the reinsurance market through the system of administrative, legal and indirect methods with the aim of achieving the development priorities of the insurance sector as a whole.

The following strategic directions of state reinsurance market regulation in the Republic of Belarus can be distinguished:

1) The guarantee of the obligations' fulfilment by the subjects of the reinsurance market. This direction is the key in the mechanism of state insurance regulation, and its objective is the formation of a mechanism for regulating the financial stability of insurers and reinsurers;

2) The reinsurance market development and the increase of its competitiveness in the conditions of ongoing integration processes. This direction unites such tasks as the creation of a reliable reinsurance mechanism, the increase in the number of objects covered by reinsurance protection, capitalization growth and the reinsurance market capacity, the formation of a healthy competitive environment in the international activities of reinsurers, the infrastructure of the reinsurance market development, the stimulation of innovations in the insurance sector etc.

The indicated directions only define the general strategy and represent various aspects of reinsurers' activity regulation, as well as other participants of the insurance and reinsurance markets.

Today in the Republic of Belarus there is no clearly structured and effective mechanism of the financial stability regulation of the reinsurance market subjects. When analysing the financial stability of a reinsurance organization, the same legal acts are used as in the analysis of the financial conditions of an insurance organization. At the same time, the reinsurance market specifics are not singled out.

In the national legislative framework of the reinsurance market, the rules defining the place of reinsurance operations in the insurance market are introduced. In particular, it is established that a special license is required to carry out solely reinsurance operations. The minimal authorized capital of a specialized reinsurance company is 5 million euros. Legislatively it is determined that reinsurance is one of the elements of ensuring financial stability of primary insurers. However, the financial stability entrance regulations for the reinsurers only allow the companies to legitimately start work in the insurance market.

The current state regulation practices on financial stability of the companies that carry out reinsurance in the Republic of Belarus are based on the fulfilment of three basic conditions: availability of paid authorized capital, sufficient insurance reserves, the subsequent retrocession system inclusion. In our opinion, those conditions should not be the only ones that can determine the financial stability of reinsurers in the new conditions of a functioning insurance market.

The following principles of financial stability management of a reinsurance organization can be distinguished:

- the recognition of the dynamic diversity of the reinsurer's capital structure, which corresponds to the international scale of its activities;
- considering the high number of risks that form the situation of uncertainty;
- the reasonable decision-making, based on the analysis of existing options for the development of the situation and the selection from their number of the optimal option that ensures the achievement of a given level of the complex of financial indicators;

- flexibility, which implies the ability of a reinsurer to react quickly and adequately to changes in the external and internal environment;
- balancing financial goals, resources and results;
- recognition of the need to systematically improve the analysis and financial sustainability estimation, taking into account the ongoing integration processes in the reinsurance markets.

Despite the fact that there is no legislative act directly regulating the reinsurance market in the Republic of Belarus, this does not give grounds for an assertion that reinsurance relations are not subject to state regulation, since reinsurance is regulated by the insurance legislation norms. In order to ensure the sustainable development of the reinsurance market and the insurance sector as a whole, there is a need in a balanced approach to choosing methods for the financial stability regulation of market participants, ensuring their compliance with the goals and conditions of the insurance sector development and the external environment and regulating them at the legislative level.

2. The approaches to the reinsurance market regulations harmonization in the EAEU

The economic relations development has reached a stage where there is a tendency to bring reinsurance markets of different countries closer together and to unify their rules and entrance requirements. However, the uneven development of national insurance systems accounts for certain difficulties in the legislative process. In this regard, the harmonization of legislative norms within the EAEU countries is necessary for the unification of implemented reinsurance rules. The following approaches to the harmonization of reinsurance market regulations harmonization in the light of the ongoing integration processes can be outlined:

1) the integration can be carried out on the legislation improvement basis in the context of global trends;

2) the most progressive integrated regulatory systems can be adopted with the integration of reinsurance regulating systems for a basic model;

3) the formation of a regulatory system based on a complex of several highly developed regulatory systems and the subsequent adaptation of the legislative base of the acceding participants.

At the same time, the integration of national reinsurance systems will be effectively implemented in case of its stage by stage implementation.

The necessity to integrate reinsurance systems in the Eurasian Economic Union territory is objective, since the reinsurance transactions and other economic relations on the international level have higher costs, which are not determined solely by the current state of the insurance markets, but also on the basis of existing barriers. It should be noted that currently the insurance markets of the Eurasian Economic Union are characterized by high dependence on foreign reinsurers. As of October 1, 2015, 28.2% of the total insurance premiums were transferred to non-residents in Kazakhstan for reinsurance (of the total 32.9% transferred to reinsurance) (Interstate Coordination Council of Heads of Insurance Supervisory Authorities of the CIS Member States, 2017; National Bank of the Republic of Kazakhstan, 2016). In the Russian Federation, 12-14% of premiums were transferred to reinsurance, including 9-10% of all premiums which were transferred abroad (during the 2013 - the first half of 2015 period), about 48% of the premiums are transferred to retrocession in the Republic of Belarus and 60% of the premiums to foreign reinsurers (Investment company Eurofinance, 2015).

The creation of a common reinsurance market in the EAEU is going to ensure transparent and regulated conditions for the reinsurance companies within the Union, expand the access to reinsurance, develop national markets of member states, and remove barriers that impede the integration of the insurance markets of the partners in the EAEU. The formation of the common EAEU reinsurance market will be able to solve, first of all, the problem of reinsurance capacities, and will also help reduce currency risks and ensure the growth of national insurance and reinsurance markets.

In general, there are common approaches to insurance activities regulation, although the insurance legislation of each state has its own specific features. The assessment of the reinsurer's financial sustainability in the EAEU is based on the system of criteria represented in Solvency I. This system is based on the ratio between the actual and regulatory margin of a reinsurer's solvency. In general, the state supervision is expressed in the financial position assessment of the reinsurer and its solvency under the contractual obligations to the reinsurers.

In our opinion, the first major barrier in the integration process of reinsurance markets in the EAEU is the differences in the licensing process. In particular, for the recognition of a national license in another state, the parties must agree on the common minimum requirements to obtain a permission to carry out reinsurance activities.

In order to make a comparative analysis there is a necessity to examine the minimum capital requirements for reinsurers (table 1) (Spletukhov, 2015).

Table 1
Minimum capital requirements for reinsurers

State	Minimum capital requirements for reinsurers
Republic of Armenia	3M euros
Republic of Belarus	5M euros
Republic of Kazakhstan	5M euros
Kyrgyz Republic	3M euros
Russian Federation	8M euros

As depicted in the Table 1, the strictest requirements for the authorized capital of reinsurers are installed in the Russian Federation, the lowest requirements in Armenia and Kyrgyzstan. In our opinion, it is necessary to install a common minimum set of requirements for all the EAEU members, setting them in common currencies as well (for example, in euros), providing the adjustment with a transition period (in individual cases of an individual) to achieve better results. The number of additional requirements should be minimal. The existing restrictions on specific reinsurance transactions are presented in Table 2 (Interstate Coordination Council of Heads of Insurance Supervisory Authorities of the CIS Member States, 2017; Spletukhov, 2015).

Table 2
Reinsurance market restrictions in the EAEU

State	Reinsurance market restrictions
Republic of Armenia	Restrictions on the retrocession transfer of risks may be established by the Central Bank if, in its opinion, it is in serious financial condition or if risk reinsurance threatens the interests of policyholders, insured persons or beneficiaries.
Republic of Belarus	Retrocession transfer of risks to foreign reinsurers can only be done via RUE "BNRO". Insurance risk transfer to foreign reinsurers is allowed only in case the agreement with RUE "BNRO" exists. The share of risks associated with foreign reinsurers, in case of rejection by RUE "BNRO", should not exceed a certain limit, which depends on types of insurance.
Republic of Kazakhstan	Risks can be transferred through retrocession to foreign reinsurers. However, there are implementation restrictions on the reinsurance operations carried out by foreign reinsurance organizations: the rating should not be lower than "A" (Standard & Poor's) or a similar rating of the other rating agencies. On the reinsurance market, not more than 25% of the insurance premium received by the insurer can be transferred to non-residents (in general, no more than 60% of the insurance premium can be transferred to reinsurance).
Kyrgyz Republic	The insurance companies that carry out reinsurance via foreign reinsurance companies are obliged to place at least 5% of the insured risk on the Kyrgyz insurance market.
Russian Federation	Foreign companies that have the right to carry out reinsurance activities according to the legislation of the country where they are established may provide the reinsurance contracts with Russian reinsurers. RESTRICTION: One of the types of insurance coverage may be a share in the insurance reserves of a reinsurer: a non-resident of the Russian Federation, provided that it has a rating not lower than the level established by the Board of Directors of the Bank of Russia (there is no rating for residents). At the same time, the total value of this asset should not exceed 10% of the value of life insurance reserves and 40 or 50% (depending on the types of insurance carried out) of insurance reserves in other types of insurance.

As can be seen in the table 2, the most significant barrier to the integration processes in the reinsurance markets is rating requirements, which deprive reinsurers from the EAEU countries of the opportunity to work in each other's markets, regardless of the size of their authorized capital.

Therefore, the success of the project to create a common multinational reinsurance company will depend on many conditions, including the country in which a single company will be based, what rating it is going to obtain. If it is created via a pool of insurers, then there will also be questions about the financial sustainability.

Therefore, the necessity of a rating agency in the EAEU, the status of which will be recognized by all market participants, is underlined. In order to accelerate the integration of national reinsurers into the common market and create the environment for the development of the reinsurance market, it is advisable to proceed with the formation of a single system of rating agencies. Thus, the standardization of national provisions on sustainability of the reinsurance business and the provision on preferences for the EAEU member countries are necessary.

Consequently, there is a need to establish common approaches to assess the financial sustainability of reinsurance organizations and the introduction of a reliability rating.

3. Common approaches to the reliability assessment of reinsurers

In our opinion, the reliability assessment of a reinsurance company should rely on national regulators, investors and consumers of financial services. Financial crises of recent years have revealed the main problem of international rating agencies – the assessment is often subjective and does not keep suit the rapidly changing global economic environment. In this regard, in the reinsurance sector, there is a tendency to reduce dependence on the international ratings.

For instance, the principles of the Financial Stability Board (FSB) for reducing reliance on ratings ("Principles for Reducing Reliance on CRA Ratings") clearly indicate the transition to an alternative definition of financial stability and solvency. Given these facts, it seems relevant to develop a comprehensive methodology for assessing the sustainability of reinsurers, considering the specifics of the reinsurance market of the EAEU. This will reduce the impact of rating assessments, will ensure sustainable development of insurance and reinsurance markets within the EAEU member states, will guarantee financial stability and protection against the consumer risks of insurance services.

The methodology of reliability assessment of reinsurance organizations has been developed and tested. The essence of this rating methodology is that it is made in compliance with the international requirements for assessing the sustainability of reinsurance organizations and can be successfully applied both in the Republic of Belarus and in the EAEU countries, which will accelerate the integration of national reinsurance organizations into the global financial market. In order to substantiate the practical use of this methodology, we carried out the calculations based on the example of Belarusian and Russian reinsurance organizations that have the largest volume of reinsurance premiums.

Within the framework of this approach, under *the financial stability rating of a reinsurance organization, one should understand an independent opinion on the financial position of a reinsurer, its ability to fulfil the obligations to insurers (assignors), and assess the attractiveness of a reinsurance organization as an investment object*.

The algorithm of a reinsurance company's reliability analysis is presented in the figure 1.

The rating and classification of reinsurers by their reliability was adjusted under the following procedure:

1. The formation of a reinsurer's rating:

1.1. the adjustment of a system of initial indicators;

1.2. expert evaluation of the weight of each indicator;

1.3. building a rating.

2. Grouping objects by the value of the rating:

2.1. division of reinsurers into groups using the k-mean cluster analysis method based on the value of the integral indicator.

2.2. The number of groups is chosen the largest, for which there is a reliable difference in the mean values of the integral index in the groups;

2.3. Control over the variance in the mean values of the integral index in the constructed clusters by mean variance of the Sheffe's criterion.

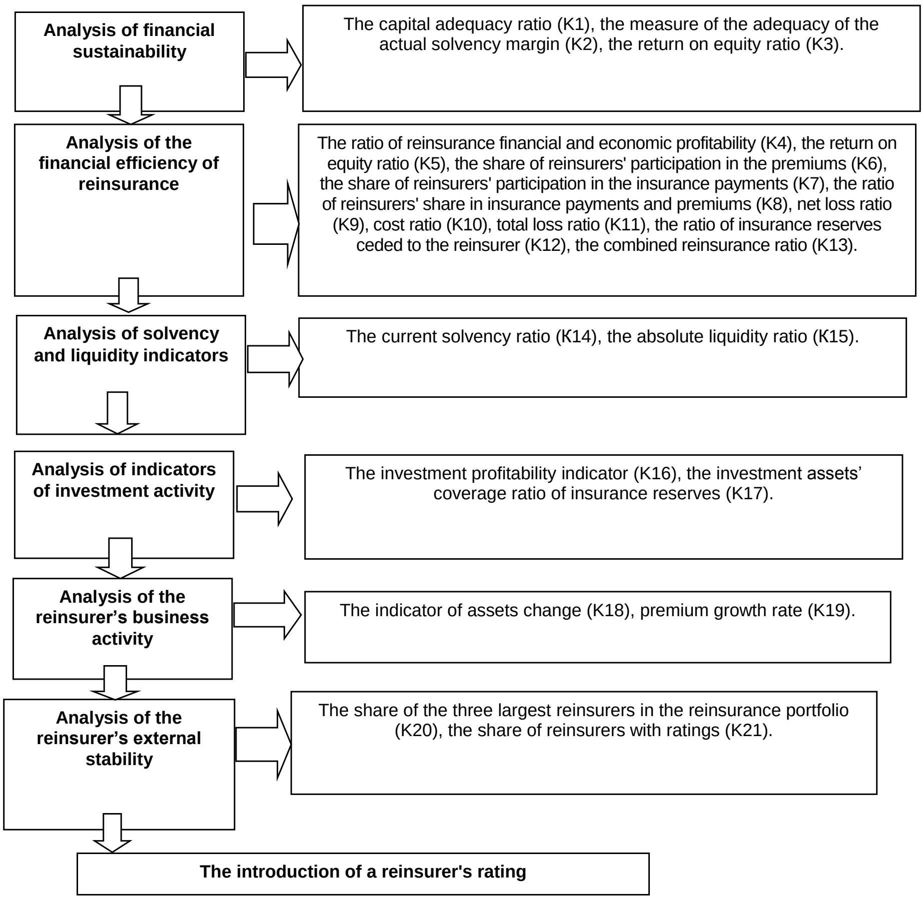


Figure 1. The algorithm of a reinsurance company's reliability analysis

The causes of the differences were examined using the factor analysis. The advantage of factor analysis is the ability to build groups of interrelated indicators, as well as sorting the system of indicators by the degree of their differentiation.

The total value of the rating is calculated by the formula:

$$R_j = \sum_{i=1}^{n} R_j^i W_j^i, \qquad (1)$$

where R_j^i – the number of points scored from each group of indicators. It is determined by the addition of scores obtained for each group of indicators;

W_j^i – weight of each group of indicators, determined by expert analysis.

Further, a grouping of reinsurance organizations was carried out using thek-meancluster analysis method. Such grouping is carried out with the purpose of revealing reinsurers having a similar rating estimation and, as consequence, a similar level of reliability. This method allows grouping reinsurers in such a way that the integral indicator values of organizations belonging to the same group are close, but at the same time significantly differ from the values of other groups. As a result of applying thek-meancluster analysis method, all reinsurance organizations were divided into 3 groups. The reliability of differences in mean values was estimated using the Sheffe's test, for all pairwise comparisons p <0.001. When choosing the four groups, in two of them the average values differ not reliably. The division into 3 clusters is clear, since the confidence intervals for the averages do not intersect.

Figure 2 shows a change in the average rating value in the clusters and 95% confidence intervals for the averages.

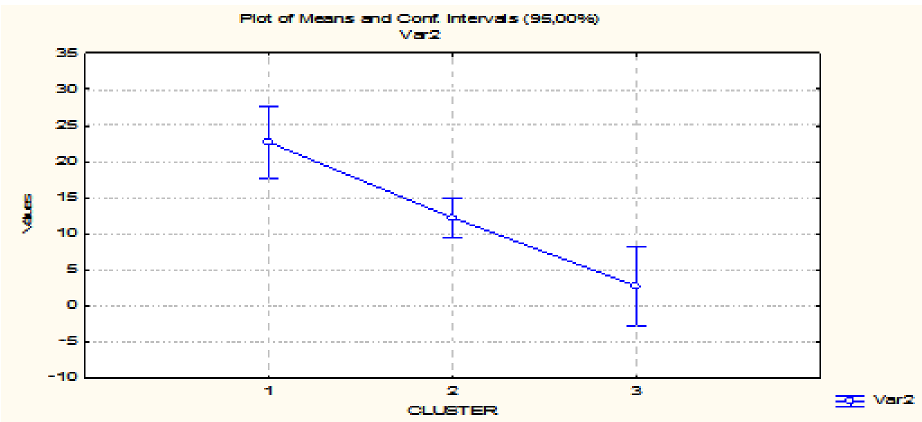


Figure 2. The average rating value and confidence intervals of the reinsurer's rating

The figure shows that the rating change is linear. This means that the sustainability of these reinsurance organizations has a significant difference. The overall rating of the reinsurer, who took the first place, is much higher than that of the reinsurer, who took the last place.

The classification of rating groups is correlated with the limits of confidence intervals (Table 3).

Table 3
Rating classes and the subsequent financial management requirements

Clusters	Rating	Total number of points	Class characteristics	Financial management requirements
1	A	Above 17	High degree of reliability	Additional measures and significant changes in the financial and marketing policies are not required
2	B	9-17	Average degree of reliability	To maintain the necessary reliability of a reinsurer, it is necessary to monitor the value of the indicators of all groups
3	C	Less than 9	Low degree of reliability	It is required to review the entire financial strategy and strengthen internal financial control

As a result of the conducted research and on the basis of the calculations made, it is possible to assign the ratings of the reinsurance organizations. The following organizations belong to the "A" rating with a high degree of reliability: RUE "BNPO", JSC "Transsiberian Re", LLC IC "VTB Insurance". The rating "B" with an average degree of reliability is represented by the following companies: LLC "Moscow Re", JSC "Sogaz", LLC "Score Reinsurance", SPAO Ingosstrakh, “Russian Reinsurance Company”. The rating "C" with a low degree of reliability is represented by the companies: "Gefest", LLC "Insurance Company AS", LLC "Capital Insurance and Reinsurance Centre".

In order to streamline the indicator system in terms of the impact on the reliability rating of reinsurance organizations and to determine the groups of interrelated indicators, the factor analysis was conducted. If the first major factor preserves more than 55% of the total variance of the initial indicators, we can assume that it is a satisfactory approximation of all the analysed partial criteria. All indicators calculated within the framework of the rating were converted into 5 main factors, with the first major factor retaining only 31.04% of the total variance. Therefore, more than one factor was used to analyse the structure of the interdependence of the initial indicators (Table 4).

Table 4

Percentage of saved and accumulated variance during 2014

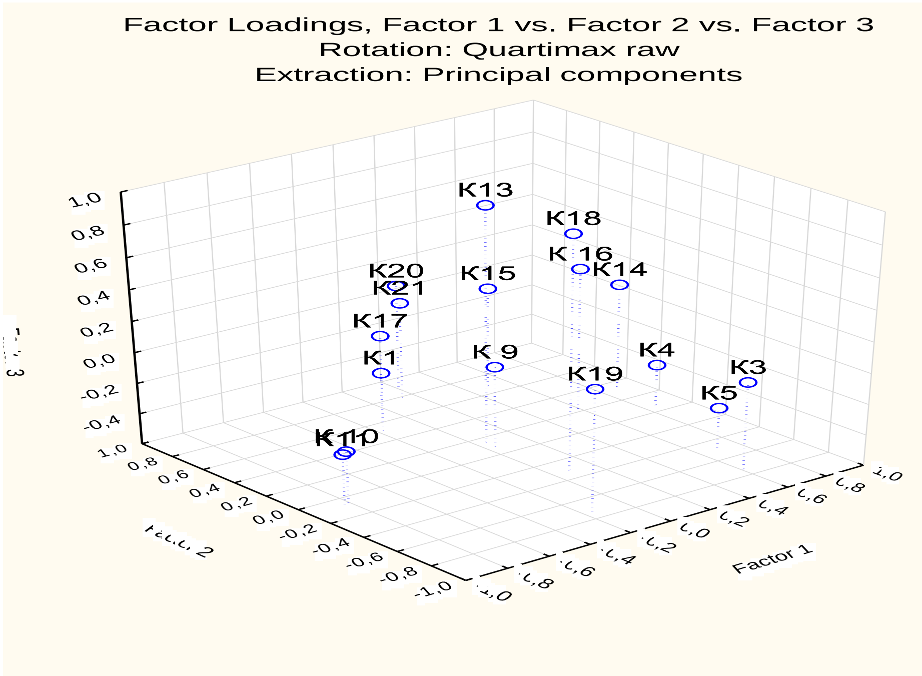
Factors	Dispersions of the main factor, %	Accumulated variance, %
Factor 1	31,04	31,04
Factor 2	25,28	56,32
Factor 3	14,30	70,62
Factor 4	13,58	84,20
Factor 5	5,05	89,25

The relationship of the first three main factors affecting the reliability rating of reinsurance organizations is presented in Figure 3.

The first factor is significantly affected by the six following indicators: the current solvency ratio (K14), the ratio of reinsurance financial and economic profitability (K4), total loss ratio (K11), cost ratio (K10), the share of reinsurers' participation in the premiums (K6), the investment profitability indicator (K16).

The second factor is affected by the six following indicators: The capital adequacy ratio (K1), the return on equity ratio (K3), the share of reinsurers with ratings (K21), the absolute liquidity ratio (K15), premium growth rate (K19), the share of the three largest reinsurers in the reinsurance portfolio (K20).

The third factor is affected by two indicators: the combined reinsurance ratio (K13) and the indicator of assets change (K18).



Source: author's own expertise

Figure 3. – The projection of the indicators on the first three main factors

The fourth major factor is determined by the loss ratio (K9), and the fifth factor is the investment assets' coverage ratio of insurance reserves (K17). In this case, the fourth and fifth factors provide the lowest percentage of the initial indicators' total variance – 13.58 and 5.05% respectively, i.e. these indicators have the least differences for different organizations. They are taken into account in order to preserve all the information of the initial indicators.

Thus, it was shown that the most significant impact on the reliability of the reinsurance is provided by the current solvency ratio and the profitability ratio of reinsurance and financial and economic activities. It was these indicators that were most closely associated with the first major factor.

Conclusion

On the basis of the research conducted in the article, it is necessary to underline that the methodology makes it possible to objectively assess the reliability of a reinsurance organization and develop a set of measures aimed at enhancing it. The practical significance of the proposed rating methodology lies in the fact that this rating can be applied in order to adjust the activity of a reinsurer within the risk transfer process to retrocession in the cooperation framework with other reinsurance organizations with the reinsurer creating a security list of insurance companies in the Republic of Belarus, which carry out reinsurance operations.

Thus, the financial integration in the EAEU is based on the experience of similar structures in Europe. The approximation of national reinsurance systems was carried out by the development and mutual interests in the harmonization of the legislation, introduction of universal conditions and requirements to subjects of the reinsurance market, the establishment of universal regulatory parameters.

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CONTENTS

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