

Experience from Developing Countries

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AGENDA

1. Why is MTPL necessary?
2. The rationale behind a “liberalized” MTPL market
3. The MTPL liberalization in Europe
4. The “Road Map” and the “Best Practice” in the liberalization process
Italy: the case history
 - TIMEFRAME
 - REACTIONS OF PLAYERS
 - IMPACT ON PRICES
 - EFFECT ON DISTRIBUTION
 - TREND ABOUT LEGISLATION AND MARKET CONTROL

WHY IS MTPL NECESSARY?

It is necessary for this...



WHY IS MTPL NECESSARY?

... and this...



WHY IS MTPL NECESSARY?

... and this...



WHY IS MTPL NECESSARY?

... unfortunately, sometimes, also for this...



*... but also
for more
dangerous
losses...*

WHY IS MTPL NECESSARY?

... and this!!!



CORRIERE DELLA SERA

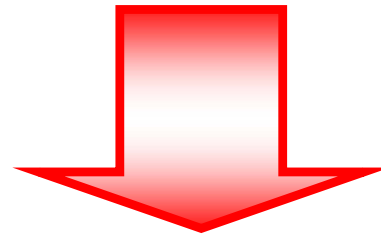
“Fog, hell on the Motorway: 4 people dead, 80 people injured in the maxi-road accident.

Closed for hours the Motorway Bologna-Padova”

2nd February 2000

THE RATIONALE BEHIND A “LIBERALIZED” MTPL MARKET (1 OF 6)

- ✓ A fundamental principal of any insurance is that the **premium** paid by policyholders must:
 - **be sufficient** to fund their expected claims costs and administrative expenses
 - **provide a profit** in order to compensate for the cost of capital
- ✓ An insurer will only survive if he charges adequate rates consistently overtime for the risks accepted. Particularly in MTPL, where policies are issued on one-year basis, he can **lose good business** or **gain bad business** very quickly if its rates become out of line with the rest of the market



IT IS VITAL THAT INSURERS KEEP PREMIUM RATES UNDER CONSTANT REVIEW AND THAT THEY ARE PREPARED TO AMEND THEM AS NECESSARY

THE RATIONALE BEHIND A “LIBERALIZED” MTPL MARKET (2 OF 6)

- ✓ In the majority of developing countries, MTPL premiums are statutory and the Government, directly or through some more complex governance process, is in charge of setting up statutory prices.
- ✓ There are several reasons for applying this approach:
 - i) if the coverage is compulsory, then the insurance should be comparable to any other price necessary for living and the Government may wish to control
 - ii) the insufficient development of a competitive market may bring up a gap between commercial and pure premiums
 - iii) the solvency of companies, in case of major claims or in case of a general deterioration of the results, must be guaranteed by the State

THE RATIONALE BEHIND A “LIBERALIZED” MTPL MARKET (3 OF 6)

Motor insurance dominates in Albania, as in many developing countries, the insurance sector:

- ¾ of Non-Life premiums relate to vehicle coverage
- for the majority of the companies is the only important line of business

AND

“Motor insurance is viewed as a kind of tax and not one administered by the Government...”

“....so, customers don’t always look at it as something they can benefit from it; it’s just something they have to pay...”

“....therefore, many insurers don’t feel much responsibility to these clients”

Statement of Mr. Varuzhan Piranjani INSIG’s General Manager taken from

THE RATIONALE BEHIND A “LIBERALIZED” MTPL MARKET (4 OF 6)

*...Nothing new! Mr. Piranjani statement could have been said by any Italian insurer...
...particularly before the MTPL liberalization.*

Here it is some newspapers' titles just before the Italian MTPL liberalization (July 1994):

la Repubblica

“RC AUTO, LIBERTA' DI TARTASSARE”

3 June 1994

“Motor TPL, freedom to harass”

CORRIERE DELLA SERA

“POLIZZE RC AUTO: DIVENTANO LIBERE MA ANCHE PIÙ CARE”

26 March 1994

“Motor TPL policies: become free ma also more expensive”

LA STAMPA

*“DAL PRIMO LUGLIO PROSSIMO SCATTA LA LIBERALIZZAZIONE
DELLE TARIFFE PER LA RC AUTO. ALLARME-RINCARI.
I CONSUMATORI: LE COMPAGNIE TARTASSERANNO I CLIENTI!”*

7 April 1994

**“From 1st July starts the liberalization of MTPL tariffs. Alarms-
increase. The Consumers: the companies will harass the clients!”**

THE RATIONALE BEHIND A “LIBERALIZED” MTPL MARKET (5 OF 6)

The regulation of insurance prices (which can be done by fixing the size of changes in premiums, by fixing a range in which the premiums can vary or by restricting the risk classification) can cause insurers to:

1. suffer operating losses, given the fact that in most cases, the Government will face political pressure not to adjust the price to meet the cost of risks. If the tariffs are set by the Government, they might indeed be kept reasonable, but this does not mean that the cost of risk is low
2. reduce supply
3. curtail investments that are necessary to support the sale of quality coverage

IN OUR EXPERIENCE, WE CAN AFFIRM THAT THE STATUTORY PRICES ON INSURANCE CAN HAVE ONLY DISTORTIVE EFFECTS ON THE MARKET, BOTH IN TERMS OF PROFITABILITY AND OF QUALITY OF SERVICES PROVIDED TO CUSTOMERS

THE RATIONALE BEHIND A “LIBERALIZED” MTPL MARKET (6 OF 6)

- ❑ Insurance companies try to offset this structural deficit by delaying the settlement process (believing that retaining cash improves the financial return)
- ❑ Generally, the damages paid relate only to the vehicle parts, while the bodily injury claims are settled “off the records” or in a very long period of time.

**BOTH THESE ASPECTS REDUCE
CREDIBILITY OF THE ENTIRE SECTOR,
PRODUCING A LOW PENETRATION OF
THE OTHER NON COMPULSORY
PRODUCTS**

THE “ROAD MAP” AND THE “BEST PRACTICE” - TIMEFRAME

The liberalization process require an extensive period of time for discussion amongst the parties involved (Government, Supervisor Authority, Insurance companies and Consumer Associations)

- ✓ It is clearly necessary to impose by law the obligation to move towards a liberalized MTPL market
- ✓ It usually requires extensive period of time (up to 5 or more years) for discussion amongst the several players
- ✓ It must be recognized that for the companies the process can be quite complicated and it is important to give them sufficient time in order to structure their own database and for training the staff who will be involved in the analysis

ITALY: THE CASE HISTORY - TIMEFRAME

1990

Beginning of the discussion about tariffs liberalizations

1992

Government decision to proceed with the liberalization

1994

Ministerial Law abolishing “administered” tariff

1995

Insurance companies begin to change their internal structure and the approach to MTPL business

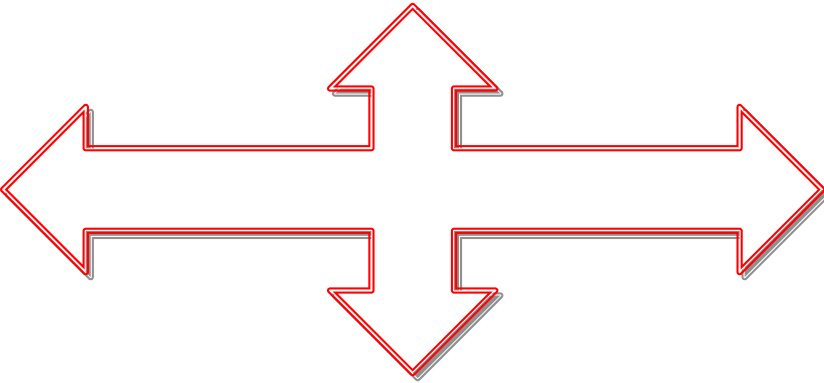
THE “ROAD MAP” AND THE “BEST PRACTICE” – REACTION OF THE PLAYERS

THE POINT OF VIEW OF DIFFERENT STAKEHOLDERS AT THE MOMENT OF THE LIBERALIZATION:

THE INSURANCE COMPANIES
“liberalization as a possible medicine against historical negative technical results”
“increase in foreign players’ interest towards Italian market”

THE GOVERNMENT
“improvement in market competitiveness”
“customers’ freedom to switch policy provider”
“medium term prices fall-down”

THE CUSTOMER ASSOCIATION
“unjustified and uncontrolled prices increase”



THE AUTHORITY
“need of a supervision to assure market stability”

ITALY: THE CASE HISTORY - REACTION OF THE PLAYERS

GOVERNMENT

PROMOTE AND LAUNCH THE INITIATIVE

- Ability to interact with the Supervisor Authority and the insurance sector

“HOW” AND “WHEN”

- It is important to impose a deadline that is feasible in particular for the insurance companies

“BAD COMPANY”

- If there is no obligation to underwrite and accept all types of risks, it is important to identify a mechanism to ensure the coverage also to the worst buyers (i.e. “Bad Company”)

INSURANCE INDUSTRY

INCREASE THE ABILITY IN TECHNICALITY

- Fundamental aspect is to improve the Actuarial function with the companies

ORGANIZATIONAL CHANGES

- Bring appropriate knowledge in the company
- Set-up a specific database for analyzing the claims frequency and the average claims costs by individual rating factors
- Face the need of new products, of transparency and of an effective communication

INVEST IN SOFTWARE

SUPERVISOR AUTHORITY

INCREASE IMPORTANCE OF THE ROLE

- Control the statistical/actuarial techniques applied and the soundness of the database used

CHANGE IN REGULATION

- Monitoring the insolvency risks of the insurers, after the probable increase in the solvency margin required
- Control on insurers assets and capital

THE “ROAD MAP” AND THE “BEST PRACTICE” – IMPACT ON PRICES

1. ECONOMIC COST

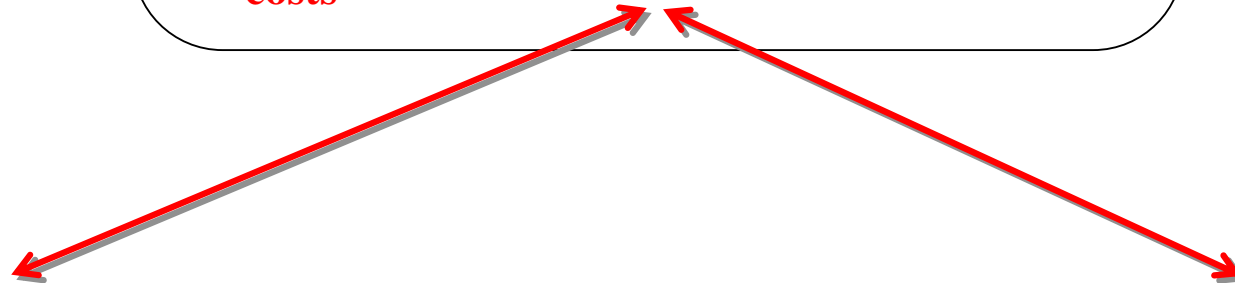
Understanding the economic cost is essential in the definition of the technical tariff. It consists in evaluating the major components of the premium. This is derived from the estimate of the probability of occurrence of a claim and from the statistical distribution of the claims costs

2. MARKET PRICES

Understanding the market dynamics is important when defining the commercial strategy

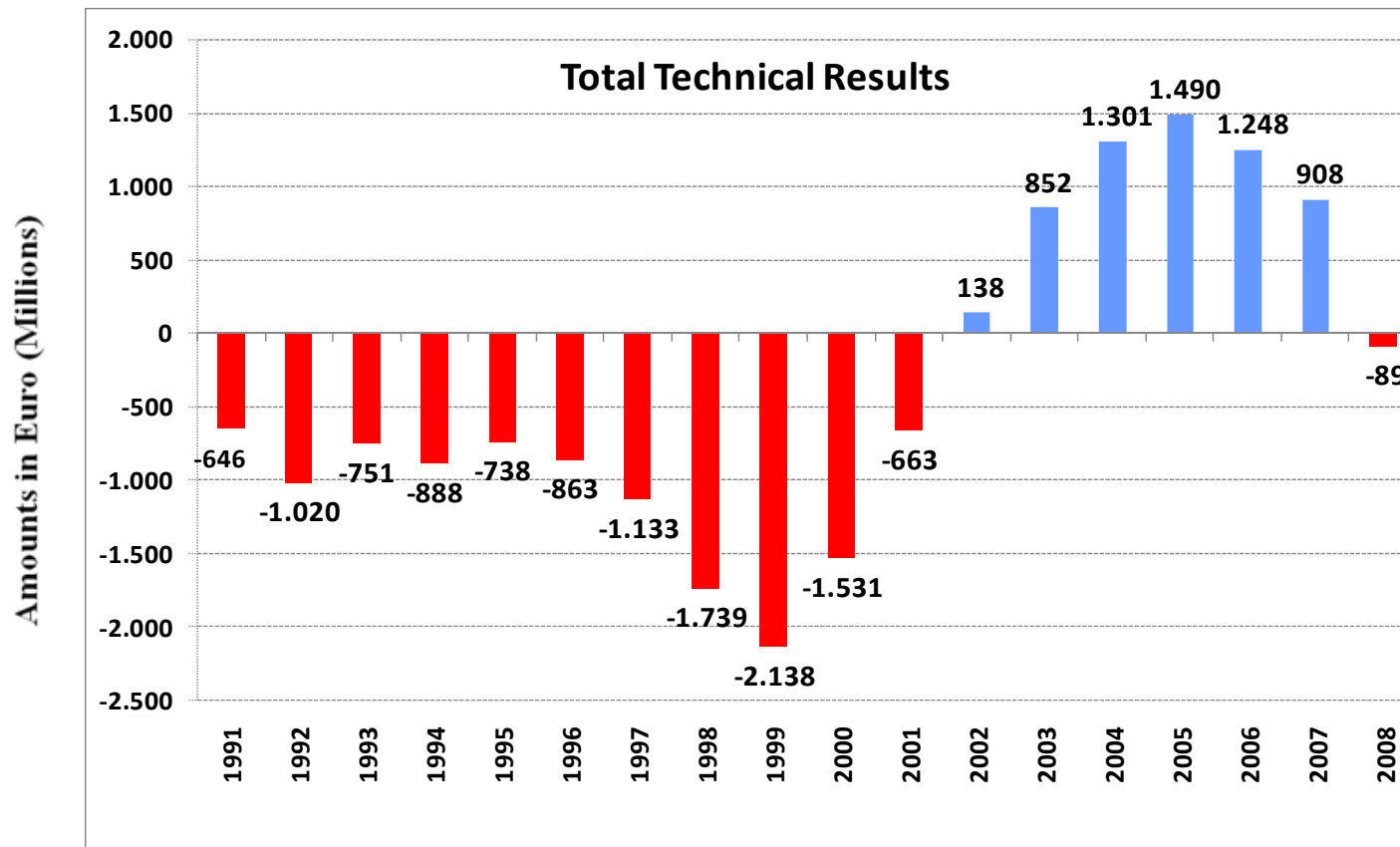
3. ELASTICITY OF DEMAND

Understanding the customer clusters' elasticity is the present improvement trend in progress



ITALY: THE CASE HISTORY – IMPACT ON PRICES (1 OF 6)

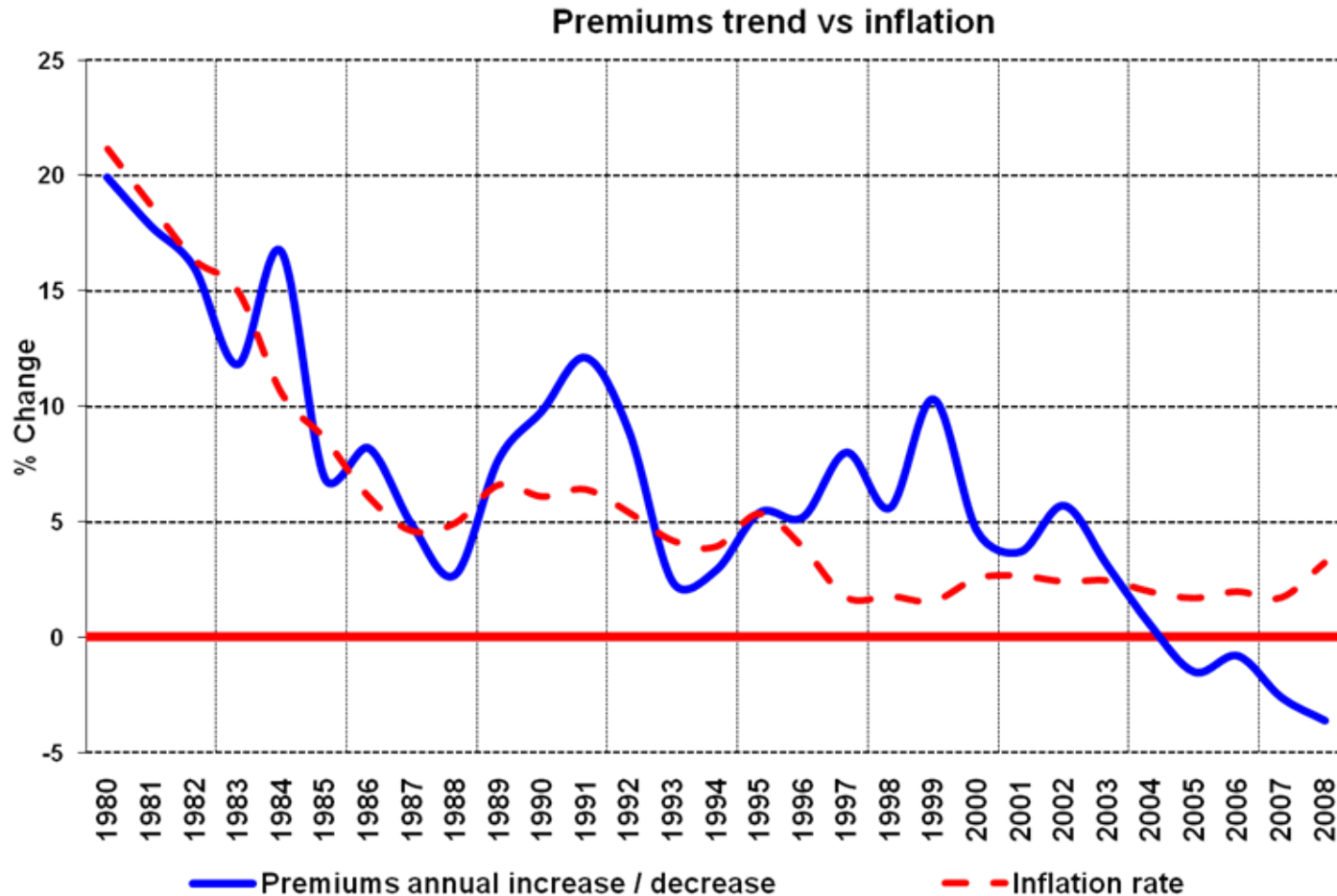
The experience and the history of insurance pricing in industrialized countries shows that increasing premiums is a fact in most of the EU countries soon after tariffs' liberalization. Statutory rates imply, in most cases, a “political” approach to the theoretical cost of the insurance companies



- Statutory tariff regime implies in many cases a price BELOW the minimum necessary*
- The insurance sector has lost for many years considerable amount of money (and in some cases companies went into liquidation)*
- the sector break-even only 7 years (!) after the liberalization*

ITALY: THE CASE HISTORY – IMPACT ON PRICES (2 OF 6)

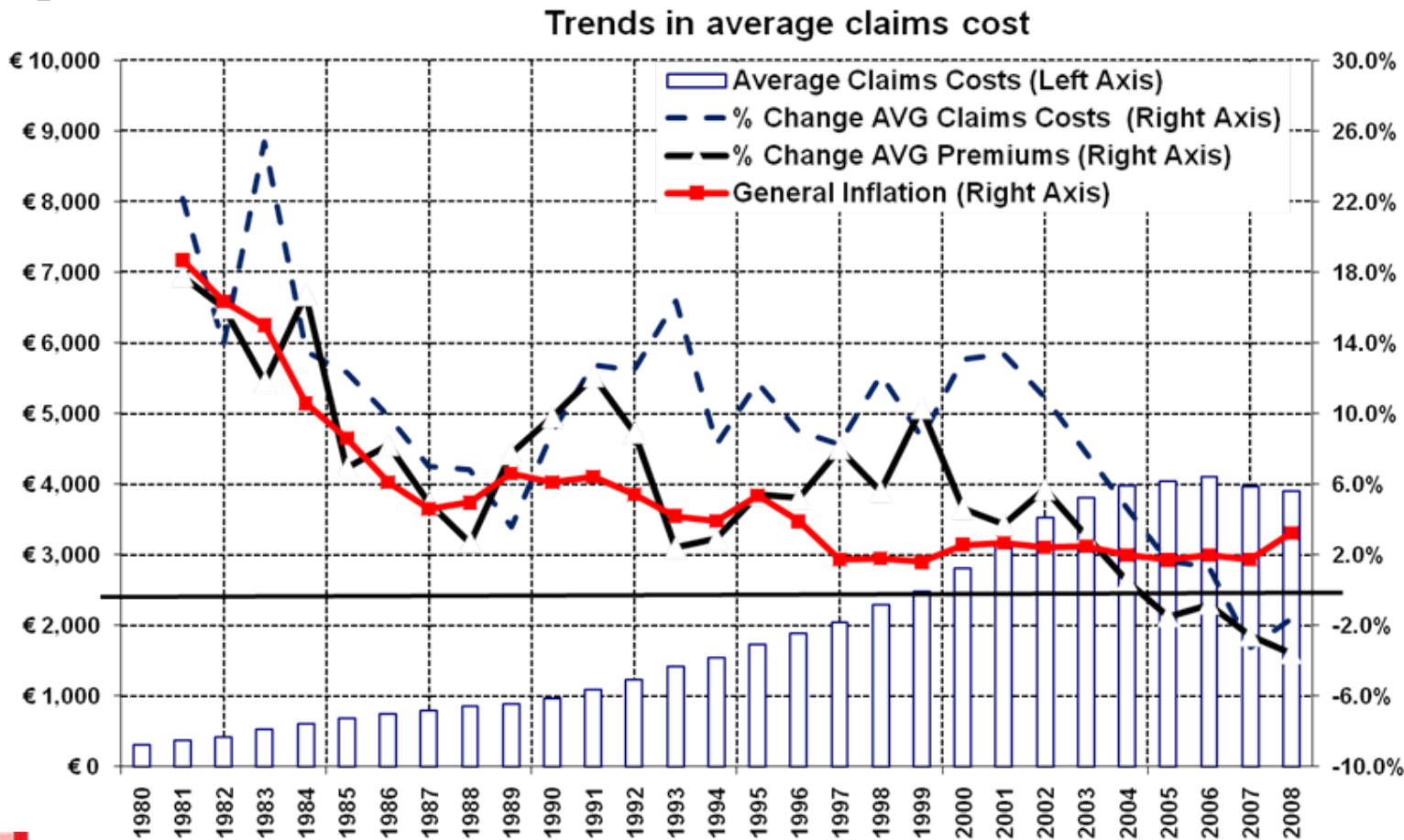
Historical negative results explain why, after the liberalization of the tariffs, all the insurance companies increased their rates



- After 1994, the premium increase has been constantly higher than inflation (a parameter usually, but wrongly, taken as a meter of comparison to judge how much the MTPL tariffs should increase)
- In 2004 (after 2 years the sector reached a profitable situation), the prices started to fall considerably.

ITALY: THE CASE HISTORY – IMPACT ON PRICES (3 OF 6)

In all years, before and soon after the liberalization, the claims cost increased far beyond the inflation and the premiums evolution followed that increase, being however constantly below that annual changes until 2001. Only from 2005, after the improvement in the results and the deceleration of the increase in the claims cost, there has been even a decrease in the average premiums.

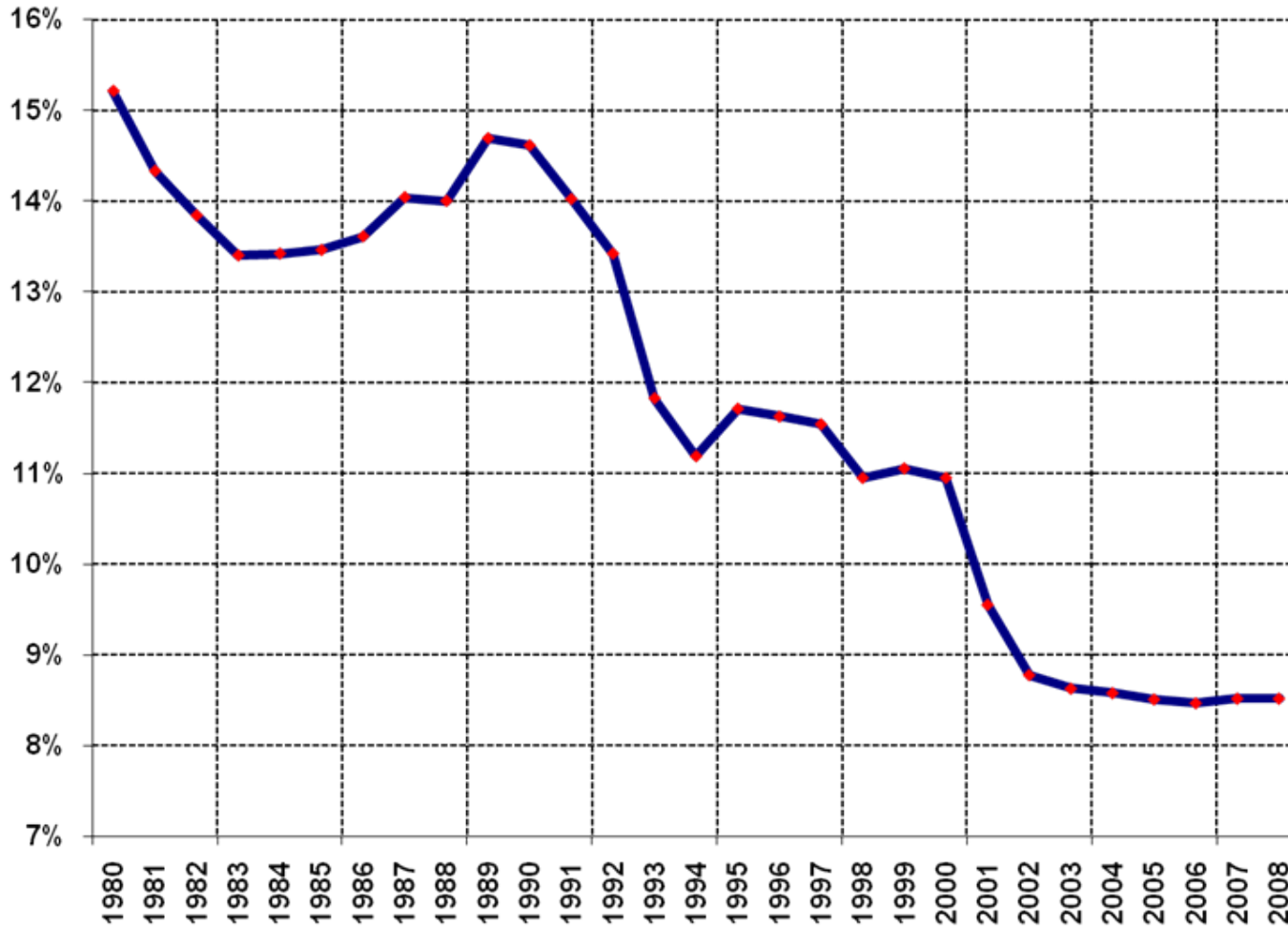


This trend in claims cost has driven the trend on prices...
 ..which contributed also in worsening the relationships between Insures and Customers

ITALY: THE CASE HISTORY – IMPACT ON PRICES (4 OF 6)

The profitability improved only indirectly because of the liberalization.....

MTPL claims' frequency



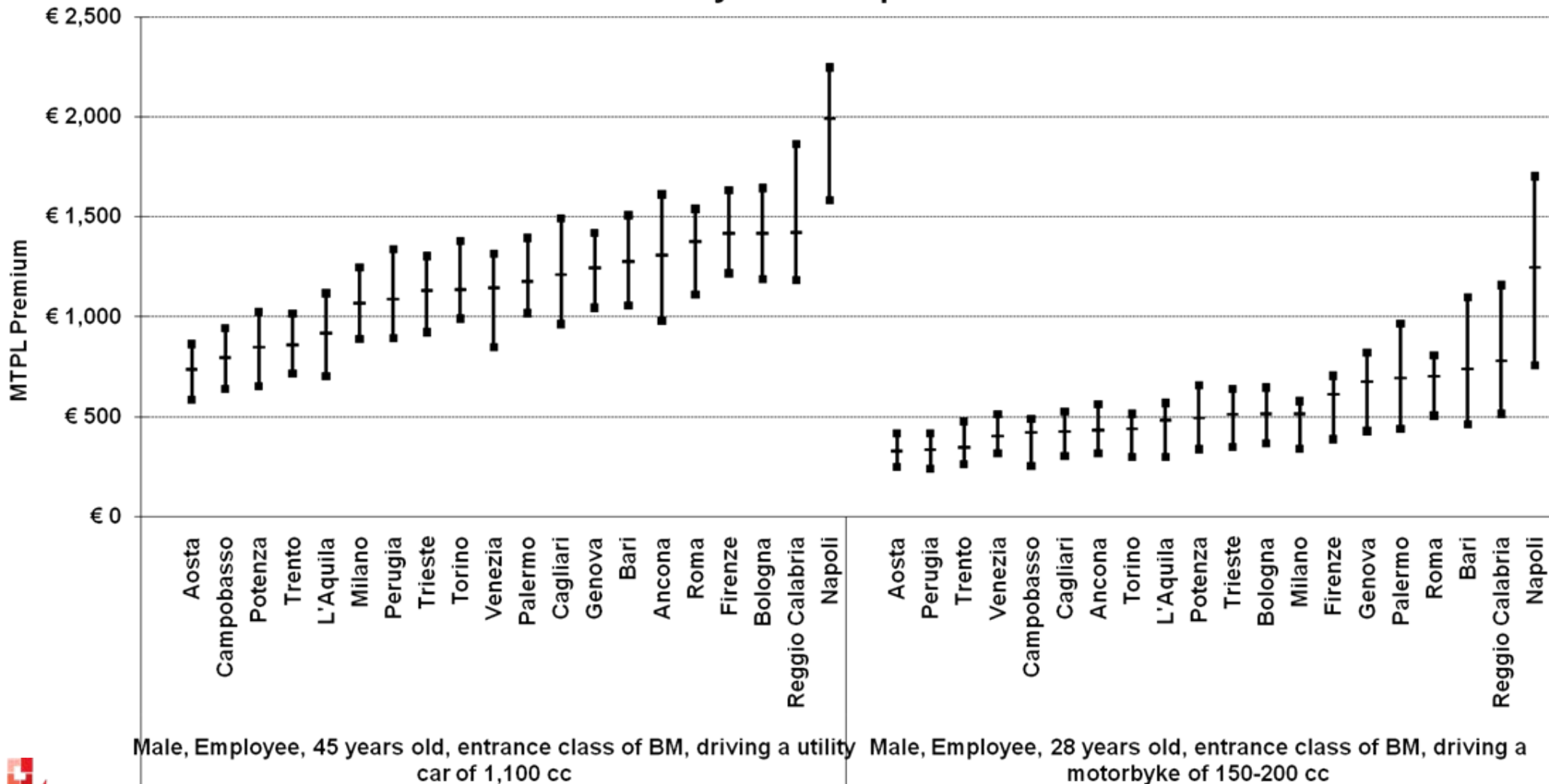
....the main reason why profitability improved is because of the decrease in claims' frequency, as a consequence of the following facts:

- more frequent use of self-payment of claims to avoid negative effects on highly customized bonus-malus scales
- reduction of frauds
- less frequent use of the car (less KM/Year) because of the increase in cost of gasoline

ITALY: THE CASE HISTORY – IMPACT ON PRICES (5 OF 6)

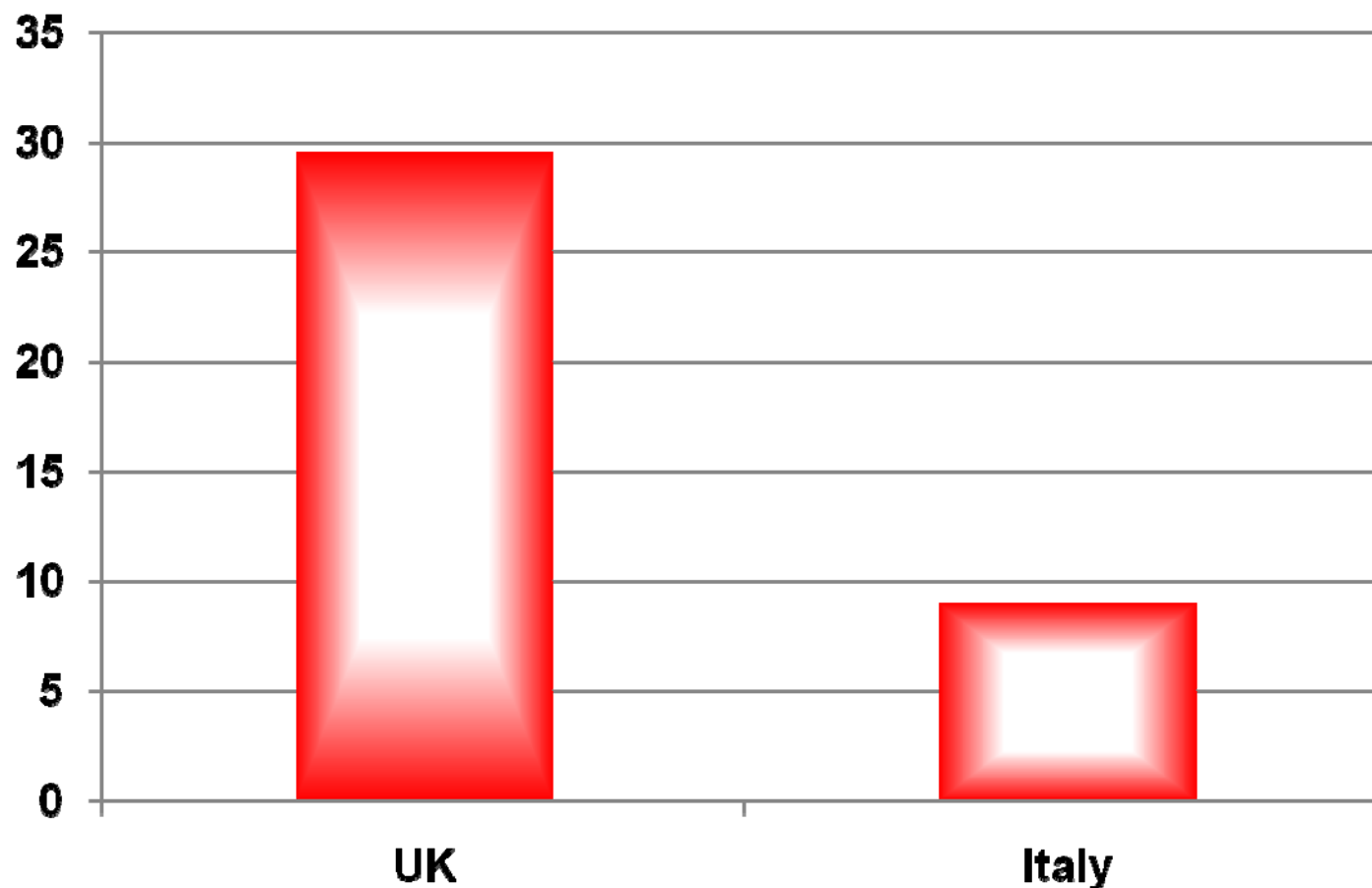
The prices variability has increased a lot in the last 10 years. Most insureds find very different prices on the market.

Variability in MTPL prices



ITALY: THE CASE HISTORY – IMPACT ON PRICES (6 OF 6)

Anyhow, the average elasticity of demand is still relatively low. Average market withdrawal rate in UK is still 3 times than in Italy



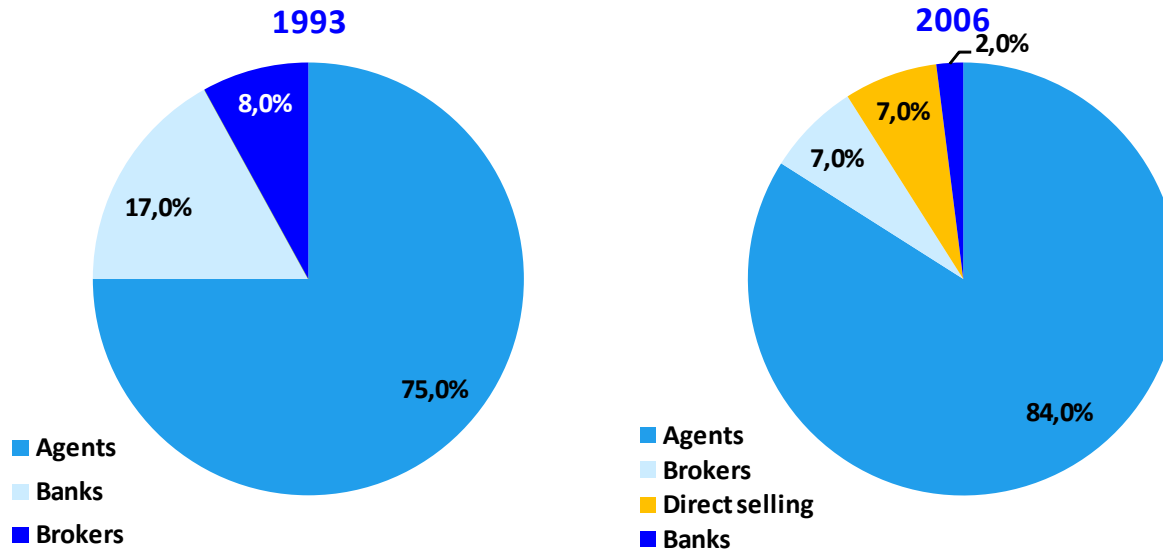
THE “ROAD MAP” AND THE “BEST PRACTICE” – EFFECT ON DISTRIBUTION

- ❑ The liberalization does not always imply a change in distribution channel
- ❑ The effect on the distribution network would really depend on the relationship which has been built during the years between the agents and the customers
- ❑ In some countries (such as Ireland and UK) the direct policies (mainly internet and telephone) have grown very quickly and there are companies that in a very limited period of time have become market leaders

ITALY: THE CASE HISTORY – EFFECT ON DISTRIBUTION

The liberalization did not affect significantly the structure of distribution: despite the appearance of “direct selling” as effect of internet diffusion, agents still remain the main distribution channel

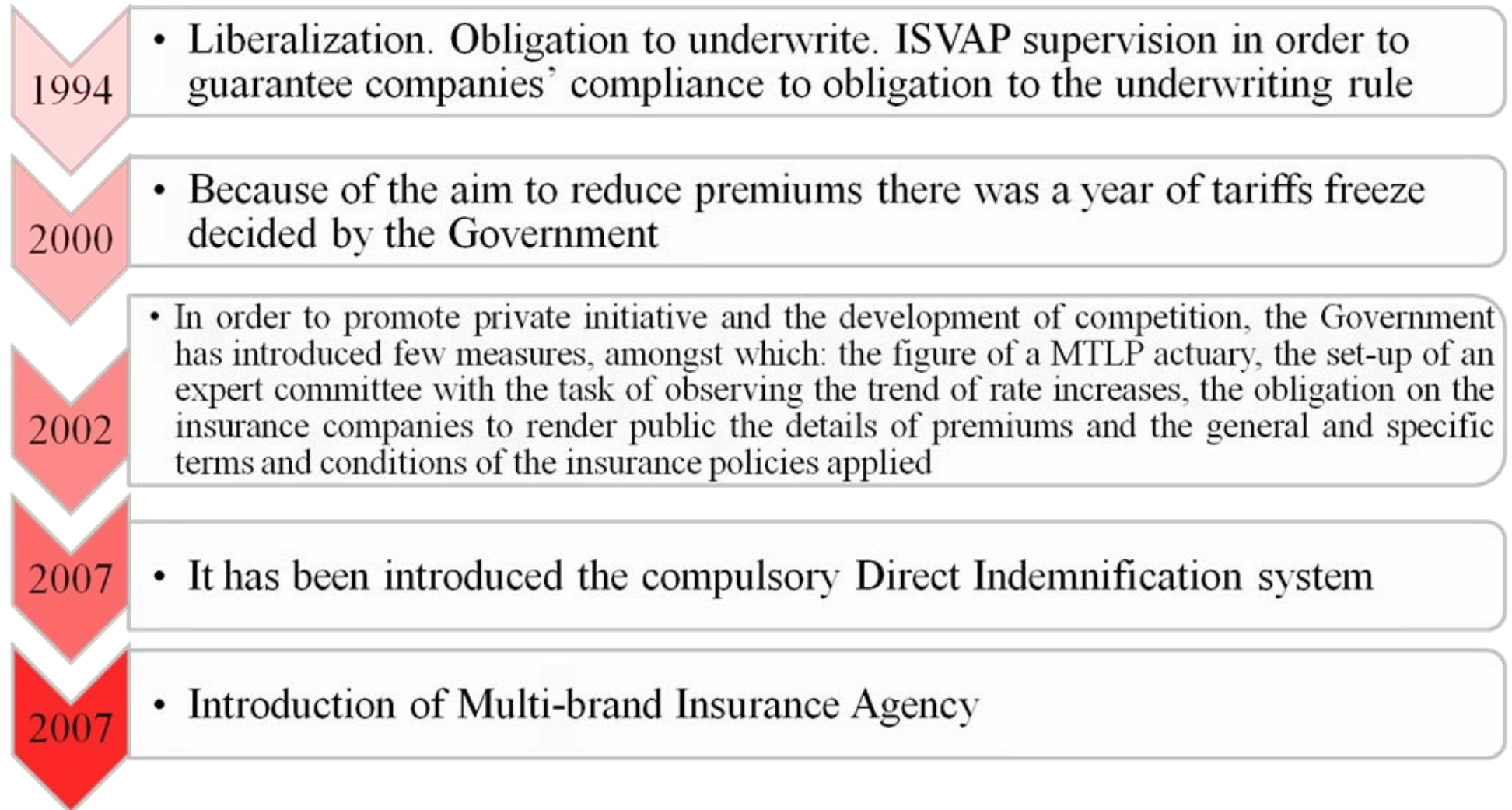
Total P&C Market



Although direct players' incoming might be due to the internet diffusion (and not necessary a direct consequence of the liberalization) direct players exploit more than the traditional ones the advantages of liberalized tariffs:

- higher risk-segmentation and profiling*
- more flexible and more dynamic approach to pricing*
- average price lower of even 20% if compared to traditional companies.*

ITALY: THE CASE HISTORY – LEGISLATION AND MARKET CONTROL



THIS IS A FORECAST ABOUT THE FUTURE OF THE MARKET



ARE YOU READY FOR ANOTHER ONE?

Experience from Developing Countries

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