

The importance of motor insurance as a main line of activity

by

Dr. M. Habib-Makar

In recent years the number of motor vehicles in developing countries has increased tremendously. A mere look at the streets of Bangkok, Bombay or Manila, and the eternal traffic jams confirms and highlights the ever-increasing role of motor transport in the everyday life.

The growth of the number of cars is caused by a variety of factors which may differ from one country to another, but on the whole those factors derive from greater productivity, the expansion of human and technical resources, the improvement of the standard of living, the increasing trend of urbanisation and the resulting mass migration to the cities, and finally the emergence of a leisure-oriented way of life in which a private motor car plays a pivotal role.

The national reports on motor insurance which you were asked to present this week will undoubtedly shed some light on the significance of motorisation in your countries and on its impact on the daily life of your own people.

Initially, the increased rate of motorisation helped development efforts, and facilitated the transport of people, merchandise and equipment, but did not fail to produce its heavy toll of road accidents in which people are killed or injured and in which property is damaged. Statistics which will be cited in your reports will reveal a common phenomenon of a sharp rise in the number of motor accidents causing human tragedies and large financial losses. Needless to say the human tragedies cannot be evaluated in terms of money, but for financial losses it may be sufficient to give the example of several developing countries in which these losses represent more than one per cent of their Gross National Product (GNP).

Motor accidents occur everywhere, even with the best systems of traffic control. However, a comparison between accident rates per vehicle will show that developing countries hold the worst record in this respect, in spite of the fact that the number of motor cars per capita of population in these countries is much smaller than that of developed countries. The reason for this situation is obvious. The increase in the rate of motorisation took place without a corresponding improvement of potential road safety of traffic codes, of traffic control, etc.

An analysis of motor accident rates shows that these depend mainly on two precise factors i.e., the number of motor vehicles on the road, and the frequency of road accident per vehicle. If the frequency per vehicle remains stable and the number of vehicles per inhabitant increases, the accident rate can only rise. As it is not realistic or even desirable under the present economic and social conditions to lower the number of vehicles on the roads, the problem concerning the number of accidents will remain unsolved until the frequency of accidents per vehicle is controlled or reduced through measures of loss prevention or loss reduction. Clearly such target cannot be easily or immediately attained, thus we have to consider motor accidents as inevitable happenings rather than fortuity, and as such a system to compensate victims even partially ought to be set up to alleviate the suffering of the people and to make good their losses.

Turning now to motor insurance after this short introduction, I must emphasize first that it is not the only remedy for motor accidents. Still, the loss or damage caused by the wrongful or negligent conduct of the driver is indemnified by the tortfeasor by application of common law and tort rules. However, as the determination of responsibility for the accident and the amount of indemnity due are often made by courts, and as the amounts of indemnity to be paid to the victims are in many cases unpredictable, at first motor owners sought motor insurance to protect themselves against the depletion of their assets through legal liability claims and the cost of defending law suits. This insurance does not alter or lessen in any way the responsibility of car owners or drivers for motor accidents. It only mitigates the financial consequences. Later on, the scope of motor insurance was extended to cover also own damage, fire, theft, glass breakage, etc.

Yet, as motor insurance was initially an optional cover contracted between the insured and the insurer, third parties could not benefit directly from motor insurance, because of the legal doctrine of privity of contracts under which only persons who are parties to the contract can derive benefit therefrom.

With the increase of the number of motor cars on the roads and the consequent increase of motor accidents, it became socially and economically necessary to make sure that innocent victims of motor accidents are indemnified. The State in most countries stepped in to protect such victims by making insurance against third party bodily injuries compulsory. Fewer States extended this obligation to cover liability to third party for property damage. As for Own Damage and other similar risks, their cover remains optional practically everywhere.

Being a business closely connected with public interest, motor insurance has been since its inception subject to many influences brought about by the vicissitudes of political, social and economic conditions, as well as by business practices and expertise. The blending of favourable influences enhanced its rapid growth, but on the other hand some unfavourable conditions hampered its profitable operation and made it in some way a bitter pill for the insurers, an expensive cover for the insured, and a heavy bureaucratic machinery for the victims who have to be indemnified.

A preface to the discussion of our subject cannot be complete without a reference to the importance of motor insurance to all parties concerned.

Naturally, the first interested in motor insurance is the motorist himself. Not many car-owners are prepared to risk pledging their assets to meet third party claims. Also, few car owners are ready to risk the loss of or damage to their vehicle especially when it is new, expensive, or difficult to replace. In this respect it is amazing to see how the attitude of car-owners in developing countries has evolved: some years ago, it was unusual for them to take out more than the compulsory insurance cover, now they seek

the most comprehensive covers, because of the steep increase in the prices of motor cars, the difficulties in obtaining spare parts, the restrictions on the import of vehicles, and the high customs duties.

From the standpoint of victims of motor insurance and particularly compulsory motor insurance is both useful and practical. Useful, because it ensures that the money is always available for their compensation, whatever the financial position of the tort-feasor. Practical, because it empowers them under certain conditions to enforce their judgements directly against the insured, although they are not party to the insurance contract. Also practical, because under compulsory insurance it is the general practice that insurers are compelled to satisfy the judgements obtained against policy holders despite the possibilities that the insured may have committed some breaches of policy terms which would otherwise entitle those insurers to repudiate the claims made against them.

For insurance companies motor insurance is one of the most important classes of business premium-wise. For developing countries in particular, where the insurance activities are restricted because of the narrow base of the modern economy or because of the lack of insurance awareness, motor business normally ranks first or second as a source of premiums. The size of motor premiums compared with other classes of business usually serves as an indicator of the stage of development of the insurance market. The reports which you will present this week will show the importance of this line of business and reveal its dominant position within the insurer's portfolio. They will also prove that this importance increases with the stagnation of the market, and decreases with its development quantitatively and qualitatively. I shall revert to this matter later, when I expand my ideas on the importance of motor insurance for the insurance industry.

From the standpoint of insurance intermediaries, who are the link between the public and the insurers, motor insurance represents the bulk of the business canvassed by them. This is particularly true in respect of developing markets where motor insurance is almost the unique source of insurance commissions.

Finally, as motor insurance plays a major role in the compensation of victims who sustained bodily injuries and/or are obliged to repair the vehicles damaged by collision, etc., the substantial amounts involved have brought about the development of many professional activities connected with it. There are the claim adjusters who investigate the insured claims, the estimators who determine the amounts of property damage, the lawyers who determine the responsibilities of the parties and defend the claimants and insurers before the courts. Several other professions and specialists are also involved in the operation of motor insurance such as doctors, mechanics whose services are required for estimating and remedying losses.

Appraising motor insurance as a principal activity for insurance companies in developing countries, it may be relevant to state some facts which play a decisive role in the life and performance of domestic insurers in these countries. As you know, motor insurance is an every-day business. This means that it is written every day of the year, and in this respect it differs from other property and liability insurances which tend to be written on certain dates. The fact that motor premiums are cashed every-day provides the insurer with a flow of funds which is called "cash flow". This cash flow is very necessary because it enables the insurer to meet his normal obligations, obviating the necessity to keep his assets in a state of liquidity. It also serves to finance his expansion, particularly into new fields of activity. This explains why most insurers write extensively motor insurance even if the underwriting results are not favourable.

Another feature distinguishing motor insurance from other lines of business in developing countries is that it enjoys enough exposure units or spread, to which the law of large numbers is applicable, and renders loss statistics highly credible. This often applies to individual companies, but in all cases to the market as a whole. The implication of such a spread, at least in theory, is that motor insurance can produce a balanced account, provided of course that the rating reflects claim ratios.

A third feature of motor insurance is that its acquisition costs and underwriting expenses are comparatively lower than other classes of business. This is principally due to the compulsory nature which characterises its liability section. Thus commissions paid to intermediaries are generally low. Also, underwriting expenses are minimal because most of the indicators of physical and moral hazards can be obtained from the application form, and seldom there is any need for inspecting motor risks for their classification and rating.

A salient feature of motor insurance is that it normally does not lend itself to proportional reinsurance. Only heavy claims require such type of reinsurance cover, called "Excess of Loss", under which the ceding company decides how much it is prepared to retain for its account on each and every loss before reinsurers become interested. The premium for such type of reinsurance is calculated at a rate per cent or per mille of the total premium income of the motor account. Thus, the major part of the premium generated by this branch remains with the insurer, contrary to what happens in other lines of business. As there is a margin of time between motor insurance receipts and disbursements, the bulk of motor premiums becomes the main investment resource for the insurers. The constitution of motor funds for the reserve purposes, and the investment of these funds operate as a stabilizing factor for the insurer in his global activities, particularly if other premium resources are insufficient.

I should not overlook the fact that motor insurance, unlike other classes of business, does not require for its underwriting a highly specialised know-how. It is sufficient for the staff working in this category of business to have firm underwriting guidelines, with sufficient classification and reasonable rating system. Only on the claim side, extensive experience and resort to specialists is required in order to process claims in an adequate manner.

Because of the concurrence of these features, motor insurance by its volume, growth rate and nature of operation will remain for a considerable time to come the main line of insurance business in developing countries. Thus, adequate profits in motor business are vitally necessary if the emerging insurance industry in these countries is to develop and grow, and if the public is to continue to be provided with an essential insurance cover.

A second conclusion which can be drawn from the above-mentioned considerations is that all the ingredients of the successful running of motor insurance exist, namely the large volume of premiums, the spread, the easiness of underwriting, the reduced reliance on reinsurance, and extended possibilities of large scale investment.

You may remember that I mentioned before the word "in theory" in respect of the prospects of balanced results for motor insurance. This is because this category of business is involved in issues much broader than the factors of spread, cost and reinsurance. In fact, motor insurance operates within a vast legal, economic and social framework in which the insurance sector has a very limited power to control or even to intervene. Take for instance the legal framework in which the motor insurance systems operate. As you know, motor insurance in its present form emerged mainly thanks to the existing legal provisions which govern matters related to liability towards third parties. The approach to these legal provisions changes with time, the concepts and interpretations also change even though the wording of the Law remains unchanged. For instance, we can clearly observe a trend prevailing in many countries to focus more and more attention on the plight of the victim and his compensation. Increased awards for victims of motor accidents mean increased disbursements by the insurance companies.

Another element which the insurance industry has no control over is the degree of motor traffic and questions of safety, as well as the behaviour of drivers on the road, the physical environment of traffic, the degree of enforcement of traffic codes, etc. All these matters have direct bearing on the performance of motor insurance. The economic environment has also an impact on the running of motor insurance and its results. Insurance companies covering motor business are in fact huge purchasers of goods and services, such as cars, spare parts, labour, doctors' fees, medical and hospital expenses, rehabilitation services and equipment, loss of wages, court awards, lawyers' fees, legal proceeding costs, etc. Thus the disbursements and expenses incurred by insurers in this field are affected by the economic conditions and particularly by inflation which is reflected in prices, salaries and money values.

Finally, there is the question of claim consciousness, which has a direct impact on the number and quantum of motor claims. Such consciousness is not a static factor, it changes with the degree of education, social awareness, economic conditions, etc.

The interaction of the aforesaid factors has led to the worsening of the experience of motor business in many developed and developing countries in varying degrees. However, unlike the insurance markets of developed countries whose bulk of premiums derives evenly from all branches of insurance, the insurance markets of developing countries have been severely hit by the deterioration of the results of motor insurance as the latter represents the major source of premium income for them. Some companies experienced heavy losses and became insolvent, others stopped or restricted their writing of motor insurance, in spite of the compulsion to give cover for liability. If the trend of deterioration continues, motor insurance could become a serious threat to the emerging insurance industry in developing countries and would handicap its growth.

All these problems, and others, have been brought to the notice of UNCTAD by several developing countries. This is why we thought of organizing this Seminar with the objective of highlighting the problems of motor insurance in developing countries, emphasising the strengths and weaknesses of the present insurance system, and finally discussing ways and means of improving the performance of this line of activity. One final word I must say before I end my intervention, is that when we discuss the solutions to the problems of motor insurance we should not overlook or undermine the fact that motor insurers have in this field a social responsibility to the public. Thus, the success of any solution depends on a wise proportion of the fulfilment of such responsibility in an efficient and inexpensive manner, and the guarantee of a decent profit for the insurers in order to continue to provide cover for motor risks.