

Restricted Private Autonomy and Discrimination of the Consumer in the Area of Compulsory Automobile Insurance

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The Bund der Versicherten has initiated the – we call it – EU-project, because we found out:

1. Good (accident-free) drivers – especially people from big cities – pay a lot more premiums during their “driver-life” than State officials in rural areas. They pay even more than those who had accidents. Many good (accident-free) drivers – especially young drivers – can never find the appropriate – most favourable – premium, because they are judged as bad drivers by all insurers according to similar tariffs and have to pay the highest premiums.
2. The so-called “insurance-market” does not function, neither nationwide nor pan-European. The intransparency increases more and more and even experts cannot get through that jungle.

I think, these facts have a circumstantial evidence that something is wrong in the area of automobile insurance.

Restriction of Private Autonomy

I am sure everybody agrees, that the freedom of contract is restricted in motor liability insurance by the compulsion for the car owners to insure their car, by the compulsion for the insurers to conclude a contract with everybody (different in USA), by prescription of terms and conditions, of minimum protection and so on. But the most important and most disadvantageous restriction of the private autonomy of the consumer (of his freedom to decide and choose) is overlooked. This is – above all – restricted by an extensively similar tariff-structure, which is the result of the “phenomenon” selection. In Munich I called that a “cartel of selectors”.

CHART 1

Although the insurers offer closely the same, only a fraction of the so-called “insurance-market” is open to young and other drivers with certain criteria. Young drivers are compelled to pay the highest premiums only because of their age. The best drivers in the world can only seek for offers and insure themselves in this small “high-premium-market-segment”.

Discrimination

By that I come to a point where we are not at one: For me this disadvantage is discriminatory, because the tariffs don't correspond to the insurance technique, that means: They are factually incorrect.

Insurance technique

The insurance technique for designing tariffs consists of two areas:

CHART 2

1. Ratemaking

That is the addition of all loss payments of the last year plus a trend- and safety-addition. The result is the contribution-need.

2. Classification

Here it is decided, how the contribution need is distributed among the insureds.

CHART 2

One part is spread equally over all insureds, another part according to the individual (inherent) risk.

CHART 3

For classification (1) all possible risks and the degree of their exposure to danger must be measured and (2) criteria must be sought, which are related to the insured danger, so that the insurer can use these criteria for the assessment of each individual risk to assign each individual risk to the appropriate risk-class.

The research for danger-criteria is the task of the statistics.

The insurance-technical starting point and starting-question is.

CHART 4, 4a, 4b

(1) What determines the occurrence and extent of a motor liability claim and (2) which criteria can be ascertained objectively with regard to the danger, to cause such a liability claim and used for the classification of the individual insured ?

The answer can only be:

Occurrence and extent of a liability claim are caused, respectively are determined

- by abnormal behaviour in driving (by instantaneous failure or constantly bad driving),
- by defects of the car,
- by things and persons, which are damaged.

Only objective criteria, combined with the risk, are measurable by statistics. Not objectively measurable are factors conditioned by chance / coincidence or subjective (abnormal) behaviour. Nevertheless subjective bad driving can be ascertained objectively with every individual insured by his driving record (losses). Possibly a coherence can be ascertained by statistics with bad driving on one hand and

- fast or old cars,
- long or dangerous distances,
- driving-areas with hard traffic

on the other hand.

Such a classification system would result in extensively uniform contributions and a differentiation prevailed by a malus-system (malus = additional contribution after losses).

Such a differentiation was not enough for the insurers especially since they know that they can influence their business result by the selection of certain groups and that they must react to the selection of their rivals.

So the statistical and insurance-technical starting question was perverted by the insurers in:

CHART 5

Which group-criteria can be ascertained, which make it possible for the insurer to influence his business result by selection of certain groups ?

The answer is: There are a lot ... up to the color of the skin, of the hair or the car.

By selection statistics the insurance technique was violated. Branch experts know that.

CHART 6

Selection statistics no longer search for danger-criteria, but compare the loss payments for different groups. If the loss payments of one group differ from the loss payments of another the group criteria – like garage, age, profession, nationality – are made “group-selection-criteria”.

The group-selection-criteria are called – in a misleading way – “danger-criteria”, although they have not at all any relation to the danger of a liability-claim. The greatest misleading, producing all the irritations and erroneous opinions and procedures, is the assertion, the

pretended danger-criteria had a statistical significance with regard to the danger of a motor liability claim of the individual. In fact, criteria like garage, age, profession, nationality ... have a statistical significance only with regard to the loss payments of correspondent criterion-groups.

Group statistics combine three procedures “determination of a criterion”, (2) “research for the criterion with every insured” and (3) “assigning the insured to the criterion-group” to only one procedure. This has nothing to do with individual judgement. If the insurers would concede, that they classify groups, they have to answer the question: Where do they derive from the right to lay down that – for example - the drivers living in Leipzig shall be cut off from the subsidy in a national compulsory insurance and pay their losses by themselves ?

Related to the insurance-technical starting question, the group-selection-statistics violate all statistical rules, especially the prohibition of generalization of average-results of heterogeneous groups. Only two examples: (1) Nowadays, the best driver in the world turns to be the worst in a group with high loss payments, because of the high average-loss assigned to him. – (2) Or all drivers of Leipzig (a German city with the highest premiums) turn to be bad drivers because of the high average loss of the Leipzig-area, although Leipzig – according to the insurance technique – is only a criterion that in Leipzig bad drivers cause losses sooner than others (which does not concern the good drivers).

About this “fundamental problem of false statistics” there will be much more written in our final report because by the answers to the questions around this problem the question of State interventions in the tariff-structures is answered, which would be admissible if the actual tariffs were factually incorrect, that means arbitrary and discriminating.

The consequences of the actual tariffs according to group-selection-statistics

CHART 7

- Although there is the highest number of good drivers within the group of young people, they pay the highest premiums because of the highest number of bad drivers and the corresponding high average-loss of the group.

CHART 7a (New Jersey study)

- Because using the group-selection-criteria without any relation to the insured danger, nowadays the bad drivers can be found in all groups – even in those with the lowest premiums! – But the good drivers are also in all groups, especially all young drivers in the groups with the highest premiums.
- By this bad drivers with losses pay less than good drivers.
- The present tariff-groups turn into insurance-communities by the grouping according to average-losses and the groups supply their own contribution need, which is wrong, because this should be the task of the insurance-community – that is the national community of the compulsory insureds (see Stanford Research Institute, 1976: „It is an incorrect view that the essence of classification lies in pooling of risk within each class.“)

CHART 7b

- The community of the compulsory insured is destroyed and split into innumerable insurance communities, supplying the premiums for their own losses.

CHART 7c

- Loss-free drivers in classes with the highest premiums subsidize excessively all the other compulsory insureds – they even subsidize the loss-free drivers in other groups, too.
- The argument, not to classify groups according to their average losses would lead to a wrong subsidy among the groups (from those with lower average-losses to those with higher average-losses) is nonsensical, because – for example – all drivers from Leipzig always pay more than other groups according to any tariff-system, because there are more accident-drivers who pay always more than the loss-free.

Classes should be established according to the insurance technique like this:

- The group of the loss-free drivers could be more differentiated for example by mileage (according to more or less using the institution “insurance”, which everybody – and this is important - can influence)
- For the group of the “accident-drivers” a different malus-contribution would be possible, if it could be statistically proved that accident-drivers cause liability claims sooner than others (1) in certain regions (2) with fast or old cars or (3) on long or dangerous distances. It is fair and can be justified to treat the “accident drivers” differently from the loss-free.

Summarized it can be stated: The present tariff-structures are factual incorrect because they violate the insurance technique. The disadvantages for millions of drivers are not justified, that means: they are discriminatory.

Weighing the interests of insureds and insurers

The question is, if the interest of the insurers in selection should be more important than the interest of the insured in insurance-technical unobjectionable classification and fair contributions.

Of course, the interest of the insureds is more important. Nevertheless the “phenomenon” selection has to be taken in consideration. The prohibition of insurance-technical wrong selection-criteria is not enough. Selection possibilities by regional and professional special insurers must be stopped, too, which is possible without problems and can be justified by the same reasons like the prohibition of selection-criteria. Besides, after the prescription of new tariff-structures, there are possibilities for the insurers to react to the selection of their rivals, for example by a “malus”, added to all contributions with an agreement for a forfeiture or repayment according to the loss-record of the individual insured. For the rest, differences in the composition of the insureds, which lead to different results from all motor-insurance-contracts (surpluses or deficits), could be equalized by a – possibly – European reinsurance-pool.

Intransparency

Intransparency is caused by the immense and steadily increasing number of tariff criteria and criteria-combinations, which make information and to inform oneself impossible. An example:

In former times there were only 11 horsepower-classes in Germany. Everybody knows the horsepower of his car and– if he would – he could look into a tariff-book and find the premiums for cars with 75 or 100 horsepower. Advertising with premiums for horsepower-classes or comparisons of horsepower-classes were useful information.

Nowadays the premium is calculated according to car-types. But there are thousands of car-types. The consumer has to find out in which type-class his car will be assigned. Data about type-classes are not useful for anybody, premium-data about a certain car-type only for a fraction of car-owners, who drive this type of car. Who does not know, which 75 horsepower-car he will buy, needs the premium for each car, that means not only one information but a lot of data.

We found out that consumers, confronted with this intransparency, resign / give up and insure themselves anywhere – to the delight of the bad and expensive insurers.

This is only one example for the information difficulties of the consumers and a reason that “market” and “competition” in motor insurance do not even function nationwide.

Here we come to my favorite subject, which – unfortunately - I can only touch.

What is insurance and can there be competition in the insurance field ?

Look at these statements:

CHART 8

If insurance is “**abolishing financial risks by providing money**” and so far the **performance of the insureds** (and not a product or service of the insurance companies) and if insurance has nothing to do with competition:

- Why not withdraw the pure insurance contribution from competition ?**
- Why not transfer the determination of the pure insurance contributions, which must be sufficient to meet the indemnification claims of the traffic victims, to national institutions ?**
- Why not prescribe the basic terms and conditions, tariffs and tariff-regulations by a – possibly European – institution ?**
- Why not establish a – possibly European – reinsurance-pool for the compensation of surpluses and deficits in the “insurance area” of the “insurance service companies” ?**

The insurance service companies would add a price for their services to the pure insurance contributions. They could – by quoting additional contributions – add components for a more extensive (voluntary) protection.

The result would be: The competition would not be abolished or restricted but even promoted, because competition would be limited to the really performed services of the insurance service companies. The prices for the services would no longer be hidden in the premiums, but had to be quoted – according to the obligation of every business man or firm to quote the price of his products or services.

By the way, another injustice would be abolished, that young discriminated drivers nowadays pay overcharged costs- and profit-portions with their overcharged premiums.

The pure insurance contributions would no longer be of interest for the consumer (because all companies would have uniform tariffs). So far the consumer would no longer have information problems but needed only to compare the prices, which the companies charge for their services.

There would no longer be restrictions of the private autonomy and no discrimination.

All this comes very close to the Japanese system and is backed up by all the interventions of EU-member-states into the tariff-structure of the motor liability insurance (France, Italy, Germany ..)

Above all, this corresponds to the fact, that anywhere in the world you cannot find insurance as a product of the companies. There is no computation of the Gross National Product where you can find a price for insurance. According to this, rating and classification has nothing to do with “cost-based-pricing” (because the insurance contribution is no price and loss payments by distributing the money, provided by the insureds, are no costs).

So we rack our brains over something not existing, over the economically impossible offer of risk-bearing, over a not existing market and an impossible competition around the so called risk-bearing. Losses arise accidentally and cannot be reduced by selection.

About all you will find much more in the final report.

I come to the end:

The target of our project is to gather opinions for decisions of the EU-Commission.

The EU-Commission would be well advised to let the questions I dealt with investigate more intensively – the essence of insurance and statistics, rating and classification, private autonomy and discrimination, transparency and competition in the insurance field – but not by or in cooperation with the insurance committee which seems to have not the right members for that.

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