

Recommendations for automobile insurance system reform

ABSTRACT

Since 2000, automobile insurance system reform has been repeated every three to four years to stabilize the sudden increases in loss ratio. The rate and product liberalization policy has been interacted with public perception of automobile insurance as a necessity good (compulsory insurance), and the leadership has been changed from “Financial Supervisory Service-led” and “pan-government-led” to “industry-led (recent)”. As of 2019, the loss rate has soared again, the system reform should be preemptively led by the industry. Industry should declare self-help efforts and make proposals to make regulators actively participate in the process of stabilizing the loss ratio.

1. Increase in loss ratio and leadership in reform

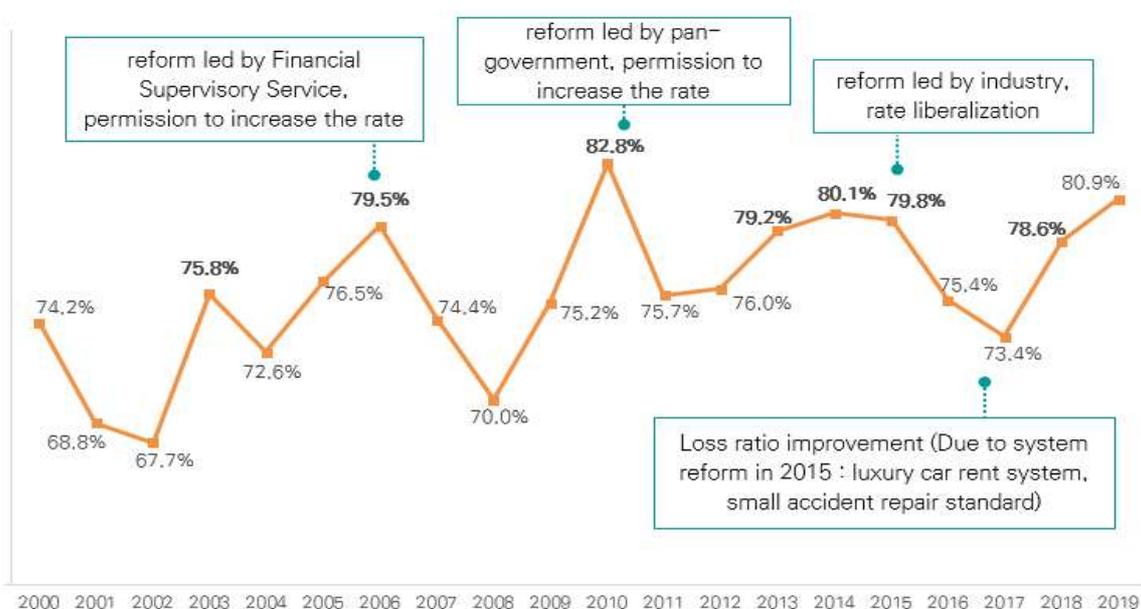
The recent automobile insurance loss ratio rapidly increased to 78.6% in 2018 and 80.9%¹⁾ by May 2019 after reaching a low in 2017. Since the liberalization policy of automobile insurance in 2000, the pattern has been repeated every three to four years that an increase in loss ratio leads to system improvements and raising insurance premium, resulting in a decrease in loss ratio. The recent deterioration in loss ratio seems to be an early stage of the pattern.

The leadership of the system reform has been changed from “Financial Supervisory Service-led” and “pan-government-led” to “industry-led.” At the time of the Financial Supervisory Service initiative (2000~2005), the loss ratio was stabilized due to the powerful rate and product liberalization policy. During the “pan-government-led” period (2006~2012), despite the deregulation policy of tariffs and products, automobile insurance was highlighted as a necessity good, thus various system improvements

1) The loss ratio which loss amount was included in the damage assessment cost was 88.4%. It means that the current deficit scale of the automotive industry is very large compared to the balanced loss ratio level (expected loss ratio). Source: Korea Insurance Development Institute monthly report May 2019

stabilizing the premium (prevention of claims leakage, reduction of accident rate, reduction of business expenses, improvement of rate system, and so on) was made by the pan-government initiative comprising Financial Services Commission, Ministry of Land, Infrastructure and Transport, and Korean National Police Agency. In the industry-led period (2012 and later), system improvements such as a luxury car rent system and small accident repair standard were made in a way that regulators accepted industry's proposals in accordance with liberalization.

〈Figure 1〉 Change in loss ratio and system reform



Note: 1) Performance loss ratio means the damage investigation cost included in business expense
 2) 2019 data is cumulative data up to May
 Source: Korea Insurance Development Institute monthly report

2. Recent challenge to stabilize loss ratio

The recent surge in the loss ratio seems to be due to the pressure to reduce premiums and unpredictable external change such as the Supreme Court's judgment. In addition, the fierce premium discount competition to increase its market share in 2017 when the overall loss ratio of the automobile insurance industry was low, was also an important factor in the sudden rise in the loss ratio. Despite the need to improve extensively automobile insurance system in order to stabilize the loss ratio, there is no clear reform leadership and the public sentiment opposing to raise the automobile insurance premium are obstacles to carry out reforms.

3. Recommendations

At the industry level, multilateral measures aligned with liberalization policy are necessary. Industry should incorporate self-help efforts such as prevention of fraud (including prevention of claims leakage), reduction of accident rate and business expenses, and make proposals to regulators so that the rates adequately reflect loss ratios. Moreover, the point should be actively advertised to the public that the recent increase in premiums was “not a raise in the industry’s profit, but only the consequences of the unpredictable environmental changes”. Excessive competition can be avoided by establishing thorough review practices of the rate determination that are consistent with the premium calculation principle. Policy makers and regulators should provide guidance for industry to engage in sound market competition along with the liberalization policy. It seems necessary to establish an official system that can assess environmental factors inducing payment increases and incorporate those factors into payment system.

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