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## **MEETING LIBERALIZATION OF MOTOR LIABILITY INSURANCE PREMIUM IN SERBIA**

### REVIEW ARTICLE

#### **Abstract**

Free definition of motor third party liability insurance tariffs leads to individual statement of premiums in agreement with the degree of risk the insured are exposed to i.e. their behaviour in the previous period.

Using the experience of neighbouring countries, which have introduced a system of liberalization of motor third party liability insurance premiums, with prior quality preparation, Serbia could establish the liberalization of motor third party liability insurance premiums which could significantly contribute to insurance market advancement. This can also affect the behaviour of drivers, whereby we would raise the level of traffic safety and reduce the consequences and damages caused by traffic accidents.

**Keywords:** *motor third party liability insurance, motor third party liability insurance in Serbia, liberalization of premium tariffs*

### **I. Introduction**

According to the estimates, almost 1.2 million people lose their lives in traffic accidents every year, worldwide, while the number of the injured and disabled (completely or partially) is significantly higher than this and amounts to between

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20 and 50 million.<sup>3</sup> Modern society invests great efforts to keep the indemnity for damages from traffic accidents under control and there is a newly imposed government obligation to reduce the risks inherent to the traffic development down to socially acceptable levels. This implies continuous improvement of rules and mechanisms to guarantee the protection of road user care for victims of traffic accidents and equitable indemnity (compensation) for damages to property and personal injuries arising from traffic accidents. The key mechanism for providing indemnity i.e. compensation but also for financial protection of tortfeasors in traffic accidents is the motor third party liability insurance, which is usually mandatory worldwide.

The governments that regulate the obligation to take out the motor TPL coverage often stipulate the conditions under which this insurance shall be provided and, in particular countries including Serbia, there is still a premium system (minimum tariff) that must be obeyed by all insurance companies - premium cannot be lower than the one defined under the minimum tariff. Non-compliance with the minimum MTPL tariff in Serbia is subject to strict legal sanctions prescribed by the law regulating compulsory traffic insurance<sup>4</sup> (including strict sanctions against the insurance companies and their management). In most countries with no free definition of motor third party liability insurance premiums, such a strictly regulated system is mainly justified by a combination of numerous arguments. Below are given examples of the most common arguments:

- 1) insurance premium (price) is like the price of standard life necessities i.e. belongs to a sensitive part of the household expenditures so the government should guarantee that the price is neither too high (because there is a risk that a large number of vehicles will not be insured), nor too low (because the premium amount will not be enough to indemnify for the losses);
- 2) insufficient quality of developed market competition may lead to a large gap between the premium for which this insurance is sold and the premium that would guarantee solvency (e.g. due to the war of prices);
- 3) settlement of liabilities to third party claimants arising from traffic accidents under motor third party liability insurance is ultimately guaranteed by the state (e.g. through a guarantee fund), etc.

However, the experience of many countries shows that the model of absolute administrative supervision, i.e. regulating minimum tariffs for MTPL insurance, no matter how justified, is not acceptable in the long run. Namely, the system of regulated minimum tariffs for MTPL insurance has proven to be inefficient due to pricing as elements of social policy, excessive administration, severely narrowed space for insurers' competition and numerous other reasons.

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<sup>3</sup> World Bank; <https://blogs.worldbank.org/opendata/>, visited on 15th November 2020.

<sup>4</sup> Law on mandatory insurance in traffic, *Official Gazette of the RS* nos. 51/2009, 78/2011, 101/2011, 93/2012 i 7/2013 – Decision of CC.

It could be said that, in contrast to the reasons for regulated motor third party liability insurance premiums, the reasons for the free formation of this type of insurance premiums (popularly called “tariff liberalization”) are more convincing, but only when the liberalization is adequately implemented. Below are listed the most frequently mentioned arguments for the free formation of a motor third party liability insurance premium that have been confirmed in the practice of many countries:

- 1) more adequate risk assessment and premium differentiation (preventing premium instability and negative risk selection);
- 2) more favourable and equitable position of the insured - through premiums measured according to the risk the insured is prone to and risk segmentation;
- 3) encouraging the desirable behaviour of the insured and a significantly more responsible behaviour of the insured (because they become aware that the insurance premium depends, among other things, on their behaviour in traffic);
- 4) better and higher quality provision of services;
- 5) strengthening “direct” sales;
- 6) more efficient regulation of market behaviour, etc.

However, the experience of countries that have introduced the free formation of MTPL insurance tariffs (popularly called “liberalization of MTPL insurance tariffs”) show that the free definition of premiums by insurers, in itself, without adequate risk management, adequacy of premiums and indemnity reserves and ongoing supervision by the competent institutions, does not necessarily lead to the improvement of the MTPL insurance system nor to a greater or better protection of claimants and insured persons.

Adequate systems for risk identification and measurement, risk avoidance and mitigation activities (preventive and repressive measures), strong market discipline, healthy competition as well as tight control by supervisory institutions are the key prerequisites for the successful introduction of liberalization of MTPL insurance tariffs, maintaining stability of the insurer’s business and ensuring the permanent fulfilment of the obligations taken over in such a system. In order for the liberalization of MTPKL insurance tariffs to be successfully completed, it is necessary to have an adequate:

- personnel training (personnel with expert knowledge and, crucially, adequate management of the insurance company, which understands and supports the work of the experts);
- analysis of risk factors and their correlations;
- data and reporting system on results achieved;
- actuarially funded models for defining premiums, reserves and capital requirements;
- adequate capital base and reserves;

- support of professional associations (usually insurers' associations) in the form of adequate multi-annual statistics by types of vehicles, registration areas, driver characteristics, etc;

- supervision over defining tariffs and achieved results in MTPL insurance.

Supervisors must have, in accordance with the law, effective mechanisms to intervene promptly if the activities of the insurer jeopardize the solvency of this participant or insurance market and it is important to have up-to-date information to promptly indicate when and to what extent intervention is needed to prevent market breakdowns.

## **II. Experiences of Countries from European Union on the Procedure of MTPL Insurance Premium Liberalization**

In all countries of the European Union (EU), motor third party liability insurance is mandatory for users of road motor vehicles. This insurance is complied (harmonized) with Directive 2009/103/EC of the European Parliament and the Council, which coordinates the laws in order to establish a free market among EU members and free movement across national borders. Free formation of motor third party liability insurance tariffs is established under the EU directives 88/357/EEC (and amendment 90/232/EEC) and 92/47/EEC, and all EU member states implement this system. Countries that are on the path to EU integration will also have to adjust to the system of free formation of motor third party liability insurance tariffs, as this is one of the preconditions for accessing with the EU. Some European countries introduced the freedom to define motor liability insurance tariffs even before the implementation of the EU directives. Thus, in Spain, the free formation of MTPL insurance tariffs was introduced in 1984 and in France in 1986<sup>5</sup>.

The experiences of other EU member states in which the definition of insurance premium rates is completely free under the auspices of EU directives are very different.

Where the procedure of introducing the free definition of tariffs for MTPL insurance premiums was not well designed, the insurance companies and the entire insurance market faced the real perils. In some European countries, in the first phase of liberalization of MTPL tariffs, there was an actual war of prices and a struggle to attract new policyholders, through too low insurance premiums. Even the most developed European countries, such as Germany, were not immune to such events, partly because the experience and possible consequences of the introduction of free definition of tariffs for MTPL insurance premiums at that time was modest. The example of Greece is often cited as the worst example of the procedure of introducing

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<sup>5</sup> Gönülal S.O., *Motor third-party liability in developing countries*, Washington, 2009, pp. 168–169.

the free definition of MTPL tariffs. In a short period of time, Greece regulated the MTPL system in accordance with the guidelines of the former European Community and quickly switched from the government stipulated tariffs for MTPL insurance premiums to tariffs completely freely defined by insurance companies. However, in the Greek system, the main problem was not short time allowed to apply the freely defined MTPL tariffs, but the lack of market discipline and the unwillingness of the supervisory body to promptly react. As a result, during the process of applying the free setting of MTPL tariffs in Greece, 30 insurance companies went bankrupt, leaving their clients without an insurance coverage.

In Bulgaria, too, the liberalization of motor liability insurance premiums led to certain problems caused by the war of prices. After the introduction of liberalization, motor liability insurance premiums fell from the original 60-70 euros (already low) to 30-40 euros per insured vehicle,<sup>6</sup> causing major market disruptions.

Romania also suffered major disruptions in the insurance sector after liberalizing motor liability insurance premiums. After joining the EU, in 2008, the country was allowed to freely form motor liability insurance tariffs. Following the initial growth of insurance premiums in the period 2008-2010, accompanied by high costs of insurance, with a constant very unfavourable combined ratio (up to 135%), in 2011 and 2012, Romania experienced a sharp decline in MTPL insurance premiums. After 2013, the insurance premiums increased again and the combined ratio dropped below 100%, but not before 2017. The unfavourable developments shown over a longer period of time in Romania led to a decrease in the number of insurers (by liquidation or merger) providing motor third party liability insurance services, from 15 in 2006 to nine in 2017. Regulatory measures have given a significant impetus to the recovery of the market in Romania. Namely, in 2017, a regulation was passed<sup>8</sup> requiring insurers to make very transparent statement of tariffs and the premium had to be determined based on the frequency and intensity of claims, multi-annual data history and trend projections, cost data and profit rate, which was significant impetus to the regulation of the MTPL insurance market.

Nevertheless, there is much more good experience with introduction of free pricing of motor liability insurance premiums. For example, in Austria, liberalization has led to positive changes. Prior to the introduction of the free definition of motor liability insurance premiums (the beginning of liberalization dates back to 1987) in Austria, the insurance terms and conditions, premiums and the bonus-malus system were government regulated. At that time, motor liability insurance premium was not sufficient and this insurance was unprofitable for Austrian insurers. In the next

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<sup>6</sup> Boban Tomevski, "Development of Motor Third Party Liability Insurance", *Market in Terms of Changing Regulation Procedia – Social and Behavioral Sciences* 44, 2012, pp. 204.

<sup>7</sup> O. Ederer, pp. 19. and 22.

<sup>8</sup> Norm no. 15/2017 adopted by Autoritatea de Supraveghere Financiară

transitional seven-year period, the government regulated the structure of the premium and the bonus-malus systems, the premiums became freely definable by insurers with the obligation to officially publish and update the premiums at least once a year. The supervisory body in charge of controlling Austrian insurers also approved the insurance terms and conditions applied by the insurers. Starting from 1994, MTPL insurance premiums were fully liberalized in Austria, and the law prescribed in detail the scope of insurance coverage and forms of insurance exclusions. In the first few years after the full liberalization of motor liability insurance premiums in Austria, the average insurance premium decreased, but such changes did not lead to the instability of the Austrian insurance market (the combined ratio of about 95% in 1994 worsened and equalled about 98% in 1998).<sup>9</sup> Tariffs introduced by Austrian insurers were updated and in addition to the standard structure (as per vehicle types and basic characteristics), premium segregation criteria have been introduced, e.g. according to the age, profession and residence of the insured. In Austria, apart from the initial loss of premium volume, relatively regular premium rate cycles ensued and there were no insurers that became insolvent.

An example of the successfully implemented liberalization of motor liability insurance premiums is the liberalization implemented in Hungary. Prior to starting the MTPL insurance system reform, only one state-owned insurer dealt with this insurance in Hungary and the insurance premium was collected through the price of the purchased fuel. From that period until today, numerous changes have taken place. These changes reflect in the privatization of insurance, competition strengthening, premium differentiation and selection of insured persons through the bonus-malus system. The system of free definition of premiums has been gradually introduced since 1998. During the three-year transition period, insurers were able to gradually deviate from the basic tariff set by the Ministry of Finance by 5% in 1998, 10% in 1999 and 15% in 2000.<sup>10</sup> This three-year transitional period ensured the introduction of gradually increased freedom for insurers in Hungary when defining motor liability insurance premiums. The basic direction of the new regulation was that insurers were free to set premiums, including the bonus-malus scheme, as long as they fully follow and respect the rules of the profession and regulations. Expectations that strong competition will develop among insurers in Hungary, with a reduction in premiums in the initial phase, have proved correct. The application of free definition in motor liability insurance tariffs led to the privatization of insurers, setting premiums according to the degree of insured risk but also to the reduction of premiums in the initial phase. However, this system can be attributed to a relatively sluggish

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<sup>9</sup> Othmar Ederer, "MTPL Tariffs liberalization", *The annual Insurance Conference of the Republic of Moldova*, Kişinev, 2018, pp. 8. and 9.

<sup>10</sup> Doganjić Jelena, *Problems of defining tariffs in motor third party liability insurance* - Master Thesis, Belgrade, 2007, pp. 21

implementation, which is understandable because the system with only one state-owned insurer that provided MTPL insurance services suddenly moved to a market with a large number of insurers competing with each other.

Slovenia, as well, can be presented as a good example of the introduction of free definition of motor liability insurance premium tariffs. Free definition of premiums for the motor insurance in Slovenia, introduced in 1998, neither led to a major turbulence in the market nor to a significant change in insurance premiums, owing to good cooperation between insurers and prompt reactions of supervisory authorities. In this country, the process of setting tariffs freely led to better risk selection and premium definition alleged to the risk insured.

The free definition of tariffs for motor liability insurance premiums, introduced in Croatia in 2013, did not lead to significant changes in the very beginning. Namely, liberalization was introduced just before Croatia's accession with the EU, but in 2013 premiums in practice remained at a similar level, which might have been the result of tacit agreements between insurance companies. Differentiation of premiums was carried out through other channels - granting discounts to insured persons or additional, often free or very cheap other insurance products (travel assistance, partial motor hull insurance, legal protection, etc.). Over the next few years, there was a stronger war of prices that led to a worsening of the combined ratio from a very favourable 75% (before liberalization) to about 95%. In the period 2013–2018, the average compulsory insurance premium per vehicle was reduced from the initial 201 euros in 2013 to 156 euros in 2014, and in the period 2015–2018 the average premium ranged from 125 to 130 euros per insured vehicle<sup>11</sup>. However, the solvency of insurers in Croatia has been preserved in the process of free definition of MTPL insurance tariffs and no insurers have lost their license due to insolvency, but there has been market restructuring (change of positions between two leading insurers, strengthening the influence of smaller insurance companies, etc.). Croatia's experience showed that liberalization led to a decline in the average motor liability insurance premium (in the period from 2013 to 2018 by about 35%), but not to a destructive competition. The insurance premium sustained a significant decrease; the profit margin reduced but still was positive.

According to expert assessments, in no case did the liberalization of motor third party liability insurance premiums have a negative impact on the broader economy, although in countries where market discipline and adequate supervision were lacking, the free setting of MTPL premiums led to initial instability in the insurance market.

It is expected that the final effect of free premium definition for this type of insurance in all countries will be a higher degree of competition and, after the initial increase, a final decrease in insurance market concentration, improved risk management, more detailed differentiation of premium groups as per policyholders,

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<sup>11</sup> Ilijana Jeleč, "Motor insurance: from liberalization to the implementation of Motor Insurance Directive", *Motor insurance conference*, Vienna, 2019, pp. 7.

increased traffic safety and other motor liability segment improvements. From the point of view of the insured (consumer), the system of free definition of premium tariffs is linked to a better understanding of the connection between traffic behaviour and insurance premiums. Therefore, it can be said that the progress towards the liberalization of motor liability insurance premiums in most countries has been useful.

### **III. Differentiation of Motor Liability Insurance Premium according to Risk Factors**

One of the basic preconditions for forming a quality motor liability insurance tariff is to identify the basic factors that affect the frequency and amount of losses. If the same insurance premium were valid for all insured persons, this would cause two significant effects: premium instability and negative risk selection.<sup>12</sup> To address these two potential problems, insurers pay close attention to defining basic, significant and less significant risk factors.

The three most important groups of risk factors for motor liability insurance comprise: 1. driver (age, registration area, annual mileage, etc.); 2. vehicle (engine power, vehicle weight, etc.); and 3. environment (road and other vehicles).<sup>13</sup> Subjective risk factors account for up to 90% of the impact on traffic accidents, technical factors slightly less than 10% (engine power, vehicle weight, braking system, etc.), while the impact of the environment (road, road environment, natural factors, etc.) is negligible. As the "driver" and "vehicle" factors mostly influence the occurrence of traffic accidents, these two factors are most often taken into account when forming the motor liability insurance tariff. The table below reflects the tariff factors used by insurers in some European countries.

**Table No.1: Tariff factors in some European countries<sup>14</sup>**

Country	A	B	CH	D	DK	E	F	GB	GR	I	IRL	L	NO	NL	P	S	FI
<b>Factors linked to the owner/user of motor vehicle</b>																	
Age (years)	Z	Z	M	M	Z	Z	M	O	Z	Z	Z		Z	Z	Z	M	M
Occupations	Z			O	M	M	Z	Z						M	M		
Nationality			Z					M									
Marital status				M	Z	M	M	Z		M					M	M	
Other agreements with insurer	Z			M	M	M	M			M				M	M	M	

<sup>12</sup> Ulrich Meyer, *Third party motor insurance in Europe*, Bamberg, 2006, pp. 10.

<sup>13</sup> Krsto Lipovac, Živorad Ristić, "Analysis of the number and structure of traffic accidents in Serbia with evaluation of consequences", Conference with international Participation, "Dunav Preving", Beograd, 2000, pp. 57.

<sup>14</sup> U. Meyer, pp. 138.



Country	A	B	CH	D	DK	E	F	GB	GR	I	IRL	L	NO	NL	P	S	FI
Driver experience	Z		Z	M		Z	Z	Z	M		Z				Z	M	M
Traffic safety training		M		M			M	M									
Auto club membership	Z			M	M		M	M								M	
Health condition								M			M						
Sign of the Zodiac								M									
Loyalty discount	Z		M	M													
Registration area		Z	Z	O	Z	O	O	O	O	O	Z			O	O	Z	Z
Use of vehicle to service purposes	Z	M	Z	M	M	M	Z	Z	Z		Z			M	M	M	M
Discount on low mileage	M		M	Z	M	M	O	Z		Z			O	Z	M	Z	
A group of drivers		M		Z		Z	Z	Z		Z	Z		M				
Driving area			M					M	M								
<b>Factors linked to vehicle</b>																	
Vehicle type/model		M	Z	O	O	O	O	O	Z	O	M		O	M	Z	O	O
Age of vehicle	Z			Z	Z		M	M			M		M		M	M	M
new purchased or used car						M		M									
Purchase price of the vehicle								M					M	M			
Engine power or volume	O	O	O					Z	O		O	O	Z		O	Z	Z
Top speed																M	
Fuel type			Z				M				M					M	
Fuel consumption																	
Engine power to weight ratio			O												O		
Vehicle weight			Z		O									O	O		
Safety equipment			M		M		M	M		M			M				
Vehicle barriers				M			M	M					M				
<b>Other factors</b>																	
Not a rental car	Z																
Sales channels								M									

Symbol meaning: O-central tariff factors, Z-significant tariff factors, M-less significant tariff factors

Experience shows that in the process of motor liability insurance risk analysis, there are problems with a huge amount of risk factors data that are sometimes or very often incomplete, and the risk assessment is complex and requires: factor classification by probability and severity, determination of specific risk changing conditions, risk factors ranking, determining their correlation, summarizing results of the impact calculation of individual factors, etc.

When defining the motor liability insurance tariff, it is important that each premium position (tariff group or subgroup) includes the standard factors that

affect the premium amount, while at the same time this tariff group / subgroup shall represent a part of the portfolio for which premium is definable from the point of view of insurance profession and structural risk balancing. It is also important to optimize the risk breakdown to the extent allowed by actuarial stabilization. This means that a compromise should be made between, on the one hand, differentiating the premium by premium groups to the extent that guarantees the equivalent premium levels, which in turn corresponds to the size of the risk acquired and, on the other hand, differentiating premium groups to the degree that is economically viable i.e. where the costs of coverage, monitoring and processing are adequate. Likewise, similar risk factors must be combined into clearly identifiable risk groups in order to avoid complicated application of the tariff, which starts with a complicated questionnaire and continues with difficult application.<sup>15</sup>

Defining MTPL insurance premium is not at all simple. The premium must be set at a level that guarantees the provision of sufficient funds to preserve the liquidity and solvency of insurers, i.e. the formation of reserve funds and capital that provide permanent settlement of liabilities to third parties, but must also be competitive. A wide range of regulatory factors, economic factors and factors that affect the occurrence of traffic accidents determine the statement of motor third party liability insurance premiums. Premiums are formed in proportion to the expected risks and the required coverage for losses, operating costs as well as in order to make a certain profit while maintaining or strengthening the market position. All of these factors much differ depending on the country, which explains the different levels of insurance premiums. Thus, for example, according to researches, the lowest average motor liability insurance premium per insured vehicle in Europe is in Latvia (around 35 euros), and the highest in Italy (around 350 euros).<sup>16</sup>

The amount of the required insurance premium depends on the incurred claims amount (claims statistics), other legal liabilities related to claims, the costs of effecting insurance and the amount of the calculated profit of the insurer. It goes without saying that the amount of the premium depends on the quality and structure of vehicles, roads, drivers, but also on the insurance market environment, economic environment in the country, as well as on the competitors.

#### **IV. Is it Necessary to Provide Insurance to Every Client?**

Although the EU countries have a fairly equal common view that the liberalization of motor third party liability insurance premiums is indispensable, there is still an uneven attitude towards the obligation of insurers to accept each and every

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<sup>15</sup> Jelena Doganjić, Živorad Ristić, "Differentiation premiums as a precondition for protection against premium instability and negative risk selection", *Insurance Trends*, Beograd, 2011, pp. 28. i 29.

<sup>16</sup> *European Motor Insurance Markets*, Brisel, 2019, pp. 16.

client (the most risk prone one included) into the insurance coverage. Thus, for example, in Italy, insurers are obliged to accept every client into insurance, whereas “bad risks” are distributed among insurers, while the situation in France, Portugal, Spain and some other countries is different. In France, Portugal and Spain, insurers are not obliged to accept every risk (every client) into motor liability insurance and the most risk prone clients can buy insurance from government institutions, at a significantly higher premium than is regular on the insurance market. Government institutions that issue policies to these risk prone clients are funded by mandatory contributions paid by insurers. In Ireland and the Netherlands, insurers are not obliged to accept every client, and the most risk prone clients are insured with companies that specialize in “bad” clients, at a very high premium and to a very limited insurance period.

## **V. What is the Current Position of Serbia in the Segment of Defining Motor Liability Insurance Premiums?**

Pursuant to the Minimum Premium Tariffs for Motor Third Party Liability Insurance adopted in 2014 by the Association of Serbian Insurers pursuant to the Law on Compulsory Traffic Insurance, every insurance company in Serbia has the freedom, in line with its own risk management rules, form their own premium tariff in its business policy acts and is free to charge the additional amounts above those set under this minimum tariff. However, looking at the data on the average MTPL insurance premium, we notice that, despite the above possibilities, the average premiums among insurers in Serbia are very close to each other. For example, based on data from the report on motor liability insurance for the first nine months of 2020 published by the National Bank of Serbia,<sup>17</sup> it can be observed that the deviation from the average premium values per vehicle ranges about 10% at the most. Certainly, this environment characterized by the same premium groups and very similar premiums will remain in the following period, until the free definition of the tariff in this market segment be allowed. This is due to the risk of losing the portfolio in the event of an increase in insurance premiums, but also because good results have been achieved in recent years.

## **VI. Potential Procedure for the Liberalization Process of Motor Liability Insurance Premiums in Serbia**

From the experience of other countries, it can be concluded that the introduction of free definition of motor liability insurance tariffs is a natural outcome

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<sup>17</sup> National Bank of Serbia, Review of insurance and claims in compulsory motor third party liability insurance, 30 September 2020. [https://www.nbs.rs/export/sites/NBS\\_site/documents/osiguranje/mesecni/09\\_2020.pdf](https://www.nbs.rs/export/sites/NBS_site/documents/osiguranje/mesecni/09_2020.pdf), visited on 11. 11. 2020.

of market development and brings many benefits, but in the case of inadequate preparation, can lead to financial instability in the market. Numerous experiences of other countries have shown that there are preconditions for a quality liberalization procedure: provision of adequate organizational, personnel and financial capacities of insurance companies, adequate statistical bases, defining premiums in accordance with professional rules, establishment of control mechanisms to prevent domino effect of inappropriate reduction of high costs, improving education and awareness of the importance of insurance among policyholders and other market participants.

It is clear that in Serbia, the liberalization of the motor liability insurance tariff could bring benefits, but also perils if there is no good preparation and adequate implementation process. The end result of the future liberalization of the motor third party liability insurance tariff in Serbia will depend on the readiness of insurers and supervisory bodies to face the changes that the implementation of this system brings. In order to preserve a stable market, it is necessary to provide preconditions that include a new law on compulsory traffic insurance (or adequate amendments to the existing one), as well as numerous activities of insurers, insurance supervision and professional associations. In the present, as preconditions have partially been fulfilled (strengthened insurance supervision, improved business of insurers and associations), it is possible that the most acceptable solution will be the liberalization of motor liability insurance tariffs, with an appropriate (not too long) transition period that would be require for the preparation. The complexity and importance of liberalization process requires of us to approach this procedure in a planned manner, with the cooperation of supervisory bodies, insurance companies and professional associations and perhaps international institutions, which are experienced in this process.

It would be important to establish a dynamic plan, with the necessary activities and a time frame for such activities. The following table proposes possible basic elements of this procedure, on the basis of researching through the experiences of countries that have successfully implemented the procedure.

**Table no. 2: Potential liberalization process<sup>18</sup>**

1	New law on compulsory traffic insurance and bylaws
2	Formation of a new, more detailed centralized database
3	Preparation of insurance companies (simultaneously with previous processes)
4	Stress scenarios (market behaviour scenarios and effects)
5	Continuation of activities on educating the insured about the importance of this insurance line
6	Procedure for documenting the fulfilment of terms and conditions by insurance companies
7	Continuous and consistent supervision over business of insurance companies

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<sup>18</sup> The dynamics would be determined upon mutual consultations of the supervisory body and the insurance companies

The next part of this Article presents the proposals of the elements of the presented motor liability insurance premium liberalization map.

**1. The new law on compulsory insurance (or adequate amendments to the existing law) could prescribe the following:**

- *Establishing a clear date for the liberalization of motor liability insurance tariffs, including the bonus-malus system, with an appropriate transition period.*

The current legal solution, which links the liberalization of motor liability insurance tariffs to the date of Serbia's accession to the European Union, does not provide for a clear time frame whereas the date of liberalization should be clearly specified under the law, with an appropriate, short transitional period.

- *Harmonization of sums insured with European Union regulations*

The lowest sums to which motor liability insurance can be contracted<sup>19</sup> in Serbia are not in line with the valid European Union standards<sup>20</sup>. The new law would have to harmonize these sums with the regulations of the European Union, allowing for an appropriate transitional period. It could also mean a change (perhaps an increase) in insurance premiums, as the experience of other countries shows that increasing the minimum sums insured leads to an increase in average claims.

- *Establishing minimum standards that insurers operating in motor liability insurance should meet (and continue to permanently maintain).*

These standards could include:

- minimum (stricter than the current) reserve and capital adequacy standards;
- minimum standards for defining the tariff of motor liability insurance premium (statistical bases, models for risk assessment - risk factors, frequency and intensity, trend projection, up-to-date review of the tariff, etc.);
- minimum standards of organizational, personnel and technical equipment;
- standards related to persons selling insurance and enabling electronic sale of MTPL insurance policies etc.

- *Further improvements in the promptness and quality of claims payment, which, for example, could include the introduction of a direct service processing and claims payment model<sup>21</sup> etc.*

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<sup>19</sup> Such a model has already worked well in our area and relies upon the agreement of the insurer, according to which the claimant would apply for indemnity to the Insurer with whom he has been insured, and the damage would then be recouped by the Insurer of the tortfeasor. In this way, the competitive advantage of the Insurers would be good relations to the clients and drivers would, when concluding the contract, take good care about the choice of the Insurer.

<sup>20</sup> Directive 2009/103 / EC of the European Parliament and of the Council, Article 9 prescribes the following: the minimum sums to which motor third party liability insurance can be contracted: 1) EUR 1,000,000 per victim or EUR 5,000,000 per claim, regardless of number of victims - for bodily injury and 2) for damage to property 1,000,000 euros per claim, regardless of the number of victims.

<sup>21</sup> Such a model has already worked well in our area and is based on the agreement of the insurer, according to which the injured party would apply for compensation to the insurer with whom he is insured,

• The new law could, after prior consultation, determine new possibilities for a professional association of insurers, in cooperation with a professional association of actuaries, in terms of:

- providing an improved premium and claims database, for compiling a framework of a new premium tariff structure and providing access to this database to insurers and insurance supervisors;
- formation of a new improved premium tariff (improved types of premium groups, more detailed segmentation of risks taking into account the driver and vehicle factors) for higher sums insured (in accordance with European Union rules), which insurers would apply in their tariffs in transitional period. (after a certain period of time, we could allow the deviation in the particular percentage range until the moment of full liberalization, when the determination of the premium shall be completely free);
- providing a database for application of bonus-malus system in the system of free formation of premium tariffs - time series of the number and amount of claims per insured persons to be defined by each and every insurer for themselves after the premium liberalization.

• Stronger mechanisms for undertaking measures by supervisory bodies and possibly prescribing higher or stricter capital requirements.

## **2. Provision of a new centralized database, with more detailed data on policyholders and vehicles**

The Professional Association of Serbian Insurers (Association), among other things, carries out the activities of common interest to insurers, effects the public authorities entrusted by law, implements the activities related to the improvement of insurance and performs numerous other tasks. From 2010–2011, the insurance companies have delivered the Association the data on vehicles and vehicle owners who have concluded motor liability insurance as well as on claims where the liability of participants in the accident has been established in order to determine the premium for the next period (bonus-malus). Ten years of experience in collecting data on vehicles and their owners and/or damages under motor liability insurance have provided some experience that could be used in the future period.

The collection of more detailed data could be considered in the future, thus creating the basis for improving the motor third party liability insurance premium tariff. The already available data, e.g. age of the insured, make, type and characteristics of the vehicle, are comprised in the databases of insurance companies and just need to be centralized. This base should be further developed

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and the damage would then be recouped by the insurer of the tortfeasor. In that way, insurers would compete each other having a good relationship with the clients and drivers would be very careful when choosing the insurer to conclude the contracts with.

It goes without saying that in this process we would very much cherish the importance of consultants within the Association of Actuaries of Serbia, that gathers experts in the actuarial profession and whose goal is to develop and improve the actuarial science and the insurance profession. Among other things, this Association is dedicated to the application of actuarial science in practice and the care of public interest and can also make a strong professional contribution to the whole process of liberalization of motor liability insurance tariffs.

### **3. Preparation of insurance companies**

This process implies the preparation of insurance companies, which would be carried out simultaneously with the above processes, to ensure the fulfilment of all prescribed preconditions for the liberalization of motor liability insurance premiums.

### **4. Implement stress scenarios**

It would be important to simulate potential scenarios and potential additional funds required (if required) for the Guarantee Fund in order to ensure the protection of all claimants.

### **5. Continuous education of market participants**

We should intensify the activities to promote the importance of insurance. In Serbia, the awareness of the importance and role of motor liability insurance is still underdeveloped and citizens often equate it with the payment of an additional fee when registering a vehicle. It is necessary to raise the level of awareness about the importance of insurance and the dependence of insurance premiums on the behaviour of the insured, the characteristics of the vehicle they drive, damage, etc. On the other hand, in order for policyholders to be able to make adequate decisions on the purchase of insurance services and in accordance with their own risk profile, it is necessary to continuously improve the user friendly information on insurance services (pre-contractual information and information of insurers), base on which the Insured could compare these services among different insurance companies.

Also, it would be necessary to remove the prejudices of insurance companies that the liberalization of motor liability insurance premiums always leads to their reduction.

### **6. Procedure for documenting the fulfilment of all requirements prescribed by the insurance supervisors**

The current law on compulsory traffic insurance already prescribes this procedure quite well, but there is always the possibility for improvements. According to the current law, insurance companies are obliged to calculate premiums on the basis of appropriate data (data on concluded insurance contracts, reported, resolved, paid

and reserved claims, costs related to settling and payment of claims, as well as other data necessary for assessment of risk and statement of premium) and to submit these data to the Association, where the Information Center was established. Furthermore, insurance companies are obliged to submit to the National Bank of Serbia the terms and conditions of compulsory insurance, tariff and premium system with the technical basis of the insurance premium and business plans, within a certain period before applying the new premium tariff in order to verify their compliance with regulations, actuarial principles and the rules of the insurance profession. A wide range of measures have been stipulated to sanction the inadequate conduct of the insurance company.

Although quite good, this system (established almost 10 years ago) could be updated, improved and refined using the positive experience of other countries, which have successfully and without major shocks implemented the process of liberalization of motor third party liability insurance premiums.

### **7. Continuous and strong supervision of the business and market behaviour of insurance companies**

In Serbia, the National Bank of Serbia carries out the supervision over the performance of insurance activities. Supervision activities have been established on strong grounds, in an institution with a high credibility and have been carried out by experts in this field. This very important precondition will certainly contribute to the success of the process of liberalization of motor liability insurance premiums, successful implementation of activities that would prevent the emergence of behaviours contrary to the law and rules of the insurance profession and preserving the stability of the insurance sector in Serbia.

## **VII. Conclusion**

Based on the experience from the process of liberalization of motor third party liability insurance premiums in different countries, it can be concluded that the process of liberalization should be supported by an adequate regulatory framework, but also by synergistic activities of insurers, insurance supervision and professional associations, so as to provide for the protection of insured and maintain solvency of insurers in Serbia. If such a system is established, the liberalization of motor liability insurance premiums can contribute to the improvement of the insurance market in Serbia.

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