Competition Issues in the Non-Life Insurance Market

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CONTENTS Volume II

Paper A

STUDY ON IRISH NON-LIFE INSURANCE

with particular reference to Motor Insurance, Employers' Liability and Public Liability Insurance

Paper prepared for The Competition Authority

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1 INTRODUCTION

1.1 This report contains Europe Economics' provisional findings about the state of competition in the non-life insurance market, with particular reference to motor insurance, employers' liability and public liability insurance.[1] The Competition Authority and the Department of Enterprise, Trade and Employment appointed Europe Economics to undertake the study under Section 30(1)(a) of the Competition Act 2002.[2]

Methodology

1.2 The study seeks to identify evidence of constraints on competition. This report comments on the evidence of rivalry, or absence of, in the non-life insurance market. Of particular interest are practices that might have the effect of preventing entry and/or permitting anti-competitive behaviour, and identifying issues relating to consumer inertia. Europe Economics intends for this report to be circulated for parties to comment, before conclusions are finalised and recommendations made about changes to enactments or administrative and industry practice that limit competition to the detriment of consumers.

1.3 The current report reflects the findings gleaned from meetings with interested parties (listed in Appendix 1) and desk-based research, including analysis of data collected during the study. Parties that agreed to meet included insurers, brokers and insureds. All meetings were held in confidence, with an agreement that nothing would be placed in the public domain attributing comments to parties without their express permission. Material in square brackets should be excised from the document before it is published.

1.4 The report attempts to assess the vast array of comments parties made about the state of competition in the insurance market, some of them conflicting. It is important to stress that the study's focus is the state of competition in the insurance sector.

1.5 During the study, parties mentioned a variety of issues related to insurance that are of interest to policy makers, but which are outside the scope of this report. For example, a number of parties expressed concerns about the level of competition in other markets, with the subsequent effect on insurance costs. The most frequently cited example was the legal profession, which is the subject of a separate Competition Authority investigation. This study does not address such concerns.

1.6 Nor does the study seek to conclude what the appropriate level for claims should be, nor whether Irish tort law should adopt a strict liability standard (which some parties suggested was becoming the case). These are public-policy issues, although clearly they will have a bearing on the cost of insurance. A competitive insurance market is possible if claims costs are high or if claims costs are low, although premium levels are likely to differ under the two scenarios. Of course, high insurance premiums may affect the competitiveness of Irish industry more generally.

1.7 Data requests were also sent to insurers, brokers and insureds. The questionnaires are reproduced in appendix 2. Eight insurers responded - AIG, Allianz, AXA, Eagle Star, FBD, Hibernian, Royal & SunAlliance and Quinn-direct. The source for tables and charts using these data is listed as "Insurance firms". The two main trade bodies for brokers, the Irish Brokers Association and Professional Irish Brokers Association, both offered to circulate a data request to their members. PIBA circulated the request in early October; the IBA provided contact details for its members on 12 November so the deadline for responses was extended into December. The response rate from brokers advising on non-life insurance products was poor, insufficient to permit any analysis. The report quotes no data collected from brokers. The Alliance for Insurance Reform circulated a data request to its members. About seventy-five firms responded. Tables and charts using these data list "Alliance for Insurance Reform" as the source. Finally, a data request was sent to local authorities. The responses provided no clues on competition in the liability insurance market since no authority reported seeking quotes from anyone other than their existing insurer in recent years. The data parties provided is often commercially sensitive; again material in square brackets should not be published.

1.8 Other data, already in the public domain, were also used. The most prominent source for data was the Blue Books produced by the Department of Enterprise, Trade and Employment. A number of charts and tables in the report rely on data from the Blue Books for the years between 1994 and 2002.

1 Europe Economics is grateful for the assistance provided by Pat Massey (Compecon), Dr Brian Greenford (University of Limerick) and Professor Stephen Diacon (University of Nottingham).

2 The Competition Authority commissioned a separate study by the Cass Business School, surveying the relevant literature and outlining the economics and regulation of the insurance industry.

Main Findings

1.9 The preliminary finding is that there are some impediments to competition in the non-life insurance market, but that the high premiums that have been observed in recent years are probably mainly due to factors other than the absence of competition. Other factors given by parties to explain the growth in premiums include:

(a) Significant claims inflation, particularly for liability claims;

(b) Reduced reinsurance capacity; and

(c) Lower interest rates and investment returns.

1.10 Regulatory barriers to entry do not appear to be significant. An insurer regulated in one Member State can operate throughout the European Union. Perhaps the main deterrents to entering the Irish insurance market relate to uncertainty; in particular, claims costs are considered too volatile and getting up-to-date information about the profitability of the sector is not as easy as some entrants might like. In the case of motor insurance, there are also concerns that the Declined Cases Agreement and the method of funding claims arising form uninsured and untraced drivers (administered by the Motor Insurers' Bureau of Ireland) deter entrants.

1.11 There may be less switching between insurers than would be ideal, with the problem perhaps greater for liability insurance than for motor insurance. Some of this is probably due to customer loyalty. If consumers are unwilling to change firm, it is difficult to foster a competitive environment since firms are not constrained by the threat of their customers going to a more efficient rival. But there are also some impediments that limit the ability of consumers to switch. For commercial customers seeking liability insurance, there do appear to be problems changing broker and this may or may not generate problems changing insurer. There are also concerns that renewal notices are being sent too late to enable commercial customers to make considered choices. Policyholders with claims against them may have trouble switching. There are also concerns that some policyholders are reluctant to switch because of a fear that they will no longer be able to get a quote from their existing underwriter in the future (customer loyalty may not always be misplaced).

1.12 A number of concerns expressed about the effectiveness of competition in the non-life insurance market relate to the role of brokers. Brokers can and do help to facilitate competition, reducing the search and switching costs for consumers, helping alert new underwriters to profitable opportunities in the Irish market, and offering a distribution channel for new entrants. But the role of brokers may not be entirely pro-competitive. The evidence suggests muted price competition between brokers. For commercial customers, the reluctance of some insurers to deal with more than one broker for each risk may hinder competition. There are also concerns about transparency - consumers seeking best advice from brokers may not be fully aware of the financial incentives brokers have to place their business with particular underwriters. The regulatory environment may not help. Some parties complained that the current regulations governing intermediaries are confusing and may distort competition.

1.13 The next section discusses, at a general level, the features that are of interest when looking at whether a market is competitive. Sections 3 and 4 review competition in the motor insurance market and the liability insurance market respectively. Many of the findings apply to both motor and liability insurance, but to avoid repetition the report seeks to address concerns in the section where the issue seems most relevant. For commercial motor insurance, often the concerns with competition share more similarities with those encountered for employers' liability and public liability than for private motor insurance; the section on liability insurance may be more relevant.

1.14 Parties are invited to comment on the findings of the paper, if they believe there to be errors or omissions. They are also invited to suggest remedies that might improve competition in the non-life insurance sector. This report has limited itself to identifying any impediments to competition, rather than making recommendations.

2 THEORY

Defining Markets

2.1 A first step in competition analysis is often to define the relevant market. Defining the relevant market involves identifying the relevant products and the geographical extent of the market. Market definition is often a complex task. However, it is only a means to an end, designed to help focus subsequent analysis. In many cases, it is not necessary to define precisely all the relevant markets.

2.2 The standard economic approach to defining the market is the so-called SSNIP test. This test works as follows. One begins with the smallest possible market definition and asks if a hypothetical monopoly supplier of the product in question could impose a small significant

non-transitory increase in price. This is generally defined as a price increase of 5 per cent for a minimum of one year. If the conclusion is that the hypothetical monopolist could not impose such a price increase, then the market is widened to include the closest substitute and the test is performed again. The process is repeated in successive iterations until a group of products is identified for which the hypothetical monopolist could successfully impose a 5 per cent price increase. This group constitutes the relevant product market. Products excluded from the market will be insufficiently close substitutes and hence unable to effectively constrain the hypothetical monopolist from raising price. Similarly, producers located in other geographical areas do not represent a constraint on the monopolist raising price, they are not part of the relevant market.

2.3 To establish whether or not the hypothetical monopolist could successfully impose a 5 per cent price increase, it is necessary to establish whether or not such a price increase would be profitable. For most products, an increase in price will result in a decline in sales other things being equal, i.e. assuming peoples' incomes and other factors that influence demand remain unchanged. The issue is whether selling a smaller quantity at a higher price will yield a higher profit than selling a larger amount at a lower price. This depends on how sensitive demand is to changes in price, which in turn depends on whether or not there are sufficiently close substitutes for the product or whether or not consumers could obtain the product from other suppliers. Such analysis can often entail detailed econometric work.

2.4 Another indication of whether the hypothetical monopolist could increase prices is to analyse whether cost increases are largely passed through. If they are, then demand is relatively inelastic, suggesting that there are no close substitutes. This exercise has to look for examples where all suppliers of the product grouping under consideration face a similar increase in costs, e.g. a rise in reinsurance costs that affect all insurers equally. If only one supplier's costs increased, it would not be able to pass on the increase in its costs if it really is in the same market as the other providers.

2.5 One problem is that if suppliers already have market power, then price is likely to already be above the competitive level. It will have been raised to a level where other products become close substitutes. Consequently if a firm or firms have market power, prevailing prices cannot be used in applying the SSNIP test because it will suggest that relevant market is wider than it actually is. This is known as the "cellophane trap".

2.6 The SSNIP test can also be used to define the relevant geographic market in similar fashion.

2.7 While the SSNIP test mainly focuses on the demand side, it is also necessary to consider the supply side. There may be firms not currently operating in the candidate product or geographic market, which could start supplying if prices rose. The potential for such supply-side substitution would constrain incumbent firms' ability to raise prices. When supply-side substitutability would require the need to adjust significantly tangible and intangible assets, additional investments, strategic decisions or time delays, it is not considered for the purposes of defining a market.

Concentration

2.8 Measures of concentration in a market may provide an indication of the level of competition in that market, provided the market has been appropriately defined. There are a number of ways of measuring market concentration. This report looks at concentration ratios and the Herfindahl index.

Concentration ratio

2.9 The concentration ratio (CR) of an industry is the proportion of total output in that industry produced by a given number of the largest firms. The N-firm concentration ratio (CR_N) is the percentage of market output generated by the N largest firms in the market. The two concentration ratios most commonly used in competition analysis are the four-firm concentration ratio CR_4, which measures the the proportion of total output produced by the four largest firms in the market, and the eight-firm concentration ratio CR_8, which measures the share of total output produced by the eight largest firms in the industry.

2.10 A CR_4 close to zero would indicate a very competitive market since the four biggest market participants have insignificant market shares. Conversely, if CR_1 is over 80 per cent then one firm is close to being a monopolist, controlling a vast share of the market.

2.11 The concentration ratio is only one indicator of the degree of concentration in a market. It does not include information about the market shares of all firms (except when equal to 100), and it does not provide information about the relative size of the largest firms. A significant change in the market shares of the four largest firms may not result in a change in the concentration ratio. For example, the following two examples both yield the same CR_4:

(a) The top four companies each have a 20 per cent market share; and

(b) The largest firm has a 60 per cent market share, the second largest 10 per cent and the next two 5 per cent each.

Herfindahl Index

2.12 The Herfindahl Index is an alternative measure of concentration. It is defined as the sum of the squares of the market shares of each individual firm. The Index ranges from 0 when there are lots of firms with very small market shares to 10,000 when a monopolist has 100 per cent of the market share.

2.13 A perceived advantage of the Herfindahl index over the concentration ratio is that it gives more weight to larger firms. In the examples above of two scenarios with the same concentration ratio, the market with the four largest firms all having 20 per cent market share yields a Herfindahl Index less than half the value when the leading firm has 60 per cent market share.

2.14 In 1982, the US Justice Department established merger guidelines based on the Herfindahl Index. These were amended in 1992. The Department considers a result of less than 1,000 to be a competitive marketplace, a result between 1,000 and 1,800 to be a moderately concentrated marketplace, and a result of 1,800 or greater to be a highly concentrated marketplace. As a general rule, mergers that increase the Herfindahl Index by more than 100 points in concentrated markets raise antitrust concerns.

2.15 The European Commission's Directorate-General for Competition has a similar banding:[3]

"The HHI {*Herfindahl-Hirschmann-Index*} is used as one possible indicator of market power or competition among firms... The higher the HHI for a specific market, the more output is concentrated within a small number of firms. In general terms, with an HHI below 1,000 the market concentration can be characterised as low, between 1,000 and 1,800 as moderate and above 1,800 as high."

2.16 The Competition Authority has adopted these thresholds in its merger guidelines.

2.17 To give some feel for these numbers, a market with 10 equally sized firms would yield an HHI of 1,000. Five or fewer equally sized firms in a market would represent a highly concentrated market, with the HHI in excess of 1,800.

Entry Barriers

2.18 When firms in concentrated markets enjoy above normal profits, the question arises as to why other firms do not enter the market, forcing prices and profits down. The most plausible explanation is that there are barriers to entry.

2.19 In considering entry barriers, economists are concerned purely with factors that enable firms to enjoy supernormal profits in the long run without attracting new entry. Stigler defined barriers to entry as a cost which must be borne by firms which seek to enter an industry but which incumbents do not or did not have to bear. Large capital requirements, on their own, would not be regarded as constituting an entry barrier, provided that the capital markets are sufficiently developed to ensure that viable projects can be financed. However, if the threat of retaliation by incumbent firms is high and a large proportion of costs are "sunk", then the need for large-scale investment might deter new entrants.

2.20 The modern view of entry barriers distinguishes between exogenous and endogenous entry barriers. The former are determined independently of the firms in the industry. Endogenous (or artificial) entry barriers are the result of firms' actions, i.e. strategic behaviour by incumbents to deter entry. Such strategies require exploiting an asymmetry between the incumbent and would-be entrant, to raise the potential entrant's costs.

2.21 In some instances, the first firm to launch a new product may gain some advantage - "a first-mover advantage". It may face lower marketing costs, able to establish its brand in an environment where there are no rivals. If the presence of the incumbent raises the costs of other would be entrants, then the first firm will enjoy a permanent advantage, which may create a permanent long-run barrier to entry. Being first attracts more consumer attention, shapes consumer preferences, and can set industry standards.

2.22 In many cases, a market may consist of various niches. Entry into all niches may not be possible, although it may be possible to enter at niche level.

3 http://europa.eu.int/comm/competition/general_info/h_en.html

If there are obstacles to expanding beyond niche level, these are referred to as "mobility barriers". There are instances where firms with well-established brands find it difficult to enter related markets, other than at niche level. In 1996, the Competition Authority reported that the two main tea suppliers had earned very high margins, while firms such as Bewleys and Robt Roberts had only managed to secure market shares of around 5 per cent in the tea market despite being well-known brands in the coffee market.

2.23 Regulations generally have an adverse effect on competition, often limiting entry. In some cases, lobbying and vested interests succeed in getting regulations introduced that specifically seek to restrict entry. Economists believe that ordinarily competitive markets constitute the most efficient means of allocating scarce resources. They accept, however, that on occasion markets may not function properly and government intervention may be required to deal with market failures. Intervention might also be justified to realise distributional goals. Nevertheless, thought should be given to whether the public policy objective could be realised by a regulatory intervention that distorted competition less. If there are "regulatory barriers", are they justified?

Contestability

2.24 If it is easy for firms to enter and exit a market, contestability theory suggests that the only way for an existing firm in an industry to deter new entrants is to operate at the level of price and output which would arise in a competitive market. Potential entrants can effectively constrain market power so that antitrust and regulatory attention may be unnecessary, even if the market is concentrated. The threat of losing market share to a new entrant will constrain incumbents to behave competitively.

2.25 High fixed costs need not deter entry. Of more concern is whether the costs are sunk. Will an entrant be able to recoup its costs if it subsequently withdraws from the market? If costs are not sunk, then it is possible for entrants to "hit and run", i.e. enter and then withdraw from the market if the incumbent(s) retaliates. In a contestable market, the only deterrent to entry is the fear of price reductions by incumbent firms, and this fear is removed if exit is costless.

2.26 The absence of past entry is not conclusive proof that entry barriers exist; an alternative explanation for no entry might be that prices were at a competitive level. Similarly, if incumbent firms perceive the threat of entry to be unlikely they will earn supernormal profits, but not to the point that the market attracts new entry.

2.27 A criticism of contestability theory is that it assumes that firms can enter markets quicker than the incumbents can respond by cutting prices. If this assumption is relaxed, the predicted outcomes can be very different.

Economic Views on Competition

2.28 For both motor insurance and liability insurance, the concentration ratios and Herfindahl indices (using very broad market definitions) suggest concentration increased in the past decade. There are a relatively small number of competing suppliers, a situation referred to in the economics literature as an oligopoly, rather than a market where an individual firm enjoys a dominant position. It may be that if insurers choose to specialise in particular segments, in some instances firms might enjoy a dominant position. An alternative explanation might be that firms have decided to carve up the market in this way, which would represent a problem of collusion rather than of individual firm dominance.

2.29 Where there are a number of firms in a particular market, capacity constraints on some firms may allow the remaining firms to enjoy a degree of unilateral market power. This possibility can be analysed by analysing whether one or more firms are operating close to capacity and whether or not capacity can be increased speedily.

2.30 There are a number of possible outcomes that theory might predict in an oligopolistic market, not all of them arising because of competition. In markets with a relatively small number of suppliers, firms may have incentives to collude rather than compete. This section briefly sketches a framework against which evidence on whether there is competition in the non-life insurance markets might be judged.

2.31 Each firm in an oligopolistic market can influence the market price by varying its output. Each firm has some market power. Because any actions firms take may affect the market price, they may also provoke a response by other firms in the market.

2.32 The recognition by firms of their mutual interdependence provides them with an incentive to come together and agree not to compete, i.e. to form a cartel. Even where firms in oligopolistic markets act independently, their behaviour will still be heavily influenced by expectations concerning the behaviour of their rivals. If firms recognise their mutual interest in high prices, then competition may be reduced and prices set above the competitive level. The smaller the number of firms in an industry, the more likely the firms are to recognise their mutual interdependence.

2.33 Oligopolists who wish to maximise joint profits, rather than compete, face problems. Although they share a common interest in keeping prices high, each firm has an individual incentive to cheat by cutting its prices. But if all firms cut prices, then they all make lower profits. The challenge facing oligopolists wishing to collude is to devise a way of overcoming the incentive for each firm to cheat.

2.34 Because firms interact over time, it may be possible for them to realise profitable outcomes (high prices) by the threat of punishing (setting low prices) in future periods any firm that sets low prices. This will depend on the discount factor that firms apply to future profits, i.e. what is the value of higher future profits relative to higher profits today. (A firm that deviates will gain higher short-run profits but future profits will be reduced relative to what they would have earned had they not deviated.) It need not be the case that there is any cooperation to sustain a non-competitive outcome. Both coordinated behaviour and non-coordinated behaviour can raise competition concerns in oligopolistic markets.

2.35 Coordinated behaviour may involve either a formal cartel or some form of tacit collusion. Explicit collusion is designed to allow participants to maximise their joint profits. Tacit collusion aims to realise the same goal, but without any formal agreement in place.

Cartels

2.36 There is a widespread consensus among enforcement agencies, economists and competition lawyers that cartels constitute the most serious form of anti-competitive arrangements. Cartels may involve greater welfare losses than pure monopolies, since the latter, in cutting output will close its least efficient plants. The need to share output amongst all the members of a cartel means that its prices must be set high enough to ensure that the least efficient firm is profitable.

2.37 Cartels face two major difficulties. First, once members have agreed to raise price and reduce output, each individual cartel member has a strong incentive to cheat, by attempting to sell more than its allotted share. Second there must be barriers to entry; otherwise the large profits of cartel members would attract new entrants forcing prices down.

2.38 Cartels are illegal.

Tacit collusion and concerted practices

2.39 The existence of legislation prohibiting formal collusion may induce firms to engage in less formal arrangements involving tacit collusion, also sometimes known as "conscious parallelism". Even though such behaviour stops short of a formal agreement, it may still run foul of national and EU competition law, both of which prohibit concerted practices. The European Court of Justice defined a concerted practice in the *Dyestuffs* case as:

> **...a form of co-ordination between undertakings which, without having reached the stage where an agreement properly so called has been concluded, knowingly substitutes practical co-operation between them for the risks of competition.[4]**

2.40 Subsequently in the *Polypropylene* case the Court held that:

> **...a concerted practice implies, besides undertaking's concerting together, conduct on the market pursuant to those collusive practices, and a relationship of cause and effect between the two.[5]**

2.41 In analysing the relevant EU case law on concerted practice, Bellamy and Child suggest that the ECJ is likely to find that a concerted practice exists where the following conditions are satisfied:

(a) there is positive contact between undertakings such as meetings, discussions or disclosure of information;

(b) such contact involves co-operation that is contrary to the normal competitive processes, for example by removing uncertainty as to future competitive conduct of an undertaking; and

(c) contact has the effect of maintaining or altering the commercial conduct of the undertakings concerned.[6]

2.42 Successful coordinated behaviour requires that participants are able to detect and punish cheating by undertakings involved. There is also a need to ensure that actions prompted by changes in market conditions are not misinterpreted by other firms as "cheating," thereby invoking retaliatory action. Consequently, where firms are afraid of engaging in overt collusion, they must find ways of indicating their commitment to collusive behaviour. Thus tacit collusion may involve various strategies designed to facilitate collusion.

4 Case 48/69 ICI v. Commission ("dyestuffs") [1972] ECR 619.
5 Case C-49/92P Commission v. Anic Partecipazioni [1999] ECR I-4125
6 Bellamy, CW, and Child, G (2001) Common Market Law of Competition, London: Sweet and Maxwell.

2.43 Practices such as pre-announcements of price changes may constitute a form of facilitating device. For example, announcing a price increase well in advance of its proposed implementation date provides ample time for other firms to respond. If other firms do not announce similar price increases, the firm can withdraw any proposed price increase.

2.44 The European Court of Justice has inferred an intention to engage in a concerted practice where there is an exchange of information, especially if such exchange is followed by conduct in the marketplace which represents a response to such exchange.[7] In the *Dyestuffs* case producers of aniline dyestuffs in Italy and the Benelux countries made a series of simultaneous and uniform price increases.[8] The Court rejected the parties' argument that such price increases reflected parallel behaviour in an oligopolistic market with producers following the producer that initiated the price increase. The Court found that the prior announcement of the price increases removed, in advance, uncertainty as regards future conduct between competitors. This fact, along with the similarity of price increases, led the Court to conclude that market conditions had diverged from the normal, and that such price increases represented a concerted practice between competitors.

2.45 In *Thyssen Stahl AG v Commission* the Court of First Instance held that in an oligopolistic market it was all the more important to ensure the decision-making independence of firms and preserve whatever limited competition existed. It therefore followed that the exchange of recent market share data could infringe Article 81(1).[9]

2.46 Phlips argues that, given the difficulties of enforcing collusion, simple exchange of information cannot be construed as implying that a collusive outcome is being achieved but concedes that such exchanges show collusive conduct, "in the sense that the oligopolists are *trying* to achieve a collusive outcome." (Emphasis in original).[10]

Non-coordinated behaviour

2.47 In oligopolistic markets, competing firms may arrive at a non-competitive outcome. For example, suppose the discount factor that firms apply to future profits is sufficiently high. Then it is possible that, despite no active attempt to collude (tacitly or formally), firms will behave in a manner that yields the same outcome as if they had colluded. In oligopolistic markets with very few suppliers, competing firms may arrive at a non-competitive outcome.

2.48 Where non-coordinated behaviour results in market sharing, the outcome may be precisely the same as under collusion. Nevertheless, competition law generally allows behaviour that stops short of some degree of collusion. For example, oligopoly pricing absent some form of actual collusion does not infringe Article 81. This reflects the fact that active collusion cannot be unambiguously inferred from market outcome. The OECD has pointed out that the fact that behaviour falling short of some form of agreement or understanding is not illegal in many jurisdictions is not

"traceable to some inexplicable gap in antitrust coverage. Once firms are aware of their interdependence, they cannot be expected or easily compelled to ignore that in deciding their competitive behaviour." [11]

The OECD notes that, although it is possible to expand the definition of what constitutes an agreement, there are limits to how far one can take this. To expect that firms will ignore the likely reactions in making commercial decisions is to expect them to behave irrationally.

2.49 This does not mean that competition policy should ignore the oligopoly problem. The OECD recommended that:

(a) Merger controls should be used to prevent the emergence of oligopolistic market structures.

(b) Practices that facilitate collusion in oligopolistic markets, e.g. exchanges of information regarding pricing decisions, which are arguably designed to overcome coordination problems, should be prevented.

(c) Measures to reduce entry barriers should be introduced where possible, since entry is likely to undermine collusion.

Signs of non-rivalrous behaviour

2.50 There is a risk of non-rivalrous (i.e. collusive) behaviour in oligopolistic markets. As competition law prohibits collusion, firms are likely to attempt to conceal collusive behaviour. Collusion may be explicit, in the form of formal cartel arrangements, or tacit. In oligopolistic markets, a non-competitive outcome may also be the result of non-coordinated behaviour. Thus, it is important to establish not only the intensity of competition in a particular market, but to analyse the behaviour of the players to establish whether it is the result of coordinated or non-coordinated behaviour.

7 Case T-1/89 Rhone-Poulenc v Commission [1991] ECR II - 869.
8 Case 47/73, Suiker Unie v. Commission [1975] ECR 1663.
9 Case T-141/94 Thyssen Stahl AG v. Commission [1999] ECR II-347.
10 Phlips, L (1995) Competition Policy: A Game-Theoretic Perspective, Cambridge: Cambridge University Press.
11 OECD (2000) Oligopoly, Series Roundtables on Competition Policy, No. 25, Paris: OECD.

2.51 In addition, it is useful to analyse the market's characteristics to establish whether they are likely to facilitate collusive behaviour. The economics literature has identified a number of market characteristics that may facilitate co-ordinated behaviour in oligopolistic markets. These include:

(a) A relatively small number of suppliers resulting in a highly concentrated market;

(b) Similar market shares;

(c) A past history of price regulation;

(d) High barriers to entry;

(e) Inelastic demand for certain products;

(f) Low buyer power;

(g) Homogenous products;

(h) Reasonably transparent and easy to monitor prices;

(i) Similar cost structures;

(j) A high degree of predictability of demand and costs;

(k) A high level of industry co-operation involving regular meetings and discussions on various issues; and

(l) Multi-market contacts, i.e. the same firms interact with one another in a number of different markets.

2.52 In analysing the behaviour of market players one needs to consider a variety of factors in addition to pricing behaviour in order to try and distinguish between collusive and non-coordinated behaviour. These include:

(a) Trends in market shares over time, since stable market shares may indicate a lack of competition;

(b) Evidence of facilitating practices, such as advanced announcements of price changes, may be designed to overcome market characteristics that make collusion more difficult; and

(c) Indications that firms' pricing and output decisions are inconsistent with their unilateral self-interest as profit maximisers, i.e. its conduct would only make sense in the context of a collusive arrangement.

Other impediments to competition

2.53 A competitive market requires more than the absence of collusion between firms. It is also important that consumers are able to choose between competing firms in a manner that rewards those that offer better-value products. This requires informed consumers able to select the most appropriate product. Competition works best when search costs are low.

2.54 Competition also works more effectively when switching costs are low, *i.e.* consumers can easily switch supplier in the event that their existing provider is no longer making a competitive offer. This is not always the case. Switching costs are significant in markets where it is difficult or expensive to change from one supplier to another. It may affect price paths, product diversity and the ability of entrants to successfully enter the market.

2.55 One paradox is that if search and switching costs are high, then more firms may reduce rivalry. If there are lots of firms, yet consumers are only able to search the prices for a few of them, then the benefit to any one firm of reducing its price will be comparatively smaller. Suppose that consumers only seek quotes from three firms. In a market with twenty firms, then the average firm will only give quotes (and stand a chance of selling) to 15 per cent of the market. With ten firms, a price cut would be observed by 30 per cent of potential customers. With only three firms, all consumers would know about all companies' offers.

2.56 Sections three and four of this report proceed by first establishing what the market might be and how concentrated it is. Then the evidence is assessed to see whether it is consistent with a process of rivalry. Evidence on barriers to entry are then considered. Finally, the report looks at possible problems impeding the ability of consumers to realise fully the benefits of competition. Possible search costs, perhaps due to an absence of transparency, and switching costs are assessed. The role of brokers is potentially important here, since they can play an important role in reducing such costs.

3 MOTOR INSURANCE

3.1 Motor insurance is the largest class of business in the Irish non-life insurance industry. It accounts for over half of total non-life premiums. Nearly 70 per cent of motor insurance premiums are for private motor insurance.[12]

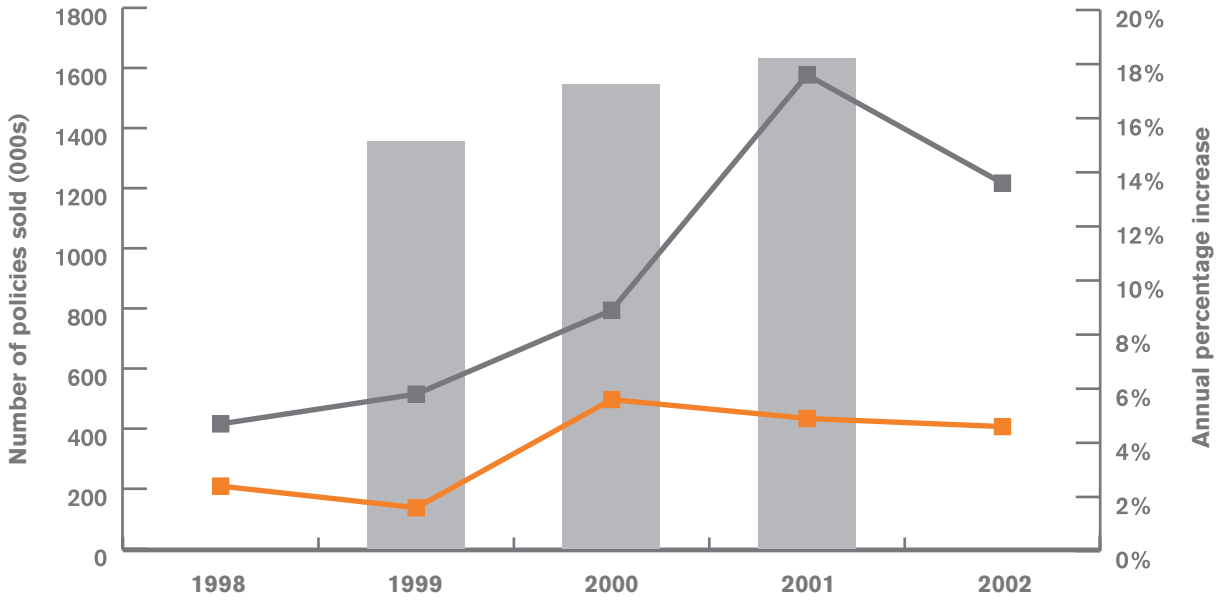
3.2 Third party motor insurance has been compulsory since the 1933 Road Traffic Act was enacted. If it was the only form of cover available, then intuitively it would appear that a hypothetical monopolist could successfully increase the price of third party motor insurance by 5 per cent as there are no alternative products that consumers can switch to. The fact that insurance is compulsory means that demand is likely to be relatively inelastic. The only options are to give up driving or to break the law and drive without insurance.

3.3 Chart 3.1 illustrates trends in motor insurance prices over the 1997-2002 period along with those in the CPI. The price of motor insurance is based on the CPI measure of motor insurance prices

3.4 The chart shows that motor insurance prices have increased significantly faster than the overall rate of inflation in recent years. In real terms, motor insurance prices increased by 33 per cent between 1997 and 2002. Despite the increases in premiums in real terms, the number of policies written increased. These results suggest that a hypothetical motor insurance monopolist could impose a small significant increase in price.

3.5 The fact that there are three different types of motor insurance, i.e. third party only, third party, fire and theft, and comprehensive may mean that there are separate markets for each of these products. Perhaps a monopoly supplier of comprehensive motor insurance could profitably raise prices 5 per cent above the competitive level, unconstrained by the prices charged by providers of third party only and third party, fire and theft insurance.

Chart 3.1: CPI and Motor Insurance Price Index



Source: Central Statistics Office and MIAB data

12 Page 18, Irish Insurance Federation (2002) Factfile 2001, www.iif.ie

3.6 A second possibility is that motor insurance can be broken down into distinct segments, for example on the basis of the age and gender of the insured. Insurers charge different rates to people on this basis, claiming that such price discrimination accurately reflects the different levels of risk of different categories of driver. Nevertheless such price discrimination would not be possible unless the market was segmented, limiting the potential for arbitrage. The price of insurance for a fifty-year-old female is lower than that for a twenty-year-old male, and the young male cannot purchase at the lower price (although he may have the option of being a named driver on his mother's insurance policy, instead of having his mother as a named driver on his insurance policy).

3.7 The product market is no wider than the market for motor insurance. It might be narrower, at least from the demand side, with a number of distinct product markets under the overall heading of motor insurance. But from the supply side there would appear to be relatively little difference between selling motor insurance to a 20-year-old male driving a Ford Fiesta and a 30-year-old female driving a Clio. This suggests that there is sufficient supply substitutability for the relevant market to be regarded as the overall motor-insurance market.

3.8 The appropriate geographic market is the State. A firm must be licensed to sell motor insurance in Ireland. The potential for supply-side substitution is again important. An insurer selling motor insurance policies in Galway could relatively easily start supplying motor insurance to drivers in other parts of Ireland. Insurers outside of the State must decide to obtain a licence to sell motor insurance in the State. Again there is obviously scope for supply-side substitution, but it seems logical to distinguish between those insurers who are licensed to offer motor insurance in Ireland and are therefore part of the relevant market and overseas insurers who could decide to enter the market. This does not mean that the relevant geographic market is wider than the State. Rather, overseas firms are seen as potential entrants to the Irish market. This report considers the possibility of motor insurers not currently operating in Ireland starting to supply the market in the context of analysing barriers to entry.

3.9 Insurers also potentially operate in a number of other related markets. Examples include markets for distributing insurance products or claims handling. In some instances, the distinction between insurers and non-insurers is blurred. For example, some intermediaries might sell policies for which they undertake the risk assessment and operate their own claims-handling services.

Concentration

3.10 As in many other countries, the number of firms actively underwriting motor insurance has fallen. In 1994, the 'Blue Book' reported 20 companies with an earned premium income greater than £500,000. In 2002, this number was down to15.

3.11 The Irish market has two major players, Hibernian (part of the Aviva group) and AXA. In 2002 they accounted for almost half of all premium income. AXA's share was 26 per cent and Hibernian's share was 20 per cent. The third, fourth and fifth largest insurers in the Irish market, measured by premium income, were Eagle Star and Quinn-direct, both with 10 per cent, and FBD with 8 per cent (Allianz is third with 12 per cent market share if the results of Allianz Ireland and Allianz Corporate Ireland are combined). Table 3.1 lists all the insurers underwriting motor vehicle insurance in Ireland in 2002, with their market shares.

3.12 Almost 97 per cent of premium income went to eight insurers, whereas in 1990 the top eight companies collected 76 per cent of motor insurance premiums. The major players then were Hibernian (20 per cent), the New PMPA (15 per cent) and the GRE (15 per cent). The latter two are now part of the AXA group.

Table 3.1: 2002 Market Shares for all Insurers Underwriting Motor Insurance

Name of Undertaking	Market Share of Earned Premium Income (%)
AXA	26%
Hibernian	20%
Eagle Star Ireland	10%
Quinn-direct	10%
FBD	9%
Allianz Ireland*	8%
Royal and SunAlliance	7%
Allianz Corporate Ireland*	4%
AIG	2%
St Paul International	2%
Europa General	0%
Irish Public Bodies	0%
Zurich	0%
Eagle Star	0%
ACE Insurance	0%
Probus	0%
Friends First General	0%
Alfar	0%
GD Insurance	0%
Eccleciastical	0%
Assicurazioni Generali	0%
NEM	-
Primor	-
Western International	-
AXA Colonia	-
Ansvar	-
Malvern	-

**Both Allianz Ireland and Allianz Corporate Ireland are part of the Allianz Group. For the remainder of this report, they are treated as the same company.*
The 0 per cent market shares show up as this due to rounding, even though the earned premium income is positive for these companies. On the contrary, the last six companies listed in the table reported zero earned premium income.
Source: Blue Book.

3.13 Mergers have had a role in increasing concentration. The table below shows the mergers that occurred between 1994 and 2002 in the Irish motor insurance market. The first column shows the present name of the insurer. The second column shows the companies that merged to form the current entity. A number of the mergers were notified to the European Commission, which decided not to oppose the mergers. In a number of the cases, the Commission's published findings discuss the impact on the Irish market.[13] (Please see table 3.2 below)

3.14 Most insurance companies are now subsidiaries of non-Irish companies. During this period, the only major new entrant into the market has been Quinn-direct. It entered the market in 1996, and now has a market share of 10 per cent. There has not been an influx of small specialist motor insurers such as Budget or Admiral into Ireland.

3.15 Plotting concentration ratios or the Herfindahl index over time illustrate the increased concentration. The calculations use annual earned premium income to measure market shares over the 1994-2002 period. Insurance placed with the syndicates of Lloyd's is excluded, since the Blue Books only report their gross written premiums. Consequently, the measures of concentration may be overstated, although looking at the trends should be informative since there does not appear to be any evidence that Lloyd's presence in the market has fluctuated significantly during this period.

3.16 Concentration ratios have increased. Over an eight-year period the market shares of the top four companies (not necessarily the same in each year) has increased by almost fifteen percentage points. Similarly, the market share of the largest eight insurers was higher in 2002 than in 1994, although this is mainly because of the increase in the top four companies' market shares. (Chart 3.2).

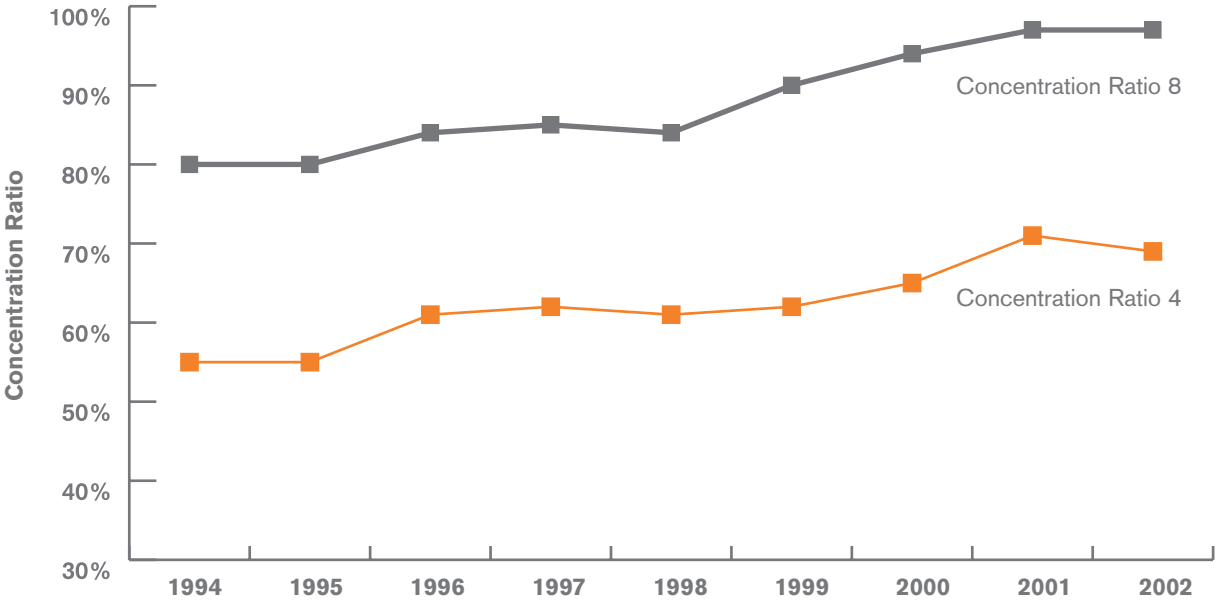
Table 3.2: Mergers in the Irish Motor Insurance Market

Most recent name	Mergers/transfers of portfolio
Hibernian:	Norwich Union, CGU (Commercial Union, General Accident)
Eagle Star:	Irish National
Royal & SunAlliance:	Amev, Royal, Sun Alliance
AXA:	AXA PMPA, Guardian PMPA, Guardian Royal Exchange, New PMPA

Source: Blue Book

13 Case No IV/M.759 - Sun Alliance/Royal Insurance, 1996; Case No COMP M.1777 - CGU/Hibernian; and Case No COMP/M.1886 - CGU/Norwich Union, 2000.

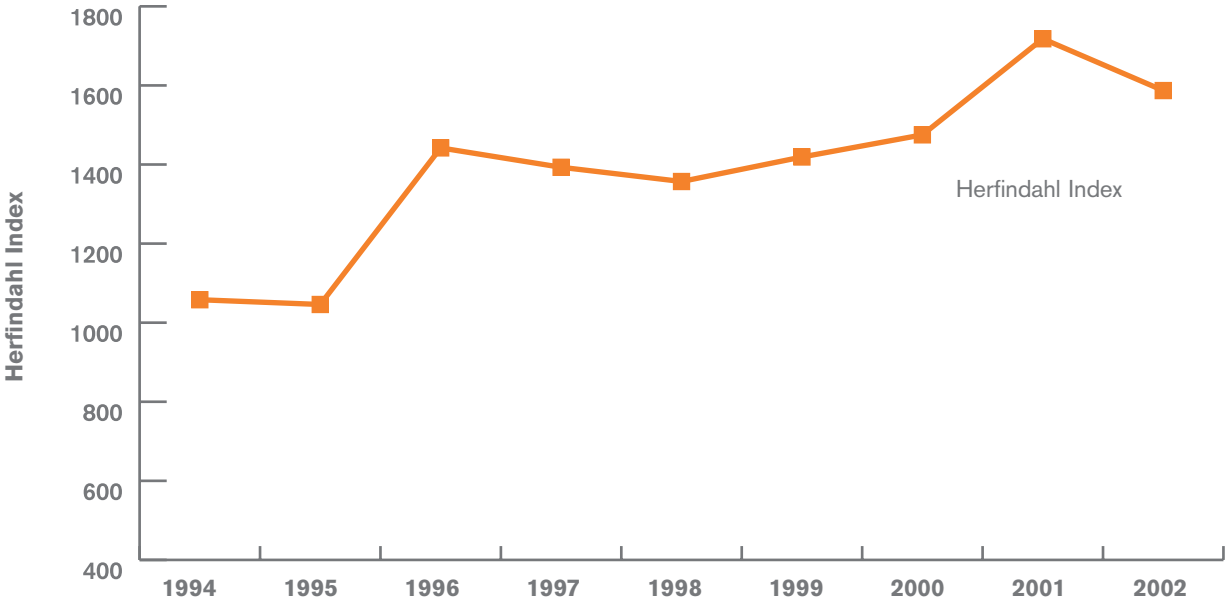
Chart 3.2: Motor Insurance Market Concentration Ratios, 1994-2002



Based on earned premium income. Source: Blue Books, 1994-2002. The analysis excludes the Lloyd's.

3.17 Chart 3.3 shows that the Herfindahl index also increased during this period, with an upward trend interrupted only for two years (1997 and 1998). The index was just over 1,000 in 1994, but up to 1,718 by the end of 2001. Over the last year of the period (2002) there has been a drop in the index. However the index still remains at levels that make the market for motor insurance moderately concentrated, to use the terminology of the US Department of Justice or the European Commission's Directorate General for Competition. Of course, concentration levels may be greater if defining the product market as motor insurance for particular segments.

Chart 3.3: Motor Insurance Herfindahl Index (1994-2002)



Based on earned premium income. Source: Blue Books, 1994-2002. The analysis excludes Lloyd's.

Evidence of Rivalry

3.18 The market is moderately concentrated. There does appear to have been an increase in the degree of concentration in the motor insurance sector in the past decade, which may raise concerns that the potential for collusive behaviour has increased, although concentration fell in 2002.

3.19 This section considers various types of information and sources of evidence in deciding whether the competition is muted. The benefits to consumers of competition should take the form of lower prices and greater variety than otherwise would be the case. Competition creates incentives for firms to offer lower prices, better quality and a more diverse range of products. Inefficient firms, unable to offer products at a cost that consumers are willing to pay will lose market share and ultimately be forced out of the market.

Market shares

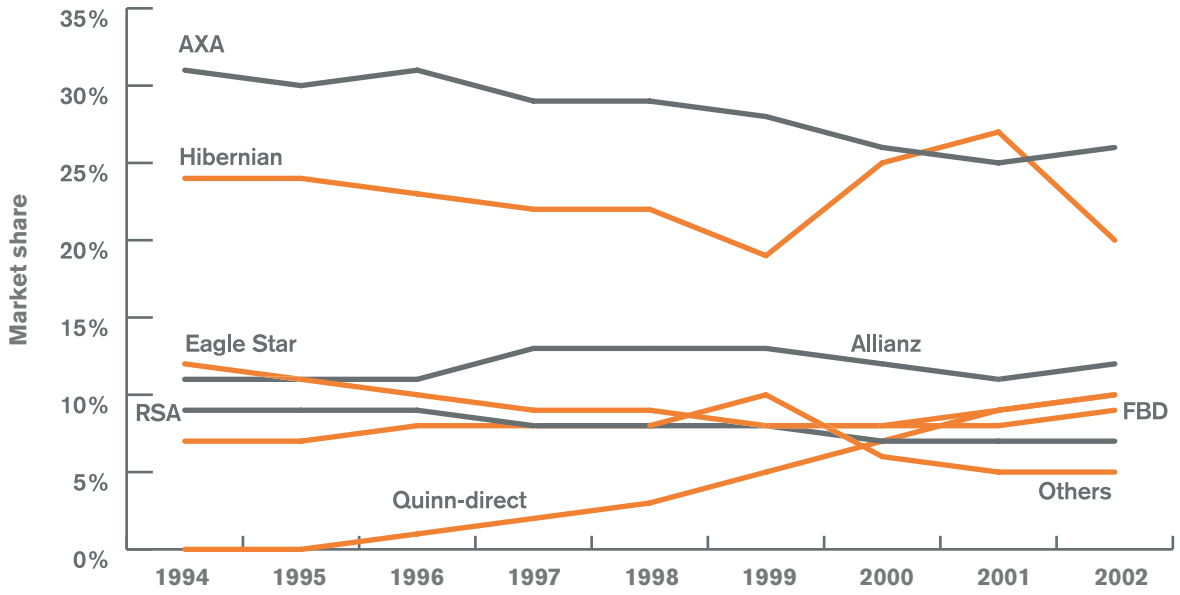
3.20 One simple measure that provides insights on the extent of competition in the insurance market is to look at how market shares have evolved over time. If market shares are changing over time, this would be consistent with firms competing to attract customers and enjoying varying fortunes. (Of course, changing market shares is not conclusive evidence that there is competition.)

3.21 The evidence from market share data suggests that there has been some competition between insurers. Chart 3.4 identifies the top seven insurers by earned premium income as at 2002 and plots how the market shares of these seven companies changed between 1994 and 2002. The market shares for firms that merged during this period show the aggregate market share of all the firms that had merged to make up the entity operating in 2002. All other insurers are grouped together under the heading "Others".

3.22 Chart 3.5 uses MIAB data on policy exposure years to measure market shares. This measure is not sensitive to the possibility that fluctuating shares are due to changes in average premiums charged by different insurers, rather than changes in the number of policies sold. The data source does not identify the insurers, instead using company codes such as AA and MC, but each insurer's code is the same in all three years. The sample period only covers three years (1999-2001).

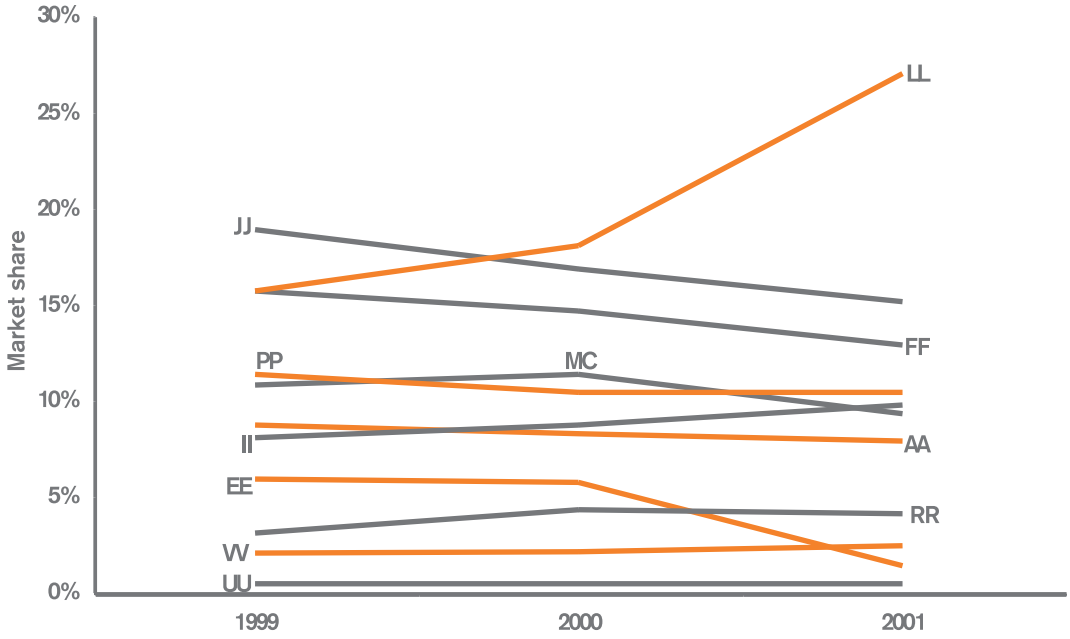
3.23 Both charts show evidence of changing market shares, treating motor insurance as a whole. This does not support claims that insurers are sharing the market rather than competing. Perhaps most notable has been the growth of Quinn-direct, at least in terms of its share of earned premium income.

Chart 3.4: Motor Insurance Market Shares (Earned Premium Income)



Based on earned premium income. Source: Blue Books, 1994-2002. The analysis excludes Lloyd's.

Chart 3.5: Motor Insurance Market Shares (Policy Exposure Years)

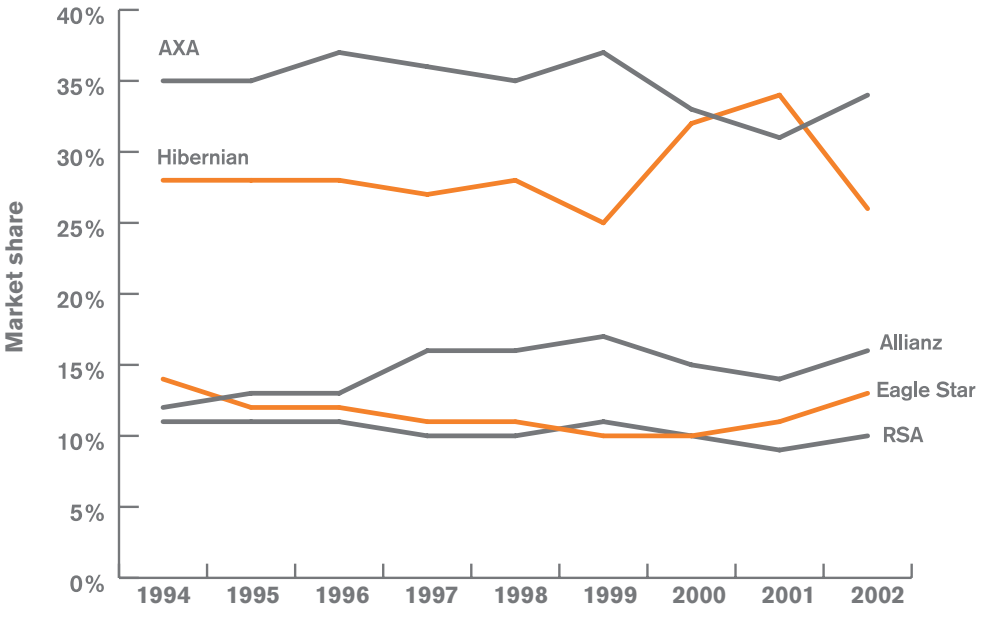


Source: MIAB

3.24 Nevertheless two alternative stories are worth exploring. First, it might be argued that the newcomers' success is against a cartel of firms that do not compete among themselves. The argument might run that even though these entrants' success demonstrates it is possible to enter the motor insurance market, it remains the case that a large portion of the motor insurance market is served by a few established firms who do not compete. Looking at market shares for just Hibernian, AXA, Eagle Star Ireland, Royal & SunAlliance, and Allianz, does not provide compelling evidence that even this market sharing is occurring.

3.25 The following chart below demonstrates this point by plotting the market shares of the "big five" (Quinn-direct and FBD now have a larger share of the market than some of these firms, as measured by earned premium income). The chart shows market shares estimated assuming that the five companies operate in a market of their own, i.e. their market shares add up to 100 per cent.

Chart 3.6: Market Shares of the "Big Five" (Earned Premium Income)



The rates in this chart have been calculated as if the five insurance companies were the only companies in the market.
Source: Blue Books, 1994-2002.

3.26 The chart suggests that there is some rivalry between those five companies, with their market shares (as a percentage of the earned premium income of all five) changing.

3.27 A second possibility is that the evolving market shares at the aggregate level mask the absence of rivalry that applies in various niches of the market. If firms segmented the market, then changing market shares at the aggregate level would merely represent changes in the sizes of the different segments, e.g. an increase in the proportion of policyholders that are young males would increase the aggregate market share of the company serving this segment of the market.

3.28 Looking at MIAB data for the years 1999, 2000 and 2001, this does not appear to be the case. Two groups for which competition is often argued to be especially muted are young male drivers and older drivers. Charts 3.6 and 3.7 look at how insurers' market shares for these two groupings, in terms of exposure years, evolved between 1999 and 2001.

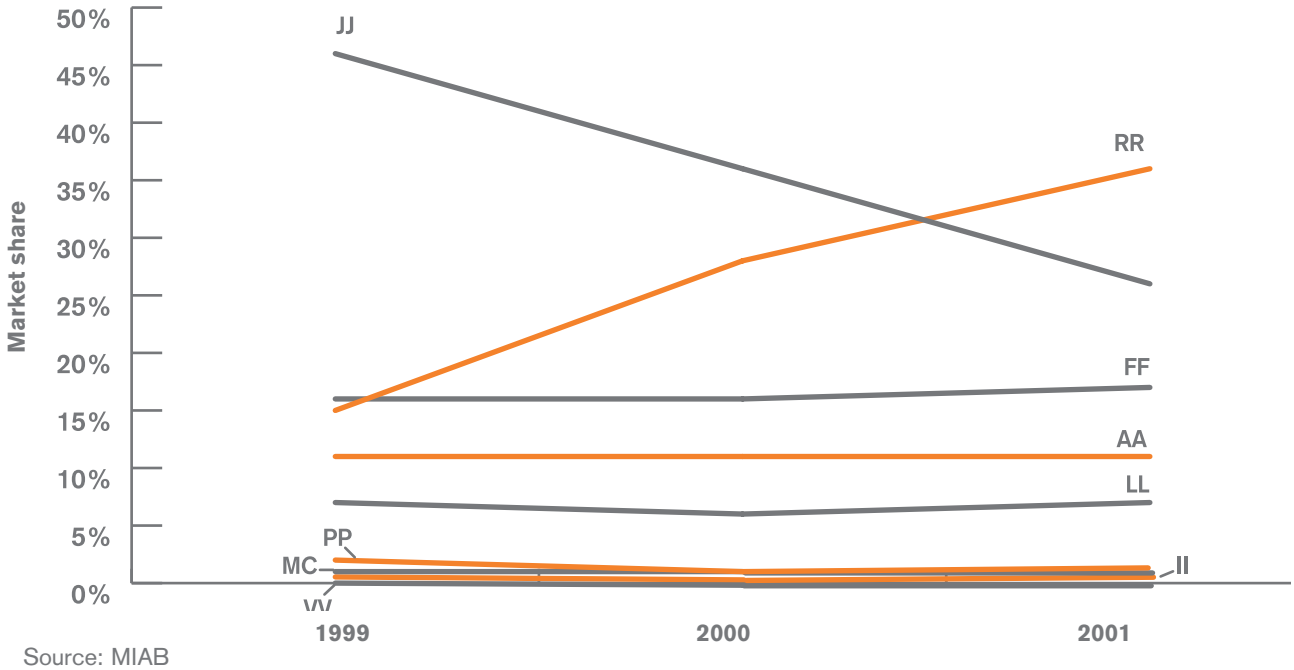
3.29 During the three years, there were changes in the identity of the insurer selling the most policies to young males and in the identity of the insurers selling the most policies to older drivers. Different companies displaced the market leader in these market sections; the outcomes were not the result of a single "maverick" motor insurer. For young male drivers, insurer RR more than doubled its market share in two years. Much of these gains were at the expense of the previous leader, insurer JJ. In contrast, the success of LL in increasing its sales to older drivers was at the expense of a number of other insurers.

Prices

3.30 Price data can also sometimes provide evidence on the degree of rivalry in a market. In a competitive market, prices might be expected to respond to changes in costs. Time-series data are needed. Such data can also potentially reveal whether there is evidence of price leadership, where one firm is recognised as the price leader and other firms only change their prices in response to a change by the price leader. Such behaviour clearly is inconsistent with price competition. Finally, cross-sectional data, looking at the prices offered by the various firms at a single point in time might provide evidence on whether or not firms are competing against one another on price (if they all quote the same price, this might suggest that there is no price competition).

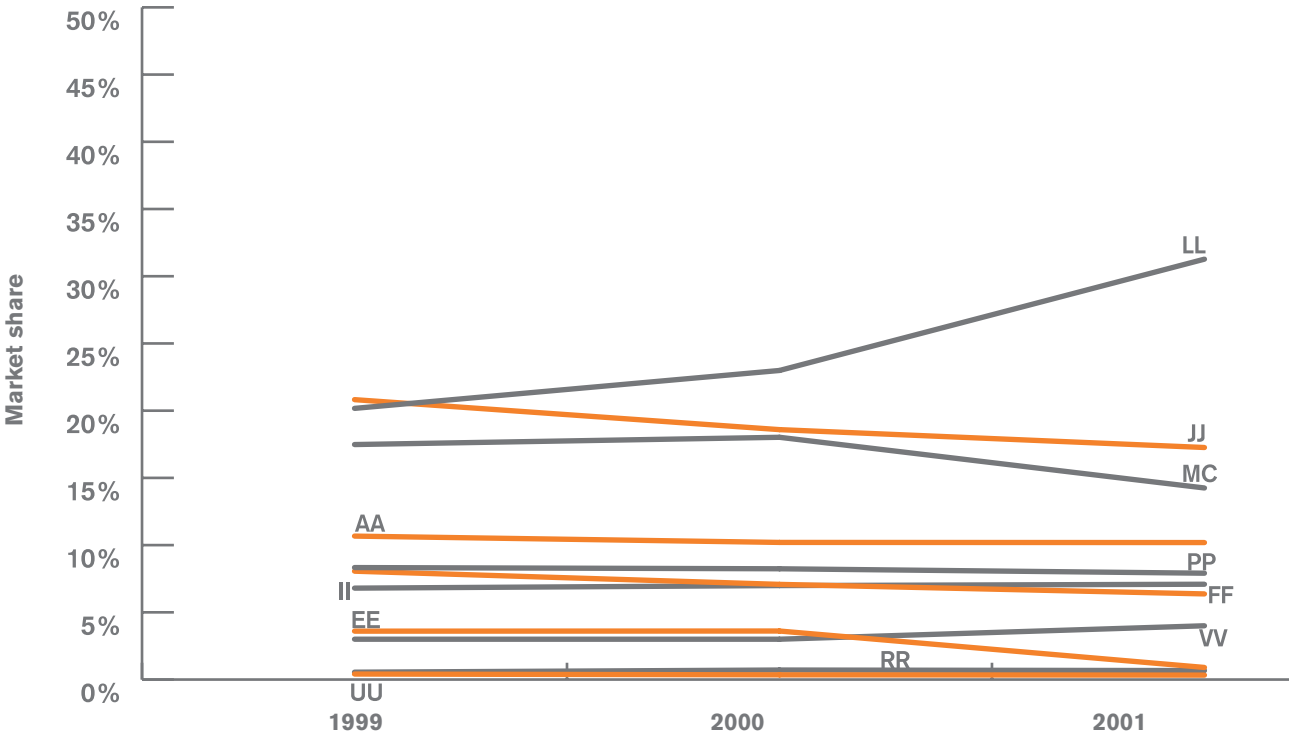
3.31 One problem with analysing premiums for insurance policies is that the products are not homogenous. A number of parties thought that motor insurance is now seen as a "commodity good" - customers want a generic insurance policy that pays out when they have a claim (and also ensures that they satisfy legal requirements to have such insurance when driving). Nevertheless, the price underwriters quote each would-be policyholder will depend on a range of factors that will be peculiar to the individual seeking motor insurance. Age, sex, make of car, size of engine, and address are all factors that underwriters might use when determining the quote. Since these factors will differ by individual, there is not a single price of insurance that can be compared. Even for an individual, the perceived risk profile is likely to evolve

Chart 3.7: Market Shares for Under-25 Males (Policy Exposure Years)



Source: MIAB

Chart 3.8: Market Shares for Over-65s (Policy Exposure Years)



Source:MIAB

over time, such that it would be difficult to make inferences about what a competitive time path of premiums might look like for that individual.

3.32 No-claims discounts are one potential exception, where comparing the "prices" (in this case the size of discount offered for drivers with a no-claims history) is not necessarily subject to the criticism that like is not being compared with like. The discounts are supposed to reflect a discount on the premium that would otherwise apply.

3.33 If this is the only time where claims history is used, then firms competing to attract customers might be expected to compete in the level of no-claims discount they are prepared to offer. The evidence supports the idea that firms compete in the size of no-claims discount they offer. Chart 3.9 illustrates this point. It plots the highest and lowest no-claims discount offered for no-claims histories of one year up to six years. In all six cases, the size of the available no-claims discount depends on the underwriter approached.

3.34 There is also some evidence of no-claims discounts in recent years changing, but not in a uniform manner. [Confidential material]

Table 3.3: [] No-Claims Discount Structure for Private Cars

Claim-free years	1997	2002	2003
1			
2			
3			
4			
5+			

Data Source: []
[Confidential material]

Chart 3.9: Lowest and Highest NCD Quote for Each Claim-Free Year

(Confidential material)
Source: Insurance firms

3.35 The results on no-claims discounts apply to customers insuring a first vehicle. There have been allegations that there are anti-competitive industry-wide practices on no-claims discounts for second vehicles. Underwriters seem reluctant to apply the discounts to second vehicles. The underwriters argue that this treatment of no-claims discounts for second vehicles is because of uncertainty about the likely driver of the vehicle. They argue that often the vehicle is driven predominantly by drivers other than the policyholder. This explanation seems to provide a business rationale for the different treatment of no-claims discounts for first and second vehicles. If all underwriters are refusing to offer no-claims discounts for second vehicles, there might be a concern that price competition is muted, but no-claims discounts are only one factor determining the final premium charged.

3.36 Looking at the overall premium paid/quoted, rather than focusing on one component (the no-claims discount), provides a better final indication of the extent of price competition. To do this requires sampling - looking at the premiums different companies quote for specific examples.

3.37 Tables 3.4 and 3.5 use two different data sources - IFSRA and the IIF. Comprehensive motor insurance quotes for eight driver profiles, further differentiated according to gender, are shown in table 3.4. The examples illustrate that savings can be realised by consumers shopping around. Underwriters are not all offering the same price. Moreover, the identity of the cheapest underwriter varies according to the risk being insured. Just looking at these sixteen risks, five different insurers offered the most competitive motor insurance coverage for at least one risk.

3.38 The most competitive quotes also varied across underwriters in a similar survey undertaken by Consumer Choice magazine.[14] (That analysis also illustrates that the distinction between insurers and brokers is blurred. AA and One Direct are both multi-agency intermediaries rather than insurers. The earlier charts based on market shares of the insurers will, for some insurers, include policies sold by intermediaries who may be competing independently-owned entities who do their own underwriting, claims management, and customer interface but who do not have the licence to issue legal insurance contracts).

Table 3.4: Motor Insurance Quotations, December 2003

	Profile 1 Comprehensive		Profile 2 Comprehensive		Profile 3 Comprehensive		Profile 4 Comprehensive		Profile 5 Comprehensive		Profile 6 Comprehensive		Profile 7 Comprehensive		Profile 8 Comprehensive	
	Male	Female	Male	Female	Male	Female	Male	Female	Male	Female	Male	Female	Male	Female	Male	Female
INSURER																
AIG	776	738	934	887	NQ	NQ	1080	1026	1102	1047	1101	1046	NQ	NQ	745	708
ALLIANZ	973	801	1036	968	7486	3419	1715	1643	5092	2870	1935	1864	NQ	NQ	1302	1009
AXA	900	808	1688	1423	3707	2129	2353	2141	3584	2040	2915	2392	4871	2582	1212	793
EAGLE STAR	1061	711	1157	1027	4396	2066	2251	1774	3326	1663	2567	2282	7343	3068	1133	759
FBD	649	594	1279	1172	4023	2969	1465	1412	2460	2054	1750	1687	4723	3897	610	554
HIBERNIAN	873	729	1199	1112	NQ	NQ	2035	1948	2037	1217	2489	2376	NQ	NQ	977	818
QUINN-DIRECT	691	615	763	792	3989	2193	4191	4191	1918	1542	4542	4542	4834	2615	785	644
ROYAL & SUN ALLIANCE	1078	897	2081	2022	NQ	2531	2949	2949	6212	4183	2938	2938	NQ	4178	1481	1187
Cheapest Insurer	FBD	FBD	Quinn	Quinn	AXA	Eagle Star	AIG	AIG	AIG	AIG	AIG	AIG	FBD	AXA	FBD	FBD

Notes: NQ = No quote.
Source: IFSRA (2003) Motor Insurance Cost Survey, Dublin: IFSRA. This includes details on the driver profiles to which quotes relate.

14 McBride, Louise (2003) "Driving you crazy" Consumer Choice, May.

Table 3.5: Motor Insurance Quotations, July 2003

	Male, 21 Years Old		Female, 24 Years Old		Male, 30 Years Old		Female, 50 Years Old		Male, 60 Years Old		Female, 70 Years Old	
	TPFT	Compre-hensive	TPFT	Compre-hensive	TPFT	Compre-hensive	TPFT	Compre-hensive	TPFT	Compre-hensive	TPFT	Compre-hensive
INSURER												
AIG	3497	No quote	3497	4534	Scheme	Scheme	601	679	630	713	601	679
ALLIANZ	3066	4047	1213	1629	1037	1068	708	744	869	895	844	886
AXA	2222	2609	931	1099	961	1141	575	699	681	788	544	660
EAGLE STAR	No quote	No quote	1159	1332	1245	1431	801	921	949	1091	900	1035
FBD	1925	2150	1279	1476	547	659	492	593	547	659	492	593
HIBERNIAN	2247	2545	1021	1247	905	968	583	623	674	720	671	717
QUINN-DIRECT	1851	2683	724	1083	750	1114	379	675	534	814	324	666
ROYAL & SUN ALLIANCE	2454	No quote	1335	1559	1208	1410	1034	1207	1207	1409	1214	1417
Cheapest Insurer	Quinn	FBD	Quinn	Quinn	FBD	FBD	Quinn	FBD	Quinn	FBD	Quinn	FBD
Cheapest insurer in March 2003 (if different)	FBD			AXA				Hibernian		Hibernian		AXA

Note: All quotes are for a Dublin-based driver with a full licence and no previous accidents or convictions driving a two-year-old 1100cc Ford Fiesta.
Source: Irish Insurance Federation (IIF)

3.39 Table 3.5 also shows the variation in prices different insurers quote, and how the identity of the cheapest insurer varies according to the risk (although the number of insurers offering the cheapest product is less than for table 3.4, perhaps because all the examples concern policyholders driving 1100 cc cars in Dublin).

3.40 For some parties, differential pricing for different types of drivers is actually evidence that competition is not working. One argument is that the differential prices represent market segmentation, with the insurers agreeing (tacitly) which insurer will serve which segment of the market. This latter model would yield similar observations to a model of competing insurers with some offering more competitive quotes to particular segments of the market. In both cases, a subset of insurers would offer lower prices than their rivals for a segment of the market and (assuming consumers are price sensitive) enjoy a relatively large market share for these segments.

3.41 Proving collusion without incriminating documentation can sometimes be impossible. Phlips (1995) gives the example of the US electrical conspiracy case of the 1950s, where firms determined who would offer the cheapest bid on the basis of phases of the moon.[15] Conversely, proving that there is no collusion is not possible; there are too many possible means of colluding to rule them all out.

3.42 There are features of the motor insurance market that suggest that collusion would be difficult to sustain, perhaps the biggest problem being exactly what insurers would collude about. The heterogeneity of the policies being sold means that any scheme would have to be elaborate, agreeing who serves what risk for a vast range of driver and vehicle profiles. Colluding on price would be hard to police, making any attempts at tacit price collusion hard to sustain. Moreover, collusion could only be sustained if there was no threat of entry (an issue considered later).

3.43 The available pricing data show inconsistencies with simple models of coordinated behaviour. One possible collusive arrangement might involve insurers never changing the segments for which they offer the lowest quote. The examples in table 3.5 are part of a larger sample collected by the IIF. The complete sample contains quotes for males and females for 16 different driver profiles, giving prices for comprehensive insurance, third party, fire and theft, and third party only. Quotes for the same risks were collected by the IIF in March 2003. Between March and July 2003, the insurer offering the cheapest comprehensive insurance policy had changed in 15 of the 32 instances, and the insurer offering the cheapest insurance policy (either third party only or third party, fire and theft for those insurers not offering the former) had changed in five cases. In all cases, the insurer that became the most competitive insurer was either FBD or Quinn-direct. These are relative newcomers to the motor insurance market, leaving open the possibility that the more established firms are not competing among themselves. Looking at the quotes of just Allianz, AXA, Eagle Star, Hibernian and Royal & SunAlliance, only AXA and Hibernian offer the cheapest quotes for any of the examples collected by the IIF. There were changes (in both directions) in which of AXA or Hibernian offered the most competitive quote in March and July 2003.

3.44 The Consumers' Association provided data on comparative quotes over a number of years that also provide evidence that the identity of the cheapest insurer for a particular risk changes over time. For four policyholder profiles, the Consumers' Association collected quotes in 2001 and 2003. Table 3.6 shows the changes in the underwriters' rankings over this period. In three cases, the identity of the cheapest underwriter changed (between 2001 and 2003 AXA went from offering the most competitive to the least competitive quote to a 33-year-old female driver from Dublin). The one exception to this was a quote for a 47-year-old male from Limerick, for which AA remained the cheapest underwriter in both periods. (The presence of entities like AA would appear to make collusion more difficult. It increases the number of firms that would have to be party to any agreement.)

15 Phlips, L (1995) Competition Policy: A Game-Theoretic Perspective, Cambridge: Cambridge University Press.

Table 3.6: Change in Ranking, 2001-2003

	Underwriter with lowest quote 2001	Ranking in 2003 (out of 9)	Underwriter with lowest quote 2003	Ranking in 2001 (out of 9)
Male 47, Limerick	FBD	2	AA	2
Female 33, Dublin	AXA	9	FBD	2
Female 40, Sligo	AA	1	AA	1
Male 25, Waterford	Eagle Star	3	Hibernian	4

Source: Consumers' Association

3.45 Table 3.7 also suggests that the motor insurers were not all engaged in a simple market segmentation exercise. For four character profiles, MIAB data were searched to see which insurers offered the ten lowest premiums in 1999 and in 2001. In all cases, there was at least one company that made the "top ten" in 1999 but not 2001, and vice versa. This analysis is looking at very narrow market segments; the number of consumers fitting each character profile is small.

3.46 A second argument is that competition results in "cherry picking". Underwriters only target those segments of the market that are profitable, either refusing to quote or offering quotes sufficiently high that they are uncompetitive. This concern is perhaps greatest when thinking about groups for whom the choice of underwriter is limited, such as young drivers, the over 70s and motorcyclists. An outcome which requires certain sections of the Irish population to pay considerably more for motor insurance is seen as evidence of a market failing. That motor insurance is compulsory for drivers increases the perception that competition is not working if certain groups face much higher premiums.

3.47 Without passing comment on the desirability or otherwise of some groups facing high motor-insurance premiums, it is nevertheless possible for such cherry picking to be consistent with a competitive market. In fact, it is arguably exactly what would be expected in a competitive setting. Firms identify a niche in the market where they can operate profitably, target the niche and drive the price down for customers in that niche. Those underwriters that identify groupings for

Table 3.7: Top 10 Most Competitive Priced Policies for Four Character Profiles

A 35-year-old male with a 4-year-old car and comprehensive insurance in the Dublin area		A 28-year-old female with a 7-year-old car and comprehensive insurance in the Dublin area		A 30-year-old female with a 5-year-old car and comprehensive insurance in the Dublin area		A 45-year-old male with a 7-year-old car and comprehensive insurance in the "Rest of Ireland".	
1999	2001	1999	2001	1999	2001	1999	2001
PP*	PP	II	II	FF	II	VV	LL
FF	MC	JJ	II	VV	LL	PP	II
PP	MC	FF	MC	PP	FF	AA	LL
FF	PP	FF	II	FF	FF	JJ	LL
FF	II	PP	LL	JJ	PP	VV	VV
JJ	LL	PP	LL	PP	II	JJ	LL
FF	PP	PP	LL	JJ	II	JJ	VV
JJ	MC	PP	II	II	PP	JJ	JJ
JJ	LL	II	FF	JJ	JJ	AA	LL
PP	FF	PP	LL	PP	JJ	FF	LL

* This is probably an error in the data file, since the recorded premium is £0.
All characters in the table have had no claims, neither provisional license nor inexperience loadings and their exposure was for one full year.
Source MIAB

Table 3.8: Instalment Plans

	AXA		Eagle Star		Hibernian
	5-Month Plan	10-Month Plan	First Year	Subsequent Years	
Initial deposit required (%)	50		30		
Number of instalments	5	10	6	9	10
APR (%)		17.04	19.9	15.2	17
Service charge ( )	20				

Data Source: www.axa.ie, www.eaglestar.ie, and www.bibernian.ie, 21 January 2004

which premiums are comparatively high relative to claims costs will realise profits by undercutting their rivals and gaining much of their business.

3.48 One insurer suggested that their competitiveness in the motor insurance market depended ultimately on their ability to "slice and dice the market" better than their rivals. Motor insurance is a commodity good, for which consumers care most about price, reducing the potential to compete by offering additional features. By segmenting the market in ways that allow more targeted premiums, the underwriter is able to offer lower quotes to groups that will, in expectation, have lower claims. Its competitors will try to do the same.

3.49 Cherry picking is an inevitable consequence of a competitive insurance market without requirements for community rating. The different categories of drivers represent different risks, and so firms should be expected to offer lower premiums to low-risk drivers. Any firm that fails to segment the market and offer low-risk drivers lower premiums will find that such drivers seek insurance elsewhere, leaving the underwriter with only the higher risks as potential policyholders. Consequently the premium it quotes all drivers will have to correspond to the premium other underwriters quote to only high-risk drivers.

3.50 Affinity schemes are one way that underwriters can target low premiums at certain groups that the underwriter perceives to be a low risk.[16] Customers that apply for insurance through an affinity scheme receive a discount from the underwriter that reduces the premium they would otherwise have been quoted.

3.51 Another business rationale given for the different quotes underwriters offer to different groups is the desire to have a balanced portfolio of risks. Some insurers claimed to seek a balanced portfolio; others did not see the sense of such a strategy. There appear to be competing business models. The re-insurance arrangements that the insurers have in place may be one reason why some insurers seek a balanced book (or refuse to offer quotes for certain groups).

3.52 A final aspect of pricing that has attracted attention concerns the interest charged on premium instalments. The MIAB Report found that a substantial proportion of motor insurance was transacted on instalment plans, and the APRs charged compared with those charged by credit-card companies.

3.53 Table 3.8 describes the instalment plans offered by AXA, Eagle Star and Hibernian, based on website searches. (Searches of other insurers' websites failed to locate relevant information.) The interest rates charged remain high: the APR for a loan from the Bank of Ireland at the fixed rate is 9.8 per cent.[17] Nevertheless, the insurers offer different plans, which does not support the hypothesis that the insurers are colluding.

3.54 Moreover, the insurance firms are constrained in the APRs they can set by the fact that customers have the option of paying the premium in a lump sum. Those customers without sufficient savings to make a single premium payment still have the option of borrowing from other financial service providers, such as credit unions, credit-card companies and banks, thereby avoiding the need to use the insurance company's instalment plan. Unless and until there is a finding that the market for personal loans is uncompetitive, it would seem that the high rates charged by the insurance firms are not inconsistent with competitive behaviour. A rationale offered for the high APRs is that the cost of collecting premiums by instalment is high (in addition to the time cost of money).[18] If the insurers are overstating the difficulties, there should be a profitable opportunity for another financial institution to start offering loans to people wishing to pay a motor-insurance premium by instalment. (The one caveat is that other lenders do not have the security that they can cancel the insurance policy if the customer does not keep paying when instalments are due.)

16 The lower premiums may also arise because of other costs being lower. For example, the distribution costs may be lower.
17 Source: www.bankofireland.ie, 21 January 2004 (quoting for "other loan" of €6,000 with 12 monthly repayments).
18 [Confidential material.]

Non-price competition

3.55 Underwriters can also engage in non-price competition. There are numerous possible examples of non-price competition: some underwriters may offer motor breakdown assistance or a priority windscreen replacement service; underwriters might differ in the arrangements they make for drivers whose cars are currently undergoing repair following a claim; rules governing when the no-claims discount is lost may vary; the policy might extend to allowing the policyholder to drive other cars.

3.56 The fact that different policies contain different arrangement indicates that such non-price competition does occur. It also highlights a problem with attempts at collusion. If prices were fixed, underwriters could still compete by varying the terms and conditions they offer when quoting premiums.

Managing claims costs

3.57 Competition between insurers might take the form of attempting to reduce the cost of claims.

3.58 Some measures that insurers cited as evidence of recent innovations related to efforts to reduce the number of claims. The most notable examples related to young drivers. Hibernian offers a discount ranging from 20 to 40 per cent to drivers who successfully complete a one-day driving course. A further 10 per cent discount is available if the drivers abide by a night-time curfew. AXA has its Traksure Initiative which allows it to monitor drivers to ensure that they do not speed. (A cynical view might be that these measures merely respond to recent bad publicity. In isolation, the actions would not suffice to demonstrate that the market for motor insurance appears to be competitive.)

3.59 Measures such as these allow the insurers to overcome an informational asymmetry problem between the insurer and the insured. Although insurers attempt to quote premiums based on factors such as age and sex, these are only imperfect proxies for the risk different drivers pose. If there were no competition in the insurance market, the incentives would be lower for a monopoly provider to improve its information since it could charge all drivers high premiums. But if there is competition, the insurer has to avoid being left with only the bad risks. The young-driver schemes described allow drivers to signal they are low risk by incurring a cost (attending a driving course or purchasing a black box). Those that are good risks will incur the costs to demonstrate that they should be offered a lower premium. Those that are poor risks will choose not to undertake such schemes.

3.60 The costs of such schemes - it costs €1,206.25 to install the equipment used in AXA's Traksure Initiative - might be one reason they have been confined to young drivers. For older drivers, any savings in expected claims costs would be largely (even completely) offset by the cost of the scheme.

3.61 There is some evidence of competition to keep costs down after a claim has been made. The Glassmatix joint venture, motivated to control repair costs, is discussed later.

3.62 Quinn-direct claims to enjoy a competitive advantage by realising cost efficiency. It claims to have a fast claims-response unit that seeks to reduce legal costs. Comments received from other insurers suggest that Quinn-direct's approach to managing claims costs differs to some of its rivals: there appear to be competing models of how best to handle claims costs. A competitive market will not feature all companies at all dates having the same costs and producing the same products. Instead, there will be occasions when a firm, possibly an entrant, innovates to realise a cost saving or to provide a product consumers value more highly.

Distribution channels

3.63 This section reviews the evidence of rivalry between insurance firms in the way that they distribute their products. Distribution is a complementary service required by underwriters wishing to sell insurance policies.

3.64 There are significant differences between the insurers in terms of the percentage of sales by the various distribution channels. Looking at the percentage of policies sold by brokers in 2002 illustrates this point starkly (see Chart 3.10). There appear to be competing models of the best way to distribute, with the insurers varying in the extent to which they have vertically integrated the distribution and underwriting services. [Confidential material.] Theory suggests that it would be easier to facilitate tacit collusion if the firms were vertically integrated to the same level.

Chart 3.10: Percentage of Policies Sold by Brokers in 2002

[Confidential material]
Data Source: Insurance companies

3.65 The chart below examines the growth of sales through the direct channel as opposed through brokers. There is no clear pattern emerging. The chart shows that the relative use of the direct channel increased for three of the companies whereas it decreased for four. [Confidential material.]
The chart may be slightly misleading because of the use of multi-agency intermediaries that are part of the same group as the underwriter, e.g. Hibernian Direct and Allianz Direct.

Chart 3.11: Percentage of Premiums Sold Directly During 2000-2003

[Confidential material]
Data Source: Insurance companies

3.66 There have been some concerns that underwriters engage in anti-competitive practices in the way that they sell their product. For example, there is a concern that underwriters discriminate depending on the how the insurance product is purchased. Buying the same policy via a broker may cost more than if the quote was sought directly. This situation is not necessarily anti-competitive. If firms are competing to realise cost savings, one way to manage their costs is to provide potential customers with an incentive to purchase the product via a distribution channel that minimises the underwriter's costs. Internet sales are likely to be cheaper than sales via the phone, which in turn will be cheaper than sales via a branch network.

3.67 If an insurance company believes that it is cheaper to sell policies directly, then customers should have the opportunity to share in those cost savings by buying directly. If competition between underwriters is to include competition to realise cost savings in the costs of selling, then it is likely that some underwriters will either price differently according to the sales channel or only sell via certain mediums. [Confidential material]

3.68 A second concern is that there is a lack of transparency about who is selling the insurance policy. The MIAB Report referred to the illusion of choice, giving the example of An Post's entry into the market through a company called One Direct, potentially masking the fact that this was another distribution channel for motor insurance policies provided by Hibernian. Other examples of possible confusion may exist. For example, do customers purchasing from AA Insurance realise that AA Insurance is not the insurer, but a multi-agency intermediary?

3.69 The potential problem for competition is that customers do not realise that just because they have sought a number of quotes, they have not necessarily received quotes from a number of different insurers. Nevertheless, underwriters still have an incentive to compete on price. The competition will be to ensure that they are the chosen underwriter for such sales channels. Any advantages An Post or AA Ireland have in selling insurance policies, in terms of a more efficient distribution channel, will fail to suffice if the underlying motor insurance policy they sell is significantly more expensive than those offered by rivals. (For similar reasons, there will be incentives for insurers to ensure a good after-sales service is in place for customers, even when the customer does not know the identity of the insurer.)

Co-operation Between Insurers

3.70 The previous section has looked at the evidence for rivalry between insurers. The facts are largely consistent with what might be expected in a competitive market. There are changing market shares; evidence consistent with price and non-price competition; and also some evidence insurers are trying to manage costs more efficiently than their rivals.

3.71 This section looks at examples where, by design, the insurers do not compete but instead co-operate. Article 81(3) of the EC Treaty allows the Commission to exempt anti-competitive agreements whose benefits outweigh their negative impact on competition. There has been a block exemption covering the insurance industry, allowing the following categories of agreement:

(a) The establishment of common risk premium tariffs based on collectively ascertained statistics or the number of claims;

(b) The establishment of common standard policy conditions;

(c) The joint coverage of certain types of risks; and

(d) The testing and acceptance of safety devices.

3.72 There is not a *per se* ban on co-operation. Agreements need to be considered on their merits. This section considers a number of areas where insurers could or do co-operate.

Data sharing

3.73 If there is a problem with co-operation on data sharing in the Irish market presently, the complaint seems to be that there is too little.

3.74 An underwriter needs to form a view on the frequency and scale of claims likely in the future, and typically will do this by reference to statistical data on past events. Underwriters who have sold many policies will have more observations on which to base statistical calculations. With the comparatively small size of the Irish market, a larger share of the market might be necessary before an underwriter can have confidence in any statistical findings. [Confidential material.] A number of underwriters indicated that they would be extremely reluctant to share data at the level of the policyholder [Confidential material].

3.75 To the extent that historical data help when setting premiums, smaller underwriters and entrants are at a competitive disadvantage to the larger incumbents. Most underwriters did not think the problem was insurmountable. Options suggested included using the premiums that the existing underwriters are setting as a guide; using the risk assessments of the larger brokers operating in the Irish market; or appointing actuaries with experience in the sector. Some insurers argued that an entrant's ability to compete in the market in the early years would depend on its ability to realise cost savings or provide a better service, rather than its ability to use its past data to segment the risks. Entrants from other insurance markets would also have some data that might be relevant, e.g. a British underwriter might use its British claims data to identify groups that constitute good risks and hope the corresponding groups in Ireland also represent good risks.

3.76 The optimal level of data sharing entails a careful judgement. A benefit of competition is that it creates incentives for innovation. Firms should have an incentive to seek an advantage in assessing risks. If underwriters always have to share the statistical analysis they undertake, then they enjoy no gain from such analysis. For example, suppose an underwriter conjectured that educational qualifications would be a good predictor of a prospective policyholder's claims. The advantages of collecting data from policyholders about their educational qualifications might be muted if the data had to be shared with rival underwriters.

3.77 Most prospective entrants probably do not need such detailed data. To enter the market, they will likely have to employ people with experience of assessing the risks. What might help facilitate entry is data slightly more disaggregated than that presented in the Blue Book. Rather than just observing annual data for motor insurance, there might be benefits if the data were split, e.g. between commercial and non-commercial motor insurance. This would give parties thinking of entering the market better information about the niches of the Irish insurance market which might offer the most profitable opportunities, and may help them convince both reinsurers and the capital markets of the viability of their business plan.

3.78 Much of the data that are shared are only available to insurers already in the Irish market, although MIAB publications are in the public domain. The Irish Insurance Federation and the MIBI only share their data with their members. For both of these bodies, an underwriter has to be an insurer in the Irish market to access the information (to join the IIF, it would suffice if the insurer offered other non-life insurance products; for the MIBI the insurer has to be licensed to write motor insurance policies). With the long lag before the Blue Book data are published, one concern is that potential entrants find out about profitable opportunities in the Irish market too late. [Confidential material]

3.79 The data that the IIF shared in 2003 included similar material to that in the Blue Book, but split between private and commercial motor insurance. For commercial insurance, IIF data are disaggregated for "Commercial Vehicle-Haulage; "Commercial Vehicle-Non-Haulage"; "Fleet-Non-Haulage"; and "Fleet-Haulage". Some of these data are published in the IIF Factfile. The IIF also shares comparative private motor insurance quotations (see Table 3.5 earlier). The data collection exercises are conducted to satisfy the MIAB's information requirements, and were not previously carried out by the IIF.

Inse-com

3.80 The Irish market is perceived to lag behind most other European insurance markets in the platforms linking brokers and underwriters. Currently, there are three systems - Relay, Mysys and Bitsys - that act as an electronic interface between underwriters and brokers, allowing brokers to receive quotes electronically from underwriters. But none offers a full-cycle electronic distribution interface (EDI) between brokers and underwriters; some information is still exchanged in hardcopy. Ireland is the last market in the EU to develop such an EDI product. The small size of the Irish market, combined with the failure to reach consensus, was offered as the reason for the slow development. Potential providers saw little upside risk with developing a platform for the Irish market, and faced the risk that there would be no take-up of the product. And underwriters and brokers had been unable to agree amongst themselves on how to develop a standard, which had thwarted previous attempts to develop such a platform.

3.81 Inse-Com was established as a joint venture in 1999 by the insurance industry to facilitate setting up a standard EDI technology platform to deliver volume retail non-life insurance products through the broker channel. The joint venture is seeking to develop a full-cycle EDI product, initially for the personal motor insurance market.

3.82 Currently, Inse-com uses Polaris ProductWriter (owned by Polaris UK Ltd, a company set up by the UK insurance industry) and Run Time Environment (RTE) as the standard technical platform. Underwriters deliver private motor insurance products on Polaris ProductWriter software to Inse-Com, which compiles and distributes to the Broker Software houses. One of these houses had integrated the Polaris RTE in its system and one other was contracted to have. Brokers can also access an internet quotation service Inse-Com provides for underwriters currently making data available to Inse-com.

3.83 That underwriters co-operate and use the same EDI product is not a problem. The product's value to brokers depends on how many insurance providers use the product and vice versa. There are efficiency savings in underwriters using the same EDI product.

3.84 The company is owned as a not-for-profit organisation by the six insurers that use Inse-com - Allianz, AXA, Eagle Star, Hibernian, Asgard Motor Policies, and Royal & SunAlliance. The board consists of four directors from the insurers, four representing intermediaries and a chair selected by the owners (the insurers). The current shareholders fund Inse-com's costs, with the contributions depending on the insurer's share of the motor insurance market as measured in the Blue Book. Other insurers could join if they wish and would be subject to the same funding requirements; there would be no requirement to contribute retrospectively. This alleviates concerns that the scheme might facilitate market foreclosure.

Glassmatix

3.85 In the meetings with insurers, the only other joint venture, other than Inse-com, identified was Glassmatix. Glassmatix is a computerised vehicle repair estimation system provided by Glass's Information Services Ltd, a UK-based firm. A consortium consisting of AXA, Allianz, Hibernian and Royal & SunAlliance entered into an agreement with Glass's. This agreement has already been the subject of a recent Competition Authority investigation, to see whether it complied with Sections 4(1), 4(2) and 5 of the Competition Act 2002.

3.86 The Authority sent the parties a letter of initiation, indicating the grounds on which it believed the agreement infringed the Act. There were concerns at the time that the insurers had shared too much information about their costs, and that looking forward the agreement might, among other things, (a) limit competition between insurers to lower repair costs and (b) foreclose the market to other insurers by denying them access to Glassmatix on reasonable terms. The parties changed the agreement to address the concerns.

3.87 Underwriters not currently using Glassmatix did not claim that the arrangement disadvantaged them. One indicated that it was yet to be convinced that Glassmatix would permit a cost saving, but was happy that it had the option to join at a later date if it wanted.

3.88 There was some concern that consumers are currently being denied access to repairers that are not part of the Glassmatix scheme. However, no firm evidence was provided that the Consortium members were co-ordinating in this regard. As the original study of the Glassmatix arrangements observed, it is desirable for individual insurers to compete on repair costs, including distinguishing between recommended repairers and others in a transparent manner. Forcing insurers to deal with all repairers would mute one form competition between motor insurers (and potentially mute competition in the motor repair market).

Motor Insurers Board of Ireland

3.89 The MIBI is a private, non-profit body set up under an Agreement between the Government and the Motor Insurance Industry. It has no formal links with the Irish Insurance Federation.

3.90 It provides coverage for claimants whose claim arises because of the actions of untraced or uninsured drivers. The MIBI is only liable if no other insurer has even partial liability. So, for example, a "victim" who has fully-comprehensive insurance will be compensated by their insurer, in respect of property damage only, rather than the MIBI, if the driver at fault was uninsured or untraced.

3.91 About 5 per cent of all claims in Ireland are paid by the MIBI, a much higher percentage than elsewhere in Europe. This reflects the comparatively high levels of uninsured drivers in Ireland. For the MIBI, disputes rarely concern the size of quantum but involve issues about the validity of the claim under the terms of the Agreement.

3.92 All firms wishing to offer motor insurance in Ireland need to join the MIBI. There are currently 31 members, i.e. 31 firms may offer motor insurance in Ireland, although not all MIBI members are currently active. Members of MIBI contribute levies according to their share of the market in the last year for which records are available, i.e. the share of premium income recorded in the most recent Blue Book. Consequently, new entrants to the Irish motor insurance market pay nothing in the first year. From 1 January 2004, each new entrant will pay an entry fee of €5,000, and there will be an annual membership fee of €5,000.

3.93 The insurance firms are represented on the Board of the MIBI. The largest five firms, by motor insurance premium income, and two others elected by insurers, all provide representatives to serve on the Board. Currently the five largest firms are; AXA, Hibernian, Allianz, Quinn-direct and Royal & Sun Alliance, while St. Paul and FBD have been elected. The typical representative will be a senior individual at the insurance company, such as the Head of Claims, although typically not the CEO. The Board is currently meeting frequently - about once every six weeks.

3.94 Aside from the Board, the insurance firms are also represented on key committees of the MIBI. The technical committee deals with issues relating to claims, making decisions on matters such as whether to allow the claims handler discretion to proceed as proposed for large claims or whether to accept that MIBI should meet the liability. The finance committee looks at reserves policy and financial trends. Actuaries, currently Watson Wyatt, review the reserving policy of the MIBI. Also Price Waterhouse Coopers currently perform a full financial audit of the MIBI each year.

3.95 Claims are handled by six insurers: AXA, Allianz, Eagle Star, FBD, Hibernian, and Royal & SunAlliance. The MIBI reimburses these insurers for the costs of meeting MIBI claims. The claims are allocated to the six insurers in rough proportion to the relative size of the firms in the motor-insurance market. The firms must report on the progress of claims every quarter, and for claims in excess of €0.5 million the firm must seek discretion from the MIBI before proceeding. The six insurers handling claims have these roles because of historical precedent.

3.96 The MIBI is currently engaged in introducing Service Level Agreements for all its service providers (claims handling offices, solicitors, accident investigators).

3.97 There are some reasons why the MIBI may have anti-competitive implications for the Irish motor insurance market. It may serve as a potential entry barrier, as discussed later. This reduces the incentive for those firms managing MIBI claims to keep the costs down or settle claims quickly. Those firms that manage the claims are reimbursed by contributions from all insurers, another factor reducing the incentive to manage such costs. Insurers not currently handling claims for MIBI complained may be at a competitive disadvantage, effectively subsidising their rivals.

3.98 A second concern is that the arrangement may facilitate information sharing between insurers. They get to see the claims costs incurred by other insurers when handling claims for MIBI. (Of course, the data's usefulness may be reduced if insurers have little incentive to manage these costs.) And it provides an opportunity for senior managers to meet.

Declined Cases Agreement

3.99 All motor insurers doing business in Ireland are parties to the Declined Cases Agreement with the Minister for Enterprise, Trade and Employment. The agreement's purpose is to ensure all licensed drivers can obtain minimum compulsory motor insurance, even when no insurer would otherwise be willing to underwrite the risk. Participation is compulsory for all motor insurers. An individual unable to secure motor insurance after approaching three companies will be able to secure cover under the Declined Cases Agreement.

3.100 The Agreement and a Supplemental Agreement between the insurers contain rules for allocating declined risks to the various insurance companies. It is for a Committee, made up of representatives of the insurers that are party to the Agreement, to decide which firm should make a quote under the agreement. If the individual held a policy within the last three years, the company that most recently insured the individual must provide a quote. If the individual has not had a policy in the last three years, then the first company approached has to provide a quote. Where this is in doubt, as can be the case when brokers send out requests for quotes to a number of underwriters simultaneously, the insurer is selected based on which firm is next on the rota. The committee will judge whether the quote is too high or the terms so excessive as to be tantamount to a refusal to supply.

3.101 The agreement has some anti-competitive features, not all of which can be justified by the public-policy objective that the agreement seeks to realise (allowing

all would-be motorists access to motor insurance). The scheme may represent a barrier to entry, particularly to firms that might otherwise be tempted to enter the market and quote to various market niches. The agreement might require an insurer to quote in a niche for which it has no expertise.

3.102 The way the scheme is run is also of concern. The oversight of the scheme by insurance companies raises the possibility that it may be used to facilitate anti-competitive practices, although there are two observers on the committee. One party queried whether the scheme might be used to punish entrants, by selecting the entrant to quote for the worst risks under the scheme and then requiring them to quote a loss-making premium. If insurers think that a quote under the agreement is too high, then rather than requiring a rival underwriter to lower its premium they should be competing for this business and offering a lower quote themselves.

3.103 There is also a more general concern that the committee running the agreement may serve as a conduit for information sharing between insurers. There do not seem to be any countervailing benefits that require insurers to run the scheme.

Entry Barriers

3.104 Although the recent evidence is consistent with what might occur in a competitive market, the previous section has indicated a number of cooperative arrangements between insurers that might be used to facilitate uncompetitive practices. The main concerns for competition currently appear to be with the arrangements to settle claims for uninsured and untraced drivers and the Declined Cases Agreement, but all the cooperative ventures provide opportunities for parties to meet, one of the conditions identified as facilitating co-ordinated behaviour.

3.105 The potential to collude will be reduced if there is a threat of entry into the market. If firms not party to any arrangements can easily enter the Irish market and start offering motor insurance, it would be hard to sustain a collusive agreement. This section reviews the evidence on entry barriers.

3.106 In the past decade, a number of large overseas insurance firms have entered the Irish market, by purchasing incumbent firms. Of more interest for competition purposes is whether it would be possible to enter the Irish market without buying up an existing entity - if the only way to enter the Irish market is by acquisition, then over time the market can only become more concentrated. Quinn-direct's success suggests that it has been possible to successfully enter the Irish motor-insurance market.

3.107 The comparatively small size of the Irish market - about 3 million potential clients seeking motor insurance - means that barriers in bigger markets that do not deter entry may nevertheless deter entry into the Irish motor insurance market. Entrants will only incur the costs of entering the market if the expected gains exceed the entry costs. The size of the market caps the potential gains from successful entry. A number of parties suggested that the Irish market is not a high priority for insurance firms based elsewhere.

3.108 More positively, insurance firms in the UK and the USA may find the Irish market attractive because of the shared language. It is easier to become informed about the market since all the relevant information that is available will be in English. Some parties also commented that for a UK underwriter, the Irish market was more similar than other European markets. A British-based underwriter may be more willing to enter the Irish market than to enter other parts of Europe, all else equal. The British retail insurance sector is the largest in Europe (twice the size of the next largest, in Germany).

3.109 The remainder of this section focuses on potential entry barriers that are specific to the Irish insurance market. The small size of the Irish market and any advantages accruing from shared linguistic or other cultural features may apply equally to other industries and are things outside the control of the Competition Authority.

Poor profits and high claims' costs as possible barriers

3.110 Most parties spoken to cited poor profitability as the main reason why underwriters had not entered the Irish motor insurance market in recent years. Poor profit opportunities do not represent an entry barrier. In a competitive market, entry should only occur when a would-be entrant detects a profitable opportunity. Suppose firms in a market compete vigorously, and as a consequence the returns they earn are only just sufficient to compensate their investors. There would be no incentive for another firm to enter the market (unless it could operate at greater efficiency). In this setting, the market is competitive by construction, and there is no need for a competition authority to intervene even if it observes no entry.

3.111 Some parties suggested that the perception is gradually changing, and that it is now possible to convince foreign insurers that profits can be earned in the Irish market. The most recent results of Hibernian

and FBD are cited as evidence that the Irish insurance market is now profitable. The current problem is convincing reinsurers that they can profitably underwrite motor insurance business in Ireland.

3.112 The absence of timely information on the profitability or otherwise of different sectors, including motor insurance, is a concern. Currently, the Blue Book is published almost a year after the year to which it relates. The IIF do produce some summary statistics in the interim but these numbers lack the authority of the Blue Book and the amount of IIF data available to non-members, including potential entrants, is limited.

3.113 Some parties were also concerned that current participants in the motor-insurance market set their reserves strategically, to deter entry. By overstating their reserves, they are able to portray a less profitable market. Others argued that the rules governing reserves prevent such behaviour. To the extent that the rules allow flexibility, the insurers may have potentially conflicting incentives when declaring their reserves. Aside from deterring entry, insurers may have an incentive to minimise their tax burden and senior management may use reserves to engage in profit smoothing (volatile reported profit streams may upset shareholders).

3.114 Relatively high claims' costs in Ireland, and their volatility, were also cited as deterring entry. This explanation of why no entry is occurring is only partial. Claims' costs are one important component of the cost base of insurance firms. Just because a class of costs are high does not automatically mean firms will not enter a market. If all their rivals face similar costs (which should be the case for claims costs), then incumbent firms do not have an advantage. In a competitive market, the competitive price would be higher than otherwise to reflect the fact that costs are high. If the explanation is that claims costs are higher than prices (premiums), then the point is akin to the earlier explanation for no entry - the absence of profitable opportunities for would-be entrants.

3.115 Uncertainty about claims' costs, allied with the fact that claims' costs represent a large percentage of an insurance firm's total costs, may represent an entry barrier. Potential entrants may have less information about what factors drive claims costs in Ireland than firms already operating in the market. Consequently, a potential entrant might want to ascertain more information about what its likely claims costs will be before entering the market.

3.116 Some parties gave this as one reason why entry into the Irish market is not occurring. They thought a "Book of Quantum" is needed. If claims costs can be forecast with accuracy, entrants can price with confidence. Even if they are forecast to be high, entry should be possible since the firms could just set prices high. When there is large uncertainty about what the claims exposure might be, would-be entrants face greater uncertainty about what would represent prudent pricing. Rather than invest time and resources developing a better understanding of how claims costs were likely to evolve, firms might instead devote their attention to other markets and forego entry into the Irish motor insurance market.

3.117 Looking forward, uncertainty about claims' costs may be resolved by some of the reforms that have already been proposed and/or introduced. For example, some parties thought that just the announcement of the setting up of the Personal Injuries Assessment Board had led to more consistency in the size of claims now being awarded, extending across all classes of liability insurance (not just employers' liability).

Regulatory barriers

3.118 In 2002, there were six insurers registered to transact motor insurance in Ireland that did not earn any premium income. For them, the regulatory costs of entering the motor insurance market in 2002 were nil. In some cases, the insurer may be part of a group that already has an active insurer in the Irish market. Nevertheless, some of the inactive insurers appear to be independent of existing insurers. Moreover all the syndicates at Lloyd's of London face no regulatory barriers to entering the Irish market.

3.119 A company wanting to establish a head office in Ireland has to comply with Irish regulations, which are similar to elsewhere in the EU. The conditions do not seem to have been too onerous (the next chapter illustrates this point by showing the growth in the number of firms with head offices in Ireland for liability insurance).

3.120 The Irish government has implemented in full the European Directives relating to insurance. The main directive regulating entry into the industry is the European Communities (Non-Life Insurance) framework regulations 1994. A firm regulated elsewhere in Europe needs to advise their home supervisory authority of their intention to enter the Irish market. If the authority approves the venture, the authority sends a certificate to the Irish authorities setting out compliance with the home countries minimum solvency requirements, the classes of business that the company wishes to transact and the risks that it is underwriting. Once this is received the Irish supervisory authority will send details of any

conditions under which the insurer must operate in terms of the general good - for Irish motor insurance these conditions are to:

(a) Appoint a claims representative;

(b) Become a member and finance the Motor Insurers' Bureau of Ireland and the guarantee fund; and

(c) Sign the Declined Cases Agreement and Declined Cases Supplemental Agreement.

3.121 Although freedom of services should facilitate entry into the Irish market, problems have been identified with the regulatory process. One concern is the 1995 Investment Intermediaries Act governing intermediaries, and its implementation. The Act is considered poorly drafted, lacking the flexibility to cover all potential business models that might apply in the insurance industry. It is also considered difficult to understand, which in itself might deter a would-be entrant.

3.122 An example cited is the Act's perceived failure to cater for brokers with an agency agreement with Lloyd's brokers or other non-resident intermediaries. Section 26 of the Act defines restricted activity investment product intermediaries essentially as parties that receive and transmit orders for investment intermediaries to product producers. In non-life insurance, much business is transmitted to entities that cannot or do not meet the definition of product producer. IFSRA authorise firms under Section 10 of the Act to receive and transmit to non-product producers (Lloyd's brokers or other non-resident intermediaries). To avoid confusion from having a preponderance of types of firm, and because the business services offered are broadly similar, these firms and RAIPIs can describe themselves as "multi-agency intermediaries". Some parties suggested that this was a practical solution by the regulator (the DETE at the time) to an Act that did not reflect the realities of the insurance industry. Others thought that the response had created separate problems, distorting competition between intermediaries to the detriment of authorised advisers.

3.123 For the purposes of competition, it would be undesirable to curtail access to Lloyd's of London or other foreign underwriters. Such underwriters can potentially serve as a competitive constraint on Irish insurers. Similarly measures should also be in place to allow firms that wish to enter agreements with either non-resident intermediaries or non-resident insurers.

3.124 IFSRA's approach to implementing the Act can significantly affect how burdensome the Act proves to be in practice. [Confidential material]

Motor Insurers' Bureau of Ireland and the Declined Cases Agreement

3.125 Two features specific to motor insurance that might represent barriers to entry are the Motor Insurers' Bureau and the Declined Cases Agreement.

3.126 All firms offering motor insurance in Ireland must belong to the MIBI, which is responsible for handling claims arising from uninsured or untraced drivers. In comparison to other European countries, the MIBI incurs large costs. This reflects the comparatively high levels of uninsured drivers having accidents in Ireland. As with high claims costs, this alone should not deter entry. All insurers face the same costs. If there were an entry barrier, it would be because entrants are at a disadvantage to incumbents in determining what the level of these costs might be. Entrants' uncertainty about what reserves to set aside to meet MIBI contributions might be greater, making it harder for them to develop a business plan. Because the MIBI costs are high, this uncertainty is more important to resolve.

3.127 The Declined Cases Agreement may also serve as an entry barrier, particularly in the case of firms wishing to enter niche markets. The agreement means that the firm potentially has to provide a quote for a risk about which it does not have expertise. This may be important, since a number of underwriters described business models that involved gradual expansion of the risks they insure. An underwriter might specialise in offering insurance to a particular profession, perhaps professional indemnity insurance to financial advisers. It may decide that the information it has learned about this group allows it to start offering motor insurance to financial advisers. Similarly, a foreign firm that specialises in certain types of motor insurance, e.g. hackneys, may be prepared to enter the Irish market and offer quotes to this group.[19] In both cases, the underwriter will build up data about the Irish motor insurance market, and may gradually become willing to quote for a greater range of risks, ultimately increasing competition across all types of motor insurance. This will only happen if the firm enters the niche it has identified, yet concerns were raised that this opportunity to learn about the Irish motor insurance market gradually was denied by the potential requirement to quote all risks under the Declined Cases Agreement.

3.128 Views on the importance of the Declined Cases Agreement were not uniform. Some parties considered it a cost of doing business but of no significance since the volume of cases was low; others considered it an important impediment to entry into the market. The concern from a competition

19 The examples described are close to actual practice. [Confidential material]

perspective is the possibility that the differing opinions reflect differences in the views of those already in the market and those outside. For entry to occur, it is potential entrants that have to be convinced that the Agreement will not entail significant costs.

Access to sales channels

3.129 To successfully enter a market, a firm needs to be able to distribute its product. A study by the Association of British Insurers found that 29 per cent of UK insurance company CEOs considered access to distribution channels an impediment to entering other European markets.[20]

3.130 The comments of parties met and the history of observed entry suggest that access to sales channels is not a barrier to entry in Ireland. Underwriters can sell direct or reach agreements to sell via brokers.

3.131 There would be concern that relying on direct sales may entail large advertising expenditure, which represents a sunk cost and therefore a potential entry barrier. These costs have not been prohibitive in the past. Quinn-direct entered the market with a business plan that entailed selling direct to customers. [Confidential material] This experience suggests that it is possible for a firm to enter the market for motor insurance even if it has to set up its own distribution channel.

3.132 Moreover, entrants also have the option of distributing via brokers. Market foreclosure, with existing underwriters using networks of tied agents to prevent new entrants from accessing a distribution channel, does not appear to be a problem. At worst, a new entrant may encounter some inconvenience setting up agency agreements with Irish brokers and will have to invest in new software to be compatible with the Irish broking market. Some parties suggested these costs may be higher than they need to be [confidential material] but they were not seen as significant. ARB Underwriting recently began trading in motor insurance in Ireland and its products will only be available to brokers (ARB intends restricting its network to about 60 offices initially because of its capacity).[21]

3.133 Another option would be to sell the policy via a so-called wholesale broker. The wholesale brokers will be responsible for making the policies available to consumers and also to other brokers who are searching on behalf of their clients. Such an option reduces the costs of establishing a distribution channel via brokers, since the wholesale broker does most of the work.

Exit barriers

3.134 An exit barrier - a cost of exiting a market - might also deter entry. Firms aware that they will incur costs if they subsequently exit the market may decide against entering in the first place.

3.135 For insurance, the obvious concern is that an insurer exiting the market must nevertheless have arrangements in place to meet any claims that subsequently arise for which it is liable. Firms ceasing to underwrite place their business in “run off”. The arrangements will need to last until the last potential claim has been settled. For some classes of insurance with long-tailed claims this could be a long time into the future, but this is less of a problem for motor insurance.

3.136 Companies intending to continue offering other forms of non-life insurance in Ireland will have to make arrangements for handling claims relating to these forms of insurance, so continuing to handle claims arising in run off is unlikely to entail large costs. If there is a problem, it is likely to be greatest for firms seeking to exit the Irish non-life market altogether. However, there will normally be other insurers and reinsurers willing to assume the liabilities in exchange for a payment. Since the exiting firm already was liable to meet the costs of outstanding claims, the cost of exiting the market should be seen as the premium it has to pay to take these claims off its books.

3.137 The Motor Insurers’ Bureau and the Declined Cases Agreement may create some exit costs, although these seem small. In the case of the MIBI, firms exiting the market must nevertheless form a view on what their share of the MIBI’s costs will be. The Declined Cases Agreement means that an insurance firm cannot necessarily exit parts of the motor insurance market. A firm that starts to offer young drivers cover may find that it is required to continue offering quotes to some of its existing policyholders as a consequence of the Agreement. Since it was the existing underwriter, it is quite likely that the underwriter will have been the first firm approached, and therefore the one required by the Declined Cases Agreement to provide a quote.

Summary of evidence on entry and exit barriers

3.138 The ability for insurers to engage in anti-competitive practices would appear to be constrained by the threat of entry. The biggest entry barriers identified appear to be the paucity of timely information available and the requirements to join the MIBI and the Declined Cases Agreement. To date, regulatory barriers to entry do not appear to have been a significant problem.

20 Association of British Insurers (2002) EU Issues Index, /www.abi.org.uk/Display/File/301/101.02_-EU_issues_index.pdf
21 See Insurance Post (2003) “ARB sets up insurer in Gibraltar”, 10 December.

Search and Switching Costs

3.139 A competitive market is only possible if consumers search for the best available product. Competition cannot work if consumers are not seeking out best value. If consumers demonstrate too much loyalty to underwriters (or brokers), then the full benefits of competition cannot be realised. The incentive for underwriters to realise cost savings or develop new products is reduced if consumers are unlikely to change from their existing underwriter. The incentives for underwriters to have the most competitive offering will only apply for those consumers that have not become locked-in with one underwriter, e.g. young drivers seeking their first insurance policy.

3.140 For motor insurance, as with many financial products, there may be concerns that consumers are ignorant of all the product attributes that they should consider in choosing between competing products. Because most policyholders will renew their motor insurance annually, this will mitigate some of the incentives for underwriters to attempt to mislead consumers - the underwriter wants repeat custom. But it is not necessarily the case that after a year, the insured will have learnt that the policy they have meets all their needs. Most drivers do not make a claim, so they are unlikely to have had any reason to revise incorrect beliefs about what the insurance policy actually covers. For example, they may not be aware of the restrictions on which repairers they can use in the event of an accident. These concerns may be alleviated by the insurer's desire to maintain a good reputation. Although most individuals do not claim on their policy in a given year, they are likely to be aware of others who have claimed.

3.141 This study was not presented with evidence suggesting that most insurance policies are uninformed decisions. Many consumers use intermediaries, which is one way that consumers can overcome any potential informational asymmetry between them and the underwriter. Of course, this may just be moving the problem to an uninformed customer having to choose between intermediaries (some of whom may only source insurance products from one insurer) instead of an uninformed customer having to choose between underwriters.

3.142 Reducing the costs of finding out about the prices of rival underwriters would reduce search costs. Again, intermediaries can provide this service. Various publications have on occasion produced information that permits price comparisons for specific examples. IFSRA recently published a motor insurance cost survey and indicated that it would be undertaking similar surveys every three months.[22] Although there is a danger that lowering search costs may make it easier for firms to monitor their rivals' prices and therefore sustain tacit collusion, this objection to such information sharing does not seem warranted in the case of motor insurance. The only concern with such information sharing is the potential that it proves less informative than intended - it is possible that underwriters will gear their pricing structure to fare well in the comparison tables. But that is a matter for those organising such exercises to overcome.

3.143 Ease of switching is another component that can facilitate keen competition. All the indications received during the study suggest that switching costs for motor insurance are not too high. One survey found that in the preceding three years, 42 per cent of motorists reported changing insurance company.[23] This turnover was attributed to driver dissatisfaction - the same survey found that 80 per cent of drivers believed they were getting a "moderate" or worse level of service. A high turnover is not inconsistent with a competitive market. Indeed, competition is working if consumers are switching from insurers that are providing bad service. It creates incentives for insurers to improve their product to win back customers and attract customers from their rivals. The switching figures reported do not inform about the proportion of individuals who sought quotes from other underwriters, but decided to stay with their existing insurer because it was the cheapest. This searching places a competitive constraint on insurers.

3.144 A number of parties commented that insurance is a grudge purchase that consumers only consider near the time of renewal; it is not a market that consumers monitor the rest of the year. Shopping around requires some time. Hence, there are concerns that renewal notices should be sent sufficiently in advance to permit the insureds time to consider their options. The data suggests that insureds are now receiving renewal notices in sufficient time - motor insurers now have to provide certain information with their renewals and this documentation has to be sent to the insured fifteen days prior to expiry of their policy.

3.145 Table 3.9 presents the practices followed by a few players in the Irish motor insurance market regarding the renewal notices. It shows how much time in advance these notices are sent, who they are sent to, and whether there have been some changes in these practices recently. Most insurance companies changed their practices of sending renewal notices to policyholders and/or insureds after October 2002 to comply with new regulations.

22 IFSRA (2003) Motor Insurance Cost Survey, Issue 1, www.ifsra.ie
23 Source: RAC/Irishcar.com as quoted on page 18, National Youth Council of Ireland (2001) "The plunder years", www.youth.ie

Table 3.9: Motor Insurance Renewal Procedure of the Insurers

Insurer	Time in advance	Sent to	General Notes

Source: Insurance companies

3.146 There are differences between the insurers in their practices for sending renewal notices. The major difference concerns the time the renewal notice is sent; [confidential material]. There are also some differences concerning the recipient of the renewal notices. Where the insurance is arranged through a broker, most insurers send the renewal papers to the broker. When a broker was not involved in arranging the insurance, the renewal notice is sent directly to the policyholders.

3.147 The practice of insurers sending renewal notices directly to policyholders, bypassing brokers, does not raise competition concerns. The converse may be true: competition may benefit. Consumers receive their renewal notice sooner, allowing them more time to consider their options. And if brokers want to receive income they have to demonstrate to the consumer that their advice is of value: brokers should not stand to receive a 5 per cent commission just for forwarding on a renewal notice.

3.148 Moreover, details on no claims bonuses are provided, making it possible for consumers to claim a no-claims discount from other underwriters. This keeps switching costs down for those without claims.

3.149 Overall, switching costs for motor insurance do not appear to be significant. If they were, it might be expected that the most competition between insurers would be to attract young drivers. No-one suggested that competition is keenest for this segment of the motor-insurance market. (One underwriter suggested that young drivers switched to save just €1, and that this was a reason for not targeting this sector of the market. No reasons were advanced suggesting that the costs of switching are significantly less for young drivers than for most other drivers.)

3.150 For drivers who have had a claim, some underwriters appear reluctant to quote to drivers who have an outstanding claim with another underwriter. The rationale given is that there is too much uncertainty about what sort of risk the driver might be, so that the premium cannot be assessed. Since the underwriters are willing to quote to their own customers who have a claim, if the underwriters really are competing then the rationale is that the existing underwriter enjoys an informational advantage over their rivals about the likely risk the driver represents. (Quicker settlements and/or greater certainty about awards would both alleviate these concerns.) One underwriter claims to state clearly on no claims discount notices the nature of the insured's loss and whether or not the insured was at fault.

3.151 There may also be a concern that underwriters' actions discourage switching for other groups. In a recent case brought under the Equal Status Act, the evidence suggested that Royal & SunAlliance stopped taking on new business from anyone over the age of 70, yet continued to offer cover to existing clients.[24] If all insurers behave in the same way, then the over-70s are locked in. Switching becomes impossible and there is no competition to insure over-70s. Either it is a profitable line of business, in which case insurers should be offering insurance independent of who the individual previously had a policy with; or it is not, in which case insurers should cease offering such insurance to all over-70s (or raise premiums) and not just stop quoting to potential new customers. The Declined Cases Agreement may be the reason why insurers currently quote for existing customers.

Role of Intermediaries

3.152 The earlier data on distribution channels shows that brokers are involved in the sale of many motor insurance policies. The IBA claims that its members provide services for approximately 80 per cent of general insurance polices sold in Ireland.[25] The role of intermediaries is potentially important for the functioning of competition in the market for motor insurance. They may reduce consumers' search and

24 Ross v Royal & SunAlliance [2003] Dec-S2003-116
25 Presentation to the Oireachtas Joint Committee on Enterprise and Small Business, 23 July 2003.

switching costs, and they can provide a distribution channel for entrants that want to be vertically disintegrated, specialising in underwriting.

3.153 The Investment Intermediaries Act 1995 defines an insurance intermediary as any person who, on a professional basis:

(a) assists or offers to assist third parties in the placing or taking up of insurance; or

(b) gives or offers to give advice regarding insurance policies to third parties

This does not include an insurance undertaking or an employee of an insurance undertaking when the employee is acting for that insurance undertaking.

3.154 The Insurance Act 2000 passed responsibility for supervising life and non-life insurance intermediaries to the Central Bank. Previously, the IBA regulated its members, having been granted approved representative status by the Minister for that purpose. Non-members were required to be regulated by the insurance undertaking that had issued the intermediary with an appointment.[26] Under the new regulatory framework, there are three categories of insurance intermediary:

Restricted Activity Investment Product Intermediary **(RAIPI) can receive and transmit orders in investment and insurance products to product producers from whom the intermediary holds letters of appointment and provide advice only on instruments available from those product producers.**

Authorised Advisors **operate independently of product producers, whether or not they hold an appointment. They must advise on the most suitable produce on the market irrespective of whether the advisor holds an appointment and can transmit an order to a product producer. An authorized adviser can only advise on investment instruments specified in its authorisation.**

Authorised Cash Handlers **are authorized to hold client assets, including cash and other investment instruments in their own name. As with Authorised Advisors, Authorised Cash Handlers may only provide the services for which they have been authorised.**

3.155 Potentially, brokers can play an important role in facilitating competition between underwriters, advising customers on the suitability of the various products different underwriters offer and reducing the costs of making price comparisons. One underwriter claimed that the effect of any change in the premiums it quotes is felt most acutely in its sales via brokers. This is perhaps to be expected, since brokers should be reducing search costs, making it easier for customers to identify the policy that represents the best value for their situation.

3.156 Brokers compete to provide a variety of services. Some multi-agency intermediaries are competing with insurers in their ability to sell policies to retail consumers, undertaking their own risk assessments, but getting the policies underwritten by the licensed insurer.

3.157 Perhaps the more traditional image of brokers is of someone giving advice to consumers about the suitable policy across a range of different product providers. The market for advice on which motor insurance policy to buy does have some features that may not be consistent with a competitive market.

3.158 The only data collected relating to brokers were provided by the insurers, and relate to the commission rates brokers charged. There is very little evidence that brokers have competed on commission rates. The rates charged by different brokers are remarkably similar. Furthermore, the rates show few changes over time. Given that premiums have varied considerably in the same period, it is surprising that the commission rates - quoted as a percentage of the premium - have not changed in this period if the market is competitive. There have been no regulatory constraints on the commissions that brokers can charge since 30 September 1999 when the 5 per cent cap on commissions to brokers was abolished. [Confidential material]

Chart 3.12: Commission Rates for Brokers

[Confidential material]

Data Source: Insurance companies

3.159 For authorised advisers, there is an obligation to provide best advice. This extends to informing the client of a policy with an insurance firm for whom the broker does not hold an agency agreement. Some brokers have complained that it is becoming impossible for them to meet this requirement and generate sufficient returns because (a) some underwriters are denying them agency agreements and (b) in some cases the cheapest quotes are only available to customers going to the underwriter directly. The problem arises because many brokers rely almost exclusively on commissions from underwriters. Consequently, they only receive

26 Since some intermediaries had multiple appointments, the IIF established the Insurance Intermediary Compliance Bureau to regulate on behalf of insurers and thus avoid duplication of regulatory effort. The insurance companies retained ultimate statutory responsibility for their appointed representatives.

payment for advising a client if the client acquires insurance through the broker with an underwriter that pays the broker a commission.

3.160 The onus is on brokers to convince underwriters and/or consumers that they provide a service worth paying for. The broker needs to demonstrate to underwriters that the brokerage represents a cost-effective distribution channel that justifies the size of the proposed commission. Consumers need to be convinced that it is worth paying for the broker's advice. A broker wanting to offer best advice but unable to fund this only through commissions will have to charge fees to clients (or secure some other source of funding). If customers are unwilling to avail of such brokers, then that is a sign that the market does not value the service sufficiently to cover the costs.

3.161 Some other tensions were described between the requirement to give best advice and the financial best interests of the broker. Some underwriters offer "over-rides" to brokers who place a sufficient volume of business with them. Some smaller brokers claim to be under pressure to place a certain volume of business with a given underwriter or face losing their agency agreement.

3.162 Competitive forces should drive the arrangements that brokers and underwriters reach. Rewarding brokers who sell lots of the underwriter's policies would be consistent with practice in many other industries, and can be pro-competitive if there is sufficient transparency. Similarly, if certain underwriters feel that the costs of maintaining an agency agreement outweigh the benefits, they should be free to terminate the agreement. The costs identified by underwriters include the costs of keeping agents informed (with regulatory requirements, a particular concern) and the fact that inexperienced small agents place the wrong type of business. Some parties expressed skepticism about these alleged costs, which if true should place the underwriters at a competitive disadvantage.

3.163 However, there are some potential problems for competition. The first concern is whether there is sufficient transparency. Competition works best if consumers are able to make informed decisions: consumers should know about the incentives a broker has to place business with particular underwriters. This should include details about any payments that the broker may receive in addition to the standard commission.

3.164 There may not be an explicit threat of an agency agreement being terminated. Hence, requirements for greater transparency in this regard will be harder to enforce. The incentives for brokers to maintain the agency agreement are arguably increased by Section 31(6)(a) of the Investment Intermediaries Act 1995 which requires publication, in one or more national newspaper, notice that an appointment has been terminated. Such a publication may negatively affect demand for the broker's services. Hence, the requirement may compound the potential misalignment of interests between broker and customer. (Although, the requirement may improve the information consumers have when selecting a broker, which would be pro-competitive.)

3.165 The detriment to consumers if brokers feel pressure to place business with certain underwriters may not be confined to individual consumers being wrongly advised about the most suitable product. There may be long-term detriment, since it may be hard for new underwriters to sell via the broker market. [Confidential material]

3.166 There may also be a transparency problem regarding the type of advice individuals should expect from their intermediary. Some are not fully independent of insurers. For example, Hibernian Direct is a multi-agency intermediary, yet it is also part of the Hibernian group.

3.167 Moreover, even those multi-agency intermediaries that are not part of the same group as an underwriter are only obliged to advise on products from providers with whom they have an agency agreement. It is therefore not the case that the prices a broker quotes are necessarily the most competitive available if that broker is a multi-agency intermediary.

Conclusions

3.168 The present section of the report considers the economic evidence on competition in the Irish motor insurance market. The market displayed a number of characteristics that warranted such a study: the market had become more concentrated and prices started rising sharply from late 2000. A closer inspection reveals that while there are some characteristics of the market that might facilitate co-ordinated behaviour, there are a number of indicators that suggest that participants' market behaviour is generally consistent with competitive behaviour in an oligopolistic market.

3.169 The motor insurance market in Ireland has become more concentrated in the past decade, with the Herfindahl Index rising from around 1,000 in 1994 to 1,660 in 2001 before falling in 2002. This increased concentration was the result of a series of mergers. Nevertheless, the level of the Index has remained

below the threshold used by the Irish Competition Authority (and other competition bodies) to denote a market as highly concentrated.

3.170 The market displays a number of characteristics that were identified in section 2 as potentially facilitating non-rivalrous behaviour.

(a) On the buyer side, demand appears to be relatively inelastic, partly due to its compulsory nature. In addition; individual purchasers lack buying power.

(b) On the supply side, underwriters face similar cost structures. Claims costs are the largest cost category that they face. Factors affecting claims costs, such as changes in the level of awards are observed by all market participants.

(c) There are various examples of industry co-operation that permit parties to meet regularly. Moreover, the suppliers interact with one another in a number of insurance markets.

3.171 There are also a number of features of the market that suggest collusion would be hard to sustain.

3.172 Although there are some barriers to entry that might be reduced, e.g. limited data availability and the requirements to join the MIBI and the Declined Cases Agreement, these do not seem to be so great as to remove the threat of entry. The success of Quinn-direct is evidence that firms can successfully enter the market. ARB Underwriting recently commenced offering motor insurance policies in Ireland, suggesting that entry barriers currently are not prohibitive.

3.173 The risks underwriters cover when offering motor insurance are heterogeneous, varying depending on the particulars of the driver and the vehicle. Although it is possible to monitor other insurers' prices, it would be difficult for the parties to tacitly agree and police an arrangement given the vast array of risks being priced. This does not rule out the possibility of some form of market-sharing arrangement. For example, firms could collude by dividing up the market into different age categories with each firm being allocated particular groups.

3.174 Underwriters are vertically integrated to different degrees. Such differences increase the difficulty of achieving a collusive arrangement. Underwriters also displayed big differences in the proportions of business secured through different distribution channels.

3.175 The evidence of behaviour is broadly consistent with a rivalrous market. Market shares have fluctuated over time (even if reserving requirements place a constraint on attempts to grow market share). Evidence on pricing shows wide variations in the prices insurers offer for different classes of driver; the firms offering the most competitive quotes appears to change over time; there is evidence of differences in the rates of no-claims bonuses offered; and premiums have all started to fall. All these observations are consistent with competition. There is also evidence of non-price competition, with insurers differentiating their products, e.g. roadside assistance plans.

3.176 For most of the population, switching and search costs do not appear to be too significant, although competition to sell policies to older drivers may be muted.

3.177 To conclude, there are some features of the market and behaviour by participants that might hinder competition, such as the limited access to timely data; and the Declined Cases Agreement and the method for funding claims arising form uninsured and untraced drivers. However, on balance, it seems likely that factors other than muted competition explain most of the large premium increases observed in late 2000 and 2001.

4 LIABILITY

4.1 This section considers both employers' liability insurance and public liability insurance. They are similar products bought from the same types of sellers. Meetings with insurers and insureds suggest that employers' and public liability insurance policies are generally purchased at the same time. For the purposes of analysing competition, it is possible to consider the products together.

4.2 Employer's liability insurance is designed to cover liabilities that an employer may incur if an employee has a claim arising from work undertaken for the employer. The claims might be for injuries, or long-term illness or death. Public liability insurance covers businesses against claims from the public (not employees) suffering bodily injury or damage to their property because of negligent business practice.

4.3 In Ireland, employers' liability insurance is not a legal requirement. The alternatives to purchasing employer's liability insurance are for firms to self-insure, e.g. large firms may set up wholly-owned captive insurance companies; to set-up mutual insurers with other firms; to assume a greater excess in return for lower premiums; or simply to go without.[27] Many firms may consider these options unacceptable. Despite the absence of a legal requirement, employers' liability insurance is considered a compulsory purchase by many businesses.

4.4 Public liability insurance is also not a legal requirement. As for employer's liability, the alternatives to purchasing public liability insurance are to self-insure; assume a greater excess; or to do without. Again, in practice, public liability insurance is often a necessity. Many contracts will require a business to hold such cover. For some industries and professions, the licensing arrangements include a mandatory or de facto requirement to have liability insurance. Local authorities are increasingly requiring their subcontractors to carry liability insurance for large levels of coverage.

4.5 The product markets are no wider than the market for employers' liability insurance and the market for public liability insurance. They might be narrower, e.g. employers' liability for churches and employers' liability for construction may constitute separate product markets. On the demand side substitutability is not possible - underwriters are able to price discriminate and quote for each firm separately. Supply-side substitutability is possible. There is probably little difference in selling liability insurance to two different dairy farmers. But the possibility of an underwriter that sells liability insurance to dairy farmers starting to supply liability insurance for retailers might not be so easily done. There might be merit in considering such a switch to represent entry into a new product market, rather than simple supply-side substitution. The analysis that follows looks at data for the entire liability insurance market, and also for narrower segments (to the extent that the data permit).

4.6 As for motor insurance, it seems appropriate to limit the geographic market to the State. Many insurers supplying liability insurance to Irish firms but not based in Ireland would be considered to operate in the market. Insurers based outside Ireland currently not selling liability insurance into Ireland would be considered as potential entrants, and the possibility that they start supplying the market would be considered when analysing barriers to entry.

4.7 As with motor insurance, there are a number of other related markets in which insurers operate, sometimes in competition with non-insurers. For competition purposes, the distinctions between brokers, wholesale brokers, insurers and reinsurers may not always be clear. For example, an insurer that offers catastrophe insurance to large self-insurers may face a competitive constraint from reinsurers.

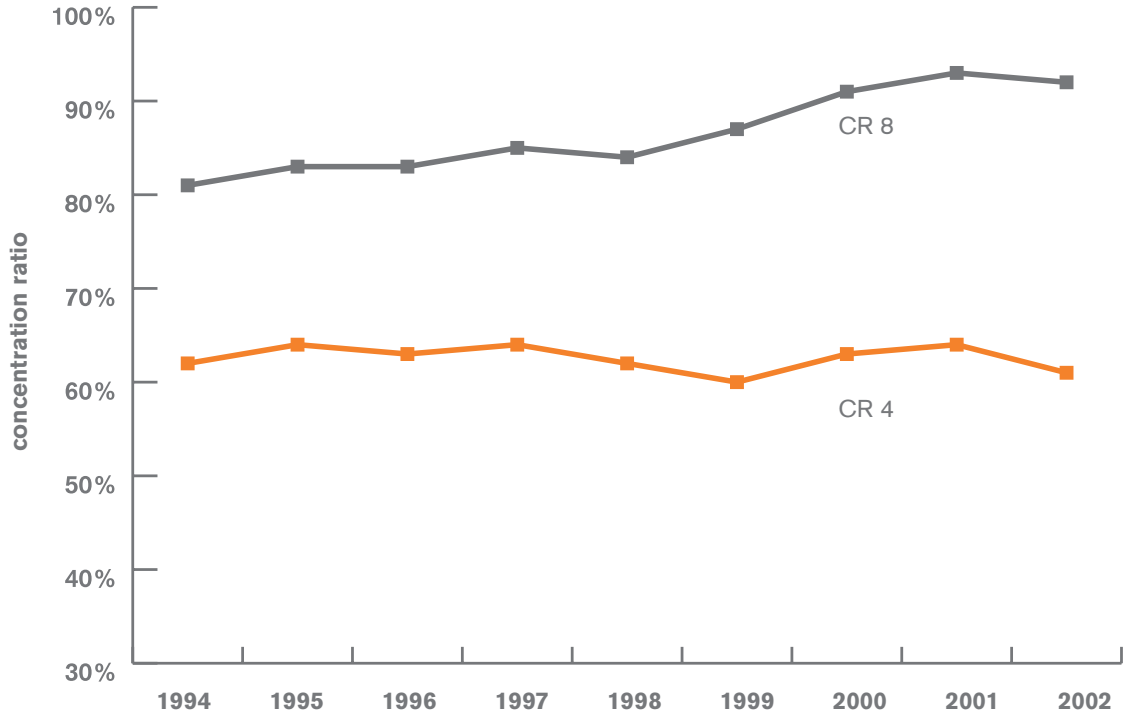
Concentration

4.8 Looking at liability insurance as a whole, the market appears to be less concentrated than the market for motor insurance. As with motor insurance, there has been an increase in concentration for liability insurance in the last decade, although the increase is not as pronounced. However, the concern is that the aggregate figures mask the possibility that for narrower market segments the concentration is much more pronounced.

4.9 The Blue Books do not distinguish between employers' liability, public liability and other forms of liability insurance, e.g. professional liability insurance. Analysing market shares using premium income for liability insurance may miss important differences between the different classes of liability insurance, although there is unlikely to be a significant difference between the market shares of earned premium income for all classes of liability insurance and the market

27 Self-insurance is used to refer to a situation where a firm sets aside money to cover against possible claims, whereas doing without means that the firm has to pay for any claims as they arise out of its general revenue stream.

Chart 4.1: Liability Insurance Market Concentration Ratios, 1994-2002



Based on earned premium income. Source: Blue Books, 1994-2002. The analysis excludes Lloyd's.

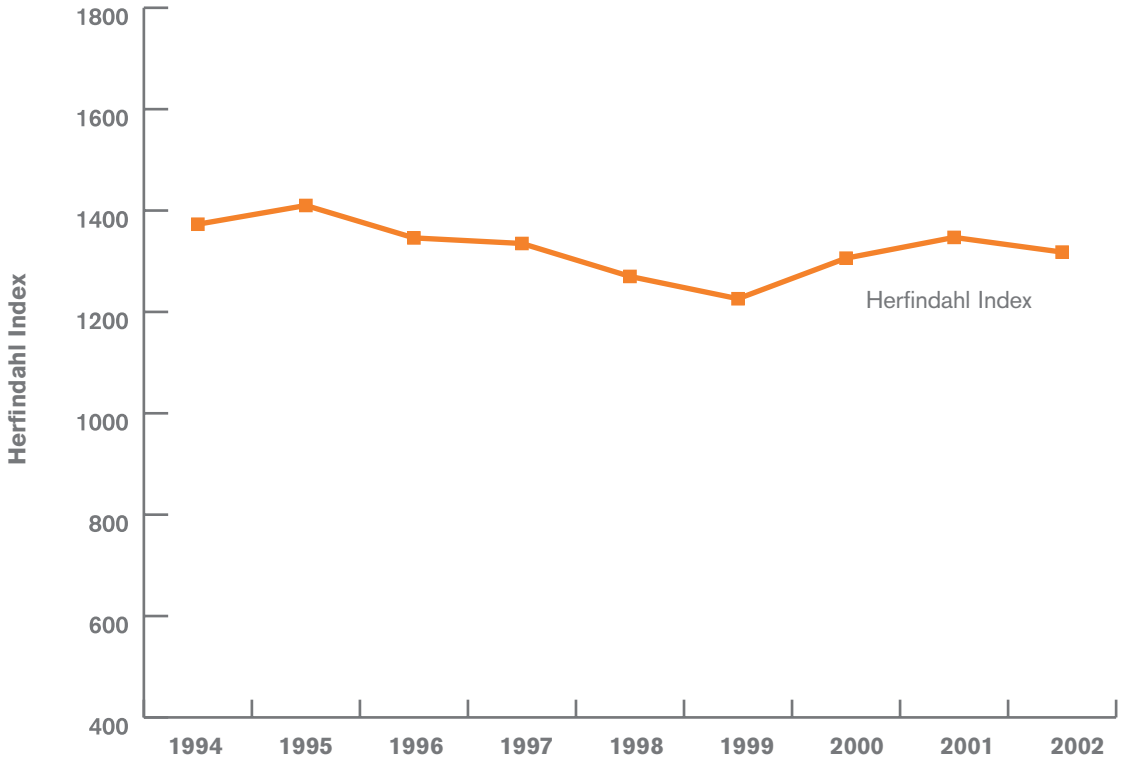
shares of just employers' and public liability insurance. The latter two account for most liability insurance: in 2002, employers' liability insurance alone accounted for 48 per cent of liability premiums.[28] Moreover, the structure of public liability and employers' liability insurance markets is broadly similar.

4.10 Looking at earned premium income for liability insurance, in 1994 the top four companies had 62 per cent of the market and the top eight had 81 per cent. In 2002, the largest four companies accounted for 61 per cent of the market and the largest eight firms 92 per cent.

4.11 The three largest liability insurers are Hibernian with 21 per cent, Allianz (20 per cent) and Irish Public Bodies (10.6 per cent) which specialises in insuring local authorities (including health boards and technical colleges). The fourth largest liability insurer is St Paul International with 9 per cent of earned premium income for liability insurance. The top companies in 1994 included Insurance Corporation and Church & General (both owned by AGF and between them having a market share of 29.5 per cent), Hibernian (13.2 per cent) and Sun Alliance & London (10.6 per cent).

28 Page 23, Irish Insurance Federation (2003) Factfile2002, www.iff.ie

Chart 4.2: Liability Insurance Herfindahl Index



Based on earned premium income. Source: Blue Books, 1994-2002. The analysis excludes Lloyd's.

4.12 Chart 4.2 plots the Herfindahl index using earned premium income to measure market shares. It was 1318 in 2002, more concentrated than in 1999 when the Herfindahl index was 1226, but still only moderately concentrated. The post-1999 increase is mainly because of mergers between Hibernian and other companies and the rapid rise in market share realised by St Paul.

4.13 One potentially important omission from the analysis is the level of liability insurance placed outside Ireland. It is not just the syndicates of Lloyd's omitted from the charts. Other insurers can write liability insurance into Ireland. The concentration measure may be overstated. Allianz have suggested that liability insurance placed with insurers based overseas accounts for as much as 20 per cent.[29]

4.14 But to conclude that the relevant markets are only moderately concentrated ignores the possibility that there is considerably greater concentration if defining the product market as liability insurance for building contractors, for example. A number of insureds complained that there were only one or two insurers willing to insure firms in their industry.

4.15 Moreover, measuring concentration by reference to market shares of the insurers completing returns to the Irish regulatory authorities does not capture the possibility that the competitive constraints on firms securing these market shares may have fallen. The underwriting capacity for Irish liability insurance fell by 20 per cent between 2000-01.[30]

Evidence of Rivalry

4.16 Concentration is only one guide to whether firms operating in a market are subject to competitive constraints. The key concern is whether firms have incentives to offer lower prices, better quality and a more diverse range of products. Provided firms face a competitive threat such that they will lose market share if they fail to offer products at a cost that consumers are willing to pay, competition is working.

4.17 To the extent possible, this section looks at evidence that might show whether firms are engaged in a process of rivalry.

29 Presentation to the Oireachtas Joint Committee on Enterprise and Small Business, 12 November 2003.
30 Page 27, Irish Insurance Federation (2002) Factfile2001, www.iff.ie

Market shares

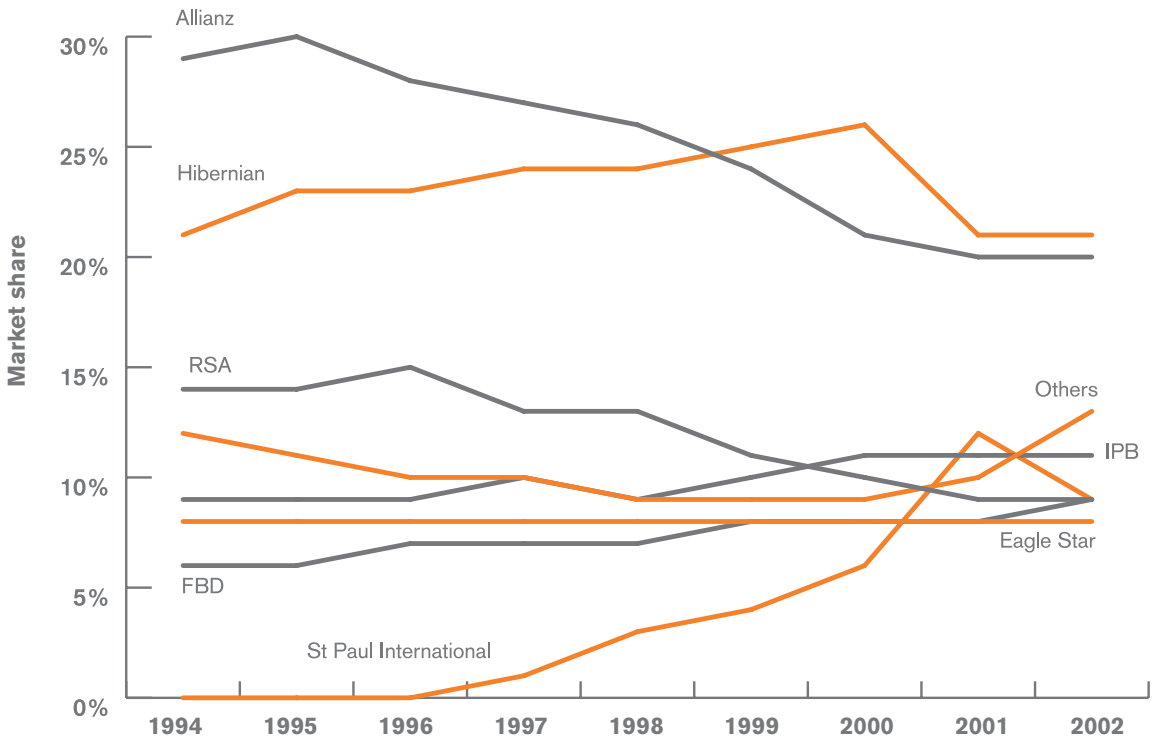
4.18 Evolving market shares provide one possible clue as to whether firms are competing or not. Looking at market shares for liability insurance as a whole suggests that there has been competition. The market shares of the seven largest liability insurers (based on 2001 earned premium income) fluctuated between 1994 and 2001, as chart 4.3 shows. (As for motor insurance, firms that merged during this period are treated as a single entity. The rationale is that the charts seek to find evidence of whether insurers were competing to attract business from their rivals, rather than evidence that they could expand simply by merging.)

4.19 The chart suggests that market shares have been quite volatile. Newcomers, most notably St Paul, have been able to capture a significant share of the market. St Paul's success explains the fall in the market share of "others" during this period, even though in the last year of the sample period St Paul International lost market share and "others" gained. Allianz and Royal & SunAlliance's market shares declined over this period; FBD, Irish Public Bodies and St Paul increased their market shares; while Hibernian's share grew until 2001 when its market share fell considerably. The chart does not include data for liability insurance placed with insurers not based in Ireland. One broker suggested that this had probably stayed static.

4.20 Some parties suggested capacity constraints might limit the ability of some insurance firms to increase their market share. (This would also be true for motor insurance.) Insurers that want to compete aggressively and underwrite more polices may find that solvency requirements constrain them.[31] One complaint was that the solvency requirements should not depend on premium income. By design, such solvency requirements cap the volume of premium income that an insurer can collect, regardless of how competitive the insurer is. It is difficult for an insurer to raise new capital at short notice if it has to source capital from the financial markets. Some parties also wondered whether the rules governing the valuation of assets were too inflexible, compounding the difficulties for firms keen to expand.

4.21 The rationale for such regulations is prudential concerns. A firm quoting very low premiums might easily increase its market share, but can it honour its claims? For liability insurance, one rationale for such requirements might be to solve a perceived market failure due to asymmetric information. The insurer has more information about its ability to honour claims

Chart 4.3: Liability Insurance Premium Earned (1994-2002) - Market Shares



Based on earned premium income. Source: Blue Books, 1994-2002. The analysis excludes Lloyd's.

31 S.I. No 359 of 1994. European Communities (Non-Life Insurance) Framework Regulations 1994 describes the solvency requirements for insurers authorised in Ireland.

than the buyer. The danger is that the prudential requirements hinder competition unnecessarily. Some parties suggested that using premium income to determine solvency requirements was an example of unnecessary regulation. The approach did not reflect the risks that the insurer faced, so it did not realise its purported policy goal of ensuring the insurer had sufficient funds to meet liabilities, yet it potentially limited the ability of some competitive firms to grow.

4.22 If rivals know that an insurer's capacity is limited, they may decide not to compete but instead serve those segments of the market that the most competitive firm does not have the capacity to serve. However, the potential for coordinated behaviour in the segments not served by capacity-constrained firms is limited, since many insurers would have to be involved. Capacity constraints only affect some market participants. There are market participants who have ready access to capital should they wish to expand, including ones with smaller market shares, e.g. the syndicates at Lloyd's. [Confidential material]

4.23 The analysis so far has been at an aggregated level, and may miss evidence on dominance and lack of competition in particular sub-markets. For liability insurance less use tends to be made of actuaries or statistics to calculate premiums. Insurers have their own rating system based on past experience of particular risks. Consequently, each insurer tends to specialise in particular classes of businesses. For example, Church and General (now part of Allianz) was known for insuring hospitals and religious orders.

4.24 One broker described having monthly meetings to review which underwriters were offering quotes for different segments of the liability market. The meetings had to be this frequent because the underwriters operating in different segments was constantly changing, as was the relative competitiveness of the different sectors.

4.25 Data were requested from insurers at a more disaggregated level than that appearing in the Blue Books. Surprisingly, all the insurers responding claimed not to hold data by size of company insured, even though this must presumably be an important factor when determining the premium to quote. Most insurers provided disaggregated data by sector, although each insurer used different sector headings, making comparisons difficult.

4.26 The analysis that follows attempts to look at market shares for the insurers in three sectors - agriculture, retail and manufacturing - chosen because comparable data for different companies were available. Nevertheless, some judgements had to be made. It is possible that a policy classed under agriculture for one insurer would not have been so categorised if held with another insurer. A priori, there is no reason to think that this will bias the results when looking at how market shares in the sectors evolve.

4.27 The following analysis uses number of policies as the measure of volume, rather than earned premium income. Because the data are not comprehensive, the analysis concentrates on evidence that market shares have changed, rather than commenting on concentration. The latter would require information about all insurers, whereas it is possible to make some inferences about whether insurers' market shares are constant from the sample.

4.28 The analysis is inconclusive. [Confidential material]

Chart 4.4: Number of Employers' Liability Insurance Policies Sold - Agriculture

[Confidential material]
Source: Insurance Companies

Chart 4.5: Number of Public Liability Insurance Policies Sold - Agriculture

[Confidential material]
Source: Insurance Companies

4.29 [Confidential material.]

Chart 4.6: Number of Employers' Liability Insurance Policies Sold - Retail

[Confidential material]
Source: Insurance Companies

Chart 4.7: Number of Public Liability Insurance Policies Sold - Retail

[Confidential material]
Source: Insurance Companies

Chart 4.8: Number of Employers' Liability Insurance Policies Sold - Manufacturing

[Confidential material]
Source: Insurance Companies

Chart 4.9: Number of Public Liability Insurance Policies Sold - Manufacturing

[Confidential material]
Source: Insurance Companies

Table 4.1: Average premiums, retail sector

Insurer	No of policies sold (EL)	No of policies sold (PL)	Average EL premium ( )	Average PL premium ( )

Source: Insurance Companies

4.30 [Confidential material]

4.31 The data provide some clues about the size of business targeted by different insurers, since in almost all cases the insurers that sold the largest numbers of policies tended to have offered the lowest average premium and vice versa. Table 4.1 illustrates this point, showing the inverse relationship between the number of policies sold and the average premiums for the different insurers selling policies to the retail sector. (An alternative explanation is that the large volumes are because the firms quoted lower premiums, but the differences in the average premiums are probably too large for this to be the only explanation.)

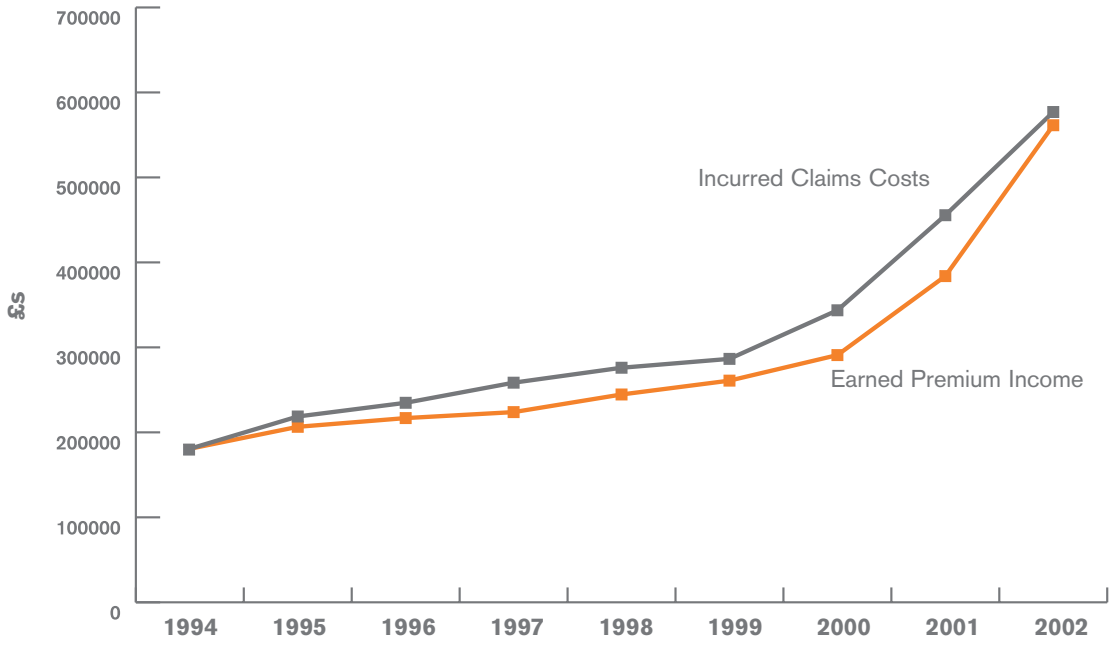
Prices

4.32 As discussed in the section looking at motor insurance, price data may provide some evidence on the degree of rivalry in a market. However, the problem for insurance is that the product is not homogenous. For liability insurance, risks are assessed on a case-by-case basis. This makes comparisons difficult.

4.33 Numerous examples have been presented of individual firms facing significant increases in their premiums in recent years. The data insurers provided are consistent with the individual examples- average gross written premiums for employers' liability insurance more than doubled between 2000 and 2002, while public liability insurance gross written premiums increased by 97 per cent.

4.34 The rises might be the result of reduced competition. They might also arise because of a change in the underlying costs: prices in a competitive market should be more responsive to changes in underlying costs than if the market was uncompetitive. The data appear to be more supportive of a competitive explanation. The chart below shows how incurred claims costs and earned premium income tracked one another fairly closely between 1994 and 2002. In contrast, concentration levels only rose moderately between 1999 and 2001, and in 2002 the market became less concentrated. Yet throughout this period premiums rose, with the steepest increases in 2001 and 2002. The difference between earned premium income and incurred claims costs narrowed considerably in 2002, after a number of years where these two series had diverged.

Chart 4.10: Incurred Claims Costs and Earned Premium Income in Real Terms



Source: Blue Books and CSO

4.35 Some parties suggested that solvency requirements mute price competition, having the most damaging effect during periods when the insurance market is "hard". When premiums are high, some insurers that want to price aggressively quickly find themselves capacity constrained because their solvency requirements depend on premium income. Because it takes time to raise new capital, this limits the competitive pressure such insurers can place on less efficient underwriters. As mentioned when discussing market shares, not all underwriters are capacity constrained.

4.36 The recent presentations to the Oireachtas by a number of insurers demonstrate contrasting time-series for commercial premiums.[32] Quinn-direct claimed that their premiums for commercial liability had fallen by 22 per cent; Allianz, with a number of caveats, suggested a fall of about 8 per cent; and Hibernian suggested that the typical SME would have faced an increased quote from Hibernian of about 10 per cent. This would not be consistent with a model of price leadership, with all insurers agreeing to follow the same price path. Of course, it is possible that the differences arise because like is not being compared with like. But the difficulty of comparing premiums across firms illustrates a problem underwriters would have sustaining a collusive agreement; it would be hard to monitor price movements by one party seeking to "cheat" on an implicit agreement.

Managing claims costs

4.37 A competitive insurance market should provide the right incentives for insurers to manage costs efficiently, including claims costs. Insurers suggested that they had to be efficient nowadays, both because the market is more competitive than ever and because many of them now had to report regularly to head offices. Insurers gave different examples of how they were trying to reduce their claims costs. Examples cited include measures to advise clients on risk management (to reduce the frequency of claims), rehabilitation schemes to help employees get back to work (to reduce the cost of claims), and efforts to manage legal fees (to reduce the costs associated with claims).

4.38 Many insureds were unconvinced. Some suggested that insurers had made too little effort to curb the professional fees associated with claims awards. There were also complaints that insurers settle too easily.

4.39 There do appear to be differences in the approaches insurers take to managing their legal fees. Some have their own in-house legal team, others use a single law firm, while some use an approved list. This suggests that at least some insurers are seeking to gain a competitive advantage by managing these costs more efficiently than their rivals.

4.40 There is always likely to be a tension between the incentives of insurers and insureds against whom a claim has been made. Because the insured's future premiums will depend on the claims history, the insured wants every effort made by the insurer to settle claims for the minimum possible. Insurers' incentives are to minimise the costs of claims. This entails deciding whether it is more cost effective to settle or to contest a decision. In some cases, the insurer will choose to settle, agreeing liability or to a level of award with which the insured disagrees.

4.41 Since some firms undertake self-insurance, managing their own claims, it might have been possible to explore whether insurers manage their claims efficiently by using the self-insurers as a benchmark.

4.42 Unfortunately, no firms that self-insure were identified as willing to share claims data. Parties also suggested that such a comparison would be inconclusive. There were a number of reasons why self-insurers were likely to have lower claims costs. The fact that they self-selected to self-insure, rather than rely on the insurance industry, suggests that they have identified a cost saving. This begs the question why self-insurers might enjoy lower claims costs. Reasons given include:

(a) Claimants and courts are less comfortable with large compensation payments when the compensation is paid by a firm rather than a large financial institution; and

(b) Greater interaction with employees (and, to a lesser extent, the public) means the self-insurer is more likely to be able to settle promptly, and also to form a realistic view on the veracity of the claim and the appropriate level of compensation.

4.43 To the extent that insurers would like to win self-insurers' custom (or persuade others not to self-insure), the option of self-insurance should impose a competitive constraint on insurers. In some instances, everyone should potentially realise gains. For example, efforts to manage claims costs efficiently should benefit all policyholders.

4.44 The competitive constraint on premiums from self-insurance might only benefit those firms for whom self-insurance is a realistic option. Firms best placed to self-insure are those large enough that they will (a)

32 Presentations to the Oireachtus Joint Committee on Enterprise and Small Business, 12 and 13 November 2003.

experience a sufficiently large number of claims each year to justify the costs of managing these in-house and (b) have a sufficient residual exposure when seeking reinsurance (if this is too small, underwriters may not be interested in writing the policy).

Profitability

4.45 There was considerable disagreement between the parties about whether or not the insurers made excessive profits (although there was more agreement that there had been a period when profits were poor). Most parties accepted that insurers need to earn a return for their investors or the capital will be invested elsewhere, but disagreed as to whether the profits being earned were excessive.

4.46 Almost all parties presenting evidence about profitability relied on Blue Book data. That they reached different conclusions illustrates the problems with measuring profits. There are many different measures. Looking at profits for particular lines of business, even at such a relatively aggregated level as liability insurance, presents problems of how to allocate costs and revenues. There is a potential for transfer pricing - payments from one part of the company to another at prices that diverge from market prices for marketing or financial reasons or to minimise tax liabilities. Some insureds suggested that reinsurance contracts are one way that insurers can engage in transfer pricing. A number also expressed concern about the way insurers estimate reserve requirements necessary to meet future liabilities. It was claimed that insurers manipulated the reserves to disguise profits. It was also claimed that changes in reserves were asymmetric, with insurers responding quickly and raising reserves in response to any developments which suggested that the value of future liabilities would increase but being far slower to reduce reserves in response to positive events from a claims perspective.

4.47 Another problem with looking at the data on profitability is that it is backward looking. What is important is the ex ante expected return that insurers will earn, not the ex post realisation. If insurers realise large losses or large gains because of unexpected investment returns or claims costs, such evidence should not be used to make inferences about the level of competition in the market. For example, the effect of the downturn in financial markets on insurers' returns would not provide evidence that the market must be competitive. It might be that the market was uncompetitive, but nevertheless a large negative shock resulted in losses.

4.48 There are problems with calculating a meaningful economic concept of profits. Furthermore, such information would be of limited value. Firms compete motivated by the prospect of earning a return. Those that successfully innovate will enjoy a temporary advantage and realise "excessive" returns; those that lag behind may suffer losses. It is for insurers to exit the market if it is impossible to earn a suitable rate of return. Conversely, if they are making large profits, the primary concern for competition purposes is making sure that it is possible for others to enter and compete these profits away. The focus should be on whether there are barriers to entry. The next section addresses this question. (Interestingly, poor profit prospects was one of the main deterrents to entry that was identified.)

Entry Barriers

4.49 For liability insurance, it is harder to find evidence of rivalry or its absence than for motor insurance. One problem is the comparative lack of useful data. Available Blue Book data showing rising premiums are consistent with a competitive market (responding to claims costs) and an increasingly uncompetitive one (re the increased market concentration). Market shares have changed over time at the aggregate level, but this does not establish that there is competition to provide liability insurance to all sectors of the Irish economy. The changes in premiums in the past 12 months that insurers reported to the Oireachtas perhaps provides the most support for a claim that firms offering liability insurance compete.

4.50 If rivalry is muted, there would need to be barriers to entry to sustain the uncompetitive outcome. Many of the same entry barriers identified for motor insurance were also given as entry barriers for liability insurance.

Profits, claims costs and access to data

4.51 As with motor insurance, many parties suggested that the perception that there were poor prospects of profits as the main deterrent to entry. There is some sentiment that insurers are withdrawing from employers' liability markets internationally. The reluctance to offer this product is not confined to the Irish market.

4.52 The Irish liability insurance sector is not seen as an attractive market to enter. It is perceived to be small with a compensation culture leading to high claims costs. Some parties opined that the presence in the Irish market already of some large insurers means that would-be entrants doubt that there are opportunities

to do better than the current incumbents. If profits were available, they would have been realised.

4.53 The entry barrier, if there is one, relating to profits is the difficulty in ascertaining up to date information. As with motor insurance, parties complained that the Blue Book is published too late to be of any use to a would-be entrant. The IIF was identified as the one other body able to publish timely information, but not all of its data are available to non-members. There was a belief that firms thinking of entering want a snapshot of the market, rather than information about long-term trends, when deciding whether to enter. The loss ratio was seen as the key variable.

4.54 Some parties indicated that they suspected that insurers in the Irish market communicate with foreign companies to discourage entry. Some insurers admitted to conversing with foreign insurers and "in passing" commenting how bad the Irish market is to do business in. This reinforces the potential importance of timely data if firms are to enter the market. In the absence of facts to the contrary, the Irish market's reputation as a bad place for insurers to do business may persist.

4.55 There are differences between the data collected and disseminated to IIF members in 2003 and the data presented in the Blue Book (which tends to be more detailed). One notable difference is that the IIF reports data for employers' liability and public liability separately. Again, some of the information is made available through the IIF's Factfile.

4.56 Otherwise, the greater reliance on experience rating rather than book rating means that entrants are arguably at less of an informational disadvantage in the liability insurance market than they are in the motor insurance market. A company's claims history and other company-specific information will be used to assess the risk and set a premium.

4.57 Nevertheless, there is a concern that uncertainty about likely claims costs deters entry. As with motor insurance, the absence of a book of quantum may deter entry. The Personal Injuries Assessment Board seeks to overcome this problem, initially for employers' liability claims (claims costs for employers' liability are higher than for public liability). The aim of this board is to provide a valuation of all personal injury claims prior to formal proceedings being issued where those claims are uncontested. The valuation will not be binding on either party and will be purely based on medical or other expert reports submitted by both sides or by the board getting reports from its own panel of experts. Some insurers thought that the plans to introduce the PIAB were already having an effect on claims costs, reducing both the size and the variability of awards. Others doubted whether the Board would work in practice.

4.58 For liability insurance, the long-tails associated with claims increases uncertainty. This is an intrinsic feature of insurance contracts based on liability for claims if insuring at the time of event (as opposed to time of claim) - insurers are liable for claims made many years later. It is one reason why some speculate that insurers will cease offering employers' liability. The problem is not peculiar to the Irish market.

4.59 Some parties thought that long tails actually facilitated entry, since new entrants were not burdened with outstanding liabilities. The increase in claims costs in recent years has reduced the capacity of existing insurers; before they can expand they have to raise capital just to meet their existing liabilities. Entrants do not have these liabilities. Any capital entrants raise can be used to back new policies. The concerns relate to the prudential regulations of existing insurers; they do not have implications for entry. (Nor was there evidence that existing insurers thought that they had been seriously disadvantaged as a result of such regulations.)

Regulatory barriers

4.60 Risk assessment, distribution, and claims handling are all tasks for which entrants into the Irish liability market do not appear to face large barriers. Agency agreements with brokers are possible, either directly or by selling policies via a wholesale broker. The wholesale brokers are also able to provide risk assessment and claims management services. An entrant just needs to satisfy regulatory requirements. (Quinn-direct's concerns that authorised advisers working on a commission basis make it difficult to break into the market are discussed later. They raise competition concerns, but they do not seem to represent an entry barrier. The concerns suggest that all insurers may face high costs because brokers insist on commissions, rather than that a new entrant faces set-up costs not incurred by incumbents.)[33]

4.61 There do not appear to be significant regulatory barriers to entry. Quinn-direct provide an example of a firm initially authorized to transact one line of insurance business (motor) now offering liability insurance. European insurers only need to satisfy their domestic regulator's prudential requirements to enter the Irish market. A number of examples were provided of cases where insurers from outside the Irish market were approached to provide insurance; in no instance were regulations cited as a deterrent to entry.

33 Presentation to the Oireachtas Joint Committee on Enterprise and Small Business, 12 November 2003.

4.62 To set up a non-life insurance head office in Ireland, a new entrant needs to submit an extensive business plan outlining the company's structure, its proposed operations, financial projections demonstrating that it will satisfy solvency requirements, and details of its proposed reinsurers. There is a €5,078.95 application fee. Applications are processed within six months. [Confidential material.] Despite this, the number of firms with a head office in Ireland increased by 50 per cent between 1994 and 2001 (see table 4.2).

Table 4.2: Changes in Irish Liability Market

Year	Number of companies with head office in Ireland
1994	19
1995	17
1996	20
1997	21
1998	21
1999	23
2000	23
2001	27
2002	30

Source: Blue Books, 1994-2001.

4.63 That Ireland has unlimited liability is not an entry barrier, even though some parties suggested that this deterred entry, particularly by US-based insurers (and reinsurers). All insurers, not just entrants, face the same conditions. (Arguably, it makes it more important that would-be entrants have good, easily available information on their likely risk exposure.)

4.64 Perhaps the best evidence that entry barriers are not significant is that the number of firms registered to transact liability insurance business increased between 1994 and 2002, from 30 to 41. Even between 2000 and 2001, the number of firms increased by four: Axis Specialty Europe, Carraig, Fairfield and Noble Insurance all became registered. But not all registered firms actively pursue business; in 2002 six insurers licensed to write liability insurance reported no earned premium income.

Mobility barriers

4.65 Moreover, just because there are insurers currently quoting for liability insurance does not necessarily mean that there is competition to sell policies to all customers. There may be entry barriers into specific lines of liability insurance. One suggested barrier is the inability to secure reinsurance contracts that allow the insurer to sell liability policies to certain sectors. This appears to be an ongoing cost of doing business that existing insurers also face, rather than an entry barrier.

4.66 Information asymmetries between incumbents and entrants may also be greater at a more disaggregated level. The published data, when it is released, is aggregated. The solution offered by insurers is for an entrant to enter a sector gradually. This would allow the entrant to learn about the expected frequency of short-tail claims; uncertainty about long-tail claims might require 40 or 50 years to resolve but that is uncertainty that current insurers also face.

4.67 The solution insurers propose, of gradual entry, raises concerns that the competitive constraints on existing insurers from the threat of entry might be muted. This would be of most concern if the other costs associated with entering a market were high. If the entry barriers are otherwise low, then the need to learn gradually could be undertaken by many entrants. Initially each would have a small share of the market, but in aggregate they could take a large share of the market from existing underwriters.

4.68 Brokers may have a role in alleviating any informational asymmetries, presenting information to underwriters about segments of the liability market where the broker thinks that profitable entry might be possible.

4.69 The barriers to entering particular segments do not appear to be insurmountable. FBD, which traditionally specialised in insuring farmers, has extended its insurance offering to the commercial and retail sectors significantly in recent years.

4.70 Some insureds complained that existing insurers engage in bundling, so that employers' liability insurance is only sold as part of a bundle that includes public liability insurance. This prevents the insured from sourcing cheaper quotes for public liability. Would-be entrants are denied the opportunity initially to enter the market by just offering public liability insurance.

Role of Intermediaries

4.71 Brokers represent an important distribution channel for liability insurance, as the following two charts demonstrate. Among insurers providing data, brokers accounted for over half of gross written premiums for both employers' liability and public liability insurance (in terms of gross written premiums) for most insurers, as the tables on the next page demonstrate.[34]

34 [Confidential material]

Chart 4.11: Share of Employers' Liability Gross Written Premiums Sold by Brokers, 2002

[Confidential material]
Data Source: Insurance Companies

Chart 4.12: Share of Public Liability Gross Written Premiums Sold by Brokers , 2002

[Confidential material]
Data Source: Insurance Companies

Why buyers use brokers?

4.72 Perhaps the obvious reason firms use brokers to secure liability insurance is that the broker is more informed about the insurance market. Even large firms that undertake a significant amount of self-insurance, such that they have in-house expertise about risk management, will still tend to use brokers. A broker interacts with the insurers on a daily basis, so should be familiar with recent developments such as the entry of a new syndicate at Lloyd's or of an insurer keen to grow market share in a particular industry sector. In contrast, a firm seeking employers' liability or public liability will not have that familiarity with the market, only seeking quotes once a year, or perhaps even less frequently for larger firms that effectively are seeking reinsurance for their self-insurance schemes.

4.73 A related advantage brokers have is that they have connections to underwriters that direct clients would not have. The superior contacts that brokers have can extend beyond Ireland. Brokers are more likely than a commercial policyholder to be aware of underwriters throughout the European Union and may well know the right person to approach within these organisations. The ability to reach underwriters outside of Ireland may be especially important for specialized risks and for self-insurers seeking reinsurance (reinsurance contracts will often be headed by underwriters based outside Ireland, although Irish insurers may bear some of the risks).

4.74 Some of these contacts will be because of superior knowledge about the insurance market, some because the underwriters choose not to deal directly with clients. A couple of reasons were suggested for why underwriters may prefer not to deal with clients directly. One common story was a belief that brokers were more efficient at dealing with customers than the underwriter would be. The underwriter's expertise was not in setting up a front office capable of handling enquiries from existing and prospective customers. A second concern alluded to was that the underwriter did not want to fall foul of charges of mis-selling. As a product provider their goal was to sell the most profitable products that they could. That would conflict with a duty to offer best advice to the customer. They felt that the best way to resolve this conflict was for the onus to provide best advice to rest with an intermediary. The underwriter wanted protection against the possibility of errors and omissions, and preferred it if a broker assumed responsibility for ensuring that the customer acquired a policy that covered all the risks it wanted covered.

4.75 The more regular interaction brokers have with underwriters gives brokers some other advantages. They are more familiar with compiling data on claims costs in a format acceptable to underwriters. (A number of underwriters commented that they did not have time to trawl through the claims and accident data of would be policyholders. They also commented that there were differences in the ability of brokers to compile such data in a user-friendly way; brokers who did the job poorly would have less success at finding underwriters willing to provide a quote.) Furthermore, a broker's incentives to "dress up" bad risks is muted by the need to retain credibility with underwriters so that they can place future business with the same underwriter. A potential policyholder does not have such a strong incentive, so will find it harder to convince underwriters that it is a good risk.

4.76 From the policyholders' perspective, using a broker to compile claims data might also help when dealing with outstanding claims. A broker should be better informed about the appropriate level of reserves that should be set aside for particular accidents. A common lament of insureds is that insurers overstate their likely future claims, making it hard to switch insurer.

4.77 Another perceived advantage of using brokers is that they can assist the policyholder with claims. If brokers do not want to get a reputation with insurers for presenting bad risks too favourably, insurers do not want to get a reputation with brokers for not honouring claims. In marginal cases, an insurer might be more willing to impose policy terms and conditions strictly if the policyholder is dealing directly with the insurer.

4.78 Finally, for larger firms a broker may advise more generally on risk management. The broker can assess the costs (greater risk exposure) and benefits (lower premiums) to the firm of retaining certain liabilities, i.e. it can advise on the appropriate level of self-insurance.

Evidence on competition between brokers

4.79 A number of ways were suggested for how brokers compete: advertising to win new clients, providing a better quality of service; being better able to network. Networking skills were important to either secure lower quotes or, in more recent times, just to place the business.

4.80 Interestingly, little mention was made of price competition. Brokers can potentially charge two groups - fees to customers seeking advice and commissions to insurance firms with whom they place business. Many smaller businesses do not pay fees for advice; for such policyholders the broker relies on commission income from the insurer. There does not appear to have been much competition on the commission rates brokers charge to insurers for employers and public liability, as the following two charts show.

4.81 The industry "standard" appears to be a commission rate of 6 per cent for employers' liability and 10 per cent for public liability. [Confidential material] If the broking market was competitive these rates might have been expected to fall when premiums were relatively high, yet this does not seem to have occurred. A couple of benign explanations might be developed.

Chart 4.13: Brokers' Commission Rates - Employers' Liability

[Confidential material]
Data Source: Insurance companies

Chart 4.14: Brokers' Commission Rates - Public Liability

[Confidential material]
Data Source: Insurance companies

4.82 First, in a "hard" market the costs to a broker of placing a policy may be higher. Thus the "cost" of broking should be expected to have risen. Yet it stretches credibility to believe that the premiums and costs of placing business are correlated such that there should never be a change in the commission rate.

4.83 A second possibility is that the rates quoted are accounting curiosities and of no practical relevance. For example, if the underwriter quotes €100,000 plus €6,000 commission for an employers' liability policy, the broker has the option of charging the client €103,000 and only retaining €3,000 after paying for the insurance policy. The feedback received suggests that brokers rarely pass on a share of the commission they receive. (Some insureds thought that the contrary practice was happening. They might be presented with a bill in the example above of €120,000, consisting of an underwriting charge of €110,000 and commission of €10,000. No evidence to support such claims was provided.)

4.84 Brokers do not appear to compete to offer lower commission rates. There also appears to be a transparency problem. Brokers are required to reveal the payments they will receive when advising a client to purchase a particular policy. Yet the majority of firms surveyed who used brokers indicated that they did not know what commission their broker received, although most presumably are aware that their broker received a commission.[35] The bigger transparency problems arguably relate to the absence of a requirement for the broker to reveal the commissions that other underwriters would have paid to the broker. And the fact that brokers do not have to volunteer information on extra payments they may receive from an underwriter. The client must rely on the requirement that brokers give "best advice" overriding any financial incentives the broker may have to direct the customer to a particular underwriter.

4.85 Commission rates only describe part of the broking market. Increasingly, larger firms are seeking out brokers who do not rely on commission income. Many brokers claim to be willing to offer advice on a commission-only or advice fee only basis. A number of parties suggested that the best approach was for consumers to engage in competitive procurement processes every couple of years, getting brokers to tender for the business. Such tenders encourage brokers to compete on fee arrangements, as well as their ability to deliver good insurance advice. Brokers are unlikely to be interested in tendering for such work unless the prospective client is sufficiently large. Each tender entails an amount of work for which there is no guarantee of any income. It may be harder for small and medium enterprises to convince brokers to compete directly for their business. Such companies may only realise the benefits of price competition between brokers if the brokers compete on the commission rates they charge insurers and/or their advertised consulting fees.

4.86 The prices brokers charge are only one factor that should influence the choice of broker, since still the major cost component associated with insurance will be the premium (for those firms that do not self-insure). Competition between brokers to realise savings on premiums is clearly in the interests of consumers. There is evidence of brokers seeking to

35 Source: Alliance for Insurance Reform

source cheaper quotes. In some instances, brokers are pro-active, pursuing underwriters with proposals for schemes to cover a certain category of business, e.g. qualified plumbers. Once a willing underwriter has been located, the broker will then proceed to advertise the scheme to prospective policyholders.

4.87 The ability to network and interest new underwriters in a class of liability is given as a reason why the broker market is consolidating. A number of parties suggested that the number of brokers in the Irish market has declined, although there were no data available to confirm or refute that claim. If the reason is that some brokers are unable to compete effectively and provide the services required in today's insurance market, e.g. unable to source new underwriters, then this is not a competition concern.

4.88 Alternative explanations for why the intermediary market has consolidated may suggest that rather than being the result of the competitive process, it has arisen because of uncompetitive features of the market. Some parties suggested that regulations of the broker market had caused the exit of a number of intermediaries. The regulatory burdens facing intermediaries today make it harder for small businesses to continue in this market. The absence of data on the number of non-life insurance brokers in Ireland over time means that it is not possible to test this hypothesis. Currently, all intermediaries in Ireland must be authorised. They must

(a) Maintain a minimum level of shareholders' funds or a capital account of €10,000 (€50,000 if acting as a product producer), except for RAIPIs who must demonstrate that they are solvent ; and

(b) Submit annual audited accounts to IFSRA (and unaudited half-yearly management accounts in the case of authorised advisers).[36]

4.89 Another reason suggested for consolidation in the broker market is the interaction between insurers and brokers. Insurers may be forcing small brokers out of the market, potentially for anti-competitive reasons. This is discussed in the next section.

Relationship between brokers and insurers

4.90 Two practices by insurance firms were cited as directly leading to a reduction in the number of brokers. First, some insurers are buying brokers' businesses, and assuming their books. Takeovers are not always anti-competitive. If an insurer identifies efficiency savings that it can realise that the broker was not realising, then there is a potential gain that can be shared between insurer and policyholders. The concern is that by buying brokers' books, the insurer is able to benefit from policyholder inertia and gain extra customers without facing serious competition. Whereas the broker would have given best advice across a range of product providers (all if the broker was an authorised adviser), the insurer will just advise over its own products. The problem is one of impediments to switching, discussed later, rather than anti-competitive per se. Other insurers could compete to purchase the brokerages; and there has been no suggestion that market foreclosure is a problem - underwriters have access to enough distribution channels.

4.91 A second practice is that underwriters are threatening brokers with a loss of agency if a certain level of business is not placed with the insurer. Some insurers claimed that it would not be in their interest to lose a selling outlet, but others admitted that they are reducing the number of agency agreements they keep. As with motor insurance, it can be pro-competitive for underwriters to choose different strategies concerning how they distribute their product. It is one way they compete. If there are only benefits to underwriters from having agency agreements, those that end agencies will find themselves less competitive. Some of the suggested costs of agency agreements that insurers have identified include the need to keep the agent informed (especially to satisfy regulatory requirements) and the worry that inexperienced or small brokerages place the wrong type of business (unprofitable) with them.

4.92 The problem for competition is that broker's incentives may not be aligned with that of the potential policyholder, and this misalignment may not be transparent.

4.93 Section 31(6)(a) of the Investment Intermediaries Act 1995 arguably increases the incentives for the broker to keep the agency agreement at the possible expense of those clients the broker is advising. The Act requires publication, in one or more national newspapers, notice that an appointment has been terminated. This advert makes it hard to attract new customers, and may scare existing customers away. In a "hard" market, the problem is compounded because often only one or two insurance companies offer a policy, so losing an agency means the broker can no longer offer existing customers any policy with underwriters for whom the broker has an agency agreement. Customers are not told that the broker has to place so much business with an underwriter or lose that agency.

36 www.ifsra.ie/documents/rii/catretintermedsd.doc

4.94 A related, more specific, allegation is that brokers are threatened with the loss of an agency agreement if they place business with Quinn-direct. No evidence was provided to support such a claim. If true, it would raise concerns about concerted practices by other insurers.

4.95 Another potential misalignment between the interests of the broker and the interests of the customer concerns the payment of commissions to brokers. Quinn-direct has suggested that customers are not being advised to take policies with Quinn-direct, in part because it does not pay brokers commissions. Since the evidence suggests that many insureds are not fully informed about the commission payments that their broker receives, it is doubtful that they are aware of the commission payments that the broker may have received from other insurers.

4.96 Furthermore, the commission rates are not always the only financial incentive. Some underwriters agree additional financial incentives with certain brokerages. There may be an over-ride arrangement. The types of incentives mentioned included commissions that depend on the brokers not placing risks with the insurers that are under priced, or commissions based on the volume of business placed with the insurer.

4.97 Offering a percentage of profits from placing certain business with the insurer is another example of the blurred distinction between insurer and broker - under such arrangements the broker is in effect assuming some risk (it might just be upside). The business rationale is easy to understand: the underwriter is putting in place incentives for the broker to assist in risk assessment. Such arrangements are sometimes necessary for a broker to persuade an underwriter to quote for certain groups that it previously did not insure. Such agreements can be potentially pro-competitive. But the concern is the absence of transparency for the potential customer who expects best advice but does not know that the broker is agreeing a deal which entails additional payments that do not appear on the quote the insured receives.

4.98 Similarly the volume payments may represent a sensible incentive scheme for an underwriter to offer a broker, but again may raise competition concerns relating to transparency. Customers are unaware of such arrangements, which might have an important bearing on the customers' ability to assess the likely quality of advice that the broker provides. (Volume payments that are targeted and sharply discontinuous might also be anticompetitive. The evidence collected does not show this to be a problem.)

4.99 The requirement that authorised advisers give best advice across all products might be seen as sufficient to alleviate any concerns about misaligned incentives. However, there are concerns. Best advice is not clearly defined, such that competing brokers advising the same client may recommend different policies with different underwriters. This could occur even if both brokers faced the same financial incentives (as they might when tendering to be the broker for a large firm). In a competitive market with full transparency, customers would be able to decide which of the two brokers appeared to be offering the best advice, mindful of any conflicting incentives they may have. In the current environment, customers are unable to make a fully informed judgement about the competing advice of competing brokers.

4.100 The requirement to give best advice itself creates problems. There is the possibility that it acts as an entry barrier for new underwriters. In practice, a broker's main concern when wishing to satisfy "best advice" requirements is to ensure that the liability policy they recommend will result in claims being honoured. Since there is no guarantee fund for liability insurance, in the event of an insurer going bankrupt policyholders may well seek redress against the broker who advised them. Brokers may therefore be wary about advising their clients to seek insurance from less-established companies, even when those companies offer lower premiums. Some parties queried whether the onus for ensuring that the insurer had sufficient funds should be with regulators, not brokers. If IFSRA, or another European regulator, is satisfied that an insurer has sufficient capital, brokers should be free to recommend its policies.

4.101 Competition between insurers might include differing levels of capital reserves in place to honour claims. Some may choose to reserve conservatively, and charge higher premiums, attracting custom from those firms least willing to face the prospect of a claim not being met. Other insurers may hold fewer reserves and charge lower premiums. A choice should be available to customers. One of the roles of brokers should be to advise on this choice, ensuring that their clients are aware of the difference. But this is not the same as a requirement that the broker should only advise clients to select the most secure insurance firm. If the broker gives appropriate advice, the client can make an informed decision about the appropriate trade-off between solvency of the insurer and the premium being offered.

4.102 It would be unfortunate if such competition were effectively denied because of the "best-advice" requirements. Yet some parties suggested that this

may be happening, claiming that brokers are wary of seeking out insurers regulated elsewhere in Europe, despite the freedom of services, and/or cite concerns about solvency as the basis for favouring established insurers who also happen to offer the highest commission rates.

Switching Costs

Renewal notices

4.103 Perhaps the biggest complaint insureds had about competition in the liability insurance market was the difficulty of switching. Many felt locked in with their existing insurer and broker.

4.104 A common complaint was that there was too little time to seek out alternatives. Renewal notices were sent too late. For example, half of respondents to an ISME survey in August 2002 claimed that they were notified of the need to reinsure with less than two weeks before the renewal date. Similar results were found with the survey of Alliance for Insurance Reform members.

4.105 Insurers varied widely in how many days they believed that a firm needed to seek out a quote for liability insurance. The suggested time to place a policy varied from a couple of days up to 60 days! The wide range might be because some of the insurers were describing how much preparatory work the insured would have to do, while others were focusing on how long it took the insurer to give a quote once presented with a risk. (There might also be differences because the answers assume a different type of firm seeking a quote. The insurers claimed that they will offer either contract site seen or site unseen depending on what the preliminary indications about the risk are. For smaller risks, they are more willing to "trust" the broker.)

4.106 Whatever the source of the differences, the table 4.3 suggests that at least 20 per cent of SMEs did not receive their renewal notice in time to seek out an alternative quote subsequently, unless they were willing to be uninsured for a period of time. Of course, it is possible that the surveys suffer from a self-selection bias, with those encountering difficulties more prone to complete such forms, but they do show that there were some firms for whom renewal notices are arriving too late.

4.107 Insureds offered a number of reasons why they needed to receive renewal notices before seeking out alternative quotes. First, their business is not primarily concerned with insurance; they need reminding. Second, it is difficult to get alternative quotes until a certificate of claims history is received. Most underwriters require this certificate before quoting. A number of insureds complained that they had difficulty getting a certificate of claims history from their existing underwriter, which hindered attempts at switching.

4.108 The reluctance of underwriters to quote for policies that will not commence for a few more months suggests that waiting until the renewal notice is not solely due to consumer inertia. Underwriters argued that there was too much uncertainty about what the claims might be for the current policy, so that the underwriter could not accurately reflect the risk for the following year. The reluctance to quote seems strange. The insurers are willing to offer insurance policies that last for more than a year. And even one-year policies entail judgments about the risks nine-months forward without any information about what the claims will be during the first nine months of the policy. More understandable is the possibility that insurers may only want to offer a quote for a limited period of time.

4.109 Table 4.4 summarises when insurers claim to send renewal notices, and to whom they send them. It currently varies by insurer, [confidential material]. The recipient of the renewal notice generally depends on whether the insurance policy was arranged by a broker or not. Since most liability insurance is arranged through brokers, one problem is identifying who is to blame for the late arrival of renewal notices. If the table corresponds to actual practice, in many instances the blame would appear to be with brokers. But insureds and brokers cited examples were they were still seeking renewal terms from existing underwriters after the previous policy had elapsed.

Table 4.3: Date when SMEs receive Renewal Notices

Date when Notified of Renewal Notice	ISME (%)	AIR (%)
Two or more weeks in advance	49	40
Less than two weeks before renewal	31	49
On the day of renewal	7	7
After the renewal date	13	4

Source: Irish Small and Medium Enterprises Association Limited and Alliance for Insurance Reform

Table 4.4: Liability Insurance Renewal Procedures of the Insurers

Insurer	Time in advance	Sent to	General Notes

Source: Insurance companies

4.110 The potential dispute as to who is to blame for the late receipt of renewal notices - brokers or insurers - arises because they are sent to brokers. Some underwriters suggested that the reason they sent the renewal notice to the brokers, rather than contacting the client directly, is the fear of alienating an important distribution channel.[37] (This suggests that some underwriters do not have confidence that the requirement brokers give "best advice" is sufficient.) Once the client's details are in the system, the underwriter does not appear to need a broker to effect a renewal. The insured might want to use a broker, but would obviously still have this option if the renewal notice is received directly from the underwriter.

Changing broker

4.111 "Blocking" was another problem identified with brokers receiving the renewal notice before the client. Some insureds alleged that their broker would phone around underwriters seeking quotes (or warning of the bad risk the insured represented), and then present the client with details on the best premium available. At this point, if the insured decided to try another broker to see if they could get a better quote, they would find that the new broker was unable to get quotes from underwriters who had already been approached by the incumbent broker.

4.112 No conclusive proof was presented of brokers deterring quotes from some underwriters, so as to ensure a commission on the high premium quoted from the broker's preferred underwriter. One complaint of insureds is that the lack of transparency concerning quotes the broker receives mean that they cannot assess whether their risk has been presented fairly to all underwriters. The broker only shows the recommended quote, and that is not broken down in a manner that allows the insured to assess whether the risk has been presented accurately.

4.113 Some underwriters, including Lloyd's of London, will only quote to the first broker that approaches them with a risk. It does seem likely that if a broker searches the market, presenting risks to lots of underwriters, other brokers will be disadvantaged in that a number of underwriters will no longer be willing to quote.

4.114 Underwriters offered a business rationale for this behaviour. It was costly to discuss a risk and provide a quote, so they did not want to incur these costs repeatedly. They were also worried that it would disadvantage the first broker, since subsequent brokers could "free ride" on some of the information the first broker had shared with the insurer. This latter explanation is less compelling, but it seems plausible that some underwriters will prefer to only deal with one broker per client believing this to be more efficient. (At best, they will only sell one policy, regardless of whether they quote to one or 100 brokers.)

4.115 It is also desirable for brokers to search the market. A broker approaching many underwriters is not anti-competitive.

4.116 Yet there is clearly a problem of generating competition in the market for broking services. If only one broker is able to secure quotes for a risk, then the benefits of competition between brokers are denied to customers. The problem is perhaps most acute because the incumbent broker has an advantage, able to contact underwriters before any other brokers have been approached by the client.

4.117 Even if this incumbency advantage were overcome, the market would not necessarily work perfectly. One service brokers offer is advice on the appropriate approach to risk management that the client should adopt. Suppose brokers differed in this advice. It is possible that the one who provides the best risk-management advice is nevertheless unable to secure a low quote because a rival broker was the first to

37 Other underwriters cited agency law as the reason for sending renewal notices to the broker.

contact the most competitive underwriter. It is possible to construct examples were the brokers are mismatched with underwriters. Suppose broker A's advice tends to feature comparatively more self insurance than broker B; and that underwriter Y is more competitive than underwriter Z for catastrophe insurance but less attractive when the excess levels are lower. If broker A gets quotes from underwriter Z and broker B from underwriter Y, the client will be presented with two choices which by construction do not represent the best policies available.

4.118 Other problems with switching between brokers exist. Industry practice is perceived to favour the holding broker. If a second broker approaches the existing underwriter, the underwriter will notify the holding broker. The holding broker has a second chance to secure a low quote, which it is argued reduces the incentive to seek out a low quote the first time. High premiums yield high commissions, and the option is available to secure a lower quote and premium should the client not display customer inertia. The difficulties of displacing the holding broker reduce the incentives for other brokers to compete for a client's business.

4.119 The IBA's code of conduct for its members may hinder switching. It was suggested that the IBA requires its members notify the holding broker of a client's intention to switch, and get confirmation that the client has no outstanding debts to the holding broker before taking on the client. This is another practice that allows brokers to concentrate their efforts on clients who have signaled that they are prepared to switch. (The practice is also open to abuse, with the option for brokers to claim outstanding debts that the client either disputes or had not previously been made aware.)

Changing underwriter

4.120 Some insureds suggested that the underwriters were deliberately conservative when reserving for future claims, since this made it harder for the policyholder to switch underwriter. Other underwriters, seeing the high provisions for outstanding claims, would either offer high quotes or not quote at all. The existing insurer was exploiting an informational advantage it enjoyed over other underwriters about the clients' expected cost of claims, an informational advantage that arises because only the current insurer is involved in settling outstanding claims. Other underwriters should be able to factor in the possibility of overly conservative reserving for outstanding claims, certainly those that have been in the market for a number of years. Of more concern is the possibility that underwriters new to the market have no basis on which to judge whether the reserves accurately reflect the likely claims.

4.121 The insurers denied deliberately overstating reserves. They argued that their reserving policies had to satisfy independent actuaries, and comply with IFSRA rules. (Some insureds suggested that these rules inflate the reserves.) It was also suggested that brokers should be able to provide a breakdown of the reserves to present to other underwriters, so that the informational advantage of the incumbent insurer can be muted.

4.122 The problem partially relates to the time it takes to settle and the uncertainty about awards in Ireland. If settlements were quicker, there would be fewer outstanding claims. A book of quantum would reduce uncertainty about the likely size of a claim, eliminating some of the debate between insurer and insured about reserving. As previously noted, "experience rating" means that a tension between the insured and the insurer over the appropriate level of reserves for outstanding claims is always likely. Insureds have an incentive, when seeking a renewal, to have the most favourable claims history possible; insurers have to make sure they have sufficient reserves in place to honour outstanding claims, to satisfy regulatory requirements designed to protect other policyholders who may subsequently have a claim.

4.123 Another problem with switching underwriter is the fear that the insured will not be able to secure a quote from the former underwriter in the future. This is a potentially major deterrent to switching to underwriters that have not previously been in the Irish market or who have a reputation for exiting and entering the market. The insurers suggested that "loyalty" demanded that they give preference to existing policyholders. It was also suggested that underwriters are better able to quote for existing customers because of more information about the business.

4.124 Both of these explanations confirm that one cost associated with switching is a reduced choice of underwriter in the future. The latter explanation, that insurers enjoy a big advantage when quoting to existing customers, suggests that competition between underwriters is more muted than the insurers claim. It runs contrary to claims that brokers can present risks and get competitive quotes from a variety of underwriters.

4.125 Despite the problems identified with changing underwriter, the evidence from the Alliance for Insurance Reform suggests that switching underwriter is more common than switching broker (see Table

4.5). This could be because of customer inertia in the market for broking advice or because the impediments to switching broker are higher than the impediments to switching underwriter. The role of brokers in facilitating switching between underwriters, i.e. "re-broking the business", might be a factor.

Table 4.5: Switching by firms seeking liability insurance

Firms that	%
changed broker in the last five years	28
changed underwriter in the last five years	58

Source: Alliance for Insurance Reform

Conclusions

4.126 The present section of the report considers the economic evidence on competition in employers' and public liability insurance in the Republic of Ireland. There are a number of similarities with the market for motor insurance, with large rises in premiums coinciding with an increase in market concentration up until 2001 (although more muted at the aggregate level than for motor insurance).

4.127 The relative absence of suitable data makes it harder to reach conclusions about whether market participants' behaviour is consistent with a competitive market. The evidence presented to the Oireachtas committee suggests some insurers may have started to reduce premiums, but IBEC and ISME both report that the most recent evidence from their members is of insurance costs continuing to rise. Evidence of changing market shares when looking at the liability market as a whole does not rule out the possibility that competition to offer liability insurance to particular sectors is more muted, although it does cast doubt on the possibility that insurers have tacitly agreed to serve different segments of the liability market.

4.128 As with the motor insurance market, there appear to be reasons to suggest that non-rivalrous behaviour between underwriters would be difficult to sustain, even though:

(a) demand is relatively inelastic, despite the absence of a legal requirement to hold liability insurance;

(b) underwriters face a similar cost structure (claims costs are the largest cost category they all face);

(c) various examples of industry co-operation permit the parties to meet regularly;

(d) the participants interact in a number of markets; and

(e) there is little buyer power, at least for small and medium-sized businesses.

4.129 The reasons why a cooperative agreement would be difficult to sustain are the relatively low entry barriers and the non-homogenous nature of the policies being sold. The entry of Quinn-direct and St Paul suggests that entry into the market has been possible in the recent past. Any regulatory impediments to successful entry do not appear to have been significant. Because risks are priced on a case-by-case basis, tacit collusion would be difficult since monitoring the pricing strategy of rivals would be harder.

4.130 Search and switching costs, rather than cooperative behaviour between underwriters, is probably a bigger concern for the functioning of a competitive market for liability insurance. Some of these costs may arise because of the incentives competing firms have, for example, to prevent existing customers from switching. For example, it was claimed that renewal notifications came too late to allow customers to shop around.

4.131 There were also problems identified with changing brokers, which seem to arise partly because some underwriters will only quote to one broker (believing this to be more efficient that quoting to many brokers). Brokers searching the market should put pressure on underwriters to compete. Measures to control costs, such as only quoting to one broker, are consistent with underwriters responding to competitive pressures. Yet it creates problems, limiting the ability of firms seeking liability insurance to get brokers to compete to find the best quote. Other practices that might help lock-in clients with their broker include the practice of brokers approaching the existing broker to confirm that the client has no outstanding debts before taking on the client; and insurers notifying holding brokers if a second broker has sought a quote for the client.

4.132 Informational asymmetries may also hinder competition. Consumers may not be fully informed about the incentives their broker has to choose between different product providers. Underwriters may enjoy an advantage when quoting to existing clients, with better information about the nature of the client's claims history. Potential entrants may be deterred by limited access to timely data at a more aggregated level.

APPENDIX 1: MEETINGS

A1.1 The study benefited from discussions with the following parties:

AA Insurance
AIG Europe (Ireland)
Aon
Alliance for Insurance Reform
Allianz Ireland
ARB Underwriting
AXA
Carole Nash Insurance
Car Rental Council of Ireland
Cork Chamber of Commerce
Coyle Hamilton
Eagle Star
FBD
Hibernian
Irish Brokers Association
Irish Business and Employers Confederation
Irish Co-operative Organisation Society
Irish Financial Services Regulatory Authority
Irish Insurance Federation
Irish Public Bodies Mutual Insurances
Irish Road Haulage Association
Irish Small and Medium Enterprises Association
McCarthy Insurance Group
Motor Insurers' Board of Ireland
Professional Irish Brokers Association
Quinn-direct
Royal & SunAlliance
Sertus Underwriting
Society of the Irish Motor Industry
South Dublin Chamber of Commerce
WG Bradley and Sons

APPENDIX 2: DATA REQUESTS

A2.1 The following data requests were circulated to insurers, and Professional Irish Brokers' Association members, the Alliance for Insurance Reform members, Local Authorities and the Irish Brokers Association members respectively. Both PIBA and the IBA were initially sent the same questionnaire. The IBA subsequently suggested a more user-friendly format might solicit a better response rate from its members (hence the two questionnaires titled "Data requests for insurance intermediaries").

DATA REQUEST for INSURERS

1 For motor insurance, please provide the data at the policyholder level that was made available to the MIAB, including the data on no claims discounts and premium history?

2 Broken down by size of company, please provide the average premium, the average excess and average claims for (a) employers liability and (b) public liability. Please indicate the number of premiums sold, and the fraction of those that were to new policyholders.

3 Broken down by industry sector, please provide the average premium, the average excess and average claims for (a) employers liability and (b) public liability. Please indicate the number of premiums sold, and the fraction of those that were to new policyholders.

4 Please provide an annual breakdown, going as far back as possible, of the premiums sold through various distribution channels? In the case of sales via insurance brokers, please indicate the percentages sold by specific insurance brokers.

5 Please provide annual information, for as far back as possible, on the fee percentages of premiums charged by specific brokers in the a) motor liability, b) employers' liability and c) public liability market.

6 Please provide an annual breakdown of the no claims discount structure, if any, that your company has employed, going as far back as possible, in the a) motor liability market b) employers' liability market and c) public liability market?

7 Please provide a detailed yearly breakdown, going as far back as possible, of the percentage of liabilities reinsured by your company in the (a) motor liability market (b) employers' liability market and (c) public liability market?

8 Please provide an annual breakdown of claim costs, going as far back as possible, e.g. settlement, legal and medical fees in the a) motor liability market b) employers' liability market and c) public liability market? Where possible, please give the aggregate costs and also the appropriate rates that applied, e.g. the agreed hourly rate that was paid?

9 Please provide annual information on the number of claims made, and of how many of these went to court. Please could you provide information for as far back as possible? Please provide information on the average amount of time taken for a settlement to be made after a claim had been instigated. Please could

provide information for as far back as possible? What is the average length of time taken for a claim to be awarded in the courts? Could you please provide annual figures for as far back as possible?

10 Please describe how many days in advance you send renewal notices, for each of motor, employers' liability and public liability. When the original policy was not sold directly, please indicate whether the renewal notice is sent to the broker, to the client or to both. If the timing of renewal notices has changed in recent years, please explain what the change was and when it took place.

DATA REQUEST for INSURANCE INTERMEDIARIES

For each question, please provide details going back for as many years as your records allow. (Where necessary, please provide an estimate.)

1 Please list your statutory status, e.g. authorised adviser, tied agent...

2 Please list the agency agreements you currently have, indicating when each commenced. Please also detail any agency agreements that have been terminated and the reasons given.

3 Please list any conditions that you must satisfy to retain an agency agreement, e.g. placing a minimum level of business.

4 Please describe the commission rates you receive from insurers for (a) motor, (b) employers' liability and (c) public liability insurance. Please describe any other financial rewards you receive from insurers. (Please detail any differences between insurers.) Please indicate the total income received, by insurer, for each of (a) motor, (b) employers' liability and (c) public liability insurance.

5 Please describe the fees you charge clients for advice on (a) motor, (b) employers' liability and (c) public liability insurance. For each category, please indicate the total annual income received in client fees.

6 Do you sell clients additional products, e.g. help with claims management? Please indicate the total income you receive for such sales.

7 For each year for which you can, please provide the number of policies and the gross written premiums sold for (a) motor, (b) employers' liability and (c) public liability insurance. What percentages were placed with different insurers?

8 Please describe how many days in advance you send clients' renewal notices, for (a) motor, (b) employers' liability and (c) public liability insurance. How many days sooner do you receive renewal information from the insurer? (Please describe any differences between the insurers in this regard. Also explain what changes you have made in recent years regarding renewal notices.)

9 What percentage of the policies that you place are "repeat custom" for (a) motor, (b) employers' liability and (c) public liability insurance?

10 What percentage of your income is attributable to "repeat custom" for (a) motor, (b) employers' liability and (c) public liability insurance?

11 For repeat clients, what percentage of policies (by number and by premium income) did you renew with the existing insurer for (a) motor (b) employers liability and (c) public liability insurance?

12 For each year, please give the percentage of policies due for renewal for which (a) the existing insurer would not offer a quote and (b) no insurer would offer a quote? Was there any noticeable difference in the willingness of individual insurers to quote?

13 For new clients that held policies previously, what percentage of policies (by number and by premium income) did you renew with their existing insurer for (a) motor (b) employers liability and (c) public liability insurance?

	Insurance firm		Broker	
	EL	PL	EL	PL
2003 2002 2001 2000 1999				

* If you arrange EL and PL jointly, please indicate.

Irish Competition Authority Data Request

For those using insurers and brokers

1 Please complete the following table above, detailing the brokers and insurers used in the past five years.

2 In years when you did not change insurance firm, was the existing insurer the only insurer willing to quote a premium?

3 In years when you changed insurance firm, was your existing insurer willing to quote a premium?

4 In years when you did not change broker, did you attempt to change? Please describe any difficulties you have encountered changing broker.

5 What fees did you pay your insurance broker? Does this include any additional services, beyond the cost of searching for the most appropriate policy?

6 What commission(s) and other payments did your broker receive from the insurer?

7 Please enclose a copy of the most recent renewal notice you received from a broker

8 Please fill in the following table below on renewals, to give an idea on how much time consumers have to consider changing policy.

9 Please document any instances in the past five years where you have been asked to pay a revised premium from that originally quoted. What was the rationale given? Were you aware of this possibility at the time of agreeing the original policy?

Local Authorities Liability Insurance Questionnaire

The Competition Authority is currently investigating competition in the non-life insurance sector, with particular reference to motor, employers' and public liability. Responses to the following questions would help the study (and would only be used for that purpose).

1 When, and with which insurer, did you last agree a policy to cover insurance?

2 Did you use a broker?

3 What factor(s) led you to choose that insurer?

4 Was it with the same insurer as you had previously used? (If not, were there any specific factors that caused you to change insurer?)

5 How many other insurers did you invite to offer quotes?

6 Which of Hibernian, Allianz, St Paul, IPB, Royal & SunAlliance, FBD and Eagle Star did you invite to offer quotes?

7 How many insurers offered quotes? (If possible, a list of those offering quotes would be appreciated.)

8 How many of Hibernian, Allianz, St Paul, IPB, Royal & SunAlliance, FBD and Eagle Star offered quotes?

Did you receive a renewal notice from your insurer, your broker, both or neither	Number of days in advance you received renewal details	Please describe any changes that have occurred in recent years, or any differences in the notification procedures of insurers and/or brokers
EL		
PL		

DATA REQUEST for INSURANCE INTERMEDIARIES

Please answer the following questions, using estimates where necessary. Feel free to include any additional information that you consider relevant, including any qualifications that apply to your answers. If the records do not allow a split between employers' and public liability, answers for liability insurance will suffice.

1 Please provide a copy of your Terms of Business.

2 How has your fee schedule for clients changed in the last five years?

3 Please complete the following table below describing payments received from insurers.

4 Do any of the insurers require you to place a minimum level of business, or impose other conditions that might affect the incentives for you to deal with them?

5 For each of motor, EL and PL, please provide a breakdown of the shares of total income due to different sources.

	Motor	EL	PL
Income from insurers %			
Client fees %			
Other income[38] %			

Have these shares changed significantly in the last five years?

Insurer	Commission Rate (%)*			Other payments, e.g. over-rides	Note any changes in these conditions in the last 5 years, including whether an agency agreement has commenced or terminated in that period
	Motor	EL	PL		
AIG					
AXA					
Allianz					
Eagle Star					
FBD					
Hibernian					
Quinn					
Royal & SunAlliance					

* Put "N.A." if there is no agency agreement, "0" if there is an agency agreement but no commission paid.

38 For example, sales of additional products, such as help with claims management.

		Number of policies	Gross written premium	Identity of leading insurer (by premium income) and percent placed with insurer*	Identity of second insurer (by premium income) and percent placed with insurer*	Identity of third insurer (by premium income) and percent placed with insurer*
2002	Motor					
	EL					
	PL					
2001	Motor					
	EL					
	PL					
2000	Motor					
	EL					
	PL					
1999	Motor					
	EL					
	PL					
1998	Motor					
	EL					
	PL					

* Treat business placed with insurers based outside Ireland, such as Lloyds syndicates, as a single entity.

6 Please complete as much of the table above as you can, to give an indication of your size and the relative importance of different insurers to you.

7 Please fill in the following table below on renewals, to give an idea on how much time consumers have to consider changing policy.

	Number of days in advance that you send client renewal notice	Number of days in advance you receive renewal details from insurer	Please describe any changes that have occurred in recent years, or any differences in the notification procedures of insurers
Motor			
EL			
PL			

8 Please fill in the following table, providing information on the amount of consumers switching between (a) brokers and (b) insurers. (If possible, an indication of how the answers have changed over the past five years would be appreciated.)

	What is the amount of custom due to repeat business		For customers you served the previous year					For new customers that were not your clients the previous year				
	As a percentage of number of policies sold	As a percentage of premium income	How many renewed with the same insurer? (%)	For how many would the existing insurer not provide a quote? (%)	For how many would no insurer provide a quote? (%)	Was there any noticeable difference between insurers?		How many renewed with the same insurer? (%)	For how many would the existing insurer not provide a quote? (%)	For how many would no insurer provide a quote? (%)	Was there any noticeable difference between insurers?	
Motor												
EL												
PL												

Paper B

REPORT ON THE ECONOMICS AND REGULATION OF INSURANCE

with particular reference to Motor, Employers' Liability Insurance and Public Liability Insurance in the Republic of Ireland

Paper prepared on behalf of The Competition Authority

Cass Business School, February 2003

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SECTION 1 THE ECONOMIC AND REGULATORY BACKGROUND

1.1 General demand and supply issues in insurance

1.1.1 Benefits that insurance provides to consumers and the wider economy

Insurance provides a mechanism whereby consumers can transfer some of the risks that they face arising from their personal or business activities onto others, viz. insurance companies. When consumers purchase insurance they are transferring an uncertain payment, which could be large and have a significant impact on their future income (profits for companies) or wealth (capital and reserves for companies) in exchange for a much more certain payment, the insurance premium. Moreover, since most consumers are risk averse they are prepared to pay insurance premiums above the actuarial or expected loss on these insurance risks. In competitive markets, insurance companies transfer some of the benefits of their ability to reduce risks from having large portfolio of insurance consumers (the law of large numbers) so that the insurance premiums that are actually charged are less than most consumers would be prepared to pay. Hence consumer welfare (consumer surplus) is increased. In addition, insurance companies usually possess more information than consumers about the probability of insurance losses occurring, and the severity of these losses should they occur, and this also increases consumer welfare. When insurance companies provide insurance to consumers they not only provide them with a risk transfer mechanism, but also provide additional services in exchange for the insurance premium paid. These include loss prevention and safety advice and services, loss settlement advice, and legal services when negotiating with aggrieved parties in suits of negligence.

These consumer benefits translate into wider commercial and economic benefits. When operating in competitive markets, industrial, commercial and trading enterprises have to take business risks in order to make profit By being able to transfer some of the risks associated with their commercial and investment decisions, the decision-taking process is itself made less risky. Hence decision-makers, being faced with less uncertainty, will be more prepared to undertake adventurous and potentially more profitable activities. Thus, the existence of insurance markets allows the economy as a whole to be more enterprising and to undertake longer term capital expenditure decisions which otherwise might not be made or delayed in their introduction.[1]

The risk transfer facility provided by insurance companies can be viewed in terms of the efficient use of capital. Industrial, commercial and trading enterprises would need to have more precautionary capital to run their enterprises if there were no insurance markets to absorb these risks. In effect, insurance companies supply contingent equity capital to industrial and commercial enterprises. This means that across the economy as a whole less equity capital is needed to support commercial and trading activities.

Moral hazard, discussed in more detail below, poses a significant potential problem for insurers. This is so because individuals and companies, having bought insurance, may be less careful in protecting their insured assets and more likely to cause financial loss to others, because they know that an insurance company will bear the cost rather than themselves. If human behaviour is markedly affected by insurance in this way then the practice of insurance might create extra costs for the wider economy and society as a whole. However, insurance companies are aware of this problem, since higher than expected losses affect them financially in the first instance. Insurance companies seek to reduce moral hazard in various ways; for example by requiring customers to share some of the risk by means of deductibles and by creating incentives, such as the promise of reduced premiums in future if loss experience is better than expected.

1.1.2 Factors that determine the supply of insurance

There are six main factors that determine the ability of an insurance market to supply insurance:

(a) regulatory and legal constraints;

(b) the potential for the pooling of risk exposures;

(c) sufficient information to price insurance contracts;

(d) an acceptable level of moral hazard;

(e) the financial capacity to absorb extremely large losses; and

(f) commercial feasibility, which allows insurers to charge adequate and actuarially accurate prices in order to earn an acceptable rate of return on their capital.

1.1.3 Regulatory and legal constraints

Insurable risks represent only a sub-set of all risks. They have traditionally covered causes of loss from acts of nature and from certain human causes, such as accidents, human error and malfeasance. Over time, insurable markets have extended their reach so as to cover other risks. Some of

1 For a detailed discussion of the factors influencing the demand and supply for insurance, see Dickinson, G (1998) 'The Economic Role of the Insurance Sector in the Risk Transfer-Capital Nexus', *Geneva Papers on Risk and Insurance*, Vol.89, Oct, pp. 519-530.

these have been economic in nature, such as the insolvency risks protected by credit insurance, and some political in nature, such as government expropriation of assets, civil disorder and terrorism. There are boundaries to what can be considered insurable, some of which arise from the contractual nature of insurance. However, the most binding constraints on what is insurable in the short term are those set by the state through its regulatory system. Insurance legislation specifies what products insurance companies can supply and, hence, partly defines what is insurable. New insurance products may be restricted because they fall outside the list of insurances permitted by national legislation. Certain types of insurance may be deemed to be against the public interest and therefore be prohibited, such as kidnap and ransom insurance in Italy. In the longer term, under the pressure of economic and social change and product innovation, the scope of what insurers can supply tends to increase as regulation adapts.[2]

In addition, insurance contracts must meet certain legal criteria. These require inter alia that claimants should prove that they have suffered a financial loss (the principle of insurable interest) and that they do not profit through insurance if the agreed event(s) causing the loss occurs (principle of indemnity). There must also be a predictable legal system in which insurance contracts can be enforced and disputes about them settled.

1.1.4 Potential pooling of risk exposures

Insurance is predicated on the pooling of a large number of risk exposures where the causes of loss are to a significant degree independent of each other. This is the application of the law of large numbers, or portfolio diversification. Where risk exposures are few in number or where there is a high degree of correlation between risk exposures, due to a common cause of loss or to a concurrence of causes, then insurance is less effective as a mechanism for transferring risk. Catastrophic losses can arise from the adverse impact of one very large risk exposure or, more commonly, from the simultaneous impact on large number of smaller risk exposures. Failure to have an effective pooling of risk exposures does not necessarily mean that insurance cannot be supplied, but it does mean that the cost of insurance will tend to be high, because more capital is needed to absorb these greater risk concentrations.

Risks can be diversified not just across a portfolio of risk exposures at a point in time but also over time. Indeed, when insurers or reinsurers provide insurance on low frequency/high severity risks (such as flood), this is their expectation. Insurance and reinsurance is a long term business. Most non-life insurance contracts are one year in duration and hence there is no contractual restriction that enforces this temporal risk spreading. There may be a case for longer term non-life insurance contracts, and they are used in some markets. However, one year contracts in non-life insurance are likely to remain the norm for the time being.

1.1.5 Information to adequately price insurance

It is essential that insurance and reinsurance companies have sufficient information to price insurable risks. Their ability to price risk depends on a number of conditions. First, the events causing or triggering an insured loss must be clearly defined. Second, insurers must have sufficient information to estimate the likelihood and severity of loss from a set of defined causes in order to determine adequate and actuarially accurate prices. Third, consumers should not be allowed to conceal information, willingly or unwillingly, about their risk propensities from insurers, as this will prevent the latter from charging actuarially accurate prices. This potential problem – that of 'adverse selection' – is considered again later.

1.1.6 Acceptable level of moral hazard

As suggested earlier, moral hazard imposes a further potential constraint on the supply of insurance. In the context of insurance, moral hazard is the phenomenon whereby the existence of insurance significantly affects the behaviour of those that are insured. Individuals or enterprises may adopt a lower level of care because they do not themselves pay for the financial consequences of their behaviour. All insurance arrangements generate moral hazard to some degree and insurers seek to minimise its impact through contract design, appropriate risk sharing arrangements (such as deductibles) or through pricing incentives. Moral hazard is not limited to policyholders. Other parties can increase this payment bias against insurers. They include claimants under liability insurances, members of the judiciary, others persons within the legal system, and those responsible for framing government policy.[3] Moreover, if moral hazard is significant and cannot be controlled, or cannot be predicted and factored into the prices charged in the market, insurers may be unwilling to provide a sustainable supply of insurance. It has been argued that moral hazard is especially significant in liability insurance, making this line of business generally unattractive to insurers.[4]

1.1.7 Adequacy of financial resources

The capacity of an insurance market depends on its financial resources relative to the scale of the potential losses that it might face. The financial resources of the insurance market derive from three main sources. These are:

2 For a further discussion on the limits of insurability, see, Courbage, C. and Liedtke, P. (2003) 'On Insurance, its limits and extensions', in *Journal of Insurance Research and Practice*, Volume 18, Part 2, July.
3 See Parsons, C. (2003) 'Moral hazard in liability insurance' *Geneva Papers on Risk and Insurance*, Vol. 28, No. 3, pp. 448-471.
4 See generally Parsons (2003), note 3.

a) the capital and reserves held by insurers and the amount of new capital that they can raise quickly;

b) the capital and reserves held by the global reinsurance network and its new capital raising capability; and

c) part of the short-term cash flow from new business (since after a very large loss, insurance prices tend to rise sharply for a period of time).

It is clear that the financial resources of the private insurance market, even a global market, may be insufficient if there are a number of extremely large losses over a short period of time.

1.1.8 Commercial feasibility

In competitive markets, insurance companies must charge prices that cover their expected costs if they are to survive. These include claim costs, marketing and administrative costs, and the cost of capital supplied by shareholders and others. The failure of insurance companies to earn an adequate rate of return on their capital means that that new capital will not come into the insurance market, and existing capital may leave the market, with the consequence that insurance supply will not be sustained. Similarly, in a competitive insurance market, there is inevitably some cross-subsidisation between consumers, even though insurance companies aim to charge actuarially accurate prices that reflect differences in risk propensity. As suggested earlier, if an insurer charges consumers with low risk propensities similar prices to consumers with higher risk propensities, there is a risk that the former will buy less insurance, not insure at all, or switch to another insurer that adopts a fairer pricing policy - i.e. there is likely to be adverse selection. However, even in competitive markets there is usually some degree of cross-subsidisation, owing to inertia on the part of consumers and their lack of full information about alternative sources of supply, and the fact that insurers themselves may not have sufficient information to price risks with absolute accuracy.

Apart from lack of information, there are two main factors that can prevent insurance companies adopting adequate and actuarially fair pricing policies. First, insurers may be prevented by regulation or government policy from charging appropriate prices, which can occur if an upper limit is set on prices. In fact, while there is still some government regulation of insurance prices in the United States and certain other markets, competition policy within the European Union has over the last decade required the removal of all direct government involvement in price setting for non-life insurances, including compulsory insurances. Second, consumers may be unwilling to purchase insurance because they consider it to be unaffordable or too expensive. This can occur, in particular, when insured events are likely to impact disproportionately on one segment of the market, as is the case with the exposure to earthquake or flood, or in certain enterprises exposed to legal liabilities. In this case the market price of insurance for the segment will be comparatively high and, possibly, prohibitively so.

What is affordable is clearly a subjective issue. It does not depend solely on the income and wealth of individuals or organisations. Any complete analysis of affordability must take into account the wider economic context. For example, even though the market price of property insurance may be high in a geographical area where there is a high exposure to a natural hazard, the cost of purchasing real estate in this area may well be significantly lower than in another area with a lower risk exposure. Similarly, companies that operate in industries where there is a high risk of being sued for negligence[5] may well face less competition, and hence be potentially more profitable, because new companies may be deterred from entering these markets and existing companies more likely to leave them, as a direct consequence of these higher risks. Hence, these higher profits may compensate for the higher risks or, if the risks are insured, the higher profits could offset the higher premiums associated with transferring these higher risks to insurers.

1.1.9 The Impact of Compulsion

In many markets certain types of insurance have been made compulsory by law. Compulsory insurance laws are passed when issues of the wider public interest override personal freedom of choice in the buying of insurance. Compulsion can arise from a variety of public interest concerns. The first and most widespread relates to third party liability. If an individual causes loss to a third party then an obligation on the part of the former to purchase insurance will help to ensure that funds will be available to compensate the latter. This clearly depends on the insurance actually being purchased and being purchased to an adequate level in relation to the loss. It also depends on the insurance contract wording being clear, so that there is no dispute over payment by the insurer, and on the insurer being sufficiently solvent to pay the claim. Compulsion tends to be applied where there is non-negligible probability of loss and where the severity of loss would have a significant impact on the party affected. Clearly, what is non-negligible and of sufficient severity will depend on value judgements within society. An obligation to insure in respect of accidents at work and accidents arising from car use is found in many societies.

Compulsion can also apply where a failure to act would result in self-inflicted loss, such as in the case of pensions; where a failure to save for retirement might put a burden on oneself. Of course, in this case there could also be a burden on society as a whole, because others would be under an obligation to provide financial support. In both cases of compulsion, there is a potential cost to government or to

5 For example, in industries in which firms may expose their employees or members of the public to harmful agents, such as asbestos, ionising radiation or toxic waste.

wider society through the tax system. Individuals who cannot support themselves or who incur additional health or medical cost to maintain a socially acceptable standard of living would, in a civilised society, have to be supported by that society, either directly or through the tax system.

Clearly, a system that makes insurance compulsory will generally create a larger demand than one where insurance is voluntary. However, the extent to which this is so will depend on the level of insurance that is required. If the level of insurance that is required is low, this may lead consumers to believe that they are adequately insured when they are not. The extent to which compulsory system is effectively enforced is also important. If the mechanisms of compulsion are not effective demand will be reduced. Nevertheless, in most developed economies compulsion is likely to increase the demand for insurance.[6]

In principle, a larger market will allow insurers to exploit the law of large numbers more effectively and hence will tend to facilitate a lowering of the average price of insurance. Compulsion might also result in savings on marketing costs. However, these savings are likely to be low as the object of most advertising is to increase the demand for a particular company's insurance products rather than to increase the demand across the market as a whole. In addition, some economies of scale in production costs, including those relating to information technology and back offices processing, could be captured from a larger market.

On the supply side compulsion causes some problems. The principal difficulty is that insurers collectively must be willing to offer insurance up the level that is legally required to all who are obliged to purchase it. Sometimes individuals find it difficult to obtain insurance cover, usually because they are perceived to have a high claim propensity. This problem is reduced in practice by insurance brokers, who are able to search the market for the insurance cover that is needed, although there may be restrictions in the terms and conditions that apply to it. However, in some cases legislation may be needed to compel insurers to offer the insurance that is required by law. For example, in Ireland, where third party motor insurance is compulsory, this legislative obligation is administered through the Declined Cases Agreement.

In any event, when it is claimed that there is a lack of market supply, it may simply be that consumers consider the prices being charged by insurers to be too high. Market failure is sometimes confused with resistance to high prices. It is true that individual insurance companies sometimes set high prices to discourage certain high risk consumers, but in general, across the market as a whole, brokers can usually identify an appropriate source of supply. Moreover, some insurers actually seek to specialise in high risk consumers.

As noted earlier, private insurance markets operate on the principle of fair and accurate pricing; that is, individuals are required to pay insurance premiums that reflect their individual claiming propensities. In other words, competitive markets require a low level of cross subsidisation in pricing between policyholders. Indeed, the degree of cross-subsidisation in pricing within an insurance market is one measure of its competitiveness. Hence, where there is the lack of a market for a segment of consumers because the price of insurance is too high for them, governments sometimes intervene. Governments tend to intervene in one of two ways. The first way is for the government to set up formal or informal agreements with the insurance industry whereby all consumers are accepted, but with some ceiling on prices. An example is found in the Assigned Risk Plans in the United States, whereby consumers that are considered high risk are allocated across insurers in the market on an agreed basis, with an upper limit on prices. When there is a ceiling on prices, an additional element of cross-subsidisation is effectively imposed on the market, because other policyholders are forced to carry the extra cost between what is an accurate price based on the calculation of risk and the price that is charged. A second solution is for the government itself to provide the subsidy (i.e., tax payers pay the subsidy). This can be in the form of state reinsurance protection or guarantees to insurers. In this case there will still be an element of cross-subsidisation as the reinsurance protection or guarantees will apply at an aggregate level and not at the level of the individual insured.

There is a further responsibility on a government that makes insurance compulsory. The government must ensure that consumers purchase insurance by having in place penalties in the event of non-compliance. By the same token, governments have a moral obligation to ensure that that there is a secure supply of insurance when they compel people to buy it. Ensuring a adequate supply extends beyond ensuring that a market exists, to ensuring that insurers deliver on their promises even in the event of insurance insolvency. Hence there is a strong case for guarantee funds, that is, funds that are available to pay compensation to those who suffer injury at the hands of negligent persons who have failed to arrange the insurance that is required by law. Governments usually pass on the cost of such funds to the insurance industry (and hence policyholders) in one way or another.[7]

Finally, we should note that compulsory motor and liability insurance schemes generate some tension between the desire on the part of governments to ensure that accident victims receive compensation through sound insurance and the desire of insurers to limit moral hazard by setting appropriate terms for the cover. For example, an insurer would normally wish to have the right to avoid the contract, or a particular claim, if its policyholder failed to take proper safety measure or, say, drove a vehicle that was not

6 But, inevitably, not to 100% of the population that is required to insure by law. For example, it has been estimated that there are at least 80,000 uninsured drivers in Ireland. In the UK one in twenty motorists are uninsured and recent reports suggest that as many as one in seven French motorists have no insurance.

7 In Ireland the Motor Insurance Bureau of Ireland administers the system in respect of motor insurance. There are similar organisations in the UK and all other EU states, as required by EU law. It is worth noting that the British government has never been persuaded of the need for a similar guarantee fund in respect of employers' liability insurance, even though EL insurance has been compulsory since 1972. This stance has often been criticised. See, for example, Parsons, C. (1999) 'Employers' liability insurance – how secure is the system?' *Industrial Law Journal*, Vol. 28, No. 2, pp. 109 – 132.

roadworthy. However, enforcement of such a condition might deprive an accident victim of compensation if the insurance contract was avoided and the policyholder did not have the financial means to settle the claim personally. For this reason, compulsory insurance regimes often prohibit insurers from relying, as against third party claimants, on various restrictive terms and conditions that would otherwise apply, effectively forcing insurers to give cover that is wider than they would provide in the absence of compulsion. To mitigate the effects of this regulation insurers are usually allowed a right of recovery against their own policyholders in cases where there has been a breach of such conditions. Thus, at least in theory, the insured is required to reimburse the insurer once the latter has settled the accident victim's claim. In effect, the risk of policyholder insolvency is then borne by the insurer rather than the claimant. Taken as a whole, this restriction on the right of insurers to underwrite compulsory insurance risks in the way they would otherwise wish may make compulsory insurance classes less attractive to insurers, thus restricting supply.

1.2 The changing structure of insurance markets

1.2.1 Greater Market Concentration

Insurance markets, including those in Europe, have traditionally been fragmented, with a low degree of market concentration compared with many other industries, including commercial banking. This fragmentation was the result of a mix of influences, including the nature of national insurance regulation, local distribution systems and the ownership characteristics within the insurance sector in some markets, such as those dominated by mutual insurers or state-owned enterprises.

Over the last two decades, national insurance markets have undergone significant change, with deregulation, an increased level of merger and acquisition activity and new types of distribution channels, such as direct and tele-marketing. In 1980 there were some 7,000 insurance companies in Western Europe, but this had reduced to under 3,000 independently- owned entities by 2002. The insurance market still remains relatively fragmented in some countries but certain segments of insurance markets have become more concentrated. This is the case with commercial insurances and reinsurances, where risk exposures are larger or more difficult to price and where there are likely to be greater economies of scale in terms of capital and sufficient information to price these risks.

1.2.2 Increasing globalisation and regionalisation of insurance markets

One of the key drivers of market change in insurance has been the continuing globalisation of business and commerce.[8] This has seen foreign-owned insurance companies gaining an increasing share of national insurance markets, sometimes by new market entry but mainly through mergers and acquisitions. The buoyant stock markets of the second half of the 1990s were a major factor in this, because listed insurance companies with a good stock market rating where able to acquire smaller insurance companies or insurance companies of similar size with lower stock market valuations. There was increased activity, regionally and globally, as some of the largest international companies, including a number of European-based firms, sought to develop operations with a wider geographical reach. A major reason for this policy lay in the fact that insurers' corporate customers were themselves 'going global' and, in a service industry such as insurance, there is a commercial imperative to have a global network to service these multinational clients.

1.2.3 The impact of EU Insurance Directives on European insurance markets

The pattern of globalisation has been characterised, not only by large multinational insurance groups setting up or acquiring operations in various national markets, but also by medium-sized insurers diversifying more at the regional level, often encouraged by governments within the region, in response to the wider globalisation process. This pattern has been apparent within the European Union and the wider European Economic Area. The introduction of various EU Insurance Directives has helped to stimulate the creation of a more integrated European insurance market. This has seen many European insurance companies setting up operations in other European countries, especially in countries that are geographically contiguous. However, the main driver of European insurance market integration has been mergers and acquisitions, and it has been the larger insurance companies that have been the most active in this regard. At first this consolidation took the form of the larger companies acquiring smaller ones. However, in the mid 1990s the pattern altered and there was a change in emphasis as large insurers merged or amalgamated through agreed take-overs. It should be noted that mergers and acquisitions were technically outside the Insurance Directives that provided for the right of establishment, (through the setting up of an overseas branch or subsidiary), or through cross-border business. This trend of consolidation and national market penetration has accelerated. By 2003 foreign penetration of national markets was much higher than it had been ten years earlier, except for countries such as Ireland, Belgium and Austria, where foreign ownership had historically been high. In these

8 For a more detailed discussion of the main drivers of change within European insurance markets over the last two decades, see Dickinson, G. (1996) 'The European Insurance Market' in *The Changing Map of Europe*, eds. Silberston, A and Raymond, C. P., Macmillan Press, pp.137-154.

countries foreign owned companies often changed hands as a result of mergers and agreed acquisitions between insurance companies in other countries, usually in the larger European countries and, in particular, France, Germany, UK, Switzerland and the Netherlands.

In the early 2000s, under the joint impact of less profitable underwriting and depressed stock markets, a reappraisal of the international operations of the larger insurance companies has been taking place. This has often been accompanied by a change in the top management within these larger companies, not least because low rates of return on shareholder capital have tended to further depress company share prices. This reappraisal occurred both geographically and in respect of certain market segments. New top management in some companies withdrew from European markets where high profitability and growth targets had not been achieved, often selling their interest to other large insurance companies and sometimes closing down the local operation. In addition, there was a reappraisal of certain product markets. These included commercial property and liability insurances. Profitability had been low in these areas, and it was thought that the capital and reserves tied up there to cover large potential losses could be deployed more effectively in other areas of business, including life and pensions. Hence, a number of insurance companies began to withdraw from or reduce their commitment to commercial insurances. These included Zurich FS, Sampo, and AVIVA (although Hibernian, a member of the Group remains the main player in the Irish liability market). In addition, there were a number of company failures, which also reduced market capacity in commercial property and liability insurance.

The sharp fall in European and North American stock markets after 2000 also had an adverse effect on the capital bases of insurers, especially general insurers, and this has reduced the ability of insurers and reinsurers to maintain their level of supply. However, after the events of September 11th, 2001, which produced the largest ever insurance claims, with total estimated losses of between $40 billion and $70 billion, there was a sharp rise in insurance and reinsurance prices. This brought some new capital into the insurance and reinsurance markets in 2002, especially in Bermuda, where some $15 billion has been raised, and within Lloyd's of London. However, this new capital was much less than the amount by which the capital levels of insurers fell as a consequence of falling stock markets. Insurance prices on some classes of business where claims costs had been high had already increased prior to September 11, but the size of this catastrophic loss had the widespread effect of hardening rates further (especially for commercial insurances) or delaying any potential downturn in rates. This effect was largely due to a reduction in the global supply of reinsurance, which pushed up its cost. This increase in cost spilled over into primary insurance markets, because reinsurance is major input into the supply of insurance.

1.2.4 Increasing concentration within international reinsurance markets

A marked trend over the last decade has been the increasing concentration within the international reinsurance market. The reinsurance market is essentially international in nature because of the need to spread very large potential risk exposures so as to exploit the benefits of the law of large numbers. There are clear economies of scale in reinsurance, not just in capital support but in the ability to acquire the requisite information to price complex risk events with low probabilities of occurrence. The four largest insurance groups, Swiss Re, Munich Re, General & Cologne Re (Berkshire Hathaway) and GE Employers Re have increased their market shares sharply, both organically and by acquisitions. Table 1 shows the top ten reinsurance companies globally and their market shares.

Table 1: Degree of concentration in the world reinsurance market 2001

Company	Premium income $bn.	Market share
Munich Re (Germany)	19.7	15.2%
Swiss Re (Switzerland)	18.6	14.4%
Berkshire Hathaway (US)	12.0	9.2%
GE Global (US)	10.4	8.0%
Hannover Re (Germany)	10.2	7.9%
Lloyd's of London (UK	8.3	6.4%
Gerling Global Germany)	5.2	4.0%
Scor (France)	4.3	3.3%
Axa Corporate Solutions	3.7	2.9%
Converium Group	2.9	2.2%
LARGEST 10 COMPANIES	**95.3**	**73.6%**
GLOBAL REINSURANCE MARKET	**129.5**	**100%**

Source: A.M. Best and Sigma (Swiss Re)

The consequence of this market consolidation is that the bargaining powers of large reinsurers has increased. Greater bargaining power has meant that the cost of reinsurance is now higher than it has been in the past, and it seems likely to remain so for the immediate future. Since property and liability commercial insurers depend on reinsurance as a key input into their own pricing and underwriting decisions, the hardening of reinsurance rates has contributed to the recent rise in insurance prices of liability and other commercial insurances. Equally, because large external reinsurers have extracted some increased profit from the rising cost of reinsurance, direct insurance companies have not benefited fully from higher insurance rates. Smaller insurance markets, such as the Irish market, are likely to be exposed to this increasing bargaining power of the large international reinsurance companies. Even if smaller reinsurers with less bargaining power are used, the influence of the larger reinsurers cannot be fully avoided since these smaller reinsurers themselves depend on the capital and technical support of the large reinsurers. It might be argued that the increasing concentration among insurance companies, caused by mergers and acquisitions, should provide a countervailing force against the greater strength of the large reinsurers. However, the degree of concentration within the reinsurance market remains, and is likely to remain, a good deal greater than in most national insurance markets.

1.2.5 Increasing power of large international insurance brokers

Although there is something of a trend towards direct writing of retail general insurance (see section 1.2.7 below), insurance brokers have increased their role in relation to large commercial insurances. This is partly because corporate buyers of insurance have sought the services of the brokers to find the best combination of price and contractual terms and conditions, not just in national markets, but in international markets also. The insurance broker market has also witnessed a pattern of increasing concentration as the larger international brokers have acquired smaller national and local brokers. Marsh, Aon and Willis, the three largest international brokers, have increased their market shares mainly through extensive programme of acquisitions around the world. Medium to large brokers have also tended to merge, partly to increase their scale and partly to avoid themselves being acquired by the largest brokers. The power of the broker is used to strengthen the bargaining position of the commercial customers for whom they act. As such, it acts as a countervailing force to the increased bargaining power of large insurers and reinsurers. However, brokers can also use this bargaining power, to some degree, to negotiate higher commissions for themselves. Indeed, because broker commissions are traditionally based on premium levels, the full benefit of their bargaining power may not be passed on fully to their corporate clients.

One key capability of the international insurance brokers is their ability to switch insurance business from national insurance markets to other markets overseas. This is especially so for commercial insurances. This switching capability might have the effect of increasing price competition in a national insurance market. However, the extent to which insurance brokers will wish to switch business abroad will depend on such factors as:

- the current and expected profitability of the insurance business (e.g. is it worth the transaction costs of searching abroad, including, possibly, carrying out an assessment of the reliability of an insurer that the broker does not know), and;
- the attractiveness of the national market to foreign-based insurance companies (if a national market is small and unprofitable it may be difficult to place business there).

1.2.6 Centralisation of insurance buying by large corporations

On the demand side of corporate insurance there has also been change. Corporate buying of insurance has moved more and more into the corporate treasury department of the larger corporations. There has been an accompanying tendency to centralise risk management policymaking. Insurance buying is increasingly centralised, and in the form of global programmes where possible. This is partly because of the benefits that accrue from deciding on risk retention/risk transfer decisions, and partly because of the economies that can be achieved through buying large amounts of insurance. In addition, most large corporations have set up ‘captive’ or in-house insurance companies that allow them to co-ordinate their global insurance needs. Because captives are legally insurance companies, when they arrange their external protection they do so in the form of reinsurance. The existence of captives, located either offshore or onshore, has reinforced this tendency to centralise insurance/ reinsurance buying. International insurance brokers provide a variety of services to captives, including risk management, claims settlement and administrative support. It can be argued that the growth of captives has strengthened the role of brokers in corporate business.

Generally, corporations tend to arrange their liability insurance separately from their property insurance programmes. This is because liability insurance needs are more complex and have to be tailored more to local legal and regulatory conditions.

1.2.7 The rise of the 'direct writers'

While the major insurance brokers dominate the distribution systems for commercial insurance, the marketing of motor insurance (and 'personal lines' generally) has undergone major change in recent years. The growth of Direct Line in the UK and Geico in the United States has prompted more insurance companies to set up direct marketing activities. Direct marketing accounts for between 10% and 30% of motor insurance across the European insurance market. The success of direct marketing of motor insurance arises from the fact that motor insurances are simpler and more homogenous products than commercial insurances and do not require the same level of risk management services and capital support. 'Direct writers' have lower cost structures than other insurers because they do not have to pay commissions to agents, brokers or other intermediaries, and this saving is usually more than enough to offset their increased advertising and administrative costs.

1.3 Determinants of the underwriting cycle and an analysis of the current cycle

1.3.1 Defining the underwriting cycle

A key feature of general insurance markets is that prices, and hence underwriting profitability, are subject to sharp swings. This is known as the 'underwriting cycle' or 'insurance cycle'. Since underwriting profitability is the difference between insurance premiums received (and earned) and claims and expenses that are incurred, the frequency and severity of claims during a period will be a key determinant of underwriting profitability. But the term 'underwriting cycle' is usually defined in terms of a pattern of upward and downward movements in insurance prices, broadly cyclical in nature, and their subsequent impact on underwriting profitability, which is similarly cyclical.[9]

1.3.2 Causes of the underwriting cycle

Cyclical patterns are common in most industries, and in the wider economy as a whole, where we speak of the 'business cycle'. However, cycles in non-life insurance markets tend to be more pronounced than in industry generally. What are the reasons for this high degree of cyclicality? There have been many studies of the insurance cycle in the United States, and a few in other countries. One common empirical finding is that while both the demand and supply for insurance varies over time, it is variations in supply that are more important than variations in demand. This is because financial capital is the main determinant of supply. New financial capital can come into a market quickly to increase supply when premiums are high, but can withdraw quickly from the market if it appears that the rate of return on capital is falling below a required rate. Again, new companies can come into the insurance industry fairly quickly, provided there are no unusual delays in gaining regulatory approval. This contrasts with the manufacturing and agricultural sectors, where supply is less elastic. However, there are many factors that might cause financial capital to increase or decrease, and the availability of capital does not mean that it will be used to provide underwriting capacity.

Three main theories of the insurance cycle have some degree of empirical support, although no single theory is fully supported by the facts. One of these theories relates to expected investment income (or more generally investment returns) that can be earned on insurance premiums. Since insurance companies receive premiums at the outset of the insurance contract, they can invest these premiums (less administration and marketing costs and reinsurance costs) until claims are eventually paid. The longer the time lags between the receipt of premiums and the payment of claims, the greater the potential to earn investment income. If interest rates (or rates of return) are expected to rise, then some insurance companies will seek to reduce insurance prices in order to attract more premiums to invest in expectation of these higher interest rates (rates of return). Other insurance companies, not wishing to lose market share in a competitive market, will also cut insurance prices. Similarly, if interest rates fall or are expected to fall, insurance rates will rise, after a time lag. See Figure 1 on page B14

A second theory is based on available equity capital and the cost of equity capital. Equity capital is more relevant than debt capital because insurance regulators accept equity capital for solvency purposes and restrict the use of debt capital (non-subordinated debt). Hence, when stock markets rise above a normal level, there are two capital effects. The first is that the cost of capital falls for existing and for new insurance companies. Second, the rise in share prices increases the value of the financial asset holdings of insurance companies and hence brings about an even greater increase in their capital and reserves. This increase in available capital, and a reduction in the cost of capital, will tend to increase supply and hence impart a downward pressure on insurance prices. Similarly, if stock markets fall and remain depressed, this will tend to cause insurance prices to rise. See Figures 2 (page B14) and 3 (page B15).

A third theory supposes that it is claims experience and not capital markets effects that are most important. This theory holds that insurance pricing tends to underestimate the potential for claims during periods when there are no large individual claims or clusters of claims. However, when a very large claim occurs, insurance prices rise sharply, especially if the large loss also depletes capital or causes insurer insolvencies. Then, if there are no major claims in the ensuing period, insurance prices tend to drift downwards until another large loss occurs. This theory is based on the concept of an 'economic shock' and assumes that the

9 A useful discussion of the underwriting cycle can be found in 'Profitability of the non-Life insurance industry: its back-to-basics time', *Sigma* No. 5, Swiss Re, 2001.

Figure 1: cycle caused by interest rate movements ('cash flow" underwriting)

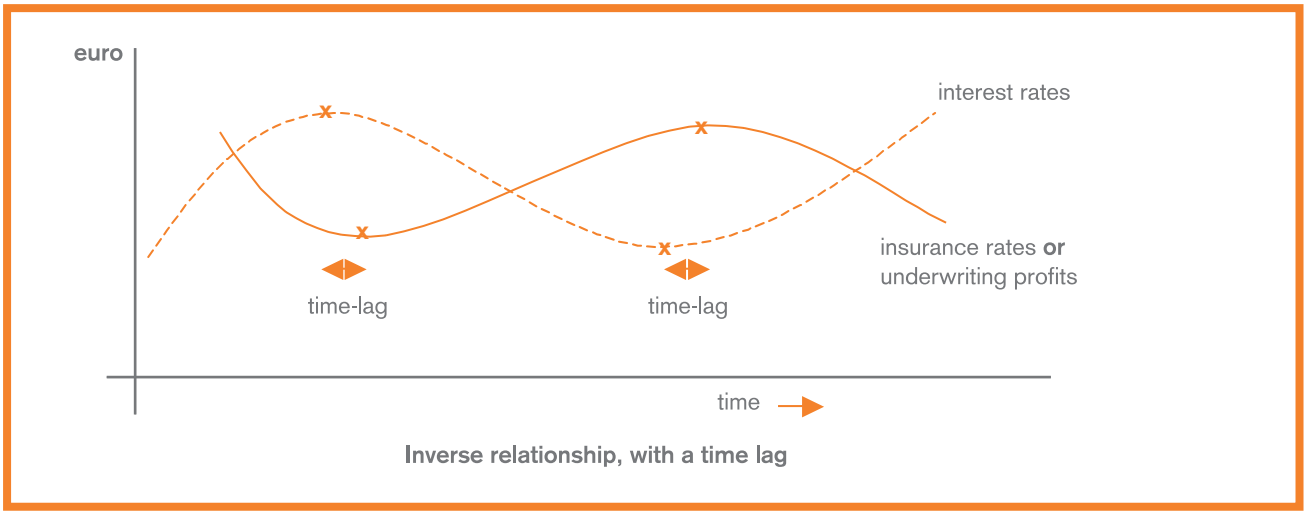


Figure 2: Impact of a rise in investment values on the capital of an Insurance Company

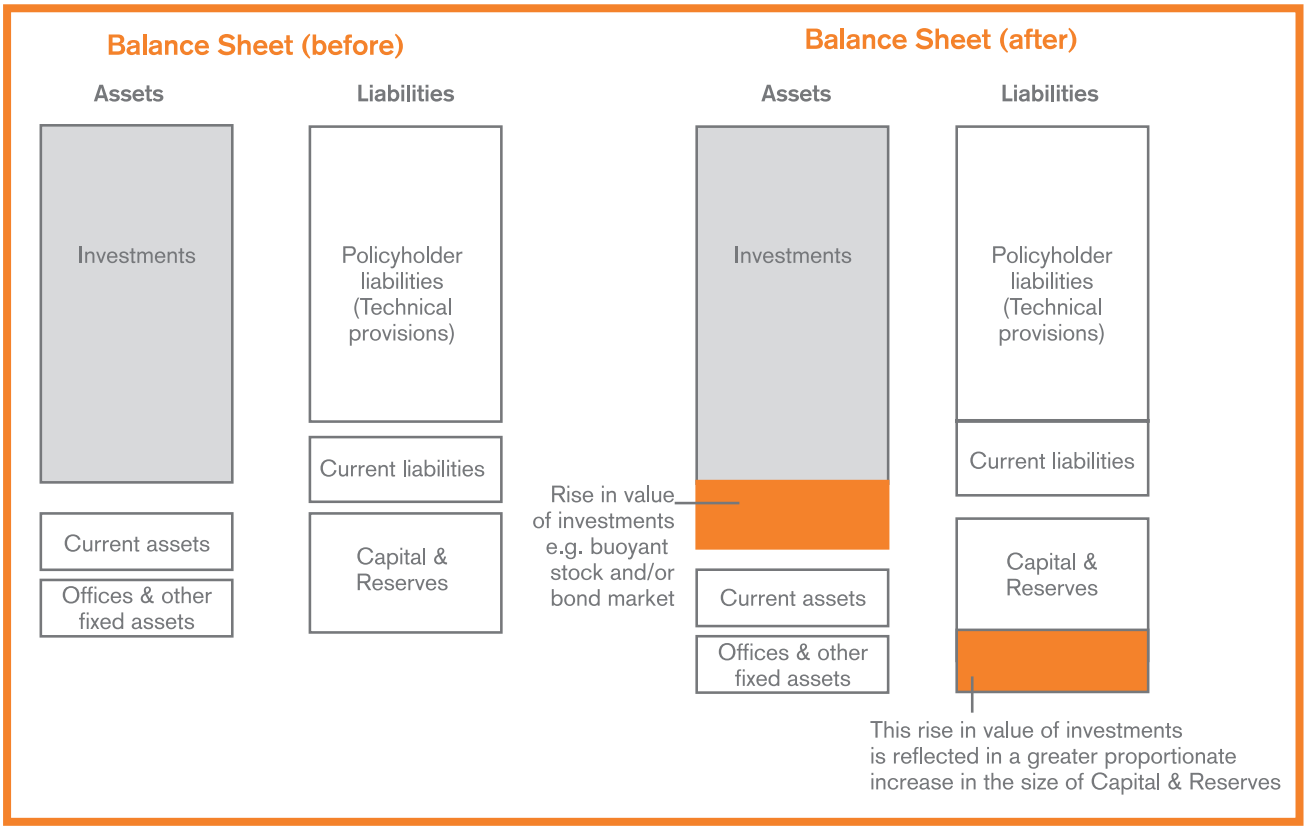
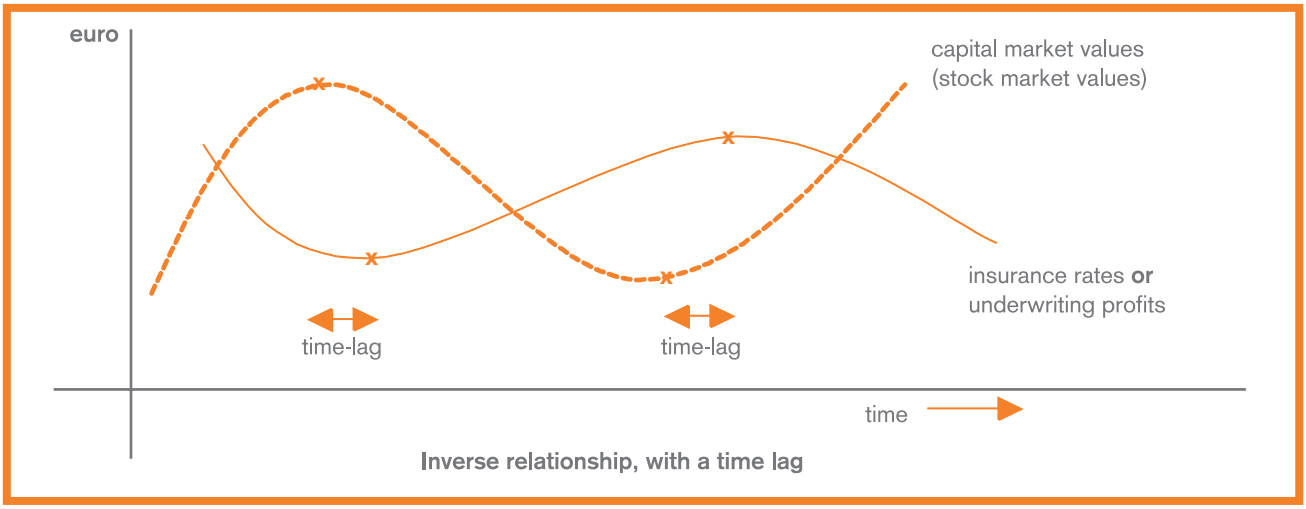


Figure 3: cycle cause by impact of movements in the stock market: (increasing captial & reserves and hence capacity)

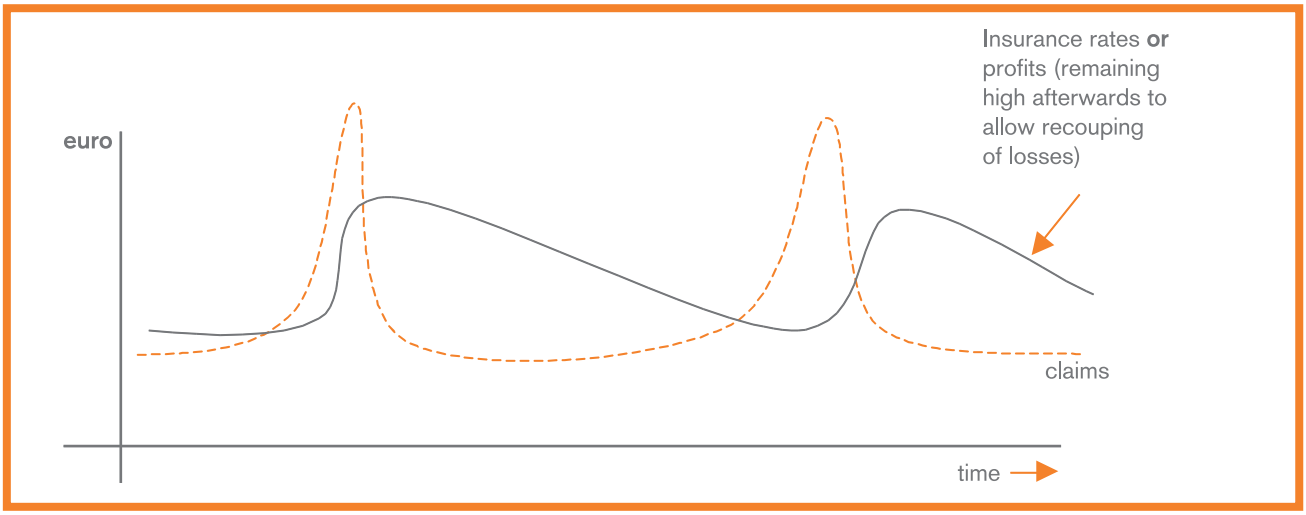


insurance market has a short memory. There is a further behavioural aspect of the 'claims shock' theory. It supposes that after a major loss, insurers will seek to recover some the losses that they have paid out, especially if these payments were well in excess of those anticipated when prices were set. However, after there has been a sharp rise in prices, competitive forces start to cause prices to fall, even though insurers may seek to resist market pressures for lower prices for a period. See Figure 4 below.

Empirical evidence suggests that all these theories apply at the same time but in differing degrees of importance, varying with the type of insurance. However, this evidence is far from conclusive since the data available for analysis is inadequate. Nevertheless, it would appear that cycles in the price of insurance in respect of natural catastrophes are more likely to be caused by the 'claims shock' phenomenon, while less risky types of insurance are more likely to be influenced by capital market effects. There also is evidence that capital market effects have become more important across all classes of business than hitherto, because capital management within insurance companies has become more important and top management are now more sensitive to stock market conditions.

Motor insurance, which is not as risky as some other types of insurance (such as commercial property insurance and marine and aviation insurance) is most likely to be influenced by interest rate and capital market factors. Liability insurance is also likely to be affected by interest and capital market factors. Interest rate effects, in particular, will be especially important in the case of liability insurance. This is so because of the high levels of investment income that liability insurers expect to earn on premiums that are received, which arise from the long time lags between the collection of liability premiums and the settlement of claims. Similarly, since supplying liability insurance ties up the capital of

Figure 4: claims shock theory



insurance companies, in part because insurance companies cannot discount future claim payment at realistic rates, a fall in capital and reserves is likely to reduce supply. The rapid rise in the price of liability insurance in the last three years is consistent with the fall in interest rates and depressed stock market conditions which have obtained during in this period.

Since many insurance companies underwrite a wide range of insurances, there is likely to be 'knock-on' effect across their underwriting portfolios as a whole. The fact that the World Trade Centre disaster occurred at a time of falling interest rates and stock markets has also had a compounding effect on the supply of insurance. Moreover, the events of September 11th are likely to have increased risk aversion among customers and hence increased their willingness to pay higher insurance prices, at least to some degree. However, there is also evidence that higher insurance prices are being resisted to some degree. This is reflected in the decisions of some corporate buyers to retain or self-insure more of their risks. For example, a survey carried out by the world's largest insurance broker, Marsh, showed that European companies had reduced their limits on general and product liability cover by 11% on average in 2003 compared with 2002.[10] There is also clear evidence of resistance to higher insurance prices in Ireland, where the issue has claimed much attention in the media.

1.4 Some theoretical methods for considering prices in insurance markets

In theory, there are two direct ways for determining whether insurance prices are 'high' or 'low'.

One way is to compare actual prices charged with a theoretical 'fair price' for insurance. To calculate 'fair prices' one would need to calculate expected claims costs (modelling both frequency and severity of loss) for a reasonably homogeneous risk class of policyholder, using statistical techniques, such as the linear models that are used in motor insurance. Risk loadings might also have to be added to allow for differences between risk classes in their inherent variability due to random causes. There would also have to be separate analysis of the administrative and marketing costs that are embedded in the insurance premiums, to determine whether these embedded costs are also fair. Unfortunately. there is no available data from public sources that would allow us to calculate these 'fair prices'.

A second way would be to compare insurance prices in Ireland with those in other markets. However, this is not possible either, because no adequate indices of insurance prices in Ireland or other European markets that would allow such a price comparison are available from published sources. In the UK there is only a crude index of motor insurance prices produced by the Automobile Association (AA), and in Ireland there is only the MIAB data. In any event, even if there were such price indices, any comparison of prices, (which should ideally for different groups of consumers), would have to subject to a large number of caveats. In particular, the scope of coverage and policy conditions would often vary greatly from one country to country to another, especially for liability insurances, and claims costs would differ because of judicial conditions and related legal cost structures. This problem – the difficulty of making international comparisons in the field of motor and liability insurance – is considered at greater length in Part 2 of the report.

An alternative approach in attempting to judge whether insurance prices can be considered high or low is to rely on indirect measures. One such measure is to look at the profitability of insurance underwriting. Even though there are problems in using profitability as a measure, and differences in the calculation of profit due to accounting differences (not least in measuring outstanding claims provisions), profitability is at least an observable measure. If profitability is consistency high over time one could perhaps infer that prices are high as a consequence of insufficient competition, because one would expect that high profits would attract new entrants, thereby putting downward pressure on prices. However, low profitability is not absolutely conclusive evidence of a competitive market: it might be evidence of an industry that is inefficient.

There are a number of ways of measuring underwriting profitability, but a simple and commonly used measure is the combined ratio, which is the ratio of claims incurred plus expenses incurred divided by earned premiums, all net of reinsurance. When the combined ratio is 100%, the insurance company is breaking even on its underwriting. If it is over 100% then the insurance company is making an underwriting loss and if less that 100% it is making an underwriting profit. However, this measure makes no allowance for the investment income (returns) on the financial assets purchased with insurance premiums that are held until claims and all expenses are paid. For liability insurance where there is long time lag between receiving premiums and paying claims, such that the accumulated financial assets are large. Therefore some adjustment to allow for investment income effect is needed. This adjustment for investment income will be discussed later. A broader measure of profitability can be achieved by calculating the rate of return on equity capital, which includes all underwriting and investment profits divided by the equity capital supporting the business. If the after-tax rate of return on equity for all companies in the market is consistency higher than the cost of capital (the opportunity cost of capital to the shareholders) then insurance companies could be considered to be earning profits that would not exist in a fully competitive market. However, the available accounting information to calculate the rate of return on equity can only be carried out for all the general insurance business

10 See Marsh (2003) 'Limits of Liability Europe 2003: a Research Report', p. 2.

of insurers and not just for the motor and liability insurance businesses. Hence it cannot be used in relation to these classes of business alone as it would be too crude a measure. It may be possible to use the combined ratio, or similar measure of underwriting performance, and to adjust this for investment income that would be earned on these pre-paid premiums. It may be impossible to tell, ex ante, exactly what investment income will be earned on pre-paid incomes, but failure to allow for investment income would seriously understate profitability (overstate underwriting losses) and hence give a poor indirect measure of competitiveness. This is especially so for liability insurances, in view of their long claim payment patterns.

The advantage of using a simple yet robust measure of profitability, such as the combined ratio is that one can look at its pattern over time and, more importantly, make comparisons with the combined ratios for motor insurance and liability insurances in other overseas market that are of similar structure but which are considered to be competitive. If combined ratios in the Irish market, when suitably adjusted for investment income, are:

(a) significantly less than 100%, and;

(b) consistently lower than those in other countries;

there is a case for arguing that higher than normal profits are being made in the Irish insurance market and that insurance prices have been higher than those of a fully competitive market. We should note that the use of combined ratios is a standard approach that financial analysts use to compare the underwriting profitability of insurance companies, after making adjustments to the accounting data. To get further insights into the sources of underwriting profitability, the combined ratio should be decomposed into the claims ratio and the expense ratio to see if the profitability (lack of profitability) is due to low (high) claims experience or to low (high) expenses; i.e. administration and marketing costs.

In the next part of this report we will focus on liability and motor insurance in particular.

PART 2 LIABILITY AND MOTOR INSURANCE

2.1 Liability and motor insurance: evolution and key features

Liability insurance has its roots in the early nineteenth century. Its growth was encouraged by rapid developments in industry, trade and transport around this time.[11] Hitherto, only three forms of insurance were commonly available. They were marine insurance, life insurance and fire insurance, the regular practice of which, in Europe, dates (approximately) from the fifteenth, sixteenth and seventeenth centuries respectively.

Industrialisation and the growth of the railways created new risks that could lead to accidents, and liability insurance originally formed part of a broad and miscellaneous class known as 'accident insurance'. This name was used to describe any form of insurance that was neither marine, life, nor fire and which covered losses arising from some sudden harmful event, unintended and unexpected by the insured, such as a boiler explosion, or a road or rail accident. These risks were assumed initially by specialist insurers, the 'accident offices'. However, in the first quarter of the twentieth century many of these were bought up by the large fire insurance companies, which then came to be known as 'composite' insurers. The liability (or 'third party') risk referred to compensation claims which victims of accidents might make against insured persons who caused them, as distinct from direct claims which policyholders might make against insurers for damage to their own property or person. Eventually, liability insurance grew into a class in its own right, and at the same time, the term 'accident insurance' fell into disuse.[12]

An alternative term, 'casualty insurance' (which seems to have originated in the United States), originally had a meaning that was roughly equivalent to that of accident insurance. However, it has now come to be associated with liability insurance in particular. Thus, the two main branches of general (non-life) insurance are now 'property' and 'liability' (or 'property' and 'casualty').

At the present time there are three major lines of liability insurance in the Ireland and two minor ones. The major lines are:

1. Employers' Liability ('EL')
2. Public Liability ('PL') – more commonly known as General Liability ('GL') outside the Ireland and the UK
3. Product Liability

Although product liability does not form a specific part of this study, it is included here because the risk is usually combined with public liability insurance in a single insurance policy. Again, premium and claims statistics for public liability almost invariably include product liability premiums and claims.

Employer's liability accounts for approximately 50% of total liability insurance premium income in Ireland and public/products liability for approximately 35%

The minor classes are:

1 Professional Indemnity ('PI')

2 Directors' and Officers' liability ('D&O')

These two classes account for the remaining 15% of Irish liability premium income, professional indemnity being by far the larger of the two classes

There are other categories of liability insurance that are outside the scope of this report. First, there are some rather specialised types of liability insurance, including libel (defamation) insurance, and environmental impairment liability insurance ('EIL'), which are of little relevance to most businesses. Second, there are liability risks associated with the operation of ships and aircraft. These liabilities are insured, often in conjunction with the associated 'property' risks, in specialised marine and aviation insurance markets. Finally, there are contracts that insure the property and activities of private individuals, such as home insurance policies which, amongst other things, cover liability claims made against policyholders in their in private capacities or their capacities as property owners.

The origins of motor insurance can be traced back to the early nineteenth century, when insurance companies were formed in France to cover risks associated with driving accidents involving horse-drawn vehicles. The initial impetus was provided by an ordinance of the Paris *Préfet de Police* on 23 August 1821 which required the cochers of Paris to pay the sum of twenty centimes per day into a central fund, for the compensation of third-party victims of driving accidents. This inspired the formation of a company, *L'Automédon*, which offered, from 1825 onwards, policies covering the third-party liability of horse and carriage drivers. Other insurers quickly offered to cover the same risk.[13] Despite their being aware of developments in France, and increasing congestion of horse-drawn vehicles the big cities, insurers in Ireland and Britain and did not offer similar policies until 1875. Before the turn of the century motor cars began to appear on the roads of Europe and drivers'

11 See generally, Parsons, C. (2002) 'From Accident to Liability: a Brief History of Liability Insurance', *Journal of Insurance Research and Practice*, 17, 2 pp. 23-34.
12 Though the term 'personal accident' is still used to describe policies that cover accidental bodily injury.
13 Including *La Prévoyance*, *La Seine* and *La Parisienne*, all of which issued policies from around 1830. See Richard, P. J. (1956) *Histoire des Institutions D'Assurance en France* p. 68.

policies were adapted to the risks associated with this new form of transport. The first motor policies insured third-party risks only, but it soon became possible to add cover for damage to the vehicle by fire, burglary, theft collision and various other risks. A number of specialist motor insurance companies were established in the early years of the twentieth century, offering cover that was broadly similar to the 'comprehensive' policies of today.

Some key features of the main liability lines and motor insurance are described below.

2.1.1 Employers' liability insurance

As the name suggests, employers' liability insurance (EL) is designed to cover the liability that might devolve upon an employer if an employee is injured in the course of employment. This form of insurance dates from 1880 in Britain and Ireland, although similar insurance was offered in other European countries at an earlier date. Essentially, EL insurance was introduced to cover tort claims against employers, which were normally founded on the negligent behaviour of the latter, or of his servants. However, establishing negligence often proved difficult in the early years. For this reason, towards the end of the nineteenth century many countries (including Ireland and the UK) started to introduce workers' compensation laws that allowed injured employees to claim compensation even when there was no fault or liability on the part of the employer.

In a number of countries (including Germany and most US states) workers' compensation laws eventually replaced employers' liability altogether, and the right of an employee to sue his employer in tort was effectively abolished. In other countries the tort remedy was retained, as an alternative or a supplement to workers' compensation benefits. In Ireland and UK the former approach was adopted, that is, the injured worker could elect either to claim no-fault workers' compensation benefits or sue the employer in tort. This system of election persisted until 1948 in Britain. The Beveridge Report (1942) had recommended that compensation for industrial injuries should be added to existing social insurance schemes (which covered pensions, health and unemployment) as part of a new unified scheme of social insurance. Accordingly, the National Insurance (Industrial Injuries) Act 1946 was enacted, becoming operative on 5 July 1948. From that date the British Workmen's Compensation Acts were abolished. In effect, the liability to pay 'no-fault' compensation under these acts was lifted from the employer and transferred to the state under a system of National Insurance. Some years later this pattern of development was followed in Ireland, when the Irish Workmen's Compensation Acts were repealed[14] and effectively replaced by a system of state benefits set out in the Social Welfare (Occupational Injuries) Regulation 1967.[15]

After the replacement of their workers' compensation laws with social insurance schemes both Ireland and the UK retained the 'alternative remedy' of a tort claim against the employer. This separated them from countries that had chosen 'exclusive remedy' workers' compensations schemes. However, Irish and British practice has since diverged in relation to the accumulation of tort damages and social insurance benefits. Under the British system state benefits paid to injured workers (under the Industrial Injuries Scheme) are now deducted from any tort damages that the worker subsequently secures, whereas Irish law, at least for the time being, allows the injured worker to claim state benefits and tort damages without any deduction or set-off.

What Ireland and the UK have retained in common is the right of injured workers to sue their employers for damages on the basis of ordinary negligence. There are very few countries where injured employees can do this. In most jurisdictions where a tort remedy has been retained claims by employees are, in reality, severely restricted. For example, they are often limited to cases where the employer has been guilty of gross negligence or actual intent to injure.[16] As a consequence of a much more liberal policy in Ireland and the UK, the employers' liability risk, and the insurance that covers it, is more extensive in these territories than in any other country.[17]

There are very few countries in which EL insurance (as opposed to workers' compensation insurance) is compulsory by law. The main exception is the UK, where EL insurance is compulsory for the vast majority of employers, under primary legislation.[18] There have been calls for mandatory EL insurance in Ireland from time to time[19] but there seems little prospect of such legislation being introduced in the very near future.[20]

It is important to note that EL insurance is generally written on what is known as a 'causation basis'. This means, in simple terms, that the insurer which meets a claim is the one that was on risk when the injury or disease was caused, rather than date when the harm became apparent or the claim by the employee was made, both of which may be much later. On the face of it, this arrangement gives good security to employers and employees. Provided that insurance was in place when the injured employee was working, the insurer will always be liable to meet a claim by him, even if it is made many years later and even if the policy has been cancelled in the meantime. However, potential

14 Social Welfare (Occupational Injuries) Act, 1966, Section 40.
15 S.I. No. 77 of 1967.
16 See Parsons, C. (2002) 'Liability Rules, Compensation Systems and Safety at Work in Europe', *Geneva Papers on Risk and Insurance*, 27, 3, pp. 364-369.
17 At the present time, the viability of the employers' liability system is being questioned in the UK. The possible substitution of an alternative model is now under discussion in Government and insurance industry circles. This alternative model might involve greater emphasis on workers' compensation insurance or involve different arrangements for 'accident' and 'disease' claims
18 Employers' Liability (Compulsory Insurance) Act 1969. This legislation came into force on 1 January 1972.
19 See for example *The Report of the Committee of Enquiry into the Insurance Industry of Ireland* ('The O'Donoghue Report'), Department of Industry and Commerce, 1973.
20 See the recent (July 2003) Interim Report on Reforms to the Irish Insurance Market of the Houses of Oireachtas Joint Committee on Enterprise and Small Business, p. 45. The Joint Committee regards compulsory EL insurance and desirable, but not affordable at the present time.

security problems remain; for example, when insurance records have been lost, the insurer is insolvent or doubt exists about the precise time when the injury was caused.[21] Furthermore, this arrangement creates severe pricing problems for insurers, who have to collect premiums that are sufficient to fund 'long-tail' claims, especially for disease, that may still be coming in decades later. The longer the potential time span for claims, the more difficult pricing becomes.

The wording of employers' liability insurance polices is, to a large extent, standardised across the market,[22] although minor differences in detail still exist amongst the wordings used by different insurers.[23]

2.1.2 Public (general) liability insurance

Public liability insurance (PL) is a broad residual class, intended to cover claims that are not met by more specific forms of cover, such as EL, motor or professional indemnity. Claimants are firms or members of the public (i.e. not employees, hence 'public' liability) who suffer bodily injury or damage to their property through the negligent conduct of the insured's business activities.[24] For the vast majority of firms, there is no primary legislation that requires them to buy PL insurance. In practice, however, it is essential for the majority of business, and not just for reasons of general prudence. This is so because the employers and trading partners of many firms often demand that PL insurance must be in place as a condition of doing business with them. This is almost invariably the case with the 'contracting' trades (builders, engineering firms and the like) where the contract under which work is done will usually stipulate that the contractor should have adequate PL insurance.

PL insurance has traditionally been written on an 'occurrence' basis. Under a typical 'occurrence' wording the insurer undertakes to meets a claim if it was on risk at the time when the damage or injury to the claimant happened rather, than the time when the injury was caused, as in the case of EL insurance. This arrangement works well for claims that arise from accidents (i.e. traumatic injuries or sudden property damage) but it is less effective when the claim is for injury, damage or financial loss that occurred gradually. In the latter case there is often a dispute about the precise date of the harm, and doubt about which insurer should meet the claim resulting from it. For this reason, PL insurance and (more frequently) product liability insurance (see below), is sometimes written on a 'claims-made' basis. Claims-made cover is discussed later, in the context of PI and D&O liability insurance.

There is no standard policy wording for PL or Product Liability. 'Core' cover is much the same across the market, but there is considerable variation in the policies offered by different insurers as regards detail. Again, many insurers use special policy forms for certain business sectors (e.g. for builders and other 'contracting' trades). Because, as we have seen, EL policies may also differ somewhat from one insurer to another, it may be prudent for firms to place the EL and PL risk with the same insurer when possible. This will ensure that the two policies dovetail precisely, with no gaps or overlaps.

2.1.3 Product liability insurance

The Irish legislation does not distinguish between public liability insurance and product liability insurance[25] and, as mentioned above, the 'PL' and 'products' risk are often insured together, under the same insurance contract. However, for underwriting purposes insurers regard product liability as a separate line.

This form of insurance covers liability that arises in connection with damage or injury caused dangerous or defective goods that are manufactured, supplied or handled by the insured. It works in much the same way as PL insurance and is traditionally written on an 'occurrence' basis. However, Products insurance is rather more likely to generate long-tail claims, particularly when the product in question (such as drugs or other pharmaceuticals) are capable of causing injury or harm that may take some years to develop. As mentioned above, a 'claims-made' wording may be used in such cases.

Neither in Ireland nor the UK is there any general legislation requiring any business to buy product liability insurance. However, the customers of some firms may demand it as a condition of doing business and, in some industrial sectors (such as pharmaceuticals), the risk is so great that it must be properly financed, with insurance the most obvious option. There are no standard policy wordings and, if anything, product liability insurance is subject to even greater variations than PL.

2.1.4 Other types of liability insurance

Professional indemnity insurance

As the name suggests, professional indemnity insurance (PI) is a form of cover that professional firms secure to cover claims against them for breach of professional duty. It is

21 Considerable problems have arisen in connection with claims for 'indivisible' diseases with a gradual onset, such as asbestos-related conditions. See the decision of the English House of Lords in *Fairchild v. Glenhaven Funeral Services Ltd* (2002) 3 WLR 89 and the more recent High Court decision in *Phillips v. Syndicate 992 Gunner and Ors.* (2003) [EWHC] 1084 (QB).
22 In the UK this is partly as a consequence of regulations that stipulate what the policy must cover and prohibit certain exclusions. There are no such legal restrictions in Ireland.
23 For example, most insurers cover liability for injuries 'caused during the period of insurance', but some use the word 'sustained' in place of the word caused.
24 See the statutory definition of public liability insurance in Section 3 of the Insurance Act 1936.
25 The Insurance Act 1936 mentions only two classes – Employers' Liability insurance and Public Liability insurance.

different in character from the lines of insurance discussed above because the vast majority of claims are purely in respect of financial loss. Claims for bodily injury are rare outside the medical profession and claims for property damage are common only in the case of professional firms that provide services to the manufacturing, construction and engineering sectors.

PI insurance is not mandatory under any primary legislation. However, for most professions PI insurance is in effect compulsory, because it is nearly always a precondition for registration, authorisation or certification by the professional association or regulatory body that governs the profession in question. There are no standard policy wordings across the market for PI insurance. Insurers tend to tailor their policies to the particular needs of each profession, so a solicitor's PI policy may differ somewhat from that of an accountant or surveyor.

The Irish professional indemnity insurance market is estimated to be worth around EUR 30m to 50m in premium income (AXCO 2003).

Directors' and officers' liability insurance

In simple terms, directors' and officers' liability insurance (D&O) covers claims made against company directors and officers (or 'executive managers') who have breached their duty in that capacity, usually through some failing in the proper stewardship of the company. Possible claimants include buyers of securities, existing shareholders, receivers or liquidators, regulatory bodies, employees and other third parties who deal with the company in some way.

D&O insurance is a fairly recent innovation. It was devised by the British broker Minet in the wake of the Wall Street crash, when a number of directors faced legal action by disappointed shareholders and other third parties. Minet thought that this risk might be made the subject of liability insurance and, in the 1930s, some policies were written in the London market to cover American risks. However, even in the USA D&O insurance was relatively uncommon until the late 1960s[26] and in Europe there was little development until ten years later. D&O insurance may be viewed as a British export[27] which the United States has re-exported to Europe and beyond.[28]

Although it is not mandatory, there is a strong case for buying D&O insurance, because firms may find it difficult to attract good people to serve on company boards if directors are given no protection against the threat of personal liability. The likelihood of such a claim may be small, but in the absence of insurance, firms would probably have to pay massively enhanced fees to directors to compensate for even a small risk of uninsured personal liability; so D&O insurance is clearly the cheaper option.

In the UK about 65 per cent of companies with an annual turnover in excess of £100m. already buy D&O, but only about 10 per cent of companies with an annual turnover of less than £5m. do so.[29] However, the Irish D&O insurance market is quite small, and estimated to be worth around EUR 25m in premium income (AXCO 2003).

2.1.5 Liability insurance policy triggers – 'causation', 'occurrence and 'claims made' wordings

The policy 'trigger' is a key element in liability insurance. In simple terms, it is the thing that is required to happen in the period of insurance if the liability insurer is to respond to a claim. We noted above that employers' liability insurance policies normally have a 'causation' trigger – i.e. the insurers are liable to indemnify the insured only in respect of claims for injuries that were caused when they were on risk. We also noted that public liability insurance usually has an 'occurrence' trigger – i.e. it is the damage or injury suffered by the claimant (rather than its cause) that must happen in the period of insurance.

Professional indemnity and directors' and officers' liability insurances use a different form of trigger. Most PI and D&O claims are for financial loss rather than injury or property damage, and financial loss resulting from the negligent provision of professional advice or services, or the negligence of directors, often accumulates gradually. Furthermore, there is often a considerable time delay between the negligent conduct and the loss that flows from it. Largely for this reason, both PI insurance and D&O insurance are normally written on a 'claims-made' basis. Under this arrangement the insurer that meets a claim is the one on risk at the date of that claim. Usually, it is the claim for compensation which the third party advances against the professional firm that 'triggers' coverage, rather than the claim by the insured for protection under their insurance policy.

Under a claims-made policy, in its purest form, insurers effectively go on risk for only one year at a time (assuming that the policy is an annual one). Cover continues only if the policy is renewed. This arrangement is advantageous to insurers, because it allows them to re-price the risk at each renewal – there is no possibility of having to pay claims under policies issued at the wrong price many years ago.

26 It has been suggested that only two D&O policies were sold in the USA in 1962, with the number rising to 50 in 1966. However, a 1967 survey of 753 US corporations showing that nearly 20% carried D&O insurance (see Bishop Jr., J. W. 'Sitting Ducks and Decoy Ducks: New Trends in the Indemnification of Corporate Directors and Officers' (1968) *Yale Law Journal* p. 1078, note 1).

27 London was the only real market for D&O until the 1970s.

28 However, a more distinctly 'European' form of D&O insurance has also developed from the separate class of legal expenses insurance, written for managers, and PI insurance, which often covered the activities of lawyers and others as members of corporate boards of European companies. 'Common Law' wordings from the USA or UK have influenced these local contracts to varying degrees, making European D&O insurance something of a hybrid.

29 From a 1997 survey by UAP Executive Partners. Not surprisingly, the tendency to buy D&O cover generally increases with the size of the company, as does both the size and frequency of D&O claims. An earlier (1991) survey by the Wyatt company suggested that 74% of British companies with a turnover in excess of £100m. hold D&O insurance, but only 6% of companies with a turnover less than £5m. do so. About a third of respondents in the Wyatt survey said they would change their decision not to buy insurance if a regime of joint and several liability was introduced for directors and 24% said they would do so if the burden of proof were reversed.

Because, in effect, claims are met by the current insurer, claims-made cover also has some advantages for buyers of insurance: the policy will be an up-to-date one, cover limits should be adequate and the risk of the insurer becoming insolvent is likely to be small. However, there is a key disadvantage to buyers of 'claims-made' insurance: that is the possibility that the insurers will 'walk away from the risk' – refuse to renew or agree to do so only on terms that are very disadvantageous to the insured. This might happen, for example, if claims experience starts to deteriorate rapidly. Owing to this difficulty, claims-made policies have sometimes been declared illegal in jurisdictions in Continental Europe.[30] In practice the problem is alleviated by the use of clauses that protect the insured from any sudden withdrawal of cover.[31]

As mentioned earlier, a claims-made wording is sometimes used for PL or products insurance in cases where there is a perceived risk of long-tail claims (as in the case of pharmaceutical firms).

At the present time there is some debate in the UK about the possible application of claims-made wordings to employers' liability insurance. Interest in the subject has been generated by the current severe problems of the UK EL market and, in particular, the problems that insurers have experienced in pricing long-tail disease risks. The use of a claims-made trigger would make pricing easier and, it is argued, thereby make the EL risk more attractive to insurers, leading to a more competitive market. However, a number of technical and legal problems would need to be overcome before claims-made EL insurance could be introduced,[32] and other alternatives, including entirely different mechanisms for compensating victims of occupational disease,[33] are also being considered.

2.1.6 Motor insurance

As explained earlier, existing forms of cover were quickly adapted to cover mechanically-propelled vehicles within a few years of the latter appearing on the roads and, quite soon after, 'comprehensive' type policies, similar to those of today, were made available.

Motor vehicles first began to appear in large numbers on the road in Europe after the First World War, where motor transport had proved a reliable means of moving goods and people. The war had stimulated new technical developments in motor engineering that ultimately made cars cheaper and more easily available. Hire-purchase contracts were used increasingly and enabled those of limited means to buy. Inevitably, the number of road accidents increased as consequence of the greater density of traffic and since, in many cases, vehicle owners had no means to pay damages to their accident victims compulsory insurance laws were introduced progressively across Europe and, eventually, worldwide.

The use of motor vehicles as a prime means of moving people and goods within Europe (and beyond), together with what were perceived to be inadequate coverage limits in some European states, eventually led to demands for a degree of international uniformity where motor insurance is concerned. Accordingly, the law on motor insurance has been strengthened and harmonised by a series of EC Directives, which have been incorporated in the law of the Member States and that of some non-EU countries. The general effect of the Directives is to bring about acceptable minimum levels of third-party coverage throughout the EU, both in terms of the amount of cover provided under motor policies and the breadth and geographical scope of coverage.

As a consequence of the massive expansion in the use of motor vehicles over the last 100 years, and the introduction of compulsory insurance laws, motor insurance has become a particularly important class of business for insurers world-wide. The market for motor insurance is very substantial, accounting for about 35-40% of world general insurance premiums. The biggest motor market is the USA, with about 44% of world premiums. Other large markets include Japan (about 20%), Germany (about 7%), France, Italy and the UK (about 4%). The Irish market, at around Euro 2 bn., is around one-tenth of the size of the UK market and roughly equivalent in size to the Danish, Swedish and Portuguese markets.

2.2 Forms of policy and policy design

Generally, insurance cover is provided under three basic forms of policy:

1. an individual policy providing only one form of cover (e.g. employers' liability or public liability);
2. a combined policy which includes a range of liability, property and other risks within a single contract, but with a separate section for each form of cover (sometimes described as a 'traders' combined' insurance;
3. a 'package' policy.

Under a combined policy (2.) the insured is allowed to select the covers that he needs from the range that is offered. He

30 Including Belgium and Spain and France. The issue has been resolved in a reasonably satisfactory way in the former two countries but there are continuing difficulties in France. The root of the problem is the tendency of the French judiciary to modify and reinterpret liability insurance contracts, which began in 1990 when the *Cour de Cassation* demanded the substitution of an 'occurrence' trigger in the interpretation of a claims-made policy.

31 First, insurers always agree to indemnify policyholders, not only in respect of claims made against them during the period of insurance, but also for claims arising from incidents, events or occurrences notified in the period of insurance which *subsequently* give rise to a claim, even if the policy has been cancelled by the time the claim actually arrives. Second, insurers normally give the insured an 'extended reporting period' (ERP) of up to a year combined with the right to buy cover for a longer period (perhaps up to six years) at an agreed price if the policy is cancelled. However, these extensions operate only for claims arising from events which took place when the insurers were originally on risk: there is no cover for claims arising from any wrongful act after cancellation.

32 For example, it would be necessary to introduce a guarantee fund for EL risks along the lines of the European motor insurance bureaux, or some similar security arrangement for late-reported claims against employers whose insurance had lapsed. For a full discussion of the issues see Parsons, C. (1999) *Industrial injuries and employers' liability – a search for the cure* Chartered Insurance Institute, London.

33 For example, the transfer of occupational disease risks to a state fund – as in Belgium and Portugal.

may choose, say, only six forms of cover from ten that are available, in which case four sections of the policy will not apply. The insured is usually allowed to tailor the sections of the policy that do apply to his own needs, choosing sums insured (for property and financial risks) and limits of indemnity (for liability risks) that are appropriate to his business. By contrast, a package policy (3) is an 'off the peg' product where there is little flexibility. There is no facility to pick some covers and reject others, and little opportunity to tailor the cover to the insured's individual needs. Motor insurance policies almost invariably take this form.

Large enterprises tend to arrange individual policies for their liability exposures, perhaps using different insurers for different lines. SMEs are more likely to buy combined policies. Apart from the motor market, package policies are issued only for small firms in business sectors where risks do not vary much one from another and where insurance needs are fairly simple, e.g. small shops, offices, restaurants and public houses. They are not suitable for manufacturing or contracting businesses.

As one would expect, package and combined policies are designed largely by insurers, and based on their perceptions of market needs. The same is true of many individual liability policies. However, for large enterprises and specialised risks cover is often tailored to the client's specific needs. In this case an insurance broker may play a major role in negotiating the precise terms of the cover or even propose its own wording for the whole contract. Similarly, policy wordings for 'scheme' business are often tailor-made, with considerable input from brokers and the other parties involved in organising the programme.

2.3 How motor and liability insurance is bought and sold

2.3.1 Who are the buyers?

Buyers of motor and liability insurance include:

1. private individuals;
2. government (including local government) agencies and other public bodies;
3. commercial firms and businesses.

Private individuals play a very significant role in the Irish motor market. There are approximately 1.3 million cars in Ireland (78.9% of the total of all vehicles – which corresponds to the EU average) and approximately 30,000 motor cycles (1.7%).[34] The remaining 300,000 vehicles (19.4%) are commercial vehicles owned and run by business concerns and state organisations. By contrast, the main buyers of public and product liability insurance are those detailed in 2. and 3., i.e. government organisations and business firms. Apart from third party motor, the only form of liability insurance of any significance bought by private individuals is the cover provided under home insurance policies for accidents arising in connection with the ownership and occupation of domestic property or other non-business activity (sometimes called 'personal liability' cover).

For obvious reasons, most individuals and organisations buy the motor insurance that is required by law. Although it is not mandatory, most organisations secure employers' liability and public liability insurance, for the reasons given earlier.

2.3.2 How do buyers choose how much cover to buy?

Motor policies are generally 'package' insurances with fixed cover limits. Similarly, small businesses often by package policies to cover all the risks associated with their business with fixed cover limits for EL and PL. However, larger firms are more likely to secure tailor-made contracts which allow them to choose how much cover to buy for their liability (and other) risks.

In fact, the size of an organisation, whether public or purely commercial, is the most significant factor in determining how much liability cover it secures and the way in which the cover is structured. Large organisations almost invariably secure higher limits of indemnity. This is simply a reflection of the scale of their activities and of their potential for causing harm to others when such activities are conducted negligently. Conversely, large firms have a greater capacity for absorbing loss than small organisations and are likely to self-insure to a greater extent, taking bigger deductibles on their cover and, in some cases, establishing 'captive' insurers to fund some or all of their risks, as discussed In Part 1.

2.3.3 How do buyers access the insurance market?

In insurance markets that are monopolistic or dominated by a very small number of insurers insurance products tend to be distributed through company sales forces and/or networks of tied agents. This is also be the case in markets where there are standardised insurance products and strict price 'tariffs', even though there may be a rather more insurance companies. However, in markets where there is little or no price control, brokers and other intermediaries tend to be more prominent, since they can help buyers in their search for the best deal amongst a wide variety of products and prices.

Traditionally, in such markets, motor insurance has been distributed through a network of small 'high street' intermediaries, especially brokers. In recent years, however,

34 Istituto per la Ricerca e lo Svilluppo delle Assicurazione (IRSA) (2001) *European motor third party liability market and trends.*

there has been an increasing tendency on the part of insurers to market motor and other 'personal lines' directly to the public, allowing the latter to arrange cover by telephone or via the internet. The rise of these 'direct writers' has already been noted.[35] Quite frequently, insurers use two or more distribution channels for the same line of insurance, e.g. selling through brokers and also via a direct writing 'arm'.

A few buyers of EL and PL insurance arrange their cover directly with an insurer, often as part of a 'package' policy (see below). However, the vast majority of buyers of commercial liability insurance access the market via an intermediary of some sort. The intermediary may be a professional insurance broker that has access to a large number of insurers or an insurance 'agent' that is effectively tied to one or a small number of insurance carriers.

2.3.3.1 Insurance brokers

The insurance broking sector includes:

- major international companies, including two firms that are very much larger than any of the rest (the Marsh and AON groups);
- national firms that operate throughout the country;
- small local brokers that draw most of their business from their own immediate area.

Some brokers aim to achieve a broad portfolio of clients and readily arrange all forms of insurance for them. Other brokers target clients in a particular sector (e.g. construction firms, SMEs, schools and colleges) or specialise in placing a particular form of insurance (e.g. professional indemnity).

2.3.3.2 'Agents' and other intermediaries

An agent in law is simply one who acts for another. However, in insurance the term is often reserved for the individuals or firms whose main occupation is in another field. For example, estate agents, law firms, accountants, garage proprietors, banks and building societies may be appointed as insurance agents: their clients may require insurance cover and these intermediaries are in a good position to arrange it. Insurance agents range in size from sole traders to very large firms (e.g. the retail banks).

2.3.4 Remuneration of intermediaries

Insurance intermediaries are traditionally rewarded by means of commission payable by the insurer, based on a percentage of the premium paid. Rates of commission may depend on the size and status of the intermediary, the benefit of the services that it provides to the insurer and the attractiveness to the latter of the business that the broker brings in. Thus, a large insurance broking firm that produces a substantial volume of business and takes on much of an insurer's administrative work may be able to command higher rates of commission than a small insurance agent that simply introduces clients in relatively small numbers. Similarly 'unattractive' business, such as employers' liability, is likely to generate less commission than lines of insurance that are more profitable for insurers.

Some insurance brokers enter into fee-based arrangements with their larger clients. These are schemes whereby the broker returns to the client the commission that the broker would otherwise earn on that client's insurance business in exchange for a negotiated (and normally lower) fee. The fee is based on the extent and value of the services that the broker provides for his client. It is reviewed periodically, sometimes annually.

2.3.5 What factors determine the choice of intermediary?

Once again, there is a strong link between the size of the firm that buys insurance and the way in which it gains access to the insurance market. Small firms with relatively simple insurance needs are more likely to use an agent or a small local broker or, in some cases, to buy their insurance directly. Large firms with complex insurance needs are more likely to use the services of one of the major international insurance brokers or large national firms. For reasons that are obvious, firms with very specialised insurance needs, including those in high risk sectors, are more likely to use specialist intermediaries.

In some cases two or even three intermediaries may be involved in an insurance transaction. For example, a major insurance broking firm may channel business to the insurance market that has been fed to it by 'producing' brokers. The latter are likely to be small, non-specialist or overseas brokers that need the services of the 'placing' broker to access the market for them. This sort of arrangement is common in the Lloyd's and London insurance markets.

Other bodies may play a part in arranging insurance. For example, special schemes are often set up for groups of firms in a particular (often specialist) trade sector or profession or for other 'affinity' groups such as consortia of schools and colleges. The scheme may be run through a trade or professional association, a local authority, trade union or other body. Typically, the design of the insurance cover and the placing of the business in the insurance

35 See Section 1.2.7.

Estimation of the current division of insurance business by distribution channel

Distribution Channel	Commercial insurance	Motor and other private insurance
Broker and other agents	95%	40%
Direct writers	0%	50%
Of which Internet	0%	5%
Banks and financial institutions	0%	10%
Direct handling	5%	0%
Total	**100%**	**100%**

Source: AXCO (2003)

market is effected by an insurance broker or other specialist insurance firm. Often the risk is placed not with a single insurance carrier but with a panel of insurers, each of which agrees to underwrite a certain percentage of each risk that comes under the scheme. The insurers on the panel may be insurance companies, Lloyd's syndicates or both. The composition of the panel may well fluctuate from year to year, with insurers that withdraw or reduce their line (percentage) being replaced by others.

2.3.6 Distribution channels in Ireland

Ireland is a traditional 'broker market' for both life and non-life business, but there have been some changes in the last few years, with direct writers gaining prominence for motor and other personal lines.

The current division of insurance business by distribution channel has been estimated as follows in the table above:

2.3.6.1 Direct marketing in Ireland

Major 'direct writers' in Ireland include Axa PMPA, which has operated on a direct basis for many years via its branch network. Axa Direct is the associated telesales operation. Celtic (later Friends First) operated on a direct basis until it was sold to Hibernian in 2000. Other new companies include First Call Direct Home and Motor Insurance (owned by Allianz) and Quinn Direct.

2.3.6.2 Insurance brokers in Ireland

The Professional Insurance Brokers' Association (PIBA), with around 700 members, and the Irish Brokers' Association (IBA), with approximately 600 members represent insurance brokers in Ireland. Regulation of insurance brokers has grown in recent years with increased compliance obligations under the Investment Intermediaries Act 1995 and the Insurance Act 2000. However, there was little government regulation of the sector until 1 April 2001,[36] when the Central Bank assumed responsibility for supervision of brokers. The function has since shifted to a new single regulator for financial services, the IFSRA. Recent research, based on questionnaires distributed to 250 Irish brokers nationwide, suggests that tighter regulation has resulted in increased costs for brokers, and that increased compliance costs are having the greatest impact on small and medium-sized intermediaries.[37]

According to AXCO (2003) the major non-life brokers in Ireland are:

Aon

Coyle Hamilton

Marsh

Willis

FBD (whose broking arm is prominent in agriculture and food processing).

As in the UK, consolidation among international brokers has been reflected on a local level in Ireland. Aon in particular has achieved a very powerful position.[38] The larger brokers, such as Aon and Coyle Hamilton, have their own schemes but act as 'wholesalers', opening these schemes to sub-brokers around the company.[39] Some brokers have 'binders' at Lloyd's.

36 Although the Investment Intermediaries Act 1995 required insurance intermediaries transacting investment business to give 'best advice'.
37 Robbins, G and Donnelly, M. 'Increasing state regulation and the Irish investment and insurance intermediary' *Forthcoming in Journal of Insurance Research and Practice*, January 2004.
38 AXCO (2003) p. 41.
39 AXCO (2003) p. 40.

2.3.6.3 Commission rates

According to AXCO (2003), commission rates for Ireland are estimated to be as follows:

Class	Commission rates
Fire and allied classes	15% - 17.5%
Household	15%
Motor	5%
Personal accident	20%
Contractors All Risks	20%
Employers' liability	6%
General liability	10% - 15%
Marine Cargo	20%
Marine Hull	15%

The Irish Insurance Federation reported the following actual commission ratios (commission paid to intermediaries as a percentage of written premium) for its members in 2001.[40]

Class	Commission rates
Motor	3.5%
Liability	7.2%
Property	14.5%
Personal accident and travel	19.3%
Other classes	26.4%
All classes	7.8%
General liability	10% - 15%
Marine Cargo	20%
Marine Hull	15%

More detailed commission rates for motor and liability insurance for the period 1990 – 2001, based on The Insurance Annual Reports, are provided in Section 3.5.

2.4 How are motor and liability insurance premiums set?

At one time many insurance offices subscribed to 'tariff' agreements which required them to employ a common pricing structure to various lines of insurance and to make use of standard policy wordings. These agreements applied to some liability lines, including employers' liability. As a consequence of the strengthening of competition law at national and European level the tariffs have disappeared.[41]

At the same time, there is no government control of liability insurance pricing: European law requires that insurance companies should be free to write liability insurance on any terms they like provided they have the funds to set up the necessary actuarial reserves against their liabilities to protect shareholders and satisfy solvency regulations.

2.4.1 Rating methods

In practice, insurers employ two main methods for setting premiums rates: group (or class) rating and experience rating.

2.4.1.1 Group (or class) rating

Group rating is the classic method, and is used for the majority of liability insurance risks. Because the probability of loss varies form one risk to another, insurers seek to divide the total pool of risks into a number of sub-groups, placing risks with similar characteristics in the same group and charging similar rates of premium. In a competitive insurance market, an insurer that does not segregate the risk pool in this way and fails to charge accurate differential premiums is likely to suffer adverse selection. It will tend to lose (overpriced) 'good' risks to its competitors and collect insufficient premium to cover losses on the (underpriced) 'bad' business that it will inevitably tend to retain. In fact, it may not be possible to identify high-risk policyholders in advance, in which case premium loadings and/or restrictive policy terms may be applied as a corrective after claims(s) have occurred (see 'experience rating', below.

To some extent, there is a tension between the need for accurate risk discrimination and the basic risk-spreading and loss-sharing principles of insurance. For example, precise risk discrimination may lead to insurance being unaffordable or even unobtainable for some very high risks. As a result, insurers may be accused of 'red-lining' – denying cover to vulnerable people such as those with homes and businesses in socially deprived areas where crime and vandalism is rife. Unfortunately, the unavailability of insurance may contribute to the further decline of the area. Accurate pricing is also necessary to reduce moral hazard.[42]

The factors that are most likely to influence annual claims cost are used to distinguish one group from another. These are known as rating (or underwriting) factors. For example, in the case of motor insurance multiple rating factors are used. These include the type of vehicle that is insured, the use to

40 Irish Insurance Federation (2001) Factfile 2001, p. 17.
41 The last in the UK, the fire insurance tariff, ended in 1985.
42 Moral hazard is a problem that affects insurance generally: it is the risk that, by giving insurance cover, the insurer will bring about a change in human behaviour which makes the adverse and economically undesirable insured event more likely to happen. For example, insured persons may become less careful or even cause losses deliberately in order to get the insurance money. To discourage this, insurers generally seek to restrict cover to losses which are 'fortuitous' (accidental) and restrict payments to an indemnity only – i.e. exact compensation for the loss and no more. However, this is not always simple. For example, the dividing line between losses caused by mere carelessness (which insurers must be prepared to cover) and losses caused deliberately (which are uninsurable) is difficult to draw. Again, there is a commercial need for cover that gives more than a full indemnity, e.g. 'new for old' cover on personal possessions. Moral hazard can be reduced by a number of standard techniques. These include the exposing of the insured to part of the risk by means of deductibles or coinsurance, the use of policy conditions to restrict coverage for high risk insureds, either in advance of losses occurring or as a consequence of claims experience, and the levying of variable premiums according to risk. In this way the incentive for taking care is provided by the insurer, rather than by the threat of suffering a loss, a risk which is now (mainly) transferred to the insurer. Of course, the absence of complete information about the risk, and the cost of control, means that insurers cannot hope to influence the insured's behaviour fully and decisively.

which it is put, the area of the country in which it is used, the age of the main user, and so forth. For employers' liability and public liability insurance the main rating factor is the trade or business of the insured but, of course, various other factors are used in each case. The basic rate of premium for a given group or class of risk is based, at least in theory, on the average claims frequency for risks in that group and the present value of average claim size for such risks.

2.4.1.2 Experience rating

In its purest form experience rating is the pricing of a risk on the basis of the proposer's own past claims experience, or rating a risk on its own merits. Where a single insurance contract effectively covers a large number of individual risks past claims experience can give a statistical base that is wide enough to predict future loss patterns with reasonable accuracy. For example, experience rating can be used successfully for motor fleet risks (where there is a large number of vehicles under one ownership) and non-proportional reinsurance risks (e.g. excess of loss treaties).

Experience rating can also be used for large liability risks. For example, if a firm has a large number of employees accident statistics and claims experience for the last few years should, on the face of it, provide a reasonably reliable guide to future claims experience, allowing the employers' liability risk to be experience rated.

2.4.1.3 The combining of 'group' and 'experience' rating

In practice, insurers often use a combination of group and experience rating, rather than just one or the other. The familiar no-claims discount (NCD) system, used by virtually all motor insurers, provides a good example. Here ex post experience rating is used to modify a premium that is initially set by the group (class) method discussed above. Policyholders that do not claim enjoy a discount on the 'book' premium, the discount accumulating to a maximum that is retained as long as the policyholder's record remains claims-free.

In much the same way, liability insurers often modify the 'book' rate that they would otherwise apply to medium-sized and large risks in the light of the proposer's own claims experience and any other relevant factors peculiar to the client, applying a loading or discount as appropriate. Effectively, pricing then becomes a process of classification ('what general class does this risk fall into?) and discrimination (is it a good risk of its type or a bad one?).

Experience rating, to whatever degree it is used, is without question the most efficient method for insurers, the fairest for policyholders and the most beneficial in controlling moral hazard. Unfortunately its use is subject to a number of limiting factors. In particular, experience rating cannot be used effectively in the case of small risks, because claims data for such risks often has little statistical significance and, in any event, the small premiums involved do not justify the expense of dealing with them on an individual basis. Furthermore, other steps that insurers might take to discriminate between small risks are often be ruled out on the basis of expense. For example, it may not be cost-efficient to carry out a detailed survey (physical inspection) of small risks, because the cost of the survey is likely to absorb much of the premium.

A further key difficulty lies in the fact that experience rating may be impractical even for large liability risks if such risks are of the type that generate long-tail claims. This point is developed later.

2.4.2 General determinants of the price of insurance

The price of insurance will obviously depend on the cost of meeting expected claims for the risk based, in the case of class rating, on the average claims frequency and present value of average claim size for risks in that group, together the cost of handling those claims. This will give the 'risk premium'. However, the final cost of the insurance will depend on a number of additional factors. These will include:

- the level of deductible (excess) taken by individual policyholders;
- the cost effects of reinsurance that is purchased by insurers;
- loadings applied by insurers for contingencies (uncertain future events or trends);
- expenses (e.g. in respect of commission, renewal costs, claims handling costs and general overheads);
- investment income generated by the funds that insurers hold and hence interest rates and equity values;
- the cost of capital.

It will be apparent from our earlier discussions on insurance cycles that market forces and market behaviour may also exert a powerful effect on the price of insurance.

2.4.3 The use of actuarial techniques in pricing motor and liability insurance (including GLM techniques)

The techniques that are used to analyse data will depend on the level of detail and reliability of the data available, and also the extent to which the data are a good predictor for the

future. In the case of liability insurance the data is usually rather limited in scope, but in motor insurance, there are often large amounts of data at a very fine level of detail. These can be used to construct premium rates based entirely on previous data, which can then be compared with the rates in use. The results have to be treated with caution, since they are based on one (or possibly a few) years' experience, but they can give indications of issues to be considered. For example, it is possible to detect which areas of the business are profitable and which are loss making. Companies can also seek to exploit niche markets where they are able to make profits and steer away from markets where they make losses. It should be noted that, while price is extremely important, it is not the only consideration for the consumer. Other factors include the service that is provided to customers after a claim, the convenience of using a particular insurer, and so on.

Motor claim types (e.g. third party property damage, third party bodily injury, theft, windscreen, own damage, etc) are modelled separately. This is known as 'component pricing'. The reasons for modelling these separately are that different factors may affect each, and the factors may affect each in different ways. Thus, it is expected that more accurate modelling can be achieved in this way.

For each claim type, separate models are formed for the claim frequency and severity, using past data, to determine the effect of various factors. The expected values for frequency and severity are multiplied together to get an expected claim cost for each claim type (per unit of exposure). These are then added over claim types and adjustments are made to allow for expenses, contingencies, etc. Finally, if a simple structure is required, it is common to fit an appropriate model to these to recover the structure of the premiums. This gives a complete set of prices based on past experience, which can be used in conjunction with the present rating structure, market knowledge, information on claim trends, and so on, to make decisions about premiums to be charged in future. This summarises the process, and more details are given below.

It is assumes that data is available at the individual policy level at a sufficient level of detail. In the past this may not have been available, but it has become standard practice to record policy records at a great level of detail, so that statistical investigations of the data have become possible. The recorded information should include characteristics of both the policyholder and the risk being insured. These include the age of driver, No Claims Discount (NCD) level, occupation, claims record, vehicle rating group, location, use, etc. The vehicle rating group is a grouping of car types, whereby small family cars will be in a low group, and large, high-performance or expensive cars will be in a high group. The intention with this, and indeed all the recorded information, is to use it to predict the number of claims that will occur per annum, per policy, and also the size of each claim. The data on the policies that the company has written over a specific period is one part of the information needed for this analysis. This gives information on the exposure to risk that the company has faced: roughly, how many policies there were of each level of the grouping factors. It is from these that the claims will emerge, and it is necessary to know the exposure in order to quantify the risk. Ten claims arising from one hundred policies is a much higher risk than ten claims arising from one thousand policies. Thus, the insurer needs information on the number of policies as well as the number of claims.

It is also assumed that the insurer has corresponding data on claims which links a claim record with a policy. This means that the insurer can associate the risk factors with each claim, and match them up with the exposure data. Claims are classified by type of claim: bodily injury, windscreen, etc. These are analysed separately. Let us consider one claim type in more detail: call this claim type i . The data available are the exposure in vehicle years or earned premium, number of claims and claims cost. Both are cross-classified by the risk/rating factors. At this point, some further explanation is needed of rating factors. It is assumed that the risk associated with each policy varies according to risk factors. These may not be directly measurable: for example, an obvious risk factor may be how good a driver is, or how willing the driver is to take risks. As these are difficult, or impossible to measure, some proxies which are easily measurable are needed, which are called 'rating (or underwriting) factors'. For example, the age of the driver is important as a measure of the risk factor of how good, or risk averse, the driver is. The aim is to find rating factors that are good predictors of the risk, and it is likely that companies will continually search for refinements to try to do this more accurately.

An example of some data, looking at claim frequency rather than claim severity, is given below. This is a small extract from a data set. Among the information shown is the year of account, and it is sometimes the aim to examine trends in claim rates or claim sizes over time. Then come the rating factors: policyholder age, marital status, NCD in years, ABI group (for the vehicle), policyholder sex. Following that is given the total exposure, which has been calculated in policy years (after taking into account new policies, withdrawals, policy alterations and so on), and finally the number of claims (here for accidental damage). Sometimes claims are recorded even though they do not eventually result in a payment, and these need to be excluded: hence the wording 'non-nil AD claims'.

Year	Policy holder Age	Marital Status	NCD years	ABI group	Policy holder sex	Total exposure	Total of non-nil AD claims
1997	22	S	4	6	M	199	1
1997	22	S	5	9	F	144	1
1997	25	M	6	9	M	23	1
1997	27	S	3	6	M	292	1
1997	30	S	1	12	M	258	1
1997	37	S	3	6	M	152	1
1997	45	M	0	3	M	66	1
1998	22	S	1	13	M	177	1
1998	22	S	5	9	F	221	1
1998	24	S	0	4	M	163	1
1998	25	M	6	9	M	315	1
1998	25	S	7	14	F	153	1
1998	26	S	2	6	M	192	1
1998	27	S	3	6	M	73	1
1998	28	S	0	7	M	648	3
1998	30	M	3	5	M	245	1
1998	30	S	1	12	M	107	1
1998	34	M	7	9	M	40	1
1998	45	M	0	3	M	299	1

Once this data has been set up, a model can be formulated. For frequency, a Poisson distribution is used, with the exposure affecting the mean number of claims in each category. Thus, the number of claims for a particular category (eg 1997, age 26, married, NCD 4, ABI group 3, female) has a Poisson distribution with mean:

Exposure x Claim frequency per policy per annum

The aim of the exercise is to find a reliable estimate of the claim frequency per policy per annum for each category. A modelling exercise is then followed to examine the effect of each of the rating factors. This explores whether the claim frequency differs by policyholder sex, age, NCD, and so on. If it does, then these effects have to be quantified, and this gives an estimate of the claim frequency per annum, for this claim type.

Next the average claim size has to be investigated in a similar way. The total cost of claims in each category is calculated from the database. This is divided by the number of claims in each category to give an average claim size. These average claim sizes, cross-classified by the rating factors is modelled using a gamma distribution, and the effects of all rating factors is explored. A final model is decided upon, which gives the estimated average claim size for this type of claim in each category.

The estimates of claim frequency and claim severity from these models can then be combined, to obtain the expected claim payment per policy per annum in each category, often known as the 'risk premium'. This is for one claim type, and the process has to be repeated for each claim type. Typically, it is found that different factors are used for each claim type, and in the frequency and severity models.

These risk premium, by claim type, can then be summed as appropriate to obtain the total risk premium:

$$\text{Total Risk Premium} = \sum_{\text{claim types}} \text{fitted frequency x fitted severity}$$

These figures will capture the relative risks of each category, known as the 'relativities'. It is usual to apply adjustments, to allow for changes in the risks over time and to project into the future, to allow for possible distortions in the reserves, and so on. In addition, as mentioned earlier, allowance has to be made for expenses (per policy and per claim), investment income, commission, profit loading and so on.

The relativities are usually multiplied by a 'base premium', which is a single figure and does not vary by the rating categories. The effect of this is to shift all the premiums up or down, and this can be done at any time.

While it is the case that most claim types can be analysed in this way, it is sometimes found that the risk cannot be quantified at such a fine level of detail. This may be due to lack of data, or simply because the risk does not vary by any significant amount. Typically, this would apply to larger claim sizes for third party bodily injury. One way forward in this situation is to cap all such claims at a reasonable amount for data analysis purposes, and work with the capped claims rather than the actual claims. An adjustment would need to be made such that all risk premiums are increased by the expected excess of the actual claims over the capped claims. This would be done as a constant loading irrespective of the rating factors.

The final figures from the data modelling exercise can be compared with the present rating structure, and used in a competitor analysis, to make decisions on new rates, to find markets where the company can sell profitable policies at a cheaper rate than their competitors (niche marketing), and so on.

An analysis is this type is common practice across the motor market in Ireland.

2.4.4. Problems in pricing liability business

It is fair to say that the rating and underwriting of liability insurance is generally more problematic than that of other lines. As we have seen, some forms of liability insurance (including employers' liability) are characterised by a 'long tail' of claims, which extends many years beyond the periods of insurance where the claims have their origin. The potentially long delay between underwriting a risk or group of risks and settling the last claims that arise from the years of insurance in question creates considerable uncertainty as regards the final cost of such claims and the level of premium that is necessary to cover them. The uncertain effects of inflation, investment yields and potential increases in the size of court awards over long time periods are likely to make pricing inherently difficult. Furthermore, the longer the time span of the whole insurance transaction, the greater is the risk that changes in legislation, scientific knowledge or accident victims' general propensity to claim will make claims greater in amount or more frequent than was anticipated. It is well known, for example, that a failure to predict accurately the level of future claims for asbestos related illness[43] and environmental damage has caused the collapse of many insurers in the United States this century[44] and contributed significantly to the problems of the Lloyd's insurance market in recent years.

It is also worth noting that problems of moral hazard are particularly complex and acute in the case of liability insurance, adding further to the problems of accurate pricing.[45]

Finally, we should emphasise a key difficulty suggested above – the fact that experience rating may be impractical even for large liability risks if such risks are of the type that generate long-tail claims. The point here is that when there are long time delays in the development and reporting of claims the current loss experience may reflect, not the present state of the risk, but rather the state of the risk thirty or forty years ago.[46] This problem is particularly acute in respect of employers' liability risks that generate a high proportion of claims for latent or gradually-developing diseases.

2.5 The Irish motor and liability market – analysis and international comparisons

In the sections that follow we provide a more detailed analysis of the Irish insurance market. We also to seek make some comparisons between the insurance systems in Ireland for liability and motor risks and those elsewhere, with a particular focus on other European systems. However, it should be stated at the outset that there are a number of inherent difficulties in comparing the Irish market for motor and liability insurance with other markets. Comparison can be difficult for a number of reasons, including the following:

- the general system of compensation of which motor or liability insurance forms a part may be fundamentally different from the Irish system – e.g. it may a predominantly social insurance system rather than a private insurance system;
- the underlying law (e.g. in respect of tort liability) may be fundamentally different
- levels of damages may vary considerably;
- the risk profile that is insured may be fundamentally different (e.g. in terms of accident or disease or, in relation to motor insurance, types of vehicle, traffic density and road conditions);
- insurance coverages may be structured differently;
- there may be different systems for collating premium and claims statistics.

The most severe difficulties are found in the field of employers' liability. This is examined first.

2.6 Employers' liability insurance

In this section we discuss the general role of employers' liability insurance in delivering compensation to people who are injured in the workplace, and compare the Irish system for delivering workplace compensation with other European systems. We begin by looking at the incidence of occupational accidents and diseases in Ireland and Europe as a whole.

43 There have been around 265,000 asbestos-related deaths in the USA. Despite the fact that the use of use of asbestos in Western Europe had more or less ceased by the 1970s, it is anticipated that asbestos-related claims will not peak until the year 2020.
44 106 American insurers became insolvent between 1988 and 1990, asbestos-related and pollution claims being a major source of failure.
45 See Parsons, C. (2003) 'Moral hazard in liability insurance' *The Geneva Papers on Risk and Insurance* (July) and 'Moral hazard and behavioural aspects of insurance: some new dimensions, Nottingham University Insurance Economists Conference paper, April 2002.
46 See Parsons, C. (1999)'Industrial injuries and employers' liability – a search for the cure' *Chartered Insurance Institute*.

2.6.1 The incidence of occupational accidents in Europe

We have suggested already that comparisons between insurance markets in different countries must take into account differences in the risk profile of the countries concerned, especially when apparent differences in the price of insurance are being considered. The risk of injury at work, like the risk of injury on the road (discussed later), is certainly not uniform across Europe. Countries differ in terms of their industrial make-up and speed of development, so the proportion of workers in heavy and hazardous occupations will obviously vary. Even within the same industrial sector, workers in one country are likely to encounter hazards that differ from those faced by their European neighbours. Thus, for example, the risks faced by coal miners will vary from one country to another according to the type of coal extracted, the method of mining used, the mineral formation and depth of the mines, and presence of hazards such as water and fire-damp. Again, the risks faced by workers in the construction industry will vary internationally according to the materials and methods of construction traditionally used, the typical height of buildings, climatic conditions and the like. Furthermore, despite an increasing harmonisation of legal safety standards in Europe, the extent and effectiveness of safety regulations and the general safety 'culture' continues to vary from one country to another.

There are various other determinants of industrial injuries besides the nature of the industry where a worker is engaged and the particular occupation that he or she follows within it. For example, research suggests that injury rates move pro-cyclically over the economic cycle and are subject to marked seasonal variations. Positive relationships have also been established between injury rates and levels of educational attainment within the workforce, average age of those in employment, length of hours worked, size of the firm or unit where work is done, levels of temporary or 'atypical' employment, systems of payment and reward, and the degree of influence of labour unions within the firm.[47]

As a consequence of all this, it is not surprising to find quite marked differences in injury rates across Europe, both in overall terms and within particular industrial sectors. However, it is quite difficult to draw accurate comparisons between European countries, for a number of technical reasons. These include:

- differences in the criteria used to define industrial accidents and diseases;
- gaps and deficiencies in national statistics;
- differences in methods of reporting injuries and collecting data;
- differences in the level of under-reporting of accidents.

The last three points are linked. In some countries the main source of statistics is claims made through insurance and social security systems,[48] whereas in others (including Ireland) they are a by-product of reports made by employers and others, usually to national labour inspectorates.[49] Levels of under-claiming are quite low in insurance and social security systems, so statistics drawn from this source will usually be almost complete. By contrast, reporting levels are much lower in countries where declarations are made to labour inspectorates. For example, a 1996 study suggested that reporting rates in Ireland might be as low as 36%. It was estimated the average reporting level in the UK at 47%, varying from 21% in the finance and business sector to 95% in extraction and utility supply. In Denmark the average reporting level was estimated at 56%.[50] More recent EUROSTAT figures suggest a reporting rate of 48% for Ireland,[51] 41% for the UK, 46% for Denmark and, lowest of all, 32% for Greece.[52] We must therefore be careful not to confuse a rise in the level of reporting with a rise in the level of accidents. For example, publicity surrounding the introduction of a new regulatory mechanism may increase the level of accident declarations as employers become more aware of their reporting obligations. However, in terms of the impact of the regulations on work injury rates, real improvements in safety may be hidden by this rise in the propensity to report.[53] For reasons that are obvious, levels of under-reporting are likely to be low in the case of fatal accidents, whatever system is used.

The latest EUROSTAT figures attempt to deal with some of these potential distortions by 'standardising' incidence rates, which means adjusting them to take into account assumed differences in national levels of under-reporting. The incidence rates are also adjusted to take into account the fact that in some countries high risk branches of industry, such as agriculture and construction, represent a higher share of the total workforce. This is done by giving each branch the same weight at national level.

EUROSTAT figures published in 1996 suggested that injury rates in Ireland are amongst the lowest in Europe and are broadly similar to those of the UK. However, fatality rates appeared to be much higher than the UK and much closer to the European average. See Table 2.

47 Davies, R. and Elias, P. (2000) 'An analysis of temporal and national variations in reported workplace injury rates' *UK Health and Safety Executive*.
48 E.g. Belgium, Germany, Greece, Spain, France, Italy, Luxembourg, Portugal and Finland.
49 E.g. Denmark, UK and Sweden.
50 Dupré, D. (2001) 'Accidents at work in the EU in 1996' *EUROSTAT*.
51 The Irish Congress of Trade Unions (ICTU) maintains that, since Occupational Injury Benefits are no longer higher than ordinary Disability Benefit rates, there has been under-reporting of minor accidents, since no extra money results from the inconvenience of filling in additional forms.
52 EUROSTAT (2002), 'European social statistics: accidents at work and work-related health problems'.
53 See Davies, R. and Elias, P. (2000) note 47. In some UK sectors reporting levels are rising quickly; e.g., in the finance and business sector, from 7% in 1989/90 to 21% in 1997/98.

Table 2: Rates of fatal and of over 3 day injuries in Europe and the USA.

Country	Fatality rate ‰	Over 3 day injury rate %	Persons covered
Finland	0.017	3.4	employees
UK	0.019	1.6	workers
Sweden	0.021	1.2	workers
Netherlands	0.027	4.3	employees
USA	0.027	3.0	workers
Denmark	0.030	2.7	workers
Ireland	**0.033**	**1.5**	**workers**
Germany	0.035	5.1	workers
EU Average	**0.036**	**4.2**	
France	0.036	5.0	workers
Greece	0.037	3.8	workers
Italy	0.041	4.2	workers
Austria	0.054	3.6	employees
Belgium	0.055	5.1	employees
Spain	0.059	6.7	employees
Portugal	0.096	6.9	employees
Luxembourg	-	4.7	workers

Source: EUROSTAT 'Accidents at work in the EU in 1996 – Statistics in FOCUS, Theme 3 – 4/2000' (except for Netherlands and USA – source UK Health and Safety Executive)

The latest EUROSTAT figures, giving 'standardised' incidence rates for injuries resulting in more than three days' absence paint a broadly similar picture. See Table 3.

Table 3: standardised incidence rate of accidents at work by Member State and year, more than 3 days' absence, 9 NACE branches (*)

	1994	1995	1996	1997	1998	1999
EU 15	**4.539**	**4.266**	**4.229**	**4.106**	**4.089**	**4.088**
EU 12	:	:	4.966	4.826	4.801	4.764
Belgium	4.415	5.616	5.059	4.933	5.112	4.924
Denmark	2.653	2.621	2.704	3.217	3.203	3.031
Germany	5.583	5.249	5.098	5.021	4.958	4.908
Greece	3.702	3.468	3.783	3.309	2.936	2.740
Spain	6.166	6.547	6.7366	6.402	7.073	7.027
France	5.5i5	5.123	4.964	4.992	4.920	4.991
Ireland	**0.852**	**0.889**	**1.494**	**1.654**	**1.433**	**1.291**
Italy	4.641	4.193	4.179	4.089	4.105	4.067
Luxembourg	4.508	4.640	4.741	4.627	4.719	4.973
Netherlands	4.287	4.236	4.251	4.168	3.909	4.223
Austria	5.259	5.451	3.554	3.501	3.321	3.301
Portugal	7.361	7.363	6.949	5.523	5.505	5.048
Finland	3.914	3.628	3.372	3.374	3.435	3.137
Sweden	1.123	1.012	1.217	1.074	1.329	1.425
UK	1.915	1.806	1.550	1.535	1.512	1.606
Norway	:	4.605	4.352	3.933	4.866	4.421

Source: EUROSTAT (2002)

(*) NACE branches: Agriculture, Manufacturing, Utilities supply, Construction, Wholesale and retail repairs, Hotels and restaurants, Transport/communications, Financial intermediation, Real estate business activities

These figures suggest a steady downward trend in accident rates in most European countries. In Ireland, an upward trend in injuries appears to have been reversed from 1997 onwards.

In contrast to accidental injury rates, fatal accident rates in Ireland appear to have been higher than the European average in most years for which figures are available. This is shown in Table 4.

Table 4: standardised incidence rate of fatal accidents at work by Member State and year, excluding road traffic accidents and accidents on board any means of transport in the course of work, 9 NACE branches

	1996	1997	1998	1999
EU 15	**0.036**	**0.034**	**0.034**	**0.029**
EU 12	0.041	0.038	0.040	0.033
Belgium	0.055	0.031	0.031	0.033
Denmark	0.030	0.023	0.031	0.022
Germany	0.035	0.027	0.030	0.024
Greece	0.037	0.028	0.037	0.063
Spain	0.059	0.063	0.055	0.050
France	0.036	0.041	0.040	0.0434
Ireland	**0.033**	**0.071**	**0.059**	**0.070**
Italy	0.041	0.042	0.050	0.034
Luxembourg	.	.	.	.
Netherlands	:	30	:	23
Austria	0.060	0.053	0.051	0.051
Portugal	0.098	0.083	0.077	0.061
Finland	0.017	0.028	0.024	0.018
Sweden	0.021	0.022	0.013	0.011
UK	0.019	0.016	0.016	0.014
Norway	:	0.014	0.043	0.024

(*) NACE branches: Agriculture, Manufacturing, Utilities supply, Construction, Wholesale and retail repairs, Hotels and restaurants, Transport/communications, Financial intermediation, Real estate business activities

Source: EUROSTAT (2002)

Again, Ireland does not appear to be following the trend of falling work accident fatalities enjoyed by most other European states. However, we should expect quite large variations in the incidence rates for work fatalities in Ireland from year to year as the number of such accidents is low in absolute terms. See Table 5, which gives work accident fatality numbers for Ireland, Great Britain and Europe as a whole.

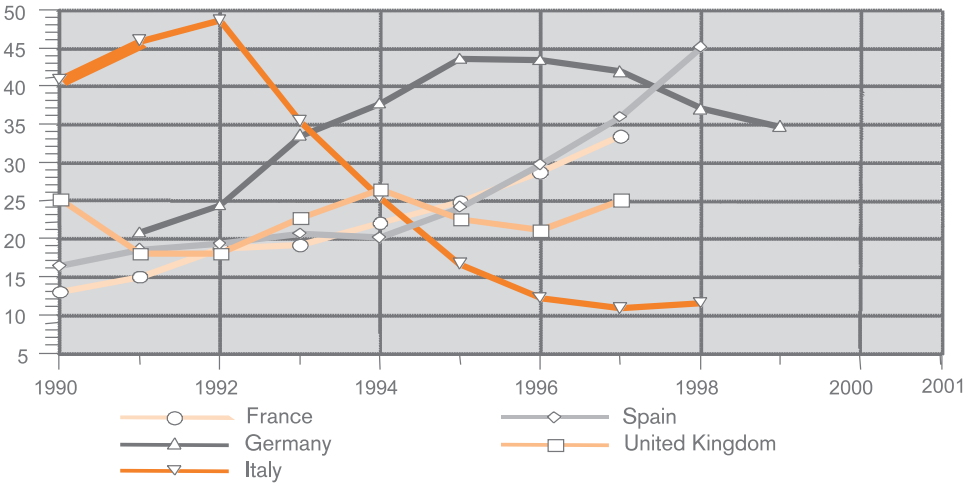
Table 5: number of fatal accidents at work in Europe, Ireland and Great Britain by year, excluding road traffic accidents and accidents on board any means of transport in the course of work, 9 NACE branches

	1994	1995	1996	1997	1998	1999	Employment (*) 1999
EU 15	3471	3092	3027	2898	3043	2645	99,269,000
Ireland	**44**	**44**	**17**	**33**	**33**	**44**	**924,000**
UK (GB only	224	197	235	215	212	182	18,596,000

* Persons in employment covered by the date on fatal accidents

Source: EUROSTAT (2002)

Occupational diseases incidence per 100,000



Source: Munich Re. (2002) (derived from European Health for All Database)

2.6.2 The incidence of occupational disease in Europe

Comparison of occupational disease rates in different European countries is particularly problematic. Again, there are different national practices for the monitoring, reporting and recording of occupational illness. Furthermore, each country works with its own list of 'prescribed' diseases. Since like is not always being compared with like, comparative studies sometimes produce startling variations. For example, a 1990 OECD study[54] recorded rates of reported disease ranging from 1 case in 100 in Sweden to 1 case in 1000 in France. Obviously, there cannot be such a huge difference in the relative health of these two countries' labour forces. Distortions also arise as a result of the long latency period for many diseases.[55] Thus, the relative position of different European countries in the OECD report in respect of their mortality from occupational disease may mainly reflect the extent to which each participated in coal mining 20 or 30 years ago, and not the conditions that prevailed when the figures were gathered. However, whilst it seemed that rates of *reported* occupational disease were rising in most European countries covered by the OECD study rates of *compensated* occupational disease did not show a similar rise, subject to some exceptions.[56] A possible explanation, offered by the OECD, is that whilst there is a greater propensity amongst European Citizens to file claims, medical assessments of occupational disease have remained relatively rigid. More recent figures, collated by Munich Re. show a general rise in the incidence of occupational disease in most of the large European countries.

No figures in respect of occupational disease in Ireland were found by the authors, but this subject would certainly merit further study.

Finally, it may be worth noting that a study by the European Foundation[57] of the workplace environment in Europe concluded that most of the northern European countries surveyed (represented by Belgium, Denmark, West Germany, Luxembourg, Netherlands and the UK) enjoyed a better physical work environment than southern European countries (represented by Greece, Spain and Portugal). Ireland fell in a third group of countries (along with France, Italy, the old East Germany) which did not fit easily into either group, their working environments having both good and bad features.

2.6.3 Classification of work injury compensation systems

As we shall see, it is quite difficult to make meaningful comparisons between the Irish employers' liability market and that of any other country except, perhaps, the UK. This is so because no two countries in Europe (or elsewhere for that matter) have precisely the same system for compensating the victims of industrial injuries.

In fact, comparing work injury compensation systems is not easy in itself, because these systems are subject to a large number of variables. However, the following characteristics provide a reasonable basis for comparison:

1 the degree of integration – i.e. the extent to which the arrangements for work injuries are integrated with those for compensating other injuries;

54 OECD, *Employment outlook July 1990*, Paris, 1990.
55 See *Occupational ill-health in Britain*, Loss Prevention Council Report SHE 10 (1993) where the OECD report is summarised.
56 The UK being one such exception. In the UK occupational illness claims under the state Industrial Injuries Scheme, after falling steadily for many years, rose quite sharply from the mid-1980s, largely as a result of an expansion in the list of prescribed diseases, changes in the rules of entitlement for occupational deafness claimants and, especially, the addition of Raynaud's Phenomenon (Vibration White Finger or 'VWF') in 1985. The number of disease claims submitted to private employers' liability insurers in the UK also increased (by around 50%) between 1986 and 1993, accounting for 56.6% of all claims in 1993. The level of disease claims dropped to 41.3% in 1995 and has dropped further since, to 34% in 2000, but the contribution of disease claims to total employers' liability claims cost remains steady at around 25%. Source: ABI Statistics Bulletin, December 1996, Greenstreet Burman *Workplace compensation: costs, trends and options for change* (2002).
57 Paoli, P., First European survey on the work environment 1991-1992, European Foundation for the Improvement of Living and Working Conditions, (EF/92/11/EN) 1992.

2 the relationship within each system between (a) tort compensation ('employers' liability') and (b) non-tort compensation ('workers' compensation');

3 the nature of the insurance arrangements (if any) for both (a) and (b);

4 the distinctions (if any) which each system makes between accidents and diseases or between some diseases and others.

Each of these things is considered in turn.

2.6.3.1 Total, partial, or non-integration?

In many countries, including a number in Europe, some, if not all, compensation for work injuries is provided through a state social insurance scheme.[58] In some cases industrial injury compensation is a separate component, but in others integration is almost total, in the sense that the system makes little distinction between work accidents and other sorts of injury. The key example of this approach is found in New Zealand, where the state accident compensation scheme does not distinguish between different sources of injury, except as regards compensation for disease, which is limited to occupational illnesses. At the same time, an employee's right to sue his or her employer in tort has been abolished in New Zealand. As a result, concepts such as 'employers' liability' and 'workers' compensation' have become almost redundant, because the injured employee has hardly any special rights.[59]

No European country has gone this far. The nearest equivalent is the Netherlands, where the social insurance programme provides, amongst other things, the same compensation for injuries and diseases regardless of whether they are job-related or not. On the other hand, claimants in the Netherlands, unlike those in New Zealand, are not barred from suing their employers in tort and can obtain extra compensation in this way, although such actions have been fairly infrequent, at least in the past. To this extent the Netherlands' compensation system retains an 'employers' liability' element, albeit a fairly small one.

All countries surveyed by the authors, other than those mentioned above, have compensation systems that make some distinction between occupational and non-occupational injuries. Generally, people who suffer industrial injuries tend to be given better rights to compensation than those who are injured in other circumstances. The extent of this 'industrial preference' (or 'industrial premium') has been reduced in many countries but it is still a distinct feature of many accident compensation systems even though it is hard to justify.[60]

We will now consider the methods by which special compensation for work injuries can be delivered and, in particular, the relationship between tort compensation for industrial injuries and non-tort compensation.

2.6.3.2 Employers' liability and workers' compensation systems

'Employers' liability' and 'workers' compensation' are not very precise terms. However, they are useful shorthand expressions to describe two basic methods of delivering industrial injuries' compensation, which can operate either exclusively or in combination. They are defined below.

Workers' compensation

Workers' compensation models vary a great deal, but they have two key characteristics. First, they provide compensation on a no-fault basis. The claimant is not required to prove negligence or breach of a legal duty on the part of the employer, and fault on his of her own part is usually irrelevant except, perhaps, in the case of wilful misconduct or self-inflicted injuries. Second, workers' compensation systems rarely, if ever, provide 'full' compensation for injuries. They aim only to provide reasonable redress for economic losses. Non-economic losses (such as pain and suffering) are rarely compensated, although exceptions are found in the workers' compensation systems of Switzerland and Sweden.[61] Compensation takes the form of benefits that are fixed or defined according to a simple formula. Core benefits typically include the cost of medical care and rehabilitation, replacement of lost earnings (usually limited to around 70% of income and often subject to a maximum figure) plus funeral costs and benefits for surviving dependants in fatal cases (e.g. 30-40% of the deceased's previous earnings for a surviving spouse in Germany).

Employers' liability

Employers' liability models, or tort-based systems, are schemes where the injured employee must establish legal responsibility on the part of the employer if he or she is to secure compensation. The obligation to pay compensation then falls on the latter although, of course, the risk may be transferred to a liability insurer. In most cases tort law requires the employee to prove negligence or fault. However, in some cases the burden of proof is reversed, and in other cases liability may be strict. In contrast to workers' compensation models, tort-based systems purport to provide full compensation. The successful claimant is entitled to redress for all losses, both economic and non-economic. This may include, amongst other things, full replacement of lost income, medical costs, and

58 France, Germany, Italy and Spain have work injury compensation schemes that are largely public/monopolistic. Ireland, UK, Denmark, Finland, Norway, Portugal and Belgium have schemes that are largely private/competitive.
59 Except in respect of occupational disease.
60 See see Parsons, C. (1999) Industrial injuries and employers' liability – a search for the cure Chartered Insurance Institute, London.
61 Swiss workers' compensation insurance includes 'integrity compensation' and the Swedish law on workers' compensation allows an element of compensation for non-economic loss.

compensation for non-economic losses such as pain, suffering and loss of amenities (loss of faculty).

2.6.3.3 The relationship between employers' liability and workers' compensation.

Since employers' liability and workers' compensation systems can operate exclusively or in combination, three types of regime are possible:

(a) a regime where tort-based employers' liability is the exclusive remedy for industrial injuries;

(b) a regime where workers' compensation is the exclusive remedy for industrial injuries;

(c) a regime which combines employers' liability and workers' compensation.

As we shall see, (a) is unknown in Europe, (b) is quite common and (c) is the most common of all. Each is considered in turn.

Tort-based employers' liability as an exclusive remedy

In theory, a state might decide that its injured workers should receive no compensation of any sort in the absence of fault or breach of a legal duty on the part of the employer. This would imply the absence of 'no-fault' benefits for injured employees and, taking the model to its extreme, no social insurance benefits at all, either general or specific. In fact, no European country has gone nearly this far. All have retained some form of workers' compensation scheme[62] and, indeed, there is hardly a county in the world where no such programme exists.[63]

Workers' compensation as an exclusive remedy

Employers' liability systems, which rely upon tort remedies, are often criticised for their inefficiency, with high transaction costs and slow claim settlements. Furthermore, the adversarial character of tort-based compensation systems makes them potentially damaging to industrial relations. For these reasons many countries, including a number in Europe, have abolished the employee's right to sue in tort, allowing only a claim for defined workers' compensation benefits.[64]For the worker, the loss of tort rights against the employer and of 'full' tort compensation is balanced by the right to no-fault benefits that are easier to claim. Of course, when workers' compensation is substituted for the tort remedy in this way the position of the injured employee may appear anomalous, compared with that of other accident victims. A number of countries have therefore extended the 'no-fault/limited compensation' principle to other groups, such as road accident victims. As we have seen, the ultimate result may be a fully-integrated no-fault accident compensation scheme such as that of New Zealand.[65]

Within Europe, Germany provides a prime example of what is virtually[66] a pure workers' compensation system. Introduced in 1884, the German scheme was the first workers' compensation programme of any nation. It has been imitated worldwide. Other European nations in this category are France, Austria and Switzerland. Outside Europe we find similar systems in most US states.

Although worker' compensation systems abolish or heavily restrict tort claims against employers, it does not follow that injured workers lose all their rights to bring a tort action. On the contrary, rights against persons other than the employer are often preserved, giving the injured employee alternative targets for legal action. These may include architects, builders or engineers responsible for the design, construction or layout of the workplace, safety consultants and, perhaps, directors of the injured employee's firm. However, the most obvious targets are manufacturers or suppliers of defective machinery or equipment used at work and suppliers of hazardous substances used in the workplace. This phenomenon – the displacement or transformation of work injury claims into product liability claims – is clearly evident in the US and is one of the reasons for the extraordinary prominence of the product liability risk in the North America.[67] The incentive for legal arbitrage of this sort is a weakness of exclusive remedy workers' compensation systems.

Regimes that combine employers' liability and workers' compensation

In many European countries compensation for industrial injuries is provided partly through an employers' liability system and partly through a workers' compensation scheme. The balance between these two sources of compensation

62 Other than those countries, mentioned earlier, where integration is total and the system does not in any case distinguish between employment accidents and other sorts of injury.
63 In a handful of underdeveloped countries workers' compensation exists as the *only* social insurance benefit.
64 Although Williams (1991) reported that workers' compensation was an exclusive remedy in only 30% of the countries surveyed many of the large industrialised nations were found in this 30%, including the USA and Germany. (*Williams Jr., C.A., An International Comparison of Workers' compensation* (1991)).
65 Although their benefits are undifferentiated, integrated compensation schemes normally employ risk-rating in an attempt to reduce moral hazard and preserve proper incentives.
66 In fact, even in Germany the tort remedy has not quite disappeared. For example, employers can be sued by their employees in respect of intentional injuries.
67 Research suggest that about 14% of product liability claims in the US arise from workplace injuries: see Moore, M. J. and Viscusi, W. Kip (1990) Compensation Mechanisms for Job Risks Princeton University Press, Chapter 10. The trend is particularly strong with regard to occupational disease, where modest benefits and short limitation periods made workers' compensation remedies particularly unsatisfactory in the US. Thus, victims of occupational asbestos-related diseases, debarred from suing their employers in tort, have increasingly sought to sue manufacturers and suppliers of asbestos products. Machinery manufacturers are another common target and there have been increasing instances of class actions being taken against computer manufacturers for repetitive strain injuries (RSI). Munich Re. suggest that claims by soldiers for dioxin poisoning from 'Agent Orange', the second largest series of product liability claims after asbestos, may also be regarded as work-related. They note that 'The principle of shifting liability like a political hot potato is characteristic of US liability law. US employers have long since passed on this hot potato and attempts to return it to them have failed. The losers are the manufacturers.' Munich Re. *Employers' Liability* (1995) pp. 27-28.

varies considerably, but in most European countries employers' liability is of marginal importance only, the contribution of tort claims against the employer to the totality of industrial injuries' compensation being very small. There are a number of reasons why, in an apparently 'mixed' system, employers' liability may be relatively insignificant:

- workers' compensation benefits may be so generous that few people consider a tort claim worthwhile.[68]
- tort claims against employers may be limited to cases where there is more than 'ordinary' negligence – for example, proof of intent or gross negligence may be necessary.[69]
- tort claims by employees may be restricted to particular types of accident.[70]
- claims against employers may be limited to recoveries by workers' compensation insurers – direct claims by employees being barred or severely restricted.[71]
- employees may be entitled to extra compensation under industrial agreements with their employers.[72]

Ireland and the UK are exceptional in that none of the above restrictions apply, with the result that employers' liability has become highly developed. Thus, if we were to rank European countries according to the degree of penetration of employers' liability within the industrial injuries compensation system we would find Ireland (together with the UK) at the far end of the scale. At the other extreme would be Germany, Austria and France, where employers' liability is of little or no importance. In between we would find countries where workers' compensation is the main source of compensation, but employers' liability plays a rather more significant role, such as Italy and Spain.

Unfortunately, it would be virtually impossible to locate most European countries accurately on the scale because, apart from exceptions such as Ireland and the UK, separate figures for employers' liability claim payments are rarely available. This is because employers' liability is rarely a separate line of insurance business in Europe and claims are often included in the figures for general (public) liability.

2.6.3.4 Insurance arrangements for employers' liability and workers' compensation

Employers' liability insurance

As suggested above, and because it is often of marginal importance only, employers' liability insurance is rarely written as a separate line of insurance business in Europe. In most European countries the risk, where it exists at all, is insured under public (general) liability policies, either tacitly or expressly. Separate employers' liability policies are found in only a few European countries, such as the Ireland, the UK and Cyprus. The UK is one of very few European countries where employers' liability insurance is compulsory for virtually all employees by law.[73] Carriers of the employers' liability risk are invariably private rather than state insurers. In Europe employers' liability insurance is never combined with workers' compensation insurance, although the practice is common enough elsewhere.[74]

Workers' compensation insurance

Arrangements for workers' compensation insurance vary quite widely in Europe. Insurance can be voluntary or compulsory, although the latter is much more common. In some cases it is provided by the state as part of a fully integrated social insurance scheme, as in the Netherlands.[75] Alternatively, it may be distinct component of a social insurance programme, such as the Irish Occupational Injuries Benefits Scheme and the UK Industrial Injuries Scheme or the workers' compensation programme that forms part of the French national social security system (Sécurité Sociale). Alternatively, it can be provided by recognised private insurers, as in the case of the 'accident' element of the Belgian and Portuguese schemes, which are discussed in the next section. Between the two extremes of state and private provision there is a variety of public and semi-public risk carriers. Examples include INAIL, the statutory public agency, mentioned above, which provides workers' compensation cover in Italy and the German Industrial Injuries Insurance Institutes – non-profit and largely autonomous corporations offering cover for member employers in particular industrial sectors (e.g. mining, gas and water, food, hotel and catering).

68 The Netherlands, where welfare benefits have traditionally been generous, are an example. However, the UK Pearson Commission reported some increase in tort claims against employers as early as 1978 and recent cuts in state welfare programmes appear to have accelerated the process. See Fauré, M and Hatlief, T (2000) 'Social security versus tort law as instruments to compensate personal injuries: a Dutch Law and Economics perspective', working paper, Maastricht University Faculty of Law.
69 In Germany claims are mainly limited to cases of intent. In France and Switzerland intent or gross negligence is required (for most types of claim).
70 In Germany direct claims by employees (apart form cases of intent) are restricted to 'participation in general traffic' – e.g. accidents during travel to or from work caused by the employer or fellow employee but which are not attributable to the sphere of work (e.g. car sharing schemes amongst employees).
71 In a number of European countries (including Germany, France, Switzerland) most claims against employers are actions for recovery brought by the workers' compensation insurer – and even these are infrequent. Direct claims by employees are subject to yet greater restrictions, and are very uncommon.
72 For example, in Sweden tort claims against employers are permitted in theory but most employees belong to schemes under which they forego the right to sue the employer in exchange for a 'topping-up' of the benefits provided under the state workers' compensation scheme. This is achieved through 'Employers' No-fault Liability Insurance' which employers purchase in the private insurance market.
73 Employers' liability insurance has recently become compulsory in Cyprus, which follows British practice in this and many other areas of insurance.
74 E.g. in some US states, Australia and Singapore.
75 Although there has been quite extensive 'privatisation' since 1993.

2.6.3.5 Treatment of accidents and diseases

Virtually all work injury compensation systems in Europe make some distinctions between traumatic injuries ('accidents') and occupational diseases. Typically, workers' compensation cover operates in respect of all occupational accidents[76] but only some diseases. Cover for the latter is often restricted to 'scheduled' or 'prescribed' diseases, such diseases being added to the list or schedule only when a clear causal connection has been established between the illness and particular types of work.[77] However, each country works with its own list of diseases, and the lists vary in their formulation and detail. For example, there are currently 67 prescribed diseases under the UK Industrial Injuries Scheme compared with around 40 in Spain and over 80 in France. Of course, tort-based employers' liability claims, where a country's law permits them, may be brought in respect of any disease, provided the illness is real and was clearly sustained in the course of employment. Successful tort/employers' liability claims in respect of an unscheduled disease may eventually lead to its being prescribed under a country's workers' compensation system, but there is often a substantial time lag in this process.

Some countries, (e.g. Belgium and Portugal) have different security systems for accidents and occupational diseases. In each case compensation for disease is provided exclusively under a state scheme with the 'accident' risk being retained by the employer, which is required to insure this liability under an occupational accident insurance policy underwritten by a recognised private insurer.

2.6.3.6 Employers' liability vs. workers compensation – incentive effects, costs and benefits

The rich international diversity of work injury compensations regimes, and the fact that no two major countries in the world have adopted identical systems, suggests that no particular scheme, whether workers' compensation or employers' liability based, is demonstrably superior to the alternatives. On the other hand, the ultimate shape of such schemes has often been determined as much by political expediency as by imperatives of economy and efficiency. Furthermore, the inherent difficulties of bringing about radical change in this field, which we touch on later in this section, has meant that most work injury compensation schemes have evolved rather slowly, rarely departing from their original basic structures.

Costs and efficiency

There is no doubt that, in a simple sense, workers' compensation systems – and particularly public/monopolistic schemes – are likely to be more economical in their operation than tort/employers' regimes. Again, in cases where workers' compensation and employers' liability combine within a single system, the former component is likely look more efficient than the latter. Tort-based systems have always been subject to criticism on the grounds of their high transaction costs. The results of research in this field have been quite consistent, suggesting that about 45-50% of liability insurance premiums are absorbed in legal, administrative and other costs. In the UK Beveridge[78] (1942), Ison[79] (1967) and the Pearson Commission[80] (1978) reported figures of 46.5%, 49% and 45% respectively for tort-based liability insurance. These figures appear to compare very unfavourably, for example, with the expense ratios of state workers' compensation programmes, which are typically in the 5-15% range.[81]

A second criticism concerns delay.[82] Tort-based claims for personal injury are notoriously slow to settle, especially if court action is involved. By contrast, workers' compensation benefits are usually quite easy to claim, disputes tend to be settled more expeditiously and are usually subject to a better procedure for deciding medical questions,[83] despite the complexity of social security law. However, simple comparisons of this sort may be misleading, because like is not being compared with like. Workers' compensation schemes are no-fault systems that pay only limited benefits based on a simple and rather inflexible formula. By contrast, the tort/employers' liability insurance regimes are predominantly fault-based systems that aim to pay full compensation exactly tailored to the particular circumstances of the injured person. This involves not only adjudication on questions of fault but also an attempt at a precise assessment of the effects of the injury on the claimant's past and future earnings and on his or her quality of life. Given that the claimant's medical condition may take some time to stabilise it is often impossible to resolve matters quickly, or cheaply.

Pursuing this point, Dingwall *et al* (1990) argue that the expense and slowness of the tort system is not necessarily to be condemned. They suggest that perhaps the system:

'merely incurs the necessary expense of ensuring that there is adequate time to make considered decisions and is sufficiently sophisticated to allow for individual circumstances.'[84]

76 Although there is considerable variation in the treatment of accidents occurring in the course of travel to and from work, which may be included or excluded.
77 In a number of countries, including Germany, Switzerland and Austria, compensation for a non-scheduled disease may be awarded when the illness is unequivocally connected with a particular claimant's work.
78 Beveridge, Sir William (1942), *Report on social insurance and allied services.*
79 Ison, T. (1967), The forensic lottery.
80 Pearson Commission (1978), *Report of the Royal Commission on civil liability and compensation for personal injury.*
81 Although the expense ratios of state schemes do not usually take into account the cost of collecting contributions (or taxes) whereas the ratio for liability insurance obviously does. Second, figures for state schemes do not take into account the fact that insurance companies contribute to state revenues through taxation, whereas government departments do not.
82 The Civil Justice Review (1988) suggested 5 years as the average delay for personal injury litigation.
83 See Cane, P. (1999) *Atiyah's Accidents, Compensation and the Law*, Sixth Edition.
84 Dingwall, R., Durkin, T and Felstiner, W.L.F. (1990), 'Delay on Tort Cases: Critical Reflections on the Civil Justice Review', Civil Justice Quarterly, vol. 9, pp. 353-65.

Finally, it may be worth repeating a point made earlier about the effects of abolishing tort liability in the sphere of employment that we find in workers' compensation schemes. Whilst 'inefficient' tort claiming against employers is reduced or eliminated the effect may be to increase tort claiming in other spheres, as injured workers may simply seek alternative targets for litigation, such as machinery manufacturers or producers of harmful substances (e.g. asbestos) that cause work-related injuries.[85]

Labour relations and worker rehabilitation

It is frequently argued that workers' compensation schemes, which are intended to be broadly non-adversarial, help to ensure harmonious industrial relations, whereas contentious tort-based compensation systems tend to pitch workers and labour unions against employers and the insurance companies that represent them. We should note, however, that workers' compensation programmes still generate quite frequent disputes concerning the origin or gravity of the injuries concerned, if not about questions of fault.[86]

It is certainly the case that workers' compensation systems have proved to be more effective than tort-based employers liability systems in promoting rapid and effective rehabilitation of injured workers. Indeed, the absence of an effective rehabilitation strategy amongst EL insurers is frequently identified as a key weakness in the current UK employers' liability regime. The reasons for the superiority of workers' compensation schemes in this respect are fairly obvious. The (largely) non-contentious nature of a no-fault workers' compensation system allows the insurer to have early access to the victim, making for more effective case management. Furthermore, and assuming the system is a public/monopolistic one, co-ordination and co-operation between insurer, employer, employee and health provider can be achieved quite easily. By contrast, contentious tort-based employers' liability systems almost inevitably result in later access to work accident victims. Furthermore, in a more or less competitive employers' liability insurance market, with each insurer having its own claims, IT and other systems, a truly integrated scheme of rehabilitation will be harder to achieve: insurers with only a small share of the market and a limited claims portfolio may not think it worthwhile to invest heavily in rehabilitation services.[87]

Safety incentives

Obviously, a work injury compensation system should, as far as possible, be structured so as to encourage both workers and their employers to avoid accidents and reduce accident costs.

Of course, the vast majority of compensation payments to injured workers are made through insurance systems, the various types of which we have already examined. We can therefore disregard the (relatively few) cases where compensation payments are uninsured and assume that the employer will have chosen, or been obliged, to spread the risk via an insurance pool.

Some commentators suggest that the provision of compensation to injured employees may result either in more accidents, or an increase in the reporting of accidents, or both. According to this view the provision of industrial accident benefits, or an increase in their generosity, reduces the cost to employees of lost earnings during the period when injury precludes work. This, in turn, reduces the incentive to avoid accidents and leads to more careless behaviour by employees. Also, because the cost of leisure (which is preferred to work) is reduced by an increase in compensation benefits, the demand for leisure will increase and the supply of working hours will decrease. Thus, employees will be encouraged to make fraudulent claims or report injuries that previously they would not have declared.

Of course, the cost of compensation payments is normally translated into insurance premiums or contributions that employers pay to shift the risk. If these premiums are risk-related and, especially, if they reflect the firm's own claims experience (experience rating), then an increase in premiums resulting from a rise in the number of accidents may encourage employers to devote more resources to health and safety, countering the employee responses described above. However, it is commonly observed that insurance premiums may not accurately reflect the safety record of individual firms because experience rating is impractical in all but the largest employers. Furthermore, 'long tail' claims in respect of disease undermine the effectiveness of experience rating systems, because the pattern of claims in recent years may reflect the risk as it was many years ago and reveal nothing about the quality of the risk as it is now. The employer will have little incentive to improve safety if current premiums are based on what the firm did in the past, rather than what it is doing at present.[88] It is also argued that insurance premiums are low in relation to the other variable costs of a firm and are therefore unlikely to exert a strong influence on employer behaviour.[89] On this basis, it is argued that employee responses are likely to dominate employer responses. Empirical research in the field supports this contention, several researchers reporting a significant positive relationship

85 See note 87 and accompanying text.
86 For example, the old (pre-1948) British Workmen's Compensation Acts generated an enormous amount of litigation, and the litigation generated by the current German workers' compensation system is also significant. See Bartrip, P. W. J. (1987), *Workmen's Compensation in twentieth century Britain*, Avebury, Aldershot and *Employer's Liability* (1995), Munich Re.
87 The weakness of employers' liability based systems in these respects was emphasised by Dr Margarita von Tautphoeus, Munich Re's representative at the November 2002 ABI conference on the problems of the UK EL market.
88 See Section 2.4.4.
89 Furthermore, the real cost to an employer of accidents at work is far greater than the premiums paid to insurers to cover the risk. For example, the UK Health and Safety Executive has suggested that for a firm paying Employers' Liability insurance premiums of £1 million the true cost of the risk is likely to be in the range of £8 million to £36 million (Health and Safety Executive (1994), *The Cost to the British Economy of Work Accidents and Work Related Ill Health*. The prospect of having to bear uninsured costs, which greatly exceed insured costs must therefore provide a much greater incentive to avoid accidents than any adjustments in liability insurance premiums.

between levels of benefit (as a percentage of wages) received by disabled workers and industry injury rates.[90]

However, the research described above largely concerns benefits payable under workers' compensation systems that do not depend on fault. Where benefits, or a significant proportion of them, are delivered under an employers' liability system such as that of the Ireland and the UK, the effect *may* be different. The point here is that carelessness on the part of an employee will actually *reduce* the benefits to which he or she is entitled (under the doctrine of contributory negligence) or extinguish them altogether where an accident is entirely attributable to the employee's own fault. Equally, the taking of care by an employer will reap greater dividends to an employer under an employer's liability system, because, unlike the employer under a workers' compensation system, he will not usually be required to pay compensation in the absence of fault. Insurance costs should then reduce.[91] Furthermore, under a tort-based liability system the award of damages against an employer who is found to be negligent may have a deterrent effect that is greater than payments under a workers' compensation system, where the question of blame may not be aired at all.[92]

Therefore, it is suggested that under an employer's liability system, employees' responses to the prospect of receiving compensation are less likely to outweigh employers' response to the prospect of having to pay it, and the availability of such compensation is therefore less likely to increase accident rates.

Of course, contributions under state (social) insurance schemes may not be risk-related. They are not related to risk in Ireland or the UK. Clark and Smedley (1995)[93] argue that since some industries are inherently far more risky than others[94] this results in the creation of perverse incentives whereby the taxpayer, and employers and employees in relatively safe industries and firms subsidise those that are unsafe. They note that low risk industries are being loaded with costs unrelated to their activities, and that high risk industries are sheltered from the true social costs which they incur.

Clark and Smedley claim to identify a further flaw. They argue that where contributions to industrial injury funds are not risk-related employers receive little payback on expenditure designed to improve safety and reduce accidents and so are less likely to invest in such measures.[95] They suggest that whilst private employers' liability insurance premiums are broadly risk-related (and hence provide safety incentives) the beneficial effect is likely to be undermined if there is a parallel state scheme where no such incentives are generated. They also suggest that the existence of a state no-fault scheme may result in accidents in which the employer was, in fact, negligent being settled via the state scheme instead of the tort/employers' liability insurance component. In this way negligent employers 'can pass on the consequences of their lack of safety-awareness to the taxpayer, and reduce the pressure they face to put in place adequate safety precautions.' Clark and Smedley therefore conclude that the existence of a state scheme where contributions are not related to risk may lead to more industrial injuries taking place than under a scheme where contributions or premiums are priced according to risk.

2.6.3.7 Reform of work injury compensation systems

As suggested earlier, reform of work injury compensation systems is not easy to achieve, for a number of reasons. First, vested interests are inevitably at stake and governments are often reluctant to disturb these for fear of encountering damaging opposition. Second, reform in the sphere of industrial injuries is apt to create anomalies elsewhere, which can only be removed by yet more radical reform. For example, a switch from a (predominantly) tort-based employers' liability system (such as that which we find in Ireland and the UK) to an exclusive remedy workers' compensation system would create anomalies in that other groups of victims (such as road accident casualties) would be denied no-fault benefits.[96]

This brings us to the central problem of any model which involves greater integration of occupational injury compensation with a state social insurance scheme - the difficulty of removing the unequal treatment of different groups of claimant without increasing the costs of the system.[97] The dilemma is summarised neatly by Williams:

'For Workmen's Compensation to be totally integrated two changes must be made ... first, either the tort system must apply on the same terms to work and nonwork injuries and diseases or this system must be totally replaced by a no-fault system providing the same benefits for work and non-work injuries. Second, because it is extremely difficult to reduce no-fault benefits once granted, to equalise the no-fault benefits for work and nonwork injuries the nation must be willing to raise the benefits for non-work injuries and diseases.' [98]

90 See, for example, Lanoie, P, (1992) 'The impact of occupational safety and health regulation on the risk of workplace accidents' *The Journal of Human Resources* 27(4) pp. 643-660 and Wooden, M. (1989) 'Workers' compensation, unemployment and industrial accidents: an inter-temporal analysis' *Australian Economics Papers* 28 (Dec.) pp. 219-235. The findings of these authors on the safety effects of accident compensation are summarised by Davies and Elias *op cit* note note 47 pp. 30-31.

91 Especially if experience rating is employed – but note the previous reservations about the feasibility of applying experience rating where there is a pattern of long-tail disease claims.

92 Since UK law requires payments to be insured the award of tort damages against an employer is largely symbolic. However, the threat of litigation and potential stigma of a finding in negligence can still have a powerful deterrent effect on the employer, a point made forcibly by Owen Tudor, former Legal Services Officer for the UK Trades Union Congress (TUC), in correspondence with the author.

93 Clark, D. & Smedley, I. (1995), *Industrial injuries compensation, incentives to change*, The Social Market Foundation, London.

94 Clark and Smedley quote data suggesting that the injury rate in the most hazardous industries is at least fifty time higher than in the least hazardous. Premium rates for employers' liability insurance typically range from around £0.10% to £10.00%, a hundred-fold difference.

95 The 'deterrence' goal of tort law is to encourage individuals and firms to invest in safety up to, but not beyond, the point where additional expenditure on safety is no longer cost-efficient in preventing accidents. The theory requires that the cost of accidents be included in goods in the production of which accidents occurred, otherwise the price will be too cheap and goods will be bought at higher than an optimal level.

96 Conversely, they would have a right to sue in tort that was denied to people who were injured in the workplace.

97 Even the radical New Zealand scheme has been subject to criticism on the grounds that it discriminates unfairly against some groups, such as victims of non-occupational disease and those disabled from birth.

98 Williams, C. A. (1991), Workmen's Compensation, an international comparison.

A third area of difficulty arises in connection with the transitional problems that inevitably occur in switching from one system to another. For example, there has been discussion for many years now about the possibility of writing EL insurance on a 'claims-made' basis in respect of the risk of disease. However, whilst this is regarded, almost universally, as a superior basis of coverage, reform has been impeded by a number of complex technical issues that would arise from the change.[99] In any event, the transition itself would take a very long time to complete, given the need to run off claims under old occurrence policies. Existing employers' liability insurers would probably see little improvement for many years, whereas new insurers would benefit straight away. This in itself might militate against change, since existing insurers - those with the most to lose - would have most influence in shaping reform. It is worth noting that the British Accident Offices Association, which considered a switch to claims-made cover in 1978 and 1984, considered the change to be impractical because of the length of the transitional period and technical problems of the sort outlined above.

At the present time there is considerable pressure for reform of EL insurance in the UK, which has experienced problems of insurance affordability and availability similar to those in Ireland. There has already been widespread consultation on the subject and something of a consensus appears to be emerging. It is mainly centred on the need to reform the way in which compensation for occupational disease is delivered, because the difficulty of pricing, and a host of other problems associated with occupational disease, has made this the key target for reform.[100] No concrete reform measures have been put forward as yet, but there is strong support for a system that would separate accidents and 'short-tail' diseases from 'long-tail' occupational diseases. The former would be covered by conventional competitive EL insurance, while the latter would be compensated out of a central fund, either in the form of a pool managed by private insurers or a state fund.[101]

2.7 Public liability insurance

In this section we comment briefly on the general role of public liability insurance in delivering compensation to people who are injured outside the workplace, and make some international comparisons. However, it is difficult to construct a comparative study of PL insurance (or indeed provide any very meaningful analysis of it) because PL insurance is not a clearly-defined class like employers' liability insurance or motor, rather it is a *residual* class of liability insurance. For this reason PL is known as 'general liability insurance' (GL) in most markets outside Ireland and the UK. In other words, a PL policy is not intended to provide cover for claims of any particular type of origin but simply to meet claims that are not met by a more specific form of liability insurance. Thus, in order to ensure that PL insurance dovetails accurately with other liability covers, a typical Irish or UK policy will exclude many types of claim, including the following:

1. Claims by injured employees (which are met by employers' liability insurance)
2. Claims arising in connection with motor vehicles (met by motor insurance)
3. Claims arising in connection with ships or aircraft (insured in marine/aviation markets)
4. Claims arising from the supply of defective products (insured by product liability insurance)
5. Claims for gradual pollution or, possibly, any form of pollution.
6. Claims arising from the provision of professional advice or services (met by professional indemnity insurance)

However, the cover provided under PL policies written by European Continental insurers, or insurers outside Europe may well be structured differently. For example, as explained above, in some markets outside Ireland and the UK employers' liability insurance is not written as a separate line of business, so employers' liability claims (although they may be relatively low in volume) fall under the PL heading.

There are further problems associated with product liability insurance. This is normally included under public liability both in Ireland, the UK and elsewhere, but not invariably so, so premium and claim figures provided by some insurers may exclude product liability, which is accounted for separately. In any event the nature of the product liability risk is likely to vary considerably from one country to another, even though the law has been harmonised to some degree.[102] For one thing, product liability cover is not standardised across Europe and the typical cover provided varies considerably from one country to another, being much broader in some Continental European countries than in Ireland and the UK. Furthermore, differences in the general structure of the accident compensation system within different countries may impact on the level of product liability claims and the cost of insuring the risk. For example, we noted earlier that in some countries (such as Germany and most US states) there are 'exclusive remedy' workers' compensation systems that preclude injured employees from suing their employers in tort. Under such systems there may be a much bigger incentive for such injured workers, being denied the right to sue their employers, to bring tort claims

99 Such as the phasing-in of the guarantee fund that would be required. Again, in some cases there would be disputes about which of the two types of cover should respond - the 'old' occurrence cover or the 'new' claims-made. This might happen, for example, if the period during which the claimant was exposed to some harmful thing bridged the transition from one cover to another.

100 Disease compensation has been described as the 'Achilles heel' of occupational injuries compensation systems. Determining whether or not a disease is occupational in origin is all but impossible in many cases, making insurance settlements difficult and raising the likelihood of expensive disputes. Again, the long-tail nature of many disease claims impedes the proper working of the mechanisms of private insurance, preventing accurate pricing and reserving, and undermining the beneficial effects of experience rating systems.

101 See Greenstreet Burman (2002) *Workplace compensation: costs, trends and options for change* (2002) and the response of the UK Association of British Insurers' to the Department of Work and Pensions review of employers' liability insurance (2002).

102 Via the 1985 EU Directive on Product Liability.

against firms that supply dangerous substances or equipment that is used in the work place. These claims (against, for example manufacturers of asbestos or allegedly dangerous machinery) will tend to be met by product liability insurers whereas in Ireland and the UK the employer would be the more likely target for a tort claim, resulting in EL rather than product liability claims.

'Professional liability' is another area of difficulty. In Ireland and the UK this risk (claims against professional firms for negligent advice) is invariably written as a line of business that is separate from PL. Elsewhere this may not be the case, or even if the risk is insured separately, the figures supplied for 'General Liability' may include professional liability premiums and claims.

Apart from the above, there is considerable difference in the detail of PL coverage from one country to another relating to such matters as the relationship between PL and motor cover and the extent to which risks such as pollution and environment damage are included or excluded.

Obviously, there are no statistics, from Ireland or elsewhere, on the incidence of accidents covered by PL policies, because, unlike workplace injuries or road traffic injuries, they do not form a distinct category. Similarly, one cannot compare different 'systems' for PL insurance or discuss potential reform in this field because of its general and residual nature.

We can conclude from the above that there are likely to be considerable difficulties in comparing the Irish PL insurance market with other markets most of the which stem from differences in the scope of PL coverage from one country to another and different ways of classifying liability insurance for accounting and statistical purposes. However, the UK market at least is fairly close to the Irish market in most respects.

2.8 The Irish liability insurance market

Liability insurance is an important class of business in Ireland, accounting for around 17% of total general insurance premium income. This is a much higher percentage than in most other markets, where liability insurance typically accounts for 10% or less or premium income.[103] For reasons that have been discussed already, employers' liability is an especially prominent class in Ireland, as it is in the UK, accounting for nearly half of all liability insurance premium and around 7% of all non-life premiums. Premium income for EL was IRP 140mn (USD 162.7) in 2000. The size of the public liability insurance market is similar, at around 7% of total non-life premiums. The buoyant construction industry is said to account for around 50% of PL premium (AXCO 2003).

The major liability insurers, with their 2000 market shares, are detailed below.

Company	Market Share
Hibernian	19.0%
Allianz Corporate	13.4%
Irish Public Bodies	10.9%
Royal and SunAlliance	10.1%
FBD	8.8%
Eagle Star	8.2%
Allianz	7.8%
St Paul	7.6%
Norwich Union	5.6%
AIG	2.3%

Source: AXCO (2003)

In 2001 the top four companies are reported to have increased their share (from 53.4%) to 56.75% of the market and the top eight (from 85.8%) to 88%.

2.8.1 Market concentration

The liability insurance market in Europe as a whole has tended to become more concentrated over time. This is partly as a result of insurers withdrawing from this class of business, and partly as a consequence of insurer insolvencies (e.g. Independent in Ireland and the UK). However, increasing concentration is mainly the result of merger and acquisition activity in the insurance market as a whole, including mergers involving many of the major offices in the last few years. This phenomenon is by no means confined to Ireland. Indeed, it is a feature of the whole European market, where merger and acquisition activity has produced a steady decline in the number of insurers in recent years. This, in turn, has been driven by deregulation at European level and a number of other factors that were discussed earlier.[104]

103 In the UK liability insurance accounts for about 8% of premium income for general insurance.
104 See Section 1.2.

2.8.2 Profitability

Liability insurance is perceived by insurers to be an unprofitable class in Ireland and employers' liability as especially so.[105] A brief analysis is provided in section 2.9.4.2 below, where the profitability of the Irish motor insurance market is also considered. We first consider motor insurance in more general terms.

2.9 Motor insurance

In this section we discuss the general role of motor insurance in delivering compensation to people who are injured in on the road, and compare the Irish system for delivering compensation with other European systems. We then provide a brief analysis of the Irish motor insurance market, looking at the structure of the market and its profitability.

We begin by looking at data on road accidents in Ireland and Europe as a whole.

2.9.1 Road accidents in Ireland and Europe

There is a large amount of data on road accidents in Ireland and Europe as a whole, of which the following represents only a tiny portion. There are also many indicators that can be used to describe road safety conditions in a country, only a few of which are used here. The figures given relate only to fatalities. Whilst, of course, the vast majority of motor insurance claims do not involve any fatal injury, the fatality rate is generally regarded as a useful indicator in comparative studies of road safety.

Road accident fatality rates can be presented in various ways. The tables and charts below show road accident deaths as a number per year, a number per million population, a number per 10,000 motor vehicles and a number per billion vehicle kilometres driven.

Table 6: Number of road accident fatalites in Ireland by class of person 1991-2001

	1991	1992	1993	1994	1995	1996	1997	1998	1999	2000	2001
Driver	229	207	198	202	229	247	231	234	233	231	217
Passenger	102	93	97	81	95	91	112	110	89	102	106
Pedestrian	114	115	136	121	113	115	130	114	92	85	89
Total	**445**	**415**	**431**	**404**	**437**	**453**	**473**	**458**	**414**	**418**	**412**

Source: European Commission Community Road Accident Database (CARE)

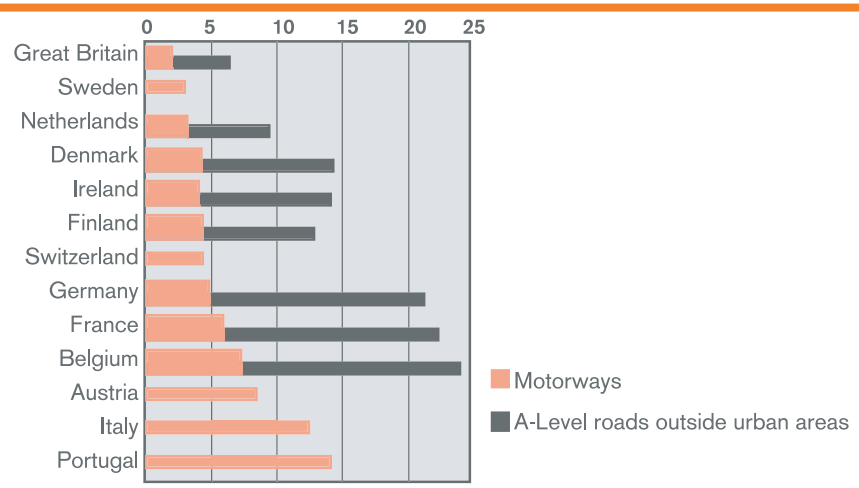
Table 7: Road accident fatalites in EU 15 countries per million population 1991-2002

	1991	1992	1993	1994	1995	1996	1997	1998	1999	2000	2001	2002
Belgium	188	167	165	168	143	134	134	147	137	144	145	-
Denmark	118	112	108	105	112	98	93	94	97	93	81	86
Germany	142	132	123	121	116	107	104	95	95	91	85	85
Greece	207	210	209	216	231	206	201	208	201	193	178	157
Spain	227	201	163	143	147	140	143	151	145	145	137	132
France	184	173	172	157	154	147	145	153	145	138	138	129
Ireland	**126**	**117**	**121**	**113**	**121**	**125**	**130**	**124**	**111**	**111**	**108**	**97**
Italy	143	142	126	124	123	116	117	110	115	111	116	-
Luxembourg	216	177	197	162	172	172	143	132	135	177	156	140
Netherlands	85	83	81	85	86	76	75	68	69	68	62	61
Austria	200	178	161	167	151	128	137	119	133	120	118	117
Portugal	326	310	271	251	271	272	250	210	200	184	163	160
Finland	126	120	96	95	86	79	85	78	84	77	84	80
Sweden	87	88	73	67	65	61	61	60	66	67	66	63
U.K.	82	76	68	65	64	64	64	61	60	60	60	60
EUR 15	**153**	**144**	**132**	**126**	**124**	**117**	**116**	**113**	**112**	**108**	**105**	**-**

Source: European Commission Community Road Accident Database (CARE)

105 AXCO (2003) describe EL as 'a chronically problematical class producing consistently poor results for insurers'.

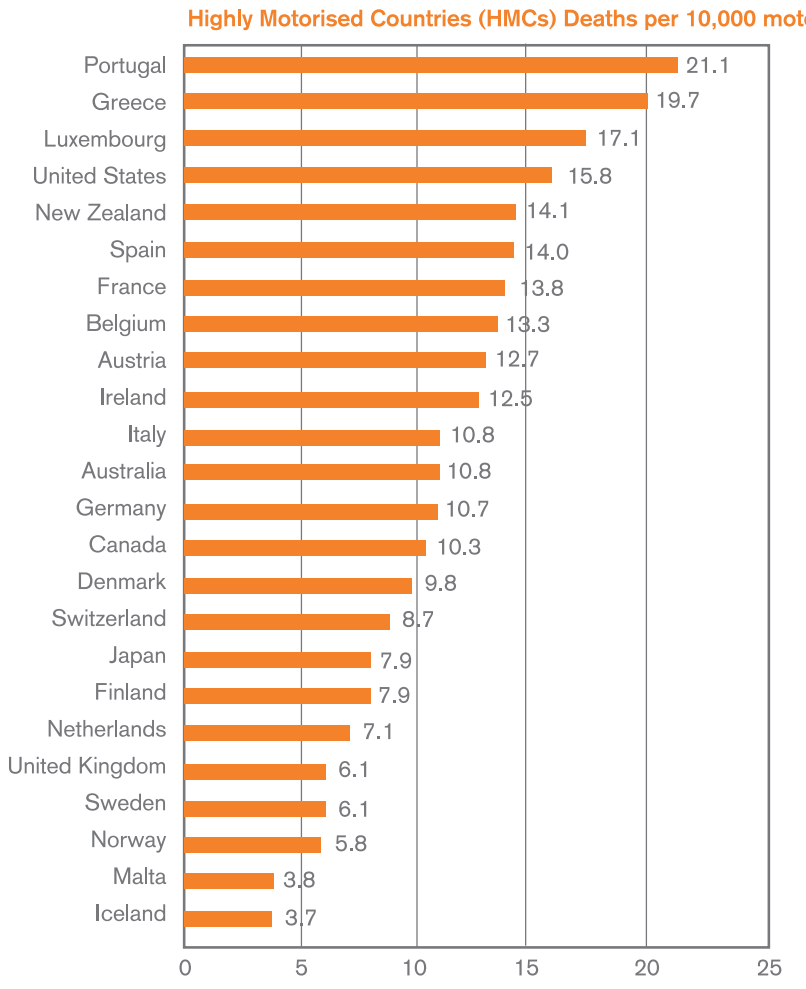
Chart 1: Road accident deaths in Europe per billion vehicle kilometres



The accident rate is measured as the number of accidents in which at least one person is killed, divided by the total volume of traffic using the roads

Source: European Road Assessment Programme Database

Chart 2: Road accident deaths per 10,000 vehicles in 'Highly Motorised Countries'



Source: 'Estimating Global Road Fatalities' Transport Research Laboratory 1999

The above data, limited though they are, show that road accident rates vary considerably in Europe and suggests that Ireland is close to the average on most measures. It also shows that Ireland conforms to the European trend of falling road fatalities in recent years, although the improvement has not been as dramatic as in some other European states.

Of course, it is notorious that whilst road accident rates in Ireland are moderate, the cost of motor insurance there is much higher in than in most other countries. Indeed, it is higher than in any other European country except Luxembourg. See Table 8.

The table shows that there is no positive correlation between road accident levels and insurance costs per vehicle in Europe. In fact, there appears to be a negative correlation, with some of the highest insurance costs in countries that have very good safety records (e.g. UK, Netherlands and Denmark) and some of the lowest in countries with very poor ones (e.g. Spain, Portugal and Greece). Of course, comparisons of this sort are highly misleading, for the reasons given below.

2.9.2 International comparisons

At first sight, it seems easier to make international comparisons in the field of motor insurance than in the 'pure' liability classes discussed earlier. This is because there is greater international uniformity in the scope of motor insurance cover and fewer structural differences in the compensation systems that relate to it. Furthermore, a series of EU Directives has brought about a considerable degree of harmonisation in the law and practice of motor insurance. In particular, the Motor Directives have set minimum standards for the level and scope of cover provided by motor insurers in Europe and ensured the cover operates on a Europe-wide basis, regardless of the where the policy is issued.

Comparison also appears to be facilitated by the fact that, in every country, motor insurance is written as a distinct line. Rarely, if ever, is it combined with any other another form of insurance. Motor policies are generally 'package' insurances that combine different forms of cover. In every market insurers offer policies that provide different levels of cover. For example in Ireland and the UK three levels of cover are commonly available. These are 'third party (liability)' (TPL) which, of course, provides only liability cover in respect of the vehicle, 'third party fire and theft' which is self explanatory, and 'comprehensive' cover which, in addition to liability cover, provides cover for damage to the vehicle on a 'all risks' basis plus various other benefits. Elsewhere in Europe insurers offer broadly similar products, i.e. covering liability risks only, or liability plus limited cover for damage to the vehicle, or liability plus 'full' cover for damage to the vehicle, although the precise way in which the 'own damage' cover is structured varies somewhat from one country to another.

Of course, motor claims arise from motor accidents and, as shown earlier, the incidence of such accidents varies from one country to another. However, the number of motor claims paid by insurers and the cost of settling them will not be directly related to the level or road accidents, for the reasons given below.

Table 8 Relative motor insurance costs in Europe 1999

Country	Number of vehicles (million)	Insurance cost per vehicle (Euro)
Luxembourg	0.3	840
Ireland	**1.6**	**755**
UK	28.3	509
Netherlands	7.3	474
Denmark	2.4	471
Belgium	5.7	432
France	35.5	398
Germany	50.5	391
Austria	5.4	376
EU	221.3	376
Italy	43.5	364
Spain	22.4	294
Portugal	5.3	279
Finland	2.8	270
Sweden	5.5	222
Greece	4.8	138

Source: Istituto per la Ricerca e lo Svilluppo delle Assicurazione (IRSA) (2001)

First, there are likely to be very significant national variations in the relative volume and cost of claims for vehicle damage, even in countries with similar accident rates. There will obviously be fewer claims in countries where only a relatively small percentage of the insured population buy cover for damage to their own vehicles. Again, the size of such claims, whether 'own damage' or 'third party damage', will depend, for example, on vehicle repair costs in the country in question and, of course, on vehicle values there. Thus, in relatively wealthy countries (such as Germany) the average vehicle damage claim is likely to be far more costly than in poorer countries (such as Portugal) where vehicle values are generally lower. There is also likely to be a compounding effect, because motorists in wealthy countries are more likely to protect their valuable vehicles with 'comprehensive' type insurance.

Second, there will inevitably by significant variations across Europe in the level and cost of claims for personal injury. This is considered next.

2.9.3 Motor personal injury claims

The level and cost of motor personal injury claims in a given country will depend not just on the incidence of road accidents there, but also on

- the scope of the legal rules governing the right to claim compensation, and;
- the levels of damages that are awarded

2.9.3.1 Rules governing the right to compensation

The scope of the legal rules that govern the compensation rights of road accident victims vary markedly from one territory to another. First, there is a broad distinction between

- (so-called) 'no –fault' schemes, and;
- 'liability-based' (or tort-based) systems.

Under a pure no-fault scheme road accident victims are entitled to compensation without any requirement to prove fault or legal liability on the part of another. The compensation may be payable by a private insurer (the victim's own insurer or the insurer or another), or a public insurer or government agency. However, the accident victim will not usually be entitled to 'full' compensation, but have only limited redress. Furthermore, and as a corollary of the entitlement to no-fault benefits, the accident victim is precluded from making a tort claim against a wrongdoer who may have caused the accident. These systems are thus analogous to workers' compensation programmes, discussed earlier. Under liability or tort-based system compensation can be secured only from another person (normally a vehicle owner, user or driver) who is held responsible for the injury under civil law. Tort-based systems are almost invariably backed by compulsory private insurance. In some countries or states there are schemes that combines no-fault benefits with tort liability. For example, quite common are 'threshold' schemes under which limited no-fault benefits are available for all injuries, but tort actions available only in the case of injuries that are serious.

2.9.3.2 European schemes

No-fault schemes are uncommon in Europe, where tort or liability systems prevail. However, there are significant differences in the conditions of liability from one European country to another. In particular, most European countries have a tort system based on *strict liability*, or at the very least, a system where the driver, or other person responsible, is presumed to be liable for any injury to others that he causes and required to pay damages unless he can rebut that presumption. Ireland and the UK are unusual in that there is no system of strict liability associated with the operation of motor vehicles, but one based on negligence which, at least nominally, places the burden of proof of such negligence on the accident victim.[106]

The following brief summaries are intended to give an indication of the variety of conditions of liability in a small selection of European states.[107]

Germany

Under the German Road Traffic Act liability is imposed regardless of fault on the *person in charge* of the vehicle for injuries caused during its operation, with an additional presumption that the *driver* also caused the injury unlawfully. Liability is in respect of material losses (i.e. excludes intangibles such as pain and suffering) and limited as to amount. Tort claims (including claims for damages in respect of pain and suffering) are available under separate legislation, with no restriction as to amount, but in this case the burden of proof rests with the injured party.

Italy

No strict liability comparable to German law, but the fault of the *driver* is presumed as a general rule. There is also an underlying liability on the part of the *owner* and the *user* of the vehicle, who are liable with the driver as joint tortfeasors, unless they can prove that the vehicle was used against their will. No restriction as to the amount of liability or restriction to material losses.

106 In reality the Irish and UK courts have tended to extend the motorist's duty of care in favour of pedestrian road users and also accept as adequate prima facie evidence of negligence, effectively reversing the burden of proof in many cases.

107 For a fuller account see Cologne Re. (2001) ' A European Comparison of Bodily Injury Claims'.

France

Strict liability is imposed on the *'gardien'* (person in charge [of the vehicle]) and *'conducteur'* (*driver*) for injuries incurred during the operation of the vehicle. Contributory negligence of the victim can be pleaded in mitigation only in a limited range of circumstances. The accident victim can seek compensation from the driver of any vehicle involved in the accident. The insurance company that pays compensation can seek reimbursement or contribution from the insurers of other vehicles involved, with compensation ultimately distributed amongst insurers according to each driver's degree of fault. In the absence of proof of negligence compensation is split equally on a per capita basis (e.g. between five insurers if five vehicles are involved).

Spain

The *driver* is always liable regardless of fault for bodily injuries arising from the operation of a motor vehicle up to the amount of a minimum sum insured set by law. However, the driver is exempted from strict liability where the injury is attributable to an Act of God or (in contrast to German law) or the negligence of the claimant. If the loss exceeds the limit set by law the general rules of civil liability apply, under which the claimant is required to prove negligence.

Ireland and the UK

No strict liability. The claimant must in every case prove fault on the part of the alleged wrongdoer. The latter will generally by the driver of a vehicle involved in the accident but may exceptionally be another person (e.g. a passenger or user of the vehicle who was not driving). No restriction in the amount of compensation that may be claimed or the forms of loss or injury in respect of which damages may be sought (e.g. no restriction of claim material losses only). Damages are reduced proportionately where the victim is partly to blame (contributory negligence).

Besides the national differences in the conditions of liability, illustrated above, there are significant variations in various other matters, for example:

- the right of the claimant to make a direct claim against the third party insurers (generally available for motor and liability insurance in a number of European countries but available in the Ireland and the UK only in limited circumstances);
- the extent to which social insurers and other public bodies (e.g. public hospitals) have rights of recourse against motorists who cause accidents and the insurers of the latter.

2.9.3.3 Levels of damages of personal injury

Levels of damages for personal injury vary greatly across Europe and there is no doubt that the high level of damages prevalent in Ireland (especially for relatively minor injuries) are a major contributory factor to high motor insurance costs there. Similarly, the low levels of damages in countries such as Greece and Portugal must help to mitigate insurance costs in these territories. This topic is considered in more detail in Part 3.

2.9.4 The Irish motor insurance market

Motor insurance is a major class in Ireland, accounting for 51.5% of all non-life insurance premium income in 2000. Measured by premium income, it is approximately three times the size of the Irish liability market. The motor market grew strongly between 1995 and 2000 as a result of substantial new vehicle registrations. This was a product of the country's economic boom, which has now flattened off. According to AXCO (2003) rising figures for total motor premiums masked falling premium rates which, combined with a deteriorating claims experience led to poor underwriting results, the 2000 loss ratio was the worst ever in Ireland. Premium rates began to rise sharply in 1999 and are estimated to have risen by between 30% and 40% since the end of 1999.

The leading motor insurers, with their 2000 market shares, are detailed below.

Table 9 Motor insurers' market share 2000

Company	Market Share
AXA PMPA	25.9%
Hibernian	20.1%
Allianz	11.1%
Eagle Star	8.2%
FBD	8.0%
Quinn Direct	7.8%
Royal and SunAlliance	7.8%
Norwich Union	5.8%
Friends First	1.5%
AIG Europe	1.4%

Source: AXCO (2003)

2.9.4.1 Market concentration and competitiveness

As in most other markets there has been a shrinkage in the number of firms actively underwriting motor business. In 1993 the 'Blue Book' reported 27 companies with an earned premium income greater than £500,000. In 2001 the

Table 9: motor insurance market concentration – EU 15 (1999)

Country	Total premium income Euro mn	No of vehicles million	No. of reg. insurers	First 5 share	First 10 share	First 5 Av. pr. income Euro mn	First 10 Av. pr. income Euro mn
Germany	19.73	50.5	124	31%	47%	1224	924
Italy	15.84	43.5	86	33%	53%	1050	845
UK	14.40	28.3	367	68%	86%	2172	1386
France	14.13	35.5	137	59%	83%	1653	1167
Spain	6.58	22.4	86	45%	64%	590	419
Holland	3.45	7.3	150	46%	72%	314	249
Belgium	2.46	5.7	103	59%	80%	289	196
Austria	2.03	5.4	33	65%	85%	264	172
Portugal	1.48	5.3	38	52%	81%	155	120
Ireland	**1.23**	**1.6**	**49**	**70%**	**97%**	**171**	**119**
Sweden	1.22	5.5	39	97%	100%	221	29
Denmark	1.13	2.4	50	70%	88%	159	23
Finland	0.75	2.8	14	80%	98%	120	53
Greece	0.66	4.8	67	52%	80%	69	10
Luxembg.	0.21	0.3	16	91%	100%	38	13
EU 15	83	221.3	1359	-	-	1223	669

Source: Istituto per la Ricerca e lo Svilluppo delle Assicurazione (IRSA) (2001)

number has reduced to 19. Most of these companies are subsidiaries of non-Irish companies: only three indigenous companies operate in Ireland whereas there were seven in 1993. One of these companies underwrites only public body risks such as local authorities.

Table 9 shows the 1999 market concentration for motor insurance in the EU 15 states, together with figures for total premium income, number of vehicles and average premium income for the first five and ten insurers in each market.

This data suggests that the structure of the Irish motor insurance market is not unusual for a relatively small country, being broadly similar in its characteristics to Member States that generate similar motor premium volumes. The Danish market, for example, looks almost identical in most respects. It is also worth noting that the Irish market is hardly more concentrated than that of the UK and (to a lesser extent) France, even though its total premium income, and that of its leading insurers, is only around 10% of that in the latter countries. We should also guard against reading too much into the low concentration ratios of the large German and Italian markets, which arise from the fact that liberalisation has only recently taken place there.[108]

2.9.4.2 Profitability of the Irish motor and liability market

As discussed earlier, measuring the profitability of insurance is not a straightforward exercise, mainly because of lack of detailed accounting data. The published financial statements of insurance companies are not disaggregated at the level of individual classes of business. The statutory returns that insurance companies are required to submit to their national supervisory authorities or submissions to insurance trade associations often give a greater breakdown in some areas; however, the valuation bases that are required to be used in statutory returns are usually prudent and conservative and these can led to some degree of understatement of profit (overstatement of losses), when business is growing. As stated earlier, a simple and widely used measure of the underwriting profitability is the combined ratio, which is the ratio of claims and expenses incurred to earned premiums, all net of reinsurance. The combined ratios, and their two main constituent components, claims ratios and expense ratios, are given in Table 10 for the Irish motor insurance market and in Table 11 for the liability insurance market for the years 1991 to 2001. No separate data exists for employers' liability insurance but included in the overall figures for liability figures.

108 See IRSA (2001), p. 177.

As can be seen from Table 10, the combined ratio for motor insurance exceeded 100% in all of the years from 1991 to 2001. The unweighted average over the eleven year period was 113.7%. It is important to take into account the investment income (returns) earned on the financial assets that are held against the technical provisions (outstanding claims and unearned premium provisions) and which have been accumulated over time from the net premiums that have been received. Information of the investment income (returns) specifically earmarked against these technical provisions for the motor insurance business is, unfortunately, only available for the years, 1995 onwards. The combined ratios, including this investment income, shows that in 1995 to 1997 were less than 100% and hence insurance companies made a profit from underwriting motor insurance business in these years; whether it was sufficient to meet the required rate of return on capital during this period is hard to say without further analysis. From 1998 to 2001 this adjusted combined ratio exceeded 100% and hence the underwriting would seem to have been unprofitable. The unweighted average over the seven year period from 1995 to 2001 was 99.4%; and hence it was only marginally profitable. It is not clear from the available data whether the valuation bases used to determine the outstanding claims provisions were measured realistically or conservatively. If these provisions were measured conservatively, or if these provisions had been revised upwards during the period to adjust for an earlier underestimation, the reported profitability would have understated the true profitability.

Table 11 provides the combined ratios, and its component parts, for all classes of liability insurance (including employers' liability) in Ireland over the same period. As can be seen, the combined ratio is very high, with its lowest value being 122% in 1994. The unweighted average over the eleven year period was 133.3%. For liability insurances, it is even more important to allow for the investment income earned on the accumulated financial assets held against technical provisions, since outstanding claims provisions set aside to meet future claims, are larger than those for other classes of business. From 1995 to 2001, these combined ratios, when this investment income is added, were 100% or over in all years, except 1995. The unweighted average for the seven years was 105.3%, which implies that the business was unprofitable. Again these underwriting losses could be overstated if companies had been setting aside provisions for future claims on a very conservative basis, or if there had been an upward revision of provisions during this period relating to past business. The only way to test this would be to carry out a detailed analysis of the run-off pattern in actual claims against the claims provisions that had been aside in these earlier years. This exercise is beyond the scope of this study. However, since the combined ratio has been consistently high over the period, it is reasonable to assume that the business has been unprofitable, or only marginally profitable, at best, over the period.

Table 10: Combined ratios for motor insurance business in Ireland from 1991 to 2002

	Claims Ratio	Expense Ratio	Combined Ratio	Combined Ratio (including investment income on technical provisions)
1991	101	17	118	investment data not available
1992	93	17	110	investment data not available
1993	91	18	109	investment data not available
1994	90	18	108	investment data not available
1995	89	18	107	86
1996	97	17	114	95
1997	99	16	115	94
1998	98	16	114	100
1999	100	15	115	103
2001	111	16	127	115

Table 11: Combined ratios for general liability (incl. Employers' liability) insurance business in Ireland from 1991 to 2001

	Claims Ratio	Expense Ratio	Combined Ratio	Combined Ratio (including investment income on technical provisions)
1991	116	24	140	investment data not available
1992	110	25	135	investment data not available
1993	105	24	129	investment data not available
1994	100	22	122	investment data not available
1995	106	20	126	95
1996	108	22	130	100
1997	115	21	136	102
1998	113	22	135	104
1999	110	21	131	101
2001	118	22	140	112

2.9.5 Comparing the Irish and UK insurance markets

It is interesting to compare the combined ratios for these two classes of insurance in Ireland with those in the UK. The UK is a larger market with more insurance companies competing on it and it has a legal system that is closer to that in Ireland than any other European country. The combined ratios for motor insurance and for liability insurances are given in Tables 12 and 13. There is no UK data which allows us to divide the overall investment income held against technical provisions between different classes of business. Hence, it is not possible to make an accurate comparison of the combined ratios with adjustments for investment income.

Tables 10 and 13 allow us to compare the combined ratios for motor insurance in Ireland with those in the UK over the period 1991 to 2001. Over the eleven year period the unweighted average of the combined ratios for the UK was 110.4 compared to 113.7% for Ireland. Hence the underwriting profitability of motor business has clearly been low in both markets as a whole. It is illuminating to compare the difference between the claims ratios and expense ratios in the two countries. In Ireland the expense ratio (the ratio of administrative and distribution costs to earned premiums) is much lower than in the UK. The eleven year average for the UK market was 24.2% compared to 16.7% in Ireland. This figure of 16.7% is low, even if it were compared to motor insurance markets in other European or North American countries. Of course, this low expense ratio is a least partly explained by the relatively high premium levels that we find in Ireland, especially for motor insurance. At the same time, the claims ratios in Ireland were significantly higher than that in the UK. Given that the overall profitability in Ireland has been low, as measured by the combined ratio, even when allowance is made for investment income, this would imply that high claims costs, or high anticipated claims costs, would appear to be the main determinant of this low profitability across the market as a whole.

We can compare the combined ratios for liability insurance business in Ireland and the UK by looking at Tables 11 and 13. The UK figures, like the Irish figures, cover all classes of liability insurance, including employers' liability insurance. A similar pattern to that in respect of motor insurance is discernible. The combined ratios for liability insurances are much worse than for motor insurance, with those for the Irish market being a little worse than those for the UK market over the period. Similarly, the expense ratios for the Irish market are lower than for the UK market while the claims ratios are higher. Since the underwriting profitability of liability insurance has been poor, and expense ratios have also been low, the evidence suggests, even more so than for motor insurance, that the cause of the low profitability is high claims experience. This would suggest that more investigation should be carried out into the causes of this high claims experience, including the claims settlement system. Even so, there is a case for analysing the valuation bases that have been used to calculate outstanding claims provisions in order to test their impact on the reported underwriting profitability.

Table 12: Combined ratios for motor insurance business in the UK from 1991 to 2001

	Claims Ratio	Expense Ratio	Combined Ratio	Combined Ratio (including investment income on technical provisions)
1991	97	26	123	investment data not available
1992	86	24	110	investment data not available
1993	77	22	99	investment data not available
1994	71	24	95	investment data not available
1995	76	25	101	investment data not available
1996	86	26	112	investment data not available
1997	94	25	119	investment data not available
1998	98	25	123	investment data not available
1999	95	24	119	investment data not available
2001	90	22	112	investment data not available
2001	78	23	101	investment data not available

Table 13: Combined ratios for general liability (incl. Employers' liability) insurance business in the UK from 1991 to 2001

	Claims Ratio	Expense Ratio	Combined Ratio	Combined Ratio (including investment income on technical provisions)
1991	116	30	146	investment data not available
1992	119	31	150	investment data not available
1993	102	28	130	investment data not available
1994	96	27	123	investment data not available
1995	87	27	114	investment data not available
1996	84	28	112	investment data not available
1997	87	27	114	investment data not available
1998	93	33	126	investment data not available
1999	82	36	118	investment data not available
2001	91	36	127	investment data not available
2001	103	28	131	investment data not available

PART 3 SUMMARY, OUTLOOK AND CONCLUSIONS

In the light of the general concern at high insurance costs and recent sharp rises in premium rates in Ireland we now summarise factors that might bring about a change in the price (and/or availability) of motor or liability insurance, either in general or for particular risks. We then try to assess the impact of these factors at the present time and their potential impact in future and consider the conditions that would need to be fulfilled in order to bring about the fall in insurance costs that is generally desired. We conclude with some comments on the potential for new entrants to the Irish motor and liability insurance markets.

The price and/or available of liability insurance is likely to alter if there is an actual or anticipated change in any of the following:

1 the frequency of claims;

2 the size (cost) of claims (including claims handling costs);

3 management expenses incurred by insurers;

4 the economic and financial environment in which liability insurance is written (e.g. in interest rates and/or equity prices);

5 market conditions and market behaviour.

Each of the above can be affected by a number of things. For example, 1, (the frequency of claims) is likely to change if there is a rise or fall in accident or disease rates or a change in the propensity of accident victims to claim. The latter, in turn, may be affected by a number of factors, such as expansion or contraction in the scope of liability rules, changes in the administration of justice that makes claiming more or less easy, or the availability of alternative compensation sources (such as state benefits) which may make a liability (tort) claims more or less worthwhile. Some of the factors that affect 2, (the size of claims) will be different. For example, the size of damages awards made by the courts will affect claim size markedly but may not effect claim frequency to the so markedly. On the other hand, some of these underlying factors, such as the availability of alternative compensation sources may affect both claim frequency and claim size.

We now consider the effect of a number of these key underlying factors at the present time, as listed below:

- Accident rates
- The substantive rules of liability law
- Levels of damages
- The relationship between liability insurance and alternative compensation sources
- Commission and management expenses
- Legal and associated claims costs
- Economic and financial factors, including equity prices and interest rates
- Market conditions and market behaviour (including the effect of underwriting cycles, changes in reinsurance markets, the impact of the Word Trade Centre terrorist attack and recent insurer insolvencies)

3.1 Accident rates

As noted earlier, there has been some decline in the number of work-place accidents, though not fatalities, in Ireland in the last few years, broadly following the trend in Europe as a whole. This trend is mirrored by road accident rates, where there has been a reduction of around 7.5% in the number of fatalities in the last ten years, despite a significant increase both in the number of vehicles in Ireland and in the total distance covered by vehicles on Irish roads.

In theory, declining accident rates should exert some downward pressure on liability and motor insurance claims frequency and at least partly counteract forces that have an opposite effect, such as increases in damages awards. However, workplace injury rates in Ireland are already very low compared with the rates in comparable countries, such as the USA, Germany, France and Italy, and road accident rates, though closer to the European average, are quite low in absolute terms, so the scope for further improvement must be limited. We should also note at this point that apparent improvements in safety do not automatically translate into lower premiums. For example, in recent years road accident fatalities have reduced in most European countries and the proportion of fatal claims dealt with by motor insurers has decreased as a result. However, while improvements in car safety (e.g. air bags) and medical advances have saved these lives, they have also had the effect of increasing the proportion of motor insurance claims that are made in respect of catastrophic injury, which are far more expensive to settle.

The situation with regard to motor accidents in Ireland has improved further in the last year following the introduction of 'penalty points'. The enforcement of safety standards at work has also been highlighted as an issue, with greater more rigorous inspection of wok places being demanded by the Irish trade unions and others. The insurance industry itself can exert some influence on safety standards by demanding improvements as a condition of cover being granted and

various other initiatives, but the overall effect of all such measures is unlikely to be dramatic. We can concludes that whilst a general decline in accident rates is likely to continue, the rate of decline is likely to be small, and is unlikely to bring about any substantial reductions in insurance costs.

3.2 The substantive rules of liability law

Clearly, there must be some link between the level of liability insurance claims and the content of liability rules. The same will be true of motor claims, though to a lesser degree.[109] If there is an extension in the reach of such rules accident victims may find it easier to claim or may be able to claim in circumstances where previously they could not. Conversely, if there is a contraction in the scope of liability law the number of claims is likely to fall, making liability insurance cheaper. The body of law that most affects liability insurance is tort law. Is there any trend of in the expansion in the scope of tort liability and, if there is, what effect should we expect it to have on premiums?

Some writers claim that there has been a long-term trend of expanding liability in the field of tort law, characterised by a gradual move away from fault-based liability towards strict liability.[110] In fact, recent changes in the substantive rules of tort law present a mixed picture, with little change in some areas and a marked expansion in others, such as the law relating to some aspects of liability for the professional services, to employers' liability and to product liability.[111]

The general law of negligence in Ireland is based on the same principles as English law, with the two systems having a common origin. There was a steady expansion in the scope of the tort of negligence in England from 1932 onwards followed by a period of retrenchment from the early 1980s to the present day (subject to expansion in some areas, mentioned above). However, it seems that the Irish courts have not followed the English courts since the 1980s in contracting the scope of the tort of negligence. Quill (1999)[112] reviews the Irish law of torts and points out the wider scope of Irish law in a number of areas.

Having made this point, we should note that the influence on liability insurance prices of changes in the content of tort rules is likely to be fairly weak when compared with the effect of other factors, such as the levels of damages which the courts are prepared to award, the ease with which claimants are able to operate the machinery of the administration of justice and economic, cultural and social factors that influence accident victims' propensity to claim. For example, it is commonly observed that differences between European and US product liability law cannot begin to explain the massive differences in the frequency and severity of product liability claims that exist in these two continents.[113]

Given this fact, and the fact that any changes in the scope of Irish tort law (whether by way of expansion or contraction) are likely to be incremental, we can conclude that the effect of any such expansion or contraction on liability insurance premiums should to be fairly insignificant. However, we should also note at this point that differences in the scope of Irish tort law and that of other jurisdictions, and evidence of continuing expansion in its scope might serve to discourage foreign insurers from entering the Irish market.[114] We will return to this point in Section 3.9.2 below.

3.3 Levels of damages

The majority of liability insurance claims (including motor personal injury claims) are settled out of court. However, for reasons that are obvious, insurance settlements tend to closely reflect the levels of compensation that claimants would receive if they were to sue their cases to judgement.[115]

Liability insurance claims may be made in respect of:

(a) death or bodily injury;

(b) damage to property;

(c) financial loss.

Employers' liability claims are in respect of (a) alone, professional indemnity and directors' and officers' liability claims are largely in respect of (c) and motor third party, public and product liability may be in respect of any or all of them. Claims for (b) (property damage) and (c) (financial loss) are for concrete and readily ascertainable amounts. The average size of such claims is likely to increase over time as a consequence of the rise in the cost of rebuilding or repairing increasingly sophisticated buildings, motor vehicles and other forms or material property and as a result of the increase in the amounts of money that are at stake in business activity. However, claims of this sort are largely unaffected by legislative action or judicial policy.

109 Because, of course, third party claims only account for a portion of motor claims. Furthermore, there is probably less scope for expansion in the liability rules that govern third party motor claims than in the liability rules governing, say, employers' liability claims. For example, a much higher proportion of the latter are in respect of disease, including stress-related and psychiatric illnesses, where the expansion of liability rules has been quite marked in recent years.

110 See, for example Spuhler, J. (2001) *Liability and liability insurance - Yesterday - today – tomorrow*, Swiss Re. Others argue that tort liability was originally strict. In any event, it has been suggested that the recent turn (or return) to strict liability is itself a result of the more widespread use and availability of liability insurance.

111 Largely as a consequence of the adoption of various European Directives on health and safety at work and a Directive on liability for defective products.

112 Quill, E. 1999. *Torts in Ireland*. Dublin: Gill and Macmillan.

113 See generally Pfennigstorf, W. with Gifford, D.G. (1991) *A comparative study of liability law and compensation schemes in ten countries and the United States*, Insurance Research Council.

114 There is also some evidence that Irish insurance contract law is becoming somewhat less 'insurer friendly' than the English equivalent. See for example *Aro Road & Land Vehicles Ltd v. Insurance Corporation of Ireland* (1986) IR 403 where the court seems to have based the test for a material fact on the perceptions of a 'reasonable insured' rather than those of the traditional 'prudent underwriter'. However, both Irish and English insurance contract law remain much more 'insurer friendly' than the equivalent law elsewhere in Europe.

115 On the basis that insurers are likely to fight hard over large claims and not waste money in defending small ones, it is often suggested that accident victims are under-compensated when their injuries are serious but over-compensated when they are trivial.

By contrast, claims in respect of (a) death of bodily injury are so affected, and there has been strong upward pressure on damages awards in respect of death and personal injury in Ireland in recent years.

There is strong empirical evidence that, as a result of this pressure, damages awarded in Ireland are now high by European standards and far higher than those awarded in the UK. Greenford (2002)[116] shows that, dependent on the type of injury, damages awarded in Ireland can be up to eight times higher than in UK. His figures are based on personal injury settlements agreed by insurers. A 1996 report by Deloitte and Touche[117] compared damages awarded by the courts rather than insurance settlements and came to the conclusion that damages in Ireland were four times higher than in England. The McAuley Report (2001)[118] found that damages in Ireland were over 12 times that of England for similar injuries. Evidence suggests that the discrepancy between Irish and English levels of damages is greatest in relation claims for minor injury. This is very significant, because the vast majority of liability and third party motor claims are in respect of such minor injuries.

There is no doubt that the high cost of motor and liability insurance in Ireland is at least partly attributable to the relatively generous damages awards for personal injury that are a feature of the Irish system.

3.4 The relationship between liability insurance and alternative compensation sources

Tort damages backed by liability insurance is not the only means by which accident victims receive compensation. There is a variety of other compensation sources, including first-party (e.g. life, health and accident) insurance. Historically, however, it is the state that has provided the main alternative form of support for accident victims, through social insurance programmes and other mechanisms, such as publicly-funded hospitals, fire and other emergency services.

For a number of years now there has been a tendency on the part of governments in Europe to trim social insurance programme. This has been accompanied by a steady upward trend in the deployment by governments of private liability insurance as a means of extending social security systems.[119] All this is part of the current world-wide trend of economic liberalisation, supported by increasing confidence in market mechanisms to meet human needs. Governments, almost everywhere, are anxious to cut welfare spending. Ideology apart, the desire to trim ambitious social security schemes has arisen as a result of demographic factors, with ageing populations, rising dependency ratios[120] and increasing public demand for sophisticated and costly health care. In this climate, it is not surprising that governments should look more closely at the relationship between social security systems and private insurance mechanisms.

Governments are increasingly reluctant to allow accident victims to accumulate social insurance benefits and tort compensation recovered from a person, or the liability insurer of a person, who caused the accident.[121] Double recovery of this sort is increasingly denied, not just to prevent 'unjust enrichment' of the victim but to ensure that public funds are used in the most economical way. To achieve this, social insurance benefits may simply be deducted from the damages payable by the wrongdoer, without any recovery by the social insurer;[122] in other cases, the victim may be required to choose one remedy or the other.[123] Most common of all, however, is a system of reduction *plus* recovery: i.e. a mechanism whereby the damages claim of the victim is extinguished or reduced to the extent of the social insurance payments that he has received, and where the social insurer is allowed to recover its outlay, either from the wrongdoer or his liability insurer. The recovery, which may be total or partial, can take various legal forms – e.g. an independent claim or subrogation to the congruent claim of the accident victim. Of course, there is a need to keep the costs of recovery to a minimum, otherwise the economic benefits of subrogation will be lost.[124]

In the UK there has been a tightening of such recoupment schemes in recent years. For example, there has been a progressive extension in the powers of the Compensation Recovery Unit (CRU) of the Department of Work and Pensions to recover from private liability insurers the value of benefits paid to injured employees under the state worker's compensation programme (the Industrial Injuries Scheme), when an employee succeeds in a tort-based claim against his employer.[125] More recently, the CRU has been given enhanced powers to recover from motor insurers the costs incurred by public hospitals in treating road accident victims.[126] In future, NHS Trusts may be given a right to

116 Greenford, B. (2002) Journal of Risk and Insurance Practice.
117 Deloitte and Touche. (1996) *Report on the economic evaluation of insurance costs in Ireland*. Dublin: department of Enterprise, Trade and Employment.
118 Second Report of the Special Working Group on Personal Injury Compensation (2001)
119 Generally, see Cane, P. *Atiyah's Accidents, Compensation and the Law*, Sixth Edition, (1999) pp. 199-208.
120 See Liedtke, P. M. (2001) 'Driving potential pension solutions' *Journal of Insurance Research and Practice*, Vol. 16, Part 2 p. 40.
121 Again, there are exceptions. For example, some states besides Ireland (including Russia and Cyprus) allow the accumulation of tort damages and state workers' compensation benefits.
122 Deduction without recovery is a logical solution when the both parts of the system - private and public - are funded from the same source: for example, where employers that are exposed to direct tort claims by employees also fund the public worker's compensation system.
123 For example, 'election' between a damages claim against an employer and workers' compensation benefits – the English system until 1948 – still applies in a number of countries. However, the worker's compensation carrier is not always a social insurer.
124 This has led to extreme rationalisation in Germany, where subrogation usually takes place through collective or 'wholesale' settlement agreements between social security carriers and liability insurers. Under these *Teilungsabkommen*, or loss-sharing agreements the liability insurer pays an agreed standard percentage of any claim reported by the social insurance carrier based on an accident in which one of the liability insurer's clients was involved. Payments are made regardless of fault or causation unless the claim exceeds an agreed ceiling (e.g. Euro 30,000) in which case there is a full evaluation of the facts and the law. There are, apparently, about 1800 individual wholesale agreements in Germany: see Pfennigstorf, W. with Gifford, D. G. op cit note 116 pp. 131-139.).
125 See the Social Security (Recovery of Benefits) Act 1997.
126 See the Road Traffic (NHS Charges) Act 1999, Road Traffic (NHS Charges) Regulations 1999, SI 1999 No. 785 and Road Traffic (NHS Charges) Reviews and Appeals Regulations 1999, SI 1999 No. 786.

recover from wrongdoers, or their insurers, the treatment costs of accident victims generally, including people injured at work.[127]

It is clear that this process of switching accident costs from public to private sector could be taken further. Elsewhere the author has suggested that agencies such as the police and fire brigades, and inspectorates such as the UK Health and Safety Executive, could be given powers to recover costs from those who cause the accidents that occasion their attendance, and from the liability insurers of the latter.[128] Indeed it was recently suggested, in the context of the recent UK fire-fighters dispute, that the funding of the fire service could be enhanced in this way.

Of course, quite apart from strengthening the recovery rights of their social insurers, many governments have, at the same time, actually reduced the scope of social insurance programmes that are offered by the state. Some countries, such as the Netherlands, have adopted quite radical measures in recent years, completely dismantling major elements of their social insurance schemes.[129]

The general effect of this trend in Europe – the switching of accident costs from the state to the 'private sector', has been to increase liability (including third party motor) claim frequency and size, and hence the cost of liability and motor insurance. Ireland, however is not typical of the rest of Europe in this regard because, compared to other EU countries, the Irish State covers a very low level of the losses that arise from accidents. Thus, although there is no 'clawback' of state benefits from private insurers in Ireland the scope for such recoupment is limited by the fact that the level of such benefits is relatively low, so the introduction of clawback, even if it were worthwhile in economic terms, would not affect premiums to any marked degree.

3.5 Commission and management expenses

The cost of motor and liability insurance will clearly depend, to some degree, on the level of insurers' expenses. Besides the cost of handling particular claims, discussed above, there are costs that are largely proportional to premium (e.g. commission), expenses per policy (e.g. renewal costs) and a variety of general overheads. Rates for the Irish insurance market are given in Tables 14 and 15 below.

Table 14: Management expenses and commission for Irish motor business 1991 –2001

Year	Management Expenses, as % of EPI	Commission, as % of EPI
2001	11.52	4.10
2000	11.72	4.09
1999	11.68	3.82
1998	11.97	3.67
1997	12.67	3.47
1996	13.96	3.29
1995	14.80	3.42
1994	14.73	3.40
1993	14.64	3.43
1992	13.55	3.43

Source: The Insurance Annual Reports 2001

This table shows that management expenses in respect of motor business rose slightly at the beginning of the nineties and then started to fall from the middle of the nineties. Commission has been rising gradually through the nineties to the present day.

127 See the Law Commission Consultation Paper 144 *Damages for Personal Injury: Medical, Nursing and Other Expenses*. Zurich Insurance estimate that employers' liability premiums would need to rise by 2% as a result (Zurich Insurance (2002) Rate Increases Explained).
128 See Parsons (2002) *An essay on liability insurance and accident compensation*.
129 See Fauré, M. & Hatlief, T. (2000) 'Social security versus tort law as instruments to compensate personal injuries: a Dutch Law and Economics perspective', working paper, Maastricht University Faculty of Law, pp. 21-25 for a description or recent changes in the Netherlands.

Table 15: Management expenses and commission for Irish liability business 1991 –2001

Year	Management expenses as % of EPI	Commission as % of EPI
2001	12.72	10.65
2000	14.46	7.64
1999	13.17	7.89
1998	13.65	8.10
1997	13.23	7.96
1996	14.24	7.57
1995	12.89	7.47
1994	14.71	7.26
1993	16.76	7.41
1992	18.29	6.75

Source: The Insurance Annual Reports 2001

Liability business involves higher management costs although these fell substantially in the nineties. Commission levels seem to have remained fairly static until the big increase in 2001. There is no obvious reason for this big increase in commission, which needs further inquiry.

As regards expenses, it is easy to say that they should be as low as possible: insurers everywhere try to keep expenses down to gain a competitive edge. This is seen most dramatically in 'personal lines' business where, as already discussed, there has been a move towards direct marketing (to reduce acquisition and distribution costs), simplified underwriting (which can be carried out by less well-qualified and less highly-paid staff) and streamlined policy processing and claims handling techniques.

It is worth noting, however, that the optimal level of expenses for any particular insurer is not necessarily the lowest that can be achieved, nor is a very low level of expenses across the insurance market as a whole necessarily beneficial in terms of its overall efficiency. Expenses can be lowered by a number of means; for example, by a reduction in the number and/or quality of risk surveys, simplified underwriting that disregards some of the finer distinctions between risks, and less thorough claims investigation. However, the adoption of such a policy by an individual insurer may well result in an influx of lower quality business, more claims and more fraud, and cost-cutting of this sort across the industry as a whole might result in the industry being less rather than more efficient. Insurers must therefore maintain a balance between containing costs and maintaining the quality of the service they provide, collectively and individually.

No attempt is made here to judge whether levels of management expenses and commission in Ireland are high or low in absolute terms. However, they are broadly comparable to the levels that we find in other markets,[130] so the scope for savings, if any, must inevitably be limited.

3.6 Legal and associated claim costs

It is well understood that legal costs are a major input into the price of motor and liability business. It is equally clear that the legal costs associated with motor and liability claims are significantly higher in absolute terms in Ireland than in England (the most obvious jurisdiction for comparison), even though they are lower as a percentage of the damages awarded in personal injury cases.

The Motor Insurance Advisory Board (2001)[131] made a number of recommendations in order to reduce the overall costs of personal injury claims by reducing the number claims where formal proceedings are commenced. This aim is to be implemented via a Personal Injury Assessment Board, to be established in 2004. The draft Act has been prepared as the Personal Injury Assessment Board Bill 2003.

Further changes have been proposed in order to reduce costs and these could affect the procedural system quite substantially. These changes are included in the General Scheme of Civil Liability and Courts Bill 2003. These two bills are discussed below as they are likely to have a significant impact on the Irish liability and motor insurance markets and might make these two markets more attractive to new companies.

3.6.1 Background to the PIAB

The MIAB supported the view of the Special Working Group on Personal Injury Compensation set up by the Department of Enterprise, Trade and employment which submitted its report in 2002. This recommended the implementation of a personal injury assessment board based on a similar board used in Scandinavia. In response to this recommendation the Irish government prepared a draft bill known as the Personal Injuries Assessment Board Bill 2003. This bill is intended to change radically the way in which personal injury claims are handled in Ireland.

130 Both commission rates and rates of management expenses in Ireland for motor business are much lower than comparable European countries. For example, they are around half the level of the UK. Of course, premium levels in Ireland are higher.
131 Report of the Motor Insurance Advisory Board (2001).

One of the concerns of the MIAB and the Special Working Group on Personal Injury Claims is that, compared with many other countries, lawyers' fees were particularly high and too many cases went through the courts. The object of the PIAB is to bring about a reduction in the number of cases that involve legal proceedings and thus reduce costs.

3.6.2 The function of the PIAB

The function of the PIAB is to make assessments for compensation following personal injury caused by the negligence or breach of duty of another. In order for formal proceedings to be commenced the parties must have obtained a release certificate from the PIAB. The board will not be able to deal with any question of negligence, only with quantum. It is intended that all personal injury claims, except those where the alleged wrongdoer denies that he or she was in breach of duty or was negligent, will be presented to the PIAB for assessment before litigation may be commenced. The presentation of a case to the PIAB will not amount to an acknowledgement of liability, therefore the merits of a case may remain open even though the PIAB has made an assessment. In the case of liability being denied the PIAB will not carry out an assessment but will issue a Release Certificate to the parties before originating documents can be served. If an assessment is made, but one of the parties is not prepared to accept it, a Release Certificate must also be issued. Once this document has been prepared by the PIAB the parties will have six months in which to commence proceedings. Initially, the PIAB will assess employers' liability claims only, but there is provision is for its remit to be extended to other types of claims, including motor and public liability.

3.6.3 Assessment by the PIAB

Application for an assessment by the PIAB is not intended to waive any rights that either party may have. This means that a respondent's agreement to the submission of a claim is not equivalent to an admission of liability. The means by which an application for assessment is to be made will be stipulated by the Board once it is constituted.

The Board will work in an inquisitorial rather than adversarial manner. This means that lawyers will not be involved in the examining of witnesses and the Board itself will have the right to obtain any information it may require. In making an assessment on quantum the board will use written reports, including those from medical practitioners and specialists. If the medical reports of either are disputed a further report or reports will be obtained by the PIAB. This is intended to reduce legal fees as lawyers will not be involved in making submissions. The PIAB assessors will use written reports only.

Irish lawyers have objected to these provisions, arguing that injured parties will be denied their rights of representation before the adjudicating committee. They also argue that the award will be made by a 'faceless body' unknown to the claimant. Furthermore, they argue the injured party will be denied the assistance of legal expertise in preparing a claim: legal advisers will be allowed to prepare the claims and assist in submitting the correct documentation but they will be unable to appear before the Board.

Damages will be assessed on same basis as that currently employed by the courts and a lump sum will be awarded for both general and special damages. Specially appointed assessors who have some experience in dealing with personal injury claims will carry out the assessment. Once an award is made the claimant will have one month, or such other period as prescribed by the Board, to accept or reject the claim. If the claimant does not accept the assessment within the required period it will be assumed that the assessment has been rejected. If the respondent does not respond to the award it will be deemed that they have accepted it. If a claimant accepts the award any legal right of action is waived and the PIAB will issue an Order to Pay. If the claimant does not accept the award then he or she may commence proceedings once a Release Certificate is provided. The time between the submission of the claim to the Board and the issue of the Release certificate will be used in the computation of the prescription period set by the Statutes of Limitation 1957 and 1991.

If the respondent rejects the award made by the PIAB an Order to Pay will not be issued and the claimant will obtain a Release Certificate and proceed to court.

Some Irish solicitors claim that aim of the Board is to reduce levels of damages. However, the Board is required to ensure that all awards are in line with court awards, failing this a case can proceed through the normal channels.

The Board is entitled to obtain information to facilitate its calculation of an award not only from the claimant but also from various Government departments including the Revenue Commissioners and the Department of Social and Family Affairs. This may be relevant when, for example, there is a claim for loss of earnings as income not declared to the authorities can no longer be included in a personal injury claim. When a third party has a direct action against the insurer, the Board will be allowed to access relevant information from the Vehicle Database held by the vehicle tax authorities.

The Board will be funded by fees payable by the parties on a case-by-case basis and subsidised by the state where necessary. The main aim is to recover all costs from the participants in the claims.

3.6.4 Membership of the Board

The Board will consist of no more than eleven persons, including a Chair Person and Chief Executive. The non-executive members of the Board will be appointed by the Minister and shall include:

- Two members nominated by the Irish Congress of Trade Unions
- One member from the Irish Business and Employers Confederation
- One member from the Irish Insurance Federation
- The Director of Consumer Affairs
- The Consumer Director of the IFSRA

The PIAB will appoint staff to carry out its day-to-day business. It is envisaged that they will include people who have experience in handling and negotiating personal injury claims. The Board will be able appoint experts, such as medical practitioners, to advise its members in relation to particular claims.

3.6.5 Civil procedure

The submission of a case to the PIAB will be required before civil proceedings can commence. Other steps which take place before proceedings commence are considered below.

3.6.5.1 Action prior to commencement of proceedings

Prior to litigation a solicitor normally submits a letter of demand to the alleged wrongdoer. This briefly sets out the name of the injured party and the alleged wrongdoer, date of accident and very brief allegations of why a claim is being submitted. The alleged wrongdoer is then obliged to forward this letter to insurers without response so that the matter can be handled by them. Insurers will respond to the letter advising the claimant's solicitor of their interest and requesting further information. Quite often this request is denied.

With respect to personal injury claims this system is to be changed by the General Scheme of Civil Liability and Courts Bill 2003 (GSCL). Under the proposed Act the claimant must submit to the wrongdoer within two months of the incident or date of knowledge of the incident a letter of claim setting out the nature of the claim and the complainant's intention to seek redress by commencing an action or referring to the PIAB. If the complainant omits to do this, the court will make an allowance in its order for costs. Thus, the failure to fulfil this requirement will not affect the action itself. Perhaps unfortunately, the rules do not insist on the claimant providing full details of the incident, so it is possible that present practice, where often only the minimum of information is provided, will continue. Without full information insurers cannot make a decision relating to liability; therefore, this could cause claims to take time to settle.

At present a claimant has three years in which to commence proceedings against the wrongdoer. The Bill reduces this period to one year. The legal profession has argued against this change on the grounds that it does not make allowances for injuries which have not settled down in the twelve month period. There may be some merit in this argument in that the change result in an increase in the number of civil proceedings commenced to protect claimants whose injuries have not settled down within a year.

3.6.5.2 Commencement of legal proceedings

Proceedings are commenced if negotiations break down or if the respondent decides to defend an action. The PIAB and the GSCL will change the present procedures, as discussed below.

Originating Documentation

Proceedings are commenced by way of a plenary summons in the High Court or Civil Bill in the Circuit Court. A general endorsement of the claim is included which states very briefly the cause of action. This may be accompanied by a Statement of Claim, or the latter may follow at a later stage. This sets out details of the claim being made including the occupation of the plaintiff and defendant, when the alleged accident occurred and brief details setting out why it is considered that the defendant should pay damages to the plaintiff. In addition, particulars of injury are included together with particulars of the plaintiff's claim. Once the relevant documents have been served the defendant has to respond by entering an appearance to defend within the period prescribed, normally ten days. If this is not done the plaintiff can obtain a summary judgement against the defendant.

The General Scheme and Civil Liabilities Bill (GSCL) prescribes the manner in which proceedings will commence once the Act has been passed. As before, the procedure will depend on the court in which the action is taken and the amount that is claimed. The court limits are set by the Oireachtas and will vary from time to time. Proceedings will be commenced in the High Court by way of special summons, in the Circuit Court by way of a civil bill and in the District Court by civil summons. These are called the originating documents. The Act prescribes what details the originating documents should include. These include the name, address and occupation of the plaintiff(s) and the defendant(s) and the Personal Public Service (PPS) number of the complainant. This is a new requirement which will

assist the court in obtaining social security and tax information. The documentation must describe the injury and the redress that is being sought. Particulars of items of special damages will also be required. In addition, a full and descriptive account of the incident leading to the injury will be required so that the defendant has a clear understanding of the factual basis of the plaintiff's claim. This improves the present position, where information supplied in the statement of claim is sometimes quite perfunctory.

Details of the alleged negligence or breach of will also have to be included in the originating documents. If this information is not declared the courts may either dismiss the action or take the deficiency into account when awarding costs. At present further information can be obtained from the plaintiff by way of a Request for Further and Better Particulars which may require the plaintiff to disclose previous accidents or injuries. The Bill prescribes that the defendant must provide the defendant in a personal injury case with certain information if so requested. The prescribed information is:

- Details of any other claims for personal injury
- Details of damages awarded for personal injury or amount at which a previous personal injury claim was settled.
- Details of medical history where relevant and of persons who carried out any treatment on the plaintiff.
- Supporting evidence from the Revenue Commissioners or the Department of Social and Family affairs where loss of earnings is being claimed.

Currently, this type of information is likely to be requested by the defendant as a matter of course. The Bill makes it mandatory for the plaintiff to provide this information. If it is not supplied the court may dismiss the claim or take the fact into account when costs are being considered.

Defence

Once the reply to the request for further particulars has been received the defendant prepares a defence, which is aimed at answering all the allegations made by the plaintiff. This has to be served on the plaintiff within a prescribed period of time otherwise a summary judgement could be obtained against the defendant. It is current practice to deny everything in this document so putting the plaintiff to proof. Generally, contributory negligence on the part of the plaintiff may also be alleged. Provision is made for the plaintiff to obtain Further and Better Particulars of the Defence.

The GSCL includes a section that will govern the submission of a defence, including a counterclaim. This requires the defendant to include in the defence a statement as to which of the allegations, if any, is being admitted and which of the claims are denied. If liability is denied the basis on which this is being done must be stated. This is not required under the present rules. If a defendant's version of the events leading to the proceedings differs from that of the plaintiff, a full statement of the facts relied upon by the defendant must be included in the defence. This must give the plaintiff a clear understanding of the defendant's version of the events. This is a new requirement, which may bring more openness to the proceedings.

In the case of a counterclaim the defendant must specify any injury caused to the defendant and provide details of the remedy sought. This should also include full details of allegations made against the plaintiff plus the full facts so that the defendant has a clear understanding of what is alleged to have occurred. If either party fails to fulfil requirements the aggrieved party can obtain a judgement against the other, thus finalising the case. Alternatively, the failure to carry out the correct procedure may be taken into account in the award of costs.

The aim of the new Act in this regard is to ensure that there is more openness in adversarial proceedings. This may make it easier for the parties to come to an earlier settlement.

Verifying Affidavit

An affidavit is a statement made before a Commissioner of Oaths affirming the truth of the contents of the document. The GSCL provides for the provision of affidavits to verify each side's case. This is an innovation aimed at opening up proceedings and reducing fraud. Where any pleadings make allegations of fact they must be accompanied by an affidavit verifying the allegations. The affidavit must be lodged within seven days of the proceedings being served although the time period can be extended by the court or by agreement. This document will provide the parties with a greater understanding of each other's case. Arguably, this information should be made available before the originating documents are issued as this would give the parties more information on which to base their decisions on how to proceed. The fact that the affidavits are not required until proceedings have been commenced might increase costs, as insurers may well await this documentation before deciding to proceed with settlement. Furthermore, extra costs may be incurred by lawyers drawing up the affidavits. The GSCL prescribes that if a person completing an affidavit makes a statement which he or she does not believe is true or knows to be false he or she will be guilty of an offence punishable by a fine or up to ten years imprisonment. This offence is in addition to the common law offence of perjury. This step is aimed at reducing the incidence of fraud in personal injury cases.

Mediation Conference

Another new approach to civil proceedings is the mediation conference. The GCSL requires that prior to the trial of any action either party may request a mediation conference. The power is also given to the court to order a mediation conference if it is felt that this will aid the proper disposal of the proceedings. The chairperson of the mediation proceedings must be a barrister or solicitor of at least five years standing and is to be appointed by agreement of the parties or, if no agreement can be reached, by the court. The aim of a meditation conference is to try to dispose of a case amicably without proceeding to court.

In the event of a mediation conference being called each party must attend and actively participate in the disposal of the claim. In addition, the persons attending the conference must have the authority to settle a claim. The notes and records of the mediation conference will not available to the court if the case continues thus keeping the deliberation of the parties confidential.

On completion of the conference the chairperson lodges a report with the court indicating the results. This can be a full settlement with a signed settlement agreement, a partial settlement with a signed partial settlement agreement, or a statement that no agreement has been reached. In the last-mentioned case the report must set out the process used in order to try to reach an agreement. A statement must be included in the report that all parties have actively participated in disposing of the claim. Failure to participate in the mediation or participate actively will be taken into account when the court awards costs.

Final Offers

Before trial, and if agreement for settlement is not reached, the parties to the action must exchange final offers of settlement in writing. The period during which the offers remain open will be included in the rules of court and once this period has expired the written offers will be lodged with the court. The judge will not see these offers until judgement has been made and the court will consider these final offers when awarding costs.

Final award

If the case cannot be settled the court will hear the evidence and decide on liability based on the evidence submitted by each side. It is up to the plaintiff to prove that the defendant was negligent or in breach of a duty and until this is achieved on the balance of probabilities no award of damages can be made. Both parties will call evidence using either lay of expert witnesses.

If the court is satisfied that the defendant is liable to the plaintiff then an award of damages aimed at compensating the plaintiff will be made. The GSCL provides that in awarding damages the court will take into account any damages that have been previously awarded for personal injury and any amounts agreed by way of a settlement for personal injury. Once the court has made a judgement it is subject to appeal either in respect of the amount of compensation or on a point of law.

Lodgement or Payment into Court

At any time during the course of proceedings the defendant may decide to make a lodgement or payment into court. The respondent can make a payment into court at any time between the entry of an appearance to defend following the commencement of proceedings and before the case is set down for trial. A lodgement can also be made with the permission of the court after the case is set down. The plaintiff must be informed of the lodgement. If that lodgement it is to be increased the respondent is allowed to do this once the plaintiff has been advised. The payment into court must be included in the defence or included in a supplementary affidavit.

In the case of an award made by the PIAB, which is not accepted by the claimant, this procedure can be used once proceedings are commenced to place the plaintiff at risk for costs, as discussed below. That is to say, a payment into court equivalent to the PIAB award can be made together with the appearance to defend.

Once the lodgement has been made the plaintiff is put on risk for costs. If the judge makes an award which is less than or equal to the payment into court the defendant is entitled to an award of costs in their favour from the date of the lodgement. If the application is successful the plaintiff will have to pay his own costs and those of the defendant from the date of lodgement until the final judgement. The judge is unaware of the payment into court until after a judgement is made although he or she may ask whether such as payment has been made either before the trial or during its course providing there are good and sufficient reasons to do so. This method of awarding costs is prescribed by the GSCL and will no longer be at the discretion of the court.

It is believed that once an award is made by the PIAB and this is not accepted by the plaintiff defendants will avail themselves of the right to make a lodgement. This procedure is not much used by insurers at the present time.

The plaintiff is entitled to accept the lodgement within fourteen days or any other period of time agreed by the parties. Once the lodgement has been accepted the action is stayed and the case is settled.

3.6.6 The effect of the new procedures

The aim of the new procedures is to reduce the legal costs surrounding personal injury claims which impact heavily on the cost of motor and liability insurance. The PIAB, it is hoped, will reduce the number of cases in which legal proceedings are commenced, thus reducing legal costs. The PIAB will be able to avoid contact with the legal profession when dealing with awards and contact claimants directly, although the latter will be able to seek legal advice about the award if they so desire. This may assist in reducing lawyer's fees and the adversarial nature of Irish legal proceedings. It is also hoped that the new procedures will speed up the settlement of claims by ensuring that each side is aware of the other's case once proceedings have been commenced. It is also hoped that the issue of affidavits will reduce the possibility of fraud and provide information upon which each party can base their investigations. It is perhaps unfortunate that affidavits from the plaintiff are not required prior to the issue of proceedings and on commencement of the claim so that the respondent is in a position to carry out investigations and come to an informed decision before proceedings are issued. This procedure would lead to some front end loading of costs but might reduce overall costs, as fewer cases would require the issue of proceedings.

If the PIAB is to be successful it may be necessary to produce a book of quantum so that the assessments it makes are consistent and both claimant and respondent can gauge the value of a particular case. If a book of quantum were to became available it could reduce the number of cases going to the PIAB and to courts – the existence of the new procedures does not prevent the parties coming to an agreement without the intervention of either the courts or the PIAB.

3.7 Economic and financial factors: equity prices and interest rates

3.7.1 Equity prices

Insurers invest much of the long-term capital which supports their business (shareholders' funds) in equities, because these have tended to deliver the best long-term returns over time. However, the falls in equity markets over the last few years, discussed in Part 1, have substantially reduced the capital base of the insurance industry. This has reduced its capacity to absorb business, because the solvency margin which regulators require for general insurers under Irish law (which is largely based on European Directives) is effectively expressed as a percentage of premium.[132]

There is also a curious effect whereby the same solvency regulations can also effectively limit the capacity of insurers to accept business at a time of hardening rates. When premiums are rising (as in the 'hard' phase of an insurance cycle) insurers are actually able to write fewer risks (unless they can raise more capital) because the premiums they are charging have increased. It follows that insurers are able to write less business when rates - and often profitability - are highest, but more business when rates are lowest, even though the possibility of insolvency is greatest).[133]

The ultimate consequence of reductions in capacity is pressure for insurance prices to increase, with insurers that remain in the market being able to carry the premium increases that are necessary to restore profitability. We should also note that in this environment there is likely to be more emphasis by insurers on risk selection as they seek to make optimal use of the capacity that they have. Thus, the appetite of insurers for classes of insurance risks that they regard as unattractive, marginal or 'high risk' will reduce, making it harder for the businesses concerned to find affordable cover.

3.7.2 Investment income

General (non-life) insurers once regarded investment income as an extra 'windfall' on top of the underwriting profit that they expected to make. However, most general insurers have seen little in the way of underwriting profit in recent years and have depended heavily for their trading profits on investment income, which is now taken into account by general insurers when setting premium rates. The life offices have always done this, because life insurance contracts are long term and investment income is likely to be substantial. Although investment earnings are likely to be modest for most lines of general insurance business, they can be rather more significant for 'long-tail' business, such as employers' liability insurance. Claims reserves are one of the sources of investment income[134] and, in the case of liability insurance, these usually stand at a level that is about 400% of premium income. Thus, for every Euro 1 of new premium collected by liability insurers each year there is likely to about Euro 4 set aside in a reserve for outstanding claims. Substantial amounts of investment income can be generated from this source, but, of course, if investment yields fall this expected income will not be realised and profits will tend to fall.

The precise effect of recent falls in interest rates on the profitability of liability insurers is difficult to assess. Insurers funds are centrally invested and it is not possible to directly link investment income to the individual classes. The underwriting results across all lines of business are aggregated and the total investment income is then applied at a company level. For this reason it is not possible to ascertain precisely the extent to which investment income bridges the gap between claims and premiums in any particular line of business.

132 Conventionally regarded as approximately one third of written premiums, so Euro 1 of an insurer's capital can support Euro 3 of premium.

133 In the UK the ABI also note that, partly because of this counter-intuitive effect, the UK Financial Services Authority is moving to a risk-based approach to regulation of insurers. As part of this approach the FSA will expect insurers to allocate capital according to the risks which specific lines of business present. While this change is likely to mean certain lines of business, such as motor, will require less capital to support them, it is likely to increase the amount of capital required to support most liability lines, including EL. This will affect the pricing of EL, if the initial analysis of it is correct, because firms will be required to hold more capital against it and will be required to make a return on capital to shareholders.

134 Investment income is also derived from unexpired premium reserves and shareholders' funds – the capital base of the business.

3.8 Market conditions and market behaviour

We will consider a number of factors, some of which are linked, under this heading. They include:

- the effect of underwriting cycles;
- changes in reinsurance markets;
- the impact of the World Trade Centre terrorist attack;
- the effect of recent insurer insolvencies.

3.8.1 Underwriting cycles

From a purely actuarial viewpoint the underwriting and rating process is one of observation and statistical modeling, with the establishing of distinct classes of risk as its object. However, we have already seen that market forces and market behaviour also play a powerful role in fixing insurance premiums and levels of cover. In a so-called 'soft' market, when insurance cover is generally cheap and readily available, underwriters may be prepared to accept business at rates of premium that they know to be inadequate in order to retain their market share. Conversely, in a 'hard' market, when insurance is expensive and more scarce, insurers may be able to achieve rates of premium that are higher than the levels that are necessary to cover costs and make a normal profit. The phenomenon, whereby insurance markets tend to swing between 'hard' and 'soft' markets, with periods of (relative) profitability and (relative) unprofitability alternating over a cycle of 6-9 years is commonly known as the underwriting cycle.

The various theories that attempt to explain underwriting cycles have been discussed in Section1.3. It should be clear from that discussion that a number of factors might contribute to create the underwriting cycle, including underwriting losses, investment returns, competitive forces and reinsurance premiums, although there is no consensus in the scholarly literature on the precise effect of each of these things. However, the recent sharp increases in insurance premiums can, at least in part, be descriptively explained as the product of the hard phase of the current insurance cycle, even if the 'cycle' does not in itself justify them.

In fact the 'hardening' of the market was already well under way by 2001, well before the 'claims shock' of the World Trade Centre disaster. However, it is possible that this event added impetus to existing trend of rising rates. This is considered next, in the general context of recent changes in the reinsurance market.

3.8.2 Changes in reinsurance markets

We have seen that he availability of reinsurance is an important part of the operation of the insurance market. Insurers rely on reinsurance, and reinsurers' capital, to protect themselves against large single losses or accumulations of smaller losses from single events. Although insurers are generally free to set the terms of insurance risks and charge the premiums they think appropriate under a reinsurance treaty the latter may specify that certain types of high hazard risks are excluded, or that these risks cannot be accepted by the insurer without prior agreement by the reinsurer.

We have also seen that recent consolidation in the reinsurance industry has led to its being dominated by four very large international groups and their domination of the market has a significant effect on the cover insurers are able to offer. If one or more of the major reinsurers decides they are not prepared to provide reinsurance for certain exposures, or only prepared to accept them in specially defined circumstances, then insurers have little option but follow reinsurers' position. For example, pressure from the international reinsurance market in the wake of the Piper Alpha disaster obliged primary insurers in the UK to stop writing 'unlimited' EL cover and reinsurers' concerns over liability for pollution has led them to greatly restrict cover in this field also.

Recently the cost of reinsurance has risen sharply. As previously discussed, the massive claims arising out of the World Trade Centre disaster, a major part of which were borne by the global reinsurance industry, have themselves served to increase the cost and decrease the availability of reinsurance. This has, in turn, impacted on the cost of direct insurance, including liability insurance.

The UK Association of British Insurers (ABI) noted in this context:

'The effect of this loss has been twofold. Coming on the back of a decade of poor profitability for reinsurers, the WTC loss has caused the cost of reinsurance to increase sharply. The typical increase in the cost of reinsurance for major UK liability insurers has been 60-80% over the last year or two … The second effect of September 11 has been a more subtle, but arguably more profound one. The size of the loss, and that it was caused in a way which had never been foreseen, has caused a fundamental reappraisal of risk and exposure by reinsurers. Reinsurers have undoubtedly become more cautious about the risks they will accept. The result has been that the reinsurance treaties of UK insurers now often carry terms which exclude certain types of risk, or require insurers to obtain reinsurers' agreement before accepting the risk. These terms apply for example to rail risks or those with any exposure to asbestos, (even for professional indemnity insurance for architects and others.)'[135]

135 ABI response to UK Office of Fair Trading inquiry into liability insurance p. 26.

3.8.3 Insurer insolvencies

Insurance is no different from any other industry, in that insolvencies of participating firms occur from time to time. When there is a spate of insolvencies, as there was in the late 1960s and early 1970s in the UK, when twenty-four insurers went out of business, there is usually pressure for a tightening of regulatory controls. We see this pattern in Ireland, where supervisory powers were strengthened following the major company failures of the Insurance Company of Ireland (ICI) and the motor insurer PMPA. More recently, the passing into liquidation in early 1999 of the Gaelic Union Reinsurance Company in Galway raised questions about the adequacy of regulation and led to a strengthening in the Insurance Act 2000 of supervisory powers an authority in relation to reinsurance entities. Although the level of insolvencies amongst insurers in Ireland has been low in recent years one insurance company failure, that of Independent Insurance, may be regarded as significant for the purpose of this study.

Independent's liability insurance account and share of the UK market grew rapidly in the late 1990s (e.g. from 3% of the EL market in 1997 to 7% in 1999). Other insurers maintain that this growth came because Independent was severely under-pricing risks. It has been argued that the presence of Independent, and its subsequent insolvency contributed significantly to the current problems of the liability insurance market, especially in respect of EL. In particular, it has been alleged that Independent's under-pricing acted as a 'drag' on the EL market which prevented other insurers from obtaining more realistic premiums. Furthermore it has been suggested that the insolvency of Independent has resulted in stronger demands from shareholders to restore profitability across all lines of commercial insurance, forcing insurers to increase premiums.[136] Independent entered the Irish market late, and was established there only in the year 2000. However, it is probable that its presence in Ireland, as in England, helped to keep liability insurance rates down and that its subsequent insolvency, in June 2001, contributed to the dramatic hardening of the Irish market at this time.

3.8.4 The current market outlook

If the capital/interest rate theories of the insurance cycle hold, insurance prices are unlikely to stop rising until stock markets levels, and hence available equity capital, increases and/or interest rates begin to rise or are expected to rise. The new capital that has recently come into the global insurance and reinsurance market is only a small proportion of its overall capital. During 2003, and especially after the Iraq war, there has been some sign of recovery in stock markets. Interest rates have fallen in the euro-zone and UK, but there are signs that medium term interest rates, which are more relevant than short term interest rates for insurance companies that have claims with longer run-off patterns, are beginning to rise. Hence the two forces might now be pulling in the same direction during 2003, implying that the rate of increase in insurance prices can be expected to slow down and, in for some lines, rates may begin to fall. At the same time, there has been some resistance to higher prices, especially among corporate buyers, which can retain more of the risks. The market evidence from brokers suggests that insurance prices will peak quite soon, if they have not already peaked, and are likely to fall. There is evidence that 2003 will be a turning point, even though it might extend into 2004 for some classes of insurance business. However, for corporate liability insurances, it is likely that some market supply uncertainties will persist, owing to the nature of the legal environment and certain structural problems affecting employers' liability in particular. This is likely to see prices for liability insurance falling at a later date than for property insurances, and perhaps less quickly, although the introduction of the Personal Injuries Assessment Board in Ireland, discussed earlier may reduce some of the uncertainty surrounding injury claim settlements and exert a beneficial effect.

The theory of cycles does not fully reflect the structural changes in insurance markets. As we noted earlier, there has been increased concentration within the insurance and reinsurance sectors. Hence, although there is evidence that insurance prices may be on the downward path of the cycle, the extent to which decreases get passed through to consumers depends, inter alia, on the extent to which there is competition in the sector. Many of the large insurance and reinsurance companies have recently brought in new top management, often with stronger financial backgrounds. They have also set up internal financial systems which will indicate more quickly when reduced insurance prices are causing the rate of return on capital to fall below the level required by the stock markets. Hence, while insurance rates can be expected to fall to some degree, they are unlikely to fall sharply. The likelihood is that insurance markets will be subject to shorter and more dampened cycles.

There will be clearer evidence on whether the cycle has turned, or is close to turning, at the end of 2003, when reinsurances and many large commercial insurance programmes are renewed for 2004.

3.9 The potential for new entrants to the Irish market

It is axiomatic that increased competition in a market is likely to exert downward pressure on prices. We consider here the potential for new entrants to the Irish market and begin by considering the factors that govern the choice of markets for insurers.

136 See ABI response to OFT inquiry, especially p. 57.

3.9.1 Factors that govern the choice of markets for insurers

At first sight, there appear to be no major barriers to entry in the Irish liability and motor insurance market, apart from the general requirement imposed by the IFSRA for the authorisation of new insurance firms. Authorisation is granted only for the specified classes for which the applicant has sought a licence. The classes of risk have been defined in an EU Directive and are reflected in the Irish legislation.

The applicant for authorisation must satisfy a number of conditions. Generally, these include legal requirements as to the legal form of its undertaking, share capital and management (directors, controllers and managers of the insurer must be 'fit and proper persons' to hold the position concerned). The applicant must also submit a business plan showing, amongst other things, that it has adequate financial resources to support the business to which the licence relates.

Generally, the effect of EU legislation has been to harmonise regulatory standards across Europe. There has been no attempt to bring about absolute uniformity of regulatory controls, rather, the aim has been remove the extremes previously found in the regulatory systems of financial firms in Europe. European countries must now comply with a common core of regulatory standards, but European law still allows a reasonable degree of variation at national level.

Freedom of establishment for insurers within Europe and the right to sell insurance across national borders by means of a mutually-recognised 'single licence' issued at national level has enabled European insurers, at least in theory, to exploit (foreign) European markets more easily. In fact, the general effect of the EU 'Single Market' programme has varied from one country to another. For insurance markets that were previously subject to very tight regulation (such as France and Germany) the effect has been to de-regulate the industry. Conversely, for markets that were subject to light regulation only in the past, such as Ireland, the UK and the Netherlands, extra regulation has been necessary to bring the industry into line with general European standards. As a result of all this the Irish market can no longer be regarded as one of the most liberal in Europe in terms of government supervision.

However, the relative stringency of the regulations set by national insurance supervisory authorities is not the only factor that determines the strategy of an insurer in allocating its capital across domestic and foreign markets, or in seeking expansion in one market rather than another. Many other issues will come into play and these, collectively, may far more significant than the 'official' regulatory controls discussed above. Other factors that determine the attractiveness of a market include:

1 The size of the market
2 The perceived growth potential of the market
3 The profitability of the market
4 The level of competition within the market
5 The nature of the legal environment (especially where liability and motor is concerned)
6 The availability of statistics and other information required to underwrite risks
7 The presence (or absence) of unconventional insurance practices or products

3.9.1.1 Market size

It should be obvious that, other things being equal, a large insurance market will be more attractive to a potential new entrant than a small one. The prospects for growth will more limited in the case of a small market. Again, the volume of business that can be gained may not justify the expenditure necessary to set up business there, including the expense of acquiring the necessary knowledge and expertise to underwrite risks successfully (see 3.9.1.6, below).

3.9.1.2 Perceived growth potential

Whatever the size of the market, potential for growth in the short to medium term will be an important factor for the potential new entrant. For example, a developing country which is experiencing very strong economic growth, but where insurance spending has been low in the past, may be a attractive proposition, because demand for insurance is likely to rise rapidly as national wealth increases.

3.9.1.3 Profitability of the market

Markets that are chronically unprofitable will not be attractive to new entrants as it will usually be impossible to build market share without matching or even undercutting the rates charged by unprofitable insurers currently in the market. Theoretically, a new entrant could still succeed in such a market, even where existing insurers have failed. It could do so by offering products that are different from or better than those of existing insurers, by operating in a more efficient way (i.e. cutting management and/or acquisition costs), by offering a better level of service (e.g. in claims handling) or by better risk selection. However, the opportunities for product differentiation, trimming of expenses or more accurate underwriting are often limited.

3.9.1.4 Level of competition

If there is already a lot of competition in a market, leading to intense downward pressure on prices, the market is unlikely to be attractive to potential new entrants. However, if, on the other hand, potential entrants can see that the existing level of competition is not forcing prices to their lowest possible level, then, other things being equal, the market will attract more new entrants.

3.9.1.5 The legal environment

This factor calls for some rather more detailed comment, because the nature of a country's legal environment is a particularly crucial issue for both liability and motor insurers. The risk that is insured by a liability policy (and the third party element of a motor insurance) is that of incurring legal liability to another and having to pay damages to them. Unlike, say, the risk of fire damage to a give type of property, this risk is not uniform across Europe. Rather, it varies according to the nature of a country's substantive liability laws, its mechanisms for the administration of justice, and the propensity of its citizens to claim damages. The latter, in turn, depends on a wide variety of economic and social factors that themselves vary considerably from one country to another. For liability and motor insurers the ideal system is one that is stable and predictable, with levels of damages and tort litigation are moderate and likely to remain so. In terms of legal stability, the most attractive jurisdictions are those where liability laws (essentially, tort rules) are contained in detailed codes that are strictly interpreted, with the judiciary having little or no discretion in interpreting and developing the law. These, in the main, tend to be Civil Law jurisdictions. By contrast, Common Law jurisdictions (such as Ireland, the UK and the USA) tend to put more power into the hands of the judges, giving them much wider discretion in interpreting and developing the law, with results that sometimes far less predictable. Similarly, court award are much higher in some countries than others, subject to greater discretion on the part of the judge (or jury) and generally more volatile. Once again, Common Law jurisdictions tend to be the least attractive in this regard. A final factor is the propensity of accident victims (genuine or otherwise) to claim, sometimes described as the level of 'claims awareness'. In some countries (including one or two in Europe) levels of tort claiming remain very low. There may be a variety of reasons for this. For example, the courts may award only trivial amounts, social security benefits may be exceptionally generous, standards of education may be low or there may be some social stigma or religious objection attached to the claiming money for bodily injury.[137] Conversely, other countries exhibit a burgeoning 'compensation' culture, a term that is lacking in precision but generally taken to mean a society where there is an increasing tendency to blame others for any accident that occurs and demand substantial compensation, even for the most trivial injuries. Not surprisingly, insurers are wary of jurisdictions where such a 'culture', real or perceived, exists.[138]

3.9.1.6 The availability of statistics and other information

New entrants to a liability or motor insurance market need information from various sources if they are to underwrite risks successfully. In particular, they need to have reliable accident and loss statistics, because actuarial modelling of liability and motor business requires access to data on historical claims. The level and validity of industry data and detailed statistical information is variable in many countries, including Ireland and the UK, and this may act as a barrier.

3.9.1.7 Unconventional insurance practices or products

Insurers may be reluctant to enter a market where the products or insurance practices are unusual or unfamiliar. For example, many European insurers will have little experience of employers' liability insurance which is not written as a separate line or, simply, does not exist at all in many countries of Continental Europe. The effort and expenditure necessary to acquiring the necessary expertise may not be worthwhile, particularly if the market is small and unprofitable.

3.9.2 Insurer perceptions of the Irish market

It is impossible to measure precisely and objectively the perceived attractiveness of the Irish market to would-be new entrants and the authors are not aware of any recent studies in this field of. However, a 1995 study by Datamonitor provides some useful insights, which appear valid today. The study focussed on liability insurance only (excluding third party motor) and attempted to gauge the attractiveness of 16 European liability insurance markets on the basis of five of five factors (market size, growth potential, legal environment, competition and profitability). Each factors carried equal weight in the analysis and was given a value between 0 and 6, the higher the value the more attractive the market. See Table 16.

137 Notably in some Islamic states, where the claiming of damages for non-economic loss may be frowned upon as shameful and humiliating, if not actually forbidden by law.

138 In fact there has been no convincing research in this field, so there is no hard evidence as to whether or not such a 'culture' exists in Ireland, the UK or elsewhere.

Table 16: Perceived attractiveness of European liability insurance markets, 1995

Country	Market size	Growth potential (short/ medium term)	Legal environment	Competition	Profitability	Total score
Switzerland	4	2	6	6	6	24
Austria	3	4	6	5	5	23
Germany	6	3	6	4	4	23
Norway	1	3	6	6	6	22
Finland	1	2	6	6	6	21
Greece	0	6	4	6	5	21
Sweden	2	3	6	4	6	21
Italy	4	6	4	4	2	20
Portugal	0	4	4	6	6	20
Belgium	3	3	4	5	3	18
Denmark	1	3	6	3	4	17
Spain	3	6	2	4	1	16
UK	6	2	4	1	2	15
Netherlands	3	4	3	1	3	14
France	5	3	2	1	1	12
Ireland	2	3	1	4	0	10

Note: 6 = very attractive market
0 = very unattractive market

Source: Datamonitor

The Datamonitor study cannot claim to be very scientific, not least because the weightings given to the various factors seem more or less arbitrary. However, it does give some clue as to the sort measures that might to help contain insurance costs in Ireland. In particular, it is clear from the Datamonitor study, not to mention much other research, that the legal environment is a very significant factor in the high cost of motor and liability insurance in Ireland. The costs of operating the claims system, and the high levels of damages that it awards to accident victims, clearly have a direct impact on insurance costs. Furthermore, it seems very probable that the high costs and volatility of the system – whether real or merely perceived by insurance underwriters – significantly reduce the attractiveness of the Irish market to insurers who might otherwise enter it, generate more competition and help to keep prices down. Little can be done to alter most of the other factors mentioned in study that, allegedly, make the Irish market unattractive to insurers, but the legal environment is something that the Government does have some power to change. For this reason, it is to be hoped that the introduction of the PIAB, and the accompanying legal reforms, will indeed help to make the system cheaper and more efficient and help to make Ireland more attractive as an insurance market. We would suggest, however, that very significant reductions in insurance costs are unlikely to result unless levels of damages, especially for minor injuries, fall to a level that is closer to the European norm.

It is also our view that there is little chance of insurance costs reducing significantly as a consequence of better safety standards and reduced accident rates, since Ireland is already a safe country by international standards, so the effects of any improvements in this area are likely to be marginal. Again, we take the view that significant premium reductions are unlikely to accrue from reduced management costs and commission payments, even if further research should prove that these are still somewhat higher than the optimal level. We make no comment on suggestions that the high cost of insurance in Ireland is partly attributable to a practice whereby Irish insurers overprice insurance and then 'hide' in their reserves the high levels of profit that result. We do observe, however, that such a policy could not be maintained systematically over a period of several years, otherwise the reserves in question would rise to an astronomical level, patently beyond that required by ordinary prudence.

Finally we note that, in any event, there is likely in the near future to be some easing in the cyclical factors and adverse market conditions, discussed at various points in this report, that have contributed to recent steep rises in Irish motor and liability insurance premiums.

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Paper C

THE NON-LIFE INSURANCE MARKET IN IRELAND: PROSPECTS FOR EMPIRICAL ANALYSIS

Paper prepared on behalf of The Competition Authority[1]

Vincent Hogan and Colm Harmon, May 2003

1 The purpose of this paper is to explore, in practical terms, prospects for empirical analysis in the non-life insurance market in Ireland, with particular reference to Motor, Employer's Liability and Public Liability insurance. The paper is being made available to potential candidates for a consultancy contract in relation to the study on insurance being carried out jointly by the Authority and the Department of Enterprise, Trade and Employment. The contract involves the provision of industrial organisation analysis, including statistical and econometric analysis. The paper is not intended as a comprehensive guide, but as an indication of some relevant issues that could be researched and some possible sources of data. The intention is that the issues raised in this paper, and the identification of possible data sources and research methods, may help potential candidates to prepare proposals for the consultancy contract in question. The contents of this paper do not necessarily represent the views of the Authority or the Department.

CONTENTS

INTRODUCTION

The purpose of this study is to set out detailed proposals to examine empirically the state of competition within the non-life insurance market in Ireland and its effects on consumers. The focus will be on motor, public liability (PL) and employer liability (EL) insurance.

The study proceeds in two sections. In section A, we examine the specific issues/questions that arise when one considers the possibility of market power in the insurance industry and its possible adverse effects on consumers. We state clearly what type of data we believe would be needed to address each particular question with any degree of accuracy and reliability. We then indicate to what extent (if any) that this data is available. Where specific data is not available in published form, but could be requested from companies or the regulator, it is, of course, taken as given that confidentiality would be accorded to the data in question unless the holder(s) of the data expressly consented to its publication.

In the second part of this study, section B, we approach the problem from the other direction. We review the major sources of data in detail; indicate what questions they could answer and what questions they cannot answer. Inevitably there is a degree of duplication between these two sections, but different presentations help clarify the issues. Finally, we summarise the material in a table that lists each question/issue, the data needed to answer it and indicates its availability.

SECTION A

The differences between a competitive and a non-competitive industry can manifest themselves in several different ways. In this section we list 11 major market characteristics or aspects of firms' behaviour that may merit detailed examination. Each of these issues can be considered a separate line of inquiry that may shed light on the question of whether there is anti-competitive behaviour in Irish insurance markets to an extent that is detrimental to consumers.

In each subsection that follows, we discuss each issue in detail, showing how it relates to the insurance industry in particular. We show how each issue would affect, or be affected by, the degree of competition. The idea is to identify the signs of anti-competitive behaviour. Each subsection also shows what sort of data would be needed to decide the issue.

The 14 major issues that we examine are (in no particular order of importance):

1. Link Between Prices and Concentration
2. International Evidence on Prices and Concentration
3. Strategic Price Changes
4. Reaction to Taxes and Regulation
5. Rents, Economic Profits and Investment analysis
6. Rent sharing and X-inefficiency
7. Structural Analysis of Supply and Demand
8. Collusion Across Market Segments
9. Regulation as a Barrier to Entry
10. The Price of Risk
11. Wholesale and International Comparisons of Risk
12. The Insurance Company as an Investment Fund
13. Switching Costs
14. Vertical relationships

1. Link between prices and concentration

The most basic analysis one can perform is to see whether prices have been affected by the number of firms (or equivalently by concentration ratios). In simple terms one could run a time series regression model with the average premiums for some class of insurance as the dependent variable and various cost factors as the explanatory variables. The concentration ratio is also included as an explanatory variable. If the industry is behaving competitively the number of firms should have no effect on the price. On the other hand, if the industry is non-competitive, one would expect to see that a decline in the number of firms (increase in concentration) leading to an increases in prices.

In principle one can perform this analysis with data publicly available in the Blue Book going back any number of years. One can easily calculate the average premium for motor, EL and PL separately. One can also calculate the concentration ratio directly for each of the markets separately. Various claims cost measures are also available from the Blue Book.

While this analysis is easy to perform, there are a number of potential problems. Firstly there may not be enough variation in the number of firms over time to enable statistical procedures to identify the link with prices even if such a link exists.[2] Essentially statistical modelling works by comparing prices before a change in the number of firms with prices afterwards. It does so in a sophisticated manner that allows us to control for many other factors that may be changing simultaneously, but the basic "before versus after" effect is what drives the result. In other words, our statistical procedures could erroneously report that concentration has no effect on prices, not because the market is genuinely competitive, but because there have not been enough changes in concentration i.e. not enough difference between "before" and "after". It becomes as much art as science to determine whether a negative result is due to the absence of an effect or the absence of *evidence* of an effect.

Another difficulty with this form of analysis is the issue of costs. As we will discuss in sub-section A6 below (Rent Sharing and X- Inefficiency), the cost data from a non-competitive industry may be inflated. Non-competitive firms have little incentive to remain efficient and keep costs low as barriers to entry protect them. This means that costs could be rising as concentration rises (and competition falls). This makes it difficult for the statistical procedure to separate out the effects of genuine cost increases (claims culture, generous court etc.) from the effect of firms' inefficiency.

One way of avoiding this problem might be to drop costs from the statistical model altogether. One could then focus on the effect of concentration on prices directly. Doubtless the objection would be raised that this method failed to account for the effect of increased costs on prices – erroneously attributing the effect of such cost increases to changes in concentration. But this would only be true if the increases in costs occurred at precisely the same time and in tandem with changes in concentration. This can be tested for directly, by running a regression of average claims costs on concentration. If it turns out that costs have risen with changes in the number of firms then this is highly suggestive of non-competitive behaviour manifesting itself in rent sharing and X-inefficiency.

2 The MIAB reports that the number of firms offering motor insurance declined from 17 to 5 over the last decade. Using the Blue Book it will be possible to calculate a similar trend for EL and PL. It is not clear whether this variation will be enough, however.

2. International evidence on prices and concentration

One can expand the analysis of the behaviour of Irish insurance prices over time to include other countries. The idea here is to see whether the concentration of the industry has had an effect on price in Ireland that is different from its effect in other European countries. This analysis is potentially very interesting as there is already some evidence of considerable falls in insurance premiums in continental European countries following deregulation in the late 1990s. The studies that show this result tend to have concentrated in the big insurance markets and exclude Ireland from the analysis.[3] It would be interesting to see if the Irish market behaved in a systematically different way.

The data for this sort of analysis seems to be readily available at modest cost from a number of international sources (Swiss Re and the European insurers representative association see section B2 below).

An obvious objection to this sort of analysis is that comparisons across countries are invalid because the legal and social security systems are so different. One can address these objections in two ways. Firstly, one can control for the observable differences by using the technique of multiple regression as in the previous section. Objections may persist, however, that one cannot control for all those factors that are difficult or impossible to observe and measure (e.g. the willingness of judges to make high awards etc.). To meet this objection one can make use of more advanced econometric techniques such as fixed effects regression. This allows us to control for unobserved effects on prices that vary across countries in an unknown way but are fixed through time.

3. Strategic price changes

As an alternative to measuring the effects of concentration on average prices (premiums), one could estimate the effect of one firm's prices on another. In the industrial economics literature this is know as the "Conjectural Variation". It varies according to industry structure. In other words, firms react to each other's prices changes differently depending on whether the industry is competitive or collusive. So the aim of this analysis is to see how one firm reacts to another's prices and whether this strategic action is inconsistent with competitive behaviour.

While the idea behind the analysis is clear there could be problems with the data. This analysis places high demands on the data. One needs price data on individual firms (ideally for specific products) – industry averages are of little use here. Furthermore high frequency data (monthly probably) is also needed for a long time (possibly up to 10 years).

High frequency data is required in order that one can observe one firm's prices very precisely, immediately before and immediately after a competitor firm changes its prices. If one had only annual data, one would see prices only a long time before and a long time after the competitors' changes, and the effect would probably be swamped by the effects of other variables. The data is needed for such a long period in order to observe a number of different price changes and derive the average strategic effect with some reliability.

While getting data at this level of accuracy seems like a tall order, it does appear to be available from two sources – at least for motor insurance. Both Software Vineyard, who compile data for the Irish Insurance Federation and the MIAB, and Relay, who run the online quotation service for brokers, seem to have the data. Both these datasets provide detailed information on each motor insurance contract written since 1997. This data could prove invaluable in studying various aspects of the insurance market and we discuss this in more detail below (section B1).

4. Reaction to taxes, regulation and cost factors

One other way of discerning the level of competition in the insurance industry is to identify the reaction of price (premiums) to changes in the tax system. The economic theory of taxation states that firms in a competitive industry will react differently to changes in taxation from firms in oligopolistic or monopolistic industries. One can probably detect this in a regression framework of the kind discussed above. The main problem with this approach is that there may not be enough changes in taxation through time to identify the effect. Just as with the effect of concentration on prices, one needs sufficient observations before and after changes in taxation.

A variation on this theme is to look at the effects of changes in regulation on premiums. Regulations are not the same as taxes from a legal point of view but can have very similar economic effects. For example, a requirement that insurance companies keep a portion of their capital in safe liquid assets leads to lower returns on their investments. This is equivalent to a tax on investment income.

More generally, if one can identify some change that is known to have affected firms cost structure in a particular way, one can trace the effect of this change on prices and deduce the effect on the mark-up. Wolfram (2001) adopted this strategy in assessing the oligopoly power of the UK electricity industry. The trick is to identify some change that affects costs in a known way. A change in the regulatory environment may suffice.

We have not yet been able to discern whether there have been many changes to the tax system faced by insurance firms.

3 See Sigma (2000)

However, it should be possible to request such information from the regulator or even from the firms themselves. We would expect it to be easier to verify changes in the regulatory framework. Changes are indicated in the Blue Book and more detailed information would surely be available from the regulator. There were a series of EU directives during the 1990s, which considerably changed the regulatory framework. We have already cited evidence that this had dramatic effects in continental Europe (see section A2 above).

Wages are another possible source of exogenous variation. Compensation for loss of earnings forms the largest single component of the claims cost for EL and is a significant component of motor and PL claims. There is clear evidence that wages have risen in recent years and this increase can be precisely measured from CSO data. It would be interesting to see to what extent this increase fed through into claims costs and premiums and whether it was consistent with competitive behaviour on the part of insurance companies.

Finally, the terrorist attack on the World Trade Centre may also provide a way to estimate the mark-up. The terrorist attack affected the cost structures of insurance firms throughout the world. It would be interesting to see if Irish premiums reacted differently to this cost shock than premiums in other EU countries. This could easily be done within the context of a fixed effects regression as discussed in section A2.

5. Rents, economic profits and investment analysis

A direct way of assessing the competitive structure of the insurance industry is to check whether firms appear to be making excess profits (also know as "Super Normal Profits" or "Economic Rents") i.e. profits over and above what a competitive firm would make providing the same service and paying for its inputs at opportunity cost.[4]

Although this is a very simple question to ask it is extremely difficult to answer in practice. Most economists regard direct measures of profits with great suspicion. Accounting standards of profit do not coincide with economic standards (valuing assets at historical price rather than replacement cost for example). In addition, self-reported profits are obviously open to manipulation, either downward to minimise tax bills or even upwards to boost share prices.

A way around this is to apply the techniques of investment analysis. This analysis, typically employed in stock brokers or investment banks, tries to take the public accounts of a company and back out a measure of the true economic profit by stripping away the effect of arbitrary accounting policies. The idea is that the resulting measure of "true" profit is used to make a recommendation to buy, hold or sell the companies shares. The practice of investment analysis has suffered from a battered reputation in the aftermath of the US stock market bubble and the various scandals at Enron etc. However, in principle the technique is valid, once it is performed by a genuinely independent analyst.

As most of the companies providing insurance in Ireland are now subsidiaries of major international groups, no investment analysis is publicly available (such as those produced by Standard and Poors etc.). However, the techniques of investment analysis could be applied to the returns of insurance companies reported in the Blue Book. Furthermore the Blue Book contains information over and above what is typically contained in published accounts making this sort of analysis unusually accurate. In fact there is anecdotal evidence that insurance companies use the Blue Book to perform precisely this sort of analysis on their competitors.

Furthermore, the regulator is in possession of, or can get, detailed actuarial reports as to the solvency of the insurance firms. One would expect these reports to contain similar sorts of analysis to that provided by full investment analysis. If the study were to proceed down the road of investment analysis, these reports would be an obvious starting point. They may have to be requested directly from IFSRA by the Authority or, alternatively, by duly appointed consultants from the companies rather than from the regulator.

Two caveats are necessary. First, while this sort of investment analysis is grounded in economics, economists and statisticians are not specifically trained in its techniques. It is probably best performed by professional invest analysts. Such analysts come with a fee and a possible conflict of interest, as some of their biggest customers are likely to be insurance companies. Secondly, it is important that the firms' costs are measured in terms of opportunity cost and not the actual cost. As shown below, there are good reasons to expect non-competitive firms to have excessive costs.

6. Rent sharing and x-inefficiency

Even if one cannot calculate the size of excess profits directly one may be able to deduce their presence indirectly. Economic theory tells us that when firms make excess profits they will often agree to share those rents with other stakeholders who co-operate with the rent extraction process.

So, for example, in the case of the insurance industry one might think that the industry shares the rents with the legal profession by paying fees that are above the minimum required to receive legal services. In principle one could examine this by comparing legal fees here with legal fees in other jurisdictions as in the MIAB report. However, if higher

4 By evaluating inputs at opportunity cost we mean the minimum cost it takes to supply the input, i.e. excluding from the calculation of costs all rent sharing and X-inefficiency (see next section).

fees are detected in Ireland, it could be suggested that this is indicative of anti-competitive behaviour in the legal profession rather than the insurance industry. To get around this, one could look at the growth in legal fees paid by insurance companies over time relative to growth in the fees earned by other legal specialities (criminal law, family law etc.). If there is evidence that fees for insurance cases have grown faster than fees for other cases, this could be taken as evidence of rent sharing. And for rent sharing to occur, there have to be rents in the first place.[5]

It is not clear what data is available to examine this question. The best hope seems the data held by legal cost accountants (see section B4 below). It is worth noting that this data could also be useful in the Authority's on-going investigation of the legal profession. Captive insurance companies and self-insurers may also be willing and able to help (see section B7).

One problem with the rent sharing analysis is that it is one sided. If evidence of rent sharing is found then we have evidence of anti-competitive behaviour. On the other hand, if there is no evidence of rent sharing then it does not follow that the industry is competitive. It could still be the case that there are rents, but that the insurance industry does not need to share them with lawyers if, for example, lawyers have no market power over firms.

The issue of X-inefficiency is related to rent sharing. Rent sharing means sharing profits with other vested interests, X-inefficiency means sharing profits with the internal bureaucracy of the firm. This occurs in terms over staffing, lax procedures, and excessive administrative costs --- a general failure to trim the excess fat in the firm. There is anecdotal evidence that the procedures that some insurers use to assess risk in Ireland are fairly primitive by international standards. For example, it seems that few firms employ actuaries on non-life business. Also it appears that relatively few factors are taken into account when assessing the risk of EL and PL contracts. It appears that not much use, if any, is made of the facility allowed by the insurance block exemption to establish common risk premiums based on collectively ascertained statistics on the number of claims. It is difficult, however, to provide formal independent evidence of X-Inefficiency. Although one could ask individual companies and/or IIF for formal statements of their risk assessment procedures and compare them to best practice (details available from CEA or Swiss Re). Of course it is unlikely that any company will admit to implementing anything other than best practice.

It might be possible to get formal evidence of X-Inefficiency by looking at labour productivity. In other words do employment figures (controlling for firm size) differ systematically in Ireland from other European countries? This sort of data would be available from the CEA or Swiss Re datasets already mentioned.

An objection to both X-inefficiency and rent sharing is that no profit maximising company would pay more than it has to for inputs. This would surely be the industry's response. In their reply to the MIAB report, they blamed the legal profession for high costs necessitating high premiums.

The counter argument is that the industry may not even know that it is rent sharing. Rent sharing and X-inefficiency can occur simply because it is easier for management that way, not necessarily as a result of a deliberate conspiracy. Providing the business is earning decent profits why rock the boat by angering stakeholders inside the firm (X-inefficiency) or outside the firm (rent sharing)? Of course such reasoning could not work in a competitive industry. A new entrant could secure business by cutting internal costs (eliminating X-inefficiency) and seeking cheaper suppliers. Competition not only drives down prices, but it drives down costs also and puts incompetent firms out of business.

The insurance industry might object that it has no control over legal costs. But it is not clear that it has tried every avenue to exert control. For example, it could employ lawyers directly or limit the number of lawyers it employs on each case, seek arbitration as opposed to courts, and aggressively contest dubious claims, complain to the Competition Authority etc. There is some anecdotal evidence that insurance companies are unwilling to contest claims even when the insured party is.

7. Structural model of supply and demand

One way of calculating the mark-up of firms is to estimate it directly in the context of a fully specified model of the supply and demand sides of the market.[6] To do so, the econometrician has to estimate a statistical model of consumer behaviour (the demand side) and also a model of firm behaviour (the supply side). Estimates of the elasticity (i.e. sensitivity of consumers to prices) can be derived from the demand side, while estimates of the conjectural variation can be derived from the supply side model. Both the elasticity and the conjectural variation can be combined to give an estimate of the mark-up.

Furthermore, estimating a fully specified structural model enables the analyst to simulate the effects of various changes on the market. In fact, these models are usually estimated in order to analyse the effect of regulatory changes, mergers or increases in costs of inputs etc. In this way, the structural modelling procedure combines the analyses of sections A1, A3, A4, A8 and A9.

There are two problems with the structural approach. Firstly, it is complicated. Not only must one derive a model of consumer behaviour and a model of firm behaviour but one must specify the link between them. This complication

5 Rose (1987) used this sort of analysis to detect the presence of rents in the US trucking industry before deregulation.
6 For a general discussion of this approach see Reiss and Wolak (2002)

implies that non-standard statistical procedures may have to be used when these models are applied to the data. The second problem is one of "Garbage In, Garbage Out". The structural approach involves making assumptions about the nature of firms' interactions and consumers' preferences. If those assumptions are not accurate, then resulting estimates will be meaningless as will any predictions/simulations based on those estimates.

Nevertheless, this sort of analysis could be carried out for the Irish insurance market. The method of Feenstra and Levinsohn (1995) could be applied to data at the level of the policyholder (i.e. the MIAB/Software Vineyard data or the Relay data). Alternatively, the method of Berry, Levinsohn and Pakes (1995) could be applied to data aggregated to market-segment level.

Note that both of these methodologies involve making assumptions about the nature of competition in the market. Essentially both assume that firms engage in Betrand competition over differentiated products. This assumption also seems plausible for the Irish insurance market. But to the extent that it is not true (i.e. if competition is really Cournot or Stackleberg etc.), the methodology would need to be amended appropriately; otherwise the results could be highly misleading.

Overall, given the complexity of the methodology (and the consequent expense) and also the sensitivity of conclusions to initial assumptions, we suggest that this mode of analysis may not represent good value for money (see also section C3).

8. Collusion across market segments

There is anecdotal evidence that all firms do not compete in all segments of the market. In the case of motor insurance, the MIAB report was able to show that some firms effectively did not provide insurance for young male drivers and one seemed to specialise in young female drivers. No detailed information on EL and PL is currently available but the Professional Insurance Brokers Association (PIBA) reports similar specialisation for no apparent reason. This raises the prospect that the Irish insurance market could be even more concentrated than the aggregate data suggests. Instead of five main companies competing aggressively everywhere, we have each firm behaving as a monopoly in a set of segments.

Can one identify whether this is true in general for EL and PL in the manner that it appears to be true for motor insurance? If policyholder data is available for PL and EL on the lines of the data eventually secured by the MIAB, then the question could be answered directly. It is not clear that such data exists in a central location, however.

As an alternative, associations of insurance brokers, e.g., the Professional Insurance Brokers' Association (PIBA) and the Insurance Brokers' Association, could be asked to conduct surveys of members. Presumably they could easily identify the nature of any market segmentation and the particular companies operating in each segment. The disadvantage of this data is that it is somewhat less rigorous than the full policyholder data. Note also that the Blue Book does not contain data for market segments. The most disaggregated data that the regulator possesses separates the non-life industry into motor, PL, EL etc.

When market segments have been identified, one can calculate segment specific concentration ratios. Then if one has segment specific prices for a number of years (which can be directly calculated from policyholder level data) the analysis of section A1 can be replicated for each segment separately. If those segments that are systematically more concentrated also have relatively higher premiums, then this will be evidence of anti competitive behaviour.

If the insurance market is indeed segmented, that raises the question of why it is so. More specifically, if some firms are very profitable in some sectors why don't other firms enter that sector? Whatever barriers to entry may exist for entry to the insurance market overall, there would seem to be very few barriers to moving from one segment to another. For example, if a company is selling insurance to young female drivers, it does not need regulatory approval or indeed additional expertise to sell insurance to male drivers. Male drivers may well be more risky. But this suggests that you charge them more, not that you don't enter the market segment. Notably the IIF could not provide a precise explanation as to why some firms didn't compete in some segments, but supposed that it was something to do with asymmetric information (see below).

Note also that the IIF reply to the apparent over-charging of female drivers identified by the MIAB by saying that there was cross subsidization from female drivers to male drivers. But this cannot be the case if different firms dominate the two different market segments. This is something that is easy to check with policyholder level data.

On a general level, there are two possible rational explanations for such failure to compete: collusion and asymmetric information. We deal with collusion first.

There may be collusion between firms who deliberately avoid "treading on each other toes" i.e. firms have agreed to allow each other act as monopolists in different segments. This kind of collusion need not be the result of a formal conspiracy -- it could be tacit. In other words, one firm simply avoids entering a market segment. A firm with a presence in that segment observes this self-restraint and as informal quid pro quo, avoids entering one of the segments

that is important to the first firm. Firms know that entering a segment dominated by another firm will probably lead to a price war in that segment and maybe even a counter attack in another segment. This will lead to lower profit all round. Thus "Mutually Assured Destruction" can maintain discipline of a cartel even in the absence of an explicit agreement.

Gathering evidence for this sort of process is difficult. But if one has policyholder data over time one could track the market share of different firms in each segment. If we observe increasing specialisation through time (i.e. firms exit some segments and don't enter others) then we will have evidence of a process of tacit collusion.

The alternative explanation is that asymmetric information creates a barrier to entry. Dell'Arriccia and Marquez (2003) show how information can give an incumbent firm an advantage over a new entrant even if the latter is more efficient. Essentially, the incumbent firm has more information about the nature of risk in that segment than the new comers simply because the incumbent has been there for some time. Using this information advantage the incumbent will in general be able to offer deals to customers whose risk it knows more accurately. The new entrant is faced with the choice of leaving the market or matching the incumbent's price to customers whose risk it cannot accurately assess.

This explanation is possible. But it doesn't seem that likely in the motor insurance market at least. Firms do not have access to each other's policy records that are provided to Software Vineyard. But they are able to observe each other's quotes in the market through the relay system and probably other informal mechanisms. In any case, if asymmetric information does count as a barrier to entry, it cannot explain why firms exit a market segment. In fact if information is valuable, there is an incentive to never leave a segment as to do so is to render valueless the information you have built up over the years and make it difficult to return to the segment at some time in the future.

In any case it is possible to test directly for the presence of informational asymmetries using the method of Cohen (2003) who found evidence of such asymmetries in Israel using policy level data. One can duplicate her work for Ireland using the policyholder data such as the MIAB data or the Relay data.

Finally, if information does constitute a barrier to entry, then it constitutes a barrier than can easily be removed or reduced if firms are granted access to information about every market segment. This would not have to be at the level of policyholder data (i.e. the software vineyard data) summary statistics would suffice. On this issue note that the IIF states that firms do not see the MIAB data of competitors. But for PL they typically see the claims history with previous insurers. It is still possible, however, for firms to check prices of competitors motor insurance via the Relay programme.

9. Regulation as a barrier to entry

Regulation can act as a barrier to entry. Indeed it is supposed to act as barrier to the entry of financially unreliable firms. There is a possibility however, that such prudential regulation may operate against the interest of consumers by preventing the entry of competitors to a non-competitive market.

In an earlier section we commented on how changes in regulation can be used as a statistical device to ascertain the reaction of firms to changes in costs and hence to deduce their competitive behaviour. One can also look at the effects of regulation directly to see if it creates a barrier to entry in practice. There are several reasons to suggest that it does and that a formal analysis of this issue is worthwhile. Firstly, a study by Swiss Re pointed out how deregulation in Europe was followed by dramatic falls in premiums – dramatic falls that didn't occur in Ireland. Suponcic and Tennyson (1995) show that US states with more stringent regulator regimes seemed to have less competitive insurance industries. Hausman (1997) showed that regulation in the US telecoms sector acted as a tax on consumers but had welfare cost far in excess of normal taxes.

Secondly, there is anecdotal evidence that the Irish regulatory requirements are more stringent that the European average. Following the reforms of the 1990s, regulation of insurance companies takes place within the same framework throughout Europe. However national authorities are free to a certain extent to choose their own parameters (reserve ratios etc.). The Irish authorities have chosen to have more stringent reserve ratios in general. Furthermore, the reserve ratios are increased substantially for new entrants during their first few years of operation, creating a very explicit barrier to new entry.

One can analyse these issues formally in the context of a multiple regression model using data across time and EU countries. Essentially, one would want to run the same model as described in section A2 where regulatory stringency is added to the list of explanatory variables. If regulation acts as a barrier to entry in a significant way, one would expect the regulatory stringency variable to have a positive effect on premium levels. In effect, this analysis would replicate the work by Suponcic and Tennyson on US states for the EU.

The additional variable needed – regulatory stringency – should be easy to get. As all the EU countries have similar regulatory structures it should be straightforward to measure the degree of stringency consistently across countries (for example different reserve ratios etc.). This data may be available from the Irish regulator, or if not, could be collected by them from their colleagues in the other member states. It should also be available from the CEA (see section B2). The

separate project being carried out by Cass Business School regarding the economics and regulation of insurance may provide greater detail regarding regulatory stringency, and differences between member states in this regard. To the extent that it is considered desirable to examine regulation as a barrier to entry, it would be appropriate in defining data requirements to liaise with Cass Business School.

A potentially straightforward exercise in considering regulation as a barrier to entry would be for the Department or regulator to ask those companies that have made enquiries about possible entry to the non-life sector, but have not gone ahead with entry, to identify what factors prevented them from proceeding with their application.

10. Price of risk

If an analyst has access to a full set of policyholder level data over a number of years then he/she can duplicate the pricing decisions of firms. To be clear, the MIAB dataset holds data on every policy issued by IIF member firms covering motor insurance over a certain period of time. This dataset contains all the information that the insurance company has about the policyholder i.e. all information on which it can base its premium decision. One can therefore duplicate the pricing decision of firms and make some judgement about the reasonableness of those prices.

This is basically what the MIAB report did. There is relatively little added value in duplicating their work. However it would suit the present discussion to reformulate the MIAB analysis in terms of calculating the price of risk. Just as economists calculate an index of consumer prices or house prices; one can in principle calculate a price of risk. In other words, one views risk as the commodity that is being transferred from the insured to the insurer for a fee. If the market is competitive then the price of risk should be constant across all segments and equivalent to the price of risk in securities markets. So for example, male drivers might be charged more but only to the extent that they have more units of risk.

Any analysis along these lines would have to resolve a number of conceptual issues. In particular it is not clear how exactly to define the unit of risk whose price we seek. In principle it could be defined in many ways: the probability of an accident; the expected value of a claim; the probability of a claim above a certain threshold etc. All of these are plausible measures of risk (used in the MIAB report) but clearly each of them is deficient in some way. What is needed is an unambiguous, logical, precise and single parameter, which captures the risk inherent in an insurance contract. We are not sure that there is any such measure. But we suggest that one could follow the practice of financial economics and define risk in terms of the covariance of the returns of the asset (insurance contract) with the returns on the stock market.

One could in principle duplicate this analysis for EL and PL. But as we discuss in section B1, it is not clear that policyholder data is easily available for EL and PL.

This price of risk is in principle a more accurate measure of price than the average premium data used in the previous sections, as risk is the commodity that is really being traded. Once one has a price for risk, one could revisit the analysis of the previous sections using price of risk in place of average premium. So for example, one could see the effect of firm concentration on the price of risk across time and within segments (sections A1 and A8).

11. Wholesale price of risk and international comparisons

Having calculated the retail price of risk in Ireland it would be useful to compare this with the price of risk internationally and the wholesale price of risk i.e. the price of reinsurance. Ideally, in order to do this, one would like policyholder data throughout Europe – which is clearly not available.

However, there may be a way of short-circuiting this requirement. Swiss Re, one of the worlds leading insurance and re-insurance companies, offers an online tool, which allows the registered user to price risk in different countries. Apparently the formulae in this software ("Liability Fac") are based on analysis of over a hundred different risk factors internationally.

The software will provide the minimum premium needed to cover the risk of a particular insurance contract. It will also provide a quote for Swiss Re to reinsure this risk. It would be interesting to use this software to price typical Irish contracts and compare the price with those charged by Irish insurance companies. The re-insurance price will have to be adjusted for the fact that insurance firms typically re-insure only a certain portion of the claims distribution. However once the price for a portion of the claims distribution is known, a price for the whole distribution can be derived, if the shape of the entire claims distribution is known. This data is available from the regulator via Form 8.

In addition to the formal Liability Fac software, Swiss Re has several publications that show how to price risk given data on claims history, risk factors etc. These publications could be used as a basis of a simple model to derive the price of certain typical insurance contracts.[7]

Another way to examine the price of risk across countries would be to get data from captive insurance companies. These are companies that don't offer insurance to the public but to a single client or group of clients. For example, McDonald's has its own in-house insurance company that insures all their restaurants worldwide. These companies

7 See for example Swiss Re (2000,2003)

tend to offer a single very standard product across countries. As such they provide a useful basis of comparison for claims costs, risk factors etc.

12. The insurance company as a hedge fund

The MIAB report pointed out that one could think of insurance companies as investment funds. They take in large amounts of cash as premiums and, at a later date, pay most of it out in claims. In the meantime, the insurance company invests the cash and earns a return. Viewing an insurance company in this way, one can see that it is in its interest to have high claims financed by high premiums, because both generate a large volume of cash flow --- the greater the flow, the higher the investment income. (This provides a rationale for why insurers may not be two concerned to fight any rent sharing of the type discussed in section A6 above).

This view of insurance companies is not unique to the MIAB; it is relatively common among industry insiders.[8] One can take the analogy further. An insurance company is like a hedge fund that borrows cash and buys shares. The insurance company has a disadvantage over a normal hedge fund in so far as prudential regulation will prevent it from investing in high return (and high risk) assets.

On the other hand, the insurance company has an advantage over the investment fund in so far as it can borrow money cheaply as customers are obliged by law and prudence to buy insurance. When individuals buy insurance they are effectively lending money to the insurer. When claims are paid, it as if the insurer is paying back the loan. Any underwriting loss can be considered the interest paid by the insurance company in return for borrowing customers' money to finance its investment strategy. In fact taking this view of the insurance company, there should always be an underwriting loss. If there is not then this indicates that the firm is not operating in the borrowing side of its business (i.e. underwriting) in a competitive manner. Instead it is using market power to extract favourable credit terms from its lenders. As the MIAB report noted, and a glance at the blue book confirms, underwriting losses are not unknown but are far from being the norm. For similar reasons one would expect the size of any loss to co-vary positively with the level of real interest rates if the insurance market were competitive. This is easy to test econometrically.

One can take the analogy one step further. Hedge funds are often valued by construction a portfolio of stocks that has similar risk profile to the fund. The return of the resulting portfolio can then be though to give the price of the risk incurred by the fund. If the fund produces an even higher return then it is rated a good buy.

One can perform similar analysis of an insurance company. The idea is that one would construct a portfolio of stocks that match the risk profile of the potential claims against the insurance company. The market value of the resulting portfolio then gives the competitive market price for the aggregate risk taken on by the insurance company. This price can then be compared with the price the insurance company charges its customers i.e. the aggregate premium. Any difference will imply some deviation from competitive behaviour.

In principle one can perform this analysis using the aggregate claims data (Form 8) submitted to the regulator but not included in the Blue Book. Established techniques exist to find a matching portfolio from among internationally traded stocks. One caveat: this calculation of the price of risk takes the claims data as given. If rent sharing and X-inefficiency exist the finding that these claims are priced at market value does not indicate competitive behaviour.

13. Switching costs

A competitive market is characterised by a large number of firms providing products that are close substitutes for each other. In section A8 (Collusion across Segments) we examined the possibility that firms may behave as monopolists within their own market segments. A consequence of this would be that it would be very difficult for a consumer to switch from one firm to another.

However, even in the case where several firms compete in a particular segment they still have an incentive to make it difficult for individuals to take their business elsewhere. There is some anecdotal evidence to suggest that this does indeed occur. For example, insurance companies have been accused of sending out renewal notices close to expiry of the policy in order to make it difficult for the individual to search for alternative quotes. Asymmetric Information (see section A8) would also act as a barrier to switching in so far as it makes it more difficult for an insurance company to quote for new business compared to returning business.

In order to analyse the extent to which switching is a problem the analyst would need access to policyholder data that contains information on identifiable policyholders through time. Unfortunately the MIAB data, while at the level of the policyholder, does not allow the analyst to identify individual policyholders. In principle this data should be available from the insurance firms or via the Relay system. Using this data the analysts could track how often individuals change firms.

A fuller analysis would require a comparison between the insurance contract that the consumer actually bought with others available at the time. The other (rejected) quotes are not recorded directly in the data. But it should be possible to proxy them by looking at the quotes received (and accepted) by other similar individuals from the other insurance companies.

8 See Swiss Re (2001) and Warren Buffett's description of Berkshire Hathaway's business strategy in Buffett (2002).

14. Vertical relationships

Insurance products are sold through intermediaries (e.g., brokers and tied agents) and, also, directly by insurance companies. A role of insurance brokers is to offer independent advice to consumers. Any person acting as an insurance brokers is required to be able to place insurance with at least five insurance undertakings. However, if brokers have an incentive to place business with a particular insurance company (in order to preserve an agreement with that company) rather than find the cheapest quote on the market, the consumer will not get the expected service from the broker, and might pay more than if they had searched the market themselves.

In order to analyse whether this is an issue, and if so, to what extent, it would be useful to find out how many brokers have had relationships with insurance companies discontinued for not placing enough business for that company (e.g., by a survey of brokers). The survey could also ask each broker what their volume of Motor, EL and PL business is, and the percentage of that business they have done in respect of each specific insurance company over the last five years.

SECTION B

In this section we review each potential source of data and comment on its availability. We also indicate the issues identified in section A that each source of data can shed some light on. These relationships are summarized in the table below.

1. Policyholder data

In principle the most comprehensive data that can be made available is data on each insurance contract made over a period of time. The dataset should contain all the variables that are used by the insurance firms to set their premiums. With this kind of data one can replicate their decisions and form a judgement on whether their behaviour is consistent with that of a competitive industry. Specifically one can answer several questions posed in section A of this report: one can price risk directly (section A10); one can identify market segments and the effects of concentration in those segments (section A8); one can test for asymmetric information as a barrier to entry (also section A8); one can test for strategic price behaviour (section A3); estimate a structural model of the insurance market (section A7) and calculate switching costs (section A13). Such data may be available from three sources:

1. Software Vineyard / MIAB/Insurance Companies
2. Relay
3. Brokers

Software Vineyard / MIAB/Insurance companies

Software Vineyard compiles data for the Irish Insurance Federation to fulfil their obligations to the MIAB. The data provided to the MIAB covered the years (1997-2001) and is now finally consistently coded across firms and time.[9] Now that the collection infrastructure has been established, it should be possible to get data going back further and also include 2002.

More importantly the MIAB data collected by Software Vineyard applies only to motor insurance. Similar data for EL and PL is not available from one source. In principle one could collect this data from the major insurance companies separately. However, bearing in mind the difficulties experienced by the MIAB, it is unlikely that data provided by different firms would be coded in a consistent way. Sorting out this data could be expensive and time consuming.

Another problem with this data is that there is no way of identifying individuals. This means that the data is of little use in answering questions regarding switching costs (section A13). In order to look at this issue we need to be able to track individuals over time as they change (or not) their insurance companies.

Relay

An alternative source of basically the same data may be provided by a company call Relay. This company is one of the two companies that supply software and on-line quotes to insurance brokers. They confirmed that they store a record of all insurance contracts agreed over their system. This data is stored electronically in an easily available and consistent format going back to 1997. In principle data is also available going back to early 1990s, but may not be coded consistently. They account for about 65% of the broker market. This data is likely very reliable because it forms the basis for real contracts. A downside is that the Relay system does not apply to EL and PL. The upside is that the Relay data would enable the analyst to track a policyholder through time and look at switching behaviour (section A13).

Broker

It has been suggested by a number of sources that a large brokerage firm may be in position to provide data on EL and PL contract in electronic format. If the brokerage firm were large enough, this would be a representative sample of the whole market and valid for statistical analysis. There would also be the possibility of tracking individuals through time to examine switching behaviour. At the moment we have no information as to the willingness/ability of a brokerage firm to provide this data.

2. International Data: Swiss Re and Comite Europeen Des Assurances (CEA)

There are two commercially available datasets that enable international comparisons of insurance markets to be made. Swiss Re provides a data set encompassing all countries in the OECD dating back as far as 1980 at a cost of e1000 for ten years worth of data.

The European insurers representative association (CEA) also provides a similar dataset at e240 for each year. In addition the CEA provides a country-by-country comparison of regulatory frameworks. Some of the CEA data may be available from the IIF.

9 This data is to be distinguished from the aggregate data produced by Software Vineyard. This is effectively an electronic version of the Blue Book and of analyses derived from the Blue Book.

It is difficult to make a judgement on the quality of these datasets without seeing them. However, we have been able to examine some of the studies conducted with both datasets and look at some introductory documentation over the WWW. It seems that the Swiss Re dataset is more comprehensive.

With these datasets one can examine the following issues: Do Irish insurance markets respond to changes in regulation and taxes in a similar manner to the rest of Europe (sections A2, A4)? They may also be able to shed light on the variation in regulatory stringency across the EU (section A9) and also on the productivity (X-inefficiency) of insurance companies (section A6).

3. Blue Book and Regulators' Data

The regulator has access to several data sources, which will be of some limited use in the analysis of the issues identified in section A. However, the legal position regarding access to this data would need to be clarified.

The Blue Book

The data in the Blue Book can be used to calculate concentration ratios for the Irish insurance market (section A1). Unfortunately it is of no help in identifying concentration in market segments as it only reports figures for EL, PL and motor as a whole (section A8). The Blue Book will also be of use in the investment analysis approach (section A5) as it collects consistent and detailed accounting data.

Form 8

The details of claims against the firm through time may be used to assess the aggregate risk underwritten by the firm (section A12). It will also enable the construction of parametric claims distributions, which can be used to derive the wholesale price of risk from the re-insurance quotes provided by Swiss Re (section A11). It may also be useful in helping to price risk from policy level data (section A10). Form 8 is not published but is in the hands of the regulator. There may be a problem with the interpretation of expected future claims data that is contained in Form 8. Clarification will be needed of the actuarial assumptions used to derive these figures.

Regulator stringency

The regulator should also be able to provide at least some data on the relevant stringency of regulations across the EU (section A9).

Actuarial reports

Finally, the regulator also has access to detailed actuarial reports on the profile of risks faced by each firm. These could be used to calculate the market price of the aggregate risk underwritten by insurance firms (see section A12). If these are not made available by the regulator, they would have to be requested from individual firms.

4. Data on legal costs

Data on legal costs are necessary to examine the rent-sharing hypothesis of section A6. Fees for most criminal lawyers should be available from the DPP or the Chief State Solicitor. For other specialities including insurance related cases, the situation is more difficult. The Bar Council has indicated that it has no data on fees. The taxing master has data, but not in electronic format. Furthermore, this data is related to disputed legal cost, which may be very different from the average.

Legal cost accountants possess this data in detail. We talked to one firm who confirmed that they had standard procedures for evaluating the costs of legal services. They keep records of thousands of cases in a standard format. Unfortunately, these records are on paper (each case is summarized on two A4 pages) and, of course, are considered highly confidential.

To the extent that cost accountants only deal with disputed legal bills, the data may constitute an unrepresentative sample of legal costs. One would guess, for example, that only the larger costs are disputed. This could cause problems for any analysis. There are, however, well-established techniques for dealing with such "sample selection" issues. The most simple is to assume a particular parametric form of the distribution of legal costs and then to assume that a certain portion is disputed. The parameters of the distribution can then be derived. A better alternative is to identify some variable, which will predict that a bill will be disputed but itself not correlated with the size of the bill. No such variable springs to mind at the moment. However, if one can be identified then we can calculate the distribution of legal costs without recourse to parametric assumptions.

The fact that the data is available raises two possibilities. Firstly, a firm could be contracted to conduct an examination of their files and construct either a fully anonymous data set or summary statistics. Secondly, the data could potentially be summonsed using the powers of the Competition Authority. However, it is unlikely that the data would be that crucial for this study as to justify the expense or inconvenience of either of these two courses of action.

5. Swiss Re Insurance and Reinsurance Quotes

Swiss Re is one of the world's biggest insurance companies. On its website it provides manuals and software to aide underwriters in the pricing risk. Most of these procedures are fairly straightforward and could be applied to Irish data with a modicum of effort.[10] This would enable to compare the retail price of risk in Ireland with its retail price elsewhere and its international wholesale price (section A11).

In addition, the Swiss Re website allows access to a more sophisticated piece of software called "Liability Fac". Apparently the formulae in this software are based on an analysis of over a hundred different risk factors internationally. Using this software is an indirect way of accessing what appears to be a very rich database of the international insurance market.

The software will provide the minimum premium needed to cover the risk of a particular insurance contract. It will also provide a quote for Swiss Re to reinsure this risk. It would be interesting to use this software to price typical Irish contracts and compare the price with those charged by Irish insurance companies.

It seems that the software is designed to be simple to use yet sufficiently rigorous to be used in real underwriting decisions. However, as we have not yet been able to use the software, we cannot state this with certainty. The conditions of use imply, but do not state explicitly, that the user must be an underwriter. Furthermore there is explicit prohibition on communicating the results of the software's analysis. Nevertheless, as the software seems potentially so useful that it is worth exploring whether it could be accessed for the purposes we have outlined.

6. Broker Survey

A survey of brokers conducted through representative association(s) could help identify market segments and which firms have entered or exited segments over time. This would help answer the market segmentation collusion hypothesis (section 8). Indeed, for PL ad EL, there may be no other source of data.

7. Self Insurers and Captive Insurance Companies

Some companies find it more efficient to self-insure i.e. to bear the risk of meeting claims against them from their own resources. Self-insurers will have data on Irish legal fees even for non-disputed costs. This would be useful for sections A6.

Captive insurance companies are a variation on the self-insurance theme. They are firms that don't offer insurance to the public but to a single client or group of clients who are also often their owners. For example, McDonald's has its own in-house insurance company that insures all their restaurants worldwide.

These companies tend to offer a single very standard product across countries. As such they provide a useful basis of comparison for claims costs and claims probabilities across countries. This would be useful for sections A2, A6, A11.

As self-insurers and captive insurance companies do not operate in the open market, they have no obvious reason not to co-operate. Furthermore, several captive insurers are based in Dublin (IFSC) they will come under the jurisdiction of the Competition Authority, as will the domestic self-insurers.

10 The documentation associated with one of these algorithms contains the following sentence which deserves to be quoted in full: "The price calculated using the above method, although accurate in risk underwriting terms, is occasionally thought of as to low by commercial standards". See Swiss Re

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DATA	QUESTIONS	SOURCES	AVAILABILITY
Policy Holder data	A3 Strategic price changes (2) A8 Collusion and across Segments (2) A8 Asymmetric Information (5) A7 Structural Model (10+) A10 Price of Risk (10) A13 Switching Costs (2)	MIAB/Software Vineyard (5) Relay (5) Broker (5) Individual Insurance Companies (?)	Available Possibly Available but Legal Issues Unknown Unknown
International Data	A2 Concentration (1) A4 Reaction to Regulation (1) A6 X-Inefficiency (1)	Swiss Re (2) CEA (2)	Commercially available Commercially available or from IIF
Legal Costs	A6 Rent Sharing (1)	Taxing master Legal Cost Accountants (4)	Unknown Data exists but confidential and in paper format
Irish regulatory data	A1 Concentration (1) A5 Investment Analysis (2) A4 Reaction to Regulation (1) A12 Insurance Company as a Hedge Fund (4)	Blue Book (0.5) Form 8 (0.5) Actuarial Reports (4)	Available Available If not made available by regulator, could be requested directly from companies
Swiss Re Quotes	A11 Wholesale Price of Risk (2)	Liability Fac (1)	Commercially available but restrictions on use and dissemination
Brokers' Survey	A8 Collusion and Segmentation (0.5) A6 Rent Sharing (0.5)	Questionnaire to members of Brokers' association(s) (4)	PIBA and IBA both willing to co-operate
Self Insurers & Captive Ins. Company	A6 Rent Sharing (1) A2 International Comparisons (1)	Claims Data	Unknown

Paper D

ANALYSIS OF THE 2002 STATUTORY RETURNS IN THE IRISH MARKET AND RELATED MATTERS

Paper prepared on behalf of The Competition Authority

Dorothea Dowling, February 2004

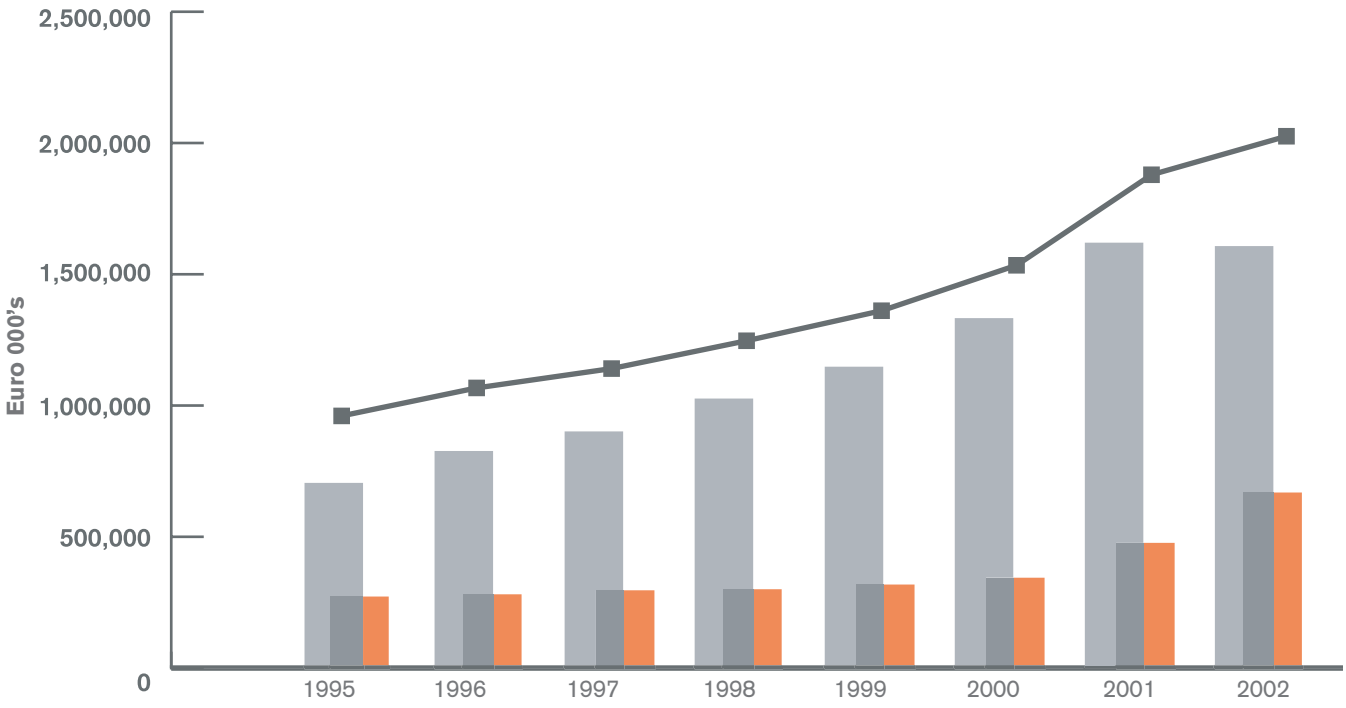
CONTENTS

Size of the market

L.1 This study is focused on the non-life insurance market and in particular on three classes of business – Motor, Public Liability and Employers' Liability. The only reliable source of national statistics on these underwriting accounts is contained in the Statutory Returns filed annually by insurers to the Solvency Supervisor. Extracts from those returns are published in the "Blue Book" approximately 11 months after the year of account to which they relate. Set out below are headline figures from those returns but, as will be explained later, these must not be interpreted as definitive reflections of market size or premium trends.

L.2 The latest available figures are for the year ending 2002. The published Statutory Returns on insurers' revenue do not provide a breakdown of the liability account between Public Liability and Employers' Liability so only the division with Motor is shown below. Over the period from 1995 to 2002, net Written Premium Income increased by 133% being 128% for Motor and 145% for Liability.

Written Premium Income - Net
Source: Form 2 - Insurers' Statutory Returns



	1995	1996	1997	1998	1999	2000	2001	2002
Motor	705,420	826,868	901,376	1,026,551	1,147,999	1,332,943	1,620,352	1,607,376
Liability	272,467	280,926	296,255	300,190	318,173	344,124	476,956	668,709
Total	**977,887**	**1,107,794**	**1,197,631**	**1,326,741**	**1,466,172**	**1,677,067**	**2,097,308**	**2,276,085**

Year of Account

L.3 Written Premium Income refers to the amount taken in by insurers for the policies sold in a particular year, net of the cost of reinsurance. However, not all the premium received in a specific year relates solely to that year of risk. For example, of an annual premium paid on 31st September only a quarter relates to cover for the balance of the current year and three quarters must be put aside in an "unexpired risk reserve" to cover the period from the following January until the next renewal. Equally, in addition to the premium payments actually received in the current year, there will be a balance carried forward from payments in the previous year for the unexpired risk period. The premium which relates solely to the current year is called the Earned Premium Income. The difference between the Written Premium Income (i.e. the actual amount of premium received in a year) and the Earned Premium Income varies each year to reflect the reality of renewal dates of the policies in the portfolio. The accruals of Earned Premium Income (EPI) as a percentage of the Written Premium Income (WPI) for Motor and for Liability are shown in the table below for the years of account back to 1995.

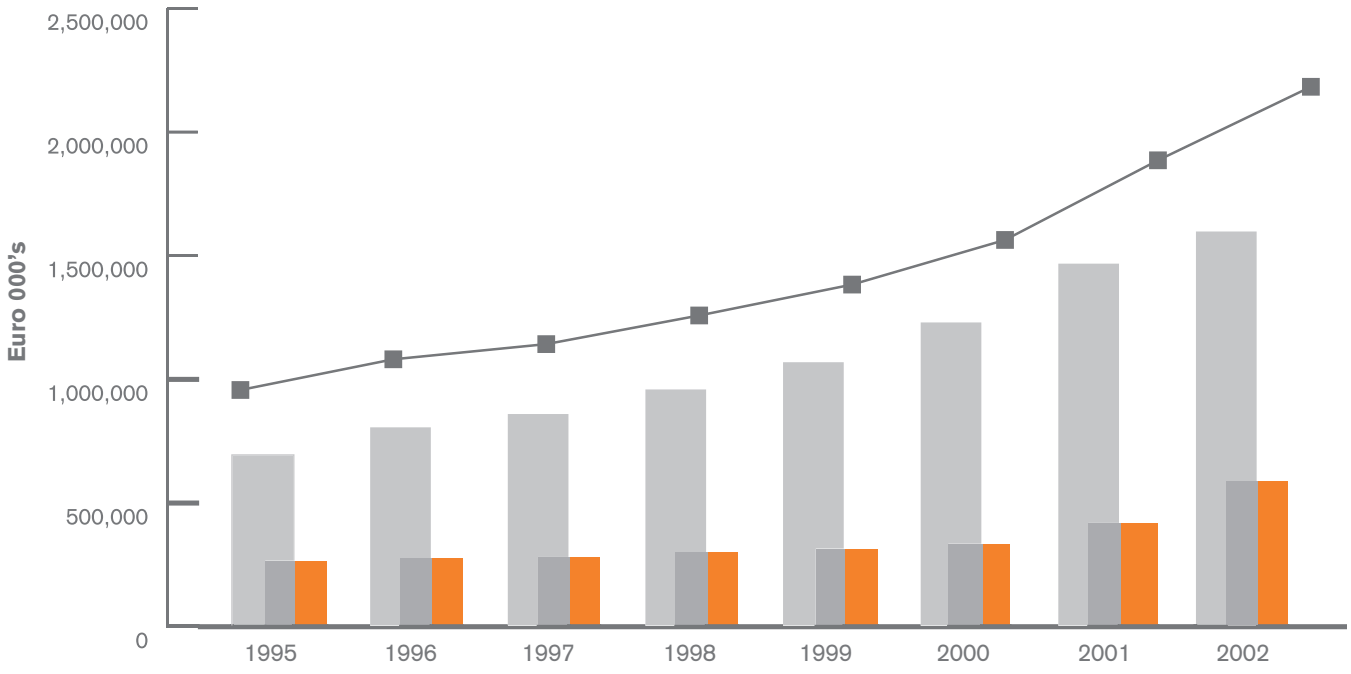
L.4 The level of Written Premium Income is also relevant to investment returns which will be examined later but Earned Premi--at 127% in total, being 130% for Motor and 118% for Liability.

EPI as % of WPI per Year of Account

Class	1995	1996	1997	1998	1999	2000	2001	2002
Motor	99%	98%	96%	94%	93%	92%	91%	100%
Liability	99%	99%	95%	100%	99%	98%	88%	88%

Earned Premium Income - Net

Source: Form 2 - Insurers' Statutory Returns



	1995	1996	1997	1998	1999	2000	2001	2002
Motor	694,603	808,693	862,533	961,910	1,071,948	1,232,765	1,470,534	1,600,561
Liability	267,119	277,189	282,191	301,173	316,035	335,641	419,899	587,108
Total	**961,722**	**1,085,882**	**1,144,724**	**1,263,083**	**1,387,983**	**1,568,406**	**1,890,433**	**2,187,669**

Year of Account

Annual Increase in Earned Premium Income

Class	1996	1997	1998	1999	2000	2001	2002	7 yrs
Motor	16%	7%	12%	11%	15%	19%	9%	130%
Liability	3%	2%	7%	5%	6%	25%	40%	118%

L.5 The annual percentage increases are as set out in the table above. However, such percentages do not reflect the trend in charges reported by individual consumers at generally higher levels. There are also different factors at play in motor insurance compared to general liability business.

L.6 The potential market for motor insurance is identifiable from the number of registered vehicles because of the compulsory nature of the cover. However, the level of indemnity may also change over time e.g. policyholders with newer cars buying comprehensive cover where they might previously have been satisfied with Third Party, Fire & Theft. It must also be recognised that there is a level of uninsured driving which, though decreasing since the introduction of windscreen discs, has not materially altered over the timespan in question. As demonstrated in the Report[1] of the Motor Insurance Advisory Board (MIAB), the trend in total Motor premium also reflects the increasing volume of the vehicles registered.

L.7 The market for liability insurance is more difficult to quantify for various reasons. More people at work and higher economic activity could increase the demand for liability insurance and add to insurers' revenue even without increase in premium charges. However, the cost trend in renewals quotations has been such that many businesses are no longer insuring all their liability exposure "from ground up". Larger companies may elect a total self-insurance programme with or without "stop-loss" reinsurance to limit their exposure. Smaller businesses may be taking a higher excess of liability retention, either electively to reduce the premium or because it is the only basis upon which cover can be secured. Further indications on changes in exposure units will emerge when we examined data on claims in a later section.

Market shares of insurers

L.8 Many insurers are licensed to underwrite both Motor and Liability insurance but chose to specialise in one area of the market. As demonstrated in the MIAB report, over 50% of the motor insurance market is held by two companies but these are not the same two lead competitors in the Liability market.

L.9 For Liability just over 41% of the market is held by two companies when account is taken of the fact that Allianz operates two identities, ranked at second and eight in the table which follows of the top ten market shares. The last two right-hand columns in the table show the previous years' ranking for Liability from which major changes in position are noted for only two companies, St Paul and Quinn Direct.

L.10 There are 578 authorised insurers who can operate in Ireland of which 411 can underwrite liability. However, as will be seen below, 10 players hold 96% of the market and others who could compete do not appear to be attracted to this business.

Liability Revenue Account 2002

Rank	Company	EPI €000's	% of Market	Rank 2001	Rank 2000
1	Hibernian	125,648	21%	1	1
2*	Allianz Corporate	82,143	14%	2	2
3	IPB	62,281	11%	4	3
4	St Paul	52,597-	9%	3	9
5	FBD	50,875	9%	6	5
6	Royal Sun Alliance	50,858	9%	5	4
7	Eagle Star Ireland	49,402	8%	7	6
8*	Allianz Ireland	36,356	6%	8	7
9	AIG	28,017	5%	9	10
10	Quinn Direct	20,728	4%	10	12

1 Published April 2002 with data up to 1999 year of account

Motor Revenue Account 2002

Rank	Company	EPI €000's	% of Market	Rank 2001	Rank 2000
1	AXA	420,870	26%	2	1
2	Hibernian	321,268	20%	1	2
3	Eagle Star Ireland	161,790	10%	4	4
4	Quinn Direct	157,252	10%	3	7
5	FBD	138,795	9%	5	3
6*	Allianz Ireland	128,747	8%	7	6
7	Royal Sun Alliance	119,286	8%	6	5
8*	Allianz Corporate	71,136	4%	8	9
9	AIG	31,155	2%	9	11
10	St Paul	25,191	2%	10	12

L.11 For the sake of completeness the market shares of motor insurers, set out in the MIAB report as at 1999, are updated above. In the succeeding years 50% of the market continued to be held by the top two companies although they had swopped lead position. The third position is more properly reflected by the combination of the two arms of Allianz with a combined share of 13%. Quinn Direct have significantly increased their ranking holding 10% of the motor market in 2002 compared to only 1% in 1999.

L.12 It must be mentioned at this point that Lloyds have had a fairly constant presence in the Irish market at about 17% in Liability and 2% in Motor but their returns are filed with the English Insurance Regulator and are not open to analysis undertaken in this study.

L.13 There are various reasons given why insurers might choose to underwrite motor and not liability or vica-versa. It must be presumed that the first priority of corporate strategy is to make a profit which provides an acceptable return to shareholders. It is, therefore, instructive to examine and compare the profitability of classes of business.

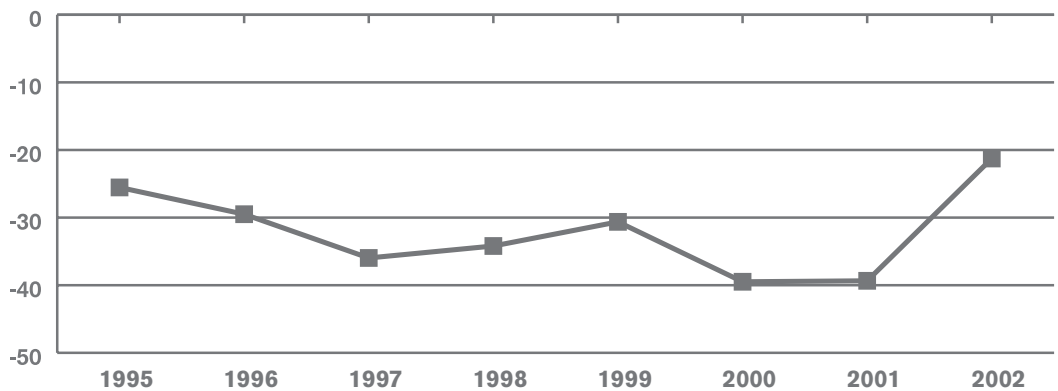
Market performance

L.14 Announcements by motor insurers indicate a significant profit in 2003 but we are currently only in a position to analyse Statutory Returns for 2002. However, insurers maintain that there is only limited improvement in liability business so the currently available information reflects recent trends.

L.15 The layperson can be confused by insurers speaking of their losses yet, at the same time, profits are being distributed to shareholders as dividends. There are essentially two levels of performance, the first being the underwriting loss and the second being the bottom line result after investment income is taken into account.

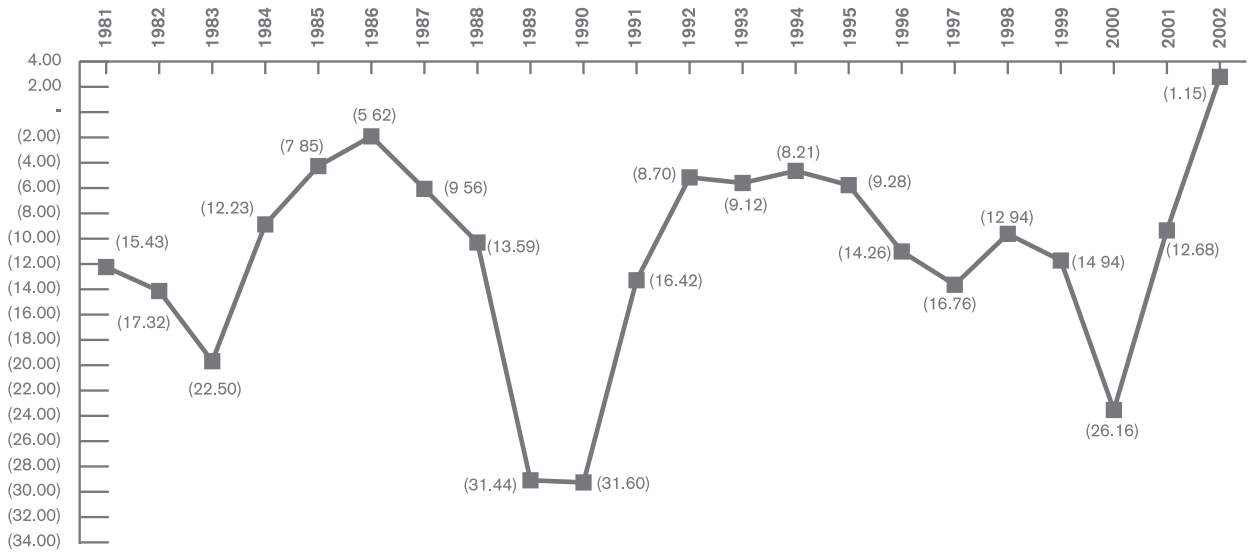
L.16 Dealing first with the underwriting loss, this is the deficit between the amount received in premium for the risk period and the amount incurred on claims plus insurers' management expenses and the commission paid to insurance intermediaries (if any). Later sections of this report will examine those items of income and expenditure separately. The chart which follows shows the underwriting result as a percentage of Earned Premium Income between 1995 and 2002 for the Liability account.

Liability Underwriting Loss as % EPI



	1995	1996	1997	1998	1999	2000	2001	2002
Underwriting loss as % EPI	-25.54	-29.5	-35.97	-34.2	-30.63	-39.49	-39.35	-21.26

Motor Underwriting Losses as % EPI



L.17 These figures indicate that for every euro of premium, insurers incurred outlay of an additional 26% in 1995 rising to an additional 40% in 2000 and 2001 before reducing to an additional 21% in 2002. It would not be unusual throughout Europe to see incurred costs exceeding premium income as insurers historically relied on investment returns to produce a positive bottom line result. However, in recent years investment income was never likely to fill the shortfall reflected by the figures above. The manner in which insurers allocate their investment returns to various underwriting accounts will be examined in a later section of this report.

L.18 For the sake of completeness the underwriting results of motor insurers, set out in the MIAB report as at 1999, are updated below. In the year 2000 there was a significant deterioration when the Underwriting loss represented over 26% of Earned Premium Income compared to just under 15% in previous year of 1999 and just under 13% in the following year of 2001. This loss trend has altered significantly with an underwriting profit shown for the first time in 2002 of 1.15% of Earned Premium Income.

L.19 It might also be noted above that the years 1989 and 1990 reported the most significant losses to date. It is understood that this reflected insurers' pricing in anticipation of positive effects on claims costs from the abolition in 1988 of juries hearing personal injury cases but these anticipated efficiencies did not convert into any savings when Judges alone assessed compensation levels. The deficits experienced at that time were made up from premium increases during 1991 and 1992.

L.20 On the basis of what is known to date, it seems likely that the deficits experienced between 1999 and 2001 have been eliminated in 2002 with further profitability likely to be reported for 2003. It has yet to be determined whether this turnaround arises solely from significant increases in premium charges during 2000 and 2001 or a combination with anticipated savings from insurance reform measures announced in mid 2002. The favourable trend in road accidents from the introduction of penalty points commenced in October 2002.

L. 21 Policyholders consider there to be less competition between liability insurers than among those offering motor cover where the value of the market is around three times higher. The comparison between underwriting results as a percentage of Earned Premium Income for Motor and Liability for the years since 1995 is set out in the table below.

Underwriting Result as % of EPI per Year of Account

Class	1995	1996	1997	1998	1999	2000	2001	2002
Motor	-9%	-14%	-17%	-13%	-15%	-26%	-13%	+1%
Liability	-26%	-30%	-36%	-34%	-31%	-40%	-39%	-21%

L.22 The favourable trends in motor have yet to reflected for liability although there is a significant improvement in 2002 over the preceding two years. Obviously, this improvement in the liability result cannot be attributed to the introduction of penalty points which related to road accidents only.

L.23 Insurers, traditionally, have not relied on the underwriting result to produce a bottom line profit. Because it takes some time before the money received in premium must be paid out in claims, insurers have substantial funds to invest for often significant periods of time. In a later section on claims costs, the rate at which claims are finalised will be examined. Information on insurers' earnings from investments only became available from the Statutory Returns of 1995 onwards, although the Deloitte Touche Report[2] of 1996 provides some estimates for previous years. The following section deals only with the data available from the Statutory Returns.

Insurers' investment income

L.24 When investment returns are factored into the equation the operating result alters considerably from the underwriting outturns observed earlier. Obviously, the rate of return varies from year to year because of external factors such as the prevailing interest rate which has been decreasing in recent years. However, as demonstrated in the table below, the rate of return accrued in any particular year can also vary between Motor and Liability. Insurers do not invest separate funds for different underwriting classes but allocate the additional income by varying criteria.

L.25 Between 1995 and 2002 the additional income from investment expressed as a percentage on top of Written Premium Income has fallen in Motor from 23% to 11% but it reduced even further in Liability from 30% to 9%. Until 2002, the investment allocation was higher for Liability than Motor and often significantly so, as in 1999 where Liability earned an extra 30% compared to 12% for Motor. There may be justification for the variance in allocations on the basis that liability claims are longer tailed with an opportunity for longer term investment.

L.26 The trend of reduced investment allocations do not appear to consistently reflect the external investment environment. In 2002 there was only a 2% difference between the two classes of business, with Motor being higher at 11% compared to 9% for Liability. In contrast, Liability in previous years had the higher investment allocation. If the historical practice had been followed in 2002, the Liability account could have reflected a considerable improvement on the technical result for that class of business.

L.27 Insurers at market level never pay out claims at an amount equivalent to the level of Written Premium Income in a year. The margin between premium taken in and claims paid out is actually widening in recent years with the balance going from 37% to 50% in Motor and from 78% to 106% in Liability, as shown in the table below. This is somewhat surprising given that the delays experienced in cases reaching Court trial have improved significantly since 1995.

L.28 In addition to making payments on claims, insurers must also make provision for outstanding claims not yet settled arising from accidents in the period for which the premium has been earned. The issue of adjustments on prior years' reserves is also part of this equation and will be examined in the section on claims costs. In the meantime, as demonstrated in the table below, the Cost of Claims Incurred consistently exceeds the amount of Earned Premium Income (EPI) for Liability but for Motor only in the accounts for 1997 and 2000.

Investment Income as % on top of WPI per Year of Account

Class	1995	1996	1997	1998	1999	2000	2001	2002
Motor	23%	19%	20%	14%	12%	12%	11%	11%
Liability	30%	30%	34%	31%	30%	28%	19%	9%

Amount of WPI as % of Claims Paid per Year of Account

Class	1995	1996	1997	1998	1999	2000	2001	2002
Motor	137%	122%	115%	131%	130%	132%	150%	150%
Liability	178%	150%	140%	127%	136%	120%	179%	206%

Amount of EPI as % of Claims Costs Incurred per Year of Account

Class	1995	1996	1997	1998	1999	2000	2001	2002
Motor	109%	103%	99%	102%	100%	90%	102%	115%
Liability	95%	92%	87%	89%	91%	85%	84%	97%

2 Economic Consequences of the Cost of Insurance in Ireland

Investment Income as % of Closing Balances for Outstanding Claims & Unexpired Risk Reserve per Year of Account

Class	1995	1996	1997	1998	1999	2000	2001	2002
Motor	8%	7%	8%	6%	5%	5%	5%	4%
Liability	7%	7%	7%	6%	6%	5%	4%	3%

L.29 In addition to shareholders' and other funds, insurers can invest the difference between what they take in by way of premium and the amount they must pay out. Because injury claims may take many years to finalise, the value of reserves for outstanding claims is usually many times the level of claims paid in a year. In addition, there are reserves for unexpired risk (explained at paragraph L.3) which are also invested. Taking these two reserve funds we can express the rate of investment return for a year of account as a percentage of the closing balances as in the table above.

L.30 When the approach above is adopted, it will be noted that there is little margin between Motor and Liability investment returns. A higher variance might be expected given the difference in average claim life within these classes. On average by payment value, it takes 3 years to finalise Motor and 6.5 years for Liability based on 2002 data. This will be examined further in the claims section.

L.31 Insurers maintain that when determining their pricing they traditionally did not seek to achieve an underwriting breakeven and that consumers share in the benefit of investment income. In 2002, the Irish Insurance Federation stated that many insurers were still operating on the basis that their expenditure would be in the region of 103% of premium thereby relying on investment returns to produce a favourable bottom line result.

L.32 In summary, when account is taken of investment income the underwriting losses (at paragraph 21) are converted into a profitable result in all but three years for Motor and in all but four years for Liability as reflected below.

Intermediaries' commissions

L.33 Insurers' outlay on commission to agents is in addition to insurers' own management expenses which are examined in a separate section. The level of commission payable on motor insurance policies and other selected non-life classes was capped at 5% by Ministerial direction under Section 37 of the Insurance Act 1989. That limit was abolished from 30 September 1999 on the advice of the Attorney General that it contravened Article 85 Treaty of Rome.

L.34 As a number of motor insurers transact a substantial portion of their business directly with the public, the average rate of commission as a percentage of premium income was lower than the 5% limit. The overall commission level had remained fairly constant at 3% of Written Premium Income until 1999 when it rose to 4% and then increased further in 2002 to 5%. The amount of commission paid on motor rose by 230% from €23ml in 1995 to €76ml in 2002.

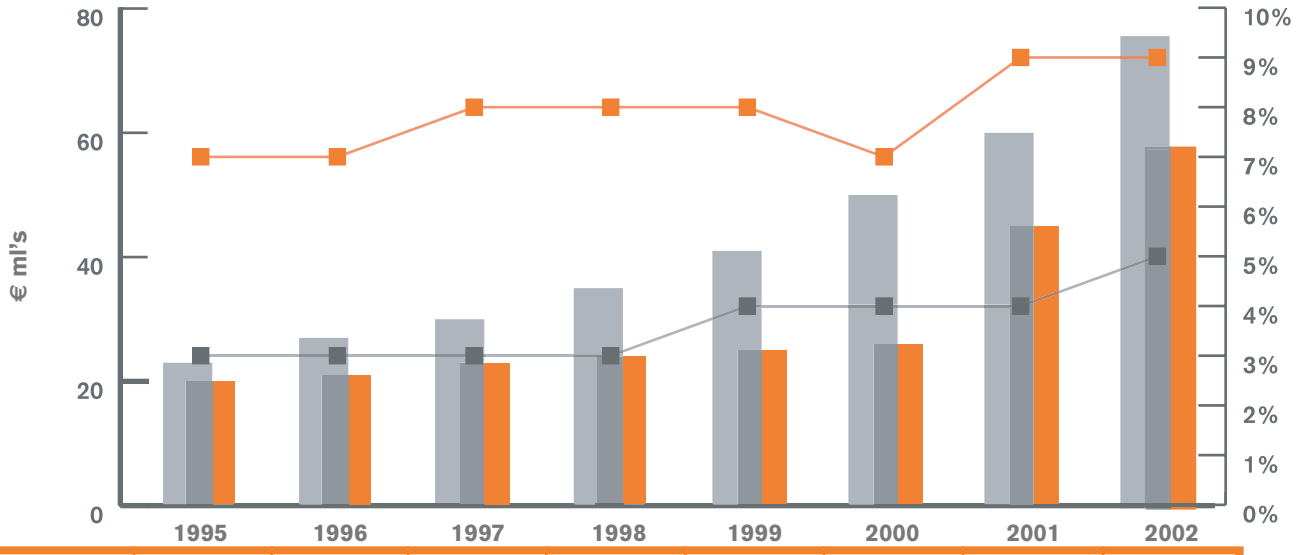
Motor Technical Result per Year of Account €ml's

Year of Account	1995	1996	1997	1998	1999	2000	2001	2002
Underwriting result	-65	-115	-145	-124	-160	-322	-186	18
Investment Income	162	154	184	145	140	156	173	169
Technical Result	97	39	39	21	-20	-166	-13	187
Technical Result as % EPI	14%	5%	5%	2%	-2%	-13%	-1%	12%

Liability Technical Result per Year of Account €ml's

Year of Account	1995	1996	1997	1998	1999	2000	2001	2002
Underwriting result	-67	-82	-101	-103	-97	-133	-165	-125
Investment Income	83	83	101	94	97	95	90	60
Technical Result	16	2	0	-9	0	-37	-75	-65
Technical Result as % EPI	6%	1%	0	-3%	0	-11%	-18%	-11%

Commission & as % Written Premium Income



	1995	1996	1997	1998	1999	2000	2001	2002
Motor Comm	23	27	30	35	41	50	60	76
Liability Comm	20	21	23	24	25	26	45	58
Motor Comm%	3%	3%	3%	3%	4%	4%	4%	5%
Liability Comm%	7%	7%	8%	8%	8%	7%	9%	9%

Year of Account

L.35 For Liability, the rate of commission has increased from 7% to 9% of Written Premium Income. The amount of commission paid has risen by 190% from €20ml in 1995 to €58ml in 2002.

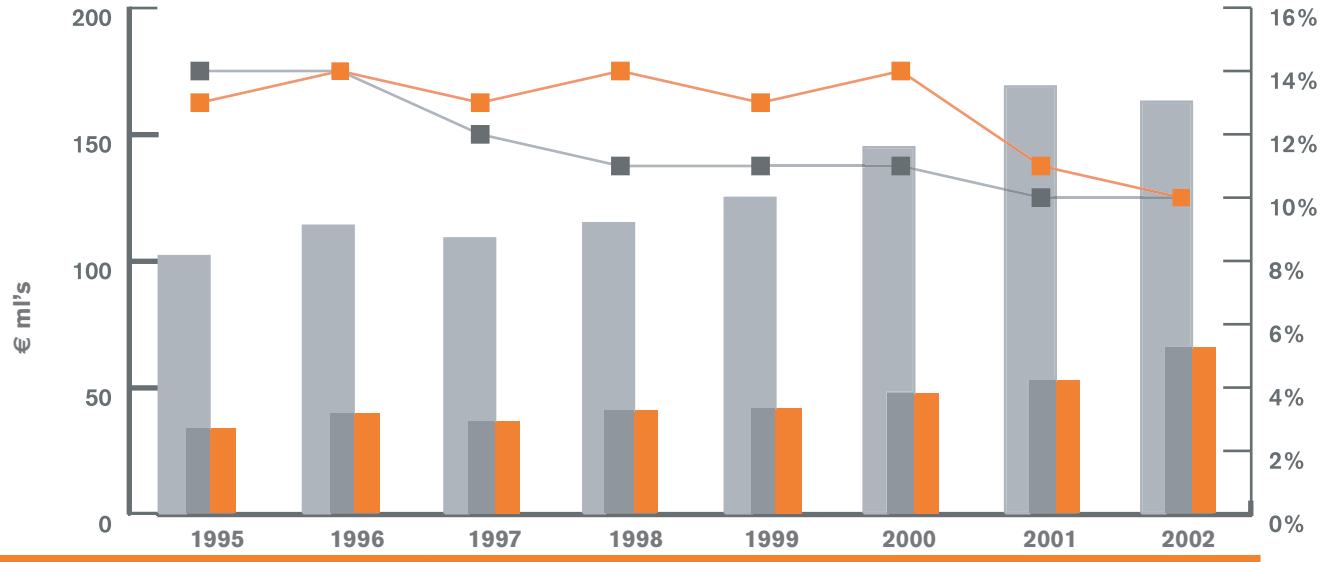
L.36 The abolition of the 5% limit on commission in 1999 does not appear to have introduced any rate competition between intermediaries, as reflected in the chart above, and earnings have risen ahead of premium income. Evidence to the Joint Oireachtas Committee on Enterprise indicates that there may be a higher level of consumer inertia about changing brokers than switching insurers[3] and there is concern about the transparency of fee arrangements.[4] Charges made directly by brokers to clients are not recorded in insurers' Statutory Returns.

Management expenses

L.37 Insurers' management expenses reflect the costs of running the company and are assigned to different underwriting accounts in accordance with internal criteria. Allocations should reflect the reality of resources and expertise required by different classes of business. For example, household insurance is generally a standard package with very little individual underwriting but larger property risks may require surveys to assess exposure. Private motor is relatively homogenous and where brokers are involved some paperwork may be undertaken by the intermediary, often electronically with the insurer. Liability risks tend to be underwritten on a more individual basis requiring analyses of accident records and even involving site visits.

3 Survey by Alliance For Insurance Reform
4 Liability quotation presented to client by broker from Quinn (who do not use intermediaries) allegedly included two layers of commission for Dublin and Local broker which were not obvious to policyholder.

Management Expenses & as % Written Premium Income



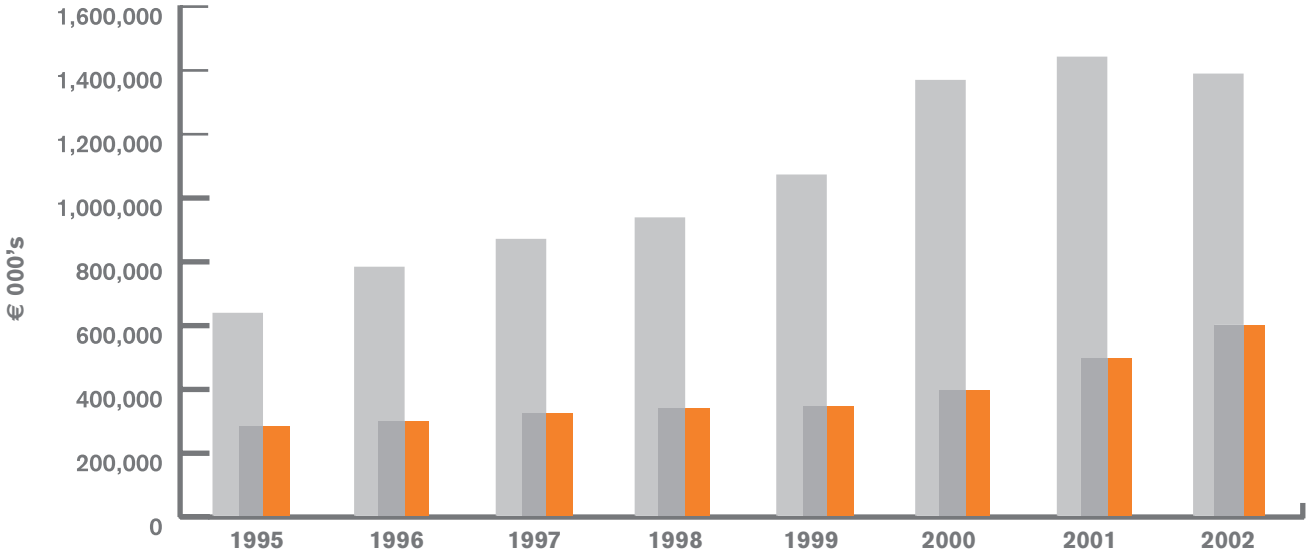
	1995	1996	1997	1998	1999	2000	2001	2002
Motor XP's	102	114	109	115	125	145	169	163
Liability XP's	34	40	37	41	42	48	53	66
Motor XP's %	14%	14%	12%	11%	11%	11%	10%	10%
Liability XP's %	13%	14%	13%	14%	13%	14%	11%	10%

L.38 Between 1995 and 2002 Management Expenses increased by 60% in Motor to €163ml and by 94% in Liability to €66ml. While there has been an improvement relative to Written Premium Income, charges have increased significantly. Greater efficiencies might have been expected from mergers resulting in economies of scale. The convergence in relativity of expenses to premium income between Motor and Liability is somewhat surprising as the latter class of business might be expected to employ greater expertise.

Claims costs

L.39 The data in this report so far was drawn from insurers' revenue accounts (Form 2's of the Statutory Returns) where the only relevant breakdown available by class of business is between Motor and Liability. Over the period 1995 to 2002 the Cost of Claims Incurred increased by 117% for Motor from €640ml to €1.4bl and by 112% for Liability from €284ml to €602ml, an overall total of €2bl in 2002 as reflected in the graph below.

Cost of Claims Incurred



	1995	1996	1997	1998	1999	2000	2001	2002
Motor	640,296	784,763	872,061	939,398	1,073,80	1,370,35	1,443,27	1,390,14
Liability	284,432	300,204	325,869	339,930	347,067	396,941	498,285	602,379

L.40 Superior information is available from the claims data contained in the Form 8's of the Statutory Returns which show Public Liability and Employers Liability separately. Values in these returns are expressed gross of reinsurance whereas the Cost of Claims Incurred from Form 2's above are net of reinsurance. The limited amount of information that is available on reinsurance will be recorded later in this report.

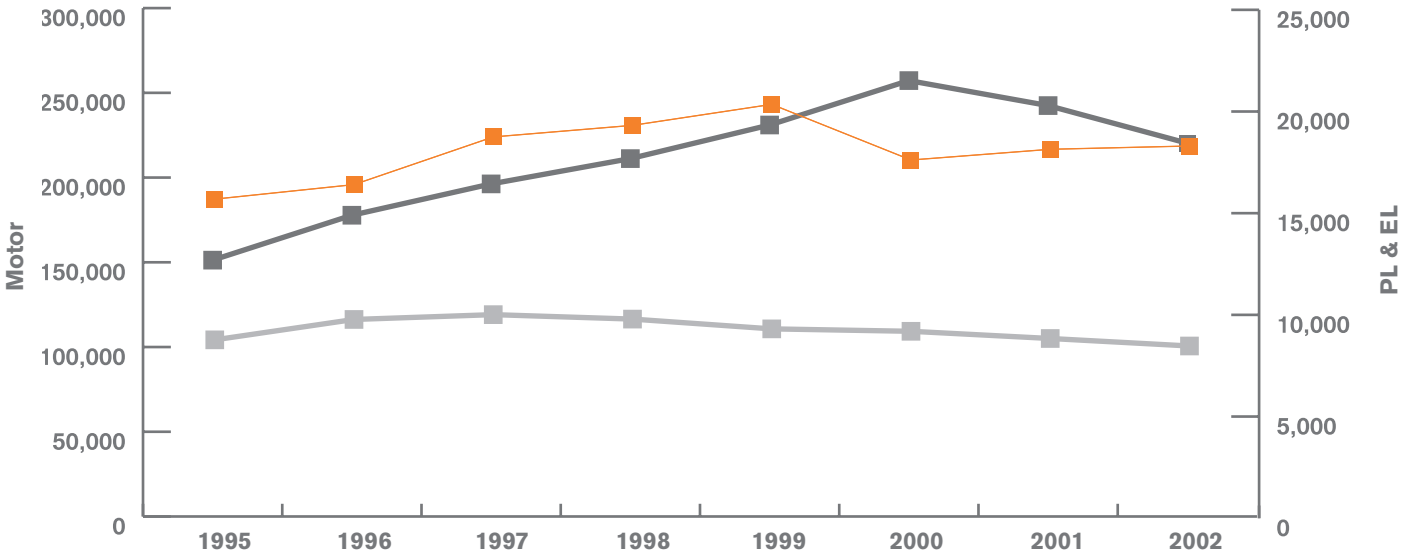
L.41 The first task is to assess the frequency of claims by analysing claim numbers. The volume of claims recorded by insurers includes those reported to date and those expected from accidents which have already occurred. The latter category of claims is referred to as Incurred but Not Reported (IBNR). Currently, injured parties have 3 years post accident to institute legal proceedings and for children that time only runs from age 18 when they reach their legal majority. Adults may be allowed longer periods to instigate claims where a latent condition has taken some time to manifest itself medically and this is particularly relevant to Employers Liability.

L.42 The trend in claims numbers for the three classes of business, now identifiable from the Form 8 returns, is as set out below.

L.43 Over the period reflected above, the most significant increase in volume was for motor claims between 1995 and 2000 with reductions since that time but an overall increase of 46%. It is not possible to identify the effect on this trend of the publication in April 2002 of the MIAB Report given the discussions that ensued about the underlying causes of premium increases, including exaggerated claims. The figures for claim numbers at year end 2002, which reduced by 9% on the previous year, are unlikely to reflect the effects of Penalty Points system introduced in October 2002 which resulted in significantly reduced road deaths. During the 1990's the relative frequency of injury accidents had already decreased. However, the volume of claims did not decrease in line with the reduced accident frequency which indicates that the propensity to claim increased.

L.44 The volume of Employers Liability claims shows an overall reduction between 1995 and 2002 of 3% and a significant improvement from the intervening high level in 1997. One might have expected to see increased EL claims, given higher rates employed rising to 1,745,500 in 2002. However, many businesses are effecting "self-insurance" in whole or in part so there may be an increasing volume of claims handled by employers

Claim Numbers Trend



	1995	1996	1997	1998	1999	2000	2001	2002
Motor	151,270	177,767	196,260	211,189	231,020	257,229	242,478	220,275
Public Liability	15,691	16,406	18,750	19,319	20,352	17,615	18,142	18,304
Employers' Liability	8,772	9,774	10,011	9,792	9,311	9,192	8,838	8,469

Year of Accident

direct. Equally important is the fact that there has been a welcome reduction in workplace accidents in recent years, as reflected in EUROSTAT data and in reports from the Health & Safety Authority. To support those data sources, the number of Occupational Injury Benefit cases to Department of Social and Family Affairs reduced from 1,499 claims per 100,000 employed in 1992 to 852 in 2002.

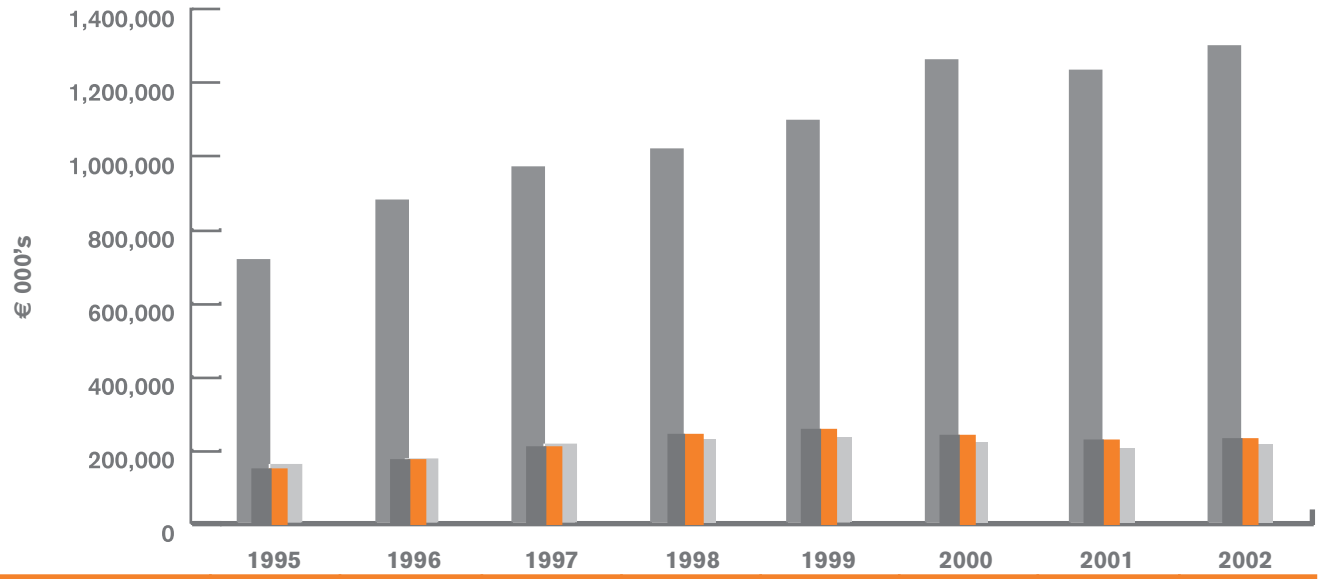
L.45 The volume of Public Liability claims shows a sharply increasing trend of 30% between 1995 and 1999 with a significant decrease in 2000 of 13% before increasing again in each subsequent year. As with Employers Liability, there may be an element of self-insurance or larger deductible reflected in the figures for 2002 so the claims frequency may be even higher than the 17% increase since 1995 which is recorded in insurers' data.

L.46 The claim numbers shown on the previous page include estimated volumes from accidents for which the resultant claims have yet to be reported as at Year End 2002. This is most significant in accounts for the more recent years of accident. Reporting patterns will be examined in a later section.

L.47 More significant than volume from an insurers' viewpoint is the value of the claims. We cannot use the Cost of Claims Incurred, detailed on page D12, to see the cost trend per accident year because the incurred cost includes adjustments in provisions for a number of accident years. We shall return to the question of adjustments to prior years' provisions.

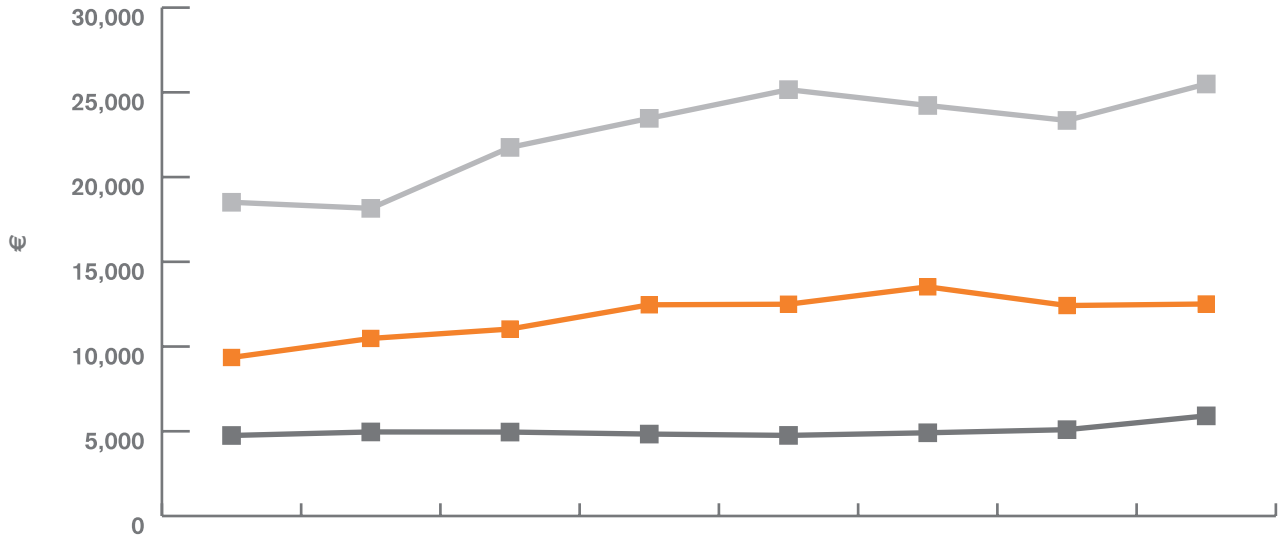
L.48 To calculate the trend of annual average cost the most reliable figure for a particular accident year is likely to be that estimated in the Year End 2002 accounts. Over the period since 1995 the cost per accident year has increased by 81% for Motor to €1.3bl, by 56% for Public Liability to €229ml and by 33% for Employers Liability to €216ml, a total of €1.75bl for accidents in 2002 as reflected below.

Cost of Accident Years from 1995 as Estimated at YE 2002



	1995	1996	1997	1998	1999	2000	2001	2002
Motor	719,757	881,736	971,981	1,020,883	1,098,761	1,263,327	1,235,074	1,301,514
Public Liability	146,768	171,903	206,862	240,769	254,347	238,202	225,314	228,975
Employers' Liability	162,400	177,437	217,750	229,775	234,259	222,672	206,291	215,897

Average Gross Claim Cost



	1995	1996	1997	1998	1999	2000	2001	2002
Motor	4,751	4,960	4,953	4,834	4,756	4,911	5,094	5,909
Public Liability	9,354	10,478	11,033	12,463	12,497	13,523	12,419	12,510
Employers' Liability	18,513	18,154	21,751	23,466	25,159	24,225	23,341	25,493

Year of Accident

L.49 For a simple illustration, we can divide the claim numbers into the currently estimated cost of each accident year to indicate an average claim value. The trend for each class of business is reflected in the graph above.

L.50 Motor consistently has the lowest average value, at €5,909 in 2002, reflecting a large proportion of property damage only. In contrast, the other two classes of Liability would be almost exclusively personal injury accidents with the 2002 average cost estimated at €12,510 for Public Liability and at €25,493 for Employers Liability.

L.51 Over the accident years in the graph above, the average claim value has increased by 24% for Motor (volume increased by 46%), by 34% in value for Public Liability (volume increased by 17%) and by 38% in value for Employers Liability (where volume decreased by 3%). The annual increases are shown in the table below.

L.52 While the increased cost for claims from accidents in 2002 is highest for Motor at 16%, as shown below, this class of business demonstrated decreases in premium charges during the latter half of 2003 which will be examined further. Both Public Liability and Employers Liability reflected increased average values for 2002 after decreases on the preceding year, being a consecutive year of decrease for Employers Liability.

Average Claim Cost Increase on the Previous Year

Year	Motor	Public Liability	Employers' Liability
1995			
1996	4%	12%	-2%
1997	0%	5%	20%
1998	-2%	13%	8%
1999	-2%	0%	7%
2000	3%	8%	-4%
2001	4%	-8%	-4%
2002	16%	1%	9%

Accident Years from 1982 to 2001	Provisions at YE 2001 for Outstanding Claims	Increase in Provisions at YE 2002 on those	% increase
Motor	3,596,935,361	111,258,088	3%
Employers Liability	1,048,926,131	104,889,261	10%
Public Liability	1,168,026,403	105,655,996	9%
Total pre 2002 Acc's	5,813,889,896	321,805,347	6%

L.53 It is necessary at this stage to address the complication that "the Cost of Claims Incurred" includes not just the paid and estimated cost of claims from the current year's accidents but also adjustments to provisions held against prior years' outstanding claims. At market level, these adjustments were very significant at year end 2002 compared to the amounts held against such claims at year end 2001. Overall the opening provisions of €5.8bl were increased by €322ml and the breakdown by class of business is shown in the table above.

L.54 These increases at Year End 2002 mean that, at a total level, the market expected claims to cost an extra 6% more than insurers had estimated for those cases at the previous year end. The top up of €111ml for Motor and €211ml for the two classes of liability are contained within the Cost of Claims Incurred of €1.4bl for Motor and €602ml for Liability shown for the 2002 year of account in the opening paragraph of this section.

L.55 The gross overall top up of €322ml in the table above cannot be readily identified within the total of Cost of Claims Incurred at €2bl for both Motor and Liability (of which it would be 16%) because the latter figure is net of reinsurance. Unfortunately, returns detailing reinsurance are no longer published and the claims accounts (Forms 8) are shown gross whereas the revenue accounts (Form 2) are given in net figures. The extent of reinsurance information which is published will be examined later.

L.56 For each class of business, it will be noted that there is a variance between annual average claim cost trend compared to the percentage increase in top ups at Year End 2002. For example, the average motor claim increased on the previous year by 16% in 2002 but the top up on outstanding claims from prior years' motor accidents was 3%. In contrast, the average Public Liability claim increased on the previous year by 1% in 2002 but the top up on outstanding claims from 2001 and prior years' accidents was 9%. The divergence between classes would indicate that these increases are not a reflection of external factors, such as compensation levels awarded by the Courts, which would effect all injury claims equally regardless of the class of business.

L.57 In this context it must be recognised that the outstanding claims date back over many years. In examining the age of outstanding claims a clear distinction must be made between the volume of claims and the value of potential liability. The claims which take the longest time to finalise are likely to be the more serious injuries with a higher than average value. The table below shows the proportion of outstanding provisions for each accident year as a percentage of the total value of outstanding liabilities at year end 2002. For ease of presentation the older years of 1990 and prior have been amalgamated.

Proportion of Outstanding Provisions at Year End 2002 per accident year by value

Accident Year	MOTOR	PL	EL
1990 & pre	0%	3%	1%
1991	0%	1%	1%
1992	0%	1%	1%
1993	0%	1%	1%
1994	1%	2%	1%
1995	1%	4%	2%
1996	2%	5%	4%
1997	3%	7%	7%
1998	7%	11%	10%
1999	10%	13%	15%
2000	18%	15%	18%
2001	24%	16%	19%
2002	33%	18%	21%
Gross value o/s	**3,157,698,051**	**1,221,966,476**	**1,015,047,713**

L.58 Of the total provisions outstanding at year end 2002 for each class of business, the value of claims outstanding for all years prior to 2002 itself was 67% for Motor, 82% for Public Liability and 79% for Employers Liability.

L.59 Taking the oldest accident years of 1990 and prior, the value of claims still outstanding from that period at Year End 2002 as a percentage of total outstanding claims cost for Employers Liability was 1% and 3% of Public Liability. In Motor 33% of provisions related to accidents in 2002 compared to 18% for Public Liability and 21% for Employers Liability for the most recent accident year.

L.60 The volume of claims outstanding for older years' accidents, in the table below, reflects a very different proportionality from that of their value.

L.61 To take examples from the tables below, we can contrast Motor and Public Liability. At Year End 2002 of the volume of Motor claims which were outstanding, 60% related to the most recent accident year but, as demonstrated in the previous table, only 33% of the value of outstanding provisions related to the 2002 year of accident. In Public Liability, 33% of outstanding claim numbers were for 2002 accidents but, as demonstrated in the previous table, these represented 18% of the value of claims provisions at Year End 2002. In Liability, larger amounts of money are set aside for older years' claims. This is a clear indication that the payment pattern differs by class of business.

L.62 The claims payments made in 2002 related to liabilities for a number of accident years. The only cases likely to finalised within the year of occurrence are those for property damage or those involving less serious injury.

Proportion of Claims Outstanding Year End 2002 per accident year by volume

Accident Year	MOTOR	PL	EL
1990 & pre	0%	1%	1%
1991	0%	0%	0%
1992	0%	0%	0%
1993	0%	1%	1%
1994	0%	1%	1%
1995	0%	2%	1%
1996	1%	2%	2%
1997	2%	4%	5%
1998	3%	7%	7%
1999	6%	10%	11%
2000	12%	13%	17%
2001	15%	25%	22%
2002	60%	33%	32%
Total no o/s	**111,489**	**38,706**	**23,348**

Amount paid in 2002 per accident year

Accident Year	MOTOR	PL	EL
1990 & pre	0%	2%	1%
1991	0%	1%	0%
1992	0%	0%	1%
1993	0%	1%	1%
1994	1%	5%	3%
1995	1%	4%	5%
1996	3%	6%	8%
1997	7%	11%	15%
1998	10%	15%	20%
1999	15%	21%	22%
2000	19%	17%	15%
2001	19%	13%	7%
2002	24%	5%	2%
Total paid in 2002	**1,033,085,314**	**161,173,321**	**186,881,802**

The table above shows, for each class of business, the proportion of payments in 2002 which related to various years of accident.

2002 payments outstanding provision at YE 2002

Accident Year	MOTOR	PL	EL
Total paid in 2002	1,033,085,314	161,173,321	186,881,802
Gross value o/s	3,157,698,051	1,221,966,476	1,015,047,713
Provisions/Paid	3	8	5

L.63 As might be expected, Motor has the highest proportion of 2002 payments for the most recent accident year because of the high volume of claims for property damage only. In contrast, very little of Employers Liability for accident year 2002 was paid within that year so those accidents only represented 2% of the payments made in 2002, compared to 22% of 2002 payments being for the 1999 accident year. While 78% of Motor payments in 2002 related to years back to 1999, the comparative percentages for Liability are 56% for Public Liability and 46% for Employers Liability. The liability classes indicate a more long tailed run off than Motor.

L.64 The extent of longer tailed nature of Employers Liability and Public Liability can be further identified by examining the levels of payments compared to the levels of outstanding provisions, as in the table above. For Motor the outstanding provisions at Year End 2002 represented three times the level of claims payments made that year, so it could be said that on average motor cases take 3 years by value to finalise. For Employers Liability and Public Liability the multiples were 5 years and 8 years of payments, although it will be recalled that the average cost of an Employers Liability claim was over double that of Public Liability for 2002.

L.65 One reason that might be offered for 8 years Public Liability payments being carried in provisions could be that these claims are reported more slowly than Motor or Employers Liability. This requires a more detailed examination of Incurred But Not Reported (IBNR) which was referred to earlier. Again we must make a distinction between the volume and the value of such claims.

L.66 As reflected in the table below, the reporting patterns of claims do differ between Motor and Liability but not significantly between Public Liability and Employers Liability. Currently the Statute of Limitations for personal injury claims is three years, with exceptional cases allowed a longer period to initiate litigation. Therefore, for years prior to 2000, we can assume that the vast majority of claims had been notified by Year End 2002 and can examine what proportion of the final claim numbers for those years were notified within the year of account or within the following year.

L.67 For the Liability classes, over 90% of the claims had been notified by the end of year two but in the case of Motor 99% have been reported at that stage. Having a claim reported and knowing its value are two very different aspects of the development of claims cost. The challenge is somewhat easier in Motor, but in all classes of business an insurer must set aside estimated provisions for the potential liability from the as yet unreported claims.

Proportion of Claim Numbers notified within year 2 of accident year

	MOTOR		PL		EL	
Accident in	Year 1	Year 2	Year 1	Year 2	Year 1	Year 2
1993	90%	9%	73%	18%	74%	18%
1994	91%	9%	73%	17%	73%	19%
1995	90%	9%	71%	19%	73%	19%
1996	91%	9%	72%	20%	70%	22%
1997	91%	9%	68%	22%	70%	20%
1998	90%	9%	68%	24%	68%	22%
1999	89%	10%	73%	20%	68%	24%

IBNR & Outstanding Provisions as Percentage of Estimated Liability at YE02

	MOTOR	EL	PL
Outstanding Provisions as % Estimated Liability '82-'02	22%	35%	45%
IBNR as % Estimated Liability all years	3%	8%	6%
IBNR as % Outstanding Provisions all years	13%	23%	13%

L.68 We have already recorded the value of outstanding provisions at Year End 2002 for each class of business and can now examine how much of that money is set aside for claims that are not yet reported (IBNR). However, it is also necessary to recognise that within the different classes of business a higher proportion of estimated liability is likely to be outstanding than paid. The table above sets out the relativity between these levels for each class of business for the accident years 1982 to 2002 as estimated at Year End 2002.

L.69 The table above reflects consistencies with other findings. For example, the fact that Public Liability takes the longest time to finalise supports the fact that 45% of estimated liability remains outstanding. Although the reporting rates for both classes of liability business do not differ significantly by volume, Employers' Liability has a much higher cost and unreported claims represent 23% of the total outstanding provisions at Year End 2002. For Motor the level of provision for IBNR at 13% of outstanding provisions seems rather high given the tighter reporting pattern for these claims than in Public Liability where a similar level is carried in provisions.

L.70 In the light of the claims reporting pattern previously examined, it is necessary to identify the levels of provisions held against Incurred But Not Reported claims (IBNR) for each class of business. For ease of presentation in the table below the accident years prior to 1995 are amalgamated.

L.71 For Liability, it will be noted below that fairly significant amounts are set aside for accidents prior to 1995 from which further claims are expected to be reported with a value of €3.5ml for Public Liability and €4.3ml for Employers' Liability. This might reflect late manifestation of industrial diseases in Employers' Liability but Public Liability is not similarly exposed. While it is accepted that the actual volume of as yet unreported claims is difficult to predict, in Liability there are also very high volumes expected from the 2002 accident year that do not seem to reflect historical reporting patterns previously analysed.

Provisions at Year End 2002 for IBNR Claims €000's

Accident Year	Motor	Public Liability	Employers' Liability
pre 1995	721	3,475	4,265
1995	437	1,323	958
1996	1,447	1,686	1,619
1997	2,082	2,332	2,683
1998	5,689	7,286	9,680
1999	12,804	7,392	9,534
2000	32,857	15,858	26,026
2001	79,478	36,075	61,360
Total 1995 to 2001	**134,794**	**71,952**	**111,860**
For 2002	**274,386**	**78,474**	**113,418%**

Claim Numbers for 2002 Year of Accident as at Year End 2002

	Motor	Public Liability	Employers' Liability
Reported by YE 02	202,044	13,412	4,567
IBNR expected	18,231	4,892	3,902
Implied total number	**220,275**	**18,304**	**8,469**
IBNR as % Reported	9%	36%	85%

Average Provision at Year End 2002 for IBNR Claims €'s

Accident Year	Motor	Public Liability	Employers' Liability
pre 1995	180,250	69,500	284,333
1995	87,400	45,621	79,833
1996	206,714	27,194	124,538
1997	80,077	28,096	62,395
1998	59,260	31,678	76,218
1999	19,851	25,142	34,051
2000	13,616	16,298	20,445
2001	16,896	18,073	35,841
2002	15,051	16,041	29,067

L.72 The additional volume of Liability claims expected does not seems to be consistent with the historical reporting pattern seen to date for either Public Liability or Employers Liability. We have already examined the proportion of outstanding provisions allocated to Incurred But Not Reported claims. Using the claim volumes recorded in the Form 8's, it is possible to calculate the average value by accident year within each class of business for IBNR.

L.73 A number of these averages stand out as exceptional. For Employers Liability, a further 15 claims are expected for occurrences pre-dating 1995 but the provision set aside represents an average value of €284,333. A further 13 EL claims are expected from 1996 at an average value of €124,538. For Motor, 7 further claims are expected for the accident year 1996 and the provision set aside represents an average value of €206,714. Pre-1995 motor accidents are expected to produce 4 extra claims averaging €180,250. Many of the other average valuations are also significantly higher than the general trend in claims costs for the different classes of business. It is not obvious why the as yet unreported claims are expected to have a value so significantly above the norm.

L.74 These observations raise the need to examine IBNR levels in the previous year's accounts at Year End 2001. In contrast to the observations at Year End 2002(see above), Motor at Year End 2001 reflects some unusually high average values held for claims which have yet to be reported. Only one extra case was expected at Year End 2001 for accidents pre 1995 but this held a provision of €950,000 and a further single motor claim was expected from 1995 with a valuation of €701,000. However, at Year End 2001 the liability classes, in the table below, did not reflect notable examples of IBNR valuations as they do in the previous table for Year End 2002.

L.75 The question now arises whether higher values are being estimated for outstanding liabilities, including unreported claims, than the trend in average cost generally within each class of business and whether these larger amounts are justified. Only the most significant deviations from the norm will be identifiable for figures at market level.

L.76 Year End 2002 was not the only year of account in which existing provisions for prior years were adjusted. There also seems to be a notable difference in the

Average Provision at Year End 2001 for IBNR Claims €'s

Accident Year	Motor	Public Liability	Employers' Liability
pre 1995	950,000	63,771	63,853
1995	701,000	22,089	27,833
1996	143,750	21,045	22,564
1997	39,778	13,912	26,039
1998	11,357	17,518	34,941
1999	16,212	17,152	28,085
2000	17,732	14,601	24,476
2001	10,270	13,958	21,753

Movement in Provisions from Previous Year End €000's

at Year End	Motor	Public Liability	Employers' Liability
1995	-43,661	-16,618	-13,684
1996	-70,429	-22,242	4,010
1997	-37,398	-24,768	-14,279
1998	-61,864	-12,861	-14,839
1999	32,471	8,472	-7,897
2000	183,385	18,090	28,781
2001	122,711	73,222	57,339
2002	111,258	105,656	104,889

accounting approach since 1999 with provisions being almost exclusively topped up compared to previous years where there were reductions. In each class of business above, the adjustments for accident years back to 1982 at years of account since 1995 are shown. A minus figure reflects a reduction in the provisions held at the previous year end for outstanding claims.

L.77 With the exception of Employers' Liability at Year End 1996, in all classes up to Year End 1999 the provisions were reduced on the previous year but subsequently increased significantly. Leaving aside the issue of reinsurance, included within the Cost of Claims Incurred since 1999 the adjustments on prior year' provisions amounted to €449ml for Motor, €205ml for Public Liability and €183ml for Employers' Liability. This profile of top ups might indicate that the external environment has become more volatile since 1999 thereby affecting the cost of all outstanding claims on hand at that point in time. Such an external factor could be compensation levels awarded by the Courts but that inference is not consistent with the trend in average cost over the same period.

L.78 This apparent sudden change in accounting policy from 1999 warrants a closer examination of the adjustments to provisions in the 2002 year of account. It must be acknowledged that the adversarial litigation system often hampers the speed with which full information can be secured about a plaintiff's claim and in instances of more serious injury it can take some time for a medical prognosis to stabilise. However, a proactive approach to claims investigation should usually ensure fairly reliable estimates on liability within 5 years of the accident. Below is the breakdown of adjustments at Year End 2002 over provisions at Year End 2001 by accident year.

L.79 It can now be seen that the largest top ups at Year End 2002 related to the preceding three years of accident, as would be expected but with the exception of Motor which showed an improvement of €9.4ml in the estimated cost of 2001 accidents. In the Liability accounts, it can be seen that accident years prior to 1995 still accounted for top ups at €7ml for Public Liability and €5ml for Employers Liability, whereas Motor showed a minor saving from those oldest years. The accident years 1995 and 1996 for Public Liability are also expected to deteriorate by €10.4ml and €6.8ml over their estimated liability at Year End 2001, which seems rather exceptional.

Movement in Provisions at Year End 2002 from Previous Year End €000's

for Accident Year	Motor	Public Liability	Employers' Liability
Pre-1995	-863	7,230	5,141
1995	1,480	10,353	-735
1996	8,581	6,789	65
1997	8,004	-692	7,909
1998	12,918	10,232	17,170
1999	35,416	19,305	31,303
2000	55,084	20,365	32,069
2001	-9,362	32,074	11,967
1995 to 2001	**112,121**	**98,426**	**99,748**
Total top-up at YE02	**111,258**	**105,656**	**104,889**

Movement in Provisions at Year End 2002 as % Previous Year End

Accident Year	Motor	Public Liability	Employers' Liability
1995	0%	8%	1%
1996	1%	4%	0%
1997	1%	0%	4%
1998	1%	4%	8%
1999	3%	8%	15%
2000	5%	9%	17%
2001	1%	17%	6%
Total 1995 to 2001	**2%**	**7%**	**7%**
Total top-up at YE02	**1%**	**4%**	**4%**

L.80 While the adjustment figures around €100ml at Year End 2002 for each of the three classes are significant in themselves, of more interest is the relativity of these top ups to the provisions as estimated at the previous year end. As might be expected, a lower rate of top up was required for Motor than for Liability. While there is consistency in the table above in the overall top ups for Public Liability and Employers Liability, at 4% for all years and 7% for the accident years 1995 to 2001, there are significant variations in the cost development pattern for individual accident years. For Employers Liability, the potential estimated for the 1999 accident year at Year End 2002 has increased at Year End 2001 by 15% and by 17% for the 2000 accident year. In contrast, for Public Liability the 2000 year of accident increased by 9% and 1999 by only 8% but 2001 increased by 17% in the space of 12 months. This is despite the average Public Liability claim cost for 2001 decreasing by 8% on the previous year, as demonstrated previously at paragraph L51.

L.81 A study of this nature is greatly restricted by the absence of raw data or at least the availability of Statutory Returns for the most recent year of account. Since we cannot at this point determine whether the provisions were actually required during 2003, we can only review the historical run-offs. For this purpose, the "final" cost of accident years between 1990 and 1995 as estimated at Year End 2002 will be examined. For ease of presentation, the difference between the cost assessed at Year End 2002 and the original estimate is expressed as a percentage of the provision established at the end of the accident year in question. Minus figures represent reductions in provisions and therefore savings on the original estimates of liability for that accident year.

L.82 The most significant savings arose on Public Liability claims. For example, the ultimate cost assessed at Year End 2002 for accident years 1992 and 1993 reflected savings of 25% and 20% on the estimated liability set up in provisions at the end of those years. It will also be noted that only the 1990 cases for Employers Liability reflected a deficit by Year End 2002 on the provisions established for these cases in 1990. While the percentage savings are lower on Motor, the amounts involved are significant because it is the largest class of business.

L.83 It must be highlighted that even those ultimate savings did not result in surpluses between claims costs and net Earned Premium Income for Liability, although the original positive margins for Motor were maintained and enhanced. The tables on the next page show the net Earned Premium Income for the years of accounts 1990 to 1995 for Motor and Liability (breakdown between EL and PL is not available in the Revenue Accounts) compared to the gross cost of those accident years both as originally estimated and as now assessed at Year End 2002. Obviously, in the interim investment income was also produced on the outstanding provisions but equally other items of expenditure such as commissions and management expenses are not factored into this equation.

Run Off at Year End 2002 as % accident year provisions

Accident Year	Motor	Public Liability	Employers' Liability
1990	-2%	-9%	5%
1991	-5%	-13%	-6%
1992	-8%	-25%	-10%
1993	-5%	-20%	-7%
1994	-8%	-3%	-1%

Motor Insurance

Accident Year						
€000's	1990	1991	1992	1993	1994	1995
Original Estimated Liability of Claims						
	593,885	578,661	618,538	650,659	705,548	736,103
Claims Cost as estimated at YE 02						
	580,462	552,330	570,822	619,552	649,179	718,757
Earned Premium Income net in accident year						
	520,819	616,942	662,840	691,582	721,836	695,010
Earned Premium Income minus Original Estimated claims cost						
	-73,066	38,281	44,302	40,923	16,288	-41,093
Earned Premium Income minus Estimated claims cost YE02						
	-59, 643	64,612	92,018	72,030	72,657	-23,747
Original Deficit/ Surplus as % Earned Premium Income						
	-14%	6%	7%	6%	2%	-6%
2002 Deficit/ Surplus as % Earned Premium Income						
	-11%	10%	14%	10%	10%	-3%

L.84 As an example to illustrate from the table above, the 2% surplus between Motor Net Earned Premium Income in 1994 and the originally anticipated gross liability for 1994 accidents was increased to a surplus of 10% by the time most of the cases had been finalised in 2002.

L.85 The same data for Liability, in the table below, shows that 20% deficit between net Earned Premium Income in 1995 and the originally anticipated gross liability for 1995 accidents was reduced to a deficit of 15% by the time most of the cases had been finalised in 2002.

Liability Insurance

Accident Year						
€000's	1990	1991	1992	1993	1994	1995
Original Estimated Liability						
	225,478	242,750	237,985	253,922	278,468	323,066
Cost as estimated at YE 02						
	221,098	219,179	196,917	218,149	272,406	309,167
EPI net in accident year						
	179,870	188,317	195,249	213,347	240,888	269,325
EPI minus Original Estimated cost						
	-45,608	-54,433	-42,736	-40,575	-37,580	-53,741
EPI minus Estimated cost YE02						
	-41,228	-30,862	-1,668	-4,802	-31,518	-39,842
Original Deficit/ Surplus as % EPI						
	-25%	-29%	-22%	-19%	-16%	-20%
2002 Deficit/ Surplus as % EPI						
	-23%	-16%	-1%	-2%	-13%	-15%

Reinsurance of Irish Risk Business at Year End 2002

	Reinsurance Cessions €000's	
	Premiums	**Claims**
Total Motor Market	305,705	152,098
Total Liability Market	177,722	153,323
Reinsurance totals	**483,427**	**305,421**

L.86 Given these positive run-off patterns historically, it is difficult to justify the recent levels of top ups unless the external environment has caused a significant sudden increase in expected claim values. Indeed to the contrary, with developments both in legislation and in the Courts, there are positive influences on claims costs which we shall review in the context of events in 2003. Also, as previously demonstrated, there were significant improvements during 2002 in underwriting results for both Motor and Liability relative to Earned Premium Income.

L.87 One significant recent event was the requirement of the Solvency Supervisor in Ireland that all outstanding provisions be certified as to their adequacy by an actuary. This was probably in response to the fallout from the collapse in the UK of Independent Insurance which left many policyholders in Ireland without cover and also left commercial clients without indemnity for outstanding claims. This additional requirement should not of itself have caused an increase in provisions but, realistically, it is quite likely that a certifying actuary would be quite conservative - if only to limit professional exposure in the event of deficits emerging. However, such certification applied to all classes of business and could not account for the higher levels of top ups observed in Liability as compared to Motor.

L.88 If larger amounts are retained for claims liability than are required, this can also have consequences for market competition experienced by commercial policyholders. Since much of Liability, and most Commercial Motor, is underwritten on an individual basis, a client who has large claims costs outstanding with his existing underwriter is unlikely to be considered an attractive risk by a competing insurer.

L.89 Since the tragic events in New York on 11th September 2001, there has been much discussion about the cost of reinsurance. The relevant data in the published Statutory Returns is limited to that contained in the table above. For Motor, premiums ceded to reinsurers in 2002 amounted to €306ml while only €152ml was laid off in claims liability. Better coverage was secured in Liability with claims recoveries of €153ml in a year when premium ceded amounted to €178ml. Proportionate to the size of the accounts, both in terms of premium and claims cost, reinsurance is of much greater significance to Liability than to Motor but it is not possible to identify the spit between Public Liability and Employers Liability.

L.90 Comparisons with insurance costs in other countries is rarely possible on a like-for-like basis. The fact that compensation levels in Ireland are the highest in Europe is not necessarily a deterrent to new market entrants, provided the environment is predictable so that underwriters can get their pricing right. It is, however, worth recording the relativity of compensation across a number of Member States for just a couple of randomly selected injury types. This data is taken from two published surveys, that of Davies Arnold Cooper in 1994 and the more recent publication in 2003 of similar research by McIntosh & Holmes[5] based on a 2001 survey. Amounts are expressed in ponds sterling and the multiple between Ireland and other Member States is indicated.

5 Kluwer Law publication

General Damages Only - paraplegia, married male age 40 with dependants

pounds sterling

Country	1994 Survey	Irl/other	2001 survey	Irl/other	2001 on 1994
Ireland	**162,500**		**152,672**		**-6%**
England	85,000	1.91	110,000	1.39	29%
Scotland	80,000	2.03	115,000	1.33	44%
Greece	3,175	51.18	8,836	17.28	178%
Portugal	6,018	27.00	30,038	5.08	399%
Netherlands	107,527	1.51	109,290	1.40	2%
Denmark	16,545	9.82	24,091	6.34	46%
Belgium	67,135	2.42	97,078	1.57	45%
Luxembourg	71,559	2.27	55,070	2.77	-23%
Spain					
France	59,524	2.73	45,914	3.33	-23%
Germany	120,482	1.35	92,308	1.65	-23%
Italy	36,166	4.49	90,784	1.68	151%

General Damages Only - amputation of arm below elbow

pounds sterling

Country	1994 Survey	Irl/other	2001 survey	Irl/other	2001 on 1994
Ireland	**80,000**		**114,504**		**43%**
England	35,000	2.29	45,000	2.54	29%
Scotland	45,000	1.78	45,000	2.54	0%
Greece	2,540	31.50	5,302	21.60	109%
Portugal	6,018	13.29	18,022	6.35	199%
Netherlands	43,011	1.86	32,787	3.49	-24%
Denmark	30,157	2.65	15,198	7.53	-50%
Belgium	35,551	2.25	59,248	1.93	67%
Luxembourg	45,608	1.75	29,162	3.93	-36%
Spain					
France	29,762	2.69	25,253	4.53	-15%
Germany	32,129	2.49	24,615	4.65	-23%
Italy	13,562	5.90	21,594	5.30	59%

L. 91 The surveys in question focus on the more serious injury types. The real challenge in Ireland is often citied as the frequency of claims for moderate and minor injury. For such cases[6], Irish awards are many more multiples of England than that reflected above for serious cases.

L. 92 It must be stressed that the above comparisons relate solely to compensation for pain and suffering, known as General Damages, so variations between Member States' social insurance systems are factored out of the equation. When account is taken of awards for financial losses and other items of Special Damages, compensation in Ireland is higher again. This is partly because some plaintiffs are entitled to double recovery without deduction for collateral benefits from first party insurance or from the State. For example, an injured party with the benefit of income replacement under Permanent Health Insurance can still claim full earnings losses to date and into the future from a defendant. Any move towards increasing the standard retirement age from 65 would greatly increase the level of such actuarial future loss claims with consequent effects on the cost of insurance.

6 Deloitte Touche 1996 Report; Research by Prof Brian Greenford 1999 for the McAuley Report

What has been happening in the Irish insurance market?

Motor Insurance Inflation

YEAR	CSO index	Change p.a.
1996	64.1	
1997	65.8	3%
1998	68.6	4%
1999	72.4	6%
2000	79.0	9%
2001	92.8	17%
2002	105.1	13%
2003	104	-1%

L.93 Unfortunately, the Central Statistics Office does not collate any data on liability insurance but an indices are maintained on motor. The rates of private motor insurance inflation since 1996 are shown in the table above.

L.94 To observe even a moderate decrease after so many years of increases warrants further enquiry into recent events in the market. During 2003 the monthly CSO index reflects the start of a downward trend from June, as set out below.

L.95 The precise basis of the CSO survey is not known but it reflects lower levels of decrease that reported anecdotally. The latter includes individuals in attractive risk groups reporting significant decreases on their last renewal, many after they shopped around and often after giving their holding insurer an opportunity to retain the business at a more competitive rate. The introduction in November 2002 of a regulation requiring insurers to give at least 15 days advance notice of renewal terms, accompanied by certification of the policyholder's "No Claims Bonus", has undoubtedly assisted consumers in comparative pricing. Additionally, an independent survey undertaken for the AA indicated 20% premium reductions between April and October 2003. On the reasonable assumption that insurers will not reduce their rates until competition offers them little choice, there must be significant factors operating to halt the increase in premium charges and to actually reverse the trend.

L.96 For Liability, commercial policyholders still report substantial premium increases and, in many instances, difficulty securing cover at any price in certain industries. In contrast, American International Group reported a 10% reduction in Public Liability premium rates early in 2004. At the Joint Oireachtas Committee on 13 November 2003, FBD also indicated an improvement in losses for Employer's Liability and Public Liability with anticipated premium reductions. Hibernian also indicated reduced charges for liability policyholders who undertake specific risk management programmes.

Motor Insurance Inflation during 2003

Month	CSO Index	change
Jan	105.9	0%
Feb	107.2	1%
Mar	108.0	1%
Apr	108.0	0%
May	107.6	0%
Jun	107.6	0%
Jul	107.2	0%
Aug	106.1	-1%
Sep	102.7	-3%
Oct	97.9	-5%
Nov	94.9	-3%
Dec	94.5	0%
Year 2003 on 2002	**104.0**	**-1%**

No.s Killed last 10 years	1993	1994	1995	1996	1997	1998	1999	2000	2001	2002	2003
	431	404	437	453	472	458	413	415	411	376	341

L.97 In the context of Employers' Liability, reference has already been made to the improvement in the rate accidents at work. Undoubtedly, the IBEC/ICTU Voluntary Code on Workplace Safety has had an influence. This had a positive affect not only on accident frequency but also on the volume of straightforward claims that are concluded at local level.

L.98 For Motor, relative rates of road traffic accidents involving injury have been reducing for some years. The introduction of the Penalty Points system in October 2002 has significantly reduced the number of fatalities, as reflected in the table above. The frequency of severe injuries, which is more relevant for the cost of insurance, has also shown a welcome improvement.

L.99 Aside from low profitability, a Datamonitor survey among EU insurers in 1995 found Ireland to be the least attractive market because of the legal environment. Aside from the elimination since that time of long delays in reaching Court trial, there have also been significant and mixed developments in the past two years.

L.100 The rate of inflation for medical treatment is a significant factor in the cost of personal injury claims. That increasing cost has been accentuated both by legislation and by the Courts. While the date of the Health (Amendment) Act 1986 might indicate that its effects should be long since absorbed in the motor premiums, the genesis of this legislation gave rise to a number of legal challenges which culminated in the Supreme Court decision of Crilly v Farrington in July 2001. Since that determination insurers have been required to fully reflect an enhanced rate of hospital charges levied on patients, many of whom would otherwise be entitled to free medical care, solely because of involvement in a road traffic accident. Those increased charges, which can be over €600 a day, apply not just to accidents subsequent to the date of the Court's clarification of the legislation but to all outstanding claims involving hospital bills. That legal precedent, which may yet be open to further legal challenge, is probably reflected in the high inflation rates for motor insurance between 2000 and 2002 as Health Boards significantly increased the daily rate which is now considered recoverable in line with the decision in Crilly v Farrington. Policyholders are already making a significant contribution to the general exchequer as what was the insurance levy is now actually indirect taxation in the form of 2% stamp duty on non-life insurance.

L.101 Treatment fees also arise in liability cases where patients are not entitled to a medical card and, in more serious cases, compensation may be required to cover these future costs for life. Again it was July 2001 when the High Court delivered its decision in McEnaney v Monaghan CC. This held that the rate of inflation in medical expenses was so high that it could not be covered by the investment return on a lump sum award and, therefore, applied a negative discount factor to the calculation of future losses. In essence, this added about 25% to the cost of compensation required for a permanently disabled plaintiff in their mid twenties. Although that decision was partly overturned the following year by the Supreme Court in Boyne v Dublin Bus on actuarial calculations of earnings losses, the precedent on medical fees was not challenged. Again the inflationary effect of this decision is probably reflected in the high motor insurance index between 2000 and 2002. The effect was likely to be particularly acute on the cost of insurance for young people who are most likely to be carrying young passengers who have an increased potential exposure as plaintiffs as a result of this Court decision. However, the case was also of relevance to liability insurance. Indeed, it arose from a Public Liability claim against a local authority by a young man whose car left the road on St Valentine's night and compensation was recovered on the basis that the local authority should have prevented ice forming. The plaintiff was held 33% contributory negligent for driving at 70mph but no deductions were made for failure to wear a seat belt or for excessive alcohol consumption.

L.102 There have, however, been some positive developments in the Courts. Aside from anecdotal evidence that the levels of awards have reduced since the introduction of the euro, the Supreme Court has made efforts to discourage exaggerated claims. Because of attempts to inflate the amounts of their claims, the Supreme Court halved the High Court awards in the cases of *Vesey v Bus Eireann* and in *Morris v Dublin Bus*. In another significant precedent the Supreme Court, while allowing the plaintiff to retain the level of compensation awarded by the High Court in *O'Connor v Dublin Bus*, ordered the plaintiff to pay the defendant's High Court and Supreme Court legal costs. The Supreme Court decision in *Fletcher v OPW* which dismissed a compensation claim by a "worried well" plaintiff may also help to stem the tide of post traumatic stress claims.

L.103 As demonstrated, the levels of compensation for pain and suffering in Ireland remain the highest in Europe, even when account is taken of the varying social welfare systems. There are no plans to lower this level of compensation. The Personal Injuries Assessment Board will be required to award the same level as currently pertains. If it did not, all such assessment would simply be rejected and litigation, with its attendant costs, would be pursued through the Court system.

L.104 Perhaps the most significant single event in 2002 was the publication by the Government on 25th October of an Action Plan to implement the 67 Recommendations of the MIAB. That publication includes an estimate from the Irish Insurance Federation of potential savings of either 31% or 36%, depending how one interprets their figures as reflected in the table below. While that estimate relates to motor insurance, which has a high proportion of property damage at which no proposals are specifically aimed, many of the measures should reflect similar savings in liability claims. Realistically, it is likely that insurers' stated expectations of savings were conservative since they could anticipate pressure to reduce premium charges accordingly as each measure was introduced.

L.105 Again the absence of raw data for the 2003 year of account is a limitation, but it is known that insurers indicated substantial profits on Motor and an underwriting profit at Year End 2002 for the first year on record. Aside from the reduction in road accidents, the ban on "no win, no fee" advertising by solicitors from February 2003 has undoubtedly helped to reduce numbers of claims. The establishment of the IIF Fraudline has also assisted identification of questionable claims.

L.106 This improved operating environment seems to have activated renewed competition within the existing market and has also motivated interest by new players. Among Lloyds syndicates expressing interest in Ireland there are aspects of the Government's insurance reform programme cited as particularly attractive. The proposal by the Bar Council of Ireland that the Statute of Limitations be reduced from 3 years to one year would reduce the exposure to volatility that has been a feature of the Irish litigation system. Any reduction in the finalisation period would also serve the interests of claimants who wait six times longer for negotiations in Ireland than in England.[7]

L.107 Also attractive to new players are the measures to tackle exaggerated claims, for which Ireland has a deterrent reputation abroad. The Government's reform of the personal injury litigation system involves a twin track approach. The Personal Injuries Assessment Board will offer a low overheads system for straightforward cases. For litigation cases, it is planned to introduce fines and jail terms for claimants and experts who overstate claims with loss of all compensation entitlement, as outlined in the Heads of Bill published in July 2003 for the Civil Liability & Courts Bill 2004.

L.108 Concerns do persist about the level of litigation overheads which, as detailed in the MIAB report, add 42% on average to every euro paid in compensation. It is also necessary to be mindful of the experience in England where the 1999 Woolf reforms of personal injury litigation were used as a vehicle for increasing legal fees and fixed costs have now been introduced there from October 2003.

Estimate by Irish Insurance Federation of Reductions in Total Claims Costs from Implementation of MIAB Recommendations

Summary of Recommendations	% reduction	Cumulative
Road Safety Strategy	10%	
PIAB	7.6%	16.8%
Reduction in Uninsured Driving	5%	21%
Promotion of Rehabilitation	3%	23.4%
Abolition of 2% stamp duty	2%	24.9%
Reform of Courts & taxation of costs	2%	26.4%
Anti-fraud measures	1.75%	27.7%
Exclusion of earnings from "black economy"	1.5%	28.8%
Reduced plaintiff solicitors' fees	1.5%	29.8%
Book of Quantum	1%	30.5%
Repeal of Health (Amendment) Act 1986	1%	31.2%
	36.35%	

7 Research by Prof Brian Greenford of Limerick University.

Paper E

ANALYSIS OF THE 2003 STATUTORY RETURNS IN THE IRISH MARKET AND RELATED MATTERS - NON-LIFE MARKET OVERVIEW

Paper prepared on behalf of The Competition Authority

Dorothea Dowling, December 2004

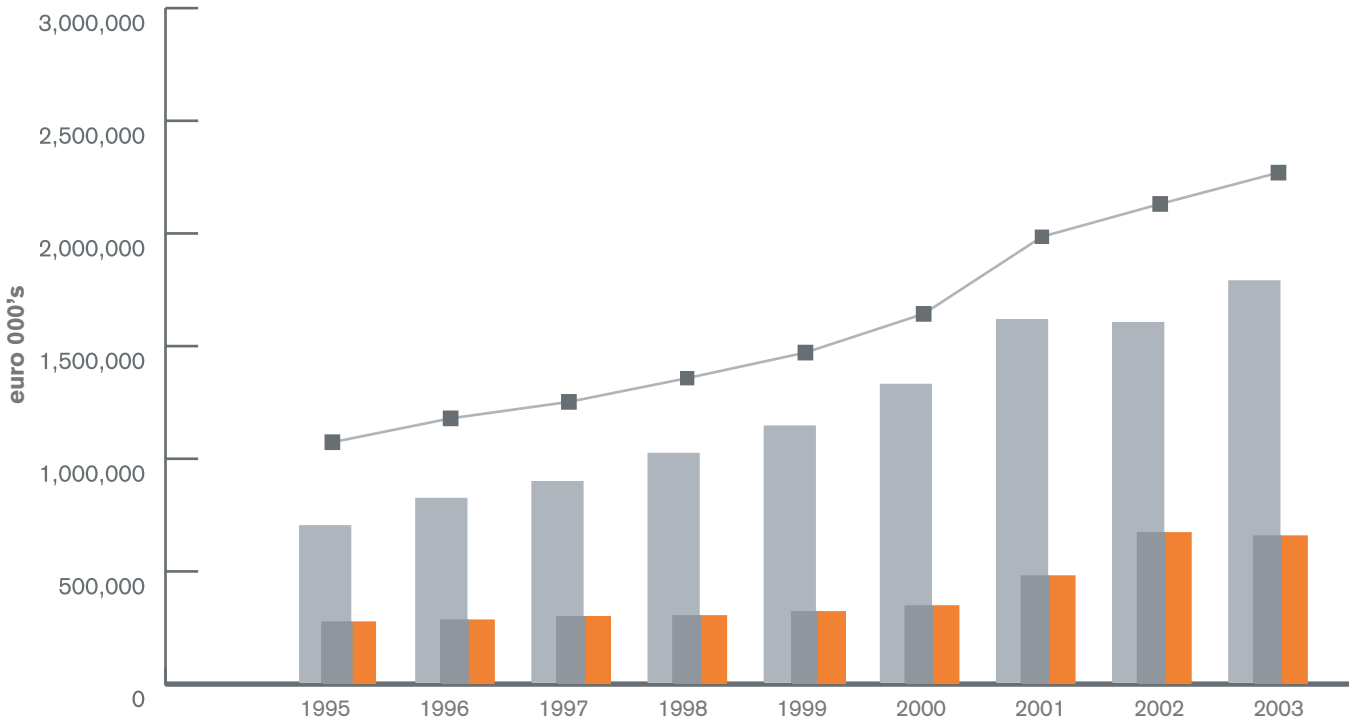
L.1 This report is supplemental to the more detailed analyses of the 2002 Insurers' Statutory Returns contained earlier in this volume. fo. This brief summary contains additional data which has now become available with the publication of the 2003 Blue Book in October 2004.

L.2 The size of the market for three classes of business – Motor, Public Liability and Employers' Liability- can be inferred from trends in net Written Premium Income. But as explained in the previous report, these figures are not definitive given both the relevance of self-insurance, either by excesses or larger retentions, and the extent of re-insurance. The latter will be examined in more detail below.

L3 The published revenue accounts do not provide a breakdown between Public Liability and Employers' Liability so only the division with Motor is shown below. Since 1995, net Written Premium Income increased by 150% overall, being 154% for Motor and 140% for Liability. It will be noted that Liability actually reduced in 2003 by 2% on the previous year while Motor was 11.5% higher than in 2002 in net terms.

Written Premium Income - Net

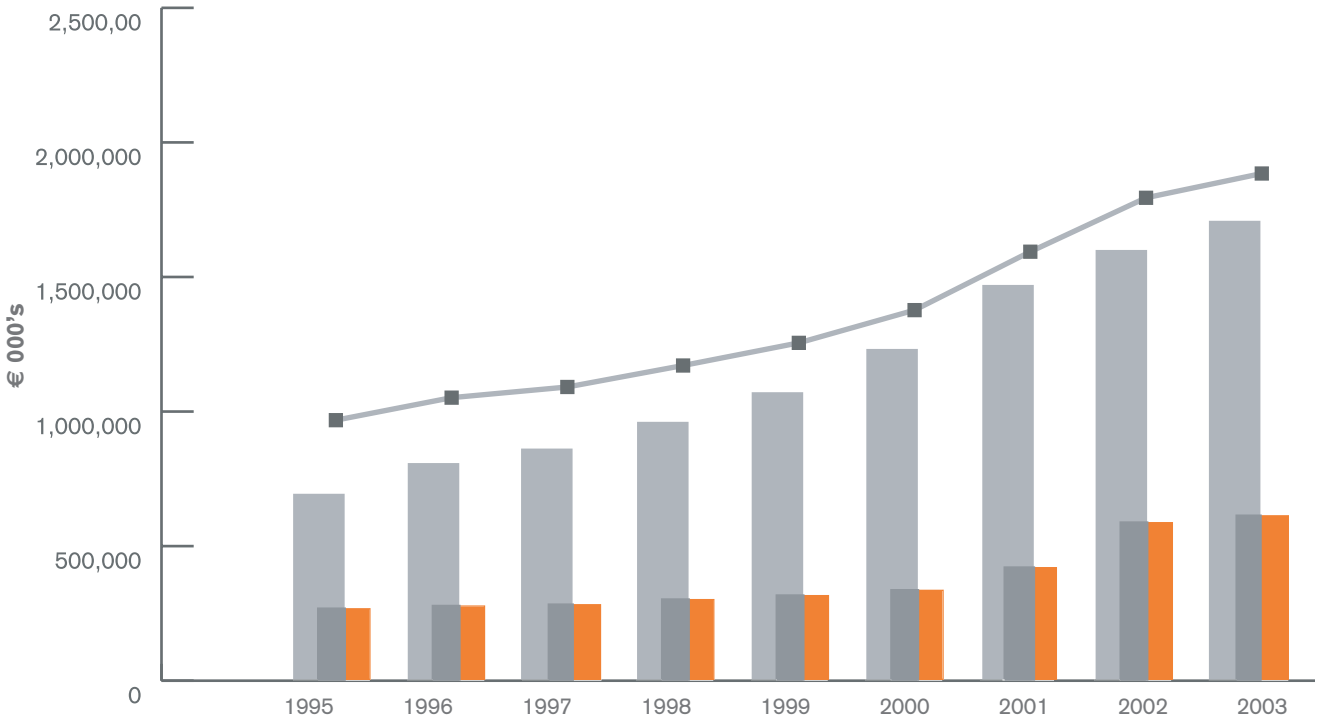
Source: Form 2 - Insurers' Statutory Returns



	1995	1996	1997	1998	1999	2000	2001	2002	2003
Motor	705,420	826,868	901,376	1,026,551	1,147,999	1,332,943	1,620,352	1,607,376	1,792,256
Liability	272,467	280,926	296,255	300,190	318,173	344,124	476,956	668,709	654,319
Total	977,887	1,107,794	1,197,631	1,326,741	1,466,172	1,677,067	2,097,308	2,276,085	2,446,575

Year of Account

Cost of Accident Years from 1995 as Estimated at YE 2002



	1995	1996	1997	1998	1999	2000	2001	2002	2003
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Liability	272,467	280,926	296,255	300,190	318,173	344,124	476,956	668,709	654,319
Total	977,887	1,107,794	1,197,631	1,326,741	1,466,172	1,677,067	2,097,308	2,276,085	2,446,575

Year of Account

L.4 The level of Written Premium Income is also relevant to investment returns, which will be examined below. Earned Premium Income is regarded as the more reliable figure for trend analysis. The breakdown in Earned Premium Income between Motor and Liability is shown in the graph above, with slightly lower increases overall than in Written Premium Income at 141% in total, being 146% for Motor and 129% for Liability.

L.5 Another factor which must be taken into account when comparing net premium levels is the variation in the level of re-insurance. As reflected in the table below, for Liability slightly higher levels of premium were ceded in 2003 than 2002 but considerably less for Motor than in the previous year. Details per company are not published but it is understood that there was an unusually high level of cession by one motor insurer in 2002 but there is no indication of a similar exceptional item in the 2003 returns.

Reinsurance of Irish Risk Business

	Reinsurance Premium Cessions €000's		
	2002	2003	Var
Total Motor Market	305,705	113,193	-192,512
Total Liability Market	177,722	191,832	14,110
Reinsurance totals	**483,427**	**305,025**	**-178,402**

net EPI Liability	2003	Rank	% IND.	2002	Rank	% IND.	2001	Rank	% IND.
Hibernian General	150,582	1	19.4	135,558	1	20.3	92,921	1	19.5
Quinn Direct	95,056	2	12.3	41,338	8	6.2	8,906	10	1.9
Allianz Corp*	94,716	3	12.2	97,187	2	14.5	66,062	2	13.9
I P B	84,100	4	10.9	64,228	3	9.6	48,341	4	10.1
FBD	74,437	5	9.6	61,047	5	9.1	40,175	6	8.4
Eagle Star Ireland	60,308	6	7.8	61,144	4	9.1	36,169	7	7.6
Royal Sun Alliance	57,228	7	7.4	58,268	6	8.7	43,918	5	9.2
Allianz Ireland*	47,453	8	6.1	40,405	9	6.0	30,251	8	6.3
St Paul	41,365	9	5.3	44,984	7	6.7	63,376	3	13.3
A.I.G	39,834	10	5.1	32,551	10	4.9	23,396	9	4.9
TOTALS	**745,079**		**96.2**	**636,710**		**95.2**	**453,515**		**95.1**

L.6 While there are over 600 insurers authorised to write liability and motor business in Ireland not all of them are active in the market. Even among active underwriters, certain companies specialise in one class of business or in a segment of the liability or motor market. Beneath the level of the leading insurers in each of class of business, the market shares of some existing insurers have changed over time.

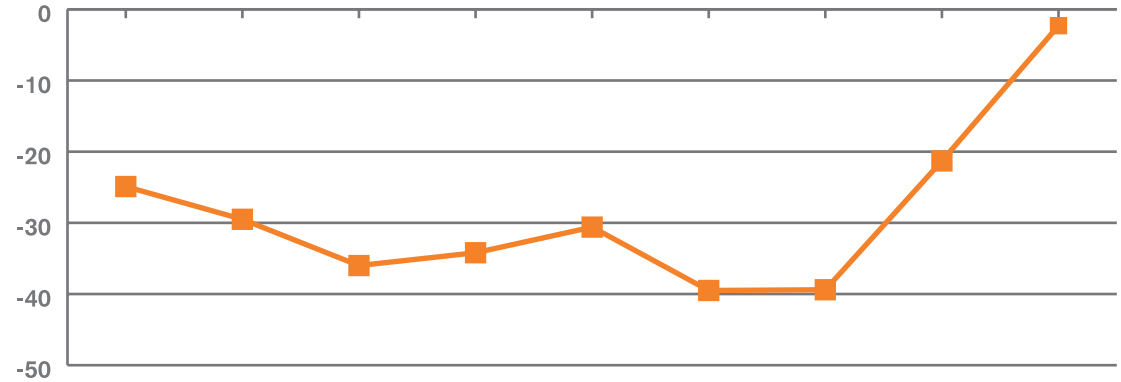
L.7 In the Liability Market the league table of the top ten in 2003, representing over 95% of Net Earned Premium Income, is shown in the table above with their relative positions in the previous two years.

L.8 While Hibernian remain in lead position throughout, the Allianz Group must be regarded as second when their two separate corporate entities (asterick in the table) combined at 18.3% in 2003. Quinn Direct have risen from tenth position in 2001 to now rival the traditional leaders and their growth is even more notable for the fact that they have not employed intermediaries for most of that period.

L.9 In the Motor Market a similar league table shows AXA and Hibernian generally holding just under half the Net Earned Premium Income. The two arms of Allianz hold 11.6% of the market but again Quinn Direct are gaining on the traditional leaders. There is little other significant movement in market shares and no evidence of recent new entrants.

net EPI Motor	2003	Rank	% IND.	2002	Rank	% IND.	2001	Rank	% IND.
AXA Pmpa	448,115	1	26.2	420,870	1	26.3	363,518	2	24.7
Hibernian General	376,602	2	22.0	321,268	2	20.1	390,322	1	26.5
Quinn Direct	185,030	3	10.8	157,252	4	9.8	130,822	3	8.9
Eagle Star Ireland	162,158	4	9.5	161,790	3	10.1	129,042	4	8.8
FBD	160,293	5	9.4	138,795	5	8.7	115,692	5	7.9
Allianz Ireland *	125,353	6	7.3	128,747	6	8.0	103,678	7	7.1
Royal Sun Alliance	89,678	7	5.3	119,286	7	7.5	107,247	6	7.3
Allianz Corp*	73,821	8	4.3	71,136	8	4.4	60,730	8	4.1
A.I.G	32,088	9	1.9	31,155	9	2.0	27,453	9	1.9
St Paul	28,244	10	1.7	25,191	10	1.6	21,766	10	1.5
TOTALS	**1,681,382**		**98**	**1,575,490**		**98**	**1,450,270**		**99**

Liability underwriting loss as % EPI



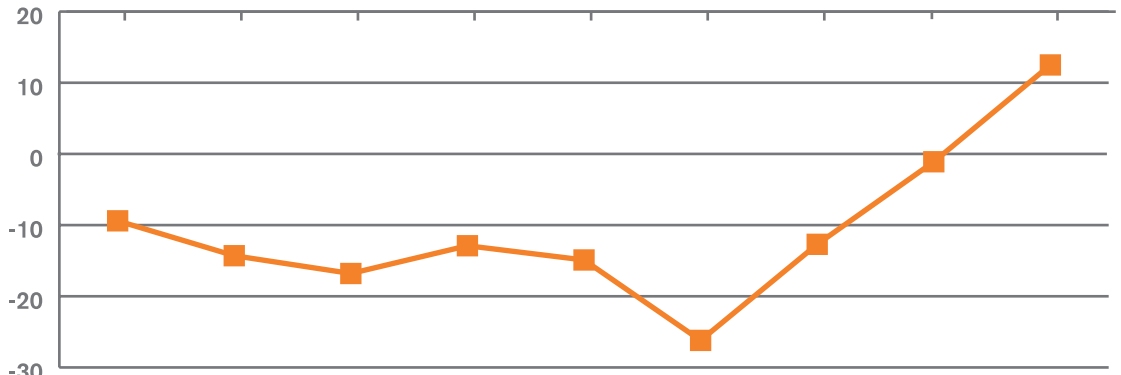
	1995 (%)	1996 (%)	1997 (%)	1998 (%)	1999 (%)	2000 (%)	2001 (%)	2002 (%)	2003 (%)
U/W loss as % net EPI	-24.9	-29.5	-36	-34.2	-30.6	-39.5	-39.4	-21.3	-2.3

L.10 Market performance is expressed as underwriting result as a percentage of net Earned Premium Income, as in the previous more detailed report. The trend in Liability shows continuing underwriting losses but a considerable improvement in 2003 on all previous years; (graph above).

L.11 Motor performance reflects a considerably healthier situation for profitability with actual underwriting profits reflected in 2002. Underwriting profitability increased further in 2003 to 12.5% of net Earned Premium Income (graph below).

L.12 Traditionally, insurers have relied on Investment Income to achieve a positive bottom line result. Expressing investment return as a percentage of net Written Premium Income shows that this is still a substantial aspect of profitability but now higher in Liability than in Motor (table below).

Motor underwriting result as % EPI



	1995 (%)	1996 (%)	1997 (%)	1998 (%)	1999 (%)	2000 (%)	2001 (%)	2002 (%)	2003 (%)
U/W Result as % net EPI	-9.4	-14.3	-16.8	-12.9	-14.9	-26.2	-12.7	1.1	-12.5

Investment Income as % on top of WPI per Year of Account

Class	1995	1996	1997	1998	1999	2000	2001	2002	2003
Motor	23%	19%	20%	14%	12%	12%	11%	11%	10%
Liability	30%	30%	34%	31%	30%	28%	19%	9%	14%

Liability	2003	2002	2001	2000	1999	1998	1997	1996	1995
Commissions €000's	73,025	58,181	44,836	25,701	24,925	24,394	22,476	20,968	19,914
comm as % wpi	9.4%	8.7%	9.4%	7.5%	7.8%	8.1%	7.6%	7.5%	7.3%

Motor	2003	2002	2001	2000	1999	1998	1997	1996	1995
Commissions €000's	80,424	76,212	60,277	50,425	40,958	35,252	29,914	26,602	22,644
comm as % wpi	**4.5%**	4.7%	3.7%	3.8%	3.6%	3.4%	3.3%	3.2%	3.2%

L.13 Commissions to intermediaries continue to grow in total amounts on both classes of business from less than €20ml on Motor in 1995 to €73ml in 2003 and from €23ml to €80ml in Liability over the same period. Commission payments have also risen proportionately in Liability at 9.4% relative to net Written Premium Income but have reduced slightly in percentage terms on Motor at 4.5% in 2003. Some intermediaries may also be in receipt of fees directly from their clients and those earnings are not reflected in these figures which relate solely to payments by insurers.

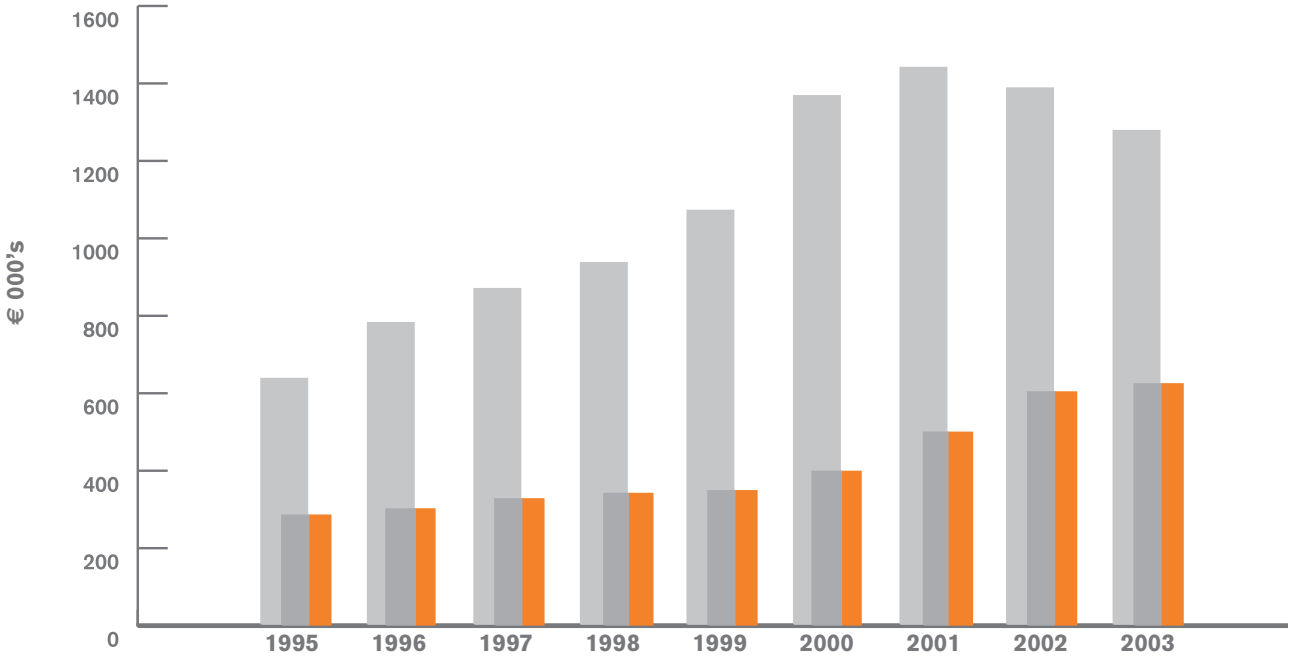
L.14 Insurers' Management expenses are in addition to amounts paid to intermediaries (for those companies which appoint insurance agents on that basis). In 2003 both classes of business showed increases in the amounts of management expenses. However, relative to net Written Premium Income, Liability has reduced to 9.3% from 9.9% in 2002 while Motor rose to 10.4% from 10.1% the previous year. (See table below.)

L.15 Claims costs trends can only be identified as between Motor and Liability in the Net Revenue Accounts which have been examined so far. The Cost of Claims Incurred shown in those Form 2's are an amalgam of adjustments to prior years' reserves as well as estimated liability for accidents in the current year. The trend in claims costs incurred, so defined, is reflected in the graph below from which it will be noted that in 2003 Motor reduced by 7.9% while Liability increased by 3.4% over 2002.

Liability	2003	2002	2001	2000	1999	1998	1997	1996	1995
Management Expenses €000's	71,848	66,026	53,401	48,201	41,606	41,113	37,318	39,466	34,259
XP's as % net WPI	9.3%	9.9%	11.2%	14.0%	13.1%	13.7%	12.6%	14.0%	12.6%

Motor	2003	2002	2001	2000	1999	1998	1997	1996	1995
Management Expenses €000's	186,504	162,837	169,370	144,398	125,146	115,086	109,314	113,792	101,614
XP's as % net WPI	10.4%	10.1%	10.5%	10.8%	10.9%	11.2%	12.1%	13.8%	14.4%

Cost of Claims Incurred Net



	1995	1996	1997	1998	1999	2000	2001	2002	2003
Motor	640	784	872	939	1,074	1,370	1,443	1,390	1,280
Liability	284	300	326	340	347	397	498	602	623

Liability	1995	1996	1997	1998	1999	2000	2001	2002	2003
CCI/ Claims Paid	1.86	1.6	1.54	1.44	1.48	1.38	1.87	1.85	2.06
EPI/CCI	.95	.92	.87	.89	.91	.85	.84	.97	1.18

Motor	1995	1996	1997	1998	1999	2000	2001	2002	2003
CCI/ Claims Paid	1.25	1.16	1.12	1.19	1.21	1.36	1.34	1.30	1.43
EPI/CCI	1.09	1.03	.99	1.02	1.0	.90	1.02	1.15	1.33

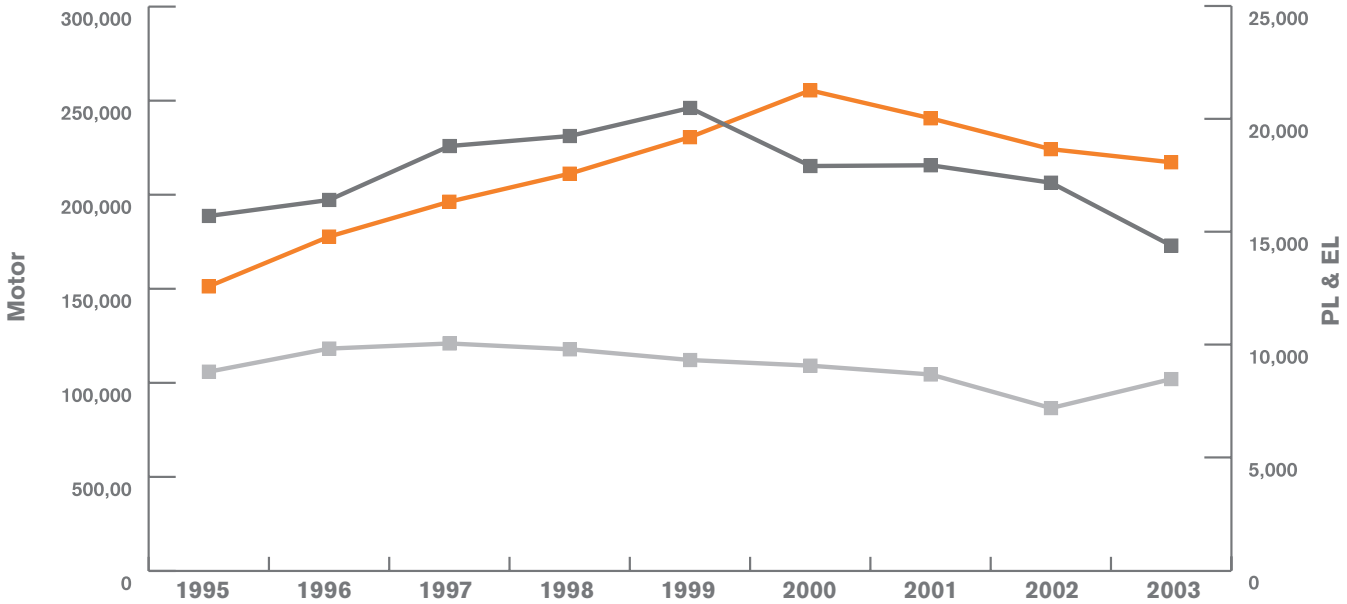
L.16 Injury claims are a long-tailed business so the Cost of Claims Incurred (CCI) is likely to exceed the level of claims paid out in a particular year of account. However the margin appears to be widening in recent years with Liability Cost Incurred being over twice claims paid in 2003 and 1.43 times in Motor. This may be indicative of insurers carrying higher levels of reserves. Greater coverage of net Cost of Claims Incurred by net Earned Premium is also emerging in 2003 at 1.18 times for Liability and 1.33 times for Motor.

L.17 Superior information is available from the claims data contained in the Form 8's of the Statutory Returns which show Public Liability and Employers Liability separately. Values in these returns are expressed gross of reinsurance whereas the Cost of Claims Incurred from Form 2's above are net of reinsurance. The Form 8's also provide data on numbers of claims in each class so that average gross costs can be calculated and trends identified.

L.18 As mentioned earlier, reference to the analyses of Statutory Returns in my earlier report in this volume, rt is advisable for a guide on the interpretation of figures. Such reference will also show that the claim numbers and costs for older years' accidents as assessed at Year End 2003 are different to the returns at Year End 2002. This arises because insurers annually revise their projections of both anticipated claim numbers and expected costs, at least until the vast majority of claims on hand have been finalised and further exposure under the Statute of Limitations has expired.

L.19 The trends in claim numbers by accident year as anticipated at Year End 2003 are reflected in the graph below, with Motor and Public Liability showing substantial reductions on the year before and for the second year running. Employers Liability claims volumes are reverting close to the level in 2001 are a series of years of reduction.

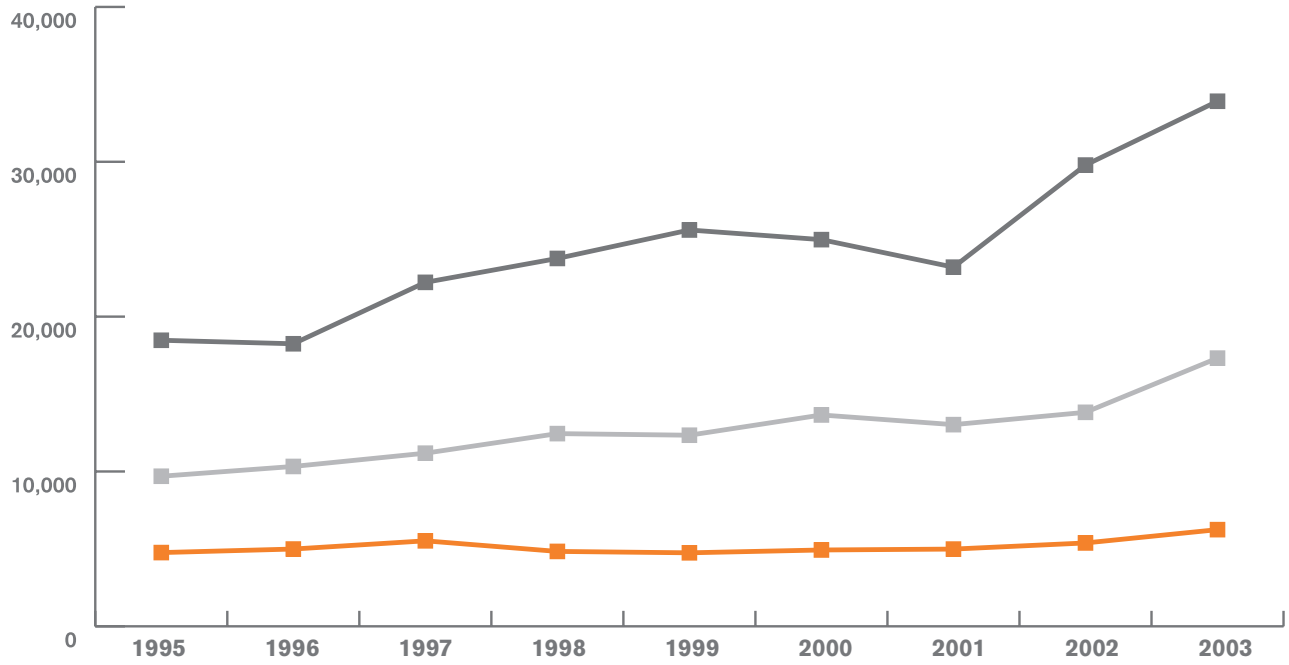
Claim Numbers Trend



	1995	1996	1997	1998	1999	2000	2001	2002	2003
Motor	151,270	177,738	196,280	211,187	230,591	255,491	240,639	224,226	217,257
PL	15,698	16,407	18,795	19,239	20,483	17,910	17,943	17,171	14,385
EL	8,799	9,822	10,049	9,790	9,315	9,065	8,675	7,186	8,471

Year of Accident

Average Gross Claim Cost €000's



	1995	1996	1997	1998	1999	2000	2001	2002	2003
Motor	4,762	4,991	5,521	4,837	4,747	4,930	4,988	5,384	6,243
PL	9,692	10,324	11,181	12,445	12,341	13,649	13,024	13,820	17,320
EL	18,473	18,247	22,213	23,757	25,595	24,972	23,194	29,788	33,909

Year of Accident

L.20 Reductions in claim numbers do not, however, necessarily equate to a reduced overall cost for a particular accident year. This is indicative of an increasing average cost per claim or it may be reflective of a particularly serious occurrence(s) in a specific year. So for example, despite the fact that Public Liability claim numbers reduced 16% in 2003 the estimated liability for that year of accident has increased by 5% on the previous year. A 3% reduction in numbers for Motor still required a 12% increase in estimated cost compared to 2002 accidents. Similarly, an increase of 18% in claim numbers for Employers Liability has translated into a 34% increase in cost.

L.21 This lack of relativity between claims frequency and overall cost accrual is reflected in the graph above of gross average claim cost, as estimated at Year End 2003, by each class of business since the 1995 year of accident. Employers Liability, which has the highest average cost, also tends to reflect the greatest volatility year on year along with the highest increase overall at 84% followed by 79% increase in the average Public Liability claim cost. Both of those are considerably higher than the 31% increase between 1995 and 2003 for Motor. As highlighted in my more detailed analysis in this volume, the increase in Comprehensive cover for newer cars is undoubtedly a factor in depressing the average cost in the Motor account.

L.22 The extent of re-insurance recoveries expected on both Motor and Liability has also changed in 2003 from the previous year. This must be borne in mind when looking at Claims Costs from Form 2 Returns which are net as compared to Form 8's which are gross but have the advantage of providing a breakdown between Public Liability and Employers Liability. In the current context, the only relevant breakdown available on re-insurance is between Motor and Liability.

Reinsurance Premium Cessions €000's

	Reinsurance Premium Cessions €000's		
	2002	**2003**	***Var***
Total Motor Market	152,098	99,279	*-52,819*
Total Liability Market	153,323	96,647	*-56,676*
Reinsurance totals	**305,421**	**195,926**	***-109,495***

Outstanding provisions at YE 2002 as multiple of paid in 2002

All Accident Yrs	MOTOR	PL	EL
Total paid in 2002	1,033,085,314	161,173,321	186,881,802
Gross value o/s	3,157,698,051	1,221,966,476	1,015,047,713
=>No of Yrs of Payments O/S	3	8	5

Outstanding provisions at YE 2003 as multiple of paid in 2003

All Accident Years	MOTOR	PL	EL
Total paid in 2003	936,278,286	145,262,919	173,991,089
Gross value o/s	3,460,489,061	1,362,040,571	1,133,279,344
=>No of Yrs of Payments O/S	4	9	7

L. 23 It must be stressed that for most recent years of occurrence insurers place heavy reliance on estimates both as to ultimate cost and anticipated final claim numbers. Exposure to deteriorations on estimated costs should be curtailed from March 2005 when the Statute of Limitations is reduced for adults to two years from three years, calculated from the date of accident or date of knowledge of cause of action. In the interim, concerns persist about the level of reserves being retained for claims not yet notified and also to cover potential deteriorations on the currently estimated cost exposure. Annually, the balance in the reserve fund for outstanding claims is many multiples of the amount paid out in a year on claims. This multiple has grown further in 2003 from the 2002 level reflected in the Form 8 returns.

L. 24 The tables above indicate that the average finalisation period by value for Motor claims is 4 years, for Public Liability 9 years and for Employers Liability 7 years – all of which are a year longer than anticipated in the 2002 Statutory Returns. This does not seem consistent with the reality of reduced accident frequency and the reforms for improved efficiency in the litigation system in 2003.

L. 25 When there are reservations about excessive claims reserves it is not possible to determine a long term run-off as the figures returned for the ultimate cost of older accident years may still contain an unnecessary margin. Analyses of insurers' raw data in the MIAB Final Report of September 2004 indicated that there had been very little rate coverage deficit over the period 1997 as developed to 2001. More recent data supplied to IFSRA should prove more conclusive provided the same statistical format is retained so that consistency is maintained until ultimate cost can be firmly determined for older years of accident.