4 March 2013

India Motor

Milliman

Finally, light at the end of the tunnel?

Proposed significant increases in motor third-party tariff

On February 16, 2013, the Insurance Regulatory and Development Authority (IRDA) issued an exposure draft on the revision of premium rates for motor third-party (TP) insurance for the financial year 2013-2014 (1 April 2013 to 31 March 2014). The IRDA has proposed significant premium rates increases for most vehicle classes. Although the premium rates vary by subclass, for the sake of simplicity and to ensure a less volatile premium change for different policyholders, IRDA proposed that the subclasses be grouped together and a single revision be made for vehicle class as a whole. Figure 1 summarises the premium rate changes for the classes.

Figure 1: Schedule of Motor Third-party Insurance Rates as of 1 April 2013

Vehicle Class	Proposed % increase over 2012-2013 tariff
Private cars	38.87%
Two-wheelers	18.30%
Goods-carrying public carriers (other than 3-wheelers)	30.21%
Goods-carrying private carriers (other than 3-wheelers)	11.02%
Goods carrying public carriers (3-wheelers)	32.99%
Goods-carrying private carriers (3-wheelers)	9.90%
Passenger-carrying vehicles (4-wheelers)	12.96%
Passenger-carrying vehicles (3-wheelers)	11.34%
Special Type of Vehicle	176.45%
Others	56.44%

Background

Historically, the motor third-party insurance business in India has not been profitable. Within this operating environment, commercial vehicles encountered extreme difficulties in finding cover. As a result, IRDA constituted the India Motor Third Party Insurance Pool (IMTPIP) on 1 April 2007. IMTPIP underwrote third-party liability covers for all commercial vehicles, with the risks shared by insurers.

However, IMTPIP brought about further deterioration of underwriting results for insurers. On 23 December 2011, the IRDA issued an order (order reference: IRDA/NL/ORD/MPL/276/12/2011) to dismantle the IMTPIP with effect from 31 March 2012.

In replacement, the Declined Risk Insurance Pool (DR Pool) was set up effective from 1 April 2012 to provide insurance to risks that cannot find cover from insurers in the market. All motor insurers are members of the DR Pool. They are required to underwrite a minimum number of commercial motor third-party policies, and the minimum premium volume can be prescribed by the IRDA each year. Insurers that fail to meet the minimum criteria are forced to insure risks from the DR Pool.

Annual revision of premium rates

Since 2011, IRDA reviews and adjusts motor insurance premium rates for third-party liability cover and publishes an exposure draft on its website at the beginning of the year. Upon receiving responses on the exposure draft, IRDA holds a series of discussions with transporter associations and insurers.

Premiums are reviewed regularly depending upon three factors:

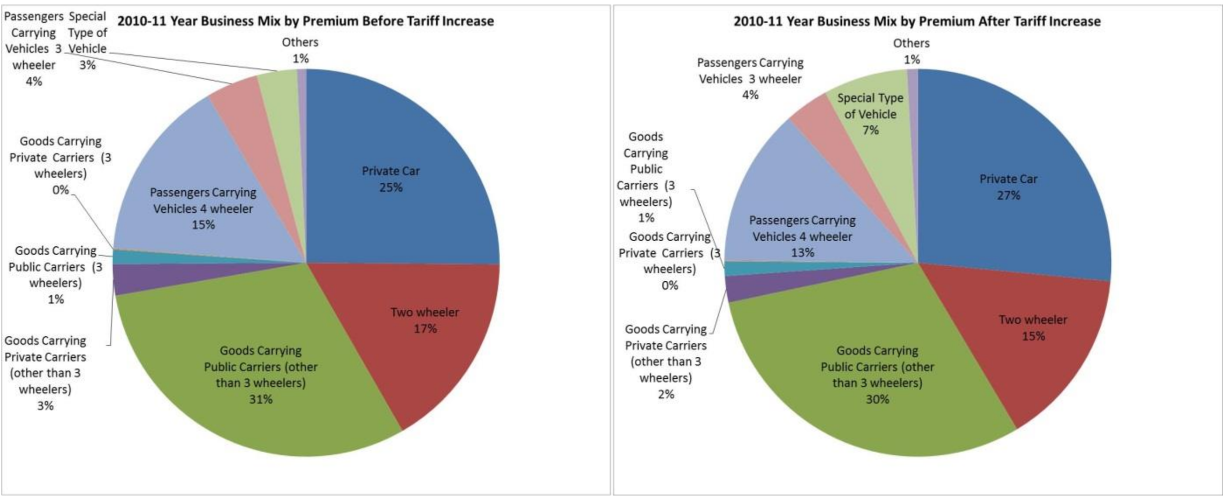
1. Average claim cost for each class of vehicle
2. Frequency of claims for each class of vehicle
3. Cost Inflation Index for the year of review

The premium adjustment is determined by using a prescribed formula that takes into account the Cost Inflation Index and adjustment factors determined by IRDA.

Potential impact of proposed change in 2013-2014

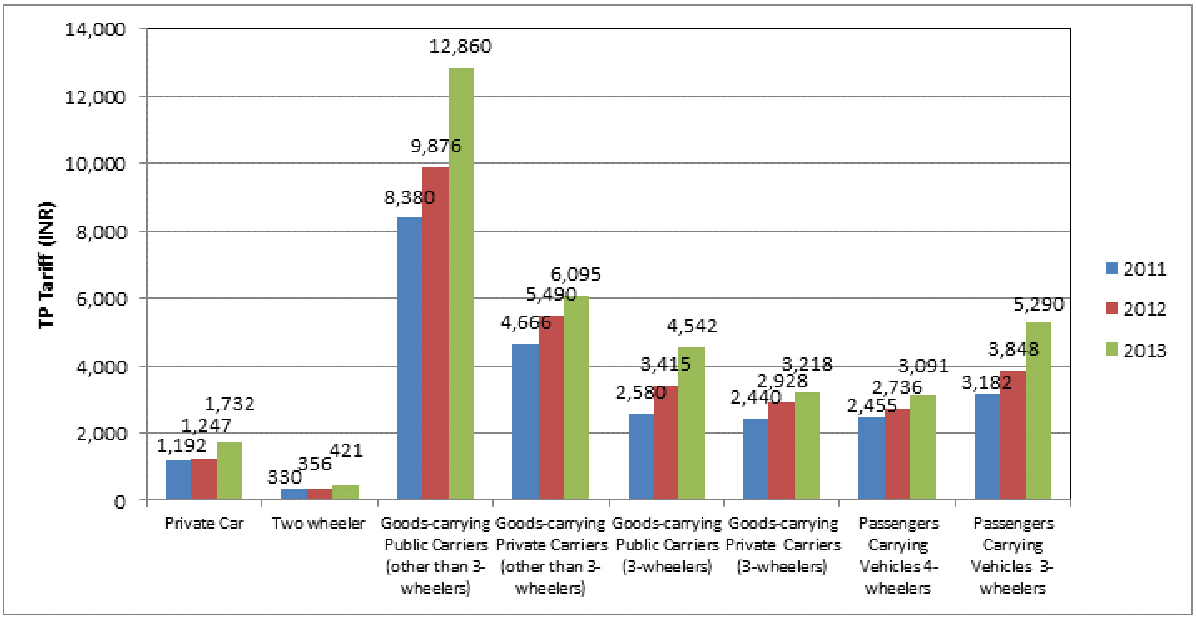
Milliman obtained data on motor TP insurance from the Insurance Information Bureau (IIB). According to reports from 2010-2011, the total premium of motor TP insurance is around INR 51,320 million. After allowing for the proposed change, it will increase by 32% to INR 67,520 million. The adjustment on the premium rates will also lead to a different business mix and average premium, as shown in Figures 2 where we will see slight increases in the proportion of private car and two-wheeler premiums, and a lower mix of goods carrying and passenger carrying vehicles. In calculating the average premium, we have assumed that the proportion of each subclass within each vehicle class is to remain unchanged.

Figure 2: TP Business Mix by Vehicle Class



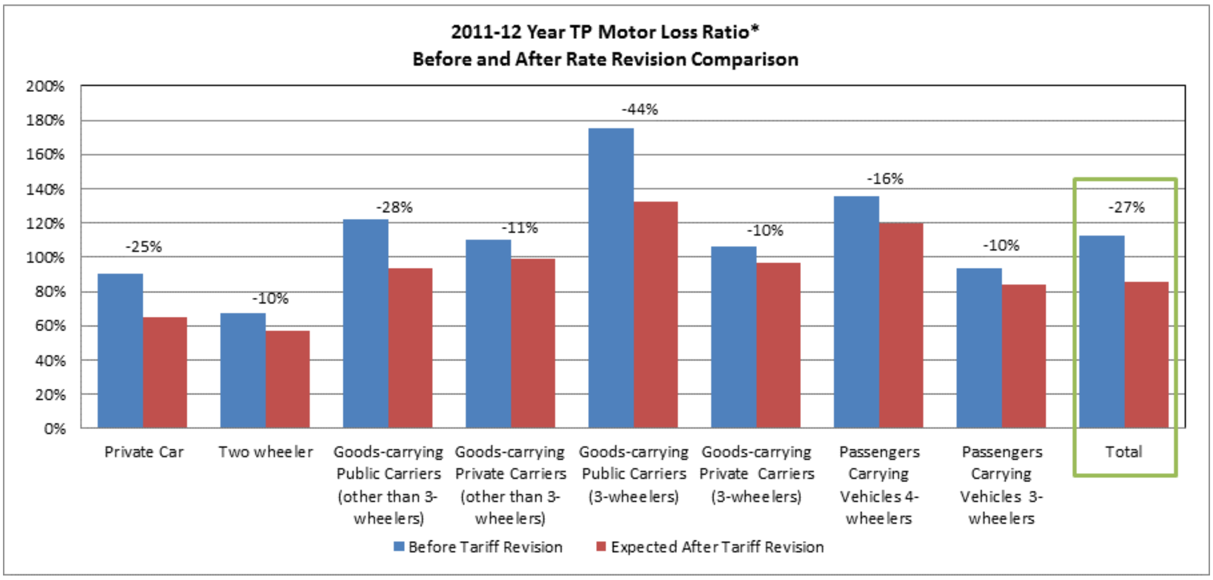
Although IRDA has been increasing TP tariff over the past years, the proposed 2013-14 change is the most material in recent times as illustrated in Figure 3 below.

Figure 3: TP Business Mix by Vehicle Class



The rate revision is expected to have a material and positive effect on loss ratios and motor profitability overall. For illustration purposes, ignoring claims inflation and assuming the mix of vehicles remains stable, the increases in premium rates are likely to improve the overall TP loss ratio of 27%. Figure 4 shows the estimated difference in loss ratios by vehicle class.

Figure 4: Improvement in Loss Ratios After Rate Revision



Note: we have used 2010-2011 underwriting year data (source: Insurance Information Bureau) as a basis of estimating the impact of loss ratio movement. The reported loss ratios may not reflect the true underlying loss ratios of the industry as we do not know the extent of provision made for Incurred But Not Reported (IBNR) claims.

For Goods-carrying Public Carriers (other than 3-wheelers) and Private Car, which are the two largest classes, the loss ratios improve from 122% and 90% to 94% and 65%, respectively. This contributes significantly to the improvement of overall loss ratio, from 113% to 86%. The improvements in the loss ratios for Special Type of Vehicle and Others are also significant.

Overall, it is expected that the loss ratio would improve by almost 27% points for TP business and 8% points for motor business overall, if we ignore future claims inflation and assume no major change in vehicle mix.

Implications

The premium rate review would significantly improve the current profitability level in India. In the past, TP has been generally unprofitable across the board and insurers have relied on selling comprehensive cover to turn a profit. Now insurers may be able to target specific segments to sell TP covers that are profitable in their own right.

This increases the opportunities to develop and sell “TP plus” policies, i.e., a hybrid between TP and own damage (OD). Some insurers, in particular the private sector players, are already doing this.

With less reliance on cross-subsidies from OD cover to turn a profit, insurers may have to refine how they segment risks in order to tease out now-profitable segments that were previously unprofitable, or how they reduce prices in other segments to increase market share.

In addition, a number of policies in the DR pool may turn back to the market as the increase in premium makes those high-risk policies a profitable business.

Overall, the increased tariffs expand the number of segments that can be written profitably. Insurers who perform actuarial risk selection analyses and sharpen their underwriting skills stand to benefit more from the increased tariffs. A boost in profitability means improving solvency margins for insurers, which in the long run is a win-win-win situation for insurers, consumers at large and regulators. This may well be the light at the end of the tunnel insurers have been waiting for.

Contact details

For more information, please contact:

Jack Jiang
Director and Consulting Actuary
Office + 852 2598 1516
Email **jack.jiang@milliman.com**

Pang Chye
Principal & Consulting Actuary
Office + 852 2147 5948
Email pang.chye@**milliman.com**

3901-02, AIA Tower, 183 Electric Road,
North Point, Hong Kong

Disclaimer