insurance europe

Insight Briefing

Compulsory insurance: when it works and when it doesn't

There are only limited situations in which compulsory insurance can be appropriate

For a developed society to function, individuals and businesses need access to appropriate, affordable insurance. Policymakers quite rightly want to ensure that this is possible, and it is often believed that compulsory insurance schemes are the best way to ensure the take-up or the availability of insurance, particularly for new risks. For example, the European Parliament recently put forward proposals for a mandatory insurance scheme for robots.

It is important to understand that compulsory insurance schemes will only work if specific conditions are met. If they are not, an inappropriate scheme can do more harm than good.

What are the conditions?

There are only limited situations in which compulsory insurance can be appropriate because the following basic conditions — at the very least — must be met:

- **Sufficient data** for insurers to assess the expected frequency and size of claims, so that they can price policies correctly.
- **Sufficient similarity in the risks being covered**. If risks are very different, complex or not well known, insurers instead need to have the flexibility to tailor their underwriting to specific risks.
- A variety of insurers interested in offering cover, so that there is:
  - **sufficient insurance capacity** and
  - **adequate competition**.
- **Enough reinsurance capacity** to allow risks to be sufficiently spread, particularly large and long-term ones.

There are, of course, other preconditions that must be met before a risk can even be insurable. One of the most basic is that the insured event must be outside the control of the insured.

This is why Insurance Europe opposed calls for EU-wide compulsory insolvency insurance for airlines a few years ago. Since insolvency is not always outside the control of an insured, it is not generally a risk that is transferable to the insurance market.

What if the conditions are not met?

Inappropriate compulsory schemes are very likely to be counterproductive — actually making life more difficult for individuals, businesses and insurers.

Effects on the insurance market:

- A lack of underwriting/contractual freedom **stifles insurance product innovation** and insurance market growth.
- There is **insufficient or no insurance**, as insurers are unwilling to offer cover under the restrictions imposed by a compulsory scheme.
- There is **less loss prevention/increased moral hazard** because policyholders who have been obliged to purchase insurance do not implement adequate protection measures or behave in a riskier manner, as they feel the burden is on the insurer.

Effects on individuals and businesses:

- **Individuals are unprotected or businesses are unable to operate or grow** because they cannot obtain the cover that they need by law, as insurers are unwilling to offer cover.

- There are **higher premiums** due to:
  - the uncertainty created by the lack of data on which insurers can base underwriting judgements
  - lack of a competitive market
  - additional administrative costs for insurers created by compulsory schemes
- **Individuals/businesses could be required to purchase more cover than they need, while others could be under-insured** due to inflexibility in distinguishing between risk levels.

Insurance Europe position

When new risks arise, insurers should usually be given the time and environment they need to develop appropriate and affordable policies. Compulsory schemes should only be considered at EU level in very specific circumstances.

For additional information, please contact Rosa Armesto, head of public affairs and communications at Insurance Europe (armesto@insuranceeurope.eu, tel: +32 2 894 30 62).

Compulsory insurance and the EU

It is far more difficult for the conditions for compulsory insurance to be met at EU level than at national level. This is because of the often substantial differences in levels of risk, liability regimes and risk prevention cultures between countries.

An EU-wide compulsory scheme that works …

Motor third-party liability (MTPL)

The motor insurance market is long-established with ample claims data and insurance capacity. Differences in risk and liability across the EU are also not pronounced. This made it possible to introduce an EU-wide compulsory scheme for MTPL insurance in 1972.

Motor third-party liability

For a compulsory EU scheme, is there sufficient:

- claims data? **YES**
- similarity of risks? **YES**
- insurance capacity? **YES**
- competition? **YES**
- reinsurance capacity? **YES**

… and one that wouldn't

Liability for robots/artificial intelligence

In February 2017, the European Parliament asked the European Commission to look into possible compulsory insurance for specific categories of robots, as part of the development of civil law rules on robotics. Compulsory insurance for the many different new liabilities, for which there is still insufficient claims data, would deter insurers from either entering the market or developing innovative and tailored products. If entrepreneurs were unable to buy statutory insurance, this could in turn stifle EU innovation in robotics.

Liability for robots/artificial intelligence

For a compulsory EU scheme, is there sufficient:

- claims data? **NO**
- similarity of risks? **NO**
- insurance capacity? **Market still developing**
- competition? **Market still developing**
- reinsurance capacity? **Market still developing**