

**EUROPEAN COMMITTEE UNDER THE GOVERNMENT OF THE REPUBLIC OF  
LITHUANIA**

Integration Strategy Department Integration Analysis Division

**EFFECTS OF DIRECTIVE 84/5/EEC ON MOTOR THIRD  
PARTY LIABILITY INSURANCE IN LITHUANIA**

Summary of study report

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The **subject** of this study is prognosis and valuation of social and economical outcomes due to implementing of the EU directive 84/5/EEC on Motor Third party Liability Insurance in the Lithuanian legislation.

The **goals** of this study:

- To determine growth possibilities of insurance industry in Lithuania due to realising of directive 84/5/EEC,
- To forecast influence of growing insurance industry upon economy and social sphere.

The **tasks**:

- to identify possibilities to harmonise compulsory Motor third party liability insurance of vehicle owners and possessors Law of the Lithuanian Republic with the requirements of the EU directive 84/5/EEC,
- to identify effective organisational and administrative measures to implement the compulsory MTPL insurance in the Lithuanian legislation,
- to characterise the effects of directive 84/5/EEC upon the insurance system growth, employment rate, state and SODra budgets,
- to characterise the effects of directive 84/5/EEC upon the activities of financial market due to shifts in insurance industry,
- to describe the effects of directive 84/5/EEC upon insurance companies and related industries activities
- to define the effects of directive 84/5/EEC upon residents and firms expenses.

Effects of directive 84/5/EEC upon different social groups and economic sectors were assessed. Research was based mainly on the quantitative characteristics of MTPL insurance market. Final report of this study contains these quantitative characteristics and prognoses:

- Assessment and prognosis of Lithuania motor vehicles situation for different groups was made. Motor vehicles were structured according to the type of owners (legal or physical entities, or pensioners), and the age of vehicles. Comparative analysis of Lithuania and Latvia motor vehicles registration and insurance systems principles are presented in this study.
- Observation of Latvia compulsory MTPL insurance system activities was made. These results were taken as analogues to forecast share of MTPL insurance contracts holders among vehicle owners and possessors, and contract duration distribution in Lithuania for the period 2002-2004.
- Prognosis of MTPL insurance risk was made, insurance premiums to cover these risks were determined.
- Forecasts of cash flows from compulsory MTPL insurance for the period 2002-2004 were made.
- Forecasts of insurance market growth because of compulsory MTPL insurance for period 2002-2004 were made.
- Quantitative prognosis on State and SODra budgets growth due to of directive 84/58EEC effects was presented in this study.

This study contains 67 pages, 50 tables and 10 appendices. Report is structured into 14 sections.

Hypotheses analysed in this study are presented in the first section. Hypotheses were formulated taking into account tendencies of the Lithuania economy growth and obligations to harmonise national legislation with the EU legislation. Within this study the following hypotheses were examined:

1. Law of the Republic of Lithuania on compulsory motor third party liability insurance of vehicle owners and possessors is the first step to meet the provisions of the EU directive 84/5/EEC
2. Sums insured for the MTPL according to directive 84/5/EEC will grow considerably. This will cause insurance premiums growth greater than income growth. This will negatively influence living standards
3. Insurance companies selling insurance contracts meeting provisions of directive 84/5/EEC will accumulate money for redistribution. This will have positive effect on the economy growth of the economy.
4. Residents' expenses for insurance will grow; this will diminish their savings and purchasing power.
5. Companies' expenses for insurance will grow. This will cause increase in prices and decrease competitiveness of the firms' competitiveness.
6. Insurance market will grow. This will positively influence financial services industry share creating GNP.

The second section of the report presents an overview of inadequacies between the Law of the Republic of Lithuania on compulsory MTPL insurance and EU directive 84/5/EEC.

The third section presents an overview of administrative measures to create effective registration and control systems for insurance contracts, policyholders, accidents, assurance premiums written and claims paid.

The fourth section presents forecasts motor vehicles number for the period 2002 – 2004.

The fifth section presents forecast of compulsory MTPL insurance contracts number and deviation. Prognosis was based on the tendencies found out in Latvia compulsory MTPL insurance system development. Taking into account our research, conclusion was made that about 60 percent of motor vehicles owners will hold MTPL insurance contract, about 30 percent of them for a period one year.

The sixth section is devoted to insurance risk valuation problems. Supposition that about 13.8 percent of the persons responsible for the damage in the road accidents hold no MTPL insurance contract is based on Latvian experience. Forecasts for the claims paid by insurance companies and Bureau for Motor Third Party Insurance are presented in Table 1.

Table 1

**Forecasts for claims per accident paid, Litas**

Claims paid by	Forecasts for claims paid, Litas		
	2002 m.	2003 m.	2004 m.
Insurance companies	1983	2181	2508
Bureau for MTPL	2189	2408	2769

This section also contains forecasts for the accident frequency and damages fluctuation. For the nine months of 2002 36.5 thousand road accidents and 52.8 million litas claims paid are

forecast, for the year 2003 and 2004 respectively 48 and 52.5 thousand road accidents and 102.8 and 127.6 million claims paid respectively’.

The seventh section is devoted to the forecasts of MTPL insurance premiums. Insurance experience legislation requirement and most common reduction of insurance premiums were taken into account when forecasting premiums presented in table 2.

Table 2

**Prognosis of average insurance premiums, Litas**

<b>Groups of policyholders</b>	<b>2002 year for new policyholders</b>	<b>2002 year for renewed contracts</b>	<b>2003 year</b>	<b>2004 year</b>
Juridical persons	441,94	378,32	437,15	462,59
Physical persons	268,77	229,81	265,65	307,72
Physical persons pensioners	157,51	138,78	158,84	185,59

The eighth section presents prognosis for the gross premiums written amount from the MTPL insurance. Gross premium written per capita will reach 58.8 litas in 2002 and 62.9 litas, and 27.3 litas for the year 2003 and 2004.

The ninth section presents results of forecasts for insurance companies gross premiums written premium earned and unearned premium positions.

The tenth section presents forecasts for MTPL insurance market for years 2001 and 2002, before implementing compulsory MTPL insurance principles.

The eleventh section presents prognosis for insurance companies and Bureau activity results in the field of compulsory MTPL insurance. The essence of this prognosis is presented in Table 3 and Table 4. Prognosis of this research is based on pessimistic valuation of the number of drivers who are responsible for the damage but hold no MTPL contracts. The number of such drivers is supposed to be higher in Lithuania than in Latvia.

The twelfth section provides information about cash flows influencing consumer market and state budget. Figure 1 describes expenses related to these outcomes. Expenses favourable for consumption growth and state spendings are shown in Figure2. It is necessary to stress that insurance system redistributes money which otherwise could have been used for consumption. This tends to the market growth and will partly moderate negative influence of growing expenses for the basic needs. Figure 3 describes the effect of the EU directive 84/5/EEC requirements upon the national Law.

Due to the Third party liability claims requirements some “shadow” businesses will be transformed into legal firms, because of the document requirements when presenting submission of claim to the insurer of the third party liability. Insurance system growth should increase demand for information technologies and qualified staff. Of course, growing insurance expenses should withdraw some part of savings and may moderate budget receipts from fuel. But on the other hand insurance companies will create new work places; they will earn taxable income.

Table 3

<b>Insurance companies financial results</b>								
Year	Gross premium written	Gross premiums earned	Gross provisions of unearned premiums (end of the year)	Gross premium written Bureau part excluded	Gross premiums of Bureau part excluded	Average provisions 1 and 2	Provisions 1 for the end of the year	Reinsurers part of provisions 1 (end of the year)
<b>2002</b>	220'419	173'789	46'631	187'356	147'720	81'652	16'845	337
<b>2003</b>	230'212	220'304	56'539	195'680	187'258	81'258	19'825	793
<b>2004</b>	283'736	267'947	74'327	214'176	227'755	100'061	24'845	1'491
<b>Incomes</b>								
Year	Premium earned, reinsurers part included	Premiums earned, reinsurers part	Premiums earned, reinsurers part excluded	Incomes from investments	Gross income			
<b>2002</b>	147'720	-5'909	141'811	3'266	<b>145'078</b>			
<b>2003</b>	187'258	-11'236	176'023	6'383	<b>182'405</b>			
<b>2004</b>	227'755	-18'220	209'535	9'492	<b>219'027</b>			
<b>Insurance expenses</b>								
Year	Claims paid	Claims paid reinsurers part	Provisions 1 adjustments	Claims adjustment expenses	Reinsures part of provisions 1 adjustments	Gross insurance expenses	Insurance loss ratio	
<b>2002</b>	45'636	-913	16'845	-337	5'476	<b>66'708</b>	45.2%	
<b>2003</b>	88'845	-3'554	2'979	-456	10/661	<b>98'476</b>	52.6%	
<b>2004</b>	110'268	-6'616	5'020	-698	13'232	<b>121'206</b>	53.2%	
<b>Expenses and technical profit</b>								
Year	Net operating expenses	Acquisition costs	Change in deferred acquisition costs	Administrative expenses	Marketing expenses	Gross expenses	Technical profit before provisions	Technical profit ratio to the earned premiums
<b>2002</b>	<b>26'068</b>	15'429	-3'264	13'115	788	<b>92'776</b>	52'302	36.9%
<b>2003</b>	<b>33'046</b>	16'115	-694	15'654	1'276	<b>131'521</b>	50'884	28.9%
<b>2004</b>	<b>40'192</b>	19'862	-1'105	19'294	1'037	<b>161'398</b>	57'629	27.5%
<b>Bonus scheme for provisions</b>								
Year	Change in equalization provision	Technical provisions for claims of future periods	Acquired claims provision	Acquired claims provision ratio to premiums written	Technical profit	Technical profit ratio to premiums earned		
<b>2002</b>	26'151	20'242	46'393	24.8%	<b>5'909</b>	4.0%		
<b>2003</b>	25'442	17'952	89'787	45.9%	<b>7'490</b>	4.0%		
<b>2004</b>	28'814	19'704	138'305	57.3%	<b>9'110</b>	4.0%		

There – “Provision 1” is technical provisions for outstanding claims.  
“Provision 2” is technical provision for unearned premiums.

Table 4

<b>Bureau of MTPL financial results forecasts</b>								
Year	Bureau part from premiums written	Deductions for the Bureau Treasury	Deductions for the prevention fund	Administrative expenses	Undivided expenses			
2002	33'063	26'450	992	4'629	992			
2003	34'532	27'625	1'036	4'834	1'036			
2004	42'560	34'048	1'277	5'958	1'277			
<b>Treasury of the Bureau earnings</b>								
Year	Written premiums acquired	Provisions 2 (end of the year)	Premiums earned, reinsurers part included	Reinsurers part from written premiums acquired	Reinsurers part from provisions 2 (end of the year)	Premiums earned, reinsurers part	Premiums earned, reinsurers part excluded	
2002	26'450	5'596	20'855	-1'058	-224	-834	20'020	
2003	27'625	6'785	26'436	-1'658	-407	-1'474	24'962	
2004	34'048	8'679	32'154	-2'724	-694	-2'437	29'717	
<b>Treasury of the Bureau expenses</b>								
Year	Claims paid	Provisions 1 (end of the year)	Provisions 1 adjustments	Claims adjustments expenses	Claims paid, reinsurers part	Reinsurers part of provisions 1 adjustments	Gross insurance expenses	Insurance loss ratio
2002	7'165	2'645	2'645	1'433	-143	-53	11'047	53,0 %
2003	13'951	3'112	468	2'790	-558	-19	16'633	62,9 %
2004	17'314	3'901	789	3'463	-1'039	-47	20'480	63,7 %
<b>Treasury of the Bureau investments</b>								
Year	Average provisions 1 and 2	Incomes from investments	Technical profit before provisions	Technical profit ratio to the earned premiums	Acquired claims provision	Acquired claims provision ratio to premium written		
2002	11'759	470	9'444	47,2 %	9'444	35,7 %		
2003	11'783	1'061	9'391	37,6 %	18'835	68,2 %		
2004	14'513	1'667	10'905	36,7 %	29'740	87,3 %		

The thirteenth section contains prognosis of social and economic environment changes caused by compulsory MTPL insurance conforming to the EU directive 84/5/EEC. Expenses growth is forecasted to be higher than income growth. Some small automobile repair enterprises will go bankrupt. But on the other hand accumulated cash flows from insurance system should be a stimulus for investments and consumer markets activation. Low-income person will be protected from tremendous problems should this person be found responsible for the expensive damage done in the road accident.

Overall conclusions of the study on consequences after implementing the EU directive 84/5/EEC on Motor third party liability insurance in Lithuania are presented in the fourteenth section. Conclusions are closely related to the hypothesis formulated when starting this research.

1. The Law of the Republic of Lithuania on compulsory motor third party liability insurance of vehicle owners and possessors creates a basis to implement Directive 84/5/EEC, but some definitions of the Law are only partly synchronised with the Directive. The main differences appear in these fields:
  - a) Definitions of vehicle, road, third party, more than one victim are distinct.

- b) Distinct definition of damage to the person who is a family member and other passengers in the car.
- c) Accidents other than traffic accidents are not defined by the law of the Republic of Lithuania ( e.g., accidents in automobile sports),
- d) When there is more than one victim, insurance sums are distinct and damage regulation is insufficient.
- e) Documentation procedures for MTPL insurance are insufficient.

Having harmonised these definitions with the EU should create a friendlier environment for the Directive.

2. Creating a specified and unified information system for MTPL insurance should be an essential prerequisite to implement directive 84/5/EEC. Registration base should contain information about insurance contracts, policyholders, accidents, and assurance premiums. Police, technical centres, and motor registration institutions should control adherence to the requirements.
3. Development of national motor vehicles register is an essential prerequisite to implement requirements of directive 84/5/EEC.

These conclusions stress that necessary prerequisites to implement directive 84/5/EEC are not complete.

4. Compulsory MTPL insurance premiums after the implementation directive 84/5/EEC should grow on average 14,5% for physical entities, 17,7% for pensioners about 17,7% (if bonus system is similar to existing one) to compare with premiums set in Law on MTPL insurance now. This growth will exceed forecast growth of incomes and pensions. This should have negative social effect. But it must be mentioned that this study is based on pessimistic forecasts. In the case of higher share MTPL policyholders the growth of insurance premiums should be moderate. For legal entities insurance premiums should grow about 4,75%. It is less than forecast growth of GNP. So, there are possibilities to cover negative effects by economic growth.
5. Growing insurance industry will create about 650 new work places. Earnings of insurance companies and their employees will grow. This will increase consumption and tax flows. SODra budget will get about 17,3 million litas and State budget will get about 12,7 millions litas additionally during period 2002-2004 due to insurance industry grow. Insurance companies will pay about 5 million litas taxes. Insurance companies purchases will increase budget receipts from value added tax in about 5,7 million litas, vehicles repair business purchases in about 22,4 million litas respectively.
6. Majority of vehicle owners has higher than declared minimum earnings. So these policy holders will not diminish their spendings for consumption but will withdraw small part or their savings and may be moderate spendings for vehicles maintenance and fuel. It must be stressed that insurance will stimulate residents' needs for insurance industry services and products (pension insurance among them).
7. Businesses' and firms' expenses for MTPL insurance will not diminish their competitiveness. Forecasted MTPL insurance premium 460 litas is just small part of motor vehicles maintenance expenses. It must be stressed that firms expenses for "green

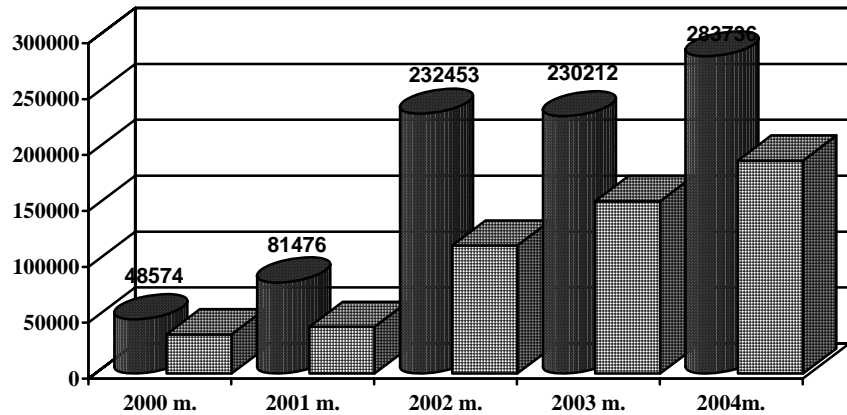
card” and law-expenses, because of not be able to pay persons be found responsible for the road accident, will diminish. These consequences will make positively influence for business organisation.

8. Demand for MTPL insurance services will grow in about 4,4 times in 2002 and in 2004 in about 25 % additionally. This will stimulate concentration processes within insurance industry and will increase effectiveness. Our prognosis showed that in 2004 MTPL insurance share will reach 0,63% of GNP of year 2000. This is marked growth because whole non-life insurance share was 0,8% of GNP in year 2000. This will drive financial services industry growth and will activate modern economy functions.

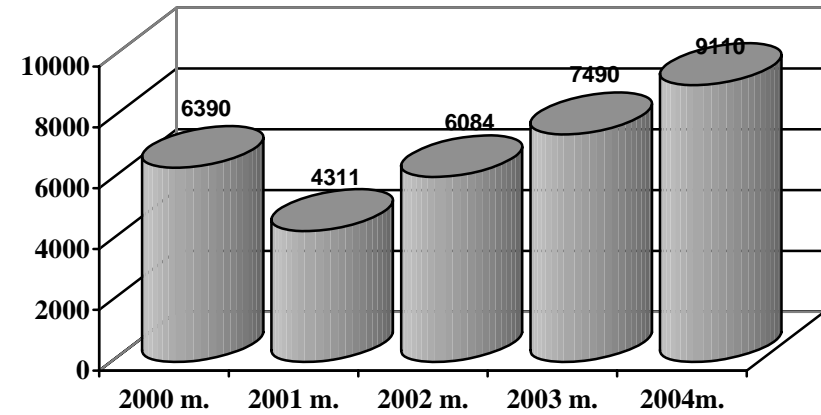
Insurance industry growth will stimulate capital market. According to our prognosis investment portfolio from MTPL insurance in 2004 will be about 223196 million litas. This is about 1,6 % of National Stock Exchange capitalization in 2001. Insurance companies will be active investors into the State and municipal bonds. Competition in this field will increase and financial institutions will search for profitable and safe investments making capital market more liquid. On the hand state institutions have possibilities to drive part of investment flows from compulsory MTPL insurance to the special areas according to the State policy priorities, for example for a pension reform needs.

Summarizing results of this study is possible to maintain that implementation of the directive 84/5/EEC into the Lithuanian Law will make positive influence to the economy and social life.

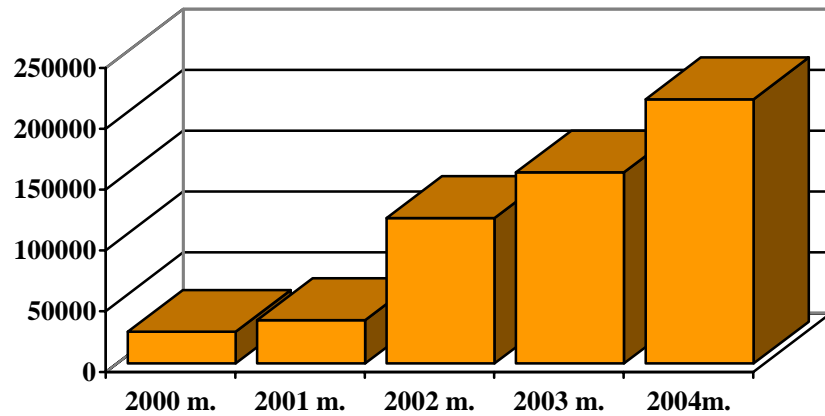




■ Prognosis on gross premium written    ▨ Of them returning to consumer market



▨ Prognosis of profit



■ Investments prognosis

### Social effect due to compulsory MTPL insurance realization during period 2002/2004

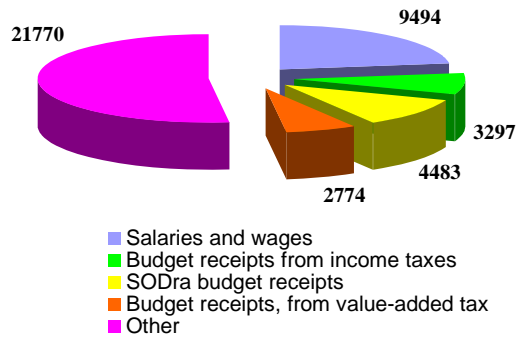
Budget receipts growth from income tax +12703

SODra budget gain + 17267

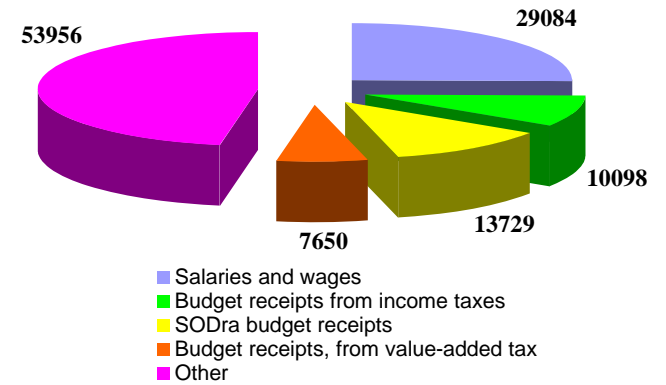
New work places created +648

**Figure 3. Prognosis on compulsory MTPL insurance according to the EU directive 84/5/EEC**

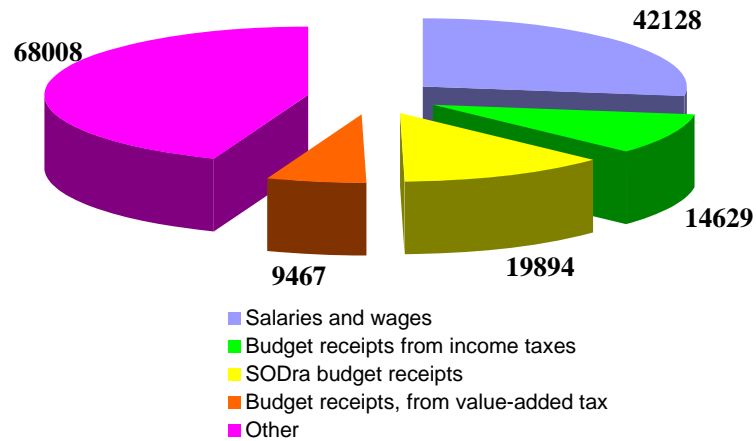
**2001 m.**



**2002 m.**



**2003 m.**



**2004 m.**

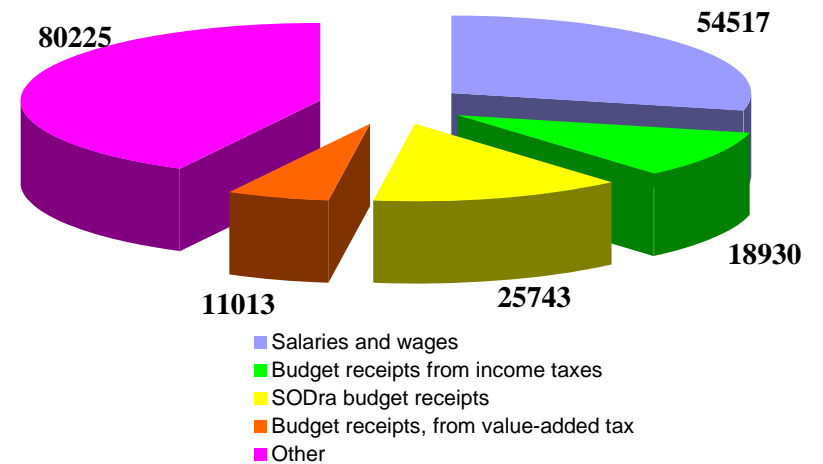
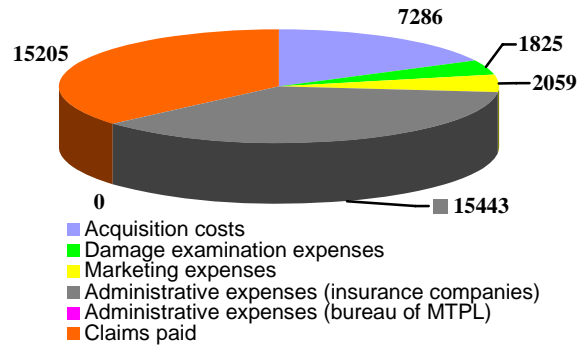
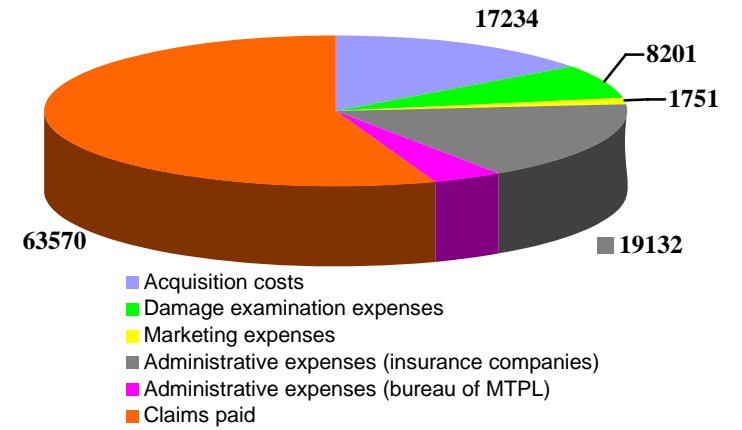


Figure 2. Prognosis of cash flows from compulsory MTPL insurance influencing social sphere, (thousands litas)

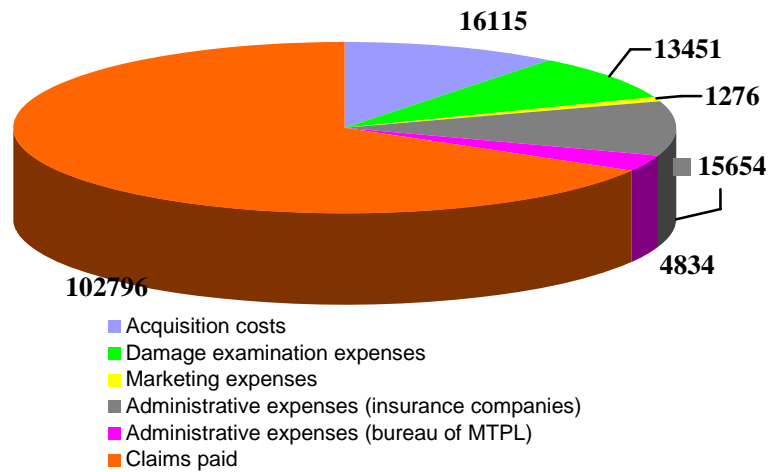
**2001 m.**



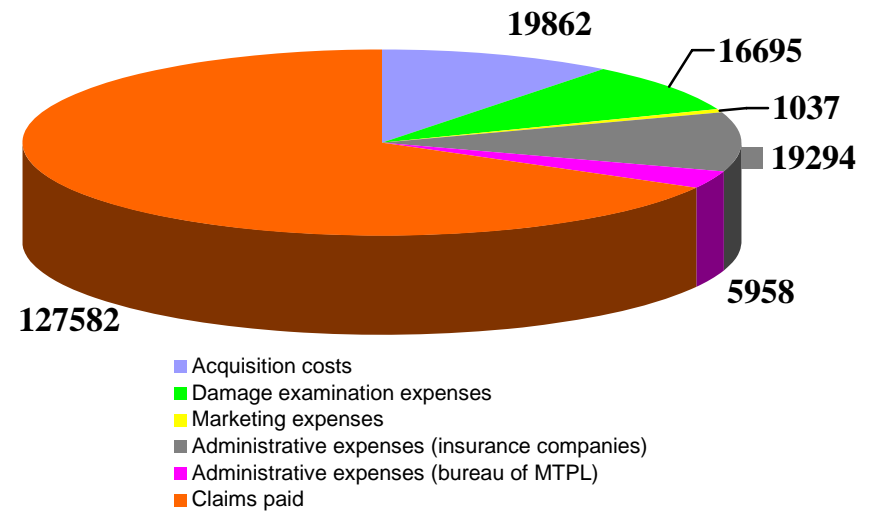
**2002 m.**



**2003 m.**



**2004 m.**



**Figure 1. Prognosis of cash flows from compulsory MTPL insurance influencing consumer market**