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Report on the introduction of mandatory drivers insurance

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ABBREVIATIONS AND ACRONYMS

AMI	Association of Mandatory Insurers
BPI	Business Plus Initiative
FRC	Financial Regulatory Commission
USAID	United States Agency for International Development

EXECUTIVE SUMMARY

The Law on Mandatory Drivers Insurance was passed in October 2011, and commenced from 1 January 2012. From that date, insurance companies have been able to sell mandatory drivers insurance policies to drivers and vehicle owners. From 1 October 2012, drivers and vehicle owners without the appropriate insurance contracts can be required to pay a penalty for lack of insurance. From 1 January 2013, a 'Drivers Insurance Fund' (the insurer of 'last resort') will be in operation.

Considerable progress has been made by the Financial Regulatory Commission (FRC), the Association of Mandatory Insurers (AMI), insurers and other stakeholders to support the implementation of the Law. 12 of 16 general insurance companies in Mongolia have been licensed by FRC to offer mandatory drivers insurance, 12 regulations have been approved, leadership positions in the AMI have been filled and a 12-month workplan has been submitted by the AMI to the FRC. A public education campaign is well underway.

Nevertheless, there are many challenges ahead in implementing the Law, including:

1. Ongoing development of the AMI, including all the systems and processes required to act as an 'insurer of last resort' and developing a comprehensive database to service the many needs of stakeholders in the system.
2. Development of a strong regulatory function at the FRC, including monitoring performance of the mandatory insurance system, ensuring insurer compliance in paying compensation, establishing dispute resolution systems, minimum solvency requirements and the capacity to set premiums and ratings factors each year.
3. Guidance on determining benefits – particularly who is 'at fault' and what compensation should be paid for personal injury
4. Insurance sector capacity – including developing strong internal systems, streamlined claims management, capacity to determining fault and personal injury compensation, and monitoring their own solvency and financial performance.

BPI sponsored a visit from Kirsten Armstrong during February 2012, to provide support to the FRC and the AMI on the implementation of the Law. Review of the Law and 12 Regulations already passed led to the following key recommendations.

Recommendation 1: Only vehicle owners should be required to obtain insurance – professional drivers should not be required to also obtain insurance.

Recommendation 2: FRC should develop Regulations or Guidance to help all parties agree who is 'at fault'.

Recommendation 3: FRC should develop Regulations or Guidance to help all parties agree compensation for health costs and personal injury.

Recommendation 4: Insurance contract period should be fixed at one year, consistent with the registration period of vehicles.

Recommendation 5: FRC should develop clear guidance about which drivers are 'uninsurable'.

Recommendation 6: FRC should consider a 'risk equalization' reserve or a national reinsurance arrangement, to manage the cost of high-risk drivers.

Recommendation 7: AMI should monitor use of the Drivers' Insurance Fund, and adjust percentage which is required to go to compensation, as required.

Recommendation 8: FRC should monitor appropriateness of ratings factors and total premiums, compared to total compensation.

Recommendation 9: The rating factor for previous insurance events should be based on insurance events in the previous year, rather than the previous contract period.

Recommendation 10: The incentive to list drivers should be reduced. Compensation should be payable regardless of who is driving the vehicle.

Recommendation 11: Insurance contract should transfer with the vehicle, on transfer of vehicle ownership.

Recommendation 12: Only insurance companies should be able to compensate victims from the insurance contract.

Recommendation 13: Emergency Service employees should only be required to attend insurance events where necessary. In more remote regions, other stakeholders (eg: police) should attend insurance events on behalf of the Emergency Service.

Recommendation 14: Emergency Service, police and insurance companies should have a duty to explain duties to drivers and victims.

Recommendation 15: The rating factor for number of insurance events should not be used for vehicles in transit.

The visit was also an opportunity to support the FRC and AMI's public education campaign, and advice was provided on international experience with mandatory drivers insurance. Advice was provided to the AMI on specifications for the database it will maintain, and to the FRC on the adequacy of premium rates and loadings. FRC was advised against seeking to join the Green Card system, as compensation in Mongolia is considerably below that required as a minimum in the European system. A range of options to deal with major 'practical' implementation issues were also proposed, including how 'fault' is determined in other jurisdictions and issues in determining personal injury compensation.

SECTION I: INTRODUCTION

The Law on Mandatory Drivers Insurance was passed in October 2011, and commenced from 1 January 2012. From that date, insurance companies have been able to sell mandatory drivers insurance policies to drivers and vehicle owners. From 1 October 2012, drivers and vehicle owners without the appropriate insurance contracts can be required to pay a penalty for lack of insurance. From 1 January 2013, a 'Drivers Insurance Fund' will be in operation – this fund will operate as an 'insurer of last resort' providing compensation when an at-fault driver cannot be identified or the driver is uninsured.

In November 2011, Kirsten Armstrong provided support to the FRC in Mongolia, to help develop a project plan for the implementation of the new law (See Appendix 1). This support was provided on a voluntary basis, following Kirsten's visit to Mongolia to present training to the Society of Actuaries of Mongolia.

The FRC then requested urgent assistance from the USAID Business Plus Initiative (BPI), in order to provide guidance on Institutional capacity building in developing regulations for mandatory drivers' insurance. The request involves policy development and regulatory capacity building on mandatory drivers' insurance, including drafting regulations. In addition, the design, development and delivery of skills training, capacity building programs on subjects including regulations, so as to ensure insurance sector capacity to formulate strategic policies, including actuarial matters, premium and rate setting, and data base development to assist FRC whereby it has capacity to build an enabling and prudentially regulated environment that encourages healthy development of drivers insurance business.

This consulting assignment

BPI sponsored Kirsten Armstrong to visit Mongolia during February 2012, to provide support to the FRC and the AMI on the implementation of the Law. This report sets out the findings of the mission, as well as next steps to achieve successful implementation of the Law. The main objective of this consultancy assignment was to assist the FRC on technical issues such as policies regarding rate setting, the creation of a database for vehicle registration for insurance, and develop training programs on insurance guidance to be issued by the FRC.

Since the original Terms of Reference were drafted, considerable progress has been made by the FRC and the AMI to develop regulations on a number of the most important aspects of the Law. As a result, FRC and the consultant agreed a revised set of priorities for the consulting assignment, as follows:

1. Review and advise on all 12 regulations and the Law
2. Communication with stakeholders to explain and support the Law, in response to negative public feedback.
3. Advice on the data which the Association of Mandatory Insurers will need to collect to fulfil its functions, and specifications for the database.
4. Actuarial advice to the FRC on the 'special reserves' which insurance companies will need to hold if they provide mandatory drivers insurance
5. Actuarial advice on the adequacy of premium rates and loadings which have been specified in the regulations, compared to benefits set out in the Civil Code, and solutions to address any mismatch.
6. Options to deal with major 'practical' implementation issues – in particular, how 'fault' is determined in practice, and how 'moral hazard' can be minimised.
7. A short presentation on the Australian system of mandatory drivers insurance, and lessons for Mongolia.

Advice was provided in relation to all these areas, except for (4) – there is a need for further clarity about what the benefits will be, before insurer solvency can be addressed. Further, FRC indicated that they want to look at this issue more broadly, and move to a ‘risk-based’ solvency framework.

This report sets out the work undertaken throughout the consultancy, the major issues which face the FRC, the AMI and other stakeholders in implementing the Law, and next steps for the FRC and stakeholders to ensure successful implementation. Details of meetings held and presentations provided are set out in Appendix 2.

SECTION II: PROGRESS TO DATE ON IMPLEMENTATION OF THE LAW

Considerable progress has been made by the FRC, the AMI, insurers and other stakeholders to support the implementation of the Law:

- 12 of 16 general insurance companies in Mongolia have been licensed by FRC to offer mandatory drivers insurance.
- 12 regulations have been approved to date; these were drafted in conjunction with the Ministry of Justice. These regulations include, premium ratings factors (so that premiums can be calculated), a draft 'pro-forma' contract, procedures for reporting road traffic accidents, the financing of the AMI etc. In drafting these regulations, the FRC has been significantly influenced by Russian laws and regulations in drafting their own regulations.
- The AMI has been established, with key leadership positions filled and many operational positions now filled or actively being recruited. The AMI has also submitted a 12-month workplan to the FRC to see it fully operational by 1 January 2013.
- Several additional regulations have been drafted and are awaiting final review and approval. These include processes for AMI, and use of data from the AMI's database.
- Considerable data has been collated to understand the extent of road traffic accidents in Mongolia, deaths due to road traffic accidents, the number of vehicles and drivers likely to be eligible for insurance, and the amount of compensation which might be payable. This has enable FRC to undertake some preliminary estimates of scheme viability, compared estimated total premiums to estimated total costs.
- Other stakeholders have been engaged and an education process commenced. This includes auto transport police, border police etc.
- A public education campaign to educate individual drivers and companies with large fleets (eg: taxi and bus companies) is well underway.

Comparing to the high-level implementation plan developed in November 2011, most of the activities targeted for December to February have been commenced or completed, with a small number of exceptions:

- Advice to insurance companies on determining compensation (particularly for personal injury) has not yet been developed.
- FRC is still working on the development of solvency standards for insurance companies – they are now considering this in a broader framework of risk-based solvency requirements for all insurance.
- Guidelines for determining who is 'at fault' are not yet available, and it is assumed that the police will make a judgement where two drivers cannot agree.

Work has already commenced on many of the medium term activities which were slated for completion between March and September. May and June are critical months to get people signed up to this insurance, as all vehicles go through a registration and inspection process in Spring. All vehicles will be required to have mandatory drivers insurance in order to pass their final inspection. As such, focus has been on preparing for driver enrolment, rather than guidance on benefits.

SECTION III: KEY CHALLENGES

There are some significant challenges ahead for the FRC, the AMI and the insurance industry in ensuring the successful implementation of mandatory drivers insurance. This section highlights the key challenges, and indicates where assistance may be sought from external experts.

Development of the Association of Mandatory Insurers

The AMI has four key functions, according to the Law. These four functions are:

1. the provision of compensation where a driver is uninsured or cannot be identified (the “drivers insurance fund”)
2. maintenance of the driver’s insurance database
3. the emergency service
4. training and advertising aimed at reducing traffic accidents.

Considerable progress has been made in developing the protocols and rules for (2) and (3), although the AMI has indicated it is looking for some practical support for (2) – to select appropriate software for the database, finalize the information which will be contained in the database, and develop the ‘interfaces’ to enable stakeholders to provide information into and access information from the database. Some initial advice has been provided to AMI on the information which should be included in the database – the information proposed to be collected by the AMI is largely appropriate, however, additional information will be required to allow FRC to perform its duties to set premium rates and monitor system performance; and additional information on claims will also be required, to enable AMI to best perform its role in (4).

This database is central to the mandatory insurance system, as it will enable all stakeholders to check that those who require insurance are actually covered and identify drivers (and their insurance company) who are ‘at fault’. It will also provide important data to the FRC to monitor the financial integrity and performance of insurance companies, and determine future premiums and rating factors which will be adequate to pay future compensation.

Little progress has been made to date in relation to (1), partly because the Fund will not be called on until 1 January 2013, and the AMI has indicated they desire support in this area. The Drivers Insurance Fund is, in many ways, a ‘new’ insurance company, which will need to be fully operational by 1 January 2013, requiring processes for managing claims, determining benefits, corresponding with insurers, police, drivers and victims, and ensuring its own financial integrity – that its fund is adequate to meet the compensation it will pay. It must also develop good processes for determining whether the drivers insurance fund, or another insurance company, is actually responsible for the claim.

In relation to (4), the AMI’s efforts to date have been focused on a public awareness campaign to inform drivers of the need to have mandatory insurance, rather than prevention of road traffic accidents. Successful mandatory drivers insurance schemes have used the considerable data at their disposal to understand the causes of road accidents and injuries, and so target prevention initiatives. The AMI is not yet ready for this role.

Development of strong regulatory function for the FRC

Mandatory insurance schemes such as the Drivers insurance scheme generally have higher levels of regulation and government intervention than voluntary schemes. This is required to protect people buying insurance and, in the case of drivers liability insurance, protect victims of road accidents to ensure that they are compensated appropriately. Because people are being

forced to purchase insurance, the onus on the FRC to protect policyholders – by ensuring insurance company solvency and compliance with all the laws – is even stronger than for voluntary insurance. The FRC needs to develop clear minimum solvency standards for the insurance sector, appropriate to the mandatory drivers insurance.

An important feature of mandatory drivers insurance is that claims tend to increase considerably when insurance coverage expands – in the past, victims have not been aware that the insurance exists, so don't know that they can claim. As coverage expands, victims are more likely to know their rights and lodge claims. There will also be greater scrutiny of individual claims and less opportunity for insurance companies to reject or avoid claims. Evidence suggests that the claims ratio (ratio of compensation paid, compared to premiums) is currently around 30% for drivers insurance in Mongolia. I would expect this to increase considerably under mandatory insurance, and the solvency of many smaller insurance companies will be threatened. FRC must develop the capacity to monitor the solvency of insurance companies closely, as well as ensuring that claims are being paid consistent with the law.

FRC has an interest in adopting 'risk-based solvency standards', which would be a considerable shift away from current solvency requirements. I understand that the International Association of Insurance Supervisors has been approached to provide some support on this matter, although it is not yet clear whether this will be provided.

The FRC also needs to develop internal capacity, in conjunction with the AMI, to ensure that

1. individual claimants receive appropriate compensation, and
2. In aggregate across the industry, compensation is being paid appropriately and the price of insurance is reasonable.

For (1), FRC needs to develop a dispute resolution mechanism appropriate for mandatory drivers insurance (see Article 27 of the Law). FRC already has a dispute resolution mechanism (Article 82 of the Law on Insurance), so will need to develop policies and guidelines to manage mandatory drivers insurance, where disputes are often considerable. For (2), FRC needs to develop monitoring systems and appropriate benchmarks, and also identify the data and information it requires to fulfill these functions. Ideally, FRC would draw on the information contained in the AMI's database to inform much of its work, and would only need to request certain financial information from insurance companies to confirm that they are solvent.

Finally, FRC will need to develop a monitoring plan to monitor insurance system performance and insurer solvency, develop the internal capacity to monitor the adequacy of premiums, in aggregate, compared to compensations, and set appropriate premium rates and ratings factors each year.

Further advice to help insurers determine claims

To date, the focus of the FRC, AMI and insurers has necessarily been on getting drivers enrolled in the new scheme. Little attention has been given to how benefits should be determined, including how 'fault' should be decided, and how the amount of compensation – particularly for personal injury claims – should be determined. To minimize disputes, to minimize moral hazard risk and to maximize the likelihood that victims receive appropriate compensation, further guidance on benefits is required. An example of a Regulation used in Canada to assist in determining fault was provided to FRC, and a short paper setting out issues in determining personal injury benefits is also being prepared.

In developing guidance regarding fault, it is essential that the police are engaged in the process – indeed, it may be appropriate that they are the ‘lead’ agency on this issue. In developing guidance on benefits, the Ministry of Health must be engaged – it is likely that their hospitals and doctors will have a role in determining what care and hence what compensation is appropriate. Drivers insurance is also an important source of funding to health systems in many countries. As yet, the Ministry of Health has not been consulted. Other insurance and compensation providers – Workers compensation, health insurance, social security – should also be consulted to ensure integration of benefits.

If the FRC does not develop this guidance, then the insurance industry should be supported to develop their own ‘voluntary’ protocols. This is in fact how many developed countries manage motor vehicle insurance, and ensure cost effective claims management processes.

Insurance industry capacity and capability

Of the 16 general insurance companies, only 3 have adequate systems for maintaining insurance records. The other 13 companies are generally using Microsoft Excel to record policies and claims. The AMI has suggested that, as a way to help improve standards, all insurance companies are required to communicate with them using the database software which AMI selects.

Additional support will be required to assist insurance companies in:

- Determining fault, and determining appropriate compensation for personal injury claims
- Identifying moral hazard risks and fraud
- Monitoring solvency / financial performance
- Improving administrative efficiency in order to increase claims ratios and maintain solvency.

Efficient claims management, and an ability to monitor financial performance is critical for this type of insurance – the FRC sets premium rates, determines what compensation limits need to go into contracts and mandates that most risks be accepted. As claims increase, and claims ratios rise, insurance companies must be able to monitor their own financial performance and identify ways to streamline administration to ensure they remain solvent.

The next section highlights key recommendations arising from the review of the Law and 12 Regulations on Mandatory Drivers Insurance. Additional areas of support may arise as a result of these recommendations - for example, if a risk pool or national reinsurance arrangement is adopted.

SECTION IV: RECOMMENDATIONS IN RELATION TO THE LAW AND REGULATIONS

Following review of the Law and 12 regulations which have been passed, recommendations were presented to the FRC at presentations on 8 February and 16 February. This section summarizes the key recommendations:

The Law of Mongolia on Drivers' Insurance

Recommendation 1: Only vehicle owners should be required to obtain insurance

Article 5.3 requires drivers to obtain insurance, independent of whether the vehicle they are driving is covered by insurance. In many instances, particularly where there is a professional driver of a vehicle owned by a company, both vehicle and driver will be covered by insurance. This situation presents a number of challenges:

- **Equity:** Is it fair to require premiums from both driver and vehicle owner? The presentation showed an example where the combined premium of a professional driver and a vehicle owner could easily be four times the premium of an owner-driver. Unless the risk of the professional driver and commercial vehicle was four times that of the owner-driver, then this is inequitable.
- It is not clear in the Law or regulations which insurance company should pay compensation, if both driver and vehicle have separate insurance contracts, nor in what ratio. The model insurance contract proposes a solution (clause 10.2.8) but not all insurance contracts will have this clause.
- This issue is further complicated when one of the parties does not have the appropriate insurance contract – will the Drivers Insurance Fund be required to pay part of the compensation?
- Requiring professional drivers to obtain insurance will be difficult to enforce – in contrast, insurance contracts for vehicles can be checked at the once a year vehicle registration and inspection process.

Recommendation 1 is consistent with the “Principles of Insurance” Clause 4.1.1 which require mandatory enrolment by every owner of a vehicle, but makes no mention of the need for drivers to obtain insurance.

If this recommendation is not adopted then, at the very least, insurance ratings factors should be reviewed to ensure that the combined insurance premiums for professional drivers and vehicles is ‘fair’ relative to the risk of road accidents.

Recommendation 2: Develop Regulations or Guidance to help all parties agree who is ‘at fault’

The Law and regulations do not clarify how ‘fault’ should be decided, but imply that there is a role for the road traffic police, the Emergency Fund and the insurance company, who are all required to attend each and every road traffic accident. Apart from the road traffic rules, there is no clear guidance on who is at fault, and no guidance about how fault should be ‘apportioned’ when two or more vehicles have contributed to the accident.

The FRC indicated that it is the job of the transport police to decide who is ‘at fault’. In fact this is not entirely true. The issue of ‘fault’ can only be decided by a court, when they determine whether a driver has a liability for compensation under the Civil Liability Act. The transport police provide their opinion to the Court.

In fact, it would be very risky to rely solely on the opinion of the road traffic police – it would put considerable power in the hands of individual transport police, who drivers may attempt to influence or bribe. It is likely that transport police will not be able to attend many accidents, especially those in more remote areas, so there will be road traffic accidents that have to be decided without the input of the police. It is very common in other countries for insurance companies to have some role in determining fault.

To minimize the risk that cases will go to court, maximize the likelihood that all parties can agree between themselves who is at fault, and avoid too much ‘power’ ending up in the hands of any one individual, it is recommended that guidelines or a regulation be developed, setting out how fault should be determined. All parties – road traffic police, insurance companies, drivers etc – should have access to this same guidance, so all are making their decision and negotiating ‘fault’ on the same basis. An example of a regulation used in Canada was provided at the presentation to FRC on 16 February. Many other countries rely on agreed ‘guidance’, which has been developed over time and agreed between all insurers. The transport police may well be the lead agency that sponsors the development of such guidance. Any guidance must specify arrangements when more than one party is partly at fault.

Recommendation 3: Develop Regulations or Guidance to help all parties agree compensation for health costs and personal injury

The Law provides very little guidance on compensation for personal injury, except to refer to the relevant Article of the Civil Liability Act, and specify that up to 80% of compensation should be paid for personal injury. International experience suggests that the costs of health and care make up the bulk of the costs of drivers liability schemes, and most countries have developed considerable guidance to specify what compensation will be paid in different circumstances.

This is an important issue for Mongolia, as insurance companies do not have much experience paying health compensation, so the potential moral hazard is high. Those companies that offer health insurance tend to provide insurance based on the number of days of hospital stay, as they do not trust hospitals or doctors to charge appropriate fees or set out an appropriate health care plan for claimants. One insurance company is considering employing a doctor part-time to help assess the appropriateness of health claims.

Also relevant is the fact that there are other insurance and compensation schemes – workers compensation, national health insurance, social security – which may also be responsible for covering health care and income replacement costs to those who are injured in a motor vehicle accident. There is no reference in the Law or Regulations to this, but integration of benefits is essential. Without integration of benefits, victims could be ‘over-compensated’ for their losses, and end up in a better position than before the accident, which increases the moral hazard. Insurance premiums and taxes end up higher as a result. It is usual to have a clause that states that any costs compensated by other insurance schemes or social security will not be eligible for compensation under the mandatory drivers insurance scheme.

A short paper is being developed for the FRC, highlighting the major considerations for deciding what health benefits should be covered, and examples of what health costs are typically covered by insurance schemes internationally.

Recommendation 4: Insurance contract period be fixed at one year, consistent with the registration of vehicles

The Law allows Mongolian citizens to purchase insurance cover for short periods – a minimum of one month. This is very unusual – most countries require that insurance is purchased for one year, consistent with the period of registration of the vehicle. By allowing

shorter contracts, Mongolia will experience higher administration costs, will increase the likelihood of uninsured drivers (and hence calls on the Drivers Insurance Fund), and divert police and government resources to following up drivers whose insurance has expired.

The regulation on distributing to insurers the drivers failing to enter into Insurance Agreement

Recommendation 5: Develop clear guidance about which drivers are uninsurable

Clause 2.1 in the *Regulation on Distributing to Insurers the Drivers Failing to Enter into Insurance Agreement* sets out the grounds for insurance companies to refuse insurance to a high risk driver - “frequent incidences of insurance events”. This is not very specific, and could be used by insurance companies to unfairly reject any drivers who they do not want to insure, or for whom they consider the insurance premium is not adequate to cover the cost of compensation. The regulation should be more specific, in order to minimize the number of drivers who are rejected under this regulation. For example, “more than 5 incidences in 3 years”, or “any drivers in rating group 12 or 13”.

In addition, to minimize potential gaps in insurance coverage, the current insurer should be required to provide ongoing cover for a short period (eg: 7 days) until a new insurer is notified.

Recommendation 6: Develop a ‘risk equalization’ reserve or a national reinsurance arrangement

The *Regulation on Distributing to Insurers the Drivers Failing to Enter into Insurance Agreement* sets out the process for distributing ‘uninsurable’ drivers to different insurance companies. The purpose of this arrangement is to share the cost of high risk drivers across different insurance companies. The principle makes sense, but the process is administratively complex, and increases the likelihood that there will be ‘gaps’ in insurance coverage for some drivers, while they move between insurance companies, and hence more chance of calls on the Drivers Insurance Fund. It is also possible that this approach is ‘too late’ in transferring risky drivers between schemes – insurance companies would end up bearing the high cost of compensation in a bad year – it is not until the following year that the insurance company is able to reject the driver as too risky.

An alternative approach is to share the cost of high cost drivers across all insurers using a ‘risk equalisation reserve’ or national reinsurance arrangement. Either of these approaches would be relevant for the longer term, as maximum compensation limits start to rise and so the riskiness and variability of expenditure for insurance companies starts to grow – reinsurance is more likely to be required if the maximum compensation limit increases. Having a national reinsurer would also be appropriate for the long-term development of the insurance sector, enabling more risk to be retained in Mongolia (rather than reinsuring outside Mongolia with an international reinsurance company). We note that the Index-Based Livestock Insurance project is considering the feasibility of a national reinsurer to support that project.

The regulation on financial centralization of the drivers’ insurance fund, fund account and transfer of fund asset

Recommendation 7: Monitor use of the Drivers’ Insurance Fund, and adjust percentage which goes to compensation, as required

Clause 4.4 of the *Regulation on Financial Centralization of the Drivers’ Insurance Fund, Fund Account and Transfer of Fund Asset* requires that disbursements for the database, emergency fund, training & advertising must not exceed 30% of the total revenue of the Fund. The implication is that the other 70% is spent on compensation. This seems inconsistent with

the overall goals of the scheme – which is to minimize calls on the Drivers’ Insurance Fund. The costs of managing the database, undertaking training and advertising etc, will remain fairly constant from year to year, and so it is likely that the percentage of the fund’s assets which goes to these activities should increase over time, as the system matures, and fewer calls are made on the Drivers Insurance Fund.

Regulation on using rates to calculate drivers’ insurance fee amount

Recommendation 8: Monitor appropriateness of ratings factors and total premiums, compared to total compensation.

The Law is unusual as it specifies the base premiums for different types of vehicles – usually premium levels would be specified in Regulations, not the Law, as premiums for this type of insurance would usually need to be adjusted each year, and Regulations offer more flexibility than Laws for making such changes. Nevertheless, there is some flexibility in setting overall premium rates, as the *Regulation on Using Rates to Calculate Drivers’ Insurance Fee Amount* sets different rates for different rating factors. If total compensation grows more quickly than expected, the rates could be increased across all drivers, to ensure total premiums are adequate.

In addition to setting the rating factors each year to ensure overall adequacy of premiums, the ratings factors will need to be checked each year to ensure that they are appropriate, compared to actual experience. The ratings factors have been set based on a similar Russian Regulation, but experience in Mongolia will likely be different. Further, while each individual rating factor looks reasonable, the resulting premiums, once all the ratings factors are combined, need to be checked to ensure they are reasonable, and consistent with actual experience.

Recommendation 9: Premiums based on insurance events in the previous year, rather than the previous contract period.

Clause 2.3.1 sets a drivers rating factor according to the number of insurance events in the previous contract period. Different drivers can have different contract periods – drivers with shorter term contracts could be unfairly advantaged, moving quickly between rating groups if they have no claims. To ensure consistent treatment of all drivers, the wording should be standardized to say the number of insurance events in the **previous year**.

Recommendation 10: The incentive to list drivers should be reduced. Compensation should be payable regardless of who is driving the vehicle.

Clause 2.7.1 provides a substantial incentive to list the drivers who can use a vehicle – up to an 80% reduction in premium by listing the names of drivers. Moral hazard risk is high – even if an unlisted driver uses the vehicle, the Drivers Insurance Fund will still pay the compensation, so there is little incentive for vehicle owners to be honest about the drivers of their vehicle. Even where a vehicle owner is found to be dishonest, not listing all drivers, the penalty is minimal – a 50% premium increase, much lower than the incentive to provide a list of drivers.

Internationally, many countries have removed these sorts of requirements, because they have been shown to encourage risky driving in emergencies. A listed driver who is sick or injured should not need to think about their insurance status if another (unlisted) driver is available to drive in that circumstance. If this clause is to continue, then at the very least there should be an opt-out that ensures the insurance cover is still valid if an unlisted driver is driving the vehicle in an emergency.

Furthermore, cars cause injuries and damage, even without a driver – a common example is when handbrakes fail, and cars roll downhill, causing damage and injury en route. If insurance

companies are required only to pay compensation for listed drivers, would the Drivers Insurance Fund be called upon in these circumstances?

To minimize calls on the Drivers Insurance Fund, and avoid the problem of insurance contracts encouraging unsafe drivers in emergencies, the incentive to list drivers should be reduced, and compensation should be payable regardless of who is driving the vehicle.

Model contract

Recommendation 11: Insurance contract should transfer with the vehicle.

According to the model contract, when ownership of a vehicle is transferred to a new owner, the insurance contract is cancelled and the new owner needs to buy a new insurance contract. It would be administratively far simpler if the insurance contract continued, and transferred to the new owner. This would also minimize potential gaps in insurance cover and likely calls on the Drivers Insurance Fund.

The regulation on submitting to the police institution the information about the provision of compensations to the victims from the insurers and the drivers' insurance fund and using such information.

Recommendation 12: Only insurance companies should be able to compensate victims from insurance contract.

Clause 3.1.1 is not entirely clear, but one interpretation is that a driver could compensate victims directly. This is a moral hazard risk – drivers and victims could collude to receive compensation. Further, there is no record of the payments be made, so a victim could subsequently argue that they did not receive a payment at all. So that the insurance company can check that a claim is valid, that the amount of the claim is appropriate, and ensure that the payment reaches the victim, only insurance companies should be able to provide compensation to victims under the terms of the mandatory drivers insurance contract.

Regulation on emergency service work of the drivers insurance fund

Recommendation 13: Emergency Service employees should only be required to attend insurance events where necessary. In more remote regions, other stakeholders (eg: police) should attend insurance events on behalf of the Emergency Service Fund

This regulation implies a role for the Emergency Service at each and every traffic accident. Clause 2.2 requires that the Emergency Service has units in every province, while Clause 6.6 requires the Emergency Service Fund to send a dispatch employee to every insurance event. This seems an onerous, unnecessary and potential costly level of intervention. In discussions with the FRC, it was clear that it was not the intention that the Emergency Service attend every event, and that this would be impractical in remote areas. This regulation should therefore be amended to reflect the fact that the Emergency Service only attend insurance events *where necessary*, or specify circumstances which do not require them to attend (eg: damage is estimated to be less than \$xx and no one is injured; both drivers agree on who is at fault; a representative such as the police attends the insurance event on behalf of the Emergency Service.)

Recommendation 14: Emergency Service, police and insurance companies have a duty to explain duties to drivers and victims

Throughout the Law and various Regulations, there are a range of duties which drivers and victims must fulfill, such as notification of police, insurance companies etc. If drivers and victims do not fulfill these duties, then their insurance may be invalid, and victims may be

ineligible for compensation. Drivers and victims may be unfairly treated as a result. Given that the Emergency Service is likely to be the first organization that many drivers and victims contact following an insurance event, they should have a duty to explain to drivers and victims their duties. Insurance companies and police should also have this duty.

Regulation on using the rate to calculate for vehicles in transit

Recommendation 15: The rating factor for number of insurance events should not be used for vehicles in transit

This regulation specifies how premiums for vehicles in transit through Mongolia should be set. Clause 2.2.1 of the regulation specifies the rating factor appropriate to the driver's number of insurance events. Drivers will likely under-report their number of insurance events, and there is no way for insurance companies to check the driving record of vehicles in transit. As such, this rating factor should not be used for vehicles in transit.

ANNEX B: MEETINGS AND PRESENTATIONS UNDERTAKEN FOR THIS CONSULTANCY

Presentations

8 February, 2012

- Presentation to FRC + invited guests (around 30) from insurance companies, AMI, Ministry of Justice
- Feedback on Law and regulation; Priorities for implementation.

10 February, 2012

- Presentation to Economics Journalists Club TV Interview with Eagle news; Radio interview with Mongolia National Radio Short document “*Why should Drivers Insurance be Mandatory – The International Experience*“ provided

16 February, 2012

- Presentation to FRC. Practical implementation issues, including Determining Fault, the Green Card System, Information exchange and event reporting etc.

17 February, 2012

- Presentation to Auto transport agency, regarding purpose of mandatory insurance and their role in ensuring drivers comply with process.

Schedule of Meetings

- 6 Feb 2012 FRC – Mr. Olunbayar (Director of Life Insurance and Drivers Insurance), Mrs. Tserendejid (Director, Policy & Planning Division, Insurance Department)
- 7 Feb 2012 Ministry of Justice & Home Affairs – Mr. Sereenov MANDAKHBAT, Responsible for drafting laws and also on Board of AMI
- 8 Feb 2012 Richard Carpenter (Adviser assisting on insurance laws and regulations; adviser assisting in development of livestock micro-insurance product), Eamon Kelly (preparing Feasibility Study for livestock micro-insurance product)
- 9 Feb 2012 Betty Wilkinson (Senior Finance Specialist, Asian Development Bank – working with FRC and insurance sector on micro-insurance.)
- 10 Feb 2012 FRC - Mr. Kherlen (Commissioner and Vice Chairman). Also Board member of AMI
- 10 Feb 2012 Participation in Forum “Mongolia Access to Insurance Diagnostic Stakeholder Workshop”, hosted by FRC, Asian Development and Access to Insurance Initiative
- 10 Feb 2012 Kelly Rendek (Actuary advising FRC and insurance sector on micro-insurance)
- 13 Feb 2012 AMI – Mr. MUNKHBAATAR Bayaraa (Executive Director)
- 13 Feb 2012 FRC – Mr. MUNKHBAATAR Bayaraa (Data expert)
- 14 Feb 2012 AMI – Ms. KHISHIGZAYA Suren (Insurance Officer), Ms. ULZIISAIKHAN Erdene (Insurance Officer)
- 15 Feb 2012 AMI – Ms. KHISHIGZAYA Suren (Insurance Officer), Ms. ULZIISAIKHAN Erdene (Insurance Officer)
- 20 Feb 2012 Mr. Gantulga Donorov, Managing Director, the Society of Actuaries of Mongolia

- 20 Feb 2012 Mr. GANZORIG Ulziibayar, President, Mandal, General Insurance LLC,
Member of Board of Directors of Mongolian Stock Exchange
- 20 Feb 2012 Ms. Erdenekhisig Pagvaa, Chief Risk Officer, Tenger Insurance LLC
- 21 Feb 2012 Mr. Yves Mathieu (Chief Technical Adviser), Ms Lena Van Den Kerchove
(Junior Technical Assistant), Financial Sector Capacity Building Project,
Luxembourg Agency for Development Cooperation