

Motor TPL in Macedonia

Consultants Report on Technical Assistance – Phase 3

September 2006

12 September 2006

Mr Richard Zechter
World Bank
Washington

Dear Richard

Macedonia Technical Assistance – Phase 3

Please find enclosed the Consultants' report on the technical assistance to Macedonia during June 2006. This mission was Phase 3 of technical assistance organised by the World Bank and funded by the FIRST Initiative.

The first part of the report deals with the issue of Claims Criteria for Motor TPL claims. (At your request, I sent a draft of this part of the report and a proposed draft claims criteria to the MOF Regulation Unit in July so that they could commence work on the claims criteria.) The second part covers a series of other issues relating to insurance supervision and the Motor TPL system.

This consolidated report is on behalf of the consulting team, which comprised:

- Geoff Atkins – Finity Consulting, Australia
- Shelley Miller, QC – Fraser Milner Casgrain LLP, Canada
- Marcin Sadek and Radoslaw Bogucki – Deloitte Advisory, Poland.

It was a pleasure to work with you again in Macedonia, and I trust this work will continue to assist the Ministry of Finance with its important development of the insurance sector.

Yours sincerely

A handwritten signature in black ink, appearing to be 'GA', with a long horizontal flourish extending to the right.

Geoff Atkins
Fellow of the Institute of Actuaries of Australia
Finity Consulting, Sydney

Macedonia Motor TPL – Technical Assistance Phase 3

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Introduction

Scope of the Assignment

The scope of the June 2006 assignment was to fulfil the responsibilities identified for the consultant team in the Implementation Plan for the new MPTL Law prepared by the World Bank in January 2006 (Appendix A), taking into account the market developments outlined below.

Market Developments in TPL

This introduction to the report gives a general update on market developments since the previous mission in early 2005.

New TPL Law

The new Law on Compulsory Insurance has been operative for about six months. There have been no significant problems identified, and some aspects of the new law are already showing benefits. For example the requirement to notify the insurer of a claim before going to Court, the imposition of shorter time limits for bringing claims, and the rules about exchange of information are allowing (at least some) insurers to negotiate and settle claims outside court.

However, not all elements of the new law are operational. In particular the Commission has not developed and issued Claims Criteria – the main objective of this technical assistance mission. Every person we spoke with, other than one practising lawyer, seems to be supportive of the idea of having the Criteria.

The Motor Insurance Commission

The Commission has been established, with three representatives from the Ministry of Finance and two from the insurance industry. The Commission has prepared its first recommendation for the premium tariff and presented it to Government for decision.

The Government quickly approved the new tariff, which involved about a 15% premium rate increase, which is an encouraging development.

The Commission remains without significant resources and is not widely known. The issue of Claims Criteria will be the next major challenge for the Commission.

Uninsured Vehicles

Despite several years of civil and political stability, no progress has been made on reducing the number of uninsured vehicles. Common estimates are at least 30% of the vehicle population, and this alone is enough to make the Motor TPL system non-viable.

The law now requires a ‘sticker system’ for vehicle registration, but no significant progress has been made on implementing this system. We met with representatives of the Ministry of the Interior who outlined progress, including work on a new Traffic Safety Law with improved enforcement powers for Police, and indicated a willingness to continue dialogue with the Commission. No other initiatives appear to have been taken to improve compliance, and there is a suggestion that employees of the relevant authorities might be among the worst non-compliers.

Making substantial inroads into the uninsured vehicle problem remains a key to improving the overall system.

Insurance Industry

One new insurance authorization was issued recently. In Motor TPL, QBE continues to reduce its market share (now between 20% and 30%). Vardar is now the largest TPL insurer with around 40% share; that company indicated it would prefer to reduce share because of the inadequacy of premiums, but it is difficult to convince policyholders to insure elsewhere.

Newer insurers continue to increase share of Motor TPL. We did not visit any of the newer insurers on this mission, but there remains a belief that at least some of these insurers:

- Do not understand the adequacy of premiums
- Want to write Motor TPL only because of the positive cash flow (it is the only class where receipt of premiums up-front is certain)
- May be reserving inadequately
- May in fact be in financial difficulty that they do not recognize and that is not revealed in accounts or in supervisory returns.

Insurers are anxious that the Council of Bureaus that is responsible for the Green Card system has criticized the Macedonian industry and expressed concerns about its financial security including the adequacy of reinsurance arrangements. Reinsurance is especially important because a Green Card claim arising in another country can be very large. If Macedonia is not recognized by the Council, then all citizens of Macedonia driving overseas would have to purchase border insurance at each country, which is inconvenient and expensive.

Claims and the Courts

The situation continues to be that insurers regard material damage claims as ‘under control’ and non-material damage claims as a major problem. The amounts awarded by the Courts (both at first instance and on appeal) are substantially higher than the amounts offered by insurers for out-of-court settlement.

While some claimants still accept out-of-court settlement because of the benefits of early payment and less stress, there is a strong incentive for claimants and their lawyers to take

claims to Court. The routine outcome is that the Court awards at least 50% higher than the insurer offered.

All participants in the system recognize this, with the viewpoint of the judges being that the amounts offered by insurers are substantially below levels of court awards and judges' concept of social fairness.

All the insurers, through the National Insurance Bureau, have agreed to a Claims Criteria document. It is believed that insurers use this document as a matter of routine, but it is not recognized by the Court and has not assisted in establishing consensus on the fair level of damages.

The number of motor injury claims going to Court is generally believed to be high (without any statistics or objective standard), and there is concern about backlogs and the drain on Court resources. Notwithstanding, the delays from commencing a case to completion of the Court case are short by international standards, with delay longer than one year being uncommon and a few months normal.

Illegal Behaviour

There is a widespread belief that there is too much illegal behaviour in the system. The most common description is that some corrupt lawyers (or other intermediaries) organize false evidence (perhaps police and medical), then arrange for a particular judge to hear the case, and share the large award with those involved.

While we are not experts in corruption or organized crime, it seems that this problem needs urgent attention.

Part I Claims Criteria

1 Report on Implementation Plan



Report on Implementation Plan:
Section 1 – Claims Criteria

For convenience, this section of the report is presented as a Powerpoint presentation with notes further explaining the issues and recommendations.

The Powerpoint is identical to the presentation used to debrief the Motor Insurance Commission and the Skopje 1 District Court at the end of the mission. Only the numbering has been changed to be consistent with this overall report.

Section 1 of the report was drafted by Geoff Atkins and reviewed by Shelley Miller.

Section 1 – Claims Criteria

- a. Purpose of Criteria
- b. Other benefits of Criteria
- c. Legal basis of Criteria
- d. Three options for structure of Criteria
- e. Option 1 – single sum
- f. Option 2 – Croatia structure
- g. Option 3 – medical table basis
- h. Setting the Level of the Criteria
- i. Recommended approach

This is the agenda or table of contents for the presentation.

1a. Purpose of Criteria

- The purpose of the Claims Criteria is to give approximate guidance so that each claim is treated fairly
- Transparent and published
- Approximate, leaving individual circumstances to be considered

The primary purpose of the Criteria is to assist the judiciary, insurance companies and lawyers to determine non-material damages to achieve fair treatment of each claim.

The Criteria are not there for the benefit of any particular stakeholder. In developing the Criteria the Commission must be aware that it represents the needs of all parties to the insurance system – premium payers and injured persons as well as insurance companies.

The transparency of the Criteria is one way to help achieve fair treatment. Because the Criteria is published, any party can read the Criteria and determine how they have been treated relative to the standards.

The guidelines in the Criteria are not exhaustive and do not present the judiciary with a particular amount for any given case. It is necessary for the Criteria to be considered in light of the Law of Obligations which requires each case to be considered on its own facts.

1b. Other benefits of Criteria

- Enable more claims to agree to settlement out of court
- Enable balance between premium that can be afforded and damages to injured persons
- Level can be increased as ability to increase premiums occurs
- Improve reputation of Judges, because they are not open to be criticised for widely different decisions
- Improve reputation of Insurance Companies, because there is an agreed basis for their offers
- Improved satisfaction of injured persons, because they do not start with unrealistic expectations
- Make illegal behaviour more difficult to conduct
- Help with the pathway for convergence with Europe

In the overall Motor TPL system the Criteria, if successfully implemented, will help to produce the range of benefits shown above, which are good for all stakeholders. The principal purpose of the criteria, though, is to assist in the fair treatment of claims.

In particular, we found that the Judges we spoke with were quick to appreciate the benefits of agreed Criteria.

1c. Legal basis of Criteria

- Law of Obligation governs the damages that are available
- Law of Compulsory Insurance provides for the Criteria (Article 45)
 - Motor TPL Insurance Commission to establish criteria on damage compensation
 - Submit criteria to the courts for decision-making purposes
- If the Primary Court judges in Skopje 1 are involved in the development, they will likely adopt the Criteria voluntarily and promote them to other Courts.
- If the Courts do not respect the Criteria, then the next steps available are:
 - Supreme Court asked to adopt criteria in accordance with Article 37
 - Amend the law to directly incorporate the Criteria (either the Law on Compulsory Insurance or the Law of Obligation)

A considerable amount of time on the mission was spent on this issue. Refer to section 2 of the report.

In summary, it is recommended that the following steps be taken:

1. Involve Skopje 1 judges in developing the Criteria
2. Skopje 1 Court will adopt the criteria, and also demonstrate their utility to other Court Districts
3. If decisions are made in the First Instance Court that do not take into consideration the Criteria, such decisions should be appealed to the appellate court with detailed presentation of the rationale and justification for use of the criteria.
4. If the Criteria are not approved for use in the Appeal Courts then take the issue to the Supreme Court:
 - ▶ The appeal to The Supreme Court action could be taken by bundling a number of selected Appeal Court decisions as a 'test case'.
 - ▶ Alternatively, the Commission could request The Supreme Court adopt the Criteria in general session as an overall opinion, without reference to individual cases.
5. If the Supreme Court is not willing to adopt the Criteria under Article 37, or if it does so, but the lower Courts do not take into account the Criteria after adoption by the Supreme Court, then there is a strong justification to seek legislative change by the Government.
6. At present the Criteria are promulgated pursuant to the Law of Compulsory Insurance and therefore have application only to Motor accident claims. The Law of Obligations applies to damages claims from any cause. It would be preferable to amend the Law of Obligations rather than the Law of Compulsory Insurance but this would require the support of the Minister of Justice as well as the Minister of Finance.
7. The recommended approach is to begin with adoption by the Commission and application by the Skopje 1 Division of the District Court and there is reason to believe the Criteria will gain acceptance in practice.

1d. Three options for structure of Criteria

- Many variations exist in European countries and elsewhere
- Three options for consideration
- Option 1 – Single sum for damages
 - Examples are published
- Option 2 – Croatia structure
 - Follows Obligations Law model
- Option 3 – Medical table basis
 - Makes more use of medical expertise

Problems with increases in the cost of non-material damages relative to property and material damages in motor insurance schemes have occurred in many countries. It would benefit Macedonia to address this problem before it becomes unmanageable.

The consultants have examined the various initiatives in other mature tort systems around the globe to address the problem effectively and have proposed a mechanism that should particularly suit the existing situation in Macedonia.

In the research done for the project and collective experience of the consultants, we have considered about ten different examples.

For the purposes of the current statutory obligations of the Commission, we have prepared three broad alternative models, which encapsulate the most viable of the reviewed examples.

The first option demonstrates one important legal principle, which is that the non-material damages are expressed as a single sum. The publication of examples is a way of sharing the past knowledge so that Judges have a convenient way of considering their own collective previous judicial practice

The Croatia structure is presented as Option 2, because this is a recent example from a country which, like Macedonia, was previously part of Yugoslavia. Also, the broad structure is similar to current practice in Macedonia.

The third option follows the direction of most advanced systems internationally following various failed experiments to stabilize the level of awards. This option makes primary the expertise of health professionals, over those of other competing experts in the motor accident compensation delivery system.

The three options are provided as an array of choice to spur development of the most effective model for Macedonians and need not be regarded as mutually exclusive. In particular Option 2 can be modified or combined with features of Option 1, or detailed medical guidelines in Option 3.

1e. Option 1 – Single Sum

- A single sum is paid for all non-economic damages to an injured person
- Combines many subjective judgements to a single answer
- Publish examples with ranges of damages

This option is adapted from the United Kingdom system and may be studied in greater depth by reference to “Guidelines for the Assessment of Damages in Personal Injuries Cases” by the Judicial Studies Board (UK).

Option 1 - Example

- Fractured arm:
 - Serious fracture with permanent problems:
 - 70,000 to 100,000 MKD
 - Serious fracture with problems for some time but with recovery:
 - 40,000 to 60,000 MKD
 - Simple fracture with quick recovery
 - 10,000 to 20,000 MKD

For example, consider an open fracture of the arm requiring limited surgery to set the bone. The normal healing process does not occur leaving continuing pain and soreness for several weeks, and a resulting infection eventually successfully treated with antibiotics after two to three months. After this time there is no continuing pain but a permanent scar of 4 cm is visible on the lower arm.

The example above displays a sample result established by the Criteria which would guide a judge during his or her consideration of the medical and other evidence of the situation of the injured person. In this example it would be expected that the judge's award would fall in the range of 55,000 MKD.

1f. Option 2 – Croatia structure

- Compensation to injured person for:
 - Pain (physical)
 - Fear
 - Mental pain (loss of enjoyment of life)
 - Mental pain (disfigurement)
- Compensation to close relatives for:
 - Mental pain caused by death
 - Mental pain caused by severe disability

The compensation structure for non-material damages in the Croatian Criteria is consistent with application of the Law of Obligations, and mirrors both the structure of the Croatian Criteria and the current practice in Macedonia.

Our review of Macedonian claims (see Appendix D) occasionally revealed variations to the above damage categories, and it is intended that the Criteria capture the possibility of such variations so that nearly all injury claims awards fall in line with the categories set out in the Criteria.

It is important to note that in addition to non-material damages, the claimant remains entitled to full compensation for material damages resulting from motor accidents, including:

- Damage to motor vehicles and other property caused by the wrongdoer
- Damage to clothing and other personal belongings in the vehicle
- Medical expenses (including reimbursement of the Health funds)
- Loss of earnings, and loss of future earnings, in excess of the amounts paid by the social security funds.

Option 2 - Example

- For the fractured arm that we have been using as an example, the Criteria would indicate:
 - For physical pain of moderate intensity for three months:
 - 70,000 to 100,000 MKD
 - Mental pain from reduced enjoyment of life:
 - Nil because there is recovered life ability
 - Mental pain from deformity:
 - 2,000 to 5,000 MKD for visible scars on arm
 - Fear:
 - Nil for such an injury of moderate severity

In Option 2 the Criteria does not enumerate specific injuries such as a fractured arm, but instead sets forth broader descriptions to help identify the relevant and applicable Criteria.

For ongoing application of Option 2 Criteria, input from the Macedonian medical community could establish and identify the medical components to support the appropriate entry point into the Criteria.

1g. Option 3 - Medical table basis

- Begin with establishment of the injuries
- For each injury a range of compensation is given, with guidance as the factors to be considered in each particular case
- Guidance for multiple injuries and prior conditions

The Queensland Australia regulation is a good example for a structure for Option 3.

Option 3 Example

- **Injury code 107: Moderate wrist injury – causing some permanent problem such as pain or stiffness:**
 - Injury scale 8 to 12 points
 - Judge adopts exact points based on pain, mental distress and fear
 - 8 points equates to 80,000 MKD damages up to age 65, reducing at older ages
- **Injury code 155: Scarring other than face:**
 - 1 point for scarring to arm (visible)
 - 1 point equates to 4,000 MKD damages

Note that the medical tables produce initial injury scores. The next step is to take the final injury score to the table for the appropriate quantum of damage applicable.

In this structure, typically lower values per point appear at the bottom of the scale and higher values per point appear further up the scale, producing a comprehensive curve of injuries to ensure higher amounts are awarded for the most serious injuries while amounts for the least serious injuries are kept under control.

The curve and the values can be modified from time to time without requiring modification of the medical table (and vice versa).

1h. Setting the Level of the Criteria

- We suggest the Criteria have an Initial Level and a Target Level (Target to be met over two years).
- We recommend that the Initial Level of the Criteria be set so that there is approximately the same total damages paid under the new Criteria as at present (mix of out of court and at court)
 - This level will be higher than that currently offered by the insurance companies
 - This level will be lower than the range currently awarded by the Courts
- The Target level should be at about the middle of the current Court awards

As with many motor accident insurance schemes globally, there is a fundamental problem of affordability of motor accident insurance in the Macedonia TPL system. In Macedonia, while the premium for motor TPL is low relative to surrounding countries, it is a high proportion of Macedonian average earnings and compounding the average cost, there is major leakage through uninsured vehicles which means those who pay for insurance bear a disproportionately higher burden of the cost of material and non material damages.

Accordingly, the damages amounts offered by insurers for settlement appear correspondingly low but may be explained by the pressure of economic requirements to maintain premium adequacy.

The courts and many observers also influenced by European standards regard the insurance industry settlement offers as too low to meet their own views of what is adequate compensation.

Setting the level of the Criteria must balance the competing needs of affordable premiums and adequate compensation. The recommendation of an Initial Level and a Target Level gives a strong incentive to all stakeholders to collectively understand and solve the uninsured vehicle problem.

Moving from Initial to Target Level

- The Initial level should be 20% less than the Target level, with increase to the Target level based on growth in the number of insured vehicles
- When the number of insured vehicles is increased by 20% (through sticker system and other measures) the Criteria will be at the Target level
- After two years the Criteria shall be reviewed and the levels re-set so that there is balance between premiums and claim awards

This feature assumes a willingness to accept a current compromise for future stability of premiums and compensation levels. While the Initial level may fall below what Judges and other knowledgeable participants may find appropriate, the recognition that with the current high number of uninsured vehicles, the premium pool available to insurers is not sufficient to cover the claims requires a present tradeoff of the goal of acceptable compensation levels until conditions have been corrected to provide for an adequate premium pool .

The introduction of an Initial level leading to a Target level establishes a common goal of establishing the premium and compensation balance to be attained collectively by the service providers to the motor accident compensation scheme on behalf of the policy holders and the traffic injured. With collaborative understanding and joint effort, the payors can raise the premium pool to an optimal level and beneficiaries may then access awards of a more optimal level.

It is important to recognize that stability of any motor accident system is a process of ongoing calibration among all participants. For example, in Macedonia, no one participant has the direct power to solve the uninsured vehicle problem. The Ministry of Interior has the legislative authority to implement the sticker system and to improve enforcement of its laws and that part of the solution can be assisted with strong Government support aided by stakeholder support.

Guidance on the Level of the Criteria

- First, agree the amount for the most severe injuries:
 - Target 3,000,000 MKD for non-economic damages for the injured person
- Second, set an ‘anchor’ for a minor to moderate injury (say the broken arm with some problems but full recovery)
 - Target 100,000? MKD – this will be a critical point
- Third, set other levels below and between
- Fourth, set levels for close relatives
- Consider a threshold for non-material damage
- Place emphasis on the most seriously injured
- Place more emphasis on long term disabilities and less on moral or psychological issues such as fear or stress

The threshold can be used to control minor claims. An example of an effective threshold would be:

There shall be no entitlement to non-material damages unless the injury has caused significant disruption to the daily life of the injured person for a period of at least seven days after the accident.

1i. Recommended Approach

- After discussion with the Commission and others, we support the Commission's recommendation of Option 2
 - Option 2 will need the least change (because it is similar to current Macedonia approach)
 - In the long term it may be necessary to move to Option 3, which makes best use of medical expertise, but this can be introduced gradually
- Multi-discipline group to finalise Criteria
- Set Initial level so that total compensation paid is roughly the same as current levels
- Set Target level around the middle of current Court awards
- Set compensation range as multiple of MAK Average Earnings
 - Damages then keep pace with economic development

In various discussions during the mission, the consultants observed uniform preference for Option 2 over the alternatives. It follows most closely the existing Macedonian approach, was considered to be more easily understood and accepted, and less likely to be subject to legal or constitutional challenges.

While the consultants recognize competing arguments for the superiority of any of the Options depending on the priorities of the society affected, they agreed that the most important consideration at this stage was to adopt one functional set of Criteria with which to move forward. Accordingly, the consultants support the preliminary preference for Option 2 Criteria expressed by the Macedonians consulted.

Following the mission we have drafted (in English language) an initial version of the Criteria, omitting any quantum amounts. The draft follows the broad structure of the Croatia criteria, with improvements and details tailored for Macedonian application.

After translation, this draft should be used the working group as the beginning of their work.

Monitoring and Control Cycle

- The Criteria and the Initial levels will be set with some information but will be a 'best judgement' basis.
- It will be about one year before the new Criteria are being used for many claims
- There should be monitoring of the levels of awards and settlements during this time
- Plan the review for a time after two years

It is important the Motor Insurance Commission has and maintains the requisite resources, knowledge and ability to continuously monitor the application of the Claims Criteria together with other aspects of the system, so as to achieve continuing control and balance of the premium and compensation levels.

This is a medium term initiative, which has several dependencies including development of information systems (see section 4 of this report) and building capability.

Steps for Implementation

- Select working group members
- Meeting 1: Commission and working group:
 - Confirm proposed option for model
 - Agree structure of Criteria
 - Discuss and agree work program
- Meeting 2: Agree draft of words for criteria with no numbers
- Meeting 3: Agree numbers for ‘anchors’ and compensation to relatives
- Meeting 4: Agree numbers for other elements of Criteria
- Meeting 5: Consider actuarial advice; final review and approval
- September Seminar to present Criteria

This proposed meeting schedule gives a logical approach for meetings of the Commission with the working group. The meetings should be scheduled immediately following the summer holidays. Late September would be a good deadline for completion, enabling time for preparation for the seminar which we understand will be in the latter part of October.

Section 3 of the report goes into further detail about implementation.

2 Legal Basis for the Criteria

2.1 The Law on Obligations

The prevailing tort law compensation principles applicable to traffic accident personal injury compensation in Macedonia is embodied in the Law on Obligations, in particular Article 189 which provides as follows:

Monetary Compensation - Article 189:

- (1) For physical and mental distress suffered due to impairment of normal life, deformity, injury to reputation, the honour, the freedom or the rights of a person, or suffered due to the death of a related person or apprehension [fear], a court shall, if it finds that the circumstances of the case and particularly the extent of distress and apprehension [fear] justify it, decide on fair monetary compensation as a separate compensation from that for physical damage or in its absence.
- (2) When deciding upon a request for compensation for non-physical damage and on the amount of such compensation, a court shall take into consideration the significance of the injured value and the intended purpose of the compensation and the court shall see that the compensation does not satisfy any objectives that are unjust and are contrary to the social goals.

2.2 Law on Compulsory Insurance

The relevant provisions of the Law on Compulsory Motor TPL Insurance provide as follows:

Article 1

This Law shall regulate the compulsory insurance of the following: a) passengers against accident in public transportation; b) owners, i.e. users of motor vehicles and sidecars; c) owners, i.e. users of aircrafts; and d) owners, i.e. users of ships or engine-powered boats, against third party liability and other issues of significance for the compulsory TPL insurance.

Article 5 - Right to lodge a claim

- (1) The claimant is entitled to lodge a claim directly to the responsible insurance undertaking.
- (2) The claimant can file a lawsuit for compensation of damages to the competent court only if previously submitted the claim to the responsible insurance undertaking.

Article 45 - Competencies of the Commission

- (1) The Commission shall prepare tariff list on premiums for motor TPL insurance and shall propose to the Government the minimum and the maximum rate of technical premium for motor TPL insurance.
- (2) The Commission shall set the criteria on damage compensation in the case of death, physical injury and health deterioration and shall submit them to the courts for decision-making purposes when determining damage compensation in the case of death, physical injury and health deterioration.
- (3) To the end of setting the tariff list for motor TPL insurance premiums and the criteria for damage compensation, the Commission can hire actuaries, legal and medical experts and other experts.
- (4) Upon the request by the Commission, the insurance undertakings and the National Insurance Bureau shall be obliged to submit insurance statistics and other information data necessary for performing its competences.

2.3 Law Governing the Supreme Court

The relevant provision of the Supreme Court Act which provides for the Supreme Court to issue opinions is set out below:

Article 37

- (1) At its general session, the Supreme Court of the Republic of Macedonia shall:
 - establish general positions and general legal opinions on issues pertaining to ensuring court uniformity in the application of the laws;
 - provide opinions on the proposed laws and other acts regulating issues pertaining to the work of the courts;
 - address issues related to the work of the courts, the application of the laws and court practice
 - adopt the rules of procedure of the court;
 - adopt the work programme of the court;
 - review the report on its work and the reports on the work of the courts in the Republic of Macedonia, adopt conclusions thereupon and take care of their implementation.
- (2) The general positions and general legal opinions established by the Supreme Court of the Republic of Macedonia at a general session shall be mandatory for all councils of the Supreme Court of the Republic of Macedonia.

2.4 The Judicial System

The judicial system is comprised of three tiers: twenty seven (27) **basic courts**, three (3) **appellate courts**, and the **Supreme Court**. There is also a **Constitutional Court** established under the Constitution. The twenty-seven basic courts are courts of general jurisdiction.

Three appellate courts in Skopje, Bitola and Stip decide on appeals against decisions by basic courts.

The **Supreme Court** is the highest court which decides on appeals against decisions of the appellate courts, as well as on appeals against decisions of fourteen second instance government commissions. Of all courts, it is reported that the Skopje 1 and 2 Courts hear the majority of personal injury cases arising from traffic accidents.

2.5 Adoption of Criteria by Skopje 1 District Court

The President of the Skopje 1 District Court indicated that the judges in her court heard the large majority of motor injury cases in Skopje, and probably more than any other district.

The general response from our interviews was that judges in Skopje 1 (and in Skopje 2) would welcome the introduction of Claims Criteria as guidelines. Judges would be willing to participate in a working group to develop such Criteria and would assist in application of the Criteria to achieve the goals identified. It would appear that the willingness by these courts of first instance to apply Criteria is likely to assist in establishing greater certainty and predictability of claims outcomes and also likely to reduce the extent of litigation in the first instance.

It is our view that the offer of the Skopje 1 judges should be taken up by the Commission. If Criteria can be developed with the input of the judges, then rapid adoption by all the judges of the Skopje 1 court is likely.

Based on the views expressed by Skopje 2 judges, we conclude they would be likely to adopt the Claims Criteria, especially if they have the support of Skopje 1. There is a good likelihood that, with relatively little effort, all the court districts in Macedonia would follow the lead of Skopje 1 without the need for further intervention. It is our view that the Criteria could be implemented before the end of 2006 by following this approach.

2.6 Requirements for Criteria to be Legally Binding on Courts

It is noted that in Macedonia the traditional tort principles are embodied in the Law on Obligations. Unlike legal systems derived from the British system, the judiciary does not have as part of its legal system a principle of *stare decisis*, which means that, when a court has once laid down a principle of law applicable to a certain set of facts, it will adhere to that principle and apply it to future cases where the facts are substantially the same. This is a defining characteristic of the common law system followed in the United States, United Kingdom, Canada and Australia. While precedents (other similar cases decided earlier) are clearly of interest to the judiciary in Macedonia, they do not have a legally binding status.

In Macedonia, the judiciary reported that only the litigants and other demonstrably interested parties could access the written reasons for judgment. As a result, in personal injury litigation in the motor insurance context, claimants, lawyers, insurers and other members of the judiciary have no ability to forecast what might be a reasonable result in a particular fact

pattern by access to previous decisions. (It is worth noting, though, that an insurer with a large market share of motor insurance business has the possibility of collecting and analyzing its pool of decided cases in determining its settlement position on future cases.)

Our inquiries of members of the legal profession and the judiciary as to the legal standing of Claims Criteria issued by the Commission produced varying viewpoints:

- Issuance of Criteria as required by the Law on Compulsory Insurance would not, of itself, make it compulsory for the courts to follow the Criteria
- Each court (and perhaps each judge) would have the ability to decide independently whether they chose to follow the Criteria in all cases
- If the Appellate court determined that the Criteria should be used, this would probably be followed by the Courts of First Instance, but not necessarily
- If the Supreme Court were to adopt the Criteria by, for example, a Section 37 determination in general session, it is highly likely that all Courts would then follow the Criteria, although the possibility of a challenge to the Constitutional Court remained a possibility
- The most certain way to make the Criteria binding on the courts would be to put the Criteria into the Law on Obligations.

We were cautioned that the some lawyers representing claimants might resist the implementation of the claims Criteria and seek to mount a legal challenge on the basis that the Criteria are an unjustified infringement upon the obligation of the judiciary under Article 189 of the Law on Obligations. Accordingly, some other judges might be encouraged to disregard the Criteria.

The legal experts we consulted indicated that this type of uncertainty is not unusual with the current state of the laws in Macedonia, and that there is a need for a practical approach.

2.7 Alternative Approaches to Legal Adoption

If the suggested approach outlined in section 2.5 above is not successful in achieving complete adoption by the courts of the Claims Criteria then there are alternatives.

The first alternative is to seek a decision of the Supreme Court at its general session in accordance with Article 37. While not an absolute guarantee that all courts would then follow the Criteria, it is highly likely that the desired outcome would be achieved. This was the path followed in Croatia for the adoption of Claims Criteria in that country.

The second alternative is for further legislation, probably by way of amendment to the Law on Obligations.

2.8 Summary of the Legal Basis for Adoption

While some legal uncertainty will remain, given the independence of the judiciary and the possibility of challenge in the Constitutional Court, it appears to us the legal basis of adoption of the Criteria is sound. We note that:

- The Claims Criteria are being developed by reference to collected data upon recent judicially determined cases in Macedonia
- So long as the Criteria are not tendered on the basis that they are to be adopted by the judiciary without regard to the facts of each case so as to interfere with its independence or otherwise fetter its discretion in applying the Law on Obligations, the introduction of such Criteria for application in traffic injury cases parallel the common law principle of *stare decisis*.
- Moreover, if the judges accept the practice of applying the guidelines in most cases, a custom of usage will likely develop and become entrenched as part of the judicial attitude and practice.

3 Process for Development of Criteria

3.1 Available Information

The information available to assist with development of the Criteria for non-material damages awards includes:

- The Croatia criteria adopted by the Croatia Supreme Court
- NIB (National Insurance Bureau) criteria adopted by all the insurance companies of Macedonia
- Descriptions from stakeholders about how and why the court verdicts vary from the insurance company offers
- A sample of about 90 recently settled claims provided by one insurer.

3.2 The Claims Sample

QBE Makedonija was requested to assist the consultants by preparing and providing information on a sample of claims for the following reasons:

- Until recently QBE was the major insurer and has the largest share of settled claims, even though its share of current policies is much lower
- QBE has the resources to translate the information to English language for use by the consultants.

The technical assistance team greatly appreciates the assistance provided by QBE. The consultants believe that the sample has been prepared with diligence and accuracy and would be useful not only for the present purpose but to assist the deliberations of the proposed working group to develop the Criteria.

Appendix D of this report describes the sample and presents findings from analysis of the information. In summary the sample showed that:

- Average awards made by the court are considerably higher than those achieved in out of court settlements by the insurance company
- There is considerable variation in the amount of damages for claims that appear to be of similar severity
- Awards for minor injuries appear to be high relative to the awards for moderate and serious injuries.

3.3 Rebalancing to More Serious Injuries

It was observed above that the current level of awards for minor injuries appears to be high relative to more serious injuries.

This trend is found in most tort motor accidents schemes worldwide and has important economic and social implications. There is much greater frequency of minor injuries relative to serious injuries, and as compensation increases both in amount and frequency of claims for minor injuries, the pressure increases on the scheme costs and on premiums to the detriment of the majority of traffic injured but most particularly the most severely injured.

Unless premiums rise to meet the increasing compensation levels, which eventually creates problems of affordability, studies have proven that the most seriously injured are found to be undercompensated. Most jurisdictions, when faced with this problem, recalibrate their systems so that:

- Adequate compensation of the most seriously injured is the first priority
- Affordability of the premium for motorists is a nearly equal priority since it ultimately determines the amount of funding available for all the scheme costs
- Compensation for minor injuries is necessarily restricted (often under protest by social commentators and specific interest groups) to maintain the required balance.

The consultants hold the unanimous view that this concern must be addressed in the motor accident compensation system of the Republic of Macedonia through reforms of Motor TPL.

At the same time, we observe that the problem of non-material damages in Macedonia is exacerbated by the large volume of uninsured motorists. Whether the extent of uninsured vehicles is 15% or 30%, the fact remains that it severely reduces the premium pool available to pay compensation.

The consultants note that in Croatia, the criteria adopted by the Supreme Court of Croatia establish adequate damages for the most seriously injured claimants relative to those with less serious injuries.

The consultants suggest that in developing the Claims Criteria for Macedonia, the Commission consider the entire spectrum of injury damages awards from minor to catastrophic both relative to each other and relative to average earnings of the population.

In the current Macedonian situation, the current range is roughly 10 to one – broadly about MKD 2,500,000 in non-material damages for the most serious injuries, and about MKD 250,000 in non-material damages for a minor injury such as the fractured arm example referenced in Section 1.

With average earnings of MKD 15,000 per month, the top level represents about 170 months (or 14 years) of average earnings, which the consultants consider to be a realistic level by international standards.

For the minor injury, the compensation represents about 16 months of average earnings which is considered unrealistically high for an injury impact totalling only a few months. By

comparison the typical non-material damages compensation for the fractured arm example would be:

- In Croatia, about three months average earnings
- In Canada, about four months average earnings
- In the United Kingdom, about 2.5 months average earnings
- In Australia, about two months average earnings (nil in some states because of a threshold).

In order to have an economically sustainable system, the working party and the Commission will have to encourage consideration of the view that Macedonia must establish levels of compensation affordable to their own citizens today rather than levels currently affordable by certain European countries.

3.4 Initial Draft of Criteria

We have prepared an initial draft of Claims Criteria (in English language) that can be used by the working group and the Commission to work from. The draft is included as Appendix B to this report.

Relevant points to note about the draft are:

- Accurate translation is vital due to the legal and social impact of the claims Criteria
- It establishes their purpose and legal basis
- It pertains only to non-material damages
- It expresses compensation as a function of average earnings so that indexation occurs (an updated table needs to be published each year).

3.5 Suggested Approach for the Commission and the Working Group

A suggested approach for the Commission to take in establishing a working group and preparing the Claims Criteria is outlined in the following steps:

1. Provide a copy of the first draft claims criteria (see Appendix B) to the members of the working group – the Commission members, the representative judges from Skopje 1 and the medical and psychiatric experts.
2. The working group and the Commission should agree to the wording of the Claims Criteria without figures for damages amounts
3. Once the words are agreed upon, the Commission should arrange for advice from the actuarial expert (Geoff Atkins) as to initial proposals for quantum figures to go into the Criteria.

4. The Commission should then finalise the Claims Criteria including words and numbers for issue to the courts.

It is possible that some interest groups and lawyers may oppose the entire concept both as to language and quantum on the basis that Criteria are inconsistent with the provisions of Article 189 of the Law of Obligations. However, if they emerge as the only interest group effectively opposing the proposal, then you should request they put forth a positive alternative for consideration. If they cannot do so, then their reaction should be registered for consideration by the working party and the Commission to determine if their input requires any additions or modifications to the proposed claims criteria.

Part II Other Technical Assistance

4 Information Systems

The development of Macedonia's insurance system requires access to good quality information.

Good quality information about insurance business is needed for several reasons:

- Insurers require proper data to properly manage their businesses and to comply with legal obligations
- the Supervisor requires proper data to oversee the financial position and conduct of each insurance company
- the Motor Insurance Commission requires proper data to perform its statutory obligations to establish the tariff premiums, monitor the application of the claims Criteria and to oversee the effective operation of the Motor TPL market
- the NIB requires proper data to fulfil its function in operating the Information Centre for Motor TPL.

Insurance companies and the Supervisor require proper data for every class of business. The NIB and the Motor Insurance Commission require proper data about the Motor TPL class, including Green Card.

4.1 Two Types of Information

There are two types of information dealt with in the law: Unit Record Information and Statistical Information. Unit Record Information is a computer database with one record for each policy and one record for each claim, with the ability to link each claim to the policy to which it relates

Statistical information is a summary report or table which shows the total information for a class of insurance or insurance company according to a specified format and definitions.

4.2 Unit Record Information for All Business

The law requires each insurance company to have minimum standards for Unit Record Information for all classes of insurance business.

The Law on Insurance Supervision already includes some requirements and should be reviewed and amended if necessary.

This requirement must also be supervised and enforced. On-site supervision should inspect the information system. If an insurance company does not meet the minimum standards, it

should be given no more than 12 months to comply. If it does not comply within 12 months, its licence should be cancelled.

There should be no flexibility about meeting this standard because it is fundamental to proper operation of an insurance company and to proper Supervision. The inability of a company to comply with basic data requirements relating to policy and claims information should raise immediate concerns about the ability or intent of that company to pay claims.

The minimum standards for Unit Record Information require careful drafting since a computer information system could be designed or operated in many ways. Provided the minimum requirements are met, the standards should not restrict the way the insurance company designs its computer system.

4.3 Unit Record Information for Motor TPL

There are more detailed requirements for Motor TPL to enable the NIB and the Commission to undertake their functions.

Two main additional requirements are best included in the Law on Compulsory Insurance:

- more fields (data items) on policies and claims
- a Central Information System with policy and claim information for all insurance companies combined.

4.4 The Central Information System for TPL

The Central Information System would best be established at the NIB. The reasons are:

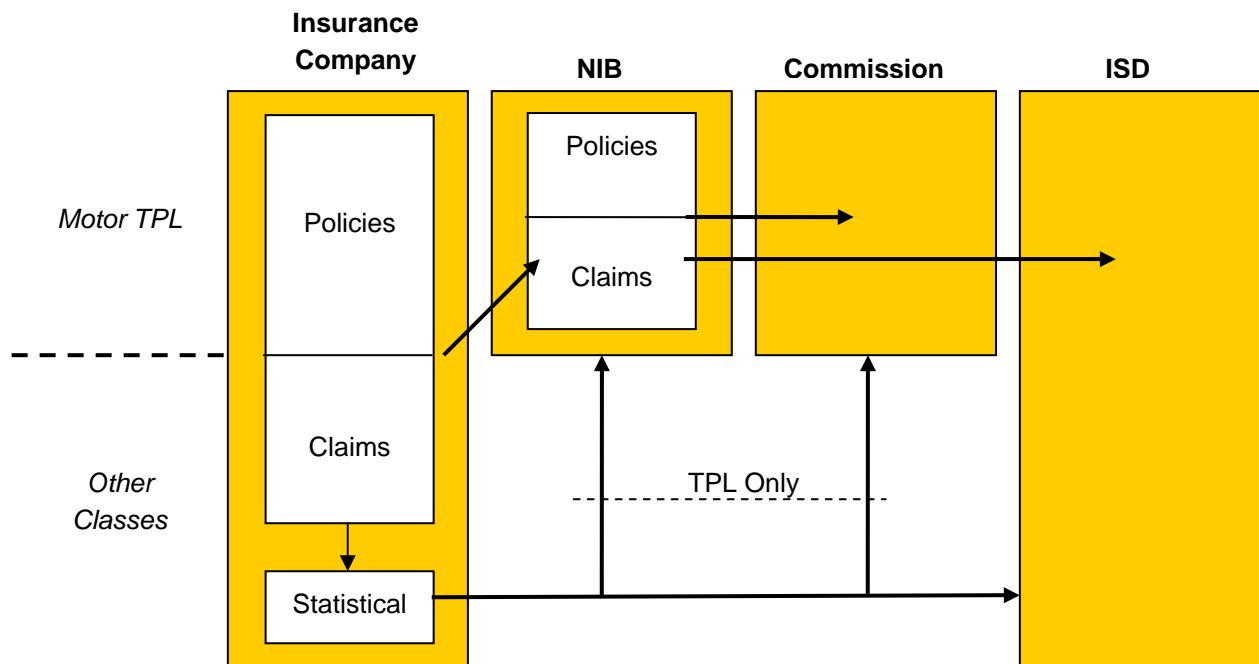
- the NIB already has this expertise
- the NIB already has a limited system for TPL policies to undertake the function of the Information Centre
- the NIB system could also link with the Ministry of Interior to help enforce compulsory insurance
- the NIB system could be used to verify the past insurance history of each insured vehicle owner for the bonus and malus system
- the NIB is already supervised by the ISD and the supervision can extend to the Central Information System.

The Law on Compulsory Insurance should require that:

- the NIB establish and operate the Central Information System for TPL including Green Card insurance
- each insurance company provide information to the NIB

- the Supervisor supervise the NIB and the insurance companies in these processes and apply sanctions
- the NIB give free and open access to the Central Information System to both the Commission and the ISD to undertake their respective functions.

Figure 4.1 – Schematic of the Stakeholders for Information



Insurance companies must maintain unit record information (policies and claims) for all of its business and prepare statistical returns. The unit record information is provided to the NIB for MTPL only. The statistical returns are provided to the ISD and (for TPL only) to the NIB and the Commission.

The NIB maintains the central unit record information system for Motor TPL.

The Commission has access to the unit record information for Motor TPL and also receives the statistical returns.

The ISD receives all statistical returns. It also supervises the unit record information at the insurance companies and the NIB, and can access that information if required under its supervisory powers.

The consultants from Deloitte Advisory plan to give training to the supervisors, the NIB and the market on the requirements for information systems.

More detail on the information systems requirements is given in Appendix F.

5 Green Card and Reinsurance Requirements

5.1 Reinsurance Requirements

Reinsurance is one important element of the effective financial management of an insurance company. In particular, reinsurance protects the company against the impact of a very large claim arising under one policy or a single event giving rise to claims under more than one policy at the same time.

It is not essential that an insurance company have reinsurance if:

- the largest sum insured under an individual policy is within its financial ability to pay if there was a total loss, and
- it is not exposed to an accumulation where one event such as a storm could give rise to claims under many policies at the same time.

Almost all insurance companies in the world, however, use some reinsurance

5.2 Green Card System

Reinsurance is very important for the Green Card system which protects a Macedonian vehicle when operated in another country. In other countries, especially in Western Europe, policy limits on Motor TPL are very high and in some cases unlimited. A Green Card policy could give rise to a claim for many millions of Euros. A Macedonian insurance company without adequate reinsurance would not be able to pay such a claim.

We recommend that the Supervisor require each insurance company to have adequate reinsurance and that such requirement be specified in the Law on Insurance Supervision

For Green Card insurance, we recommend that the Supervisor require reinsurance to cover a claim up to EURO 50 million.

5.3 Central Arrangement of Green Card Reinsurance by NIB

The recommended limit of EURO 50 million may present a practical problem because the reinsurance may become unavailable or unaffordable.

To overcome the practical problem, the NIB should arrange a reinsurance treaty to cover Green Card insurance for claims from EURO 0.5 million to 50 million. This treaty would protect all the insurance companies that choose to subscribe to it, and those insurance companies would pay the premium in proportion to their Green Card premium earned in the year.

We believe all insurance companies, with the possible exception of QBE, would find it most economical to join this single treaty organised by the NIB.

For a claim up to EURO 0.5 million, each insurance company would require its own reinsurance (which could be combined with its TPL business) or have adequate capital to retain the risk without reinsurance.

6 Technical Reserving Standards

It is a vital part of insurance regulation that insurance companies be required to establish adequate technical provisions and that the supervisors are able to verify that technical provisions are in accordance with the requirements. Note that in this section the industry term ‘reserves’ is generally used in place of the equivalent accounting term ‘provisions’.

This section deals only with technical reserves for non-life insurance business. We have not considered life insurance business.

The consultants were provided with a draft by-law on technical reserves that had been provided by EAR to the Ministry of Finance. We have recommended significant amendments to that draft and a new draft by-law is contained at Appendix E.

6.1 Components of Technical Reserves

There are five components of technical reserves for non-life insurance companies to be considered. These components, in the same order as they appear in the draft by-law, are as follows:

1. Unearned premium reserve, including deferred acquisition cost
2. Outstanding claims reserve, including IBNR and claim settlement costs
3. Unexpired risk reserve
4. Equalisation reserve
5. Reserve for bonuses and rebates for policyholders.

The following paragraphs explain the approach that is recommended and included in the draft by-law in Appendix E.

6.2 Unearned Premium Reserve

The widely used methodology recommended for determining the unearned premium reserve is called the daily pro rata method (or 365ths method).

The unearned premium is the total for each policy of the premium pro rated by the number of days after the balance date divided by the total number of days of the policy period.

It should be noted this method is not appropriate in the case of business with a non-uniform distribution of risk over the insurance period. Virtually all the business written in Macedonia is suitable for the daily pro rata method.

Consistency of the definition of the premium used in the calculation (gross premium written) is crucial. A recommended definition is in the draft by-law.

Simplified methods for unearned premium are possible, for situations when the information systems do not allow policy-by-policy calculations. Examples are the 1/24 methods (when monthly premium information is available) or the 1/8 method (when quarterly information is all that is available). These methods do not need to be in the by-law, but they should be understood by the Supervisors because they can be used to check the adequacy of the UPR calculations.

Deferred acquisition costs (DAC) are used to match the recognition of premiums and acquisition expenses in the accounts. In accordance with the latest IFRS the only method which can be used for deferral of acquisition cost is to calculate the DAC as the same proportion of the unearned premium that the acquisitions costs bear to the gross written premium.

6.3 Outstanding Claims Reserve

The outstanding claims reserve has three parts, for each class of business:

- Reported claims
- Incurred but not reported (IBNR) claims
- Claims settlement expenses.

Reserve for Reported Claims

The individual, case by case method should be applied for claims that have been reported to the insurance company but which are not finalised at the balance date. In some situations the amount of the claim payable may have already been determined, and in other cases an estimate is made based on the information available.

Making proper estimates of the outstanding amount for reported claims should be verified during the supervision process. Review of the procedures and guidelines used by the insurance company, along with a sample review of actual claims, should be undertaken by the supervisors.

Reserve for Incurred but not Reported (IBNR) Claims

The IBNR reserve should be sufficient to cover:

- true IBNR claims (where the accident has occurred but the claim has not been reported to the insurance company)
- any deficiency in the total of the case by case reserves for reported claims (which can occur if there is inadequate information to make good estimates)
- the cost of future reopened claims that appear to be finalised at the present time.

There is no merit in trying to separate these components. It is most helpful to regard the IBNR reserve as covering all three, and to test the adequacy of the IBNR reserve in total.

International best practice is for the IBNR reserve to be determined by an actuary in accordance with professional standards and using recognised actuarial methods. For Macedonia, this approach is not practical given the current state of the market (both insurance companies and the supervisors). We recommend a two stage process:

- A simple prescribed formula and factors for the IBNR reserve for each class of business
- The ability for a company to use actuarial methods if it has enough experience and can demonstrate the required capability to the supervisors.

The prescribed formula is a simple one that can be used for all classes of business (with appropriate factors) and places the least reliance on the availability and accuracy of data.

For each class an IBNR factor is prescribed, that is applied to the gross earned premium for the year prior to the balance date. For long tail business, factors are applied to the gross earned premium for three years prior to the balance date.

The consultants have arranged to obtain relevant information from one insurer, to recommend IBNR factors. This work continues at the date of this report.

Claim Settlement Expenses

External claim settlement expenses such as independent claims adjusters, medical experts and the like, form part of the cost of the claim, and allowance should be included in the case reserve for anticipated external costs.

Internal claim settlement expenses are those that form part of the management expenses of the company – claims managers, salaried lawyers, computer system costs and the like. A reserve for internal settlement expenses is required to be sufficient to cover the expenses of paying all of the outstanding claims – both reported and IBNR.

The draft by-law requires the reserve for claims settlement expenses to be set for each class of business as a percentage of the total reserve for reported and IBNR claims. If there is no better information available for the market in Macedonia, we suggest a percentage of 6%.

6.4 Unexpired Risk Reserve

The unexpired risk reserve is required if the unearned premium, less the corresponding deferred acquisition costs, is not sufficient to meet the claims and related costs arising after the balance date in respect of policies written prior to the balance date.

In order to determine a proper value for the unexpired risk reserve it is necessary to make a forward-looking assessment of the profitability of the business. This is very difficult even

with good information systems, and virtually impossible in a developing market with poor information.

Nevertheless, there should be a requirement for the unexpired risk reserve to be assessed, in order to encourage insurance companies to examine their profitability, and to enable the Supervisor to require the establishment of suitable accounts if necessary.

6.5 Equalisation Reserve

As international insurance regulation is gradually being standardised along with the introduction of IFRS, the use of equalisation reserves is reducing. For Macedonia, an equalisation reserve should be required only for Credit business. There is probably no credit business currently being written in the country.

6.6 Reserve for Policyholder Bonuses and Rebates

It is possible for non-life insurance to include bonuses or rebates to policyholders, although it is relatively unusual.

There needs to be a technical reserve established for the expected value of bonuses and rebates that have been accrued up to the balance date.

6.7 Draft By-law

In Appendix E we have included a draft by-law for technical reserves. The consultants from Deloitte Advisory plan to give training to the supervisors (and if required to the market) on the use of this by-law at an appropriate time.

7 Premium Setting for MTPL

Item 3 on the implementation plan deals with setting of tariff premiums for Motor TPL, which is one of the main tasks of the Motor TPL Insurance Commission.

We were provided with the new tariff that was recommended by the Commission to the Government and adopted at about the time of the mission ('the 2006 tariff'). We were also given a briefing by the actuary member of the Commission who undertook the technical work for the 2006 tariff.

7.1 Summary of the Current Situation

The current tariff is complex – the document itself is 18 pages, and there are many details for various types of vehicles. The main focus in its development seems to have been the relative fairness of the tariff for different vehicles – this also was the topic of much consultation we had about the tariff. For example many people would like to see a 'bonus/malus' system reintroduced, where an individual vehicle owner's premium would be increased or decreased based on their previous claims experience.

As we understand it, the tariff deals only with the 'risk' component of the premium, i.e. the amount required to cover the cost of claims. The total premium charged by an insurance company also needs to take into account expenses, levies, guarantee fund contributions, target profit (or return on capital) and potentially other issues. We understand that the tariff requires a minimum loading of 15% on top of the published tariff, and we expect that in the market place every insurer uses a 15% loading most if not all of the time.

Little attention seems to be paid to the overall adequacy of the tariff premium, and in our opinion this is the most critical issue at the current time.

The difficulty in setting the tariff is greatly exacerbated by the lack of information systems in the insurance companies and a consequent lack of reliable information at a total industry level. At present, all work on the tariff has been (and in practice can only be) based on information from QBE Makedonija. In the past this has not been a great impediment, because QBE has had by far the largest market share and also has good systems. In future, however, this approach rapidly becomes unsatisfactory (and already is to a degree) because QBE's market share has dropped considerably and it is not known whether the TPL business now written by QBE is typical of the whole market or not.

A further difficulty with setting the tariff is the uninsured vehicle problem. The large (and unknown) volume of uninsured vehicles makes it very difficult to set a reasonable tariff premium for the insured vehicles, especially when claims arising from uninsured vehicles must be met through the guarantee fund and (ultimately) by the premiums of those that do insure or the insurance company shareholders.

We believe that the Insurance Commission needs to establish a five year plan for tariff premiums. The key components of this plan include:

1. Initial simplification of the tariff structure
2. Initial focus on the overall adequacy of the tariff premium
3. Information systems to obtain reliable industry wide data
4. Information systems to track the insurance history of individual policyholders
5. Gradual extension of the complexity of the tariff
6. Eventual reintroduction of a bonus/malus system
7. Future consideration of methods of increasing competition in the market.

7.2 Initial Simplification of the Tariff Structure

In the short run, some simplification of the tariff structure will assist with establishing a stable market and getting systems established at both an insurer and industry level.

The suggestions we have for this process are:

- establish the tariff for the total premium to be charged, not just the actuarial risk premium
- concentrate on the largest class (cars)
- move the details for smaller vehicle classes to Appendices or Schedules in the document
- remove any reference to bonus and malus for the time being (refer to item 6 of the plan).

7.3 Initial Focus on the Overall Adequacy of the Tariff Premium

The Commission should require the actuarial report prepared for the next tariff to deal specifically with overall adequacy of the tariff premium. This will require assessment of the total claim cost arising from recent accident periods, the oncosts (including guarantee fund assessments and reasonable profit margin) and the actual premium collections from insured vehicles.

While this will be a challenge in the absence of adequate data systems, it is by far the most important issue. Focussing on this challenge will assist in getting the required systems in place (see section 7.4). Even if the actuarial report is unable to provide a confident answer to this question, it should at least provide a range of likely outcomes and highlight the critical issues and judgements.

7.4 Information Systems to Provide Reliable Industry-wide Data

This topic is covered in Section 4 of the report. The Commission should study that section, and take positive steps to play its part in the actions needed.

7.5 Information Systems to Track the Insurance History of Individual Policyholders

The central information system recommended in Section 4 needs to be able to track the insurance history of individual policyholders, including as they change insurance from one company to another.

This is a vital pre-requisite for operation of a bonus and malus system. It is also an important tool in a comprehensive system to deal with the avoidance problem.

7.6 Gradual Extension of the Complexity of the Tariff

Once the above steps are in place, the Commission will be in a position to move the tariff structure more towards best international practice, in taking account of more rating factors and recognizing differences in risk across different vehicles and owners.

The medium term plan should require, however, that refinements to the tariff are not attempted until the preceding steps are in place.

At that time a plan to progressively improve the tariff can be put in place and implemented over succeeding years.

7.7 Eventual Reintroduction of a Bonus/Malus System

Many stakeholders, especially in the insurance industry, believe that there should be a bonus/malus system in the tariff.

We agree with this sentiment, but believe that the underlying conditions need to be in place first, in particular:

- having solved the avoidance problem and achieved a satisfactory (around 95%) compliance rate with vehicle owners purchasing TPL insurance
- having satisfactory information systems to give reliable industry-wide data
- having a central information system with the ability to track the insurance history of each policyholder.

We suggest that the Commission articulate its support for a bonus/malus system, but only once the above conditions are in place.

7.8 Future Consideration of Increasing Competition

The tariff is, by its nature, a system that limits competition, because it leads all insurers to charging similar, if not identical, premiums. A well managed tariff does, however, provide a stable system which has benefits especially in an unsophisticated and developing market.

In the current market conditions in Macedonia, there is no argument for removing the tariff. In future, however, once a stable and viable insurance industry is established, there will be merit in looking at ways to increase competition in the market. This might include the use of ranges in the tariff, limiting application of the tariff only to some vehicle types, changing the distribution arrangements or other methods.

At present, however, it is premature to consider these issues.

7.9 Training and Further Technical Assistance

The consultants from Deloitte Advisory plan to give further training on premium setting methodology, but it is likely in our view that further technical assistance will be required beyond the scope of the present project.

8 Further Recommendations

In drawing together the strands of the technical work undertaken for this mission and the overall implementation plan for the Motor TPL reforms, there are several further recommendations arising.

1. Limit the commission that can be paid for the issue of MTPL and Green Card to 4% of the premium.
2. Remove the levy for Fire Safety. It is not correct for the motor insurance to pay for the fire service.
3. Suspend the levy for Traffic Safety. It can be correct for the motor insurance to pay for some amount for traffic safety but only if it is a special initiative where the money is properly spent.
4. Limit the contingency fee that the lawyer can charge for the services for personal injury claims to a maximum of 20% of the recovery and require the agreement be committed to writing at the outset of the retainer
5. Require the lawyer to lodge the fee agreement between the lawyer and client with the Court. Give the Court specific power to override the compensation provided in the agreement if it is not fair to the client, and to refer the matter to the Bar Association to consider disciplinary proceedings against the lawyer.
6. Implement a liaison group between the Ministry of Finance, National Insurance Bureau (or the Motor TPL Insurance Commission) and the Ministry of Interior on the MTPL system to discuss priorities and progress on:
 - (a) reducing uninsured vehicles
 - (b) efficient procedures for registration and insurance
 - (c) best procedures after an accident – for police report and interaction with insurance companies and Courts
7. Ensure the Sticker obtained as part of the registration process identifies that the vehicle is registered and insured, as well as that it has satisfied the roadworthy requirements.
8. Consider whether the IT system from Turkey could be acquired to implement in Macedonia more quickly and cheaply than developing a system locally.

Part III Appendices

A Implementation Plan

MACEDONIA LAW ON COMPULSORY MOTOR TPL INSURANCE

IMPLEMENTATION PLAN

Successful implementation of the MPTL law to achieve the objectives of the reform will require a broad set of actions. An implementation plan for the MPTL law is outlined below. This plan is based on discussions involving the MOF Insurance Systems and Supervision Divisions, the World Bank and FIRST-funded consultants, and on consultations with the MPTL Commission.

1. **Information system on premiums and claims.** In order for the MPTL Commission to fulfill its responsibilities under Article 45 (1) to propose to the Government a premium structure and (2) to set criteria for damage compensation, the Commission needs accurate information from insurance companies on motor premiums and claims. Article 45 (4) provides the Commission with the authority to request insurance companies and the NIB to submit insurance statistics necessary for performing these tasks.
 - The initial task is to design the information system for premiums and claims and collect the information needed for preparation of a new premium and the claims criteria. The system should reflect sound actuarial practices, yet take into account the capacity of Macedonian insurance companies. When the information system and statistical parameters are designed, the NIB and insurance companies will need to be trained to collect and submit information in the required format. The MOF and the NIB will have to enforce compliance with the information system on insurance companies.
 - FIRST-funded consultants will work directly with the MOF, NIB and insurance companies to collect currently available information on premiums and claims, assist the MOF in the design of a new information system, and train the MOF, NIB and companies to collect and submit the information according to the required parameters. Companies will also be trained on how the same information can be used internally.
2. **Technical reserving requirements.** The MOF Insurance Supervision Division has to be able to verify that insurance companies have sufficient technical reserves for MPTL claims. In order for this to occur, the MOF Insurance Systems Division has to approve a by-law on technical reserving requirements.
 - There is currently a draft by-law on technical reserving requirements prepared by EAR consultants. FIRST-funded consultants will review the by-law prior to its

approval by the Insurance Systems Division. The consultants will subsequently provide guidance and training to the Insurance Supervision Division on how to review and analyze the information received from insurance companies.

3. **Premium setting.** Under Article 45 (1), the MPTL Commission shall prepare a tariff list on MPTL premiums and propose to the Government the minimum and maximum rate of MPTL technical premium. Article 46 requires the Government, on the proposal of the Commission, to set the minimum and maximum tariff rates once a year.
 - Preparing a new tariff recommendation is a high priority for the MPTL Commission in order to comply with the law. The new tariff should be designed to keep premiums and claims in balance. In order for this to occur, satisfactory information on premiums and claims history will have to be collected. One additional consideration is that there are a significant but unknown proportion of unregistered and uninsured vehicles that are avoiding compliance with the law. Bringing premiums and claims into balance could best be accomplished by first reducing the number of uninsured vehicles (by introduction and enforcement of a sticker system) and then increasing premiums as necessary.
 - FIRST-funded consultants will assist the MPTL Commission in the development of a methodology for calculation of the premium pool needed to support a viable TPL system at the current level of claims. The consultants will prepare scenarios for the premium rates required to create an adequate premium pool given different assumptions about increased collections from reducing the proportion of uninsured cars. The consultants will then assist in preparing the premium recommendation for this year. Additional scenarios could then be calculated for the level of premiums based on different assumptions about total claims resulting from implementation of new claims criteria.
4. **Claims criteria.** Under Article 45 (2), the MPTL Commission shall set the criteria on damage compensation in case of death or injury and submit the criteria to the courts for decision-making purposes.
 - Preparation of the new claims criteria is a key objective of the reform. The new claims criteria, if approved by the Supreme Court for use by the judiciary, would establish consistency between compensation awarded by insurance companies and that awarded by judges. This would contribute to bringing premiums and claims into balance and reducing the number of claims being brought to the courts. It will be essential to develop the criteria in close coordination with the Supreme Court to maximize the likelihood that the criteria will be approved for use by the judiciary. The consultations with the Supreme Court may need to focus on two issues. First, the form of the criteria will need to be acceptable from a legal perspective. Second, the implied level of compensation from the criteria may need to be seen by the Court as socially acceptable.

- The World Bank and FIRST-funded consultants will assist the MPTL Commission with preparation of the claims criteria. The World Bank has engaged the Government and the judiciary on judicial reform and Bank staff involved in this effort will advise the team that will meet with the Court. FIRST-funded consultants will prepare a recommendation on the form and substance of the claims criteria, based on a thorough review of international best practice, review of regional practices and current practice in Macedonia, and consultation with the judicial community. The consultants will also prepare a recommendation on the ranges/levels of compensation to be proposed to Supreme Court based on calculations of the likely size of the premium pool in the next several years and on consultations with the judiciary.
5. **Sticker system for inspection/registration/insurance.** Article 3(1) requires owners of vehicles to conclude an MPTL insurance contract prior to placing the vehicle in traffic. Article 4(1) requires the owner of the vehicle to keep proof of the insurance contract in the vehicle and to present it to an authorized person upon request, while Article 4(2) provides that upon failure to provide this proof, the authorities will prevent the person from further use of the vehicle. Additionally, a traffic safety law sponsored by the Ministry of Interior provides for the use of stickers placed on the vehicle to demonstrate that vehicle inspection, registration and insurance are current.
- A sticker system was in place before the break-up of Yugoslavia. The MPTL law and the traffic safety law provide sufficient legal basis for the implementation and enforcement of the sticker system, however the Ministry of Interior has not yet implemented the provision of the traffic safety law that requires this. Estimates of non-compliance with the law are between 20-50% of all vehicles. It is not known what proportion of uninsured vehicles are actually on the road. If the rate of non-compliance is at the low end of the range, then the benefits from introduction and enforcement of the sticker system will not be significant in increasing the premium pool. However, if the higher estimates are more accurate, the benefits would be substantial. In either case, the Government should implement the system, first – to strengthen the culture of compliance with the law, and second – to increase the size of the premium pool. Taking this step would have the further advantage of enabling the Government, when considering an increase in the premium rate, to assert that all other possibilities for expanding the premium pool had been implemented.
 - The Insurance Systems Division will develop a strategy for implementation of sticker system. As a first step, the Division will obtain figures/estimates from the MOI and other sources on avoidance and likely reduction of avoidance through the sticker system. The MOF will develop a strategy for a political solution to implement the system, which may require high level Government involvement.
6. **MTPL Commission arrangements.** Certain administrative steps need to be taken to ensure that the MPTL Commission can carry out its functions under Article 45.

- A secretary to the Commission needs to be established and a rule book prepared. Provision for funding has to be arranged so that subsequent to the FIRST assistance the Commission, under Article 45(3), can hire experts to assist with revisions to the tariff and claims criteria.
 - The MPTL Commission and the Insurance Systems Division will be responsible for these tasks.
7. **Measures to conform to the MPTL law.** The MPTL law includes provisions that change the minimum insurance amounts (Article 20) and obligations of insurance companies and persons involved in traffic accidents (Articles 21-23).
- Measures to conform to the MPTL law in these articles will require changes to insurance policy documents and other steps. The public will have to be informed regarding its new responsibilities, including reporting accidents first to the insurance company before filing a court claim. The Insurance Systems Division will have to communicate with the NIB and the insurance companies on these changes and programs and ensure that appropriate measures are being taken.
 - The Insurance Systems Division will be responsible for these tasks.
8. **Mediation.** Article 24 provides claimants with the right to mediation if dissatisfied with an offer of compensation and insurance companies with the obligation to envisage in the contract the claimants right to mediation.
- Establishing procedures for mediation is intended to reduce the number of claims being brought to the courts. Currently, the Ministry of Justice is preparing a general law on mediation, which must be enacted before mediators can be licensed and offer services to claimants from motor vehicle accidents.
 - FIRST-funded consultants will review and provide input into the draft MOJ legislation to facilitate the use of mediators in case of motor accident claims. Following the adoption of the mediation law (within a reasonable time-frame), the consultants will provide specialized training to licensed mediators.
 -
9. **Green card system.** Articles 25 to 43 set out the domestic legal framework for Macedonia's participation in the green card system, including the responsibilities of the National Insurance Bureau.
- The Insurance Systems and Supervision Divisions have to ensure that the NIB and insurance companies are complying with their responsibilities as part of the green card system, and that the participation of these entities in the green card system is being handled in a financial sound manner. Participation in the green card system can be financially challenging for insurance companies in countries with lower per capital incomes than the EU average, because the insurance companies in these countries may have to compensate for accidents abroad at higher amounts than for

equivalent accidents domestically. This could reduce the premium pool available to pay domestic claims. A key risk mitigation measure is for insurance companies to buy sufficient, high quality reinsurance to reduce the risks from potential large claims.

- The MOF Insurance Systems and Supervision Divisions have to provide sufficient oversight on the operations of the NIB in carrying out its responsibilities under the green card system. In addition, the Supervision Division should make as a priority a review of the reinsurance programs of insurance companies for green card obligations and require upgrading as needed. FIRST-funded consultants can provide advice on reinsurance standards as needed.

10. Organizational responsibilities under a new MTPL Law. The Commission should clarify and inform parties of their responsibilities under the MPTL law.

- The MPTL law requires actions by a range of governmental and non-governmental entities. The Commission is best placed to clarify and inform parties of their responsibilities. Several areas of focus include:
 1. MOF regulation and supervision units responsibilities and coordination arrangements
 2. NIB responsibilities – information systems, Green Card system, Guarantee fund – work with NIB to ensure implementation changes
 3. Ministry of Interior and other – insurance/sticker system issues.
 4. Other relevant issues not specifically raised by the MPTL law, such as utilization of the 2% MPTL set-aside for traffic safety.
- FIRST-funded consultants will assist the Commission in this task as needed.

B Draft Claims Criteria

REPUBLIC OF MACEDONIA

Criteria for the assessment of a Fair Award for Non-material Damage arising from a Motor Accident

Introduction

The Law on Compulsory Motor TPL Insurance governs the compulsory insurance of motor vehicles against liability to third parties, including claims by third parties against such insurance.

Article 44 establishes the Motor TPL Insurance Commission, made up of representatives nominated by the Ministry of Finance and the National Insurance Bureau.

Article 45(2) provides that:

“The Commission shall set the criteria on damage compensation in the case of death, physical injury and health deterioration and shall submit them to the courts for decision-making purposes when determining damage compensation in the case of death, physical injury and health deterioration.”

The rights of persons injured by the fault of another are established by the Law on Obligation. The Criteria are set to be consistent with the Law on Obligation (Article xx), which establishes ...

The Commission adopted these Criteria on xx September 2006 and hereby submits them to the Courts as required by the law.

Purpose of the Criteria

The main purpose of the Criteria is to assist the courts and insurance companies to determine damages amounts that are fair for each injured person relative to others who have similar injuries and circumstances.

The Criteria are expressed as approximate amounts because there is great variation in the circumstances of each individual and in the injuries that may be suffered in motor accidents. The role of the court (if it is necessary for a claim to be determined by the court) is, among other things, to make an individual assessment taking account of those circumstances. Where relevant, the Criteria identify certain factors that should be taken into account, but these factors are not exclusive.

Should the court determine an award for Non-material Damages that is outside the range identified in the approximate Criteria, then the court is requested to explain in the judgement the particular reasons for the variation.

Scope of the Criteria

Motor TPL Insurance covers the owner and user of a motor vehicle for damages caused to third parties including death, physical injury, health deterioration, destruction or damage of items.

The destruction or damage of items is referred to as 'property damage' and is not covered by these Criteria. The compensation for property damage is part of the 'material damages' under a claim.

Death, physical injury and health deterioration are referred to as 'personal injury'. The compensation for personal injury is of two types:

- Material damages – in respect of losses that can be readily assessed in monetary terms – includes loss of earnings, loss of earning capacity, funeral costs, additional expenses and reimbursement of health, pension and disability insurance costs paid by the relevant insurance schemes
- Non-material damages – compensation for physical pain, fear and mental distress.

These Criteria deal only with Non-material Damages for personal injury. At this time the Commission has not established any Criteria in respect of Material damages.

The Non-material Damages may be paid in respect of a person injured or killed in the accident and also to close relatives of the person injured or killed. The criteria deal with each in turn.

In respect of the person injured, there may be four types of Non-material Damages:

1. Physical Pain
2. Fear
3. Mental Distress from Loss of Enjoyment of Life
4. Mental Distress from Disfigurement.

In respect of close relatives, there may be two types of Non-material Damages:

Compensation for death of a close relative
Compensation for severe disability of a close relative.

Indexation of the Approximate Damages Amounts

The approximate damages amounts in these Criteria are expressed as multiples of the Average Monthly Earnings for the population of Macedonia.

The table for the year 2006 is shown at the end of the Criteria, using the Average Monthly Earnings <published by the Statistics Department for the period June 2005>. Each year, prior to 1 January, the Commission will publish a new table for that year, which is based on the Average Monthly Earnings for June in the previous year.

The table is to be applied according to the year in which the claim is settled or determined by the Court. By using this mechanism, the following benefits are obtained:

- The level of damages awards will keep pace with the economic development of the Republic of Macedonia and the ability of the motor vehicle owners to pay insurance premiums sufficient to cover the total level of claims
- If the claim of an injured person is delayed, the Non-material damages awarded to the injured person or their close relatives will be increased to the extent that there has been growth in average earnings between the time of the accident and the time of settlement or determination of the claim.

The approximate damages amounts are expressed in Macedonian Denars (MKD). While the amounts may be translated to Euro for comparison purposes, they are to be calculated and awarded in MKD. Any change in the currency exchange rate between MKD and EUR will not change the appropriate damages amount.

Non-material Damages for the Injured Person

1. Physical Pain

In the assessment of fair monetary compensation for this aspect of damage it is relevant to consider the duration and intensity of the pain caused by the bodily injury. This information is most reliably obtained by an independent medical report from an expert in the particular type of injury.

Other factors that may be relevant include:

- the age of the injured person;
- inconveniences arising during medical treatment, such as long-term confinement to bed, difficulty swallowing, number and types of surgical operations
- subjective factors in relation to the injured person that can affect the level of compensation (e.g. the isolation of a child from home due to medical treatment in a hospital).

The compensation for physical pain is granted only as long as the pains last, or by the end of medical treatment at the latest. If pain lasts after the end of medical treatment, then this should be considered as part of Mental Distress for Loss of Enjoyment of Life (item 3).

Compensation Ranges for Physical Pain

Duration of Pain	Moderate Intensity	Severe Intensity	Extreme Intensity
1 week			
1 month			
3 months			
6 months			
12 months +			

<include descriptions of moderate, severe and extreme?>

Pain that is of mild intensity, such that it is only felt occasionally during daily activities and does not prevent the injured person following normal activities, does not receive separate compensation for physical pain.

2. Fear

According to the Law of Obligations, compensation for fear suffered may be awarded depending on the actual circumstances of each case. The duration and intensity of fear need to be considered.

Because most injured persons experience some fear, and because of the difficulty of obtaining reliable evidence about the duration and intensity of the fear, the Criteria allow assumptions to be made regarding the normal level of fear arising from an injury.

The damages awarded for fear should only go outside these normal ranges if there is clinical demonstration of a recognized psychiatric condition resulting from the fear.

Compensation Ranges for Fear (Normal)

Period of Serious Impact	Compensation Range
Under one week	Nil
One week	
One month	
Three months	
One year+	

A ‘serious impact’ arising from fear may be assumed if the injured person is in hospital or is immobilized at home because of the injury.

In cases of fear that are much worse than normal because there is a clinical demonstration of a recognized psychiatric condition, the compensation awarded may be two times the range

shown above. However, care should be taken not to duplicate with compensation for Mental Distress due to Loss of Enjoyment of Life (item 3).

In awarding compensation for fear in the normal range, the court may use the evidence of the same medical expert who assessed Pain. Only in cases of compensation above the normal range is it necessary to obtain evidence from a Psychiatric expert about the intensity, duration and impact of fear on the injured person.

3. Mental Distress from Loss of Enjoyment of Life

Mental distress caused by loss of enjoyment of life (also known as loss of amenities) represents a non-material damage that results from bodily injury. It is not the bodily injury itself that entitles the injured party to compensation, but the consequences that reflect themselves in the mental sphere of the injured person and manifest themselves as mental distress.

This aspect of impairment of the injured person is relevant only after the initial physical recovery from the injury has reached a stable position. If the injured person is fully recovered within a period of three months, then only the compensation for pain is relevant. If the life of the injured person is affected for more than a period of three months, there may be compensation for loss of enjoyment of life, and it is especially relevant in cases where there is a permanent disability or impairment.

To begin the assessment of compensation for this item it is relevant to obtain expert medical evidence of the degree of disability caused by the injury, on a scale for zero to 100%, including whether the disability is permanent or, if not, the period over which it has been/will be experienced.

Beyond the medical assessment, the factors to consider include:

- consequences for the person's profession (but not loss of earning capacity)
- consequences for leisure activities such as sports and recreation that the person previously enjoyed
- consequences for family and social interaction that may be restricted.

The maximum compensation, equivalent to 100% loss of enjoyment of life, is reserved for younger people with the most extreme injuries, e.g. quadriplegia or serious brain injury that renders the person incapable of any normal life enjoyment.

Compensation Ranges for Loss of Enjoyment of Life

Percentage Loss of Enjoyment of Life	Age Under 45	Age 45 to 60	Age 60 to 70	Age Over 70
5% or less				
10%				
20%				
30%				
40%				
50%				
60%				
70%				
80%				
90%				
100%				

Degrees of disability expressed in percentage according to various 'disability tables' of social security or insurance companies should not to be applied automatically - the appropriate evidence is the degree of loss of enjoyment of life established by the medical expert who has examined the injured person and considered all the relevant circumstances in the assessment of the case.

4. Mental Distress from Disfigurement

The right to compensation for this aspect of damage is based on the impairment of the previous appearance, and on the mental distress the injured person suffers because of this impairment.

Circumstances that particularly affect the level of compensation are the age and gender of the injured person, whether parts of the face have been disfigured or any other exposed parts of the body, the severity of the disfigurement, the profession and activities of the injured person and the like (with some professions e.g. actors, singers, presenters, entertainers visible disfigurement can strongly affect the intensity of mental distress the person suffers).

Compensation Ranges for Disfigurement

Gender	Age	Small Disfigurement	Medium Disfigurement	Strong Disfigurement
Male	Up to 35			
	35 to 50			
	50 to 65			
	Over 65			
Female	Up to 35			
	35 to 50			
	50 to 65			
	Over 65			

Non-material Damages for Close Relatives

In the case of Non-material Damages for the injured person, it is usually necessary to obtain expert medical evidence about the injuries and the impact they have on the injured person. However, in the case of Non-material Damages for close relatives (whether following death of a close relative or extremely serious disability of a close relative) it is reasonable to assume a level of mental distress based on generally known facts. It is usually not necessary, therefore, to obtain expert medical evidence about the impact on the relatives and the degree of mental distress that they have suffered.

1. Compensation for Death of a Close Relative

The nature of the relationship is the main factor determining the relevant amount of compensation. If the family relationship is in fact not a close one (e.g. a couple that have separated, or children that do not often see their parents), then the amount of compensation should be reduced and may be nil.

Compensation Ranges for Death of a Close Relative

For Death of a ...	Compensation Range
Spouse	
Parent up to age 65	
Parent over age 65	
Child living at home	
Child having left home	
Unborn child (foetus)	
Brother or sister	

Compensation for death of a brother or sister is only paid if ... (see Law of Obligation)

In the case of common-law marriage provided that the life companions have shared the way of life before and at the time of death the survivor is entitled to compensation of the same amount as a spouse.

Children under age who are not yet capable of comprehending the meaning of loss of their parents, are entitled to compensation due to mental distress, since this mental distress does not arise directly after the death of the parents but will arise afterwards - as a consequence of the loss of parental love, charge, care and attention that the child would have received from its parent, and the notion of death itself respectively.

If there are several people entitled to compensation in respect of the death of a person (e.g. parents, spouse, children and siblings) the total damages to the close relatives shall be limited to <maximum>, and the damages to each relative shall be reduced accordingly.

2. Mental Distress caused by Extremely Severe Disability of a Close Relative

According to Article 201, para 3 of the Law on Obligations, the injured party's spouse, children and parents are entitled to compensation for mental distress caused by extremely severe disability of a close relative. This means that the right to claim for damages is strictly assigned to claimants designated by the law.

The Law on Obligations does not define the extent of extremely severe disability, however according to the present judicial practice it is defined as the degree of disability by which almost all important vital bodily functions have been reduced.

The disability is to be regarded as extremely severe if the percentage loss of enjoyment of life determined in respect of the injured person is 70% or more.

Compensation Ranges for Disability of a Close Relative

For Extremely Severe Disability of a ...	Compensation Range
Spouse	
Parent up to age 65	
Parent over age 65	
Child living at home	
Child having left home	

Non-Material Damage Must be Directly Caused by the Accident

It is important to note that the damages are only in respect of the degree of non-material damage that is directly caused by the accident.

Some people may have a prior existing medical condition, or may have suffered an earlier or later accident in addition to the motor accident that give rise to the claim.

While it may be a difficult task, it is the responsibility of the medical expert to assess the injuries and the consequences of the injuries that are due to this accident. For example, if there is a 20% disability due to a prior condition and extent of disability is now 30%, it would be reasonable to attribute 10% disability to this accident.

It is, however, relevant to consider the physical and mental condition of the injured person prior to the accident in assessing the impact that the injuries arising from this accident have created. For example, the damages for loss of sight of one eye will be different for a person who had sight of both eyes prior to the accident (and still has one after) compared to a person who had sight of only one eye prior to the accident (and now has none).

If a person has suffered more than one motor accident giving rise to claims, it is correct to award damages for pain and fear in respect of each accident presuming the accidents occur at different times. However, the total compensation for mental distress (loss of enjoyment and life and disfigurement) from the two accidents should not be greater than the amount that would be awarded if all the injuries had arisen in a single accident.

C Discussion of Claims Criteria

THE PURPOSE OF CLAIMS CRITERIA FOR NON-MATERIAL DAMAGES IN MACEDONIA’S TPL SYSTEM

I. INTRODUCTION

This note is intended to provide the judicial community in Macedonia with background on why claims criteria for non-material damages are being introduced into the Macedonian motor TPL system.

In short, claims criteria are seen as an effective method for:

- Ensuring that the motor TPL system maintains a sustainable balance between the needs of claimants for compensation and the cost of motor TPL insurance to motorists.
- Improving equity between claimants by promoting greater consistency in court awards and out of court settlements.

II. THE PRINCIPLES UNDERLYING TPL

TPL systems are based on two basic principles:

- Compensation should be provided to restore injured victims as far as it is possible to the victim’s pre-accident position.
- The cost of motor TPL insurance should be affordable and available to the majority of motorists and premiums should be relatively stable from year to year.

Unfortunately, as the compensation payable to injured victims is provided by motor TPL premiums, these two principles can come into conflict with each other.

In Macedonia, while the premium for motor TPL is low relative to surrounding countries, it is a high proportion of Macedonian average earnings. In addition, there is a major problem with uninsured vehicles. This means that the amount of money available from the motor TPL premium pool to pay TPL claims is relatively smaller than it might otherwise be.

As the overall amount of compensation available is limited to the premium pool, achieving equitable outcomes – between premium paying motorists and victims and between different victims – is difficult.

In Macedonia, only the litigants and other demonstrably interested parties are able to access the written reasons for judgment in a particular case. As a result, in relation to non-material damages for motor TPL, claimants, lawyers, insurers and other members of the judiciary have

no ability to refer to other cases in order to forecast or determine what might be a reasonable result in a particular set of circumstances.

A sample review of motor TPL cases has shown that in Macedonian:

- Average awards made by courts are considerably higher than those achieved in out of court settlements by insurance companies.
- There is considerable variation in the amount of damages for claims that appear to be of similar severity.
- Awards for minor injuries appear to be high relative to the awards for moderate and serious injuries.

In addition, the long term viability of any motor TPL system depends upon the ability of insurers to continue to provide the product to motorists at an affordable price.

A lack of consistency in compensation awards for non-material damages is problematic for insurers. In an environment of considerable uncertainty, insurers cannot properly undertake prudent reserving for future claims and can not uniformly adjust claims, practices and procedures to reduce the extent of litigation and expedite early settlement of claims.

Uncertainty over future claims costs also complicates the actuarial determination of a fair premium.

II. THE PURPOSE OF THE CLAIMS CRITERIA

The primary purpose of the Claims Criteria is to assist the judiciary, insurance companies and lawyers to determine non-material damages in motor TPL to achieve fair treatment of each claim.

The Criteria achieve this aim by providing transparent guidance on how different claims should be treated. This will assist the judiciary of Macedonia to evaluate claims in order to make awards which are fair and predictable. This will also inform litigants who seek to settle out of court on what might form a reasonable claim for damages.

The Criteria are also designed with the following aims in mind.

- Adequate compensation of the most seriously injured is the first priority
- Affordability of the premium for motorists is a nearly equal priority since it ultimately determines what amounts of funding are available for all the scheme costs
- Compensation for minor injuries is limited to maintain the required balance.

The guidelines in the Criteria are not exhaustive and do not present the judiciary with a particular amount for any given case. It is necessary for the Criteria to be considered in light of the Law of Obligations which requires each case to be considered on its own facts.

III. INTERNATIONAL EXPERIENCE

The difficulties seen in Macedonia are not unique. Various approaches have been utilized by jurisdictions around the world to control the escalation of the levels of non-material damages in order to maintain a balance between the needs of fairness and affordability of the motor TPL system. Some of the mechanisms used are described briefly below.

A. Upper Limit

The Supreme Court of Canada first prescribed an upper limit for non-material compensation in catastrophic injury cases in 1978. The court observed:

“There is no medium of exchange for happiness. There is no market for expectation of life. The monetary evaluation of non-pecuniary losses is a philosophical and policy exercise more than a legal or logical one. The award must be fair and reasonable, fairness being gauged by earlier decisions; but the award must also of necessity be arbitrary or conventional. No money can provide true restitution”.

Rather than attempting to set a value on lost happiness, the Court adopted a functional approach and attempted to assess compensation that would provide the injured person with a reasonable measure of consolation for his misfortune. Except for adjustments for the cost of living, the upper limit set by the Court in 1978 has held to the present.

B. Thresholds

Some jurisdictions such as the Canadian province of Ontario and the Australian state of New South Wales have introduced a deductible system which precludes any monetary recovery for non-material damages falling below some threshold amount (e.g. Canadian \$10,000). This is considered to be equitable to all claimants since it applies in every case, is simple to administer and is easy for the public to understand. It removes the most minor claims, which are disproportionately expensive to litigate in light of the amount at stake, from the system. The savings attained through the deductible are justified as a reduction to the amount of insurance required to be paid by all motorists as well as a benefit that could be delivered to the more seriously injured.

C. Caps

The Australian state of New South Wales and Canadian provinces of Alberta, Nova Scotia and New Brunswick have implemented through legislation a system of caps. These are legislated monetary limits on the recovery of non-material damages which are considered minor. Each contains its own definition of an injury that does not result in permanent serious disfigurement or permanent serious impairment of an important bodily function. These caps were introduced as instruments of social policy to help control inflation in the cost of compulsory motor insurance.

D. Assessment according to a Tariff or Compensation Criteria

The assessment of compensation in Canada involves a rough scaling of the gravity of the injury compared to the upper limit. It also involves taking into account the individual circumstances of each case – how the victim has been affected by the injuries. The fairness of a non-material

compensation award for a less serious injury is gauged in large part by reference to earlier decisions which will generally establish an upper and lower range for awards in the same class of case. Damages are normally fixed within those limits although Courts can exceed them in one direction or the other when the evidence in an individual case justifies such a result. Where precisely the damages should fall will depend on individual factors including the need for solace and any adjustments for inflation.

In 1999 the Australian state of New South Wales introduced a more restrictive legislative tariff for non-catastrophic personal injury claims after a negotiated reform process was undertaken and input for the legislative reforms was secured from all service providers and a member of the judiciary.

In 2003, several jurisdictions in Canada introduced for the first time a legislative tariff for minor personal injury claims in motor accident cases, as a further effort to balance the needs for fairness and cost affordability competing social needs discussed above.

In 2003, the Supreme Court of Croatia adopted compensation criteria for the broad spectrum of motor insurance injuries occurring in its Republic. The Croatian criteria define categories of non-pecuniary damages and establish monetary compensation levels for each such category. The Croatian experience may be indicative of a more appropriate compensation model for the Balkan region since their claims criteria are reportedly very effective to date in achieving the twin goals of equitable treatment of claimants and maintaining the stability of the system.

Balancing fair outcomes, cost and stability of insurance systems is an ongoing requirement. The approach being developed in Macedonia combines the best elements of the internationally known practical examples and the conceptual innovations currently under consideration.

IV. CONCLUSION

In Macedonia, the adoption of the Claims Criteria by the judiciary when considering damages for motor TPL will help to achieve the goals of equity, affordability and stability in the motor TPL system.

If the judiciary is prepared to utilize the Claims Criteria as guidelines to their adjudications, they will contribute to a balanced motor TPL compensation delivery system that will provide significant benefits to all participants in the motor TPL insurance system.

D Sample of Non-Material Damages Claims

D.1 Information Provided

A sample of 92 recently settled claims was provided from one major insurer (QBE) to assist in developing the claims criteria. The sample requested focuses on claims that received some non-material damages for personal injury – say non-material damages in excess of Euro 500, and the claims were representatively selected from various levels of litigation proceedings in the court.

The ‘out of court’ claims should be representative of all of QBE’s out of court settlements, and similarly with the ‘court verdict’ claims. However, the mix of ‘out of court’ and ‘court verdict’ claims is probably not representative of the overall claims population because of the way the sample was constructed.

Out of the sample of 92 claims, 8 claims have been removed as 6 claims were duplicated and 2 claims did not receive any non-material damages, and 2 claims were added as there were multiple injured individuals in each claim. Overall, 86 claims were included in the analysis.

Details of each of the claims include the following information:

- Claim number (for reference purposes)
- Date of the accident
- Date of report of the claim to the insurer
- Date of settlement of the claim
- Brief description of the accident giving rise to the claim
- Age of the injured person
- Gender of the injured person
- Employment status of the injured person at the time of the accident
- Approximate monthly earnings from employment of the injured person at the time of the accident
- Description of the injuries to the injured person in the accident
- Description of any continuing medical problems caused by the accident still persisting at the time of settlement
- Period of time in hospital following the accident (days)
- Economic damages for property damage in the claim
- Economic damages for loss of earnings, medical or other expenses in the claim
- Non-material damages paid in the claim

- Legal costs etc paid to the injured person in addition to the damages
- Legal costs etc of the insurer in defending the claim
- Did the injured person have a lawyer represent them for the claim?
- Brief description of the stage in the legal process at which the claim was settled (e.g. court proceedings not issued, proceedings issued by not started, before court hearing commenced, during court hearing, judgement issued by court, after court appeal)
- Did the insurer make an offer of damages before the claim was settled?
- How much did the insurer offer for non-economic damages?
- Did the injured person claim for a particular amount of non-economic damages?
- How much did the injured person claim for?
- How did the amount of the settlement for non-economic damages compare with what the insurer thinks would be normal for a claim of this nature?
- What do you think were the reasons that the settlement was more or less than normal?

D.2 Number of Claims in Sample

Table D.1 - Number of Claims According to Legal Levels

Legal Level	No of Claims	% of Total
Out of Court		
No action started	56	
Before court	2	
	58	67%
Court determination		
First Instance Court	13	
Second Instance Court	15	
	28	33%
Total	86	

Table D.1 shows the number of claims in the sample according to the legal proceedings levels. About two-thirds of the sampled claims were settled out of court. This sample of 58 claims is a reasonable size for analysis. About one-third of the sampled claims went to court. This sample of 28 claims is smaller than would be desirable. This sample mix of claims does not necessarily reflect the actual mix of claims, which is believed to be more heavily weighted to court determinations.

D.3 Fatal and Non-Fatal Claims

Fatal claims refer to death claims, and are analysed separately. Most of the remaining analysis excludes fatal claims unless otherwise stated.

Table D.2– Fatal and Non Fatal Claims in Sample

Legal Level	Number of Claims in Sample		Non-Material Damages (MKD)	
	Fatal	Non-Fatal	Fatal	Non-Fatal
Out of Court	8	48	254,000	375,000
Court Determination	5	25	1,126,000	895,000
Total	13	73	589,000	553,000

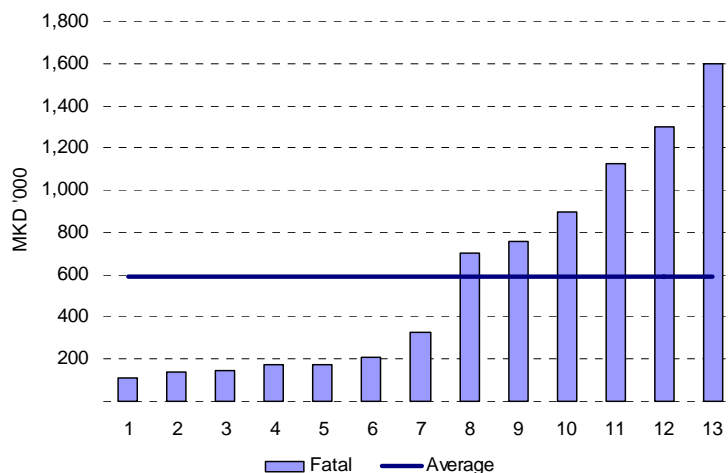
Out of the 86 sampled claims, there are 13 fatal claims. The average non-material damages for fatal claims is only marginally higher than non-fatal claims. This differential in non-material damages is higher for claims with court determination. Non-material damages for fatal claims with court determination is 25% higher than non-fatal claims with court determination, as compared to 6% on overall level.

Table D.3 lists the 13 individual fatal claims with the legal level and non-material damages. Fatal claims with court determination have significantly higher non-material damages benefits.

Table D.3– Fatal Claims

Fatal Claims	Legal Level	Non-Material Damages (MKD)
1	OOC	108,000
2	OOC	140,000
3	OOC	144,000
4	OOC	175,000
5	OOC	175,000
6	OOC	210,000
7	OOC	324,000
8	FIC/SIC	700,000
9	OOC	756,000
10	FIC/SIC	900,000
11	FIC/SIC	1,129,000
12	FIC/SIC	1,300,000
13	FIC/SIC	1,600,000
Average		589,000

Figure D.1 – Average Non-Material Damages for Fatal Claims



Almost half of the fatal claims were settled for less than MKD 200,000. Three of the thirteen fatal claims received in excess of MKD 1 million in non-material damages.

D.4 Analysis of Non-Fatal Claims in Sample

Summary of Average Claim Size

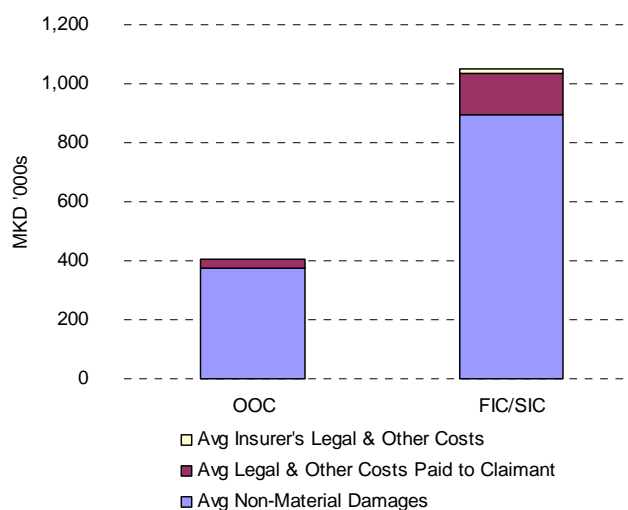
Table D.4 - Summary of Average Claim Size by Legal Levels

	Legal Proceedings Level		
	OOO	FIC/SIC	All
	(MKD)	(MKD)	(MKD)
Average Non-Material Damages	375,300	895,300	553,400
Average Legal & Other Costs Paid to Claimant	1,700	121,500	42,800
Average Insurer's Legal & Other Costs	300	5,500	2,100
Total	377,300	1,022,300	598,300

Table D.4 shows the average claim sizes for Non-Fatal claims by legal levels, broken down into non-material damages, legal costs paid to claimant and legal costs incurred by insurer. Average claim sizes for court determined claims are higher than 'out of court' claims for both non-material damages and legal costs.

The Insurer's costs are low because QBE employs its own lawyers and medical experts to represent the company in court actions.

Figure D.2 – Average Costs According to Legal Levels



Although claims with court determination have higher average claim size, the mix of claim types in each legal level is not necessarily similar. Claims with high severity of injuries are more likely to obtain court verdicts. Hence, the higher average claim size for claims with court determination can be due to the higher proportion of high severity claims in the court determination claims.

There are two ways of analysing severity of injuries:

- The severity coding by consultants based on injury description (minor, moderate, major)
- Number of days spent in hospital

Injury Severity Category

Each claim was categorised to an Injury Severity Category (Minor, Moderate, Major and Fatal) according to the injury description provided in the sample. For each Injury Severity Category, the average non-material damages are higher for FIC/SIC legal levels.

Table D.5 - Average Non-Material Damages by Injury Severity

Legal Level	Injury Severity Category		
	Minor	Moderate	Major
OOO	187,000	412,000	727,000
FIC/SIC	210,000	567,000	1,430,000
Average	194,000	439,000	1,289,000

Figure D.3 - Average Non- Material Damages by Injury Severity Category

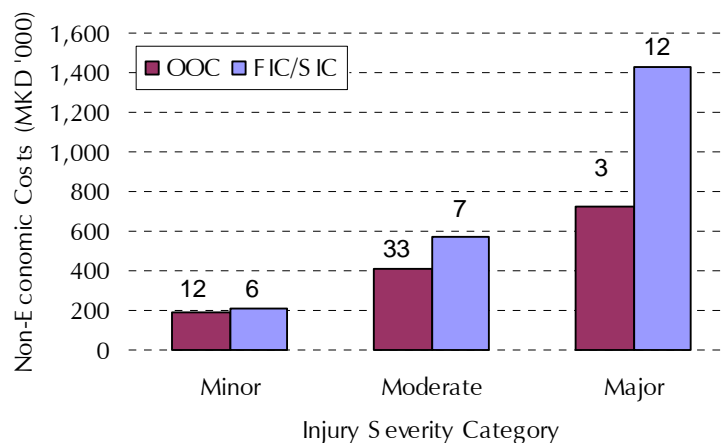
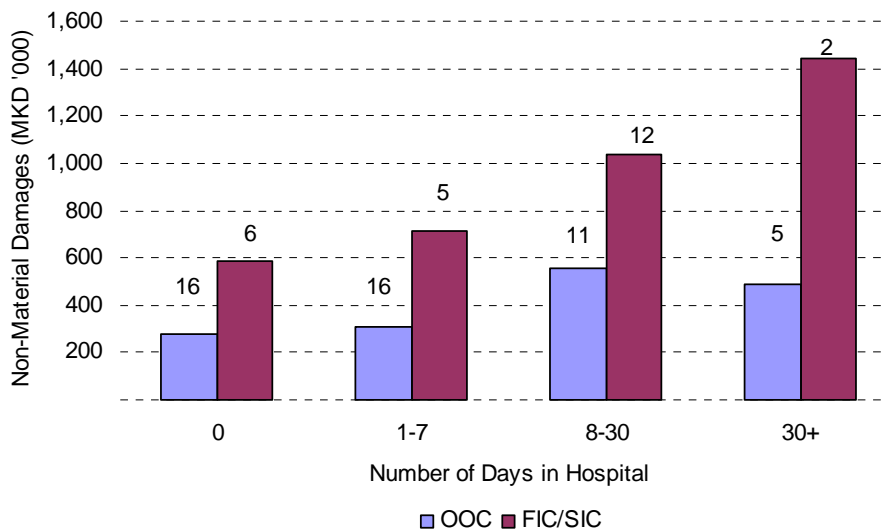


Figure D.3 shows that out of 15 major claims of the sample, 80% of the claims went to court, as compared to 22% for minor and moderate claims. This confirms the higher average claims size of court determined claims is partly due to the higher proportion of more severe claims. Within each group the awards are higher for claims that went to court, although the difference in the Minor severity claims is small.

Number of Days in Hospital

The number of days spent in hospital may not be a good indicator of severity at an individual claim level, but it is a useful objective indicator at an average or overall level. Out of the 48 non-fatal ‘out of court’ claims in the sample, two-thirds of the claims spent less than 7 days in hospital, as compared to 44% of the 25 court determination claims. Court determination claims spent on average 20 days in hospital as compared to 16 days for ‘out of court’ claims.

Figure D.4 - Number of Days in Hospital vs. Non-Material Damages



Within each grouping by 'days in hospital' the claims that went to court received significantly higher damages than the claims that settled out of court.

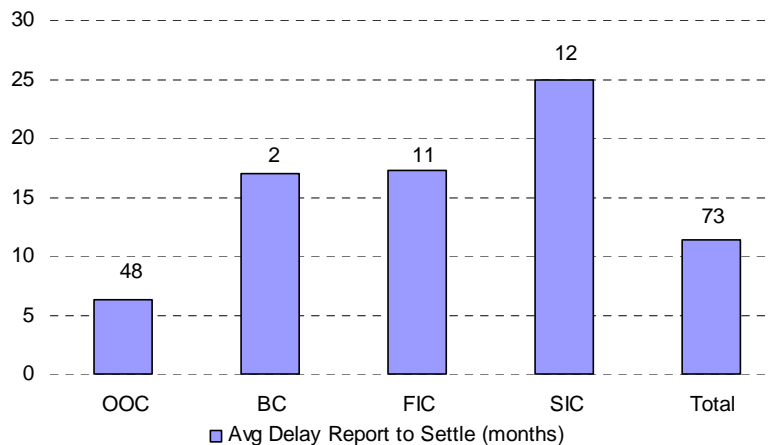
Delay Report to Settle (months)

Table D.6 - Average Delay Report to Settle (months) by Legal Proceedings Level

Legal Level	Avg Delay Report to Settle (months)
OOC	6
BC	17
FIC	17
SIC	25
Total	11

Table D.6 shows the average delay of months from date of report to date of finalisation. The court determination claims have a higher delay as expected.

Figure D.5 - Delay Report to Settle (months) by Legal Level



Delay to Report (months)

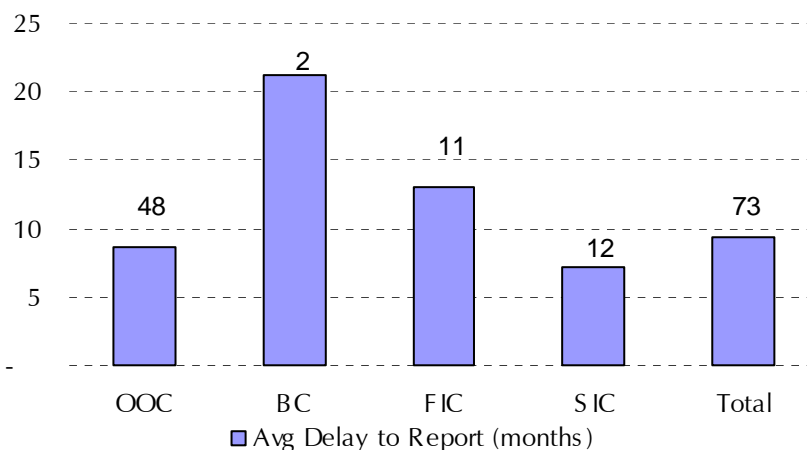
Table D.7 - Average Delay to Report (months) by Legal Proceedings Level

Legal Level	Avg Delay to Report (months)
OOC	9
BC	21
FIC	13
SIC	7
Total	9

Table D.7 shows the average delay from accident to report (months) by legal levels. Delay to report for both ‘out of court’ and court determined claims are in line with average of 9 months. This average reporting delay is too long for an effective motor accidents scheme.

The 2 claims settled before court had a high delay to report of 21 months due to the previous practice of some lawyers of holding back the claim then starting court action before notifying the insurer. This is no longer possible under the new law.

Figure D.6 – Delay to Report (months)



Appeals Outcomes - FIC vs. SIC

Out of 28 court determined claims (including 3 fatal claims), 15 claims were appealed and determined at a Second Instance Court (SIC). Table D.8 lists the claims which went to SIC and the outcome of the appeals.

Table D.8 – Claims settled SIC

Sample Number	Amount Offered	Amount Requested	Amount of FIC Outcome	Amount Paid	Appeal Outcome
1	789,600	2,450,000	1,420,000	1,420,000	Unchanged
18		2,700,000	825,000	625,000	Lower Amount
19		1,250,000	730,000	730,000	Unchanged
22		3,200,000	3,000,000	1,600,000	Lower Amount
23		1,200,000	650,000	650,000	Unchanged
24		1,800,000	900,000	900,000	Unchanged
24A		400,000	250,000	180,000	Lower Amount
27	250,000	1,400,000	1,040,000	530,000	Lower Amount
28		1,800,000	1,118,000	700,000	Lower Amount
30			900,000	1,150,000	Higher Amount
31	42,000	195,000	65,000	65,000	Unchanged
61	180,000	1,400,000	1,300,000	1,300,000	Unchanged
80		450,000	225,000	225,000	Unchanged
90		2,500,000	1,470,000	1,470,000	Unchanged
91		1,400,000	720,000	720,000	Unchanged
Average	84,000	1,476,000	974,000	818,000	

Table D.9 - Appeal Outcome

Appeal Outcome	No of Claims	Avg Non-Material Damages
Lower	5	727,000
Higher	1	1,150,000
Unchanged	9	831,000
Total SIC	15	818,000

Table D.9 shows that around two-thirds of claims which went to SIC had no change in outcome. Five had the damages amount reduced and one increased.

Table D.10 – Average Non-Economic and Legal Costs for FIC/SIC

Legal Level	Avg Non-Material Damages	Avg Legal & Other Costs Paid to Claimant	% of Non-Material Damages	Avg Insurer's Legal & Other Costs	% of Non-Material Damages
FIC	1,131,000	150,000	13%	-	0%
SIC	722,000	122,000	17%	12,000	2%

Table D.10 shows that this insurer does not obtain external legal advice for claims at FIC, hence there were no legal costs incurred. The costs awarded to the claimant average about 15% of the non-material damages awarded.

E Draft By-Law for the Calculation Of Technical Reserves

Article 1

Purpose and Scope

A. The purpose of this by-law is:

- a. To lay down detailed rules and minimum standards on the Technical Reserves that insurance undertakings are required to establish in order to cover their financial commitments.
- b. To determine, in accordance with Articles 80-85 of Law 27/2002, the technical bases, methods and manners for the calculation of Technical Reserves, which are to be established in the annual accounts of all insurance undertakings in Macedonia.

B. The establishment of Technical Reserves by insurance undertakings is compulsory. Insurance undertakings must submit annual accounts and quarterly returns to the Insurance Supervision Department (ISD) of the Ministry of Finance setting out the amount, calculation and investment of the Technical Reserves for the preceding year to date. These returns must be signed by duly authorized persons in accordance with Art. 105 of Law 27/2002.

Article 2

Technical Reserves

A. The requirements for establishing Technical Reserves for insurance undertakings are set out in Schedules to this by-law.

Schedule 1 – Definitions

Schedule 2 – Non-life insurance – Technical reserves on premiums carried forward (unearned premiums) and Deferred Acquisition Costs

Schedule 3 – Non-life insurance – Technical reserves for claims outstanding, including IBNR and claim handling expenses

Schedule 4 – Non-life insurance – Technical reserves for unexpired risks

Schedule 5 – Non-life insurance – Equalisation reserve

Schedule 6 – Non-life insurance – Reserve for Discounts and Rebates

Schedule 7 – Life Insurance – Mathematical reserves

Schedule 8 – Life Insurance – Other Technical Reserves

- B. Each non-life insurance undertaking must comply with schedules 1, 2, 3, 4, 5 and 6.
- C. Each life insurance undertaking must comply with schedules 1, 7 and 8.

Article 3

Data notification - methods of calculation

- A. For the purposes of verifying compliance with the provisions laid down in this by-law, all insurance undertakings are required to notify the ISD the technical bases used for calculating Technical Reserves. This notification is to be provided to the ISD with the insurance undertakings annual accounts.
- B. The method of calculation of the Technical Reserves shall not be subject to discontinuities from year to year arising from arbitrary changes to the method or the bases of calculation and shall be such as to recognise the distribution of profits in an appropriate way over the duration of each policy.

Article 4

Penalties

Breach of any of the provisions of this by-law shall entail administrative and/or criminal penalties.

Article 5

Transitional provisions

- A. This by-law shall be effective from 31 December 2007.
- B. As a transitional measure, each insurance undertaking shall undertake a road test of the by-law by applying the calculations as if the by-law were effective from 31 December 2006.
- C. Each insurance undertaking shall report to the ISD before 31 May 2007 with:
 - a. The results of the road test as at 31 December 2006.
 - b. An explanation of any aspects of the by-law that the insurance undertaking expects it will be unable to comply with at 31 December 2007.
 - c. Proposals for any amendment to this by-law, and in particular the Schedules.
 - d. If required, a preliminary request for further transitional relief after 31 December 2007.

D. It is the intention of the ISD to consult with insurance undertakings about the road test results and to recommend any required amendments to the Minister so that amendments may be made to this by-law before 31 December 2007.

E. Following the publication of amendments, or by 30 September 2007 (whichever comes first), an insurance undertaking may make a final request to the ISD for further transitional relief after 31 December 2007.

F. The ISD shall consider any request for further transitional relief and may grant, deny or vary a request as it sees fit, and shall notify the insurance undertaking of its decision about further transitional relief as soon as practicable and in no event later than 30 November 2007.

Schedule 1

Definitions

A. For the purposes of this by-law, including the Schedules, the following terms are defined:

a. “Acquisition Costs” shall comprise the costs arising from the conclusion of insurance contracts. They shall cover both direct costs, such as acquisition commissions or the cost of drawing up the insurance document or including the insurance contract in the portfolio, and indirect costs, such as advertising costs or costs connected with the processing of proposals and the issuing of policies. Levies for the guarantee fund, insurance supervision, fire prevention, traffic safety and the like that become a liability when the insurance contract is entered to shall be regarded as part of Acquisition Costs.

b. “Administrative Expenses” shall include the costs arising from premium collection, portfolio administration, handling of bonuses and rebates, and processing of inward and outward reinsurance. They shall in particular include staff costs and depreciation reserves in respect of office furniture and equipment in so far as these need not be shown under Acquisition Costs, claims incurred or investment charges.

c. “Equalisation Reserve” has the meaning given to it in Schedule 5 of this by-law.

d. “Gross Earned Premium” shall be equal to the Gross Premium Written plus the Gross Unearned Premium at the start of the period less the Gross Unearned Premium at the end of the period.

e. “Gross Premium Written” shall comprise all amounts due in respect of insurance contracts entered into during the financial period regardless of the fact that such amounts may relate in whole or in part to a later financial year, and shall include, but not be limited to:

(i) premiums yet to be written, where the premium calculation can be done only at the end of the year;

- (ii) in non-life insurance, premiums for the full duration of the term of the insurance contract, even if such premiums are payable in instalments;
- (iii) single premiums, including annuity premiums;
- (iv) in life insurance, single premiums resulting from bonus and rebate reserves in so far as they must be considered as premiums on the basis of contracts;
- (v) additional premiums in the case of half-yearly, quarterly or monthly payments and additional payments from policyholders for expenses borne by the insurance undertaking;
- (vi) in the case of co-insurance, the undertakings portion of total premiums;
- (vi) reinsurance premiums due from ceding and retroceding insurance undertakings, including portfolio entries, after deduction of portfolio withdrawals credited to ceding and retroceding insurance undertakings, and cancellations;

The above amounts shall not include any amount of taxes or charges levied with premiums. Levies for guarantee fund, insurance supervision, fire prevention, traffic safety and the like shall not be regarded as taxes and charges for this purpose.

f. “Gross Unearned Premium” shall comprise the amount determined in accordance with Schedule 2, before any deduction for reinsurance.

g. “Mathematical Reserve” has the same meaning as “Mathematical Provision” for the purposes of accounting administration and has the meaning given to it by Schedule 7 of this by-law.

h. “Outstanding Claims Reserve” has the meaning given to it in Schedule 3 of this by-law.

i. “Reserve for Discounts and Rebates” has the meaning given to it by Schedule 6 of this by-law.

j. “Technical Reserve” has the same meaning as “Insurance Technical Reserve” for the purposes of accounting administration.

i. For non-life insurance undertakings, the Technical Reserves are made up of the Unearned Premium Reserve, Outstanding Claims Reserve, Unexpired Risk Reserve, Equalisation Reserve and the Reserve for Discounts and Rebates.

ii. For life insurance undertakings, the Technical Reserves are made up of the Mathematical Reserve and Other Technical Reserves.

k. “Unearned Premium Reserve” has the meaning given to it in Schedule 2 of this by-law.

l. “Unexpired Risk Reserve” has the meaning given to it by Schedule 4 of this by-law.

Schedule 2

Technical Reserves on premiums carried forward (unearned premiums) and deferred Acquisition Costs

A. According to Article 81 of Law 27/2002, a Technical Reserve on premiums carried forward (Unearned Premium Reserve) comprises the amount representing that part of the Gross Premium Written and Administrative Expenses which are to be allocated to subsequent financial years to cover claims and expenses for the period from the reporting date to the end of the duration for which the contracts are written, less allowance for reinsurance ceded.

B. The Unearned Premium Reserve is to be calculated pro rata on a “contract by contract” basis and formed separately for each class of insurance.

C. The reserve is calculated according to the following formula:

$$\text{UPR} = P * \frac{\text{RD}}{\text{TD}}$$

Where:

“P” = Gross Written Premium for the contract

“RD” = days remaining from the reporting date until the end of the insurance contract

“TD” = Total days that the insurance contract is expected to be in force

“UPR” = Unearned Premium Reserve

D. Where, for any reason, an insurance undertaking believes that it cannot calculate its Unearned Premium Reserve in accordance with the formula set out at paragraph C, at least three months prior to the date at which the insurance undertaking is required to submit its annual accounts to the ISD, the insurance undertaking must make a submission setting out in detail why the method set out at paragraph C cannot be used and must propose an alternative method of calculation. The ISD may reject or approve the submission (including the alternative method proposed for calculation) or alternatively prescribe another method which the insurance undertaking must comply with to calculate its Unearned Premium Reserve. The ISD must provide advice of its decision to the insurance undertaking within one month of having received the submission from the insurance undertaking.

E. Especially in the case of Class 7 of Article 5 of Law 27/2002 (“Insurance of goods in transportation”), this Technical Reserve is determined at the rate of 0.20 of Gross Premium Written at this class in the respective financial year.

Schedule 3

Technical Reserves for claims outstanding, including IBNR and claim handling expenses

A. In accordance with Article 83 of Law 27/2002, the reserve for claims outstanding (Outstanding Claims Reserve) shall be the total estimated cost to an insurance undertaking of

settling all claims arising from events which have occurred up to the end of the financial year, whether reported or not, less amounts already paid in respect of such claims. Deduction is to be made for amounts expected to be recovered from reinsurance.

B. The Outstanding Claims Reserve is made up of:

a. The costs expected to arise for each claim reported to the insurance undertaking prior to the reporting date where those costs are yet to be paid by the insurance undertaking (reported but not settled “RBNS”). These costs are to be established separately for each claim and by each year of accident. The year of accident shall be the financial year in which the event giving rise to the claim occurred.

b. Claims incurred but not reported (“IBNR”) by the reporting date. These costs are to be established separately for each year of accident. The year of accident shall be the financial year in which the event giving rise to the claim occurred.

c. Claims handling expenses sufficient to cover the expenses of the insurance undertaking in settling both the RBNS and the IBNR claims.

d. Less any amounts recoverable through the acquisition of the rights of policyholders with respect to third parties (subrogation) or of the legal ownership of insured property (salvage). Recoverable amounts shall be estimated on a prudent basis and, where such amounts are material, they shall be disclosed in the notes to the accounts of the insurance undertaking.

C. Where benefits resulting from a claim must be paid in the form of annuity, the amounts to be set aside for that purpose shall be calculated by recognised actuarial methods.

D. Implicit discounting or deductions, resulting from the placing of a present value on the Outstanding Claims Reserve, is prohibited, except in the case of annuity claims.

E. For an insurance undertaking that has been writing a class of business for a period less than two complete years, IBNR shall be set according to the following formula:

$$IBNR = \max((ULR * GEP) - RBNS - GCP, 0)$$

Where:

“ULR” = the ultimate loss ratio for Technical Reserves for the class of business established by the ISD.

“GEP” = Gross Earned Premium for the class of business since the company began writing the class.

“GCP” = gross claims paid for the class of business since the company began writing the class.

G. For an insurance undertaking that has been writing a class of business for two complete years or longer, the reserve for IBNR shall be set according to the following formula:

$$IBNR = \sum_{i=1}^{12} IBNR_i$$

Where:

“IBNR_i” = the IBNR for the quarterly period that is the *i*th quarter prior to the reporting date. For some classes of business, the IBNR is only needed for 4 quarters prior to the balance date, while for some classes it is required for 12 quarters.

$$IBNR_i = GEP_i * IBNRF_i$$

Where:

“GEP_i” = the Gross Earned Premium for the class of business during the *i*th quarter prior to the reporting date

“IBNRF_i” = IBNR reserving factors for the class of business and relevant quarter as established by the ISD.

H. An insurance undertaking that has been writing a class of business for at least five years, may, with the agreement of the ISD obtained at least three months prior to the reporting date, establish the IBNR by a recognised actuarial method taking into account the experience of the insurance undertaking.

I. Where an insurance undertaking is authorised to use a recognised actuarial method to calculate its IBNR, the insurance undertaking must submit to the ISD a report from its actuary with its annual accounts. This statement must document how the IBNR was the determined.

Schedule 4

Technical reserves for unexpired risks

A. Pursuant to Article 85 of Law 27/2002, a Technical Reserve is to be set aside in respect of claims and expenses in connection with insurance contracts in force at the end of the financial year where those claims and expenses are expected to be in excess of the related unearned premiums and any premiums receivable on those contracts (Unexpired Risk Reserve).

B. Where the amount of the Unexpired Risk Reserve is material, it shall be disclosed separately either in the balance sheet or in the notes to the accounts of an insurance undertaking.

C. The Unexpired Risk Reserve shall be calculated on the basis of claims and Acquisition Costs likely to arise after the end of the financial year relating to contracts concluded before that date, in so far as their estimated value exceeds the Unearned Premium Reserve and any premiums receivable under those contracts.

Schedule 5

Equalisation reserve

A. In accordance with Article 85 of Law 27/2002, each undertaking established in the country and underwriting “credit insurance” is obliged to set up an equalization reserve for the purpose of offsetting any technical deficit or above-average claims ratio arising in that class for a financial year.

B. One of the following methods of calculating the equalization reserve can be selected, all being equivalent.

a. The reserve shall in each financial year receive 75% of any technical surplus arising on credit insurance business, subject to a limit of 12% of the net premiums or contributions until the reserve has reached 150% of the highest annual amount of the net premiums or contributions received during the previous five financial years.

b. The minimum amount of the equalization reserve shall be 134% of the average of the premiums or contributions received annually during the previous five financial years after the subtraction of the cessions and the addition of the reinsurance acceptancies. Such reserve in each of the successive financial years receive 75% of any technical surplus arising in that class until the reserve is at least equal to the minimum calculated in accordance with the previous sentence.

C. All calculations shall relate to income and expenditure for the insurance undertaking’s own account. An amount in respect of any claims shortfall for each financial year shall be placed to the equalization reserve until it has reached or it restored to, the required amount.

D. There shall be deemed to be a claims shortfall if the claims ratio for a financial year is lower than the average claims ratio for the reference period. The amount in respect of the claims shortfall shall be arrived at by multiplying the difference between the two ratios by the Gross Earned Premium for the financial year. The required amount shall be equal to six times the standard deviation of the claims ratios in the reference period from the average claims ratio, multiplied by the Gross Earned Premium for the financial year.

E. Where claims for any financial year are in excess, an amount in respect thereof shall be taken from the equalization reserve. Claims shall be deemed to be in excess if the claims ratio for the financial year is higher than the average claims ratio. The amount in respect of the excess claims shall be arrived at by multiplying the difference between the two ratios by the Gross Earned Premium for the financial year.

F. Irrespective of the claims experience, 3.5% of the required amount of the equalization reserve shall be first placed to that reserve each financial year until its required amount has been reached or restored. The length of the reference period shall not be less than 15 years and not more than 30 years. No equalization reserve need be formed if no underwriting loss has been noted during the reference period. The required amount of the equalization reserve and the amount to be taken from it may be reduced if the average claims ratio for the reference period in conjunction with the expenses ratio show that the premiums include a safety margin.

Schedule 6

Reserve for discounts and rebates

A. The Reserve for Bonuses and Rebates comprises amounts intended for policyholders or contract beneficiaries by way of bonuses and rebates to the extent that such amounts have not been credited to policyholders or contract beneficiaries (net of reinsurance).

B. Bonuses comprise all amounts chargeable for the financial year which are paid or payable to policyholders and other insured parties or provided for their benefit, including amounts used to increase Technical Reserves or applied to the reduction for future premiums, to the extent that such amounts represent an allocation of surplus or profit arising on business as a whole or a section of business, after deduction of amounts provided in previous years which are no longer required.

C. Rebates comprise such amounts to the extent that they represent a partial refund of premiums resulting from the expiry of individual contracts.

D. Where material, the amount charged for bonuses and that charged for rebates shall be disclosed separately in the notes to the accounts.

E. The Reserve for Bonuses and Rebates shall be calculated by approximation methods.

Schedule 7

Life Insurance - Mathematical Reserve

A. The Mathematical Reserve is concerned with life assurance activities falling in classes 19 and 20 of Article 5 of Law 27/2002. It is calculated on a contract by contract basis in the insurance year t under the following technical bases.

- a. tV = Mathematical Reserve at the end of the (t) Policy Year.
- b. Guaranteed technical interest rates: For the calculations referred hereto the guaranteed technical interest rates cannot be higher than 3%. In the case of assurance with a lump sum premium and duration shorter than seven years, the guaranteed technical interest

rate shall be equal to the yields of public bonds, provided that the respective Technical Reserves are invested in this kind of bonds.

B. The Mathematical Reserve is formed and registered in the annual accounts as annual accounts Mathematical Reserve $t+1/2V$ and is calculated under the following three methods:

a. When Acquisition Costs are paid in a time period shorter than the time period for cashing premiums.

$$t+1/2V = \frac{1}{2} * (tV+t+1V) + UPR(tx)$$

$$t=0, 1, 2, \dots\dots$$

Where:

“UPRx” = Unearned Premium Reserve at the end of the (x) year

C. The above Mathematical Reserve is formed separately for each insurance class and registered in the chart of accounts under “Liabilities” and is analysed in the Notes to the annual accounts.

D. For the Acquisition Costs paid or brought forward at the time of closure of annual accounts, the following principles are applied.

a. For each contract the Acquisition Costs cannot exceed 6% of the Gross Premium Written multiplied by the number of years to be paid (n) and not higher than 1.5 yearly Gross Premium Written.

b. The Acquisition expenses carried forward are calculated at the closure of the annual accounts on a contract by contract basis, according to the following mathematical type:

$$t+1/2AAC = \frac{tAAC+t+1AAC}{2} \quad / \quad t = 0, 1, 2, \dots\dots$$

tAAC= Acquisition expenses brought forward at the end of the (t) policy year

c. When the payment of Acquisition expenses is spread over the time period for cashing premiums.

$$t+1/2V = \frac{1}{2} * (tV+t+1V) + UPR(tx) \quad / \quad t=0, 1, 2, \dots\dots$$

The Acquisition expenses brought forward, which are invested cannot be higher than 0,10 of UPR(tx) in the case of group insurance and 0,30 of the UPR(tx) in the case of personal insurance.

d. When premiums are prepaid (lump sum).

$$t+1/2V = \frac{1}{2} * (tV+t+1V) + \frac{1}{2} * (tPVEX + t+1PVEX) \quad / \quad t=0, 1, 2, \dots\dots$$

$tPVEX$ = the present value of Administrative Expenses, incurred during the t year

D. Where the surrender value of a contract is guaranteed, the amount of the Mathematical Reserve for the contract at any time shall be at least as great as the value guaranteed at that time.

E. In the case of cancellation, the Mathematical Reserve will be calculated under the following method:

$$tCV = f * (tV - tAAC)$$

tCV = "Cancelled Value", i.e. the amount paid to the policyholder at the end of the (t) year if he cancels then his policy

f = a cancellation penalty factor depending on the years of the contract. It cannot lower than 0,90

$tAAC$ = Acquisition expenses brought forward at the end of the (t) policy year

c.If cancellation takes place sometime between t and $t+1$, the surrender value is calculated as follows:

$$t+1/2CV = \frac{tCV + t+1CV}{2}$$

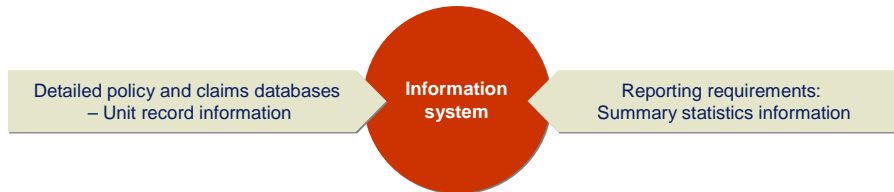
Schedule 8

Life Insurance – Other Technical Reserves

F Draft Information Systems Standard

Data collectioning standards

Strengthening collectioning of data – workplan



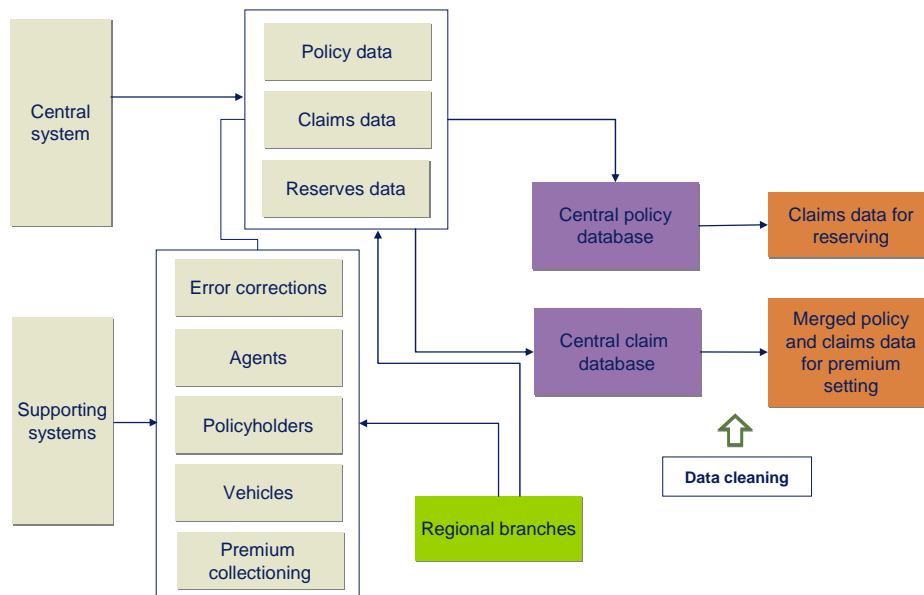
- Designing suitable policy and claim information system
- Designing suitable supervision reporting standards
- Carry out training on data collectioning

Data collectioning standards

Policy and claims data collectioning – general remarks

- every insurance company should collect detailed information about policies written and claims reported
- policy and especially claim data should be kept in the form of register - history of every change in dataset should be kept together with particular date of change
- different sorts of data should be stored in separate databases – then merged
- policy and claim data should be kept in databases – Access, SAS, Oracle, SQL Server
- policy and claim data storing standards should be regulated by law
- it is extremely important that none of data is overwritten!

Data collectioning standards



Data collectioning standards

Rules of data collectioning

One change – one record

- Any change in the dataset should be documented by separate record:
 - new business policy, policy cancellation, policy renewal
 - changes in policyholder characteristics
 - bonus-malus system register
 - premium collectioning (instalments)
 - claims – payments, initial reserve, any change of reserve due to payments or reestimation
 - correction of errors

Easy merging of data

- Identifiers that enable data merging:
 - merging policies and claims
 - merging policies with different types of coverage, e.g. packages, MTPL domestic and GC

Homogenous datasets

- Data related to different aspects of insurance activity should be kept in separate datasets
- Then merging should be possible

Data collectioning standards

Two aspects of data collectioning standards

Data requirements for premium rating	Data requirements for reserving
<ul style="list-style-type: none"> • claim details – amounts paid, amounts reserved • policy details – risk factors, exposure • possibility of merging claim and policy data • split by lines of business 	<ul style="list-style-type: none"> • claim details for RBNS reserving • claim details for IBNR reserving – claim dates • policy details for unearned premium reserving • other data, e.g. expenses • split by lines of business

Data collectioning standards

Supervision reporting standards – statistical reports

Example European contents of statistical reports – Poland and Slovenia	Current contents of Macedonian statistical reports
<p>Slovenia</p> <ul style="list-style-type: none"> Premium written gross and net of reinsurance Unearned premium reserve gross and net of reinsurance Claims paid gross and net of reinsurance Claim handling costs gross and net of reinsurance Recourses and recoveries gross and net of reinsurance Claim reserves gross and net of reinsurance Other reserves gross and net of reinsurance Equalisation reserve Summary of reserves <p>Poland</p> <ul style="list-style-type: none"> Number of policies and gross written premiums by 2 types of split: private / business and individual / group Number and amount of claims paid by 2 types of split: private / business and individual / group 	<ol style="list-style-type: none"> 1) Number and amount of settled claims and claim provisions in the current year (1999-2005), which are reported in particular year (1999-2005) or in the previous years by lines of business <ul style="list-style-type: none"> – This contents enables building claim triangles based on reporting year – How can we use these data? 2) Number of policies with k claims over time interval <ul style="list-style-type: none"> – What sort of claims – settled, reported or paid? – What is the time interval (0,t) ? – How can we use these data? 3) No policy exposure for claims!

Data collectioning standards

Supervision reporting standards – statistical reports

- Define the purpose of gathering these data!
- Contents of statistical reports to supervisory body is different in various European countries
- If the reports were planned to be used in tariffication we would recommend the following:
 - add exposure information
 - add risk factors information
 - add expenses and profits information
- If the reports were planned to be used in reserving we would recommend the following:
 - change the underlying structure from reporting period to accident period
 - collect data on changes in claim reserve, not reserve amount itself

Unit Record Information – Policies

There is a record on the database for each TPL, Green Card and Border Insurance policy issued by each insurance undertaking. The minimum requirements for the policy record for the purposes of the MTPL Commission are stated below. There may be other requirements for other purposes of the NIB or otherwise, so this list is not a complete definition of the information system requirements.

- Identity of insurance undertaking
- Type of policy (MTPL, Green Card, Border Insurance)
- Policy number identification
- Commencement date of policy
- Expiry date of policy
- Country of registration of the motor vehicle
- Registration number of the motor vehicle
- Premium tariff class of the motor vehicle
- Gross premium payable for the policy (taxes?)
- (rating factor information)

Unit Record Information – Claims

There is a record on the database for each motor TPL claim received by each insurance undertaking including the Damage Compensation Service of the NIB. The minimum requirements for the claim record for the purposes of the MTPL Commission are stated below. There may be other requirements for other purposes of the NIB or otherwise, so this list is not a complete definition of the information system requirements.

(Rules for multiple claimants)

(Different information for property damage and bodily injury?)

- Identity of insurance undertaking
- Claim number identification
- Policy details of the insurance policy against which the claim is made
 - ▶ <select from the policy list above the fields required>
- Date of accident
- Place of accident (codes?)
- Details of the claimant:
 - ▶ Nationality
 - ▶ Age at date of accident
 - ▶ Gender
 - ▶ Role in the accident
 - ▶ Nature of injuries (codes?)
- Amount paid for the claim:
 - ▶ Total
 - ▶ Material damages
 - ▶ Non-material damages
 - ▶ Defence costs (legal and investigation)
- Latest estimate of the amount yet to pay to finalise the claim
- Liability of the insurance undertaking
 - ▶ Not yet determined
 - ▶ Full liability
 - ▶ No liability
 - ▶ Percentage liability determined or agreed
- Whether the claim is open, closed or reopened

- Date the claim was reported to the insurer
- Date the claim was last closed
- Date the claim was last reopened

Summary Statistics – Policies

By policy type and tariff class:

- No of policies issued
- Total policy years issued
- Gross premium written
- Policy years earned
- Gross premium earned

Summary Statistics – Claims

By accident year

For period, YTD, life to date:

- Number of claims reported
- Amount of claims paid
- Number of claims open
- Total estimate of unpaid amount of claims

For tariff purposes, yearly tables as above by premium tariff class