

**Republic of Macedonia:
Compulsory Third Party Liability
System
Phase 1: Recommendations for
Reform**

**Ministry of Finance
Republic of Macedonia**

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MA Anita Angelovska-Bezoska
State Secretary
Ministry of Finance
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Dear MA Angelovska-Bezoska

Reform of the TPL Insurance System

It is our pleasure to enclose the report from Phase 1 of the technical assistance project for the reform of Macedonia's TPL Insurance System.

We wish to acknowledge the cooperation and assistance we received during our mission, both from the staff of the Ministry of Finance and from insurers and other stakeholders.

Yours sincerely



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cc: Mr Robert Woodbridge, FIRST Initiative
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Republic of Macedonia: Compulsory Third Party Liability System

Phase 1: Recommendations for Reform

Part I	Executive Summary	i
Part II	Detailed Findings	
1	Uninsured Vehicles	1
2	Distribution	4
3	Balancing Insurer, Motorist and Accident Victim Needs	8
4	Viability of Insurers	14
5	European Consistency and Other Systems of Insurance	16
Part III	Appendices	
A	Compliance with EU Directives	
B	Requirements in other European Jurisdictions	

Part I Executive Summary

1 Introduction

This report sets out the results of Phase 1 of a technical assistance project to reform the Macedonian law of compulsory third party liability insurance (TPL) for motor vehicles.

The World Bank financial sector assessment in May/June 2003 identified significant weaknesses in the Macedonian system of motor vehicle TPL.

At the request of the Republic of Macedonia's Ministry of Finance (MoF), the World Bank prepared a proposal for funding from the Financial Reform and Strengthening (FIRST) Initiative¹ to provide technical assistance to the MoF to enable the reform of the Macedonian motor vehicle TPL system. The Deloitte Emerging Market practice was engaged by the FIRST Initiative to undertake this project.

The reforms are to be contained within a new Law of Compulsory Insurance and Traffic.

During Phase 1, the project team considered alternative systems for the provision of motor vehicle TPL and consulted with stakeholders on options for the reform of the system.

The process of stakeholder consultation in Phase 1 included individual meetings with:

- Insurers participating in the Macedonian TPL market.
- The Macedonian Bar Association.
- The Macedonian Doctors' Chamber.
- The Ministry of the Interior, including the police service.

These meetings were followed by a group meeting involving all stakeholders at which draft recommendations were presented for consideration and discussion.

Phase 2 of the project will assist the MoF in the drafting of the new Law of Compulsory Insurance and Traffic. Phase 2 is to be completed by 31 December 2003.

The third and final Phase of the project will assist in the implementation of the new Law, including assistance in the preparation of by-laws and practical

¹ The FIRST Initiative is a multi-donor technical assistance financing facility.

implementation. Timing of Phase 3 will depend on the progress of the Macedonian Government and Parliament in adopting the proposed new Law.

2 Weaknesses in the TPL system

The key weaknesses which have been identified in the Macedonian motor vehicle TPL system are:

- A high level of uninsured drivers reducing the premium pool and placing a large burden on the guarantee fund.
- A distribution system that has not been updated to allow for the emergence of a competitive, multi-insurer environment.
- Large differences in the amount of damages for personal injuries between amounts offered by insurance companies and amounts awarded by Courts, leading to an increasing number of Court appeals, slow and expensive resolution of claims, escalation in the cost of claims and poor outcomes for motor accident victims.
- Premiums which are tightly controlled by Government and which do not take into account escalating claims costs. The current system, which does not balance tariff rates with claims payments is inherently unstable, and does not differentiate individual premiums according to risk.

3 Objectives

After consultations with stakeholders, the project team identified 10 objectives for a reformed system of motor vehicle TPL in Macedonia.

Objectives of TPL Reform

1. Ensuring that premiums are adequate to cover the cost of providing TPL
2. Ensuring that premiums remain affordable to the insuring public
3. Ensuring that motor accident victims are treated fairly and equitably
4. Improving compliance with European Union (EU) Directives
5. Reducing the number of uninsured vehicles
6. Encouraging the continued development of the Macedonian insurance market
7. Reducing the burden on courts and the judiciary in dealing with motor accident claims
8. Ensuring that the TPL system and practices surrounding this system do not undermine the financial viability of insurance companies
9. Ensuring that any reforms proposed are understandable to stakeholders and the community
10. Improving public confidence in the Macedonian insurance system

4 Recommendations

The project team considered each of the key components of the motor vehicle TPL system and identified issues in the existing system which may prevent the realisation of the objectives identified above. In these cases, the project team has recommended reform to help achieve the stated objectives.

Reducing Uninsured Vehicles

The protection of innocent victims of motor vehicle accidents is achieved by making TPL insurance compulsory in the Law. Uninsured drivers increase the cost of TPL insurance to all others through the operation of the guarantee fund. In accordance with the EU Directives, all reasonable steps should be taken to ensure that owners of motor vehicles in Macedonia take out TPL insurance.

The TPL system should have necessary mechanisms and technological advancements to enable an easy check for uninsured motorists and appropriate processes for dealing with these motorists to minimise violations.

R1: We recommend a sticker system to enable police and other authorities to easily identify unregistered and uninsured vehicles.

We have been advised by the Ministry of the Interior that it is planned to introduce such a system in the new Law on Traffic.

R2: We recommend that a central information system at the Ministry of the Interior should be available to the police, technical stations, insurers and other authorised users.

The central information system should contain information on the history of registration and TPL insurance for each vehicle, and identify the insurance company. The information system would also be used as part of the Information Centre for green card purposes as required by the EU Directives. We have been advised by the Ministry of the Interior that a project to develop such a system is already under way, with the first stage involving access to the technical stations.

R3: We recommend that penalties for uninsured drivers should be increased and police should have the capacity to issue on-the-spot fines.

The current penalties for not taking out TPL insurance are low compared to the cost of insurance, and the police have difficulty with enforcement because of the lengthy process through the Magistrates Court required to impose a fine.

Distribution of the TPL Product

The current distribution of motor vehicle TPL policies is mainly through technical service stations. This distribution method is not suitable for a competitive, multi-insurer environment.

R4: We recommend that distribution of TPL insurance be made by a variety of channels other than the technical service stations, and in compliance with the Law of Insurance Supervision.

In the short run this change will create some disruption for vehicle owners, but in the long run it will have significant benefits because:

- It makes clear the premium paid for TPL separately from the cost of registration of the vehicle.
- It will ensure that motorists receive a copy of the policy (insurance contract) including the terms and conditions.
- It permits more flexible pricing, including charging premiums more according to the individual risk, and (at a suitable time) price competition among insurers.
- It encourages a direct relationship between the insurance company and the customer, allowing insurers the chance to provide other products.
- It is necessary to permit fair competition among insurers for TPL business.

In the next stage, planning will be needed on the methods of distribution to be encouraged, the best way to enforce the change, and transition arrangements that will minimise disruption.

A new Motor Insurance Commission

The TPL system must continually balance the needs of accident victims, vehicle owners who pay the premiums and insurance companies that underwrite the risk. This balance is difficult to achieve without a process that brings the best knowledge and expertise together with independent decision making.

R5: We recommend the establishment of a new Motor Insurance Commission. Members of the Commission will be appointed by the Minister of Finance and will include:

- ***An insurance professional.***
- ***A leading lawyer (advocate) and/or a Judge.***
- ***A leading doctor.***

- ***Chaired by the Ministry of Finance.***

The Commission will be responsible under the Law for:

- Establishing and reviewing Claim Criteria.
- Approval of premium tariff.

The Commission may be asked to undertake other functions to assist in the smooth operation and viability of the TPL system.

We believe that this approach is the best method to balance the interests of the various parties. The activities of the Commission should not be onerous and require only part-time operation. In order to ensure independence of the Commission there will need to be transparent methods of appointing members and of making decisions. The funding of the Commission's activities needs to be secure and should not be reliant on any one interested group.

The critical aspect of the Commission is that it is able to balance the community needs in a credible way, so that Courts, insurance companies, lawyers and injured persons have trust in the integrity of its decisions.

The processing of claims and litigation

The current process of claims settlement, particularly when a Court appeal is made, is often slow and does not deliver equitable outcomes for injured persons. The level of compensation should be reasonably consistent from one case to another, bearing in mind the circumstances of each case. Compensation should meet community expectations about what is fair and equitable, especially when compared to outcomes for victims of non-traffic accidents. Claims should be resolved promptly to reduce unnecessary hardship on injured persons.

R6: We recommend that required procedures and timeframes should be introduced into the Law to encourage fair dealing and prompt settlement.

The best method of creating these obligations will need to take into account the operation of other relevant laws. Examples of the desirable obligations on injured persons and insurers are:

- An obligation to notify accidents and injuries promptly (say 30 days) – this first notification does not require detailed evidence, which may not yet be available, but gives the insurer the opportunity to investigate the accident

- An obligation on insurers to accept liability within (say 30 days) of receiving the police report of the accident unless there are reasonable grounds to deny liability.
- An obligation to make a claim for personal injury within (say 6 months) to the insurer including medical and other evidence.
- An obligation on insurers to make a reasonable offer of settlement within (say 60 days) of receiving a personal injury claim and supporting evidence.

R7: We recommend that the new Law should establish obligatory Criteria for personal injury claims (both material and non-material damages).

The criteria will be guidelines for the factors that are to be considered in determining the amount of award and ranges for the amounts in certain circumstances. In accordance with the current legal principles they should not be based on a strict formula or table, but should permit consideration of the individual circumstances of each injury.

The process of developing the Criteria will be important. Two of our suggestions are to:

- Combine all the present non-material damages into a single Criteria.
- Limit purely fear claims (no physical injury) to defined serious cases.

The Courts will be required to respect the Criteria when making an assessment of the appropriate level of damages for an individual case.

The Criteria will be established by the new Commission for Motor Insurance, after taking expert advice and balancing the needs of injured persons and the required premiums.

The essential purpose of the Criteria is to achieve consistent treatment among injured persons, and to avoid the situation where different Courts may award widely varying amounts, and where the Court decision may be many times larger than the amount offered by an insurance company by way of settlement. The most effective way to narrow this gap is to have a community standard for a reasonable level of damages and the methods of judging the degree of loss of each individual.

If all parties have a reasonable expectation of the range of damages for a particular type of case, then the chance of agreement is improved and the need to make Court appeals should be reduced.

The implementation of these Criteria would need to take into account the operation of other laws.

R8: We recommend that in the next Phase careful consideration be given to a system of Mediation in order to increase the chance of agreement between the parties prior to any Court appeal.

The need for mediation will depend on the extent to which the other recommendations are successful in reducing the need for Court appeals. This in turn will depend on the behaviour of insurers and advocates.

The best way to run the Mediation would be by a specialist tribunal under the control of the Motor Insurance Commission. The tribunal members should include relevant experts including:

- An expert facilitator.
- Expert doctor specialists
- A traffic engineer.

It is important that the Mediation be independent and respected, which is why we recommend that it be controlled by the Commission. The tribunal needs to have expert insurance knowledge, but it cannot be controlled by insurers and still be seen to be independent. The Mediation should deal in a practical way with issues of dispute between the injured person and the insurer, and should encourage agreement by ensuring all information is exchanged and the parties have realistic expectations. The Mediation would not have the power to make binding decisions.

Not every personal injury claim will need to participate in Mediation. The system should encourage early settlement by agreement between the parties, with the Mediation only being necessary if no agreement can be reached.

R9: We recommend that no restriction be placed on the right to appeal to the Court, other than to participate in Mediation.

The Macedonian people place a high value on the right to appeal to a Court. If there is still disagreement between the parties after mediation, the right to make a Court appeal should be maintained. In determining the merit of any Court appeal, the Court will be obliged by the Law to respect the Claims Criteria.

We would expect the other recommended changes to greatly reduce the need of injured persons to make a Court appeal. To discourage frivolous Court appeals, it will be worth considering a system where a party to a Court appeal would be required to pay the court fees if they do not achieve a significantly better result than they were offered during Mediation.

An important benefit of the reforms will be a reduction on the burden placed on the Courts and Judges in dealing with motor accident cases. Most motor accident cases should not involve difficult issues that require the valuable expertise of the Courts. There will always be some difficult cases requiring the Court, but these should be small in number.

Setting Premiums for TPL

Premium rates for TPL are tightly controlled. The National Insurance Bureau is required to ensure that all insurance companies use the same premium tariff, and the level of premiums must be approved by the Government. TPL premium rates have been frozen in recent times, and insurers have removed all bonus discounts in response. At the same time, claims costs are continuing to escalate.

If premium rates continue to be tightly controlled without control over claims costs, the profitability of TPL insurance is likely to continue to deteriorate and insurers may withdraw from the market.

Premium rates should be set in direct reference to claims costs. The level of premium has to strike a balance between that required to cover the cost of benefits while not imposing too heavy a burden on vehicle owners who pay the premiums.

R10: We recommend that once the distribution method has been changed, that a range of maximum and minimum premium rates should be set through by-laws to ensure both affordability of premiums and insurer viability.

We believe that the insurance market is not ready for unrestricted competition on the basis of price. There are several new entrants who are only beginning to gain experience in the market, and there is not a base of information available for most insurers on which to set rates. However, gradual steps should be taken towards price competition as the market conditions allow.

R11: We recommend that all insurers be required to submit policy and claims information on TPL to a central system at the National Insurance Bureau for the benefit of the Bureau and (subject to privacy) all other insurers.

Maximum and minimum premium rates should be approved by the Motor Insurance Commission, following application by the National Insurance Bureau. The Commission should be required to have regard to the financial viability of insurers and should be required to obtain independent actuarial advice.

Tariffs under the new arrangement should initially be structured according to vehicle type and power, similar to the present structure. Over time, the tariff

should be moved towards greater risk rating with greater use of a bonus-malus system. Eventually there should be a flexible tariff under which insurers are permitted to use their own underwriting criteria.

The impact of TPL on the viability of insurance companies

There are three aspects of the current arrangements where the TPL system might inadvertently threaten the viability of insurance companies. In order to respond to these issues we make the following recommendations.

R12: We recommend that the Technical Reserving standards be upgraded for TPL so that the minimum technical reserves are a realistic estimate of the amount ultimately required to be met by the insurer.

R13: We recommend that insurers be required to have adequate reinsurance to protect their TPL business, especially the Green Card under which claims can be for an unlimited amount in some countries.

R14: We recommend that the guarantee system be reviewed so that the failure of one insurer cannot flow through and cause the failure of other insurers.

Moving to EU Standards

It is critical that any reforms to TPL move the Macedonian system towards meeting the requirements of the EU Directives. There is also a desire to move towards general European standards of operation where possible.

R15: We recommend that in the next stage a complete review of compliance with EU Directives be made.

The EU Directives set a high level framework for Motor Insurance. Many variations are possible while still meeting the Directives. In addition, it is important to note that there are many variations in the TPL systems across European countries, even though there are many common principles.

Our initial review indicates that the reforms recommended in this report will help meet EU Directives. Most aspects are already fully in compliance.

R16: We recommend that limits of indemnity be reviewed at the next stage taking into account the EU Directive requirements and the possibility of multiple claims from one accident.

R17: We recommend that the Law establish a timeframe for moving to a single premium for both TPL and Green Card.

At present only a minority of Macedonians need to buy Green Card cover, and the premiums are high relative to TPL. At the present time we believe it is preferable that only those Macedonians who travel outside the country pay for the Green Card cover, rather than requiring all vehicle owners to pay through a higher TPL premium.

R18: We recommend that an exclusion for acts of terrorism be added to both TPL and Green Card policies.

Other Compulsory Classes

The current law deals with several other compulsory classes in addition to motor – public transport, aviation, marine and railways.

R19: We recommend that other compulsory classes under section 5 of the Law of Insurance should continue to be compulsory. The recommendations R6 to R9 relating to claims and litigation should apply to these classes.

Other recommendations relating to distribution, compliance and premium tariff are not applicable to these other classes.

5 The Legal Basis of the System

The TPL system in Macedonia, as with virtually all European countries, is based on the principle of *responsibility* – that is, if a person causes damage to another, then that person should be responsible for repairing the damage they have caused.

In some parts of the world – Scandinavia, United States, Canada, Australia, New Zealand, South Africa – there have been moves towards basing TPL more on the principle of *solidarity* or social insurance. Under this principle, the first consideration is for the compensation that the injured victim receives, rather than on the liability of another party. Taken to its extreme, this principle leads to a “no fault” system, where all motor accident victims receive compensation regardless of who was at fault.

We have recommended that the TPL system in Macedonia continue to be based on the principle of *responsibility*. This principle best matches the understanding of the scheme in the country and also keeps Macedonia on the same basis as the systems in other European countries.

We anticipate that there will be increasing debate in Europe on the merits of the *solidarity* principle for TPL in future. There is time then for Macedonia to consider whether any further changes to the TPL system are logical. For

readers who are interested in this fundamental question of the legal system we recommend the following paper:

www.aida.org.uk/worldcongress02/themela_generalreport.doc

The recommended model for reform of the system is therefore only to improve on the current system, not to bring in a whole new system. The proposals do make some important modifications to the legal basis, which amend the effect of the Law of Obligations. These modifications are, however, consistent with EU Directives, consistent with trends in other European countries, and remain consistent with the principle of *responsibility*.

6 Next Step

After the Government has considered the recommendations in this report, the next step will be to prepare a draft Law to be issued for consultation.

Part II Detailed Findings

1 Uninsured Vehicles

The large number of uninsured vehicles is a recent phenomenon in Macedonia. Uninsured vehicle numbers increased as a result of civil disturbances in the country in 2001 and have continued to the present day.

The level of uninsured vehicles is currently estimated at around 20 per cent of all motor vehicles in Macedonia.

As TPL is a pre-condition of registration in Macedonia, these numbers indicate that around 20 per cent of vehicles in operation in Macedonia are not registered for road use. The MoF has indicated that the problem of uninsured vehicles is not restricted to any particular group within Macedonia, but rather is a community wide problem.

Uninsured drivers increase the costs of TPL to those that are insured. This is because of the operation of the guarantee fund, which provides insurance to the uninsured and is funded by contributions from insurance companies in proportion to their share of the motor TPL premium pool. Insurance companies must pass on any contributions to the guarantee fund to insured drivers through increased premiums.

1.1 Why are there so many uninsured vehicles?

The cost of registering and insuring a vehicle in Macedonia is high relative to the cost of living.

It is estimated that in Macedonia the combined cost of registration and TPL insurance is equivalent to one month's average income.

In addition to this, the penalties for driving an uninsured vehicle are relatively low, and penalties are slow and difficult to impose through a process involving the Magistrates Court.

Police are constrained in their ability to check for compliance with the annual requirement to register and insure motor vehicles. Compliance can only be checked by physically pulling a vehicle over and checking the registration documents.

In addition, it is difficult for police to follow the status of insured vehicles over time because of the absence of a comprehensive database of vehicle registration and insurance details.

1.2 Options for reform

The combined cost of registration and TPL poses a significant burden on motor vehicle owners. This cost may be a significant factor in the level of non-compliance with TPL insurance.

The Macedonian Government has recognised this in recent years and has refused premium rate rises to try to ensure maintained affordability levels. However, this system is not sustainable in the longer term, as premiums cannot be contained in a system where claims costs continue to escalate.

If insurers are unable to charge sufficient premiums to meet claims costs, insurers may:

- cross subsidise TPL premiums from other classes of business;
- withdraw from the market; or
- find themselves in financial difficulty.

If premiums are to be allowed to move to a level which is sustainable for insurers, the Macedonian Government may wish to consider the extent to which the registration cost for vehicles remains appropriate.

If the level of premiums for TPL increases, then this could, to some extent be absorbed by a reduction in the registration fees for motor vehicles in Macedonia.

Any loss to Macedonian revenue through reducing registration fees will be offset by the extent to which lower registration costs encourage more motor vehicle owners to register their vehicles.

The Ministry of the Interior advised us that consideration is being given to a draft Law on Traffic which seeks to address some of the difficulties for police in enforcing compliance with registration and TPL requirements.

The planned Law on Traffic includes requirements for vehicles to display a sticker verifying current registration and insurance. It also allows police to impose 'on the spot' fines and increases the level of fines for non-compliance with registration requirements.

Similar sanctions should be available to the police for non-compliance with TPL insurance requirements. The cost of the fine for vehicle owners should be at least equal to the amount of the annual premium in order to provide proper incentives for compliance.

The Ministry of Interior has also advised that it is constructing a database of license and insurance details of vehicles in Macedonia.

All participants in the TPL market should have access to this database to enable proper checking and tracing of vehicle details. This database could also be extended for use as the information centre required by Article 5 of the 4th EU Directive relating to insurance against civil liability in respect of the use of motor vehicles and could be used in fulfilment of Article 109 of the Law on Insurance Supervision.

1.3 Recommendations

R1: We recommend a sticker system to enable police and other authorities to easily identify unregistered and uninsured vehicles.

R2: We recommend that a central information system at the Ministry of the Interior should be available to the police, technical stations, insurers and other authorised users.

R3: We recommend that penalties for uninsured drivers should be increased and police should have the capacity to issue on-the-spot fines.

2 Distribution

In Macedonia, TPL insurance for motor vehicles is primarily distributed through technical service stations. Technical service stations are responsible for performing vehicle checks for registration purposes, issuing certificates of registration and offer insurance from the insurers operating in the market. Motor vehicles must be registered and insured for TPL on an annual basis.

The current system is effective in ensuring compliance with motor TPL for vehicles that are registered. The vehicle registration document (licence) is stamped with proof of insurance paid.

In practical terms, it is not possible to have a registered but uninsured vehicle in Macedonia. The high proportion of vehicles that are not insured indicates that these vehicles are also not registered for road use.

There is a limited amount of direct insurance business undertaken, primarily through agents and through the branch networks of insurance companies.

Insurers indicate that approximately 90 per cent of policies are issued through the technical service stations with only 10 per cent through direct customer contact with the insurer.

Technical service stations receive a 7 per cent commission from insurers for issuing policies on their behalf. Commissions are prescribed by the National Insurance Bureau.

The technical service stations are licensed by the Ministry for the Interior and are tied to automotive associations in Macedonia.

2.1 What is wrong with the current distribution system?

The current reliance on technical service stations for the delivery of TPL insurance appears to be based on historical practice. This system has been in operation for around 50 years and dates back to a time where the provision of TPL was undertaken by a single State owned monopoly insurer.

The persistence of this model within a competitive, multi-insurer environment has a number of drawbacks.

The payment of motor vehicle TPL insurance premiums at technical stations is bundled together with the payment for annual renewal of registration. While this is convenient for motor vehicle owners, it leads to a situation where

consumers are not aware of the break down in registrations costs between general registration fees and the TPL insurance premium.

In addition, this method of distribution treats TPL insurance coverage as a commodity article or tax similar to registration and does not assist the car owner to fully understand the scope of the coverage.

Contrary to Article 50 of the Law on Insurance Supervision, we are advised that many motorists do not receive a copy of policy documentation upon concluding TPL insurance at a technical station. Further, contrary to EU Recommendations on insurance intermediaries, sales of TPL policies through technical service stations are not undertaken by qualified insurance intermediaries. Section 10 of the Law on Insurance Supervision appears to restrict the sale of insurance policies to individuals who are insurance agents and licensed brokers and would outlaw the sale of TPL policies through a technical station unless that station had an agent located on its premises.

The sale of motor TPL policies primarily through technical service stations also poses a significant difficulty for insurance companies in controlling the volume of policies sold. It also does not encourage any lasting relationship with clients and does not allow insurers any control over underwriting and removes any capacity to base premiums on individual risk.

Further, distribution through technical stations makes entry for new companies into the market difficult. In its current form, TPL policies tend to be a commodity product meaning that it is sold in a standard form and there is no price competition. This makes it likely that consumers will select well known brand names over newer entrants.

The current registration IT system situated in the Ministry of Interior is not currently used to trace the unregistered and uninsured vehicles. There is no central registry of claims and insurance details available to insurers – reducing the capacity to monitor fraud and to risk rate premiums.

2.2 Options for reform

The reform of the motor vehicle TPL insurance system has to balance the traditional acceptance and convenience of the process of purchasing motor TPL through the technical service stations with the stunting effect that this process has on the development of insurance in Macedonia.

It would be possible to continue the sale of motor TPL through technical service stations if it were combined with incentives to motorists to purchase insurance directly from insurers. Such a system would see the importance of technical

service stations as a distribution source weaken over time without imposing an outright ban on their sale of the product.

For example, technical service stations could be allowed to continue to sell policies at a standardised tariff rate, whereas insurers would have the advantage of providing discounts for low risk drivers.

Allowing technical service stations to continue to sell TPL insurance at a standardised tariff would reduce the need to require these centres to be authorised insurance intermediaries as the sale of a standard commodity product does not require any underwriting and reduces the need for insurance advice.

Some enforcement would be required to ensure that technical service stations did not discriminate against motorists who had pre-purchased their insurance prior to inspection.

However, such an approach would be inconsistent with the current requirements of the Law on Insurance Supervision and is not favoured by the MoF.

If the Law on Insurance Supervision were to be enforced to require TPL to be sold only through agents or brokers, consideration should be given to how this would apply in practice.

To be an agent for the purposes of the Law on Insurance Supervision simply requires that an individual be given authority from an insurer to sell its products and for the agent to be registered with the National Insurance Bureau. There are no further licensing requirements such as those that apply to insurance brokers.

An insurer could simply authorise a staff member of a technical station to sell its products or install one of its own employees in each station. Simply enforcing the current law is unlikely to lead to a dramatic change in the distribution method.

Consideration should be given to imposing additional requirements on agents selling TPL products within the new Law on Compulsory Insurance and Traffic.

Consideration of appropriate transitional arrangements to minimise disruptions to motorists of a change in the distribution system should also be undertaken.

In addition, in many countries certain motor vehicles are not required to have an annual inspection for registration purposes. For example, many jurisdictions do not require inspections for vehicles under three to five years of age on the basis that newer vehicles are more likely to be roadworthy and the benefits of annual inspections are minimal.

The Macedonian Government may over time wish to consider the frequency of technical checks for registration purposes. This would have the effect of both removing the convenience of selling insurance at technical service stations for some drivers and be a more efficient use of resources.

2.3 Recommendations

R4: We recommend that distribution of TPL insurance be made by a variety of channels other than the technical service stations, and in compliance with the Law of Insurance Supervision.

3 Balancing Insurer, Motorist and Accident Victim Needs

In order for the Macedonian TPL system to remain viable over the long term, it is essential that premiums are in balance with the cost to insurers of underwriting TPL products. At the same time, the system must also balance the need of motorist to obtain affordable insurance with the need of motor accident victims to have access to adequate compensation.

3.1 Why are premiums and claims costs out of balance?

The premium rate for TPL insurance is currently tightly controlled by the Government and determined by the Ministry of Economy. The NIB is charged with proposing tariff adjustments and these proposals are sent to the Ministry of Economy for approval.

At the same time, claims costs are not controlled and are escalating. This situation is inherently unstable and likely to lead to a situation where insurers withdraw from the market.

In recent times, the Government has declined increases in premium rates. This is presumably on the basis that the Government is concerned to ensure that premium rates remain affordable for motorists.

While the National Insurance Bureau schedule for calculating non-material damages is broadly followed by insurers in offering settlements, these criteria are not adhered to by the judiciary providing a strong incentive for claimants to appeal claims to a court.

Insurers are of the view that current premium rates are not sufficient to cover claims costs especially given claims inflation through increasing court awards. As a result, all insurers now charge the maximum premium allowed and no longer provide bonuses for good driving records. All vehicles within a particular class are now charged a single rate of insurance regardless of risk profile or insurer chosen.

At the same time, lawyers and the judiciary are of the view that the current level of compensation offered by insurers in settlement discussions is insufficient.

The level of compensation should be reasonably consistent from one case to another, bearing in mind the circumstances of each case. Compensation should meet community expectations about what is fair and equitable, especially when compared to outcomes for victims of non-traffic accidents.

3.2 Claims Handling Processes

The current process of claims settlement, particularly when a Court appeal is made, is often slow and does not deliver equitable outcomes for injured persons. Claims should be resolved promptly to reduce unnecessary hardship on injured persons.

In the current system, there are no impediments to a claimant turning immediately to the Court for satisfaction of a claim. Insurers report that they are sometimes unaware of the existence of a claim until it is lodged with a Court. This provides insurers with no capacity to mediate a settlement prior to Court.

In addition, there is some concern within Macedonia that insurers may unreasonably be denying claims or deliberately stalling settlement.

3.3 Options for bringing the system into balance

Premium Setting

It would be possible to move to a system in which TPL policies are set by a free and competitive market. Under this system, insurers would be able to set premiums as high or as low as they determined was feasible or required.

We do not support this option for two reasons. Firstly, in our view, it is unlikely that the Macedonian Government would wish to move instantly from a system where premiums are tightly controlled and where premium increases have not been allowed to a situation of full competition with the potential that premium costs for TPL could increase substantially.

Second, given the relative immaturity of many of the companies operating in the Macedonian TPL system and their lack of access to claims data, allowing insurers to price competitively may lead to a bidding war where insurers underprice without understanding the full risks of the business. In the medium to longer term, this may lead to a situation where insurers' financial positions are put at risk.

Processes which require Government agreement in the pricing of compulsory classes of insurance are not uncommon in other international jurisdictions.

However, such arrangements typically lead to unsatisfactory outcomes. This is largely a product of the conflict between the short term political undesirability

of increasing premium rates against the longer term consequences of an under funded insurer.

To address this issue, Governments most commonly establish independent authorities to undertake the premium setting task. These authorities are generally subject to parameters established by Government, but beyond these parameters, maintain full responsibility for setting and enforcing pricing decisions.

In our view, an appropriate way of achieving greater balance between premiums and claims costs would be to establish a Motor Insurance Commission which would have responsibility under the Law for establishing and reviewing claim criteria and approving premium tariffs. A similar Commission currently operates in Sweden.

Maximum and minimum premium rates could be approved by the Motor Insurance Commission. The Commission would be required to have regard to the financial viability of insurers and to obtain independent actuarial advice to assist in setting premium rates.

In view of the limited experience of many market participants, tariffs under the new arrangement could initially be structured according to vehicle type and power, similar to the present structure. Over time, the tariff should be moved towards greater risk rating with greater use of a bonus-malus system. Eventually there should be a flexible tariff under which insurers are permitted to use their own underwriting criteria.

However, in order to enable this development, it will be essential that insurers have access to comprehensive information on the claims histories of particular drivers and vehicles.

The activities of the Commission are unlikely to require full-time appointments or operation. In order to ensure independence of the Commission transparent methods of appointing members and of making decisions would need to be established by the Law. The funding of the Commission's activities would need to be secure and should not be reliant on any one interested group. The cost of the Commission could be recouped through insurance company contributions.

It is essential that premium rates remain affordable over time. Experience in other jurisdictions shows that even with the best designed schemes, the cost of TPL insurance increases over time.

In Australia, some jurisdictions have introduced 'affordability indexes' to address this issue. For example, in Queensland an affordability index of 45 per cent of average weekly earnings (AWE) has been established for standard TPL

motor vehicle premiums². When premiums exceed the index, the Queensland Motor Accidents Insurance Commission is required to prepare a report on trends in affordability and recommend whether benefits should be revised. This report is prepared for the Minister responsible and must be tabled in Parliament.

Similar mechanisms could be established in Macedonia to provide the Government with comfort as to ongoing premium affordability for Macedonian motorists.

Claims Handling

To improve the timeliness of claims processing, obligations could be established by Law to ensure that insurers and claimants deal with each other in an appropriate manner. Examples of obligations which could be established by Law are set out below.

- An obligation to notify accidents and injuries promptly (say 30 days) – this first notification does not require detailed evidence, which may not yet be available, but gives the insurer the opportunity to investigate the accident
- An obligation on insurers to accept liability within (say 30 days) of receiving the police report of the accident unless there are reasonable grounds to deny liability.
- An obligation to make a claim for personal injury within (say 6 months) to the insurer including medical and other evidence.
- An obligation on insurers to make a reasonable offer of settlement within (say 60 days) of receiving a personal injury claim and supporting evidence.

Such obligations are common in other European jurisdictions and are required, in part, by EU Directives.

Stabilising Claims Costs

In order to ensure that premiums and claims costs remain in balance, it is necessary to ensure greater certainty and equity in awards for damages. In other countries, for example France, Italy and Spain, this is achieved by requiring adherence to criteria for damages. In some cases, these criteria are prescribed by Law.

Such criteria could be adopted within Macedonia to reduce the uncertainty surrounding awards for damages. This would also help to reduce the burden on

² TPL insurance in Australia only includes claims for bodily injury, not third party property.

courts by reducing incentives for court appeals. The claims criteria could be established by the Motor Insurance Commission after taking expert advice to ensure a balance between the needs of injured persons and required premiums. The Criteria would be prescribed in by-laws under the new Law on Compulsory Insurance and Traffic and courts would be required to follow them when determining damages in cases of motor accidents.

In addition to this, consideration should be given to simplifying the awards for non-material damages. For example, all non-material damages could be combined into a single category. Such a system currently operates in Germany.

Further, to reduce payouts for small claims to enable a greater level of compensation for more seriously injured people, claims for pure fear (that is, where there is no physical injury) could be limited to very serious cases. Such limitations apply in Germany.

Consideration should be given to the need to require mediation prior to a claim being appealed to a court. The need for such an arrangement will depend on the extent to which the other reforms are successful in reducing the need for Court appeals.

Mediation could be undertaken by a specialist tribunal under the control of the Motor Insurance Commission. The tribunal members should include relevant experts including:

- An expert facilitator
- Expert doctor specialists
- A traffic engineer.

However, given the high value that Macedonians place on the right to appeal to a Court such a mediation process should not be binding. If there were still disagreement between the parties after Mediation, the right to make a Court appeal should be maintained. To ensure that mediation is effective in reducing unnecessary litigation, it may be appropriate to consider a system where a party to a Court appeal would be required to pay the court fees if they did not achieve a significantly better result than they were offered during Mediation.

3.4 Recommendations

R5: We recommend the establishment of a new Motor Insurance Commission. Members of the Commission will be appointed by the Minister of Finance and will include:

- ***An insurance professional.***
- ***A leading lawyer (advocate) and/or a Judge.***
- ***A leading doctor.***
- ***Chaired by the Ministry of Finance.***

R6: We recommend that required procedures and timeframes should be introduced into the Law to encourage fair dealing and prompt settlement.

R7: We recommend that the new Law should establish obligatory Criteria for personal injury claims (both material and non-material damages).

R8: We recommend that in the next Phase careful consideration be given to a system of Mediation in order to increase the chance of agreement between the parties prior to any Court appeal.

R9: We recommend that no restriction be placed on the right to appeal to the Court, other than to participate in Mediation.

R10: We recommend that once the distribution method has been changed, that a range of maximum and minimum premium rates should be set through by-laws to ensure both affordability of premiums and insurer viability.

R11: We recommend that all insurers be required to submit policy and claims information on TPL to a central system at the National Insurance Bureau for the benefit of the Bureau and (subject to privacy) all other insurers.

4 Viability of Insurers

It is essential to the stability of the Macedonian TPL system that insurers operating in the market are safe and stable. In the course of considering the operation of the TPL system, we have identified some weaknesses in the existing system of prudential regulation which require upgrading to ensure the continued stability of the market.

4.1 Reserving for Insurance Liabilities

The current requirements for reserving for insurance liabilities in Macedonia may significantly underestimate the actual cost of claims likely to arise from the sale of TPL policies.

In particular:

- Case reserves may currently be based on NIB scheduled payments for non-material damages rather than realistic assumptions based on expected court awards.
- Case reserves may not be brought to account until a relatively late stage of a claim.
- The requirement for an IBNR calculated as 10 per cent of case reserves significantly underestimates the real claims liability, particularly for new entrants to the market which may have only limited case reserves.

The absence of appropriate reserving requirements may make the Macedonian market look more attractive to new entrants, particularly those seeking short term cash flows. In addition, there is some concern that assets backing the technical reserves may be inappropriately illiquid.

4.2 Reinsurance

Most European countries have significantly higher limits of liability for TPL than Macedonia. In some instances, liability may be unlimited.

All Macedonian TPL insurers underwrite green card business. In these circumstances, it is essential that insurers have in place appropriate reinsurance programs to protect their financial viability.

However, some smaller insurers in Macedonia may not have sufficient premium income to participate in reinsurance programs. This places both their own company and other insurers, through the operation of the guarantee fund, at significant risk.

4.3 The Guarantee Fund

If an insurer fails within Macedonia, other insurers are required to fulfil its obligations to policyholders through the operation of the guarantee fund. This structure could mean that the failure of an insurer within FYR Macedonia would have flow on effects to other insurers in the market.

4.4 Recommendations

R12: We recommend that the Technical Reserving standards be upgraded for TPL so that the minimum technical reserves are a realistic estimate of the amount ultimately required to be met by the insurer.

R13: We recommend that insurers be required to have adequate reinsurance to protect their TPL business, especially the Green Card under which claims can be for an unlimited amount in some countries.

R14: We recommend that the guarantee system be reviewed so that the failure of one insurer cannot flow through and cause the failure of other insurers.

5 European Consistency and Other Systems of Insurance

As part of Macedonia's desire to ultimately become part of the European Union, consistency with EU Directives and European practice is of great importance in the design of any reforms to TPL insurance in Macedonia.

5.1 EU Directives

There are currently four EU Directives relating to insurance against civil liability in respect of the use of motor vehicles with a fifth directive currently in a draft form.

The EU Directives are broad in nature and designed to encompass a wide range of different systems across Europe.

In many respects, Macedonia's system of TPL already complies with the requirements of the Directives. In some cases, reasonably small adjustments could be made to ensure compliance with other aspects of the Directives.

However, in a limited range of circumstances, it is our view that moving to immediate compliance would not be suitable for the Macedonian market.

In particular, immediate compliance with the requirement for all TPL policies to cover both domestic and green card claims for a single premium would significantly increase the cost of TPL for most Macedonians. Currently only about one third of motorists in Macedonia take out green card insurance and it is considerably more expensive than domestic TPL.

Further, immediate compliance with EU requirements for minimum levels of cover would be a substantial change for Macedonia. Currently, the Law on Insurance prescribes a maximum cover of EURO 100,000 for load vehicles and buses and EURO 50,000 for all other vehicles. The draft 5th Directive requires a limit for personal injury claims of at least EURO 1 million per accident victim and for property, at least EURO 500,000.

Rather than requiring immediate compliance, it may be more appropriate to require compliance with EU Directives in these limited areas over a period of years.

A table setting out the requirements of the EU Directives including an indication of whether the Macedonian system is currently compliant, could be

moved to full compliance at this time or circumstances where a transition period should be allowed is set out at Appendix A.

5.2 European Consistency

In addition to moving toward EU compliance, those consulted expressed a strong desire to implement reforms which are not inconsistent to those found in other parts of Europe.

It is important in this context to understand that there is no uniform system of TPL insurance within Europe.

The reforms recommended by this report are not inconsistent with the EU Directives and examples of similar arrangements can be found in EU jurisdictions.

A table setting out examples of European and other international jurisdictions which currently utilise systems similar to these recommended by this report is at Appendix B.

5.3 Alternative Systems of TPL

As part of our engagement by the FIRST Initiative, the project team was asked to consider alternative systems of TPL, including no-fault models.

The current system of TPL in Macedonia is based on the law of tort. That is compensation is paid by the insurer of the at-fault driver to remedy damages incurred by innocent parties. The at-fault driver is not eligible for compensation.

In other jurisdictions, such as Sweden, Denmark, some States of Australia, some States of the United States and some provinces of Canada, a 'no fault' system operates for personal injury losses³. Such a system is also about to be introduced in South Africa.

In these systems, benefits are paid to every person injured in a motor vehicle accident regardless of fault. The principle behind no-fault schemes is to ensure that accident victims receive appropriate care.

No fault schemes are designed to reduce legal costs because the question of fault does not need to be decided for the purposes of compensation.

³ No fault systems do not apply for third party property damage.

Benefits under no-fault schemes tend to be more standardised and lower than in pure tort systems where compensation is determined by a court.

After considering the current situation within Macedonia and the desire to maintain a system which is broadly equivalent to most European countries and is easily understandable to market participants, it was determined that it would not be appropriate to recommend that Macedonia move to a system of no-fault at this stage.

5.4 Recommendations

R15: We recommend that in the next stage a complete review of compliance with EU Directives be made.

R16: We recommend that limits of indemnity be reviewed at the next stage taking into account the EU Directive requirements and the possibility of multiple claims from one accident.

R17: We recommend that the Law establish a timeframe for moving to a single premium for both TPL and Green Card.

R18: We recommend that an exclusion for acts of terrorism be added to both TPL and Green Card policies.

R19: We recommend that other compulsory classes under section 5 of the Law of Insurance should continue to be compulsory. The recommendations R6 to R9 relating to claims and litigation should apply to these classes.

Part III Appendices

A Compliance with EU Directives

EU Directive	Compliant Now	Should be amended to full compliance	Transition to compliance	Should remain uncompliant	Comment
1st Directive 24 April 1972					
Article 1 Definitions	Yes	N/A	N/A	N/A	Although consideration of the definitions should be considered to ensure TPL policy is tied to the vehicle rather than any particular driver or owner.
Article 2 Member states to refrain from making border checks	No	No	No	Yes	Not applicable until EU member state.
National Bureau should enter into agreement with other Bureaus to enable settlement of claims for accidents caused by Macedonian vehicles	Yes	N/A	N/A	N/A	
Article 3 Shall take all appropriate measures to ensure vehicles are insured	Yes	N/A	N/A	N/A	However, more could be done to reduce uninsured vehicle numbers
Shall take all appropriate measures to ensure that the contract of insurance also covers accidents in other States	No	No	Yes	No	Requiring each contract to contain a green card would increase the cost of insurance. Should be phased in over time.

EU Directive	Compliant Now	Should be amended to full compliance	Transition to compliance	Should remain non-compliant	Comment
Article 4 In certain circumstances a State may decide to allow derogations from Article 3	Yes	N/A	N/A	N/A	No exemptions currently in operation.
Article 5 NIB should obtain information on foreign vehicles which have caused an accident in Macedonia and transmit this information to the vehicles home Bureau	Yes	N/A	N/A	N/A	
Article 6 Member States to take all appropriate measures to ensure vehicles of non-member States have insurance when entering the EU	Yes	N/A	N/A	N/A	
Article 7 Non EU vehicles entering member States should have either valid green cards or frontier insurance.	Yes	N/A	N/A	N/A	
2nd Directive 30 Dec 1983					
Article 1 Shall cover both property and personal injury damage	Yes	N/A	N/A	N/A	

EU Directive	Compliant Now	Should be amended to full compliance	Transition to compliance	Should remain uncompliant	Comment
Minimum cover*: Personal Injury 350,000 ECU per accident victim OR 500,000 ECU regardless of number of victims Property 100,000 ECU regardless of number of victims OR 600,000 ECU combined property/personal injury regardless of number of victims.	No	No	Yes	No	Requiring immediate compliance would increase the cost of TPL to Macedonian motorists.
Must set up a body to provide compensation for unidentified or uninsured vehicles.	Yes	N/A	N/A	N/A	
Law may exclude liability for victims who entered a vehicle knowing that it was uninsured.	Yes	N/A	N/A	N/A	Current Law does not allow this exclusion.
Law may allow for excess of 500 ECU for property damage	Yes	N/A	N/A	N/A	Current law does not allow deductibles.
Article 2 Any provision which excludes liability for damage caused by unauthorised drivers should be void.	Yes	N/A	N/A	N/A	

* To be increased by the proposed 5th Directive.

EU Directive	Compliant Now	Should be amended to full compliance	Transition to compliance	Should remain uncompliant	Comment
But such exclusions may be invoked against passengers who knew the vehicle was stolen.	Yes	N/A	N/A	N/A	Exclusion exists in current law
Exclusions may be in place where compensation is available from social security.	Yes	N/A	N/A	N/A	Current Law requires insurers to reimburse social security and other providers for costs incurred.
Article 3 Family members of at fault driver cannot be excluded from compensation.	No	Yes	N/A	N/A	Family members could be excluded by the operation of subarticles 63(1) & (2) of the current Law.
3rd Directive 14 May 1990					
Article 1 Except for exclusions set out in Article 2 of the 2nd Directive, all passengers must be covered for personal injury.	No	Yes	N/A	N/A	Some passengers could be excluded by the operation of subarticles 63(1) & (2) of the current Law.
Article 2 Shall take all necessary steps to ensure on the basis of a single premium cover in all member States	No	No	Yes	No	Immediate compliance would increase the cost of TPL in Macedonia.
Article 3 Payment of compensation cannot be conditional on any person being unable or refusing to pay.	Yes	N/A	N/A	N/A	

EU Directive	Compliant Now	Should be amended to full compliance	Transition to compliance	Should remain uncompliant	Comment
Article 4 Where there is a dispute between an insurer and the guarantee fund as to liability to pay a claim, measures must be in place to require one of these parties to pay in the first instance and obtain reimbursement.	Yes	N/A	N/A	N/A	
Article 5 Shall require prompt exchange of insurance information after an accident.	No	Yes			
4th Directive 16 May 2000					
Article 3 Must ensure a direct right of action by a victim against at fault driver's insurer	Yes	N/A	N/A	N/A	Although Law could make this more specific.
Article 4 Must ensure that insurers operating in other States appoint a claims representative.	No	Yes	N/A	N/A	
Within 3 months of injured party presenting claim, insurer must respond	No	Yes	N/A	N/A	

EU Directive	Compliant Now	Should be amended to full compliance	Transition to compliance	Should remain uncompliant	Comment
Article 5 State must establish an information centre containing registration and insurance details of all vehicles. Details must be retained for 7 years.	No	Yes	N/A	N/A	
Article 6 State must establish a compensation body responsible for providing compensation to ensure all victims of motor vehicle accidents paid.	Yes	N/A	N/A	N/A	However, scope of the guarantee fund must be extended to include payment of claims where insurer has failed to meet 3 month time limit under Article 4.
Article 7 Where vehicle unidentified, victim entitled to seek compensation from compensation body in State of residence.	Yes	N/A	N/A	N/A	
Draft 5th Directive					
Article 2 Minimum amounts of cover should be increased to: Personal Injury - 1 million EUR per victim Property Damage – 500,000 EUR And indexed.	No	No	Yes	N/A	Increasing minimum covers to this level immediately would increase the cost of TPL.
Article 4 Cannot exclude liability on basis passenger knew a driver was under the influence of alcohol or other intoxicating agent.	Yes	N/A	N/A	N/A	

EU Directive	Compliant Now	Should be amended to full compliance	Transition to compliance	Should remain noncompliant	Comment
Article 5 Pedestrians and cyclists should be eligible for compensation irrespective of driver fault.	No	N/A	N/A	N/A	Unlikely to be adopted by the EU.

B Requirements in other European Jurisdictions

Description of proposal	Examples of European Jurisdictions where this proposal applies
<p>Motor Insurance Commission</p>	<p>In Sweden, compensation for personal injury in road traffic accidents is rarely taken to court. This is because a special body, the Swedish Road Traffic Injuries Commission exists to settle such claims.</p> <p>The Commission hears major compensation cases and determines the compensation payable to the claimant. Under the law, insurance companies are required to maintain and fund the Swedish Road Traffic Injuries Commission, referred to here by its Swedish abbreviation TSN.</p> <p>The TSN's constitution is approved by the Swedish government, which also appoints a legally trained chairman. Deputy Chairmen, who are legal practitioners, also serve on the Commission, as well as lay representatives of various interested organizations and of the insurance companies. The Commission is made up such that external interests – i.e. interests from outside the insurance industry – exercise a majority influence on the way TSN conducts its business.</p> <p>TSN's pronouncements are of only consultative effect to the parties involved. Even when a pronouncement has been issued, the claimant is entitled to have his or her case heard before a court. In practice, TSN exercises a very strong influence over the nature of the right to compensation.</p>
<p>Claims Criteria</p>	<p>The United Kingdom, France, Italy and Spain all currently use damages tables to determine compensation in cases of personal injury.</p> <p>In the UK these guidelines are published by the Judicial Studies Board and are followed by the Courts. In France, the Ministry of Justice and the Court have officially endorsed a 'le taux de l'incapcite permanente partielle' which is followed by the courts when</p>

	<p>determining damages. Under this system, a medical expert quantifies an injured parties damages by way of a bodily percentage of injury and damages are calculated by applying one 'point' (which is a sum of money depending on age and other factors) per percentage of damage.</p> <p>Italy has sought to introduce a point system ("Tabellazione Indicativa Nazionale") based on the French experience but the system has to some extent been ignored by the courts. There are increasing calls in Italy for this point scale to be legislated.</p> <p>Spain has introduced a statutory table of point scale damages for motor which is an Annex to the 'Ley de responsabilidad civil y seguro en la circulacion de vehiculos a motor' or Road Traffic Liability Act. There was considerable debate in Spain about whether this was constitutional but in a decision dated 29 June 2000, the Spanish Constitutional Court held the legislated damages point scale to be constitutional for non-material damages.</p>
Damages for Pain and Suffering	<p>In Germany, damages for pain and suffering constitute one single sum which compensates for all pains suffered. A judge is not permitted to provide for separate amounts of compensation for different types of suffering. In the case of traffic accidents, compensation for non-pecuniary losses is restricted to cases of severe injury.</p>