Study on the relationship between risk evaluation and premium making in motor insurance market

Pricing in financial industry is based on customers and business’s intrinsic risk. In particular, Korea motor insurance industry, which has been suffered from huge underwriting income loss for last ten years, has raised some issues as whether customers’ insurance risk should be considered in making premium reasonably since motor insurance premium liberalization. If premium is not reasonably made based on the motor insurance customers’ risk, it could hurt motor insurance industry’s long term growth potential and even more, customer’s welfare might be aggravated even though the short term premium level is lower than it should be.

In this study we found empirical evidence on the relationship between customer’s risk and premium making. Motor insurance rates and loss ratios with respect to auto insurance coverages has been analyzed. We found are competitive low premiums were resulted from additional premium rate competition initiated by price liberalization in 2001. Since then, as price competition gets severe, motor insurers price competition could be spread over insurance premium rates. That means motor insurers has probably made their premium rates lower than customer’s insurance risk and this practice could result in huge underwriting loss. Some reasons could be raised regarding this premium making practice including market competition and/or market sentiments over low motor insurance premium. Some implications has been suggested from the view point of both motor insurers and regulatory institution.