Short Paper on Geo-blocking consultation

Background

The Commission has identified the prevention of unjustified geo-blocking[1] as one of the priorities of the Digital Single Market strategy.

The Commission announced that it: "will make legislative proposals in the first half of 2016 to end unjustified geo-blocking. Action could include targeted change to the e-Commerce framework and the framework set out by Article 20 of the Services Directive. The Commission is also launching a Competition Sector Inquiry focusing on the application of competition law in the e-commerce area".
At the June 2015 European Council, Heads of State and government concluded that: "action must be taken on key components of the Commission communication, notably to remove the remaining barriers to the free circulation of goods and services sold online and tackle unjustified discrimination on the grounds of geographic location."

In this way, the Commission launched in October 2015 a consultation which aims at gathering views on the different "barriers" faced by users, consumers and businesses when they access or provide information, shop or sell across the borders in the European Union.

Although this consultation is mainly addressed to consumers and traders, the Actuarial Association of Europe (AAE), and in particular the insurance committee, have decided to write a short paper, which aims at giving an actuarial point of view on this issue.

Executive Summary

The AAE supports the principles of the single market and agrees that Geo-blocking is an issue and that consumer choice and competition are important.

Insurers use geographical location as one of the main factor for pricing insurance products, such as property and motor insurances. From an actuarial point of view, it can be justified by statistical analysis and it is not related to the country of the policyholder but in fact to the location of the insured object.

Thus, the AAE shares the view that the use of geographical criteria in insurance pricing should not be considered as Geo-blocking. Elsewhere, the restriction of the use of this factor can lead to change in policyholders' behavior, which can also lead to deterioration in risk profile and potentially the profitability of the business and the insurers' ability to pay in the event of a claim.

[1] "Geo-blocking" : situation where a consumer may be prevented from accessing certain websites or content or making a purchase on the basis of their IP address location, residence, or credit card billing address, or may be automatically redirected to domestic websites with different prices.

Topics

- ✓ Risk management for insurers
- ✓ Drop of preventative campaigns sponsored by insurers: since the geographical criteria is useless, insurers will not be incited to lead preventive campaigns
- ✓ Society: why the Austrian should pay a flood insurance premium just like the English?
- ✓ Solvency II: geographical criteria is crucial in the calculation of solvency capital requirement in non-life insurance

Practical case study: the flood insurance

Weather events may be a good example to illustrate this issue:

- ✓ Weather events are strongly correlated to geographical parameter. Indeed, floods' occurrence will be more severe for countries or cities close to a water sources, such as England for example. On the contrary, in countries such as Austria, flood events will occur less frequently.
- ✓ Weather events could have a significant impact on insurer's balance.

1. Geographical criteria and risk management

Risk management processes in non-life insurance should use geographical criteria. The first level of risk mitigation in risk management is actually done at country level.
Considering flood risk, the country is one of most important parameter which allows to guarantee the insured protection with a proper risk management:

- ✓ Several pool insurance schemes are built at country level considering an agreement between local insurers and the Government to develop a not-for-profit company and offer an affordable protection of the overall local insured against one particular risk. For instance, for flood: CCR in France, more recently flood Re in UK.
- ✓ For insurance companies with international expositions, the calculation of Solvency II Capital Requirement is done considering a country level

2. Geographical criteria, guarantee of insurance protection fit on local risk

Graphics here under[2] lead to the observation of high volatility between countries both on frequency and average cost for floods.
This phenomenon encourages the segmentation by country within the risk management process, providing model and price risk closest to local needs.

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[2] Statistical analysis has been done based on historical floods in Europe since 2000 (Here under).
Source : http://www.dartmouth.edu/~floods/Archives/index.html

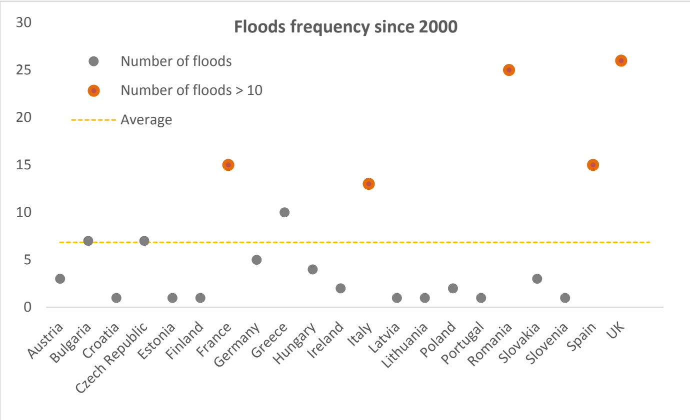

Figure 1 - Floods frequency by country since 2000

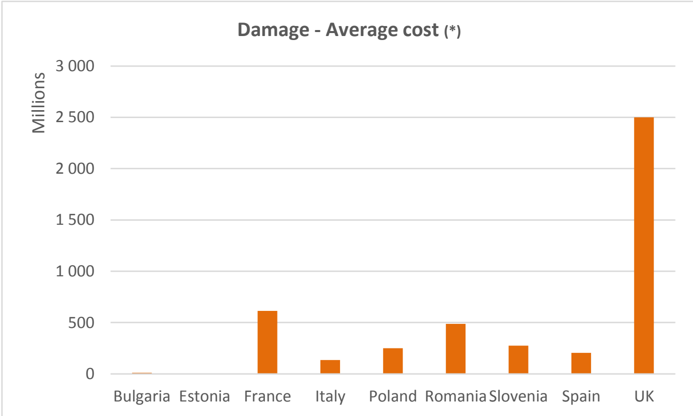

Figure 2 - Average cost for caused damage by country since 2000

If no geographical segmentation is applied, the differences between countries on level of risk (leading also to differences on insurance premiums) could create anti-selection phenomenon.

3. Scenario with no use of geographical criteria for risk pricing

Let's consider that every insured could take out via a website, his insurance contract on any insurance companies within the EU.

If we consider two insurers selling flood protection:

- ✓ Insurance company A in UK
- ✓ Insurance company B in Austria

The statistics here above show that the exposition to flood risk is much higher for UK than for Austria. Considering this, we can guess that flood insurance is more expensive in UK than in Austria.

So, in the scenario with no use of geographical criteria, there is an arbitrage opportunity where local policyholders in UK could subscribe massively, a cheaper contract in the insurance company B in Austria.

This scenario leads to:

- ✓ An anti-selection for the insurance company with the lowest prices: all bad risk will be concentrated in the same insurance company B in Austria
- ✓ The removal of the mitigation effect: everyone would subscribe in the same cheaper insurance company
- ✓ The bankruptcy for the insurance company with the highest prices in EU, here the company A in UK

However, we may assume that the removal of geographical criteria for risk pricing could be practicable with the following constraints:

- ✓ Setting up of reinsurance pool at European level (as for the state-level pool put in place in France for instance), for the mitigation of risks and prices in the European Union.
- ✓ Setting up of a single regulation for insurance contracts at European level, to avoid abuses

References

- ✓ https://ec.europa.eu/digital-single-market/geo-blocking-digital-single-market
- ✓ 2012 - "Reflection on the current debate on how to link flood insurance and disaster risk reduction in the European Union" - S. Surminski et al.

- ✓ 2007 – “Adaptive flood management: the role of insurance and compensation in Europe” – Bouwer et al.