



31 May - 03 June 2016

at  
ISEG- Lisbon School of Economics  
and Management

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## SUBMISSION FORM

Name: Lourdes Belchior Afonso

Company: CMA/FCT- UNL

T:?

M: ?

E:?

Title of Paper / Presentation / Session to appear in program: The impact of Bonus malus systems in finite and continuous time ruin probabilities in motor insurance considering an open versus a closed portfolio

Author/s:

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What will your final submission be? Presentation and Paper  Presentation Only

If selected, what level of knowledge will delegates attending your session require? (please select only) one

No prior knowledge  General industry knowledge assumed  Technical/specific industry knowledge assumed

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## ABSTRACT

### THE IMPACT OF BONUS MALUS SYSTEMS IN FINITE AND CONTINUOUS TIME RUIN PROBABILITIES IN MOTOR INSURANCE CONSIDERING AN OPEN VERSUS A CLOSED PORTFOLIO

L.B. Afonso, R. Cardoso, A.D. Egídio dos Reis, G.R. Guerreiro

**Key words:** Ruin probabilities; bonus malus system; motor insurance; open portfolio; closed portfolio

**Purpose of your paper:** To measure the impact on the ruin probability in finite and continuous time of an insurer operating in Portugal of the bonus malus systems that is usual to have in a motor insurance. We will consider the usual closed portfolio and a more realistic approach, an open portfolio.

**Abstract:** In motor insurance, we consider usually two types of ratemaking, *a priori* and *a posteriori*. Here, premium calculation is based on past experience and volatility is higher when compared to classical procedures where premium are paid continuously at a constant rate. Typically, the ruin probabilities are computed according to the classical Cramér-Lundberg model. Afonso *et al.* (2009) consider a model applicable to large portfolios where a varying premium is used by means of a mix of calculation and simulation. That procedure differs from the usual literature and allow us to obtain fast and reliable results in a finite and continuous time horizon. Those ideas can be brought for application in motor insurance ratemaking (experience rating), for two main reasons: First because premium calculation is applied for large portfolios, common in motor insurance, second because premium calculation is based on the past claim record. However, the model needs to be changed to fit in the features common in motor insurance.

Common experience rating models produce variations in annual premiums as function of the past claim number record, and not as a function of the past aggregate claims. This is approached by a Markov chain procedure. Only the number of claims is essential to determine the next rating class and calculate the applicable premium. However, aggregate claims are necessary to compute ruin probabilities for the portfolio.

We will measure the impact of a bonus malus system (BMS) in the ruin probabilities, considering different known optimal scales (e.g. Norberg, Borgan *et al.*, Gilde and Sundt and Andrade e Silva and Centeno), as well as real commercial scales. We will consider both closed and open portfolios and compare the results. In these scenarios we will use real data from automobile third-party liability portfolios of an insurer operating in Portugal.

The methodologies and tools to be used are Markov chains, compound Poisson process, translated gamma distributions approximations, optimal premium scales and simulation.

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