

# Bonus malus systems and finite and continuous time ruin probabilities in motor insurance

Afonso, L.B.<sup>1</sup>, Cardoso, R<sup>1</sup>, Egídio dos Reis, A.D.<sup>2</sup>, Guerreiro, G.R.<sup>1</sup>,

<sup>1</sup>*CMA and FCT, Universidade Nova de Lisboa*  
*lbafonso@fct.unl.pt, rrc@fct.unl.pt, grg@fct.unl.pt*  
<sup>2</sup>*ISEG and CEMAPRE, Universidade de Lisboa*  
*alfredo@iseg.ulisboa.pt*

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## 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. In these scenarios we will use real data from automobile third-party liability portfolios of a Portuguese insurer. The methodologies and tools to be used are Markov chains, compound Poisson process, translated gamma distributions approximations, optimal premium scales and simulation.

Keywords: Ruin probabilities; bonus malus system; motor insurance.

Lourdes B. Afonso  
Depart. de Matemática  
and CMA  
Faculdade Ciências e Tecnologia  
Universidade Nova de Lisboa  
2829-516 Caparica  
Portugal

lbafonso@fct.unl.pt

+351 212 948 388

Rui M.R. Cardoso  
Depart. de Matemática  
and CMA  
Faculdade Ciências e Tecnologia  
Universidade Nova de Lisboa  
2829-516 Caparica  
Portugal

rrc@fct.unl.pt

+351 212 948 388

Alfredo D. Egídio dos Reis  
Departamento de Gestão  
ISEG and CEMAPRE  
Universidade de Lisboa  
Rua do Quelhas 6  
1200-781 Lisboa  
Portugal

alfredo@iseg.ulisboa.pt

+351 213 922 766

Gracinda R. Guerreiro  
Depart. de Matemática  
-  
Faculdade Ciências e Tecnologia  
Universidade Nova de Lisboa  
2829-516 Caparica  
Portugal

grg@fct.unl.pt

+351 212 948 388