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ROLE OF THE LIABILITY INSURANCE IN THE ENTERPRISE RISK MANAGEMENT

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Summary: Safe, stable environment and predictability are of utmost importance during the operation of enterprises. One of the possible ways of preparing to the unexpected events and decreasing future risks is the insurance. Insurance companies offer several insurance products for companies, from which liability insurances are the most relevant. In the lack of insurance, uncommon damages which touch significant amount may destroy companies which affect negatively even the economy. Insurances and liability insurances therefore have outstanding, stabiliser role. This stabiliser role has significant effect particularly during economic crises, as it contributes to the economic growth by providing safe environment background to the recovery. The aim of the study is to shed light on the role and significance of liability insurances, by presenting the individual products of liability insurance and the possible risks of the enterprises. Also to assess the development, tendencies and current state of liability insurance market by interviewing the main actors of the liability insurance market and by analysing the aggregated market data of the past 10 years. The study highlights the risks of the currently under-insuranced market and that of the enterprises that possess low insurance limits, and the necessity of the mutually positive cooperation for both the domestic entrepreneur and insurance market.

Keywords: Liability Insurance, Enterprise Risk Management, Economic Stability

1. Introduction – types of the liability insurance

The managements of enterprises (especially of SMEs) are often not aware of the special features and the content of the different types of liability insurance products available on the market. In order to clarify these issues, in the introductory part of this study our aim is to define and describe the special features of liability insurance services, as well as the types and content of the most important liability insurances.

Liability risks are defined as loss exposures or loss through legal liability arising from actions of businesses (and individuals) that cause harm to others. This risk is considered to be one of the key risks a company faces, and the type of risk varies greatly according to the type of the activity, the size and the legal environment of the specific company. Besides the typical noninsurance risk management techniques (such as risk avoidance, loss control, risk retention), liability insurance have proven to be an effective method to protect market players against liability losses. Liability insurance is special construct, in which the insurance company covers the losses, damages causes by the insured (specifically the company or the manager of the company). The insurance company in this case covers the losses for which the insured is legally liable (Trieschmann et al., 2005).

The specificities of liability insurance differentiate it from other insurance lines, notably from the commercial property insurance. As you see in Table 1, these objective differences make the world of liability insurance more complex, the coverage is usually broader and the construct is loaded with much more uncertainty.

Table 1: Main differences between liability and property insurance

	Commercial liability insurance	Commercial property insurance
Trigger event	Usually all events which are not excluded	Often confined to named perils
Insured risk	Refers to liability claims of third parties; scope of insurance uncertain	Refers to an insured object
Size of claim	Payout restricted by policy limits	Payout restricted by policy limit or by the value of the insured object
Time between premium payment and claims settlement	Claims may be discovered with a lag and settlement need time	Usually no lag and quick settlement

Source: Swiss Re (2009), p.5.

The tipology of the classic commercial liability insurances and professional liability insurance offered on the market is presented in Table 2.

Table 2: Types of commercial liability insurances

Commercial general liability (CGL)
Excess liability, umbrella
Environmental impairment liability
Product liability, Product recall and product integrity
Workers compensation and employers' liability, employment practices liability
Directors'& Officers' insurance (D&O)
Professional liability or errors and omission (such as medical malpractice or cover for accounting firms, layers, architects, etc.)

Source: based on Swiss Re (2009) p.7-8 and Swiss Re (2014) p.32.

The commercial general liability (CGL) used by companies to cover their general liability loss exposures. This liability policy covers bodily injury, property damage, personal and advertising injury and medical payments. The insurance company agree to pay on behalf of the insured except the damage is expected or intended. Among other things, contractual liability, liquor liability, workers compensations, employers' liability, environment pollution and aircraft are also in the exclusion list. As catastrophic loss exposures are not covered by commercial general liability, an excess or umbrella liability can help and provide protection to the business firms. Directors and Officers liability insurance (D&O) protect managers from claims which may arise from their own activities and own decisions. These activities and decisions are out of the company's contractual relationship and not in connection with the company's operations and goals. Professional liability insurance offers liability covers for special professional risks. These types of insurance provide protection to professionals such as lawyers, brokers, accountants, physicians, pharmacologists etc., who may cause damage to a third person under performing their professional services. These third persons are in contractual relationship with the professionals (Rejda & McNamara 2014).

2. Analysis of the Hungarian business liability market

The presentation of the assessment of changes and tendencies occurred on the liability insurance market and the presentation of the role and significance of the corporate liability

insurances were amongst our research goals. While concluding our analyses, we reviewed the current literature regarding the topic, assessed the aggregated market data provided by the MABISZ and interviewed the main actors of the liability insurance market.
The Hungarian liability insurance market is underdeveloped; the insurance penetration is significantly lower than the world average. As it is shown on Table 3, the largest market is by far the liability market of the United States, where 0,5% of the total GDP was spent on liability insurance in 2013. In Hungary, the same ratio was only 0,06%, which shows that the Hungarian companies have not yet realized the importance and significance of liability insurance as a risk management technique. As recent (2010) tragic event in Hungary has proven, some already paid a high price for that (the largest industrial disaster: waste reservoir collapsed at MAL Co. (covered up to 10 million HUF limit with liability insurance) released hazardous red sludge killing 10 people and causing at least 39 billion HUF in overall damages (hvg.hu).

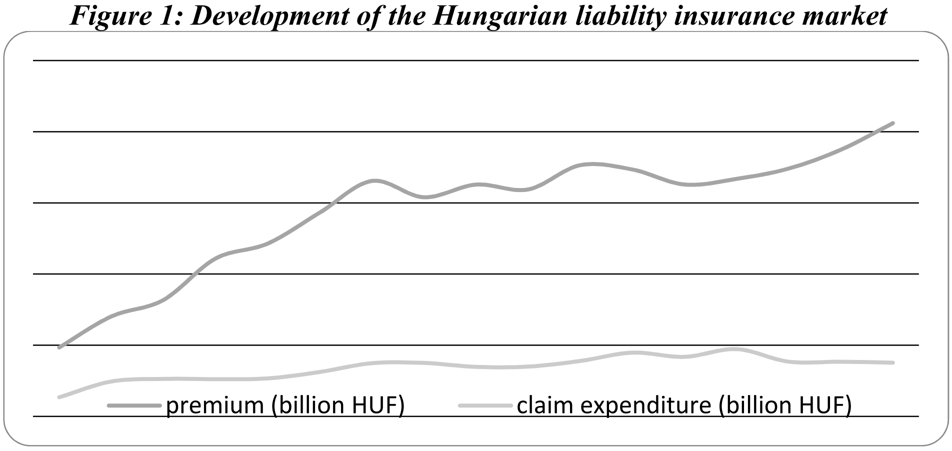
Table 3: Liability insurance penetration in international comparison

		Premiums & GDP (USD billions) - 2013			Percentage share	
Rank		Liability	Total Non-Life	GDP	Liability/Total Non-Life	Liability/GDP
1	**US**	84	531,2	16802	15,8%	**0,50%**
2	**UK**	9,9	99,2	2521	10,0%	0,39%
3	**Germany**	7,8	90,4	3713	8,6%	0,21%
4	**France**	6,8	83,1	2750	8,2%	0,25%
5	**Japan**	6	81	4964	7,4%	0,12%
6	**Canada**	5,2	50,5	1823	10,3%	0,29%
7	**Italy**	5	47,6	2073	10,5%	0,24%
8	**Australia**	4,8	32,7	1506	14,7%	0,32%
9	**China**	3,5	105,5	9345	3,3%	0,04%
10	**Spain**	2,2	31	1361	7,1%	0,16%
	TOP10	**135**	**1150**	**46900**	**11,7%**	**0,29%**
	World	160	1550	61700	10,3%	0,26%
	Hungary	0,067	1,3042	105	5,1%	**0,06%**

Source: Swiss Re (2014), p5.

The Hungarian insurance market has been steadily growing from a very low base level (see Figure 1).

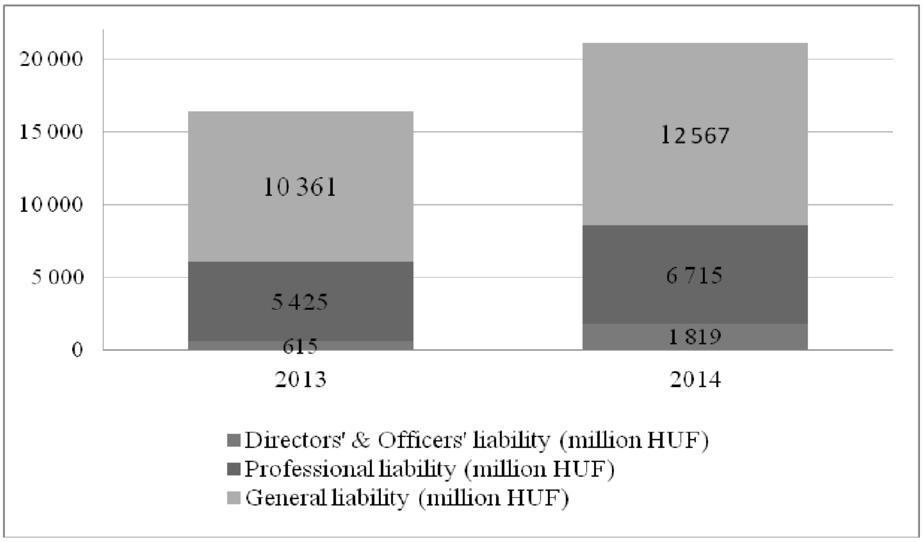
Figure 1: Development of the Hungarian liability insurance market



Source: MNB (2015)

In 2014 the total liability insurance market amounted up to ca. 20 billion HUF gross written premium. The claim ratio has only been 23% on average in the last 10 years (2005-2014), signalling a market segment with above average profitability compared to the total non-life insurance market profitability.
In 2014, the small segment (8.8% of the liability insurance market) of Directors & Officers Liability Insurance has received more attention and focus due to significant changes in the Hungarian Civil Code, according to which from March 15, 2014, companies and the management of companies are universally liable for damages caused by the company. As a result, D&O insurance grew significantly: closing portfolio was 615 million HUF in 2013 vs. 1,819 million HUF in 2014. The number of contracts is still very low (only 3811). Despite of the low number of contracts (3.7% of the liability insurance market), the increasing of premium of D&O insurances (1204 million) on the whole liability insurance market means almost 30% of the 4 billion increase which took place in the past year. Figure 2 shows the total premium and ratio of the three main types of the liability insurance in 2013 and 2014.

Figure 2: Premium of the Hungarian liability insurance market



Source: MABISZ (2015)

The growth of the total premium can be explained partly by the increasing number of contracts (professional and D&O) and partly by the increasing of general premiums. The degree of being exempted from responsibility during professional damages decreases which show to the direction of the objective responsibility.
Regulations make compulsory to conclude liability insurance in case of an increasing number of professions which draw the market's attention to the liability insurances. Besides, the insurance amounts of HUF 5-10 million laid down in the contracts concluded by the domestic companies deemed to be rather low. This is partly due to the bounding nature of insurances, as companies cannot see the real significance of the insurance, their primary goal is to conclude the contract on the lowest price possible. The management of most of the companies is not able to seize correctly the risks and their degree which the company has to face which also leads to the consequence that the chosen liability insurance does not cover the possible risks.

3. Conclusion

Although in the past year the modification of the legal background contributed to the increasing role of the liability insurance, the domestic enterprises are still not fully aware of their significance. One of the biggest problems of the domestic market is the extremely low penetration. Having insurance is not sufficient in itself if it does not cover the real risks or does not provide the appropriate cover on the given risk.

To decrease the lack of information on corporate side, experts should also be involved. Regarding real risks seized by these experts, the insurances concluded on appropriate limits (even HUF 50-100 million) may provide real cover for the companies.

By communicating the significance of the liability insurance, by the economic up-turn and by the change of the legal background, the level of insurance is expected to increase in the future. Market actors become more conscious and they turn their attention to the insurance companies, so that the demand of insurance increases on corporate side.

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