COMMERCIAL INSURANCE AS A TOOL OF CONSUMER PROTECTION IN THE CZECH REPUBLIC[69]

Eva Ducháčková[70]
Jarmila Radová[71]
Jaroslav Daňhel[72]

DOI: https://doi.org/10.31410/limen.2018.181

Abstract: *Guarantee insurance is used by the state to solve some questions of consumer protection. To be specific it is insurance of tour operators against bankruptcy. The insurance covers business risks of businesses and legal entities and that is the reason why the use of guarantee insurance in this context brings about several problems. On the one hand there are theoretical problems which deal with interpretation and explanation of the nature and principles of insurance and their application to insurance products and also problems concerning risk assessment of these products. On the other hand, there are problems which deal with practical application and which are connected with the fact that there is no big interest in this kind of guarantee insurance among insurers with regard to their nature.*
Consumers demand full insurance coverage, however, taking into account the regulation of insurance market and the nature of insurance it is not possible to guarantee full insurance cover of losses which are caused by bankruptcy of a tour operator or an employment agency. At present, travel agents have a new duty to contribute to the guarantee fund. This means that there is an effort for multi-source funding to protect the consumer. The aim of this article is to analyze and assess the role commercial insurance plays in consumer protection within the context of the business of tour operators.

Keywords: *Tour operator, guarantee fond, guarantee insurance*

1. INTRODUCTION

Consumer protection is an issue, which in recent years, has been addressed in different areas of economic life. In some cases, commercial insurance has been used by the state as an alternative tool of consumer protection, especially in those areas where problems with the financial losses of consumers are involved, and where consumers have already suffered losses (especially financial losses) as a result of business activities. Tour operators and employment agencies in the Czech Republic are among those businesses whose activities may result in financial losses for consumers, and thus they are affected by attempts to compensate consumers for their losses using commercial insurance.

Tour operators are legally obliged to have a financial guarantee against bankruptcy:
either guarantee insurance,
or a bank guarantee.

[69] The article is processed as an output of a research project Trends in the banking and insurance sectors in changing financial markets registered by the University of Economics under the registration number IGA F1/21/2016 and of a research project GAČR 16-21506S, "New Sources of Systemic Risk in the Financial Markets"
[70] University of Economics, Prague, 130 67 Prague 3, Czech Republic
[71] University of Economics, Prague, 130 67 Prague 3, Czech Republic
[72] University of Economics, Prague, 130 67 Prague 3, Czech Republic

In accordance with the requirements of European legislation, consumer protection is further ensured by the creation of a so-called guarantee fund. The implementation of the guarantee fund is linked to the requirement to cover all the claims of tour operators' clients who have suffered a loss, as insurers and banks are willing to cover losses up to a specific limit.

The aim of this article is to analyze and assess the role commercial insurance plays in consumer protection within the context of the business of tour operators. It also evaluates the problems regarding the use of relevant insurance products, in particular from the theoretical point of view.

2. INSURANCE OF TOUR OPERATORS AND EMPLOYMENT AGENCIES AGAINST BANKRUPTCY

Tour operators mainly use guarantee insurance as a guarantee (in accordance with the requirement of the relevant legislation).

The term itself - insurance against bankruptcy – is controversial, as both the conduct of business and the likelihood of bankruptcy are associated and linked to deliberate risk. From the theoretical point of view, deliberate risks are not supposed to be a subject matter of commercial insurance. Commercial insurance entails, from the theoretical point of view, net risks, i.e. risks which, if taken, may have only a negative impact (in contrast to deliberate risks, which, if taken, may result in either a positive or a negative outcome) and, consequently, net risks are not caused deliberately (in the course of conducting business, companies deliberately take risks when expecting the positive outcome of such risks).

The main problem concerning the insurance of employment agencies is the risk assessment of their business, as the insurance involved is insurance to cover financial losses and is closely related to the agencies' approach to doing business. Moreover, the use of mandatory insurance may be linked to moral hazard in business.

3. A HISTORICAL VIEW

The insurance of tour operators was introduced in the Czech Republic as mandatory contractual insurance in the year 2000 (October 1st). The reason for the legal regulation of the activity of tour operators and the introduction, at the same time, of the mandatory insurance of tour operators in the Czech Republic against bankruptcy was the attempt to solve the problems connected with the functioning of tour operators in the second half of the 1990s. During that period, tour operators were going bankrupt, with a negative impact on their clients (in 1997 alone, six thousand clients of tour operators got stranded abroad without any provision of repatriation). These problems were caused by the rapid development of the tourist industry in the 1990s, which was connected with the growth in the number of tour operators (in 1989, there were only six tour operators in Czechoslovakia, while in 1990, the number had already reached 600). Insurance is one of the tools that can be used to relieve the negative impact of the bankruptcy of tour operators on their clients (no provision of repatriation and no financial compensation for services paid for but provided only in part or not all). In addition to insurance, tools such as a guarantee fund, a pledged deposit or bank guarantee may also be used. The insurance of tour operators against bankruptcy was introduced in the conditions of the Czech Republic in the form of mandatory contractual insurance. That means that taking out insurance is a precondition for the commercial activity of a tour operator, a tour operator being defined as a "commercial entity, which, on the basis of a concession, is authorized to organize, offer and sell excursions" [1]. The term "excursion" is taken to mean the combination of at least two of the following services: transport, accommodation, and other tourist services constituting a significant part of the excursion, or whose cost constitutes at least 20% of the cost of the excursion [1].

This means that mandatory insurance does not apply to the services of so-called travel agencies; neither does it apply to those services offered by tour operators which do not fall within the definition of an excursion (individual tourist services, the sale of objects connected with tourism etc.) The insurance of tour operators is, by its nature, guarantee insurance, that is insurance, which is meant to cover the obligations, which the insurance policy holder has towards other parties [2]. According to the law governing this type of insurance, the function of the insurance is to cover losses incurred by the clients of a tour operator in the event of its bankruptcy, namely: the total lack of provision of a purchased service, the failure to provide contractual services in the location of the excursion (for example, failure to provide a transfer from an airport, or a lack of accommodation), failure to provide repatriation to the client's home country, interruption of the client's stay.

4. AN INSURANCE POOL

Since October 2000, the provision of insurance to cover the bankruptcy of tour operators has meant, on the one hand, a new business opportunity for insurance companies, while, on the other hand it has been a relatively questionable product [3]. The insurance companies were given the task of introducing a new type of product (at that time, even guarantee insurance was not widespread on the Czech market). They had no experience of covering that type of risk. Before offering insurance products, it is necessary first to determine the presumed size of the possible indemnity payments in order to set the level of the insurance premium. In the case of the insurance of tour operators, it is necessary to evaluate the seriousness of the risk (financial risk). When an insurance product is introduced, it is very complicated to evaluate in advance the probability of bankruptcy and the extent of the damage it may cause.

Concerns about the size of the risk (especially following the development in the second half of the 1990s) led the insurance companies to unite in a co-insurance pool [2] (p. 107), in order to cover the possible impact of the risks. A co-insurance pool is a voluntary association of insurers established to create a greater insurance portfolio and joint cover of large-scale insurance events.

At the same time, a co-insurance pool means that the associated insurers offer an insurance product under the same conditions, and that one insurer is empowered to do business in the name of all the members of the pool. It also means that the coinsurance pool can hedge its assets as whole. This characteristic clearly means that, on the one hand, risks are covered jointly, while on the other hand the pool has an impact on the principles of market competition. That is why the pool was granted a two-year exception for its activity by the Office for the Protection of Competition valid from 12.1.2001 [4].

Membership of the pool (see Tab. 1) brings several advantages, above all:
the distribution and minimization of risk through the acquisition of quality reinsurance abroad and also the reduction of administrative costs,
a certain amount of standardization of the evaluation of risks of those parties interested in insurance, which contributes to the harmonization of the insurance conditions of tour operators of comparable type,

a simpler system for the clients thanks to the centralization of the reporting of loss occurrence and the harmonization of conditions for the payment of damages.

Table 1: Structure of the co-insurance pool

Insurer	Share in %
Allianz pojišťovna	11,11
Česká podnikatelská pojišťovna	11,11
Česká pojišťovna	11,11
Česko-rakouská pojišťovna	5,56
Generali pojišťovna	16,67
ČS-Živnostnská pojišťovna	11,11
IPB pojišťovna	11,11
Kooperativa pojišťovna	11,11
Komerční pojišťovna	11,11
Total	100,00

Source: Internal sources of the company Etics ITP, s.r.o. [5]

The division of capacity within the pool means that when there is an insurance claim incurring indemnity of less than 45 million Czech crowns, the amount is paid out by the members of the pool according to a given ratio. If the indemnity exceeds that amount, the difference between the amount to be paid and 45 million Czech crowns is covered by the reinsurer up to the total capacity of the pool (to a maximum of 150 million Czech crowns). If the amount required to cover exceptionally high risks exceeds that total capital, the leading insurer provides individual reinsurance to the required amount.

During the autumn of 2002, the Office for the Protection of Competition issued a ruling [6] which extended the validity of the exception from the ban on an agreement on a joint approach by insurers towards guarantee insurance in the case of the bankruptcy of a tour operator until 31.12.2003. Nevertheless, the granting of that exception was subsequently restricted by several conditions, which were, however, not fulfilled by the insurance companies (for example, the setting of a unified tariff scale, the lack of individual reinsurance, and, above all, the lack of competitive insurance). For that reason, the insurance pool terminated its activity at the end of 2003, which, in fact, led to the de-monopolization of the market for that type of insurance.

At the beginning of 2004, there were only five insurers on the market, which offered insurance against the bankruptcy of a tour operator. During the course of the following years, the structure of that market has changed. Currently, a relatively small number of insurance companies offers the insurance of tour operators: Česká podnikatelská pojišťovna, ERV pojišťovna, Generali pojišťovna, Slavia pojišťovna, UNIQA pojišťovna, and the Slovak insurance company Union. This lack of interest in providing insurance for tour operators is due to the nature of the insurance, its level of risk and problems connected with providing insurance as a matter of principle.

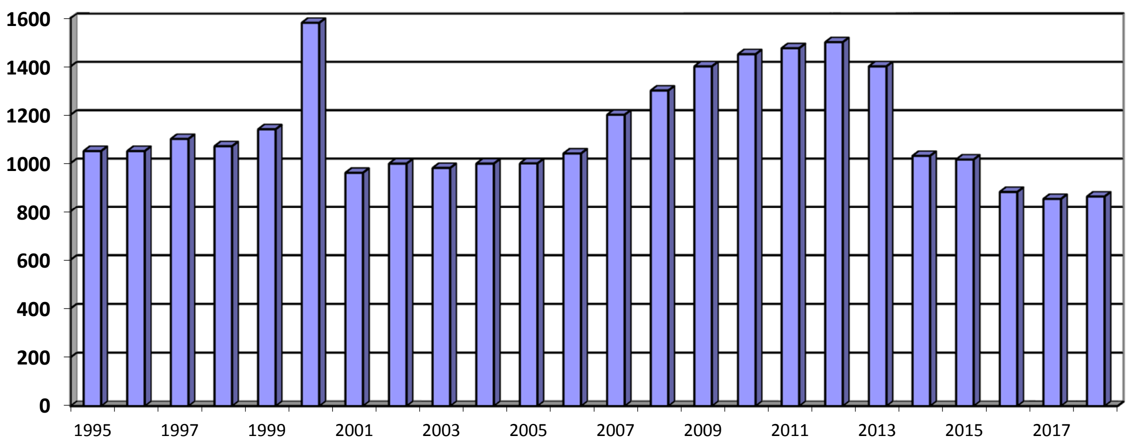
5. PROBLEMS CONNECTED WITH THE INSURANCE OF TOUR OPERATORS

From the point of view of insurance theory, the question of the nature of the risks covered when applying the mandatory insurance of tour operators is a problematic one. According to insurance theory, insurance as a financial category is focused on covering so-called net risks [7] the negative impact of which is determined by completely random factors. The opposite of net risks are so-called calculated risks, which can be influenced by an interested party. From a theoretical point of view, the character of this type of insurance is, therefore, questionable, as the major causes of the bankruptcy of tour operators include the wrong business plan, the underestimation of risks, a decline in demand, a too narrow focus on a particular type of tourism or region, and the devaluation of the Czech crown. In the past, the cause of the bankruptcy of tour operator sometimes turned out to be fraudulent practices, or even the establishment of a tour operator with the intention to commit fraud. The fact that the insurance of tour operators is in conflict with the very nature of insurance as a financial category gives rise to some problems connected with the operation of that type of insurance.

There is a relatively large number of tour operators on the Czech market (see Fig. 1), but the number of tour operators has fallen in recent years. The decline in the number of travel agents is due to new regulatory approaches, particularly mandatory insurance.

The tour operators are insured by six insurance companies (see Tab. 2).

Fig. 1: Number of tour operators on the Czech market



Source: Statistics on tour operators, Ministry for Local Development, available at www.mmr.cz [8]

Table 2: Distribution of tour operators insured by individual insurance (2018)

Insurer	Number of insured tour operators
Generali pojišťovna	208
Česká podnikatelská pojišťovna	192
Uniqua pojišťovna	118
Union poišťovňa	190
ERV pojišťovna	117
Slavia pojišťovna	37

Source: Number of insured tour operators, available at https://www.accka.cz/stranka/zakony-a-dokumenty/seznam-pojistenych-ck/12093 [9]

Tour operators are obliged to take out insurance, although there have, of course, been cases where that obligation has not been fulfilled. If the insurance of a tour operator expires and the operator continues to sell excursions, the lack of insurance usually only becomes apparent when a problem arises. In the case of a formerly insured, but now uninsured tour operator, according to the principles of insurance, the insurance company, which insured the tour operator, does not pay out indemnity to the tour operator's clients. Practically speaking, from the point of view of the timescale of the insurance of tour operators, the principle of loss occurrence is applied, which means that insurance applies to excursions sold during the period when the tour operator's insurance policy was valid, even if the loss occurs when the policy is no longer valid. In addition, there is a problem with the definition of the term "excursion", which is the subject of the insurance. If a tour operator intentionally divides the services it offers into parts (for example, accommodation, transport), the services of the operator are no longer insured and, in the case of bankruptcy, the clients have no claim to indemnity.

Another problematic issue is the size of the insured sum. According to the law, a tour operator must take out insurance to cover a sum equal to at least 30% of its annual planned takings from the sale of excursions. At the same time, the size of the insured sum has an impact on the insurance premium (alongside other factors such as the destination countries of the excursions, the means of transport, the evaluation of the creditworthiness of the tour operator, the structure of its assets, its liquidity etc.). If the insured sum is underestimated and an insurance claim is made, the insurance company, according to the principles of insurance, pays out indemnity only up to the agreed insured sum. In some cases, this situation has arisen following the bankruptcy of tour operators. The clients did not receive indemnity in full. In some cases, this has led to litigation, and some insurance companies have been required to pay indemnity greater than the agreed insured sum. This approach displays a lack of understanding of the principles of insurance, as insurance companies, when taking on risks by insuring them, and when evaluating the risks (in order to set the insurance premium), base their decisions on the insured sum.

An insurance company cannot assume the pay-out of indemnity greater than the agreed insured sum. If that was required of an insurance company, it would mean the possibility of moral hazard on the part of the tour operators and the rejection of the basic principles of insurance theory. It would also be in conflict with the rules on the economic activity of insurance companies, especially those rules found in the law on the insurance business (any proposed law on the tourist industry requiring insurance companies to pay indemnity greater than the agreed insured sum could deter commercial insurance companies from offering that type of insurance).

Within the context of the insurance of tour operators a debate has arisen about the fact that insurance companies use limit of cover when constructing their insurance products. Aggrieved clients in particular did not understand that, when an insurance company went bankrupt, they did not receive insurance cover equal to their real financial losses caused by the failure of the tour operator to fulfil its obligations, but a smaller amount, because the tour operator had agreed an insufficiently large insured sum.

A lack of understanding of the nature of commercial insurance has also been seen in the approach of relevant state institutions, which have requested unlimited insurance cover from insurance companies. In such cases it is very complicated for insurance companies to evaluate the level of risk and to set an appropriate insurance premium, which is something required of them by the regulation of the insurance sector.

Within the framework of mandatory insurance cover, the current modification assumes a limit on insurance pay-outs, but requires greater responsibility on the part of insurance companies when making decisions about the size of the insured sum (coverage limit) and, at the same time, requires that the tour operators regularly inform their insurance companies about the sales of their excursions.

The fact that there is a problem connected with the activity of tour operators is currently shown by the number of tour operators that have gone bankrupt in the period following the introduction of mandatory guarantee insurance (see tab.3).

Table 3: Number of bankruptcies of tour operators

year	Number of cases
2001	3
2002	4
2003	5
2004	4
2005	4
2006	1
2007	3
2008	1
2009	3
2010	9
2011	10
2012	8
2013	5
2014	3
2015	3
2016	2
2017	2
2018	3

Source: Number of bankruptcies of tour operators, Ministry for Local Development, available at https://www.mmr.cz/cs/Pro-media/Tiskove-zpravy [10]

According to the legal regulation [1] a bank guarantee is an alternative to guarantee insurance. In reality, however, bank guarantees are not utilized. The solution to the problem of tour operator bankruptcy requires a specific approach, and the banks on the Czech market basically do not offer an appropriate product.

5. GUARANTEE FUND

Efforts to ensure full compensation for clients' losses in the case of the bankruptcy of a tour operator led to the creation of a multi-source solution to the negative impact of bankruptcy. This stemmed from the decision to introduce a guarantee fund (from 1.7.2018).

In addition to their obligation to have a guarantee in the form of guarantee insurance or a bank guarantee, tour operators are also obliged to contribute to a guarantee fund. It is from this fund that compensation is paid out to the aggrieved clients of a tour operator if the company goes bankrupt and the limit of its indemnity payment is not sufficient to cover all the claims of the clients.

Tour operators are obliged to pay annually into the guarantee fund 0.1% of the revenue from excursions sold (the original aim was for this to be 0.25% of revenue from tour sales). The size of this contribution will change in future as the volume of the guarantee fund increases – The contribution could be reduced to zero when the fund reaches 50 million CZK. The introduction of the guarantee fund increases the overall costs of tour operators, which has led to a discussion about its necessity [11].

At the same time the use of the financial resources concentrated in the guarantee fund poses a problem, as, alongside its basic purpose of covering clients' claims in the event of the bankruptcy of a tour operator, it is assumed that it will be used for other purposes, for example the promotion of tourism in the Czech Republic.

6. SUMMARY

Guarantee insurance has a relatively short history on the Czech insurance market. Under the conditions of the Czech insurance market the state uses guarantee insurance, within the framework of the two forms of mandatory insurance, to resolve the issue of consumer protection. It could be said that, to a certain extent, responsibility for the entrepreneurial risk of selected commercial entities is transferred to commercial insurance companies. In the case of tour operators and employment agencies the risk that is insured is the risk of bankruptcy. The very nature of these insurance products is a theoretical problem. According to insurance theory, one of the basic principles of insurance as a financial category is the fact that insurance covers only so-called net risks. The business activity of tour operators and employment agencies is, however, connected with so-called deliberate risks (and, according to insurance theory, insurance should not deal with those). A theoretical problem connected with the implementation of insurance covering deliberate risks is then the possibility of moral hazard, which is incompatible with the essence of insurance.

Within the framework of the provision of the monitored insurance products a complex issue arises on the one hand from the setting of an appropriate insured sum (limit of cover) and, on the other hand, from accurate risk assessment, that is the setting of an appropriate insurance premium and other connected technical parameters of insurance, such as the size of the technical provisions and sufficient reinsurance. The result of this is that there is little interest among insurers in offering guarantee insurance in the form of the insurance of tour operators against bankruptcy. That type of insurance is offered only by a limited number of insurers.

Guarantee insurance is used by the state to resolve the issue of consumer protection, and, in this case, it is mandatory insurance. Because it involves the covering of the entrepreneurial risk of an economic entity, the use of guarantee insurance for this purpose brings a number of problems. Some are problems of a theoretical nature connected with the explanation of the fundamental nature of insurance and its application to specific insurance products and problems arising from the issues of risk assessment connected with those products.

Others are problems with the practical application of insurance arising from the fact that insurers are not greatly interested in offering that kind of guarantee insurance. (Only six insurers offer it on the Czech insurance market).

The problems of ensuring consumer protection using commercial insurance are also connected with an understanding of the fundamental nature of insurance. Consumers demand insurance compensation in full, but due to the regulation of the insurance business and the very nature of insurance itself, it is not possible in all cases to cover all losses caused by the bankruptcy of a tour operator.

That is why over time other tools have come into use to provide a guarantee for tour operators. These include a bank guarantee as an alternative to guarantee insurance. However, that option is not currently used as it is unavailable. (The banks simply do not offer that product).

In addition, the guarantee fund was introduced as a superstructure for guarantee insurance and bank guarantees. This made the system of consumer protection in the travel business more complicated and more expensive. The introduction of the guarantee fund solved the problem of how to cover the claims of tour operators' clients in full in cases of bankruptcy (which was also a requirement of European legislation). However, because it is so costly, the justification for such strong consumer protection remains questionable.

REFERENCES

[1] Law no.159/1999 Coll., on certain conditions of commercial activity and the performance of certain activities in the field of tourism. Available from: <http://www.podnikatel.cz/zakony/zakon-c-159-1999-sb-o-nekterych-pod-minkach-podnikani-v-oblasti-cestovniho-ruchu-a-o-zmene-zakona-c/>. [30 October 2018]

[2] Ducháčková, E., 2015. Pojištění a pojišťovnictví. Praha, Ekopress, p. 206

[3] Ducháčková, E., Radová, J., Daňhel, J., 2015. The role of the insurance of tour operators against bankruptcy in the conditions of the Czech Republic, Czech Hospitality and Tourism Papers 25, 30-39.

[4] Ruling of the Office for the Protection of Competition on the granting of an exception. Available from: <http://kraken.slv.cz/UOHSS001/2000>. [14 February 2016].

[5] Internal sources of the company Etics ITP, s.r.o.

[6] Ruling of the Office for the Protection of Competition on the granting of an exception. Available from: <http://www.compet.cz/hospodarska-soutez/sbirky-rozhodnuti/903>. [23 February 2018].

[7] Rejda, G E., 2005. Principles of risk management and insurance. Boston, Addison-Wesley.

[8] Insured tour operators, Ministry for Local Development. Available from: <http://www.mmr.cz/cs/Regionalni-politika-a-cestovni-ruch/Cestovni-ruch/Dovolena-bez-starosti/Cestujete-s-cestovni-kancelari>. [10 October 2018].

[9] Number of insured tour operators, available at https://www.accka.cz/stranka/zakony-a-dokumenty/seznam-pojistenych-ck/12093

[10] Number of bankruptcies of tour operators, Ministry for Local Development, Available from: <http://www.compet.cz/hospodarska-soutez/sbirky-rozhodnuti/903/>. [13 October 2018].

[11] Guarantee Fund of tour operators managed of State Housing Development Fund. Available from: < http://www.sfrb.cz/garancni-fond/>. [14 October 2018].