ABSTRACT

The main purpose of this study is to empirically investigate the existence of adverse selection and market signaling in the Malaysian automobile insurance market. The sample contains data on 345 insured parties under the comprehensive insurance scheme for the year 2001. While adverse selection and market signaling are widely regarded as the outcome of information asymmetry, there have been few empirical studies testing for their presence in the market.

The main finding of the study is that the problem of adverse selection exists in the Malaysian automobile insurance market. However, the insurer can differentiate between risk types of customers. The results suggest that market signaling occurs in the Malaysian insurance market.

Evidence also points towards cross-subsidization of high-risk customers by low-risk customers in the nonlinear pricing equilibrium.