

The Hon Christine Robertson MLC
Committee Chair
Legislative Council Standing Committee
on Law and Justice
Parliament House
Macquarie Street
Sydney NSW 2000

21 July 2010

Dear Ms Robertson

**TENTH REVIEW OF THE EXERCISE OF THE FUNCTIONS OF THE MAA AND MAC
& THIRD REVIEW OF THE EXERCISE OF THE FUNCTION OF THE LTCSA AND
LTCSAC**

The Insurance Council of Australia and our members thanks you for the opportunity of giving evidence to the Standing Committee on Law and Justice's Tenth Review of the exercise of functions of the Motor Accidents Authority (MAA) and the Motor Accidents Council (MAC) in addition to the Third Review of the review of the exercise of the function of the Lifetime Care & Support Authority (LTCSA) and the Lifetime Care & Support Advisory Council (LTCSAC) on 11 June 2010.

Our specific responses to questions posed by the committee are attached.

We value our relationship with the MAA, MAC, LTCSA and LTCSAC and the ability to provide information and assistance to each of these bodies over a wide range of areas. The Insurance Council and its members look forward to working with all stakeholders to continue to evolve the successful CTP and Lifetime Care schemes.

Yours sincerely,



Robert Whelan
Executive Director & CEO

STANDING COMMITTEE ON LAW AND JUSTICE
Tenth review of the exercise of the functions of the MAA and MAC
Third review of the exercise of the function of the LTCSA and LTCSAC

Insurance Council of Australia Supplementary Submission
Questions asked by Committee

CTP Insurance market

1. Can you describe the current state of the CTP insurance market in NSW?

The Insurance Council supports the MAA's view that the CTP insurance market in NSW is competitive and generally healthy.¹ We submit that the objectives of the scheme are being met. There is strong competition between the insurers with meaningful price variations between the segments and shifting market shares, indicative of competitive forces.²

In particular we believe that all the stakeholders have gained a deeper appreciation of the scheme as they further understand the dynamics of claimant behaviour, motorist behaviour, claims management practices and pricing. Our members report that there is generally good communication between the stakeholders which leads to regular enhancements to the scheme for the benefits of injured persons and stakeholders.

Affordability

2. It has been suggested that because the global financial crisis caused a drop in returns on investments for insurance companies, this has led to an increase in CTP premium prices.
 - Do you agree that the global financial crisis has led to the increase in CTP premium prices seen in the 08/09 financial year?
 - Do periods of high return on investment, such as the years leading up to the global financial crisis, lead to a corresponding reduction in premium prices by insurance companies? If not, why?

NSW, as a privately underwritten state, is a file and write system. Individual Insurers must file a base rate premium with the MAA who can then approve or decline to approve it.

The base premiums for all classes of vehicles and regions are calculated by applying the relativities set by the MAA in accordance with their Premium Determination Guidelines (PDG's). Insurers can then discount or add loadings (bonus/ malus) to the rate in accordance with the PDG's. A range of factors go into premium price setting including claims severity, claims frequency, investment returns on capital etc.

The MAA highlighted this process when giving evidence before the Committee on 21 June 2010. When speaking about the premium setting process Carmel Donnelly, General Manager of the MAA referred to the process insurers need to go through:

They need to put in a very comprehensive submission, which is looking at the claims frequency of their own and the industry, the average cost of claims, the risk-free rate of Commonwealth bonds, inflation in the scheme,

¹ Motor Accidents Authority Annual Report 2008-2009, page 72

² Motor Accidents Authority Annual Report 2008-2009, page 73

inflation in the economy—a large number of factors. They need to document those for the past and estimate them for the future. They need to have all of that signed off by independent actuaries according to a standard from the Australian Institute of Actuaries, then it needs to be signed by the chief executive officer and then it needs to be tabled with the insurance company's board. Then they give it to us. They are only able to say, "We are setting a premium now for the policies that we intend to write in the next future period to provide for the claims that we expect to arise from accidents in the future period." At the moment we are protected from them coming back and making up for any losses.³

The Insurance Council notes that the Global Financial Crisis has affected investment returns, primarily through interest rates. As such we submit that the Global Financial Crisis is one of the factors that has led to an increase in premiums. Insurers pay claims partly from the premiums they collect and partly from the interest income they derive on those premiums. In the absence of interest income, insurers needed to increase premiums to ensure that claims could be paid.

Increasing interest rates will generally lead to reductions in premium if all other things are equal. The reduction in premiums prior to the Global Financial Crisis is testament to this. The requirements of the PDGs require insurers to allow for future investment earnings at the expected rate based on the investments. This ensures there is a direct correlation between interest rates and premiums.

Bulk-billed ambulance and hospital costs

3. From 1 October 2006 bulk-billed ambulance and hospital costs became payable by the MAA rather than the insurer. Over the previous four financial years this cost to insurers averaged around \$41 million.⁴ Did being relieved of this cost result in insurers lowering the price of premiums? If not, why?

The Insurance Council notes that the MAA has taken over direct control of the bulk billing arrangements for hospital and ambulance costs for motor vehicle accidents.⁵ While the cost of these payments is no longer reflected in the insurer's base premium, they are now accounted for under the MCIS levy. In these circumstances there has been no effect on the total amount of greenslip costs for the motorists as a result of these arrangements. The insurers' role is limited to collecting the levy on behalf of the MAA.

Insurer profits

4. During the hearing on Friday 11 June the Bar Association tendered a document titled 'Summary of Insurer Profitability Projections' (*copy attached*). Could you please comment on the information in the document?

The Insurance Council notes that this issue was raised with the MAA on the second day of hearings on 21 June 2010. Carmel Donnelly referred to the Taylor Fry report dated 10 June 2010 tendered at the first hearing on 6 June 2010. The scheme actuary commented on the information contained in Annexure A of the Bar Association Submission.

³ Transcript Law & Justice Committee Hearing 21.6.10 p, 61

⁴ MAA Annual Report 08/09, p 75 (footnote 1 for table)

⁵ This includes all accidents irrespective of fault from 1 July 2009, referred to in the Motor Accidents Authority Annual Report 2008-2009, page 21

In relation to the estimation of ultimate insurer profits, Taylor Fry concluded that the estimates of insurer profits for any given underwriting year are “inherently uncertain”.⁶ We submit that this table should not be looked at in isolation having regard to the changes in the methodology which have been used to calculate the estimates over time.⁷

We believe that the entire report prepared by Cumpston Sarjeant Pty Ltd, Consulting Actuaries to the Law Council of Australia should be examined by the Committee in the light of the comments provided by Taylor Fry. In fact Cumpston Sarjeant has acknowledged the uncertainty of the estimates when they stated “*The actual profit to emerge is uncertain, and shall depend on the ultimate payments for each underwriting year.*”⁸

It is in this context that we refer to the Bar Association’s evidence to the Committee which asserted that there was a systematic discrepancy between the budgeted profits and the projections of actual profits resulting in consistently higher projected actual profits than those originally budgeted for. The Bar Association went on to say that “falling accident numbers have had a role to play in this”. The Insurance Council submits that falling accident numbers are primarily responsible for the difference between the budgeted profits and the projections of future actual profits.

Although there are certain historical underwriting years (2000 to 2008), where the ultimate profit margins are estimated to be higher than the filed profit margins, we do not believe that this implies any conservatism in the insurer filings. Rather, we submit that this arises when the actual experience is quite different to that which had been expected. For each year from 2000 through to 2008, the actual claim frequency has reduced unexpectedly, and we believe that this is the primary cause of the profit being higher than expected. For every year during this period, neither insurers nor the MAA expected the claim frequency to continue to reduce at the rate it did.

The issue of insurer profits generally and the reduction in claims frequency has been examined by the Committee in its previous reviews. We note the evidence and reports provided by the MAA on this issue to the Seventh and Eighth Review. The issue of claims frequency has also been commented on by this committee in the report on the Seventh Review of the MAA:

*2.131 The Committee is satisfied that the primary reason for the discrepancy between profit margins contained in CTP filings and the MAA’s estimate of the profit likely to be realised on those premiums is the fall in the risk premium between 1999 and the present, comprising a reduction in the claim frequency, propensity to claim and the average cost per claim.*⁹

However, frequency does not always reduce and, in fact, for the 2007/08 underwriting year through to 2009/10, our members report that the claim frequency has increased and is higher than what was expected in the filings for those periods. Accordingly we submit that insurers’ filings did not reflect this higher claim frequency until 1 July 2010, resulting in more than two years of premium priced to a lower frequency than what has actually occurred.

⁶ Taylor Fry Hindsight estimates 10 June 2010 pp 1 and 5-6

⁷ Transcript Law & Justice Committee Hearing 21.6.10 p, 59

⁸ Cumpston Sarjeant February 2010, p4

⁹ Review of the exercise of the functions of the MAA and the MAC - Seventh Report dated September 2006, p38

The Insurance Council submits that this is a clear example that shows insurers' assumptions, while uncertain are not conservative, and that actual profit margins for these two years could be lower than originally estimated.

5. The Committee understands that insurer profits from a given underwriting year change over time due to the fact that claims may not be made until some time after that year's premium is paid – hence the distinction between 'estimated' profits and 'actual' profits.
 - Is it the case that if the 'estimated' profits from a given underwriting year are based on accurate assumptions, the 'actual' profit from premiums paid that year should, in the long term, trend closer and closer to the 'estimated' profit?

The Insurance Council refers to our discussion under question 4 concerning the difference between the circumstances at the time of the original estimate and the actual experience many years later. The Insurance Council submits that insurers set their assumptions on the best information they have at hand at the point the premiums are set.

The PDGs confirm that the following different checks of the premium setting process are made by:

- The insurer's qualified actuaries,
- external qualified actuaries,
- the MAA's qualified actuary,
- product and claims managers, and
- the executives of each insurer.

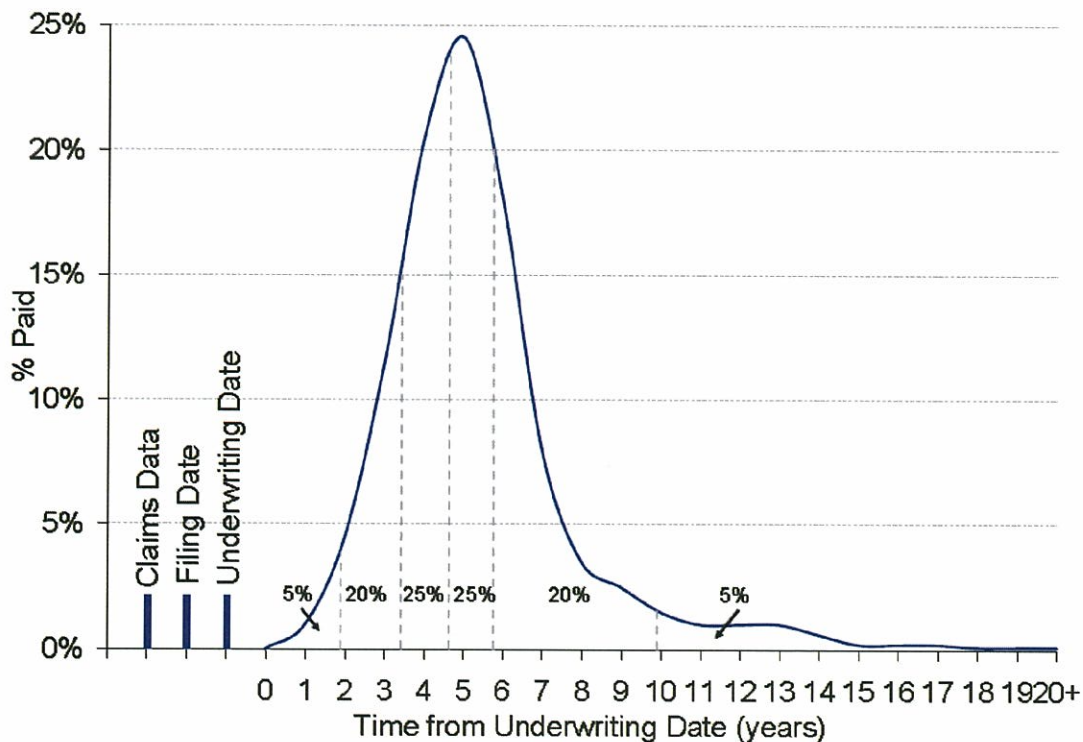
Accordingly the Insurance Council submits that the MAA has strict regulatory control over the premium setting process. This was highlighted during the evidence given by Carmel Donnelly:

That being said, the scheme that we are responsible for implementing has got regulatory oversight, to some degree, over profit. The way that that is designed in the legislation is that the MAA has the power to undertake a compliance assessment when insurers lodge a submission because they want to change their premiums, and we have a six-week period in which we can look at the compliance of the filing of that submission for a change of premiums against four criteria in the Act.¹⁰

¹⁰ Transcript Law & Justice Committee Hearing 21.6.10 p, 59

However the Insurance Council would like to draw to the Committee’s attention that the payment of claims often occurs many years later that the date the original premium was set. This is reflected in the graph below:

Graph – Timeline of Claims payments from Underwriting Date



Source: Insurance Council information obtained from members

In the experience of our members:

- 5% of claims payments are made up to 2 year after setting of premiums.
- The next 20% of claim payment are made up to 3.5 years after setting the premiums.
- The next 25% of claim payment are made up to 4.5 years after setting the premiums.
- The next 25% of claim payment are made up to 5.5 years after setting the premiums.
- The final 25% of claim payment are made up to 20 years after setting the premiums.

Our members report that the payments made in the few years after setting the premiums are likely to closely match the assumptions. However, we submit that for the payments made up to 20 years later than the original premium was set, it is likely that the actual experience will differ substantially from the original assumptions.

Some of the reasons for this divergence from the original assumptions over a 20 year period are:

- Changes in legislation,
- Changes arising from decisions in case law,
- Developments in case law resulting in superimposed inflation,
- Changes to interest rates and other economic parameters,
- Changes to claims management practices,
- Changes to the regulations by which insurers must manage claims, and
- Increases or decreases in claim frequency.

The Insurance Council submits that it is these environmental changes that render insurers' original assumptions less accurate over time. By the time insurers settle the last 25% of claims, the political, economic and claim environments are often substantially different to when they made the original calculations for the greenslip premium. Accordingly the estimated and actual profits recorded over time may diverge considerably.

6. Does the consistent trend over the life of the Scheme of annually revising estimated profits upwards for each underwriting year indicate that original profit estimates are incorporating unrealistically high estimates of future compensation payouts into their premiums?
- If so, at what point do you consider the method of making these estimations should be reviewed?

The Insurance Council strongly refutes any suggestion that our members provide unrealistic estimates of future payouts in setting premium levels. While the MAA has set a particular profit margin for insurers when calculating premiums, the Insurance Council does not concede that this is an appropriate level of profit in commercial terms and notes that this has been an issue of discussion with insurers over many years.¹¹

Following our discussion under questions 4 and 5 above, the Insurance Council submits that it is important to differentiate between prospective and retrospective profit.

Unlike many other products the cost of an insurance product is not known at the time an insurer establishes the price and in the case of CTP will not in fact be known for several years after the insurer sells a policy. As an example, NSW CTP insurers were required to file their premiums for policies to be written between 1 July 2010 and 30 June 2011 at the start of April 2010. The claims component of these premiums would mainly have been based on analysis of claims experience up to December 2009. Claims from the policies written after 1 July 2010 will occur sometime between 1 July 2010 and 30 June 2012. The majority of the claims will be paid after 2015. There is therefore up to a 10 year delay between the environment when analysis of claims costs was undertaken and prices established and the environment when claims will be paid.

We submit that the final cost of these claims will depend on a large number of factors including –

- the number of people injured in motor vehicle accidents and the seriousness of their injuries
- the number of those injured people who lodge a CTP claim
- the future economic, social and legal environment which will influence the amount of compensation a person with particular injuries and disabilities is entitled to.

While our members have control of their claims management processes there are a number of influences on claims costs over which they have little or no control.

When insurers set their prices they make an estimate of the prospective claims environment based on analysis of the past environment and include a target profit margin – this is the prospective profit margin and this is what is relevant when looking at the adequacy or otherwise of current premiums.

¹¹ See the reported discussions in this regard in the Review of the exercise of the functions of the MAA and the MAC - Seventh Report dated September 2006, p18

The actual or hindsight profit margin will depend on how the claims environment actually unfolds, including those elements over which insurers have little control. It is in the light of these variances that the MAA as regulator monitors the level of insurer profits.

7. The MAA's 08/09 Annual Report states that the estimated profit for insurers from the 2008 underwriting year is 1%.¹²
- Does this mean that insurers 'expect' to make 1% from the 2008 underwriting year?
 - If not, can you explain why insurers would expect to make a profit that differs from the estimated profit?
 - If so, what is the incentive for insurers to remain in the Scheme when expected profits are so low?

The Insurance Council supports the information provided by the MAA in their answer to question 9 raised by the Standing Committee on Law & Justice on the Tenth Review of the MAA and MAC. Our members are bound by the minimum capital requirements set by APRA. In applying to the MAA for approval of a particular premium, our members are also required to take into account adequate returns on that capital, long term interest rates and claims frequency and size.

Specifically insurers have to comply with the PDGs issued by the MAA when seeking approval for new premiums. In regard to profit the PDGs reflect the statutory requirement that an insurer's filed premium must **fully fund** the liabilities including providing a profit margin "in excess of all claims costs and expenses that represents an adequate return on capital invested and compensation for the risk taken".¹³

The Insurance Council submits that the fully funded test means that if an insurer has under or over estimated the anticipated claims costs included in premiums it cannot –

- Use excess profits to subsidise future premiums, or
- Recoup any losses made from future premiums.

It also means that once insurers recognise that they have under or over estimated prospective claims costs they need to include the new higher or lower view of claims in prospective premiums. The Insurance Council submits that the fully funded test is very important from the perspective of premium stability for consumers as well as financial security for insurers.

As each insurer is required to take these factors into consideration when applying for a new premium rate, the Insurance Council submits that the competition in the market affords the consumer a range of green slip prices to choose from.

Insurer-initiated court proceedings

8. The MAA has noted that a working party including the Insurance Council of Australia has considered the issue of insurer-initiated court proceedings in the context of a review of the Motor Accidents Compensation Regulation 2005.¹⁴
- Can you explain the significance of the issue of insurer-initiated court proceedings in the context the review of the Regulation?
 - Can you outline the Insurance Council's view on this issue?

¹² MAA Annual Report 08/09, p 75

¹³ Section 27(8) of the *Motor Accident Compensation Act 1999*

¹⁴ MAA answers to pre-hearing QONs, q 15, p 10

Our members are participating in the MAA's working party considering the issue of insurer-initiated court proceedings in the context of the statutory review of the costs regulation in addition to other issues concerning legal costs. That process is continuing and we have not received details of any recommendations arising so far.

Care provided under the LTCS Scheme

9. Your submission argues that insurers should be involved in determining what care is provided to participants of the Lifetime Care and Support Scheme since this will have a 'flow-on' effect to the CTP scheme in which our insurers operate.¹⁵ The LTCSA has not supported this proposal, arguing that 'any participant who is receiving care for their brain injury or spinal cord injury will probably become a lifetime participant in the Scheme' and therefore 'the insurer will not be paying for the care of these participants.'¹⁶
- Can you elaborate on the 'flow-on' effect mentioned in your submission?
 - What role do you envisage insurers could play in determining what care is provided to LTCS Scheme participants?
 - What is your response to the LTCSA not supporting this proposal?

The Insurance Council notes that the LTCS Scheme remains in its early stages. The CTP Insurers involvement in the LTCS Scheme is limited in that they are responsible for the other heads of damages for Injured Persons who are in the lifetime care scheme. From the Insurance Council's understanding and experience of our members, to date the LTCS Scheme is working well, although the operation of the scheme is a work in progress.

Accordingly we accept the view of the LTCSA to maintain control over costs of care under the scheme.

However, we remain keen to work with the LTCSA as the scheme progresses. We are also participating in ongoing dialogue with MAA and the LTCSA to ensure that there is no duplication of services for those participants in the Scheme and that insurers are also included in any significant changes to the operation of the scheme.

10. Your submission recommends that the Motor Accidents Compensation Act be amended to clarify that no additional damages can be claimed for treatment and care apart from those available under the LTCS Scheme'.¹⁷ Can you explain this issue and your recommendation to us?

The Insurance Council submits that the original intention of Parliament was to ensure that any medical, rehabilitation and care needs for those catastrophically injured are provided through the LTCS Scheme.

However we believe that the current wording of the section does not make this clear and so has opened the potential for injured persons to claim particular types of care – such as gratuitous attendant care services – as part of their CTP claim against the driver of the vehicle at fault.

¹⁵ Submission 14, Insurance Council of Australia, p 10

¹⁶ LTCSA response to pre-hearing QONs, q 35, p 26

¹⁷ Submission 14, Insurance Council of Australia, p 10

There are two different funding mechanisms for the payment of damages and compensation for catastrophically injured persons. The MCIS levy is designed to fund expenses provided by the LTCSA to all those who suffer a catastrophic injury. The greenslip premium covers the payment of damages for those who were injured because of the fault of another vehicle.

We submit that there should not be any ambiguity as to which funding source is required to cover the particular expense sought.

As such we have approached Minister Daley to recommend that the section be amended to make it clear that only particular damages (which do not include medical expenses and care) can be awarded to catastrophically injured persons who claim damages against an at-fault vehicle.