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18 April 2006

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11-9 APR 2006

LAW & JUSTICE

Ms Rachel Callinan
Director
Standing Committee on Law and Justice
Legislative Council
Parliament House
Macquarie Street
Sydney NSW 2000

Dear Ms Callinan,

Seventh review of the exercise of the functions of the Motor Accidents Authority and the Motor Accidents Council

I refer to your letter of 4 April 2006 forwarding the transcript of my evidence and a number of questions taken on notice during the hearing.

I return the transcript of my evidence, with some minor corrections.

For the information of the Standing Committee, I can confirm that the Insurance Council of Australia provided nominations for appointment to the Motor Accidents Council on 27 September 2005. During my evidence, I indicated that the nominations were provided in December 2005 "but it may well have been earlier than that". ICA records confirm that the nominations were in fact provided in September 2005.

I will now respond to the questions taken on notice.

Level of Capital in the Scheme

In general, long tail insurance products such as compulsory third party insurance carries with it a larger degree of uncertainty than does short tail insurance, where the claims are largely made and paid shortly after the period covered by the policy. Because of this level of uncertainty, APRA requires insurers to carry higher levels of capital in respect of CTP business than is required for short tail products such as motor property damage insurance.

The Motor Accidents Authority has argued in the past that because of the close level of monitoring of the NSW CTP scheme by the MAA, and the Government's readiness to adjust the scheme if negative cost trends are emerging, the level of uncertainty is not as great as other long tail classes such as public liability insurance. To date, APRA has not accepted this argument, and treats CTP insurance in a similar manner to other long tail classes of insurance for the purposes of calculating minimum capital requirements.

APRA has indicated that it is difficult to determine a specific level of capital backing for each particular class of business an insurer writes. APRA prefers to examine the whole book of business being written by an insurer, and to ensure that the insurer overall has sufficient capital and other reserves to be able to pay its claims as and when they fall due. APRA takes account of the nature and type of insurance products sold by the insurer in determining its minimum capital requirement, but ultimately determines a capital requirement for the insurer as a whole rather than for individual product lines.

"Are capitalisation levels in the scheme appropriate?"

Insurers manage their financial position to ensure that they are meeting APRA obligations at all times (in terms of the overall capital position of the company). Insurers also allocate capital internally across their various product lines. The internal allocation of capital is a process undertaken within each insurer, and ICA plays no role in relation to this process.

Overall, insurers underwriting the New South Wales Motor Accidents Compensation Scheme are comfortably capitalised, according to recent data published by APRA. Insurers currently maintain more than two times the minimum capital requirement. This means that insurers are well placed to meet their obligations to policyholders and claimants if the industry experiences larger than expected claims costs or other adverse conditions.

The most recent discussion by APRA of these issues is contained in *APRA Insight*, 3rd Quarter 2005, available at: <http://www.apra.gov.au/Insight/>

It should be noted that the level of capitalisation required for the NSW Motor Accidents Compensation Scheme is likely to change with the introduction of the Lifetime Care and Support Scheme. The actual nature of any such change is currently being considered by individual insurers.

"Can we infer that an adequate return on capital is the rate of return sufficient to attract the required amount of capital to the NSW CTP scheme?"

Insurers seek capital from the financial markets to operate their overall books of business. Insurers aim to provide a return on that capital consistent with the expectations of the providers of the capital – ie the capital markets. Hence, it is important that the overall performance of an insurer is one that enables the company to provide a return on capital that is consistent with market expectations.

"Can we also infer that an adequate return on capital will change as the cost of capital on international capital markets rises and falls?"

Capital is provided via the financial markets in Australia and overseas. A true market operates in this regard, and the market expectations can change over time. It is more correct to state that an adequate return on capital will change as the cost of capital in the Australian capital markets rises and falls.

Other Matters

In addition to the foregoing, I would like to provide the Standing Committee with brief additional comments on questions put to representatives of the NSW Bar Association. I was not provided with an opportunity to comment on these matters while giving evidence on 31 March 2006.

The *Motor Accidents Compensation Act 1999* was passed by the Parliament with the aim of reducing the level of general damages that would be available in cases of relatively minor injuries, and with the specific aim of reducing green slip premiums.

The early experience of this legislation has proved favourable, because the number of claims has been fewer than expected. The cost of claims has been consistent with what was predicted at the time the legislation was passed.

As the early experience in relation to the number of claims was observed and understood, insurers reduced premiums further. The benefits of the early trends were passed on to motor vehicle owners in the form of cheaper green slips.

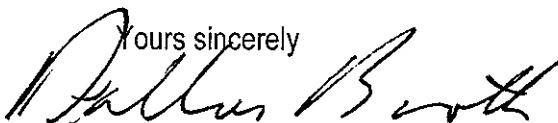
There are cost penalties that dissuade any party to legal proceedings from presenting baseless arguments to the courts. Insurers, on behalf of their policyholders, are subject to cost penalties if they pursue groundless defences to a claim. The costs penalties apply to all parties to the proceedings, not just to the claimant (see section 348, *Legal Profession Act 2004*).

Finally, the most recent information regarding the performance of compulsory third party insurance is contained in the APRA Half Yearly General Insurance Bulletin, published on 30 March 2006, available at: <http://www.apra.gov.au/Statistics/GI-Half-Yearly-Statistics.cfm>

This publication provides aggregated information regarding compulsory third party insurance in New South Wales and the Australian Capital Territory. For the 12 months to 30 June 2005, insurance companies reported Gross Premium Revenue of \$1,549 million for NSW and ACT CTP business (table 10). During the same period, insurers reported Gross Claims Expense of \$1,486 million (table 11). In addition to the Gross Claims Expense, insurers will also incur the cost of acquiring the business and of administering the policies. It is clear from these figures that the overall level of premiums is not excessive when compared to the overall level of claims.

Please do not hesitate to contact me if I can be of further assistance to the Standing Committee.

Yours sincerely



Dallas Booth
Deputy Chief Executive