

STANDING COMMITTEE ON LAW AND JUSTICE

12TH REVIEW OF THE EXERCISE OF THE FUNCTIONS OF THE MOTOR ACCIDENTS AUTHORITY

SUPPLEMENTARY QUESTIONS

1. Which elements of the CTP pricing review are still being progressed?

In 2012 the Government directed the Motor Accidents Authority (MAA) to undertake a review of Compulsory Third Party (CTP) pricing and develop options to assist in containing Green Slip price increases and ensure the long term sustainability of the motor accidents scheme.

The Terms of Reference for the review looked at:

- insurer profits and costs;
- transparency in legal costs to ensure injured parties are fairly treated in terms of entitlements;
- fair and affordable CTP Green Slip pricing; and
- ensuring the MAA has optimal regulatory powers.

The CTP Pricing Strategy led to the now withdrawn *Motor Accident Injuries Amendment Bill 2013*. The MAA is continuing to progress elements of the Strategy which did not require legislation through a program which seeks to improve the CTP scheme within the current framework. This includes:

- giving effect to the overarching objectives of the motor accidents compensation scheme, including to provide just and fair compensation to claimants and to encourage early and appropriate treatment and rehabilitation to achieve optimum recovery from injuries sustained in motor accidents;
- simplifying the claims processes and forms to encourage early resolution and reduce Scheme costs, particularly the need for legal expenses;
- enhanced dispute resolution processes so that claims can be finalised more quickly which will lead to improved health outcomes;
- a more robust premium framework to increase transparency in price setting, reduce costs and examine options for risk management and equalisation;
- strengthening scheme guidelines to provide improved guidance for insurers, and modernise and streamline market practices; and
- remaking the *Motor Accidents Compensation Regulation 2005* to provide incentives for fair and early resolution of claims and disputes.

2. Can the MAA provide examples to the Committee of effective scheme designs that incorporate pooling as an incentive for insurers to avoid bad risk?

Risk pooling is a way of removing higher risks from the general market and placing them in a pool so the risk is shared or underwritten by all insurers on an agreed basis thus removing the incentive to avoid bad risks in a compulsory scheme and ensure this pool is equally subsidised by the market as a whole.

Section 29 of the *Motor Accidents Compensation Act 1999* allows for the entering into arrangements to make a risk adjustment among licensed insurers by:

- allocating high risk third-party policies among insurers;

- the pooling of premiums collected from the issue of third-party policies and for the allocation of the premiums among insurers; and
- the pooling of the costs of claims for motor accidents covered by high risk third-party policies and for the allocation of those costs among insurers.

Risk pooling mechanisms are commonly used in compulsory insurance schemes. In Australia, risk pooling is used within the health insurance market. Health insurers that write more than their share of poor risk business can take from the pool, thereby equalising the effect of an unbalanced portfolio.

The MAA is reviewing all aspects of the premium framework in NSW and will consider the efficacy of risk pooling and other options.

3. Please provide information on the Premium Determination Guidelines.

The MAA regulates premiums by issuing Premiums Determination Guidelines (PDGs). The PDGs specify the manner in which insurers determine Green Slip prices and what is required to satisfy the MAA that the pricing proposal is neither excessive nor insufficient to cover future liabilities.

The MAA has developed a new approach to the PDGs to address a number of issues with the current Scheme pricing. The new PDGs have been written in order to:

1. create a more robust filing process from both the insurer and MAA perspectives;
2. create a more transparent process for filings; and
3. communicate the MAA's expectations in relation to insurers' rate filings submissions.

These changes have been the subject of consultation with insurers and will be submitted to the Safety, Return to Work and Support Board in June for approval and commencement in the second half of 2014.

The summary of the main changes are:

- re-structuring the PDG into:
 - a formal Guideline to clarify where insurers must comply with MAA requirements;
 - a Practice Note for aspects of the rate filing process or requirements that are not compulsory, and explain good practice; and
 - an Explanatory Note which sets out the rationale for the changes;
- requiring the assumptions such as claims costs, expenses and economic assumptions to be based on central estimates (thus limiting the capacity for insurers to adopt overly conservative estimates across all assumptions);
- establishing higher levels of justification, explanation and documentation required in the filings;
- setting up new engagement processes that should result in a better mutual understanding between and the MAA and insurers; and
- making the accountabilities for filings clearer.

4. In your view, if the MAA were to provide an annual scheme performance report which examines drivers of insurer profits, would such a report fit under s 28 of

the *Motor Accidents Compensation Act 1999*, or would the legislation need to be amended?

Section 28 provides for the Motor Accidents Authority to assess the profit margin of individual insurers, based on premium filings, the actuarial basis for its calculation, and to present a report on that assessment annually to the Parliamentary Committee. An annual scheme performance report to the Committee, which includes a report on the assessment of profit, would appear to satisfy the MAA's reporting obligations under Section 28

5. Has the MAA identified barriers to entry to Green Slip provision?

There are a number of barriers to entry for insurers in writing New South Wales CTP business. These include:

- The likelihood that a new entrant would pick up a higher proportion of bad risks, and make losses, in the early years;
- The likely need for sufficient scale to enter the market (eg a critical mass to write at least 5% of the market) and for insurers to make a long term commitment to the market;
- The need to write policies for 'all-comers', thus removing the prospects for specialist or niche insurers to enter the market;
- The significant capital requirements including the need to comply with the Australian Prudential Regulation Authority's (APRA) minimum capital adequacy requirements, and the length of time capital must be reserved (the opportunity cost of capital); and
- The need to establish specialist teams for the distribution of policies and the management of claims (especially personal injury specialists) that are not normally found in general insurers.

6. Is there any modelling to suggest what level of competition optimises a required rate of return for insurers and value for consumers of Green Slips?

Market competition should provide benefits in terms of better price competition for motorists. However, the necessary rate of return for insurers is in large part a product of the capital requirements (opportunity costs and uncertainty), which is not overcome by competition alone but may be addressed by underlying scheme design.

7. Is there any evidence the current number of insurers is behaving inefficiently or in a manner that distorts pricing?

In general, scheme design is the main source of inefficiency in the market rather than the level of competition. There is, however, evidence of poor levels of price competition, especially within sub-markets of CTP, which enable individual insurers to influence price setting in these sub-markets. For example, in practice, only between one and three insurers actively compete in markets such as taxis, fleets, new cars, and motorbikes. The existence of a dominant insurer allows that insurer to also influence overall price setting in the market. Such design aspects can be addressed, in part, through a restructure of the premium framework, which will be undertaken by the MAA this year.

8. Has there been any studies by consultants (such as Deloitte or KPMG) analysing the market for Green Slips in NSW?

In late 2009 the MAA commissioned economist and academic, Dr Peter Abelson, to lead a review of competition issues in the NSW CTP scheme. Dr Abelson produced a report that is commercial in confidence due to the detailed comment and analysis of individual insurers. The findings of this report were used in the Pricing Review and are being considered in aspects of the current non-legislative scheme enhancements.

The report, which was presented in early 2011, found that the CTP system was generally stable, but with limited price competition.

There appears to be little interest in entry into the market which is characterised by complex regulations and where insurers are required as part of the business to take on, and subsidise, bad risks.

Given the restricted nature of competition within the industry (along with the current regulations) competition cannot be relied upon to ensure that CTP prices are never excessive, particularly in sub-markets that are dominated by one or two insurers.

There are some arguments for reform of the premium system including exploration of risk pooling or maximum prices schemes, with relaxation of other regulations to encourage more innovation and price competition.

These issues are being considered in the review of the premiums setting framework.

9. Are there any non-legislative strategies available to increase competition in the NSW Green Slip market?

Some non-legislative strategies that could be considered which may, in part, address barriers to entry include:

- Improvements to the premium framework including consideration of risk pooling provisions of the current Act;
- The adoption by the MAA of Market Practice Guidelines, currently under development, which are principle-based and encourage innovative acquisition approaches that encourage challenger brands with lower cost or alternative marketing strategies; and
- Measures to make claims handling more expeditious, also part of the current program of improvements, which may, in small part, address the capital reserving issues.

10. Are there any changes to the regulatory framework around Green Slips that could improve the attractiveness of the market to potential insurers that would not materially impact on risk to the taxpayer or consumer?

The principal barrier to entry is the capital required by underwriters in the scheme. There is only limited opportunity to address this as insurers wishing to apply for a licence to underwrite New South Wales CTP business must demonstrate to the MAA that they are compliant with APRA's minimum capital adequacy requirements and relevant Prudential Standards.

Although encouragement of competition is important, it is also important to protect the interest of consumers and, ultimately, taxpayers by ensuring insurers have sufficient funds to pay all claims (i.e. to avoid insurers becoming insolvent and passing the risk onto taxpayers). The findings arising from the HIH Royal Commission established compelling reasons to maintain good prudential supervision of insurers.

However, scheme design reforms which increase certainty and reduce capital requirements would likely create a more attractive market for new entrants.