

Submission

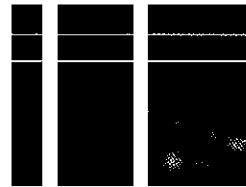
No 14

**INQUIRY INTO REVIEW OF THE EXERCISE OF THE
FUNCTIONS OF THE MOTOR ACCIDENTS AUTHORITY
AND THE MOTOR ACCIDENTS COUNCIL - SEVENTH
REVIEW**

Organisation: Insurance Council of Australia Ltd
Name: Mr Dallas Booth
Position: Deputy Chief Executive Officer
Telephone: 02 9253 5100
Date Received: 9/02/2006

Theme:

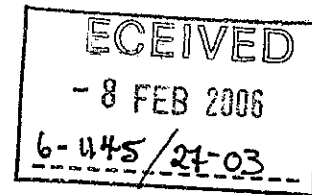
Summary:



Insurance Council of Australia Limited ABN 50 005 617 318 Level 3 56 Pitt Street Sydney NSW 2000 Australia
Telephone: 61 2 9253 5100 or 1300 728 228 Facsimile: 61 2 9253 5111

23 January 2006

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



Dear Ms Robertson

Seventh Review of the exercise of the functions of the MAA and the MAC

Thank you for your letter inviting the Insurance Council of Australia (ICA) to make a submission to the Standing Committee's Seventh Review of the exercise of functions of the Motor Accidents Authority (MAA) and the Motor Accidents Council (MAC).

All CTP insurers in New South Wales are members of the ICA. The ICA is pleased to have the opportunity to make the following submission on behalf of those insurers. The submission will address the "Motor Accidents Compensation Scheme 2004-05 Report", set out at page 75 of the MAA's Annual Report for 2004-2005.

CTP Insurance Market

The MAA considers the CTP insurance market is stable and competitive. ICA agrees with this conclusion – a competitive market is operating in New South Wales for the benefit of motor vehicle owners. Owners have a choice of insurer, each of which offers a range of prices depending on the insurer's assessment of the price needed to fund the risk exposure provided by the CTP policies they underwrite. At all times, insurers offer prices in accordance with the *Motor Accidents Compensation Act 1999* (the MAC Act), and the MAA's Premium Determination Guidelines.

CTP Premiums

The MAA notes that CTP premiums reduced during 2004-2005, with the average premium for a Sydney metropolitan passenger vehicle in the June 2005 quarter being \$324, compared to a premium of \$343 in the June 2004 quarter. The average premium for all NSW vehicles was also lower in the June 2005 quarter.

CTP insurers have clearly passed the benefits of recent claims experience on to motor vehicle owners, via lower premiums in 2004-2005. The affordability of Green Slips in NSW is now at historically very low levels, when determined as a percentage of average weekly earnings.

The affordability of Green Slips has been improving despite –

- Ongoing community wage inflation in the order of 3-4 per cent per annum;
- Ongoing consumer price index inflation in the order of 4-5 per cent per annum;
- Inflation allowances assumed by actuaries normally being at rates that are higher than these, to include provision for superimposed inflation.

Competition

The competitive nature of the CTP market in NSW is confirmed by the Scheme Annual Report, where the MAA indicates that a number of insurers reduced prices voluntarily during the course of the year, and that insurers also adjusted their bonus/malus structures during the year. Insurers regularly review and adjust both their prices and their bonus/malus arrangements to ensure they continue to offer the best prices they believe are appropriate for the CTP market and the portfolio of risks that they insure.

Report on Profit

Insurers cannot charge an insurance premium that has not been filed with the MAA under sections 25 and 26 of the MAC Act.

The MAA may reject a proposed set of premiums if they will not fully fund the present and likely future liabilities of the insurer under the Act, or if the premiums are, having regard to actuarial advice and to other relevant financial information available to the MAA, excessive – section 27 (1)(a) and (b) of the MAC Act. The MAA may also reject a premium if the Premium Determination Guidelines have been breached or if there is a contravention of section 30 relating to the maximum commission payable to insurers' agents.

A fully funded premium is defined by section 27(8) of the MAC Act. Section 27 specifically provides that a fully funded premium will include "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".

Section 28 requires the insurer to "disclose to the MAA the profit margin on which a premium is based and the actuarial basis for calculating that profit margin". The MAA is then required to assess that profit margin, and the actuarial basis for its calculation, and to present a report on that assessment annually to Parliament.

CTP insurance is long tail in nature – insurers will not know the extent to which a set of premiums were adequate to cover the risk taken until a number of years after the premiums have been collected.

CTP insurance is also uncertain, in that claims payments will be influenced by a wide variety of factors, some of which will not be known at the time the premium is determined by the insurer.

Experience under the current and former Acts is that the claims cost outcome is rarely in line with the level of costs expected to be incurred at the time the premium is set. The longer-term history of the Motor Accidents Compensation Scheme, since 1989, has been both positive and negative for insurers.

In order to provide for these uncertainties, insurers provide (and are required by the Australian Prudential Regulation Authority to provide) substantial capital to support the business they underwrite. The presence of this capital ensures that claims will be paid as and when they fall due for payment, regardless of whether the level of premium initially collected by the insurer at the time the policy was issued was sufficient to meet the cost of those claims.

The presence of insurer capital, in addition to the premium pool collected from motor vehicle owners, ensures that claims will be paid as and when they fall due.

Each insurer determines the level of capital it applies to NSW CTP business, and the return on capital it wishes to seek to achieve by participating in the business. Obviously, an insurer wishes to offer a sound financial return to its shareholders, as it competes for their support (ie capital) in the Australian and international capital markets. At the same time, the insurer's desire to maximise the return on capital is tempered by the competitive nature of the business, and the statutory obligation to justify the expected return on capital to the MAA.

Each CTP insurer provides substantial information and justification on expected profit to the MAA when filing proposed premiums, in compliance with section 28 of the MAC Act.

The MAA has reported, on pages 79 and 80 of the 2004-2005 Annual Report, on its assessment of the level of profit loadings included in insurer premium filings. ICA notes that the MAA believes the range of profit margins currently being filed as being reasonable, and also notes that the MAA has had discussions with individual insurers where appropriate.

The MAA argues that the risks associated with underwriting CTP business in NSW is less than for other long tail business because of the legislative changes to promote scheme stability and the existence of a regulator to closely monitor scheme performance. ICA notes that the level of capital will ultimately be influenced by APRA prudential requirements, and to date APRA has shown no indication of accepting the MAA's views in this regard.

ICA respectfully submits that both insurers and the MAA have fully satisfied their obligations under section 28 of the MAC Act.

Realised Profit

As noted in the Annual Report, section 5 of the MAC Act provides that insurers "as receivers of public money that is compulsorily levied, should account for their profit margins, and their records should be available to the Authority to ensure that accountability".

Insurers do not receive public money. Motor vehicle owners are required to maintain CTP insurance in respect of their vehicles. Owners purchase Green Slips from insurers, and in the course of doing so liabilities under the MAC Act are transferred from the owner and drivers of the vehicle to the insurer. The owner pays a premium to the insurer, which is then pooled with premiums paid by other vehicle owners, and claims are subsequently paid from this premium pool as and when they fall due for payment.

As part of the monitoring of insurers' financial position, the MAA receives both quarterly and annual financial statements from CTP insurers. These financial statements include the formal company accounts prepared in accordance with Australian accounting standards, and copies of financial returns provided to APRA, which are prepared on a differing accounting basis.

The MAA receives extensive financial information from each CTP insurer.

The MAA has included, at page 82 of the Annual Report, an estimate of profit for the first four years experience of the MAC Act. ICA wishes to emphasise that the "Estimated Profit" set out on page 82 is just that – an MAA estimate.

In particular, it is premature to attempt to assess either estimated or realised profit when only 66% of the estimated total claims cost of the first year of the MAC Act have been paid, and only 17% of the fourth year of the Act have been paid.

ICA also wishes to stress that since 1989, the Motor Accidents Compensation Scheme has provided both positive and negative returns for insurers. During periods of negative returns, insurers have met the cost of claims without subsequent recourse to motor vehicle owners, public funds or other funding sources.

In recent times, the scheme results have been positive. The key reason for this development is that in the early years of the MAC Act, claim numbers and claim frequency have been lower than expected by insurers, expert actuaries reviewing scheme experience, and by the MAA. As lower claim frequency trends were confirmed, insurers allowed for the new experience in their premium filings, but were again confronted with even lower claim frequency. Scheme experience indicates that claim frequency has now stabilised.

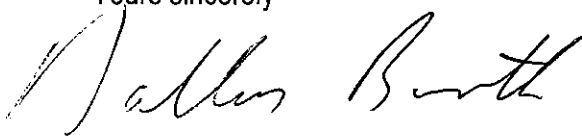
As a result of that positive experience, insurers have reduced the cost of Green Slips both in a relative sense (as a proportion of AWE) and in an absolute sense (historically lowest prices since the enactment of the MAC Act). At all times, insurer prices have been subject to oversight by the MAA.

ICA submits, therefore, that the processes for preparing and reviewing CTP prices in the NSW Motor Accidents Compensation Scheme are appropriate (in the way that they take account of developing Scheme experience as it becomes known), that there is full disclosure by insurers to the regulator, and that there is full transparency and accountability as required by the MAC Act.

It should also be noted that even where the scheme is profitable, these profits are taxed under the *Insurance Protection Tax Act 2001*. This Act prevents insurers from passing the tax on to their policyholders, hence making the tax payable out of insurer profits or insurer capital. The funds raised by this tax cover the cost of claims remaining after the failure of HIH Insurance.

Representatives of ICA and insurers would be pleased to discuss these important issues with the Standing Committee if required.

Yours sincerely

A handwritten signature in black ink that reads "Dallas Booth". The signature is written in a cursive style with a large initial 'D'.

Dallas Booth
Deputy Chief Executive