

The Hon Greg Pearce MLC
Minister for Finance & Services
Minister for the Illawarra

5 April 2013

Dear Minister

**THE NSW COMPULSORY THIRD PARTY GREEN SLIP INSURANCE SCHEME:
SUBMISSION TO THE CONSULTATION ON THE PROPOSED REFORMS**

The Insurance Council of Australia (ICA) is the representative body of the general insurance industry in Australia. ICA members represent more than 90 percent of total premium income written by private sector general insurers. ICA members, both insurers and reinsurers, are a significant part of the financial services system.

The New South Wales motor accidents compensation scheme (scheme) is underwritten by five private sector insurers operating under seven licences that are issued by the NSW Motor Accidents Authority (MAA), namely: NRMA, QBE, Allianz (Allianz and CIC-Allianz), Zurich and Suncorp (AAMI and GIO).

The five insurers that underwrite the scheme are regulated by the Australian Prudential Regulation Authority (APRA) and are subject to the requirements of the *Insurance Act 1973* (Cth).

The NSW Compulsory Third Party (CTP) scheme is a vital social support framework for NSW motorists and injured people alike. The scheme provides compensation for those people injured in a motor accident who are not at fault. It also provides, in certain circumstances, limited compensation for at fault injured people (for example, children, and people who have sustained catastrophic injuries).

The scheme ensures that injured people have a reliable source of funding for their compensation payments through the insurance mechanism that underpins the scheme. The scheme protects families from the financial burden of a motorist being personally responsible for compensation payments due to an injured person - which in some cases can amount to hundreds of thousands of dollars.

Private sector insurers have underwritten the CTP scheme in accordance with the *Motor Accidents Act 1988* (NSW), and they continue to do so in accordance with the *Motor Accidents Compensation Act 1999* (NSW).

The scheme has evolved over many years, and the ICA and its members have worked with successive NSW governments on scheme reforms since 1988 to better balance the needs of motorists and injured people.

Motorists need an affordable price for their CTP insurance. The community needs a scheme with a pricing framework that has some capacity to price according to the risk posed by the insured motorist, and thereby provide price incentives against risky behaviour or choices on our roads. Injured people need appropriate compensation that best supports them to fully recover as quickly as possible. If an injured person is permanently and seriously disabled, he or she needs lifetime care and support.

The ICA therefore welcomes the opportunity to provide this submission to the “Your Say” consultation on proposed reforms to the NSW Compulsory Third Party Green Slip Insurance Scheme , as set out in the MAA’s Consultation Paper released in February 2013 (MAA Paper).

This submission sets out the general insurance industry’s view on the objectives and principles for a compulsory accident compensation scheme, and a high-level response to the key reforms proposed in the MAA Paper.

As noted in the MAA Paper (page 12), the MAA will be consulting with stakeholders to guide the final shape of the legislation, regulations and guidelines. The MAA Paper also notes that the exact timetable for reform will be determined in consultation with insurers, in recognition of the considerable operational changes that will be involved (page 12).

For these reasons, this submission does not attempt to provide a detailed analysis of the reform proposals set out in the MAA Paper, and the ICA and its members look forward to consultations with the MAA as the finer details of the scheme reforms are developed.

The ICA’s objectives for compulsory accident compensation schemes

The NSW Motor Accidents Scheme is a compulsory accident compensation scheme. NSW motorists are required by law to have a CTP policy, purchased at the same time as a motor vehicle is registered.

In Australia, some motor accident schemes are underwritten by the State or Territory government. In these government schemes, compensation payments are funded by “premiums” collected and managed by a government agency.

The motor accident schemes in NSW, Queensland and the Australian Capital Territory are underwritten by private sector insurers. These privately underwritten schemes are funded by insurance premiums collected by private sector insurers, and the relevant State or Territory government is not “on risk” for the finances of the scheme. The financial risk of the scheme is borne by private insurers.

The ICA promotes the following key objectives for compulsory accident compensation schemes:

- a competitive industry for personal injury insurance;
- private underwriting for compulsory accident compensation schemes (the deployment of private sector capital to “underwrite” statutory schemes); and
- personal injury management and compensation frameworks that are focused on optimal health and work outcomes for injured people.

In considering the fundamental issue of scheme design reform, it is the ICA’s position that it is for governments to determine whether a compulsory compensation scheme is fault based, no fault, or a hybrid scheme that captures aspects of fault and no fault.

It is also the position of the ICA that it is for governments as a matter of public policy to determine the types and levels of benefits to be received by injured people under a compulsory accident compensation scheme.

However, ICA members that underwrite or insure the motor accident schemes in NSW, Queensland and the ACT have formed some consistent views about the most effective features of scheme design that can deliver a stable and efficient scheme, and good outcomes for injured people. These views derive from their long-standing experience in underwriting compulsory State and Territory accident compensation schemes.

ICA members can, and do, underwrite fault based, no fault and hybrid schemes in various jurisdictions. They also underwrite defined benefits schemes.

Irrespective of the scope of a particular scheme, important principles and scheme features for private insurers committing capital for a motor accidents scheme are:

- a long-term commitment by government to private underwriting, due to the significant allocation of capital required by private insurers, as well as funding for infrastructure costs;
- a recognised necessity for insurers to earn a reasonable return on capital;
- full scheme funding, and risk pricing (with affordability supported by a limited form of community rating);
- a regulated pricing framework that is free from political interference;
- no significant exposure for private insurers to adverse risk selection;
- no retrospective changes that would increase incurred claims costs - without the opportunity to collect premium to cover those liabilities; and
- effective controls to minimise superimposed inflation in order to limit scheme volatility.

More broadly, the ICA submits the following scheme design features are most likely to enhance scheme stability and effectiveness, and to deliver fair levels of benefits to injured people:

- a competitive market;
- an appropriate balance between premium affordability for motorists and levels of benefits to injured people;
- early access for injured people to medical treatment and rehabilitation;
- a focus by all scheme service providers on health outcomes (rather than a focus on maximising compensation);
- a framework that inhibits volatility and reduces friction costs such as legal fees, and superimposed inflation;
- access to a rapid and cost effective dispute resolution process; and
- permanent impairment or injury categorisation thresholds to provide a reasonable balance between access to appropriate benefits for the most seriously injured and scheme affordability for motorists.

Objectives for the CTP Review and the proposed Reforms

The proposed reforms in the MAA Paper are designed to achieve three main objectives, namely:

- improved scheme efficiency – the delivery of a greater proportion of premiums collected to injured people;
- improved affordability of Green Slip prices; and
- universal or no fault cover.

We make the following comments on the objectives of efficiency and affordability.

Efficiency

The efficiency of the scheme can be measured by calculating the amount returned to injured people divided by the total premium collected.

On page 6 of the MAA Paper, it is noted that:

“Since 1999, the proportion of dollars in the CTP Scheme (excluding LTCSS) going to claimants has averaged at 50% of money collected from vehicle owners. That is, **50 cents from every single dollar average NSW CTP Scheme efficiency 2000 to 2010 collected by CTP insurers from vehicle owners since 1999 has found its way to injured people.** If additional legal costs (known as contracted out legal costs) over and above the amounts payable under regulated schedules are taken into account, the efficiency of the Scheme is even more parlous.”

The ICA submits that improved transparency and understanding of all scheme costs will support the efficiency objective of this Review, and it will help to maintain public and political confidence in the scheme.

Complete transparency for all legal costs in the scheme is required.

Further, the ICA submits that the industry can assist with a better understanding concerning insurer profits in the scheme.

These matters have already been the subject of much recent debate – especially during hearings of the NSW Legislative Council’s Standing Committee on Law and Justice.

On the matter of insurer profits, we note a measure of transparency is already in place because insurers are required to disclose prospective profit levels. We submit, however, that further education of stakeholders is required. The ICA suggests that it works with the MAA to prepare a submission to the Standing Committee on Law and Justice to properly explain the central concept of an *adequate return on capital* - and the link to the range of profit margins required by private insurers that underwrite a statutory scheme in order to achieve an adequate return on capital. This paper will undoubtedly require the assistance of the Actuaries Institute, and we note that the Institute has already formed a working group to advance this issue.

On the matter of transparent legal costs, we note that plaintiff lawyers’ solicitor-client costs are the only costs borne by the scheme *that are not disclosed to the MAA* and, thus, can only be estimated. The ICA suggests that scheme transparency could be significantly improved if mandatory disclosures of plaintiff lawyer solicitor-client costs are made to the MAA and that these costs are reported in a manner similar to all other costs borne by the scheme. These should include legal costs paid in accordance with the scheme’s regulations, and costs which the plaintiff lawyer contracts with the claimant to be paid, which are outside of the regulated legal costs framework of the scheme.

Affordability

Affordability is an important scheme measure for NSW motorists. Over the last three years the price of CTP premiums has increased by over 30%. The ICA submits that this increase has been mainly due to falling investment returns for insurers and increased claims costs.

In particular, the overall number of claims being made in the NSW scheme has increased sharply – by 20 per cent over the past four years. In addition, the proportion of people injured in motor vehicle accidents who are making a claim has increased by 25 per cent in this time.

Due to the serious and complex nature of injuries that can be sustained in a motor vehicle accident, it can take many years to finalise a CTP claim. In order to meet claims payments as they fall due over a number of years, insurers invest CTP premiums until a claim is paid. Prudential regulatory requirements mean CTP insurers typically invest in government bonds. In the years since the onset of the Global Financial Crisis, the investment return on government bonds has fallen from more than 7 per cent to about 2.5 per cent. This is a record low rate of return that insurers receive for invested premiums. When investment returns are relatively high, insurers can reduce the cost of premiums, as investment income can be used to meet claims payments. When investment returns are relatively low, insurers must increase premiums to have sufficient money to meet expected claims payments.

The ICA believes that improved affordability can be achieved through a range of measures, including:

- increasing the efficiency of issuing policies, and the friction costs in managing and finalising claims from injured people;
- a transparent analysis of levels of competition within the scheme;
- a better understanding of the range of returns on capital that is required to deliver fair, but not excessive, profits to CTP insurers, and
- a greater allowance for full risk pricing within the scheme and the reduction of cross-subsidies - unless absolutely necessary for affordability purposes (for example, for young drivers).

Reform Options in the MAA Paper

The NSW Motor Accidents Compensation Scheme has evolved through a number of comprehensive scheme reviews into a mature and effective scheme with many favourable aspects when compared to other domestic and international schemes. Many of the issues confronting the scheme are the same as those considered and addressed in previous reviews. The policy settings evidenced within the current scheme are reflective of those reviews.

However, insurers recognise that, with the passage of 13 years since the last significant reforms to the scheme (with the introduction of the *Motor Accidents Compensation Act 1999*), it is time to revisit the fundamental features of the scheme to address adverse trends in efficiency and affordability, improve transparency, and to deliver the best scheme to meet the expectations of the NSW community.

In this regard, the ICA and its members fully support the Principles of Reform set out on page 9 of the MAA Consultation Paper, and we note the following matters in response to key proposed reforms.

A defined benefits scheme

The ICA notes the significant advantages of a defined benefits scheme are as follows:

- injured people have greater certainty as to the benefits to be received;
- a higher proportion of benefits can be delivered to those most seriously injured;
- there is potential to reduce the time needed to finalise some claims - with consequential reductions in the impact of movements in bond yields and insurer capital requirements;
- legal costs should be reduced;
- superimposed inflation may be contained;
- levels of benefits paid are more consistent and objective, with a greater likelihood of stability for the pricing of premiums; and
- the need for formal decisions on quantum will be reduced.

A no fault scheme

Though the extension of benefits to all people injured in motor vehicle accidents is the key advantage of this option, it should be balanced by the additional costs that will be borne by the community.

Any reductions in premiums under a defined benefits scheme will necessarily be utilised, at least in part, to fund a no fault scheme.

A first party scheme

The nature and advantages of a first party scheme are set out on page nine of the MAA Paper.

However, a first party scheme will have significant implications for the risk pricing of individual motorists. This is a matter that needs a substantial amount of further, detailed analysis by insurers and the MAA - as necessary adjustments are made to the premium framework, as well as sharing arrangements between insurers.

Summary of proposed reforms in the MAA Paper

The Table below sets out the ICA's position in response to the summary of proposed reforms on page 13 of the MAA Paper.

The support of ICA members for reforms proposed by the MAA Paper (as set out in the Table below) is qualified by the need for the industry to assess the details of the scheme reforms and the cost impact of those reforms.

Proposed Reform	ICA Position
Statutory defined benefits for all & common law only for > 10% whole person impairment	SUPPORT IN PRINCIPLE
Benefit structure: periodic payments; lump sum after stabilisation; functional work tests for lost income; lump sum payment for permanent impairment	SUPPORT IN PRINCIPLE
Streamlined entry for claimants and simpler ADR	SUPPORT
Only common law lump sums affected by degree of fault	SUPPORT
Measures to reduce overhead costs, streamline purchasing, increased flexibility around pricing for insurers, simplified premium setting regulations, capacity for single transaction, improved electronic transactions, addressing acquisition activities, reviewing admin	SUPPORT IN PRINCIPLE

costs and funding model of MCIS levy	
Sub-licences for niche insurers	This will be a matter for individual insurers to discuss with the MAA.

Implementation of reforms and transitional arrangements

The proposed reforms represent significant changes to all aspects of the scheme. As with previous major reforms, they will require extensive and highly technical changes to the operational systems of insurers, and they will demand a significant allocation of resources by insurers. The changes will also require detailed training programs for insurers' staff, including claims managers and call centre staff.

The successful implementation of these reforms will depend, in large part, on insurers having sufficient time to effect the necessary systems changes, and to properly train staff.

In this regard, the ICA and its members appreciate the NSW Government's acknowledgment of this matter in the MAA Paper.

The reforms may also require technical transitional arrangements to be put in place. The ICA and its members seek to work on the transitional arrangements with the MAA, once the details of the scheme reforms have been settled.

Conclusion

The reform proposals set out in the MAA paper are necessarily high level. During the course of designing the details of the scheme reforms, much technical work remains to be done on specific matters, including:

- the defined benefits structure;
- the practical operation of a first party scheme;
- more efficient, simpler and streamlined frameworks for claims management and dispute resolution; and
- the premium framework, and premium regulation for a no fault, first party scheme.

This detailed work on the design of a reformed scheme is vital in order to meet the NSW Government's stated goal of reducing "the cost of the average CTP premium by about 15 per cent"¹.

¹ The Hon Barry O'Farrell MP, Premier of Western Sydney, Minister for Western Sydney, "A fairer, cheaper CTP scheme for all", Media Release, 17 February 2013.

The MAA Paper (page 11) also notes that, "The proposed reforms are expected to result in: Significant premium reductions on 2013 prices, although actual savings for individuals will vary by vehicle class and risk factor, and could be more for some people. Special legislative provisions will be adopted to ensure insurers deliver on the price savings in the short term."

The ICA and its members look forward to working with the MAA and the NSW Government on the details of the reforms, and assisting with the implementation of the reforms.

If you have any questions in relation to this submission, please contact Vicki Mullen, General Manager, Consumer Directorate on (02) 9253 5120 or vmullen@insurancecouncil.com.au.

Yours sincerely



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