25 November 2016

CTP Review
State Insurance Regulatory Authority
580 George Street
Sydney NSW 2000

Submitted by email: ctp_review@sira.nsw.gov.au

Dear Sir/Madam

Reforming insurer profit in compulsory third party (CTP) motor vehicle insurance

The Insurance Council of Australia (ICA) is the representative body of the general insurance industry in Australia. This includes the four licensed insurers who currently underwrite the NSW compulsory third party (CTP) motor accidents compensation scheme.

The ICA welcomes the opportunity to respond to this Discussion Paper on Reforming Insurer Profit in CTP motor vehicle insurance (Discussion Paper). The ICA recognises that there has been stakeholder concern regarding the levels of insurer profit that has been historically realised by NSW CTP insurers.

Following the release of the *Report of the Independent Review of Insurer Profit within the NSW CTP Scheme*, insurers have been working closely with SIRA to implement recommended changes to the premium framework, whilst also working with the regulator on matters of broader scheme reform. We are strongly supportive of measures intended to deliver a more affordable and sustainable CTP scheme.

The ICA considers that some of the topics canvassed in this Discussion Paper are ultimately a matter for individual insurers to determine in consultation with SIRA. As a result, our submission provides general commentary, on behalf of all NSW CTP insurers, in response to those matters where an industry response is appropriate.

Insurer profit and CTP scheme design

The Discussion Paper outlines measures intended to improve the premium system to provide insurers with fair but not excessive profit levels. While changes to the premium framework may be required, the ICA considers that it is changes to scheme design that will ultimately deliver this objective.

As noted in *Options for Reforming Green Slip Insurance in NSW* (Options Paper), there is a correlation between the current scheme design and the need for insurers to take this uncertainty into account when setting premiums.[1]

As we submitted in our response to the Options Paper, scheme reform designed to significantly reduce uncertainty and volatility in the scheme will reduce the overall amount of capital that insurers will need to hold. This in turn should reduce the required profit margin for

[1] NSW Government, *On the road to a better CTP scheme: Options for reforming Green Slip insurance in NSW*, March 2016, p6

insurers underwriting the CTP scheme and narrow the gap between estimated and realised profits.

Regulatory and administrative actions being taken by SIRA

Insurers have been working with SIRA on a number of changes to the premium framework. This includes the Risk Equalisation Mechanism (REM); Review of premium relativities; Premium Determination Guidelines; and Market Practice and Business Plan Guidelines. We will continue to work closely with SIRA on these matters and we look forward to consultation and constructive dialogue in this regard.

With regards to expanding the bonus/malus range for commercial vehicles, SIRA may wish to engage with representatives of commercial vehicle owners to obtain feedback on the proposed change.

Profit normalisation

Insurers have commenced working with SIRA on a profit normalisation mechanism and we understand there is still further detail to be worked through. We do not oppose implementation of a profit normalisation mechanism during the transition period to the new scheme, however, we do not believe that the operation of such a mechanism is required beyond two or three years. Disadvantages with maintaining the profit normalisation mechanism beyond the transition period include reducing the incentive for insurers to invest in efficiencies and innovation. It could also result in premium volatility if the scheme experience deteriorates. In such circumstances motorists could face premium increases for higher prospective costs whilst also paying a levy to fund past excess losses.

As previously noted, a scheme with lower levels of superimposed inflation should narrow the difference between filed and realised profits. Taking this into account with the aforementioned disadvantages, we consider an ongoing profit normalisation mechanism unnecessary.

Appropriate insurer profit levels

The ICA considers that it is a matter for individual insurers, in consultation with SIRA, to establish appropriate profit margins. However, we believe that insurers must realise an adequate return on their capital and the scheme must be fully funded to ensure future liabilities can be met.

Over the last few years the topic of appropriate profit levels for insurers in statutory schemes has been the subject of many reports and studies. It would be prudent for SIRA to engage an independent body, who have been informed by recent studies in this area, to work with insurers to determine appropriate profit levels.

Abolition of the fully funded test

The fully funded test requires the premium to cover (i) the expected claims cost; (ii) expenses; (iii) profit margin to deliver an adequate return on capital; (iv) any other matters a prudent insurer should make provision for.

This test has been useful for maintaining scheme stability over many years. In a scheme where historically if one insurer failed, the remaining insurers had to manage the consequences, it is reasonable to have some constraints on the opportunities to under-price. Having the ability to bid the price down to unsustainable levels may not be in the long term interests of the scheme, insurers or the public.

Increased disclosure on insurer profits and increased transparency in the premium setting process

It is unclear what specifically would be achieved if SIRA were to publish annual profit by insurer. It is noted in the Discussion Paper that the benefit of a competitively underwritten scheme is the promotion of competition and the leveraging of private sector efficiencies. Insurers able to achieve higher profit levels can only do so through innovation and efficiencies. These are endeavours that should be encouraged, however they will not be appropriately captured in a table that simply shows profit by insurer.

For listed insurers, there could be unintended consequences of publishing CTP profit levels in silo. We note that in the *General Insurance Institution–Level Statistics*, APRA already makes publically available insurer specific information about financial performance including net profit amounts.[2]

With regards to increasing disclosure, we note that SIRA requires legal practitioners to provide the cost break-down of a CTP claim once the claim is finalised. The disclosure requirement has provided SIRA with insight into the contracted out legal costs that are paid out of a claimant's settlement money. There has been no formal publication of this data even on aggregate. The ICA submits that in order to obtain a complete picture of scheme costs and thereby improve scheme efficiency, the aggregate publication of insurer profit, legal costs and other scheme performance indicators should adequately inform stakeholders of the effectiveness of the scheme.

Similarly, with regards to publishing more information on the premium review process, we would welcome further clarification on the intended outcome. Insurers submit their premiums to SIRA and SIRA has the authority and powers to ensure the appropriate price is set. Further engagement with the community may be required to ensure NSW motorists are confident in this process. Opening up the premium filing process may not be appropriate and could stifle competition and the openness that currently exists between insurers and the regulator.

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[2] APRA, *Statistics: General Insurance Institution-Level Statistics,* June 2016 (released 9 November 2016)

INSURANCE COUNCIL OF AUSTRALIA

We thank you for the opportunity to provide comment on this Discussion Paper. If you have any questions with regards to our submission please do not hesitate to contact Tola Ogudipe, Senior Policy Advisor, Consumer Directorate on [redacted] or [redacted]

Yours sincerely

[redacted]

Robert Whelan
Executive Director and CEO