Submission to NSW Government's discussion paper on reforming insurer profit in CTP insurance

November 2016

About QBE

QBE is one of the few domestic Australian-based financial institutions to be operating globally, with operations in and revenue flowing from 37 countries. Listed on the ASX and headquartered in Sydney, stable organic growth and strategic acquisitions have seen QBE grow to become one of the world's top 20 general insurance and reinsurance companies, with a presence in all key global insurance markets.

As a global insurer, QBE believes that Australia must continually look to refresh its financial and regulatory systems, to ensure the nation remains competitive with global financial markets, and attractive to investment.

As a member of the QBE Insurance Group, QBE Australia & New Zealand (***QBE***) operates primarily through an intermediated business model that provides all major lines of general insurance cover for personal and commercial risk throughout Australia.

QBE has a major presence in the Australian workers compensation and compulsory third party (***CTP***) sectors providing insurance and specialist agency services in most jurisdictions throughout the country. QBE also has extensive experience in these areas in international jurisdictions.

QBE is one of the licenced insurers currently providing CTP insurance in New South Wales.

Background

In March 2016, the NSW Government (***Government)*** announced a major review of the NSW CTP scheme (***Scheme***) aimed at creating a fairer and more affordable scheme for road users and focusing on four key objectives:

- Increasing the proportion of benefits provided to the most seriously injured road users;
- Reducing the time it takes to resolve a claim;
- Reducing opportunities for claims fraud and exaggeration; and
- Reducing the cost of green slip premiums.

QBE supports the key objectives of the Scheme, outlined by Government, and appreciates the opportunity to participate in the reform consultation process.

Mandatory compensation schemes supporting injured persons are generally developed as a response to serious societal problems and are established to address a range of socio-cultural, economic and political arrangements. As societal expectations and scheme experience changes, there is a continual challenge to ensure suitability and sustainability for the future. Compensation schemes need to be reviewed and adjusted to ensure societal needs and benefits for injured individuals are recognised and appropriately balanced against the rising costs for participants, inefficiencies and funding deficits that can be faced.

QBE recognises that determining this balance and establishing and maintaining a statutory compensation scheme that is both financially and socially sustainable, is a matter of public policy for governments.

QBE underwrites and provides agency services in a variety of statutory compensation schemes, both in Australia, and internationally. These schemes have varied design and benefit structures including fault based, hybrid and no fault schemes. QBE has the capability and capacity to underwrite and provide support for any variant of a viable and sustainable compensation scheme.

In November 2016, the Government issued two further discussion papers focusing respectively on insurer profits and also claims handling and dispute resolution. QBE has participated in and supports the Insurance Council of Australia's submissions on these matters.

QBE welcomes the opportunity to provide this brief supplementary submission in response to the Government's discussion paper on the best way to improve the premium system to provide fair, but not excessive, profit levels for insurers in CTP motor vehicle insurance (***Discussion Paper)***.

CTP scheme design

As outlined in the initial Government options paper for Scheme reform, *On the road to a better CTP scheme*[1] ***(Options Paper)***, it has become increasingly clear in recent years that the system is not serving injured road users as well as it could. Only 45 cents in every Green Slip dollar ends up in the hands of injured road users – the rest is absorbed by scheme costs and provider fees[2]. Additionally, a person injured in a motor vehicle accident can wait between three and five years for their claim to be resolved, and the Scheme is being challenged by a significant increase in fraudulent and exaggerated claims.

As the Options Paper also notes, the relatively low proportion of scheme funds that go towards helping injured people, **is largely a result of scheme design**[3].

The Scheme currently is primarily fault based, making it complex and adversarial leading to disputes over liability, extent of fault, severity of injury and the amount of compensation. This can create friction points which can lead to high legal, medical and administrative costs, court action and delayed compensation. Green Slip price increases have also been driven by increasing claim numbers since 2008; especially claims by people who have minor injuries and are legally represented.[4] Under the current Scheme, the benefits available, plus caps and thresholds where they exist, are considerably higher than in most other Australian jurisdictions. The amount actually received by claimants, however, is often reduced by legal fees[5].

It is important to focus holistically on these embedded issues and how they are impacting on the amounts ultimately received by the injured road user. QBE urges Government to pursue the broader reform agenda to ensure the NSW CTP scheme remains financially and socially sustainable into the future.

Insurer profit

QBE recognises that the level of insurer profit in the Scheme has attracted criticism with actual profits exceeding expected profits (as filed with the regulator) over a number of years. It is important however, to consider this in context of the current Scheme design as outlined above. As noted in the *Report of the Independent Review of Insurer Profit with the NSW CTP Scheme,* the long delay between when claims are reported and when claims payments are finalised means there is significant inherent uncertainty in the ultimate claims costs. As noted in the Options Paper, care costs have also increased at very high rates relative to other payment types, particularly in claims from injured people who have minor injuries and are legally represented. Consequently, it is very difficult to predict the level of insurer profit at the time of filing.

Unlike other industries, a large portion of the ultimate costs are uncertain for insurers when they agree to provide insurance. Uncertainty or ambiguity is a key factor that will influence insurance premiums. The higher the uncertainty, generally the higher the premium will be set to hedge against this inherent uncertainty.

Given the complexity of the CTP product in NSW and the need to ensure liabilities are "fully funded" as required under the Scheme, insurers need to act conservatively and allow for this uncertainty when setting premiums. Against expectations, this has resulted in actual profits exceeding expected profits at a Scheme level for a number of years[6].

With the Government's proposal to implement a hybrid no-fault scheme with defined benefits for low severity injuries and retaining common law only for the most seriously injured, QBE anticipates that the current significant uncertainty and volatility in the Scheme will reduce. As such, the capital required to be held by insurers against these outstanding liabilities should also reduce. As outlined in

[1] SIRA, '*On the road to a better CTP scheme',* Page 3
[2] Ibid, Page 3
[3] Ibid, Page 6
[4] Ibid, Page 10
[5] Ibid, Page 10
[6] Trevor Matthews *'Report of the Independent Review of Insurer Profit within the NSW Compulsory Third Party Scheme',* Page i

the ICA Submission, this in turn should mean that unexpectedly high profit levels will not be realised by insurers.

Calculating profit

The Scheme is currently exposed to approximately $4 billion in outstanding claims which is presently borne by, and diversified amongst, the licensed insurers of the Scheme. For long term sustainability of the Scheme and to ensure ongoing participation by private insurers, insurers need to receive a reasonable level of profit for the risk they bear.

As the Government would appreciate, the competition globally for capital is fierce. Companies compete for investment capital and millions of investors compete, in turn, for the most attractive returns on their investments. Private insurers need to ensure investors receive an appropriate return for the capital they invest.

Any determination of what would be “reasonable profit” needs to be carefully considered in this context.

Individual insurers have different profit requirements based on the levels of capital required to support their insurance portfolio and their individual business strategies. Return on capital is measured in a variety of ways and insurers participating in the Scheme provide multiple lines of business with differing capital and profitability requirements. As acknowledged in the Independent Review, it would be very difficult to view the capital ownership of a CTP insurance business in isolation without a complete understanding of the interdependencies that exist between this portfolio and other business lines of the insurer.

QBE **supports** the implementation of an appropriate profit equalisation mechanism to address the potential concerns that may lead to profits or losses for insurers that are different to the profit margins that they estimated **during the transition to the new scheme.** During the transition period, it is acknowledged that there is increased uncertainty on claims costs and it is not unusual for there to be a “honeymoon” period in the first few years post reform. However, it is possible that such a mechanism may have perverse outcomes so it will be important for the design of this mechanism to be carefully considered and tested to ensure that there are no unintended consequences and ramifications that may arise for industry and Government from its implementation.

QBE however **does not support** the ongoing operation of a profit equalisation mechanism beyond the transition period. QBE believes this would significantly impact competition and innovation in the operation of the Scheme.

If an insurer has underwriting or claims management or expense management materially different from the market, it will technically end up with a price which is different from the market, higher or lower. In the normal commercial environment an insurer would be free to make a commercial decision to have a higher or lower profit margin than normal in order to get a price which places the insurer where it wants to be in the market. In essence, if an insurer has effective underwriting and claims management practices, under an ongoing profit normalization mechanism, an insurer’s ability to capitalise on those efficiencies is compromised.

Efficient and innovative insurers should not be inadvertently penalised for effective underwriting and claims practices. QBE believes that by maintaining a profit equalisation mechanism beyond the transition period, the incentive for insurers to compete and innovate to improve prospective profit will be significantly reduced.

QBE also believes an unintended consequence of an ongoing profit equalisation mechanism may be that the incentive is reduced for insurers to manage claims once it is clear that profit is beyond the profit normalisation boundaries.

It is also possible that a profit normalisation mechanism may result in increased volatility in prices for consumers. For example, if experience was deteriorating in the Scheme overall, consumers would be facing price increases implemented to address higher prospective costs at the same time that they may also be paying a levy to make up for past excess losses.

Increased disclosure and transparency

As outlined above, the calculation of individual insurer's profits is idiosyncratic in that it is dependent on the specific business strategies, capital requirements and return hurdles of insurers. Given these complexities and the interdependencies that would need to be assessed, QBE is concerned that publishing "annual profit" by insurer for the Scheme is likely to be derived from a number of assumptions and could be misleading.

For listed insurers in particular, we are concerned there may be unintended consequences of such a publication that could cause difficulties with companies continuous disclosure requirements.

QBE also questions what would be achieved by this approach particularly in the context of ensuring that an appropriate level of competition and innovation in the Scheme should be maintained and encouraged. As outlined above, insurers that are able to operate more efficiently and innovate effectively so as to maximise their profit, should not be penalised for this behaviour. QBE considers that the publication of insurance profits at an industry level is more appropriate.

In the Queensland Government's Discussion Paper *A review of Queensland's Compulsory Third Party Insurance Scheme* released in October 2016, it was noted that legal costs incurred by claimants represents a significant percentage of the total agreed settlement amount., with MAIC finding that 48% of the total settlement amount being paid in legal costs to their lawyers along with statutory disbursements.[7]

QBE **strongly submits** that transparency around legal fees in the Scheme should be increased and in particular, there should be public disclosure of legal fees and the percentage of settlement amounts for injured persons that are paid in legal costs to lawyers.

Caps of expenses

It is important to ensure the scheme design does not inadvertently favour one insurance business model over another. A scheme that inadvertently favour one distribution model over the other needs to be avoided. In this context regulating the total costs of policy acquisition needs to be done in a way that treats all insurers equally.

Conclusion

QBE appreciates the opportunity to respond to the Discussion Paper. Please do not hesitate to contact Kate O'Loughlin, Head of Government Relations & Industry Affairs, on [redacted] or at [redacted], if we can provide any further assistance.

[7] MAIC, *'A review of Queensland's Compulsory Third Party Insurance Scheme',* October 2016, Page 30