

Estimated cost per policy of the proposed NSW Green Slip Scheme

Motor Accidents Authority of NSW

29 July 2013



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1. Introduction and benefit design

1.1 Purpose

The Motor Accidents Authority of NSW (MAA) has, as part of the NSW Government reforms to the NSW Compulsory Third Party (CTP) Green Slip Insurance Scheme as outlined in Motor Accidents Injuries Amendment Bill 2013 (the Bill), requested Ernst & Young (EY) to:

- ▶ Provide an estimate of the cost per policy (i.e. green slip premium) for the proposed NSW Green Slip Scheme (proposed Scheme) for the 2014 underwriting year assuming it was in a mature position. This includes an estimate of the number of claims expected to be reported in the proposed Scheme
- ▶ For the 2014 underwriting year provide an estimate of the difference in the cost per policy between the proposed Scheme and the current NSW Green Slip Scheme (current Scheme) assuming both schemes are in a mature position
- ▶ Estimate the cost per policy affordability (defined in Section 4) for the current and proposed Schemes for underwriting years 2014 to 2019 to enable a longer term comparison of the cost differences between the two schemes
- ▶ Estimate the efficiency (discussed and defined in Section 4) of both schemes in 2014.

Cost per policy results presented in this report are for Class 1 vehicles (i.e. motor cars) rather than all vehicles since the premium rate for Class 1 is mostly used by scheme stakeholders to indicate how much the premium vehicle owners pay for their green slip (almost 80% of vehicles are Class 1).

Our costings presented in this report are based on a mature scheme environment where the motorists and the general public are fully aware of their rights under the scheme, relationships between insurers and medical and allied health providers are well established and the general infrastructure of the MAA and insurers is fully setup. This means that the actual cost of the proposed Scheme within the first few years may be different to our cost estimates.

Our estimated cost of the proposed Scheme is not the premium that will be charged to individual vehicle owners in the proposed Scheme since:

- ▶ Premiums are set by the seven licensed insurers that operate in the NSW Green Slip Scheme, not the MAA. Insurers are permitted to set their own premiums within the guidelines set by the MAA; these guidelines aim to ensure that premiums are affordable and fund the cost of claims, expenses and a reasonable insurer profit margin (i.e. premiums are not excessive). In NSW, insurers operate competitively and are allowed to offer different prices within limits, depending on a vehicle's risk factors, similar to comprehensive insurance. The mechanisms available to the MAA to regulate green slip prices are discussed in the separate EY report titled "Premium system transition for the proposed NSW Green Slip Scheme" and dated 29 July 2013 (EY Premium System Report)
- ▶ The estimated cost is the average for Class 1 vehicles which by definition means that the actual cost for some vehicle owners will be higher than the average cost and the actual cost for others will be lower than the average cost
- ▶ The estimated cost does not allow for the treatment of the unearned premium surplus arising for insurers following the transition to the proposed Scheme. The unearned premium surplus will be returned via an explicit reduction in premiums charged by insurers. The EY Premium System Report provides further details
- ▶ In the first few years of the proposed Scheme it is possible the volume of claims will be lower than assumed as at-fault claimants become aware over time of their eligibility for benefits; this

could mean that the cost of the Scheme in the first few years of the Scheme is lower than our estimated results

- ▶ There may be a different number of motor vehicle journey to work claims in the proposed Scheme arising from the NSW WorkCover legislation changes to journey claims in June 2012 than we have estimated
- ▶ As discussed in the EY Premium System Report CTP premiums vary by vehicle class and district and are also subject to the application of loadings/discounts to premiums (i.e. malus/bonus) by insurers within guidelines established by the MAA. Therefore, actual savings for individual vehicles will vary by vehicle class and risk factor, and could be more or less for some vehicle owners since the proposed Scheme will impact different groups of vehicle owners differently. For example some groups will have more/less at-fault claims than other groups of vehicle owners and consequently the premium rates for those groups will be more/less than the average premium for all vehicle owners
- ▶ There may be other factors that the MAA will take into account in guiding insurer premiums during the first few years of the proposed Scheme.

As discussed in the EY Premium System Report we do not expect the actual average cost per policy in the first few years of the proposed Scheme to be higher than our estimated average cost per policy (for Class 1 vehicles) excluding the impact of factors extraneous to the NSW CTP reforms (e.g. changes in discount rates, changes in state/federal government taxes, changes in NSW road accident crash rates).

EY is the NSW Green Slip Scheme's independent actuary. This report sets out the results of our work.

1.2 Structure of this report

This report consists of the following sections:

- ▶ Benefit design - a comparison of the benefits costed between the current and proposed Scheme as set out later in this section
- ▶ Background - a discussion of key features of the current Scheme and learnings from other similar schemes (see Section 2)
- ▶ Data, approach and key assumptions used to estimate the 2014 underwriting year cost per policy for the current and proposed Scheme, including an estimate of the number of claims (see Section 3)
- ▶ Results of our costing of the Bill - a discussion of the key results from the above analysis, including discussion of the future affordability of both schemes (Section 4)
- ▶ Risks and uncertainty - a discussion of the sources of uncertainty in the costing results (see Section 5)
- ▶ Reliance and limitations (see Section 6).

1.3 Benefit design

The current Scheme is essentially fault based (i.e. primarily only not at-fault people receive benefits), but reforms since 2006 have extended access to all, regardless of fault, to recover up to \$5,000 of treatment expenses and/or lost income (i.e. through Accident Notification Forms (ANFs)), and to access the Lifetime Care and Support scheme (LTCS scheme) (if catastrophically injured). There are also special conditions for claims arising from blameless accidents and where

claimants are children. Other than that, an injured person must establish that their injuries were caused by the fault of another vehicle owner or driver, before they can claim benefits.

In the current Scheme for full claims (excluding ANFs) claim settlement amounts are determined under modified common law provisions defined in the Motor Accidents Compensation Act 1999 (the MACA), and paid as a lump sum either following negotiation between the injured party and the insurer (representing the at-fault party), or by a decision of an independent claims assessor appointed by the MAA or in court proceedings. Medical treatment, rehabilitation and care costs are paid as and when they are incurred until the date of settlement at which point in time the future costs relating to these benefits are paid as part of the lump sum settlement once liability for a claim is accepted.

The proposed Scheme is primarily a no fault scheme with defined statutory benefits available to almost all injured parties regardless of fault except for those drivers charged with a serious driving offence or uninsured. The proposed Scheme will retain access to (modified) common law, where an injured person is not at-fault and is assessed as having greater than 10% Whole Person Impairment (WPI).

Changes to the proposed Scheme will not change the eligibility criteria or nature of benefits available under the LTCS scheme as the LTCS scheme is not subject to review by the Government.

References to the Victorian scheme in this report refer to the Transport Accidents scheme which provides compensation for motorists injured in vehicle accidents in Victoria. The Victorian scheme has been referenced because of similarities in several features between it and the proposed scheme. Furthermore the Victorian scheme has been operating for over 25 years and thus has a significant volume of claims experience.

The analysis and results shown in this report reflect the following benefit design elements for the current and proposed Schemes.

Table 1: Benefit design comparison

Benefit type/ design feature	Current scheme	Proposed scheme
ANFs	<ul style="list-style-type: none"> ▶ Up to \$5,000 is available for medical and loss of income benefits regardless of fault 	<ul style="list-style-type: none"> ▶ Not applicable. The benefits provided to at-fault claimants will not be limited to \$5,000 as in the current Scheme for ANFs. At-fault claimants will be entitled to significantly more benefits than at present especially for the more seriously injured
Motor vehicle journey to and from work claims and motor vehicle claims during the course of work	<ul style="list-style-type: none"> ▶ These claims can be made on both CTP and the NSW WorkCover schemes with the exception from June 2012 where most journey claims are now ineligible for compensation under the NSW WorkCover scheme. Insurers under the NSW WorkCover scheme can seek recoveries from CTP insurers for those claims involving a motor vehicle made on the NSW WorkCover scheme if the claims are eligible for compensation under the current Scheme 	<ul style="list-style-type: none"> ▶ All motor vehicle journey claims are eligible to claim on the proposed NSW Scheme but not on the NSW WorkCover scheme ▶ Motor vehicle claims during the course of work are not eligible to claim under the proposed NSW Scheme. These claims will be made on the NSW WorkCover scheme and recoveries will still be made against the proposed Scheme
Contributory negligence	<ul style="list-style-type: none"> ▶ The final settlement amount may be reduced if the claimant partly contributed to the accident ▶ This does not affect ANFs 	<ul style="list-style-type: none"> ▶ Defined statutory benefits will not be reduced for contributory negligence ▶ Common law benefits will be reduced for contributory negligence
Earnings capacity assessments	<ul style="list-style-type: none"> ▶ Not applicable 	<ul style="list-style-type: none"> ▶ Operates as per work capacity tests in the Victorian scheme. Work capacity tests are required for claimants to access loss of earnings capacity benefits in the Victoria scheme
Whole person impairment assessment	<ul style="list-style-type: none"> ▶ American Medical Association 4th edition (AMA 4) as amended by the MAA guidelines 	<ul style="list-style-type: none"> ▶ As for the current Scheme (i.e. AMA 4 as amended by the MAA guidelines)

Benefit type/ design feature	Current scheme	Proposed scheme
Indexing of caps and economic loss benefits	<ul style="list-style-type: none"> ▶ Indexed annually based on gazetted rates 	<ul style="list-style-type: none"> ▶ Economic loss benefits and weekly benefit caps are indexed in line with the NSW Wage Price Index published by the Australian Bureau of Statistics (in line with NSW workers compensation indexation provisions)
Economic loss	<ul style="list-style-type: none"> ▶ For not at fault claimants: 100% past and future economic loss, or the deprivation or impairment of earning capacity, is recoverable up to a maximum of \$4,236 net (i.e. after tax) per week ▶ For at-fault claims - only available via ANFs and only up to a maximum of \$5,000 including any treatment costs 	<p data-bbox="970 439 1433 488">Statutory benefits are delivered to both at-fault and not at fault claimants on the following basis</p> <ul style="list-style-type: none"> ▶ 95% of pre-injury income is paid to a claimant for up to 13 weeks from the date of injury, providing injured person was working when injured and who are, as a result of the injury, totally unfit for work ▶ If the injured person remains totally unfit for work past week 13 post injury then 80% of pre-injury income is paid for those wholly unfit for weeks 14 - 78 from date of injury ▶ If the injured person is partially fit for work and has returned to work then 'top-up' payments to 95% of pre-injury income for up to 13 weeks will be paid from the date of injury and 85% of pre-injury income will be paid for the period of partial incapacity, between weeks 14-78 post date of injury ▶ Loss of earning capacity benefit is paid after 18 months for the period up to 5 years post date of injury, unless the injured person's injuries have resulted in a WPI greater than 20%. If WPI is greater than 20%, loss of earning capacity is paid indefinitely while there is evidence of incapacity or to retirement age ▶ Loss of earnings and loss of earning capacity payments are capped at a maximum payment of \$1,903.70 gross (i.e. before tax) per week, indexed (in line with NSW workers compensation indexation provisions) before deducting actual earnings ▶ Loss of earning capacity benefits is assessed based on an earnings capacity assessment which must be undertaken prior to 18 months from the date of injury. <p data-bbox="970 1379 1305 1402">Damages available at common law</p> <ul style="list-style-type: none"> ▶ Only available to claimants who can prove someone else was at fault ▶ The threshold for access to common law, where an injured person is not at-fault, is assessed as having greater than 10% WPI ▶ Allow recovery of past and future economic loss, subject to a cap of \$1,903.70 (net of tax) per week (indexed), net of benefits paid after tax under defined statutory benefits and adjusted for any contributory negligence

Benefit type/ design feature	Current scheme	Proposed scheme
Treatment (i.e. medical treatment, rehabilitation and care) (defined statutory benefits for the proposed Scheme)	<ul style="list-style-type: none"> ▶ All past and future costs are recoverable ▶ Costs of gratuitous care are compensable ▶ Domestic care will be provided in line with S15B of the Civil Liability Act ▶ Public hospital costs are covered by the Green Slip premium via the MCIS Levy ▶ Only available to at-fault claimants up to a maximum of \$5,000 including any loss of income 	<ul style="list-style-type: none"> ▶ The injured person's reasonable and necessary treatment costs are to be payable until five years post date of injury ▶ These benefits are available beyond five years post date of injury for claimants with an assessed WPI greater than 10% ▶ If the injured person is cared for by family or friends without payment, that is gratuitously, there will be no compensation for the cost of that care. Commercial care will be provided in these circumstances ▶ If an injured person usually provided domestic services to a dependant (e.g. a child), but are unable to do so because of your injuries, they will be able to claim statutory benefits for the cost of employing a person to provide these services, in line with the Civil Liability Act 2002 ▶ Public hospital and ambulance costs are covered by the Green Slip premium via the MCIS Levy
Impairment benefits / non-economic loss type benefits	<ul style="list-style-type: none"> ▶ No damages may be awarded for non-economic loss unless the assessed WPI of the injured person is greater than 10% ▶ The maximum amount that a court may award for non-economic loss is \$462,000 ▶ Not available to at-fault claimants 	<p>Defined statutory benefits</p> <ul style="list-style-type: none"> ▶ Will be payable to at-fault and not at-fault claimants with a WPI greater than 10% on a sliding scale in bands of 5% WPI similar to the NSW worker's compensation scheme. These benefits are not automatically indexed consistent with the NSW worker's compensation scheme. The maximum benefit for claimants is \$220,000 per claim <p>Damages available at common law (i.e. non economic loss benefits)</p> <ul style="list-style-type: none"> ▶ Only be available to claimants who can prove someone else was at fault ▶ The threshold for access to (modified) common law, where an injured person is not at-fault, is assessed as having greater than 10% WPI ▶ Non-Economic Loss (NEL) payments (lump sums for pain and suffering) capped as at present at \$462,000 and indexed, net of any impairment payments under defined statutory benefits and adjusted for any contributory negligence
Which benefits/damages are available at common law	<ul style="list-style-type: none"> ▶ All benefits, excluding ANFs, are accessed through modified common law 	<ul style="list-style-type: none"> ▶ Damages at common law will only be available to claimants who can prove someone else was at fault ▶ The threshold for access to (modified) common law, where an injured person is not at-fault, is assessed as having greater than 10% WPI ▶ Only economic loss and non-economic loss benefit types will be accessible through common law
Death	<ul style="list-style-type: none"> ▶ Compensation to Relatives Act applies plus any funeral expenses for not at fault claimants ▶ Funeral expenses not available to at-fault claimants 	<ul style="list-style-type: none"> ▶ Compensation to Relatives Act for not at-fault claims ▶ Funeral expenses of a maximum of \$9,000 consistent with the NSW workers compensation scheme for all claims
Redemptions	<ul style="list-style-type: none"> ▶ Not applicable 	<ul style="list-style-type: none"> ▶ Redemptions of ongoing benefits will be allowed subject to eligibility and an approval process. Redemption amounts will be calculated as specified in MAA guidelines and will be calculated on a cost neutral basis

Benefit type/ design feature	Current scheme	Proposed scheme
Disputes and legal representation	<ul style="list-style-type: none"> ▶ Negotiations are initially conducted between the injured party and the insurer (representing the at-fault party) to determine the settlement amount ▶ Disputes may be addressed through the MAA's Motor Accidents Assessment Service (MAAS) which assesses medical disputes as they arise between an injured person and an insurer throughout the course of a claim ▶ The Claims Assessment & Resolution Service (CARS) provides an out of court dispute resolution system for claims where the injured person or claimant and the insurer cannot agree on the amount of compensation ▶ If cases are exempt from CARS then the dispute is resolved through a court process or via negotiation between the parties ▶ Legal expenses are compensable as per the MAA's legal cost regulations but the claimant and their legal representative can contract out of the legal cost regulation 	<ul style="list-style-type: none"> ▶ Disputes involving statutory benefits will be resolved using a non legal process (i.e. exclude legal representation) and legal advisors will not be entitled to receive fees in relation to statutory benefits except in exceptional circumstances and in those situations legal costs will be paid according to guidelines issued by the MAA. CARS assessors will assess if the circumstances are exceptional and MAA will issue guidelines for CARS ▶ Common law claims will include legal representation. Contracting out of the legal costs regulation between lawyers and claimants will not be allowed and a revised legal cost regulation will be implemented

For additional details of the current Scheme please refer to the document titled "Reforms to the NSW Compulsory Third Party Green Slip Insurance Scheme, February 2013" available on the MAA website.

Details of the proposed Scheme can be found in the Motor Accidents Injuries Amendment Bill 2013 (the Bill) and the explanatory note and in the Ministers second reading speech. Guidelines and regulations will be issued by the MAA in due course.

1.4 Risks and uncertainty

There is significant uncertainty associated with actuarial estimates. Estimates of future claims experience (claims numbers and payments) are always inherently uncertain because they depend on the outcome of future events which cannot be forecast precisely. Examples of claims experience that are particularly challenging to forecast include changes to social, economic and legal environments. Therefore, actual claims experience may emerge at levels higher or lower than the actuarial estimates.

This report contains results relating to the current Scheme and the proposed Scheme. Given that there is no actual claims experience for the proposed Scheme the results relating to it have been estimated based on relevant claims experience in the Victorian scheme, the NSW WorkCover scheme and the current NSW CTP Scheme. However, as there is no actual claims experience for the proposed Scheme naturally the uncertainty associated with results relating to it is greater than for the current Scheme results.

Further comments on uncertainty are included throughout the report; however the most important are outlined in Sections 3 and 5.

1.5 Reliance and limitations

In undertaking this costing analysis, reliance has been placed upon the data provided to us by the MAA, WorkCover NSW, the Victorian scheme, Roads and Maritime Services (RMS), WorkCover NSW and VicRoads. With regards to the MAA data we are specifically relying on the accuracy of the data insurers have provided to the MAA.

It is essential that any reader of this Report understand its associated qualifications and limitations. These are described throughout this report; however the most important are outlined in Sections 3, 5 and 6.

Judgements regarding the data, methods and assumptions contained in this report should be made only after studying the entire report, as conclusions reached by a review of a section or sections on an isolated basis may be incorrect.

2. Background

EY has previously provided the MAA with our “NSW CTP Scheme Performance Update Report, 2012” (EY Scheme Performance Report) which analysed key performance metrics of the current Scheme. The analysis of the key metrics identified the current Scheme has:

- ▶ Low efficiency, particularly when compared to other schemes in Australia
- ▶ The least affordable green slip premiums in Australia
- ▶ Significantly longer delays in claimants receiving benefit payments compared to schemes in Australia which have statutory defined benefits.

The MAA subsequently released a policy statement titled “Reforms to the NSW Compulsory Third Party Green Slip Insurance Scheme, February 2013” (MAA Policy Document) and conducted a public consultation process; the outcome of this process is the Bill. During this process we have also assisted the MAA in assessing various green slip scheme design options particularly the cost of these options.

The remainder of this section provides further discussion of features of the current Scheme.

2.1 The current Scheme (excluding the Lifetime Care & Support Scheme)

As discussed in Section 1.3 the current Scheme is primarily a modified common law scheme. In order to claim benefits, injured people must be not at fault and must lodge a claim with the insurer of the vehicle most at fault. Once all the details of the injury have been established, the insurer is required to make an offer of settlement.

Key features of common law schemes such as the current Scheme are:

- ▶ Compensation is only provided to not at fault injured parties in motor vehicle accidents. In the current Scheme at fault parties are only entitled to ANF benefits (a maximum of \$5,000 in economic loss and treatment). There are also special conditions for claims arising from blameless accidents and where claimants are children
- ▶ Extensive legal involvement
 - ▶ Because benefits are not defined in legislation, the complexity and adversarial nature of the scheme, and because many claimants have never dealt with formal dispute resolution processes many claimants engage a lawyer to assist with the claim process. There may be disputes over liability, the extent and cause of injury, the extent and level of entitlement to benefits and the settlement amount. The negotiation and dispute processes are often costly and protracted.
 - ▶ The complexity of the system, combined with benefits not being defined in legislation deters unrepresented claimants. In the current Scheme, between 2000 and 2011 legal payments have been over 30% higher than medical and related payments, and in any one year they have been at least 19% higher than medical and related payments; this has been increasing in recent years. The figures for legal costs would be higher if contracted-out legal costs (i.e. legal costs above the level allowed for in the MAA legal cost regulation) were included.
- ▶ Lower efficiency

- ▶ Common law schemes have a lower level of efficiency i.e. a lower percentage of the total premium collected is returned to claimants than for other scheme designs; refer to the EY Scheme Performance Report for additional details. In the current Scheme between 2000 and 2010 only 50% of premium found its way to injured claimants and efficiency reduces to 47% if contracted out legal costs are taken into account. For claims less than \$50,000 the proportion paid to the injured person is estimated to be less than 30% for legally represented claims if all legal costs are taken into account. This tends to be due to:
 - ▶ The high level of legal and other overhead expenses involved in negotiating and disputing settlements. Whilst there are cost regulations regarding how much lawyers can charge for services provided to claimants they often receive more in payments and this additional amount is taken from the settlement amount awarded to claimants i.e. it reduces the net amount received by claimants; this is referred to as contracted out legal costs
 - ▶ Significant uncertainty in future claims costs which results in insurers pricing conservatively. If insurers' expectations of claims costs don't eventuate the differential is retained as additional profits. The involvement of lawyers and their strategy to negotiate higher claim settlements is a significant contributor to this claims cost uncertainty.
- ▶ A part of the compensation amount is based on an estimate of the future needs of the claimant
 - ▶ The settlement amount includes estimates of the future needs of the injured person; for minor injuries the settlement amount may over estimate the eventual needs of the injured person while for the seriously injured it may under estimate the needs of the injured person
 - ▶ The financial compensation received by injured people is based on an estimate of their current and future needs relating to treatment, rehabilitation, care, loss of earnings and other needs. Due to the difficulty involved in estimating the future needs of the injured person for the next 10, 20 or more years many stakeholders view the settlement amounts as having a "buffer" built into them which may end up being an over estimate of the true needs of the injured person
 - ▶ This is demonstrated by the growth in the use of care benefits in the current Scheme. An increasing number of people with small claims are receiving payment for care and domestic assistance in the current Scheme. The proportion of claim costs recorded as care is now almost as large as medical and related costs - growing from 5% to 13% of claims payments over the last 11 years.
- ▶ Delay in payments to injured people
 - ▶ Until negotiations are completed injured people do not receive the majority of their benefits; generally the majority of the compensation in the current Scheme is paid out between three and five years after the accident; this is significantly later than some other schemes. The majority of claim payments are made in one large lump sum amount to the injured person when the claim is settled. This means that, unless severe hardship can be established, funds are not received by injured people when they need it most and would be most effective in assisting with a quicker recovery
 - ▶ Many disputes end up in a formal assessment process or in court, which may be stressful for injured people, contributing to secondary injuries. There is limited incentive for the injured person to recover, as the continuing need to prove disability or incapacity perversely discourages quick recovery as this tends to equate to reduced payments, creating a lump-sum compensation mind-set.

2.2 Learnings from other common law schemes

A common feature across common law schemes over the past few decades is that when an attempt is made to restrict benefits there may be an initial reduction in scheme costs but this is usually eroded over time as other avenues for maximising compensation are identified by lawyers - this is commonly referred to as 'buffers' in settlements. Further savings erosion is a result of settlement negotiations focussing on lifting settlements from just below a threshold to above a threshold so that the access to benefits can increase materially, which is referred to as 'bracket creep'. This is distinct from another form of bracket creep within these schemes where a threshold is held constant and inflation causes higher than intended benefits and/or limitation of benefits.

The related lessons learned in many schemes including the current Scheme include:

- ▶ Subjective criteria to restrict access to compensation in common law schemes (i.e. dollar thresholds, verbal thresholds) have limited impact in reducing scheme costs over the long term
- ▶ Restricting access to compensation at common law for certain heads of damage, even if the criteria is objective, results in claim settlement negotiation buffers developing over time in settlements that will erode the expected savings of the legislative reforms.

Examples of these lessons in the current Scheme are:

- ▶ Prior to 1987 the compensation paid to claimants with minor injuries had been escalating substantially and had caused a major increase in claims costs in the Scheme mainly in relation to non economic loss. In 1989 when the Scheme was privatised, restrictions on non economic loss were introduced to limit the compensation to minor claims. These changes initially resulted in significant reduction in claims cost but over time the savings were eroded by the subjective nature of the assessment criteria of the restrictions resulting in substantial bracket creep and consequently a substantial increase in the cost of claims for minor and moderate injuries
- ▶ Following the 1999 amendments where access to non economic loss benefits was restricted, there had been a significant increase in care benefits in claim settlements or court awards (i.e. commonly referred to as a care 'buffer'). The 1999 amendments restricted access to general damages/non economic loss to claimants with a whole person impairment (WPI) greater than 10% as assessed using guidelines issued by the MAA on impairment assessments; prior to this many claimants could access general damages particularly prior to the 1995 amendments. These changes resulted in a significant reduction in claims cost but over time the savings have been eroded as the share of claims cost attributable to care has increased from 5% to 13% with care claims costs experiencing significant superimposed inflation (at rates above 10% p.a.).

3. Data, approach and key assumptions

This section describes the approach used to estimate the cost per policy for the current and proposed Scheme for the 2014 underwriting year.

Our costing results are based on a mature scheme environment where the motorists and the general public are fully aware of their rights under the scheme, relationships between insurers and medical and allied health providers are well established and the general infrastructure of the MAA and insurers is fully setup. This means that the actual cost of the proposed Scheme within the first few years may be different to our cost estimates.

In the first few years of the proposed Scheme it is possible the volume of claims will be lower than assumed as at-fault claimants become aware over time of their eligibility for benefits; this could mean that the cost of the Scheme in the first few years of the Scheme is lower than our estimated results.

The length of time it takes for the proposed Scheme to become mature will determine how quickly the true cost of the Scheme will materialise.

For both the current and proposed schemes we initially estimated the cost per policy for all vehicles and then converted this into a cost per policy estimate for Class 1 vehicles only based on the ratio of premiums, in the current Scheme, set by the MAA between Class 1 and all vehicles. For the proposed Scheme this approach assumes that the relative premiums between different vehicle classes in the proposed Scheme will match those in the current Scheme.

3.1 Current scheme

3.1.1 Data

To undertake the costing for the current Scheme we utilised data from the MAA and other sources including the RMS, Australian Bureau of Statistics and WorkCover NSW.

3.1.2 Approach to estimate cost per policy

The cost per policy for the current Scheme in underwriting year 2014 is based on insurers' premiums filed for an effective date of 1 February 2013 and the changes in premiums we estimate insurers would make for the 2014 underwriting year if the reforms are not implemented. This includes allowance for:

- ▶ An additional year of inflation and superimposed inflation
- ▶ Growth in claim numbers and increasing proportion of higher cost claims (which equals a 2% increase in the cost per policy, consistent with trends since 2008)

Implicit in the estimated cost per policy for the current Scheme is an assumption that superimposed inflation will be in line with the average rate chosen by insurers in their 1 February 2013 premium filings. The rates of superimposed inflation adopted by insurers are lower than the rates experienced over the life of the current Scheme which has averaged around 3% p.a.

We also considered the impact of additional motor vehicle journey claims on insurer premiums arising from the change in the NSW workers compensation legislation relating to journey claims in 2012. We have made reference to the Victorian scheme's motor vehicle journey claims experience in estimating this impact.

3.1.3 Ultimate number of claims

Our estimate of the ultimate number of claims in the current Scheme is based on our assessment of the current Scheme's outstanding claims liabilities as at 30 June 2012 taking into account the claim number experience to 31 March 2013.

In projecting the cost per policy to the 2014 underwriting year we have assumed recent trends in claims frequency and mix of claims between legally represented and non legally represented claims will continue.

3.2 Proposed scheme

3.2.1 Data

Our costing analysis relied primarily on data provided by the MAA and the Victorian scheme but we also used other data from the RMS, VicRoads, the Australian Bureau of Statistics and WorkCover NSW.

3.2.2 Approach to estimate cost per policy

3.2.2.1 Overall approach

For all benefit types, appropriate allowances for inflation, superimposed inflation and discount rates were made. The same inflation and discount rates were adopted as the average used by insurers in their current premium rates except for indexing of benefits where the NSW Wage Price Index is adopted.

As noted above details of certain provisions in the Bill will be set out in guidelines or regulations that will be issued by the MAA in due course. The content of these guidelines will impact the cost of claims. We have had discussions with the MAA on the intended contents of those guidelines and regulations to assist with the setting of assumptions in our costing. The actual cost of claims will vary from our cost estimates depending on the variation of the actual content of the guidelines and regulations from our understanding of the intended content.

3.2.2.2 Benefit types using Victorian scheme claims costs

The Victorian scheme's claims cost estimates, expressed as a premium per vehicle, has been used to estimate the cost per policy for statutory economic loss and treatment benefits. These costs were adjusted to exclude the Victorian claims costs for equivalent claims covered under the NSW LTCS scheme and for the same economic assumptions adopted by NSW insurers except for indexing of statutory benefits where the NSW Wage Price Index has been adopted.

We adjusted the Victorian claims experience where the benefit design was different to the proposed Scheme and for differences in factors such as average weekly earnings between the two states.

We have assumed that the Victorian scheme estimated claims costs per policy truly represent a central estimate of the Victorian scheme cost. Any under or over estimation of the Victorian scheme breakeven premium will lead to a corresponding under or over estimation of our costing results. This risk is partly mitigated because the Victorian scheme has been operating for over 25 years and the claims cost per policy has been estimated by Victorian scheme actuaries who perform this analysis annually and are familiar with the features of the Victorian scheme.

Economic loss benefits

Earnings capacity assessments will be used in the proposed Scheme to determine the eligibility of claimants to receive and continue to receive loss of economic capacity benefits; this is a similar design feature to that which exists in the Victorian scheme. The detail of the earnings capacity assessments in NSW will be set out in guidelines to be issued by the MAA and these guidelines are not yet available. We have included a loading on top of the Victorian loss of economic capacity benefits to allow for the earnings capacity assessments not operating as effectively in the proposed

Scheme as they currently do in the Victorian scheme. The actual cost of claims for the loss of economic capacity benefits in our costing will vary from our cost estimates to the extent to which the earnings capacity assessments in NSW result in higher or lower claims costs than in the Victorian scheme.

Treatment benefits

The Victorian scheme has centralised fee schedules for treatment providers and a centralised consistent treatment regime. NSW insurers and the MAA will have to control these costs in the proposed Scheme at the cost levels we have assumed to ensure that treatment claims costs are contained within our cost allowance. The MAA intends issuing guidelines that will set the maximum fees payable for treatment providers. We have had discussions with the MAA on the intended contents of those guidelines to assist with the setting of assumptions in our costing. The intended fee schedules will be significantly higher than in the Victorian scheme and consequently we have included a significant loading on the equivalent Victorian treatment claims cost. The actual treatment cost of claims will vary from our cost estimates depending on the variation of the actual content of the guidelines from our understanding of the intended content.

We excluded the costs of public hospital and related services from the Victorian scheme claims cost as these costs are included in the MCIS levy.

Legal expenses and disputes

The Bill restricts legal representation for statutory benefits to extreme cases as assessed by CARS and for appeals to the Supreme Court. We have included an allowance for these legal costs in our estimated claims costs based on discussions with the MAA.

We have assumed significantly fewer disputes than in the current Scheme and similar to levels in the Victorian scheme and an efficient non-legal dispute process. Except for the above legal representation we have assumed lawyers will not be involved or represent claimants in disputes in relation to statutory benefits including the earnings capacity assessments and whole person impairment assessments. In addition we have assumed claimants will access medico legal reports to the extent they do so in the Victorian scheme.

Insurer claims management

The standard of insurer claims management relative to the Victorian scheme will impact the costs of all statutory benefits. Management of claims under statutory benefits will require a change of mind set, and significant change in insurers' claims management, from an adversarial approach to achieve the optimal financial settlement to one which focuses on achieving better health outcomes. We have included a loading on the cost of economic loss and treatment benefits to allow for insurers not managing claims as effectively as the Victorian scheme.

Redemption of statutory benefits

The design features relating to redemptions are yet to be finalised and our costing results assume that the final design will have a cost neutral impact. In order to achieve this eligibility for redemption must be restricted to only the most serious claims so that a perverse incentive is not created for claimants to remain on benefit just so they can redeem their claim. This risk is partly mitigated due to the natural exit points contained within the proposed Scheme benefit design which will restrict the number of claimants on benefits indefinitely (e.g. restricted access to medical, treatment and care beyond five years, the earnings capacity assessments to access the loss of earning capacity benefit, restricted access to statutory economic loss benefits beyond five years).

Superimposed inflation

We have assumed superimposed inflation will be low in the proposed Scheme for statutory economic loss and treatment benefits and the cost of claims will be stable over time. Our costing for economic loss and treatment statutory benefits assumes that the proposed Scheme will experience superimposed inflation consistent but somewhat higher than the rates assumed by the

Victorian scheme but lower than the superimposed inflation rate experienced over the life of the current Scheme which has an average around 3% p.a. since 1999; our assumption is 1% p.a. superimposed inflation.

MAA guidelines

Whilst the cost estimates for the proposed Scheme reflect the Bill, the cost of the proposed Scheme will depend considerably on the details of the MAA's guidelines and regulations for the proposed Scheme. These are yet to be finalised.

Other assumptions

In addition to the above points our costing methodology and results assume that the following aspects of claims experience of the Victorian scheme will be reflected in the proposed Scheme; this is a key assumption:

- ▶ We have assumed the same ratio of at-fault and not at-fault claimants as in the Victorian scheme. This assumed mix is also supported by the analysis of RMS casualty data for NSW
- ▶ Our costing analysis assumes that both the range of injuries and the mix of impairment scores in the proposed Scheme will be similar to the Victorian scheme. We note that whilst both the current Victorian and NSW schemes use AMA4 to assess impairment scores they also both overlay this with their own, and different, guidelines. Our costing assumes that the impact of the Victorian scheme guidelines will be replicated in the proposed Scheme. This risk is partly mitigated for our costing of the common law and statutory impairment benefit as we have assessed the number of eligible claims using the current Scheme experience
- ▶ Our costing methodology assumes that in the proposed Scheme the mix of earners and non-earners and the pre-injury earning distribution of earners (after allowing for differences in average weekly earnings between the NSW and Victorian populations) will be similar to the Victorian scheme
- ▶ We have allowed for the full impact of motor vehicle journey claims to the level experienced in the Victorian scheme.

After analysis of NSW and Victorian scheme's casualty and claims frequency we have added a loading to the cost of statutory benefits in our costing to reflect the higher casualty rates and therefore higher expected claim numbers in the proposed NSW Scheme (see also Section 3.2.3 in relation to claim numbers).

3.2.2.3 Payment types using current Scheme claims costs

The claims experience for the current Scheme has been used to estimate the cost per policy for common law benefits (i.e. non economic loss and economic loss), legal and investigation costs associated with common law claims, statutory impairment benefits and death benefits.

For each of these benefit types our methodology estimated an expected number of claims per year and their expected average claim size. We adjusted the current Scheme claims data to exclude LTCS scheme claim costs arising from claims from accident years prior to the commencement of the LTCS scheme; this ensured that all claims experience we analysed reflected the current Scheme design. In addition we have adjusted the average claims size for the abolition of contracting out of legal costs between the lawyer and the claimant. It is not possible to explicitly identify the contracted out legal costs in the current Scheme claims data; they are likely to have affected amounts recorded under non-legal payment types. The EY Scheme Performance Report details how we have estimated the amount of contracted out legal costs.

An amended cost regulation will be issued by the MAA and we adjusted legal expenses in line with the intended increase in the maximum legal expenses after discussions with the MAA.

The number of common law claims in the proposed Scheme was based on the number of claims receiving NEL benefits in the current Scheme as the eligibility criteria is identical for both benefit types; the costing assumes 1,300 common law claims per annum. The average claim size for economic loss and non economic loss benefits in the proposed Scheme is based on the claims experience of claims that receive NEL benefits in the current Scheme (after allowing for the impact of contracted out legal costs and the reduction in the economic loss weekly cap). The costing assumes a 2% p.a. superimposed inflation rate for these claims.

The number of statutory impairment claims in the proposed Scheme was based on the expected number of not at-fault claims that will be eligible to access these benefits based on the current Scheme claims experience and the mix of at-fault and not at-fault claims in the Victorian scheme and from RMS casualty numbers. The average claims size is based on the benefit scale in the proposed Scheme and the impairment scores distribution under the Victorian scheme.

We have included an allowance in the cost per policy for common law benefits and statutory impairment benefits for an expected increase in the number of motor vehicle journey claims arising from the change in the NSW workers compensation legislation for these claims in 2012.

The number of death claims has been estimated based on RMS casualty data with the average claim size based on the average claim size within the current Scheme and \$9,000 for funeral expenses.

3.2.3 Ultimate number of claims

The approach we adopted to the costing outlined above in this section for the proposed Scheme did not directly utilise the expected number of claims that will be reported in the Scheme. However we made an adjustment to the cost of the proposed Scheme as outlined below to allow for a higher claims frequency in NSW than in Victoria. All else being equal we have assumed that the cost of the proposed Scheme will be 15% higher than the Victorian scheme due to the claim frequency difference.

Using Victorian scheme data, VicRoads and RMS data we adjusted our estimate of the number of claims in the current Scheme to allow for at-fault claims, any potential under reporting of claims in the current Scheme and additional motor vehicle journey claims to arrive at an estimate of the number of claims in the proposed Scheme. No allowance has been made for motor vehicle claims during the course of work, above the experience in the current Scheme, as the cost of these claims will be borne by the WorkCover scheme. To ensure our results are conservative we have not made adjustments to the Victorian scheme claim numbers for vehicles covered in that scheme that are not covered in the current Scheme or in the proposed Scheme.

Our analysis of the NSW and Victorian scheme's casualty and claims frequency suggests the proposed NSW Scheme will have a higher claims frequency than the Victorian Scheme. For the benefit types where we have used the Victorian scheme claims experience we have increased the claims frequency and claims cost above the Victorian levels by 15% to allow for a claims frequency in the proposed NSW Scheme.

We have also analysed the claim profile between the current Scheme, NSW casualties and the Victorian scheme by vehicle class and district. From this analysis we conclude that the average claim size in the proposed Scheme, all else being equal, should not be greater than the Victorian scheme experience. It is possible that the average claim size in the proposed Scheme may be lower than the Victorian scheme. However, we have not reduced our cost estimate as a result of this analysis.

3.2.4 Insurer expenses, insurer profits and MCIS levy

The following assumptions have been adopted for the non claims cost components of the cost per policy:

- ▶ Acquisitions and policy expenses have been based on the average dollar cost per policy charged in the current Scheme. Some elements of these expenses have been reduced based on changes the MAA intends to make in the proposed Scheme on a mature scheme basis. Details of these changes will be contained in the revised MAA guidelines for the proposed Scheme
- ▶ The claims handling expense rate as a percentage of claims costs has been assumed to increase significantly from current levels after reference to the allowance made in the Victorian scheme experience. The claims handling rate is assumed to be 7.5% of claims cost, on a mature scheme basis, this is approximately mid way between the current Scheme rate and the Victorian scheme rate
- ▶ We have assumed a reasonable level of reinsurance costs and profit margins (at 8% of total insurer premium). Given the benefit structure of the proposed Scheme, and the relative certainty in claims costs it creates, and the additional powers of the MAA to regulate price we expect that in the long term the realised rate of insurer profits in the proposed Scheme are more likely to be closer to the filed profits (i.e. our assumption) than in the current Scheme
- ▶ The LTCS and MAA components of the MCIS levy have been based on the levy rates for the year 2013/14 as approved by the Board of the Safety, Return to Work and Support Division (SRWSD) for the current Scheme and applied to our estimated 2014 underwriting year cost per policy results. We have assumed the same dollar per policy levy for the current and proposed Schemes for the 2014 underwriting year.

We have not been requested by the MAA to estimate costs for the transition to the proposed Scheme. The transitional matters include possible reductions in premiums to allow for the unearned premium surplus from existing premium collected by insurers, claim numbers being lower than estimated in the mature scheme (as noted in the introduction to Section 3 and Section 3.2.2.3 in respect of motor vehicle journey claims) and other aspects of implementing the proposed Scheme.

3.2.5 Key assumptions

In addition to the discussion above the table below lists the key assumptions we have adopted to estimate the proposed Scheme cost per policy.

Table 2: Other key assumptions

Cost component	Assumption
Superimposed inflation	<ul style="list-style-type: none"> ▶ Statutory benefits - 1% p.a. ▶ Common law benefits - 2% p.a. ▶ Both these assumption are higher than adopted for the Victorian scheme
Motor vehicle Journey claims	<ul style="list-style-type: none"> ▶ We have allowed for the full impact of motor vehicle journey claims to the level experienced in the Victorian scheme
Statutory economic loss and treatment costs	<ul style="list-style-type: none"> ▶ Loading of 15% above Victorian scheme to allow for greater expected claims frequency and casualty rates in NSW. No adjustment has been made for additional coverage of Victorian scheme including interstate claims. ▶ Loading of 10% above Victorian scheme costs to allow for claims management differences between Victoria and NSW
Statutory medical costs	<ul style="list-style-type: none"> ▶ Loading of 44% over Victorian scheme costs to allow for higher medical fee rates in NSW
Statutory care costs	<ul style="list-style-type: none"> ▶ Loading of 15% over Victorian scheme costs to allow for higher hourly care rates in NSW ▶ Included allowance for domestic care at double the level of Victorian scheme costs
Common law and statutory impairment benefit	<ul style="list-style-type: none"> ▶ 1,300 not at fault claims assumed to access common law per annum, 730 at fault claims assumed to access the statutory impairment benefit per annum
Death	<ul style="list-style-type: none"> ▶ 400 death claims per year

4. Results

This section contains the results of our costing. As discussed in Section 1.1 our costings are based on a mature scheme environment where the motorists and the general public are fully aware of their rights under the scheme, relationships between insurers and medical and allied health providers are well established and the general infrastructure of the MAA and insurers is fully setup. This means that the actual cost of the proposed Scheme within the first few years may be different to our cost estimates. However, as discussed in Section 1.1 we do not expect the actual average cost per policy in the first few years of the proposed Scheme to be higher than our estimated average cost per policy (for Class 1 vehicles).

Furthermore, our estimated cost of the proposed Scheme is not the premium that will be charged to individual vehicle owners in the proposed Scheme. Refer to Section 1.1 for a description of factors explaining the difference between cost and premium.

4.1 Estimated cost per policy result

The following table shows the estimated average cost per policy for the current and proposed Schemes for 2014 underwriting year for Class 1 vehicles only based on the approach and assumptions adopted as described in Section 3. As this is the average cost it means that the actual cost for some vehicle owners will be higher than the average cost and the actual cost for others will be lower than the average cost.

Table 3: Estimated average cost per policy results for the 2014 underwriting year - Class 1 Vehicles (\$) (for nil ITC policyholders, excl GST)

Cost component	Current scheme	Proposed scheme	Difference
Medical and related costs	60	76	16
Care	56	17	-39
Economic loss	125	109	-16
Non economic loss and impairment benefits	40	47	7
Legal costs	72	29	-43
Risk premium	352	277	-75
Insurer expenses	67	54	-14
Insurer profit loading	36	28	-8
MCIS levy	115*	115*	0
Total	571	474	-97
Scheme affordability**	39%	32%	-7%

Excludes GST

**This is based on MCIS levy rates from 1 July 2013*

***Affordability is defined as green slip prices (including levies but excluding GST) divided by average weekly earnings (AWE) (i.e. \$571 or \$474 in the above table divided by the AWE in 2014 values)*

****Totals may not equal the sum of the parts due to rounding.*

The above table shows that:

- ▶ The estimated average cost per policy for Class 1 vehicles of the proposed Scheme is \$97 less than for the current Scheme for underwriting year 2014
- ▶ The estimated scheme affordability improves from 39% to 32% in the proposed Scheme.

The table below describes the change in Scheme cost for each cost component. A decrease in Scheme cost doesn't necessarily mean a reduction in benefits provided to claimants. A considerable part of the cost reduction arises because benefits in a statutory benefits scheme (i.e. the proposed Scheme) are defined leading to certainty of what benefits each claimant is entitled to rather than negotiation or determination at common law. That is, benefits under the proposed Scheme are

provided on a reasonable and necessary or demonstrated basis as defined in the Bill. In the current Scheme lump sum settlement amounts are based on uncertain estimates of the future needs of claimants which can frequently lead to “buffers” in common law settlements to allow for that uncertainty.

Table 4: Change in Scheme cost

Cost component	Comments
Medical and related costs	<ul style="list-style-type: none"> ▶ The cost increases because additional benefits will be provided to at-fault claimants and also because contributory negligence reductions will not be applied to these statutory benefits. In the current and proposed Schemes contributory negligence reductions are applied to the common law lump sum settlement amount ▶ This cost increase is partly offset by providing medical benefits on a reasonable and necessary basis rather than uncertain estimates of future medical needs at common law ▶ It is estimated that very few claims, per annum, with a WPI of 10% or less will be impacted by the 5 year cut-off in medical and related benefits based on the experience of the Victorian TAC scheme
Care	<ul style="list-style-type: none"> ▶ Care costs reduce considerably because of the removal of gratuitous care and the provision of care benefits on a reasonable and necessary basis rather than uncertain estimates of future care needs at common law ▶ The above cost reductions are partially offset because additional benefits will be provided to at-fault claimants and also because contributory negligence reductions will not be applied to these statutory benefits. In the current and proposed Schemes contributory negligence reductions are applied to the common law lump sum settlement amount. Despite these additional claims total care costs are estimated to reduce ▶ It is estimated that very few claimants will be affected by the 5 year cut-off in benefits for claimants with a WPI of 10% or less based on the experience of the Victorian TAC scheme
Economic loss	<ul style="list-style-type: none"> ▶ The cost reduces because only 95% of earnings will be compensated for the first 13 weeks and 80% (85% for partial incapacity claims) after that date rather than 100% as at common law ▶ The cost also reduces because of the change in the maximum weekly cap (the cap will be a per annum salary of \$98,500) and the income benefit ratio. We estimate that around 2% of all claimants will be affected by the maximum weekly cap ▶ Payments in the proposed Scheme will be made on a demonstrated loss of earnings basis (i.e. earnings capacity assessments) rather than uncertain estimates of future loss of income at common law ▶ The above cost reductions are partially offset because additional benefits will be provided to at-fault claimants and also because contributory negligence reductions will not be applied to these statutory benefits. In the current and proposed Schemes contributory negligence reductions are applied to the common law lump sum settlement amount ▶ It is estimated that very few claimants will be affected by the 5 year cut-off in benefits for claimants with a WPI of 20% or less based on the experience of the Victorian TAC scheme
Non economic loss and impairment benefits	<ul style="list-style-type: none"> ▶ There is a small cost increase because statutory impairment benefits will be available to all claimants above 10% WPI in addition to common law non economic loss benefits for not at fault claimants
Legal costs	<ul style="list-style-type: none"> ▶ There is a significant reduction in legal expenses as legal representation is only maintained for the more seriously injured claimants (i.e. claims above 10% WPI) ▶ There is some allowance for legal costs recovery for statutory claims in limited circumstances
Insurer expenses and profit	<ul style="list-style-type: none"> ▶ Insurer expenses will reduce due to new legislative powers the MAA will have to restrict the expenses insurers can include in the CTP premiums ▶ Insurer profits will reduce in line with overall scheme costs. Insurer profits will be managed through the new legislative powers of the MAA ▶ The EY Premium System Report provides further details on both matters

In summary, savings from legal fees, capping insurer expenses and managing insurer profits through new legislative powers of the MAA, and paying benefits on a reasonable and necessary basis (as defined in the Bill) are expected to be more than sufficient to offset the increase in scheme costs from extending benefits to at-fault claimants.

4.1.1 Scheme efficiency

Scheme efficiency is defined as the proportion of the green slip premium which is returned to claimants in claim payments (excluding the LTCS Scheme costs and levies). The estimated Scheme efficiency in the proposed Scheme improves by 19% from 50% to 69%. The 50% figure is the average of the historical current Scheme efficiency observed from 2000 to 2010 (excluding any allowance for contracted out legal costs). Based on the 1 February 2013 insurer premium rate filings the estimated Scheme efficiency is approximately 58% being 11% lower than the estimated proposed Scheme figure of 69%. The difference arises because historically actual claims costs have emerged lower than insurer expectations (which are used to estimate premiums) and this has contributed to higher insurer profits. Refer to the document titled "Reforms to the NSW Compulsory Third Party Green Slip Insurance Scheme, February 2013" available on the MAA website and the EY Scheme Performance Report for further detail on efficiency.

4.1.2 Other comments

Based on the above cost estimates the proposed Scheme is expected to improve the key metrics of affordability of premiums and scheme efficiency as well as providing a balance between :

- ▶ Claimants receiving benefits earlier
- ▶ Preserving the rights of the more seriously injured not at-fault claimants to access damages at common law
- ▶ Providing full statutory benefits to at-fault injured motorists without application of contributory negligence
- ▶ Improving the health outcomes of all people injured in motor vehicle accidents.

In summary, the estimated cost demonstrates that introducing statutory benefits, including the cost of extending full statutory benefits to between an estimated 7,000 and 8,000 at-fault claimants, whilst maintaining access to damages at common law for seriously injured not at-fault claimants, is expected to result in the cost of the Scheme reducing while improving Scheme efficiency.

4.2 Ultimate number of claims

Our estimate of the ultimate number of claims for the current Scheme in accident year ended June 2012 and proposed Scheme in underwriting year 2014 is provided in Table 5 below (this represents all claims, not just those from Class 1 vehicles). There are around 26,000 road/traffic casualties a year in NSW and we estimate not all motorists injured will make a claim as is the case in the Victorian scheme. In addition there are around 2,000 claims per annum that are motor vehicle claims made against the existing WorkCover NSW Scheme that will not be provided benefits under the proposed Scheme but will still be eligible for benefits under the WorkCover scheme.

Table 5: Claim numbers

Claimant status	Current scheme* (claims and ANFs)	Proposed scheme
Not at fault	13,067	13,500-14,500
At fault	871	7,000-8,000
Total	13,938	20,500-22,500

* Current scheme numbers represent our estimate of the ultimate number of claims and ANFs for the FY2012 accident year

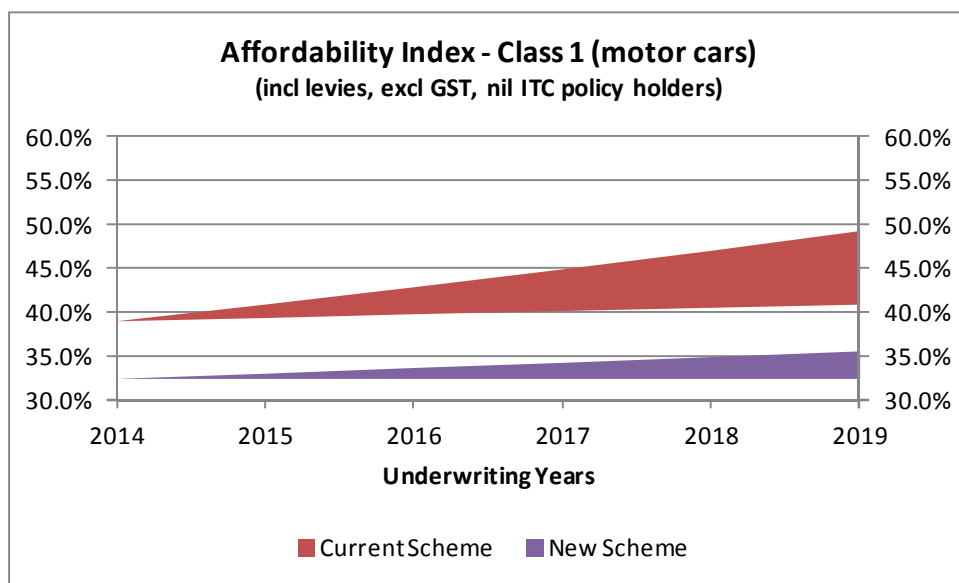
4.3 Estimated future scheme affordability

We have also estimated the future affordability for Class 1 vehicles for the current and proposed Schemes using the cost estimates in the 2014 underwriting year from Section 4.1 as the starting

point. It should be noted that the cost estimates below are on a mature scheme basis i.e. excluding the uncertainty associated with the transition to and commencement of the proposed Scheme (which would be expected for any scheme design change).

The figure below compares the estimated future affordability for the current and proposed Schemes based on our estimate of the costs of the current and proposed Schemes. As there is significant uncertainty in the future cost of the current and proposed Schemes we have presented the results in the figure below as a range for both schemes.

Figure 1: Affordability for average Class 1 (i.e. motor cars) for current and proposed Scheme



The figure shows the expected affordability measure in each future year for the two schemes; the lower the result the more affordable the scheme is. The results are based on estimates of expected future costs for the two schemes, adopted in our costings of the two schemes plus alternative scenarios, and the expected growth in wages.

For the current Scheme:

- ▶ The upper range assumes that the cost per policy will increase at the rates experienced on average over the last five years
- ▶ The lower range assumes that the cost per policy will increase at rates slightly higher than normal wage inflation being due to superimposed inflation (i.e. average claims size increases above wage inflation) at rates consistent with the past scheme experience offset by falling claim frequency arising from reductions in casualty rates consistent with the long term reduction in casualty rates.

For the proposed Scheme:

- ▶ The upper range assumes that the cost per policy will increase at rates slightly higher than normal wage inflation which is consistent with the claims inflation, including superimposed inflation, assumptions in the costing and with limited change in claims frequency over time
- ▶ The lower range assumes that the cost per policy will increase at the rate of normal wage inflation which is consistent with the claims inflation, including superimposed inflation, assumptions in the costing offset by falling claims frequency arising from reductions in casualty rates consistent with the long term reduction in casualty rates.

Our costing of the proposed Scheme on a mature scheme basis as set out in the Bill is expected to result in:

- ▶ A reduction in cost per policy in 2014 while allowing for the proposed Scheme and significant benefits to between 7,000 and 8,000 at-fault claimants above current scheme benefits. The savings mainly arise from a reduction in friction costs in the current Scheme and provision of treatment and economic loss benefits on a reasonable and necessary or demonstrated basis (as defined in the Bill)
- ▶ More stable and predictable claims cost over time. As a consequence this is expected to lead to stable premium increases, more consistent with normal inflation, and increased premium savings to vehicle owners over time compared to the current Scheme.

Without reforms the current Scheme cost could increase by about 10% over the next year.

Cost savings on a mature scheme basis on average of around 15% (excluding the reduction in the MCIS levy) for Class 1 vehicles on our projected 2014 cost against the current Scheme is estimated. Actual savings for individuals will vary by vehicle class and risk factor, and could be more or less for some vehicle owners since the proposed Scheme will impact different groups of vehicle owners differently. For example some groups will have more/less at-fault claims than other groups of vehicle owners and consequently the premium rates for those groups will be more/less than the average premium for all vehicle owners.

5. Risks and uncertainty

5.1 Key assumptions for costing of proposed Scheme

In our professional capacity we are required to highlight and discuss the risks and uncertainty associated with our results.

In undertaking our costing of the proposed Scheme we have made a number of key assumptions about which there is significant uncertainty and risk. These key assumptions are discussed in Section 3.

5.2 Uncertainty

5.2.1 General uncertainty

There is significant uncertainty associated with actuarial estimates. Estimates of future claims experience (claims numbers and payments) are always inherently uncertain because they depend on the outcome of future events which cannot be forecast precisely. Examples of claims experience that are particularly challenging to forecast include changes to social, economic and legal environments. Therefore, actual claims experience may emerge at levels higher or lower than the actuarial estimates.

This report contains results relating to the current Scheme and the proposed Scheme. Given that there is no actual claims experience for the proposed Scheme the results relating to it have been estimated based on relevant experience in the Victorian scheme, the NSW WorkCover scheme and the current NSW CTP Scheme. However, as there is no actual claims experience for the proposed Scheme naturally the uncertainty associated with results relating to it is greater than for the current Scheme results.

In recent years interest rates have been very volatile and during the last two years interest rates have fallen substantially. The reduction in interest rates has reduced the investment income insurers earn on their premiums which is used to pay claims. Consequently insurers have increased premiums to offset the fall in interest rates. It is not possible to predict whether interest rates will increase or fall in the future. We have not considered the impact future changes in interest rates will have on our estimate 2014 underwriting year premiums for the current and proposed Scheme. This risk will impact both Schemes in the same direction.

A particular uncertainty in our estimated cost for the current and proposed schemes is in relation to motor vehicle journey claims. The workers compensation legislation in NSW was only recently changed to exclude coverage of most journey claims. Our costing estimates that this legislative change will give rise to the same additional claims in the current and proposed schemes to enable a like for like comparison. The estimated cost is based on our review of the reduction in claims in the WorkCover NSW scheme (i.e. the removal of journey claims) and the mature state experience in the Victorian scheme (in which all motor vehicle journey claims are reported to the CTP scheme). It is still too early for the actual impact to be evident in the claims data of the current Scheme and therefore our estimate of the cost impact of this change is uncertain in respect of both the current and proposed schemes. If the projected increase in journey claims does not materialise at the levels we have estimated then the cost of both the current and proposed schemes will reduce.

5.2.2 Uncertainty - costing of proposed Scheme

There is significant additional uncertainty and limitations associated with our costing results and projection of the affordability of the proposed Scheme, much more than our estimates of the cost of the current Scheme. Specific areas of uncertainty and limitations in the costing results of the proposed Scheme are discussed in Section 3. Other areas of uncertainty include:

- ▶ While the Bill sets out details of the proposed Scheme, the guidelines to be issued by the MAA are yet to be finalised and in addition it is possible amendments may be made to the Bill during its journey through Parliament; as a result, the costing results are uncertain.
- ▶ The costing results have been developed by reference to the claims experience from the current Scheme, the Victorian scheme and the NSW WorkCover scheme. Our costing results are based on the assumption that the claims cost in the proposed Scheme, with the exception of specific variations we have made, will reflect the claims experience observed in the reference schemes after allowing for different benefit design, demographic and operational differences. It is not possible to predict whether the claims experience of the proposed Scheme will reflect the claims experience of the reference scheme including adjustments we have made
- ▶ A further reason for uncertainty in our costing results for the proposed Scheme is that there is no actual claims experience of the proposed Scheme to rely upon other than comparable experience of other schemes in Australia
- ▶ We have assumed the legislation will be interpreted and implemented as intended. However there is significant uncertainty about how the proposed Scheme will be interpreted and implemented and this adds to the uncertainty in our cost estimates
- ▶ The proposed Scheme will represent a significant change in the scheme for all stakeholders that interact with the scheme. It is not possible to accurately estimate the impact of behavioural changes that may result from these changes. This difficulty is further increased as the proposed Scheme will impact stakeholders differently and therefore their responses to the scheme change will differ
- ▶ As discussed in Section 3.2.4 we have not been requested by the MAA to estimate costs involved in transitioning to the proposed Scheme for operational changes such as staff retraining and IT system changes
- ▶ In the current Scheme insurers set premiums subject to the MAA rejection of the premium under certain criteria. In the proposed Scheme, during the first few years under transitional arrangement, the MAA will guide the premiums, within a band, insurers are able to charge. There are a number of matters that will influence the premium the MAA will allow insurers to charge including any surplus on the unearned premium reserve at the time the proposed Scheme enters into operation, uncertainty of the number of claims that will be reported in the early years of the proposed Scheme and other aspects. Accordingly the MAA may allow insurers to charge a different premium to the cost estimated in this report. Further discussion of the premium system is provided in the EY Premium System Report.

As discussed in Section 1.1 we do not expect the actual average cost per policy in the first few years of the proposed Scheme to be higher than our estimated average cost per policy (for Class 1 vehicles).

6. Reliance and limitations

In our professional capacity and EY operating policy requirements we are required to state the reliance and limitations of our report.

In undertaking this costing analysis, reliance has been placed upon the data provided to us by the MAA, the Victorian Transport Accident Commission, RMS, WorkCover NSW and VicRoads. With regards to the MAA data we are specifically relying on the accuracy by which insurers have provided their data and classified appropriate payment types and injury severity coding and that this allocation has been accurate over time.

We have also made judgements and estimates where the information provided here was not part of the analysis conducted as part of the costing analysis. In general, reliance was placed on but not limited to the information provided. Except where indicated, the information has been used without independent verification. However, it was reviewed where possible for reasonableness and consistency.

We have performed the work assigned and have prepared this document in conformity with its intended utilisation by persons technically familiar with the areas addressed and for the stated purposes only. Judgements based on the data, methods and assumptions contained in the report document should be made only after studying the report in its entirety, as conclusions reached by a review of a section or sections on an isolated basis may be incorrect. EY staff are available to explain or amplify any matter presented herein.

Although we have prepared estimates in conformity with what we believe to be the likely future experience, the experience could vary considerably from the estimates. Deviations from our estimates are normal and are to be expected.

We have described certain reliance and limitations of our analysis throughout the Report particularly in Sections 3 and 5.

In accordance with normal professional practice, neither EY, nor any member or employee thereof undertakes responsibility in any way whatsoever to any person other than MAA in respect of this report.

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