Law Council
OF AUSTRALIA

7 October 2011

Ms Caroline Le Couteur
Chairperson, Public Accounts Committee
ACT Legislative Assembly
Canberra ACT 2600

Email: Andrea.Cullen@parliament.act.gov.au

Dear Ms Le Couteur,

RE: ROAD TRANSPORT AMENDMENT (THIRD PART INSURANCE) BILL 2011

I refer to the Law Council of Australia's submission to the Public Accounts Committee of the ACT Legislative Assembly concerning the *Road Transport Amendment (Third Part Insurance) Bill 2011* (**the Bill**) dated 15 September 2011.

I **enclose** the following documents, by way of addendum to the Law Council's earlier submission:

1. Article in The Sydney Morning Herald entitled "Revealed: The great green slip rip off", dated 7 October 2011;

2. Extract from the NSW Motor Accident Authority's 2005/6 Annual Report; and

3. Extract from the NSW Motor Accident Authority's 2009/10 Annual Report.

The Law Council submits these documents for consideration by the Committee, as they tend to re-enforce the Law Council's earlier submissions with respect to the compulsory third party (CTP) insurance scheme in NSW.

A simple comparison of the profit estimates for 2000-2004 between the MAA's Annual Reports for 2005/6 and 2009/10 demonstrates both the size of profits realized by NSW CTP insurers and the extent to which projected profits have been consistently under-estimated since changes to the NSW CTP scheme were introduced in 1999.

As previously stated, the CTP insurance market in NSW is comprised of 7 major insurers, none of which enjoys a dominant market share. Since changes to NSW CTP laws were introduced in 1999, those insurers have consistently claimed

GPO Box 1989, Canberra
ACT 2601, DX 5719 Canberra
19 Torrens St Braddon ACT 2612

Telephone **+61 2 6246 3788**
Facsimile +61 2 6248 0639

Law Council of Australia Limited
ABN 85 005 260 622
www.lawcouncil.asn.au

profits in the range of 25-31 per cent, notwithstanding that the NSW Government's actuarial advisers, Taylor Fry, estimate profits in the range 4 ½ - 6 per cent are considered reasonable.

The Law Council emphasizes that those insurers are simply acting in the best interests of their shareholders, within the limits of the legislative framework introduced in NSW in 1999. The NSW Motor Accidents Authority regulates premiums in NSW and requires CTP insurers to lodge estimates of profit margins annually. Due to the long-tailed nature of the scheme, the actual profits claimed in any given underwriting year do not crystallise until 5-6 years after the premium is written. Accordingly, while NSW insurers continue to over-estimate claims and underestimate profits to be realized for more recent underwriting years, all evidence suggests profits well in excess of estimated returns will ultimately be realized.

While the NSW Government has consistently turned a 'blind-eye' to these matters, 12 years after the 1999 changes were introduced significant pressure is now building to reverse the inequities apparent under the NSW scheme and to restore benefits that were transferred from injured motorists to CTP insurers.

Accordingly, the Committee, and the entire legislature, should view with caution the Government's assurances that premiums in the ACT are regulated. There is no transparency around estimated and actual profits in the ACT CTP scheme, given neither the NRMA Ltd, ACT Treasury or the Road Transport Authority have been required to publicly disclose this information, as is required in NSW. If the present Bill proceeds, there will be no public scrutiny of the basis upon which premiums are determined or the estimated or actual profit claimed by the ACT's monopoly CTP insurer.

The Law Council would be pleased to respond to any queries on this matter when its representatives appear before the Committee on 12 October 2011.

Yours sincerely,

Bill Grant
Secretary-General

Enclosures: 3

Revealed: the great green slip rip-off

$50

The sting in every motorist's third-party insurance policy

EXCLUSIVE
Heath Aston
STATE POLITICAL EDITOR

CAR owners in NSW are paying $50 too much for compulsory third-party insurance, delivering billions of dollars in super profits to insurers. The companies have been allowed to overestimate accident claim costs consistently, adding as much as $300 million a year to their coffers since 2000.

The state government declares an 8 per cent profit margin as "reasonable" but insurers have been bagging an average 24 per cent. While the number of accidents has been falling, insurers have continued to overstate expected payouts.

Many of the state's 1.3 million drivers will want a $50 refund. But lawyers say the money should go to accident victims, 90 per cent of whom are not entitled to any compensation.

Victims left empty-handed include a woman who lost seven teeth in a car accident but was denied compensation. The insurance assessor concluded she could still "chew on the other side of her mouth".

▸ **Full report** – Page 14

$2.5 billion

The estimated extra profits insurers have collected since 2000

The $2.5 billion green slip slap

EXCLUSIVE
Heath Aston
STATE POLITICAL EDITOR

MOTORISTS have been overcharged $500 each over the past decade under a green slip system that allows insurance companies to consistently overestimate future claims and pocket billions in resulting "super profits".

Since 2000, insurers have taken an estimated $2.5 billion above an 8 per cent profit margin deemed reasonable by the NSW government. Their actual margin has averaged 24 per cent and in 2002 reached 31 per cent.

The profit gouge equates to an extra $50 on every one of the 1.3 million compulsory third-party policies, or green slips, issued each year by companies such as NRMA Insurance, Suncorp, GIO, Allianz and QBE.

The state government has begun an internal review on the issue.

The legal profession is calling for an overhaul of the scheme, saying a "systemic failure" in the way prices are set – and the lack of any powers to rein in insurers – has led to drivers being overcharged and accident victims hung out to dry. While motorists will demand $50 off the price of green slips, the NSW Bar Association wants the inflated profits redirected to the 90 per cent of accident victims who receive no compensation under the scheme, established by the former premier Bob Carr in 1999.

Lawyers believe the fault in the system lies in the way insurers produce their own estimates to set prices. The cost of green slips rose from $343 in 2000 to $428 last year, according to industry figures. At the same time claims tumbled by 2000 to a low of 10,220 in 2007-08.

Between 2000 and 2007, insurers bagged $1.78 billion in excess profits and lawyers say preliminary figures for the years up to 2011 suggest that will rise past $2.5 billion.

For years lawyers have been frustrated by the inequity in the system but have now taken action.

"It appears as if the [Motor Accident Authority] is unable to acknowledge a fundamental flaw in scheme design," the NSW Bar Association wrote to the Standing Committee on Law and Justice, which is conducting its annual review of the authority.

"It may well be that the MAA thinks premiums are being set in anticipation of insurers keeping 8 per cent of premium written, yet the insurers inevitably seem to end up with a profit in excess of 25 per cent premium written. For this to happen once or twice might be an understandable anomaly. For it to happen year after year points to systemic failure in the premium approval process."

The chairman of the Bar Association's common law committee, Steve Campbell, SC, said: "Looking at the size of the profits … there is no reason why you couldn't have a reduction in green slips and an increased level of compensation for victims."

The Australian Lawyers Alliance was just as critical of the seemingly toothless authority in its submission, written by a barrister, Andrew Stone. "It is simply too easy for insurers to hide excessive profitability in excessively pessimistic calculations of future payouts," he wrote.

The Greens MP David Shoebridge wants a parliamentary review of the authority's role. "This is an ongoing rort by insurers which the NSW government has been turning a blind eye to for more than a decade," he said. "The government must either give more generous benefits to injured people or take some effective action to rein in the prices charged by green slip insurers."

A spokesman for the Finance Minister, Greg Pearce, said an internal review of excessive profits and green slip pricing was under way.

The MAA released a statement saying the government was looking at issues including "excessive insurer profits and costs" and "fair and affordable CTP green slip pricing".

The Insurance Council refused to comment but its submission says the system is effective and equitable.

"We submit that the CTP scheme is meeting public expectations to ensure that more of the compensation dollar is going to meet the needs of injured people, which has been estimated to be 66.5 per cent of total premiums in the period commencing 1 July, 2010."

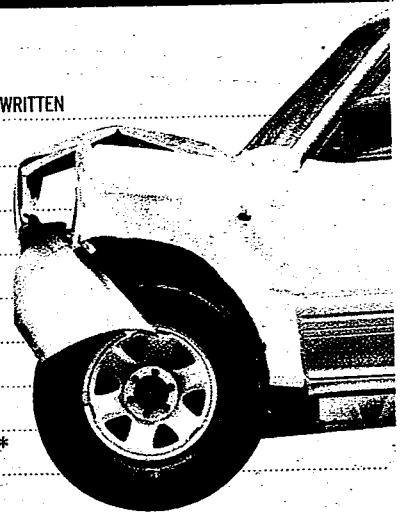
▸ **Editorial** – Extra, Page 8

A smashing business

Insurers' profits

YEAR	ABOVE THE 8% AGREED "REASONABLE" RETURN	AS A % OF PREMIUMS WRITTEN
2000	$292m	30%
2001	$271m	29%
2002	$310m	31%
2003	$228m	24%
2004	$278m	27%
2005	$193m	21%
2006	$147m	18%
2007	$54m*	12%*

* Bar Association says these estimates will rise once "long tail" claims are settled.



SOURCE: MOTOR ACCIDENTS AUTHORITY'S ANNUAL REPORT 2009-10

Report on profit

Section 28(1) of the MAC Act requires a licensed insurer to disclose to the MAA "the profit margin on which a premium is based" and "the actuarial basis for calculating that profit margin". Section 28(2) requires that the MAA report annually to the Legislative Council Standing Committee on Law and Justice on its assessment of the profit margin on which a premium is based and the actuarial basis for its calculation, as provided to it by a licensed insurer.

The MAA usually receives a premium filing from each insurer at least annually and considers all of the factors that go into calculating the proposed premiums. The MAA may reject a premium if it will not fully fund the liabilities or if it is excessive. In relation to profit, the Act provides that a premium will fully fund the liabilities if the premium is sufficient to "provide a profit margin in excess of all claims costs and expenses that represents an adequate return on capital invested and compensation for the risk taken" (section 27(8)(c)).

The MAA must, therefore, not reject a premium on the basis of the level of the profit as long as the level is within the range that ensures an adequate return on capital but is not excessive. The MAA has made every effort to ensure that the profit component of the premium is assessed against objective criteria and has adopted a methodology prepared by Taylor Fry actuaries.

The Taylor Fry methodology refers to a 'representative' insurer and involves three components:
1 the determination of a suitable quantum of total capital (net assets) for a representative insurer
2 the determination of a suitable allocation of insurer capital to NSW CTP
3 the calculation of a profit loading to service the allocated capital at a fair rate of return.

The representative insurer is based on the average of insurers writing CTP business in NSW. Taylor Fry calculations are based on a representative insurer holding capital equal to 58 per cent of CTP technical provisions, which is approximately equal to 66 per cent of outstanding claims provision (OCP) for NSW CTP. The insurer also holds additional (implicit) capital as a prudential margin within the provision for outstanding claims. The Taylor Fry methodology for allocating capital to the CTP line of business is consistent with APRA's new prudential regime.

There are wide variations in levels of capitalisation between individual insurers. The allocation of capital by the representative insurer used in the derivation of the profit margin is slightly higher than the highest notional capital allocation reported by an individual CTP insurer.

The indicative range resulting from Taylor Fry's calculations is a profit of 4.5-6 per cent of gross premium for the representative insurer. As the range of profit margins relates to a representative insurer, they are illustrative only. It is fully expected that profit margins filed by individual insurers may vary from them, reflecting the insurers' own business structures. The MAA accepts that the level derived by the Taylor Fry methodology sets the minimum level of profit to ensure an adequate return on capital and that actual profit levels will be within a range above this as long as the level is justified by the insurer and not considered by the MAA as excessive.

Over the last six years, profit margins ranged from 7.5 to 10 per cent for individual insurers, with an industry average between 7.7 and 8.7 per cent. The MAA considers this range of profit margins to be reasonable although the MAA has ongoing discussions with the CTP insurers who believe that the level of profit derived from the Taylor Fry methodology is not adequate.

Following the passage of legislation by the NSW Parliament in May 2006, special benefits for children including lifetime care and support were scheduled to commence on 1 October 2006. This required insurers to submit filings to the MAA in July 2006 for policies incepting 1 October to reflect the new benefit structure. Given this need, the MAA did not require insurers to lodge a filing in 2005-06. According to s26(1) of the MAC Act an insurer must lodge a filing once each year or such longer period as the MAA may allow. Insurers were still able to file for changes to their premiums at any time.

Profit margins in insurer filings

Filing period	Range (%)	Weighted average (%)
1999-00	7.5 – 9.5	7.7
2000-01	7.5 – 9.5	7.9
2001-02	7.5 – 9.5	8.2
2002-03	7.5 – 9.5	8.2
2003-04	7.5 – 9.7	8.5
2004-05	7.5 – 10.0	8.7
2005-06	7.5 – 10.0	8.7

The slight increase in the projected profit margin in recent years reflects increased allocation of capital to this line of business in accordance with revised APRA standards. The MAA believes the risk of writing business in the NSW CTP scheme is less than for other long tail business because of the legislative changes to promote scheme stability and the existence of a regulator to closely monitor scheme performance. The MAA also believes that with the introduction of the Lifetime Care and Support (LTCS) Scheme, insurers will require less capital to underwrite CTP as a significant portion of the risk will be included in the LTCS fund and therefore insurers will require a lower amount of profit from CTP.

Realised profit

Section 5(2)(d) of the Act provides that the insurers, as receivers of public money that is compulsorily levied, should account for their actual profit margins. The assessment of profit requires a review of the development of the underwriting year from the time of the premium filing. The premium filing includes the insurers' prospective estimates of the profit margin but the actual profit or loss that an insurer may ultimately make will depend on the extent to which the other assumptions in the premium filing are correct.

The profit or loss that an insurer makes on an underwriting year will depend in the main on the level of claim liabilities. During the development of an underwriting year as claims are received and paid, insurers identify a central estimate of claims cost in regular valuations. To meet APRA requirements insurers must hold a risk margin above the central estimate. If subsequent valuations identify a reduction in the claims cost, insurers will be able to release a proportion of the prudential margin for that underwriting year. That can happen at any time during the development of an underwriting year. However, it may also be necessary for insurers to strengthen their reserves if the valuation identifies increased claims cost.

The table opposite presents the current estimates of claims liabilities for each underwriting year and the estimated profit as a percentage of written premium. It is important to note that this is only an estimate of what the realised profit will be if the current liability valuation is correct.

Historically, NSW CTP experience has been volatile. Insurers' profit under the *Motor Accidents Act 1988* from 1991 to 1999 varied from an estimated 33 per cent loss in 1994 to an estimated 26 per cent profit in 1996. The average profit for this period is estimated to be eight per cent of premiums.

The MAA assesses the estimated future profit by accounting for the actual payments made to date and current estimates of the liabilities for each underwriting year. These estimates do not represent actual profit but a current indication of the profit that may be realised once all claims are paid if the current liability valuations prove correct. They are, therefore, heavily qualified by the fact that they will change as the scheme develops further and claims are paid. For example, even for the first underwriting year of the new scheme with 94 per cent of full claims finalised, this represents only 80 per cent of the estimated ultimate incurred claim cost. As the larger claims are finalised over the next few years, this may change the estimated incurred claims cost.

Scheme development by underwriting year (all figures are in $ millions)

Year ended 30 Sep	Premiums written	Acquisition costs [1]	Estimate of ultimate claims costs in insurers' premium filings		Estimated ultimate claims cost excluding claims handling expenses			Estimated ultimate claims cost including claims handling expenses	Estimated profit
			Discounted [2]	Discounted +15% prudential margin [3]	Undiscounted	Discounted	Discounted +15% prudential margin	Discounted +15% prudential margin	
2000	1325	200	1053	1211	998	710	732	774	350 (26.5%)
2001	1321	198	977	1123	1033	767	806	852	271 (20.5%)
2002	1342	185	997	1146	1095	796	860	909	248 (18.5%)
2003	1395	197	1018	1171	1211	907	1005	1063	135 (9.7%)
2004	1476	222	1061	1220	1292	935	1053	1117	137 (9.3%)

Claim payments

Year ended 30 Sep	Claim payments to 30/9/06		% of full claims finalised	Estimated proportion of claims costs paid	
	Actual $m	Discounted $m		Undiscounted	Discounted
2000	722	566	94%	72%	80%
2001	614	511	91%	59%	67%
2002	435	372	82%	40%	47%
2003	282	256	66%	23%	28%
2004	159	149	49%	12%	16%

Notes:

1 Including estimated net cost of reinsurance

2 The discounted value of the claims estimate translates the estimated ultimate total claim payments back to underwriting year dollars for valid comparison. The actual amount that insurers pay will be greater than the discounted amount.

3 APRA requires that insurers' estimates of their claim liabilities include a prudential margin that will provide at least a 75% probability that the insurers' provisions are sufficient to cover their liabilities. This represents a prudential margin of approximately 15%.

Realised profit

Section 5(2) (d) of the Act provides that the insurers, as receivers of public money that is compulsorily levied, should account for their actual profit margins. The assessment of profit requires a review of the development of the underwriting year from the time of the premium filing. The premium filing includes the insurers prospective estimates of the profit margin but the actual profit or loss that an insurer may ultimately make will depend on the extent to which the other assumptions in the premium filing are realised. The Authority has made every effort to ensure that the profit component of the premium is assessed against objective criteria and has adopted a methodology prepared by the scheme actuaries.

The following table presents the current estimates of claims liabilities for each underwriting year and the estimated profit as a percentage of the written premium. It is important to note that this is only an estimate of what the realised profit will be if the current liability valuation is correct.

SCHEME DEVELOPMENT BY UNDERWRITING YEAR

	PREMIUMS WRITTEN DURING THE YEAR	ESTIMATE OF INSURER'S ACQUISITION EXPENSES AND NET COST OF REINSURANCE	BULK BILLED AMBULANCE AND HOSPITAL COSTS	PROPORTION OF REPORTED CULL CLAIMS FINALISED	ESTIMATED DISCOUNT VALUE		ESTIMATE OF DISCOUNTED VALUE OF PROFIT/(LOSS) FOR INSURER					
					CLAIMS PAYMENTS (EXC BULK BILLING)	INSURER'S CLAIMS HANDLING EXPENSES	1 IF ESTIMATE OF CLAIMS LIABILITIES TURNS OUT TO BE 10% MORE THAN CENTRAL ESTIMATE		2 USING CENTRAL ESTIMATE OF CLAIMS LIABILITIES		3 IF ESTIMATE OF CLAIMS LIABILITIES TURNS OUT TO BE 10% LESS THAN CENTRAL ESTIMATE	
							AMOUNT	% OF PREMIUMS	AMOUNT	% OF PREMIUMS	AMOUNT	% OF PREMIUMS
	$M	$M	$M	%	$M	$M	$M	%	$M	%	$M	%
UNDERWRITING YEAR ENDED 30 SEPTEMBER												
2000	1,325	200	36	99	652	39	396	30	398	30	400	30
2001	1,321	198	36	99	670	40	373	28	377	29	380	29
2002	1,342	185	36	98	664	40	414	31	418	31	423	31
2003	1,395	197	39	97	773	46	332	24	340	24	348	25
2004	1,476	222	42	96	766	49	385	26	397	27	409	28
2005	1,451	224	41	92	817	60	288	20	309	21	331	23
2006	1,426	218	42	83	843	62	221	15	262	18	302	21
2007	1,221	173	n/a	68	835	61	92	8	152	12	213	17
2008	1,178	167	n/a	46	890	65	-26	-2	56	5	137	12
2009	1,328	180	n/a	24	1,084	79	-128	-10	-16	-1	97	7

Note:

1. With effect from 1/10/06, bulk-billed costs became payable by the Motor Accidents Authority out of levy revenue, and ceased being paid by insurers out of their premium revenue. Thus, for the 2007 (2006/07) underwriting year (and subsequent underwriting years), bulk-billed costs are not part of the total costs borne by insurers in analysing estimated profitability of premiums for insurers.
2. Since further claims development is anticipated for underwriting year 2010, it would be more sensitive to changes in the assumptions and projections and hence it has been excluded from the above table.
3. Since claims payments occur over a period of time after premiums have been collected, the estimated value of ultimate claims payments per underwriting year is discounted back to the time of premium collection in order to obtain a valid measure of profit as at the time premiums were paid.
4. The proportion of ultimate claims liabilities which are still outstanding is much more for recent underwriting years than for earlier underwriting years. Therefore estimates of the discounted value of profit for recent underwriting years are much more sensitive to uncertain assumptions regarding future claim payments than estimates for earlier underwriting years.
5. Estimated profit is presented in three (3) scenarios depending on the estimate of outstanding claims liabilities.
6. Claims payments shown in the table above, relate only to scenario (2) of the profit estimates.

The previous table presents the current estimates of claims liabilities for each underwriting year and the estimated profit as a percentage of the written premium. It is important to note that this is only an estimate of what the realised profit will be if the current claims liability valuation is correct.

The estimated profit is presented in three scenarios:

1. If outstanding claims liabilities turn out to be 10 per cent more than the updated central estimate of those claims liabilities
2. If outstanding claims liabilities turn out to be exactly the updated (as at 30 June 2010) central estimate of those claims liabilities
3. If outstanding claims liabilities turn out to be 10 per cent less than the updated central estimate of those claims liabilities

The previous table above shows the amount ($m) and proportion (%) of profit estimated for each scenario (numbering in the table corresponds with the summary above). The results show the range of estimates of profit calculated assuming that the outstanding claims liabilities as at 30 June 2010: (1) 10 per cent more (2) Exact (3) 10 per cent less than the updated central estimate of outstanding claims liabilities. For instance, for the underwriting year 2000 (1999/2000) the estimated profit is: $396m (30 per cent), $398m (30 per cent) or $400m (30 per cent) using scenario 1, 2 or 3 respectively.

The estimates of profitability with respect to a given underwriting year, in this report, could be different to the previous report as at June 2009. Such differences arise largely due to revisions in the actuarial estimates of ultimate claim costs.

CLAIMS

At the end of June 2010, a total of 72,234 notifications had been received by insurers in relation to accidents since 1 October 2003. Of these, there were 58,866 full claims, and 13,368 Accident Notification Forms (ANF) which had not converted to full claims by 30 June 2010. After nine years of steady decline, the estimated ultimate number of notifications per accident year appears to be rising as from 2008/09, which has almost 12,000 notifications.

No-fault ANF

From April 2010, the NSW Compulsory Third Party or Green Slip insurance scheme has been expanded so that anyone injured in a motor vehicle accident in NSW, regardless of who was at fault, may be able to access benefits. The change relates specifically to the ANF which provides for the early payment of reasonable and necessary medical expenses and/or lost earnings up to a maximum of $5000.

	FULL CLAIMS	ANFS	TOTAL CLAIMS	IBNR[2] ESTIMATES	ESTIMATED ULTIMATE CLAIMS
ACCIDENT YEAR[1]					
2003/04	9,995	2,269	12,264	26	12,290
2004/05	9,676	2,035	11,711	46	11,757
2005/06	9,178	1,908	11,086	81	11,167
2006/07	8,928	1,654	10,582	147	10,729
2007/08	8,625	1,293	9,918	302	10,220
2008/09	8,786	2,141	10,927	805	11,732
2009/10	3,678	2,068	5,746	1,321	7,067
TOTAL	58,866	13,368	72,234	2,728	74,962

1. Accident years run from 1 October to 30 September. 2009/10 covers only nine months, and the IBNR claims projection is for these nine months. No estimates have been made for the last three months of this accident year and the associated IBNR claims.
2. IBNR - Incurred but not reported claims.
3. Data as at 30 June 2010
4. 2009/10 ANFs are higher due to the introduction of no-fault ANFs in April 2010.
5. The truncated report does not give a clear picture of the claims development process This is a case where more data is definitely better.

The estimated ultimate number of notifications is used to calculate two measures, claim frequency and propensity to claim. Claim frequency is the number of notifications per 10,000 registered vehicles. The following table shows that the estimated claim frequency continued to drop from 30 for the 2003/04 accident year to 23 for 2007/08. However, in line with the recent increases in notifications, the claim frequency estimate for 2008/09 has gone up to 26 notifications per 10,000 registered vehicles.