

AAMI

This submission is presented by Australian Associated Motor Insurers Limited (AAMI), 616 St Kilda Road, Melbourne, Victoria, 3004.

This document has been prepared in response to the Productivity Commission's request for submissions for their inquiry into the impact of NCP and related reforms. The Commission has also asked for comments on other areas that offer opportunity for significant gains to the Australian economy, by removing impediments to efficiency and enhancing competition.

Australian Associated Motor Insurers Ltd (AAMI) is a part of the Promina Group (Promina), which is Australia's third largest insurance company.

AAMI is a substantial underwriter of Motor, Home and CTP insurance, and is anticipating writing almost 3 million policies in 2004 with gross written premium of over \$1.2b. CTP is an important component of our business with AAMI writing business in both New South Wales and Queensland.

AAMI is a direct distributor, with no intermediary involvement. It provides insurance for the general population, including younger people through its non-standard risks agency, Just Car Insurance Agency Pty Limited (JCIA). AAMI now operates in all Australian states except Western Australia and the Northern Territory, and has a network of 53 branches and service centres.

In 2002 the National Competition Council wrote a summary of their findings to date in regards to long tail insurance services¹. This paper also contained various recommendations in terms of steps forward. Since this time there appears to have been little activity in regards to CTP Insurance.

This paper looks at those findings and examines whether there has been any significant changes since. It reaches some conclusions and makes some recommendations on the way forward.

Summary of Concerns

Although there has been a great deal of restructuring in the financial sector over the last 10 years or so, to support the philosophy of a competitively based markets, the CTP Insurance market continues to be largely run by State based monopolies and heavily regulated. The table below (Table 1) gives a summary of the status of CTP Insurance provision across Australia. The table demonstrates the continuing dominance of state based monopoly schemes, and the lack of uniformity in approach across the country, which from our view (as supported by our industry, please see the Insurance Council of Australia's submission to this Productivity Commission's inquiry²), causes an inefficient market place, whether due to lack of economies of scale or scope being realized or unnecessary compliance costs.

¹ 2002 NCP Assessment chp 9

² ICA Submission to the Productivity Commission Inquiry into NCP – June 2004

Table 1

Queensland	<ul style="list-style-type: none"> ▪ Private underwriters ▪ Regulatory and structural barriers to competition ▪ Very minor change after NCP review
NSW	<ul style="list-style-type: none"> ▪ Private underwriters ▪ Some capacity for competition ▪ Satisfied NCP tests
Victoria	<ul style="list-style-type: none"> ▪ Public underwriting ▪ TAC is pure monopoly ▪ No effective change following NCP review
Tasmania	<ul style="list-style-type: none"> ▪ Public underwriting ▪ MAIB is pure monopoly ▪ No effective change following NCP Review ▪ Pricing subject to review by GPOC
South Australia	<ul style="list-style-type: none"> ▪ Public underwriting ▪ One insurer appointed as claims manager ▪ No effective change following NCP review
Western Australia	<ul style="list-style-type: none"> ▪ Public underwriting ▪ ICWA is pure monopoly ▪ No effective change following NCP review
ACT	<ul style="list-style-type: none"> ▪ Private underwriting ▪ Currently one insurer only, others can apply to participate
Northern Territory	<ul style="list-style-type: none"> ▪ Public underwriting via TIO ▪ No private sector participation ▪ No change following NCP review

In the private markets there are currently 7 insurers underwriting, the majority in NSW.

The 2002 NCP Assessment examined the CTP Insurance markets in each State, but reached no overall conclusions, asking instead for more data. The tone of the Assessment however suggested that there was concern that the state based monopoly schemes were inconsistent with the National Competition Policy's objectives, i.e. that the public interest arguments that were fielded by the States/Territories did not conclusively outweigh the ongoing costs that the consumer is having to absorb when purchasing CTP Insurance. (For example, in NSW, a major market, where private insurers underwrite, consumers generally enjoy strong levels of competition between the insurers. This experience contrasts sharply with the reality for those consumers living in State based monopoly markets).

Since this point there has been no real movement within the CTP Insurance area, although the Productivity Commission has conducted an inquiry into Worker's Compensation and Occupational Health and Safety Frameworks, which has clear parallels to the CTP Insurance market. AAMI supports the findings of this inquiry, principally that the existing workers compensation arrangements undermined competitiveness, finding that differences in Australia's workers compensation arrangements resulted in significant compliance burden for multi-state employers and uncertainty for employers and employees.

This thinking can be extrapolated to CTP Insurance where many of the issues, for example, private insurers underwriting in different legislative environments, causes inefficiencies and increased compliance costs impacting on insurers and consumers. The lack of ability to transfer the CTP product from one jurisdiction to another and the links between CTP and State based vehicle registration systems, means there is no competition for the State based monopoly schemes. Additionally with the differences between levels of access to compensation/benefits within the State based schemes means that the consumer is treated differently, depending on where he/she lives. Equity clearly is an issue as is forum shopping.

AAMI recommends that the National Competition Council continues to examine the area of CTP Insurance, in line with its original mandate. If the Council wishes to approach AAMI about the realities of being a private insurer underwriting and managing claims in the area of CTP Insurance, AAMI would be delighted to provide assistance.

Brief Overview of the CTP Market

In all jurisdictions CTP insurance is mandatory and applies to the vehicle. Government believes that these requirements are important, ensuring all not at fault injured parties have access to insurance. NCP reviews and AAMI support this view, also noting that the mandatory nature of these forms of insurance ensures parties responsible for accidents cannot avoid contributing to the benefits available for affected individuals.

Benefits paid under CTP Insurance typically cover medical, hospital and rehabilitation expenses, legal costs, loss of earnings and in many cases, compensation for pain and suffering. In some cases, benefits are paid on statutory formulas, in others they are based on common law or statutory benefits and the common law. Access to the common law is provided in the ACT and restricted in NSW, Victoria, WA and SA, Queensland and Victoria. In Victoria and Tasmania, statutory no fault benefits are also available. In NT statutory benefits are available to residents only, while non-residents have access to common law.

Concerns with Current Status

Review and Reform Progress by the States and Territories

All governments completed reviews of their statutory monopoly insurers by early 2001.

Victoria – conducted a second review of CTP in 1999. This review reversed the first reviews' recommendation for multiple provision. In its 2001 annual report to the Council, the Victorian Government informed the Council it will review the scope for greater contestability in the provision of CTP via further outsourcing (market testing) by the Transport Accident Commission (TAC). The government is still considering the mechanism for third party reviews of the TAC premiums that was a recommendation of the 2000 reviews.

WA – review of CTP was finalised in 2000, recommending multiple provision. Amending legislation was withdrawn in 2000 and no action has been taken since.

SA – second review of CTP – 1999. Reversed 1998's review that multiple provision should be introduced. The Government reaffirmed in 2001 that the Motor Accident Commission remains the sole provider of CTP insurance in SA. SA's NCP report reiterates that the State has demonstrated a public interest case for retaining the single statutory provider of CTP.

Tasmania – In the 2002 NCP annual report the Government stated that it would examine the Victorian review of the TAC before making decisions about its Motor Accident Insurance Board.

NT – review of CTP completed in late 2000 and the Government is considering the recommendations. Review argued for retaining the monopoly arrangements but suggested that the Government consider franchising out the operation of the CTP Scheme. It recommended clarification of legislative objectives and replacing references in legislation to the Territory Insurance Office with the 'designated insurer'.

NSW, ACT and Queensland – allows for multiple suppliers therefore no NCP issue.

Overall there has been a clear lack of activity in this area of government.

Public Interest Evidence

The issue of monopoly versus multiple provision is central to the Council's consideration of whether jurisdictions CTP arrangements are consistent with NCP. Governments have used the public interest argument, in that the benefits of a monopoly provision outweigh the costs. However they have been unable to clearly demonstrate this and arguably the success of the NSW scheme in promoting active competition between providers, together with significant international experience, shows that this argument is not valid.

Premiums

In most jurisdictions there is little connection between the risk-profile of the insured and the premium the insured pays in CTP. All motorists tend to pay the same regulated premium regardless of their driving history or the evidence of driving behaviour of their peer group. The 'community rating' aspect of CTP diminishes the incentives for risk minimisation that could arise from differential premiums reflecting factors such as age, driver history, experience and measures taken to reduce risk.

One concern that arises from this methodology, is that the neither the insured or the community is aware of the level of cross-subsidisation. There is a clear lack of transparency between what the insured pays for CTP and the real cost. The insured is given no choice (in all jurisdictions, bar NSW) and even then, no information to make an informed choice.

Therefore should the benefits of risk related premiums be considered? It would give the consumer a more equitable outcome, instead of asking low risk drivers to subsidise high risk drivers.

In Australia the privately underwritten NSW scheme goes closest to aligning risk profiles with the premium charged.

Of equal concern is the potential for Government's to utilize these monopolies as sources of revenue via premiums that exceed the necessary prudential level. In such instances, a hidden tax is clearly in operation.

Economies of Scale

Some state/territory governments have argued to date that the size of the market in their state does not justify the provision of insurance by more than one supplier because economies of scale would not be realised.

However it is felt that states/territories have not provided sufficient evidence of the market size required to achieve economies of scale, but they have implied to date that costs would be higher if smaller, multiple suppliers were allowed in place of monopoly providers. This has not been the private insurance sector's experience to date with small scale operators being able to successfully compete against larger scale operators in the NSW and Queensland markets. And in any case, private insurers can spread many of their fixed costs over a range of insurance products and thus enjoy economies of scale that governments are unable to realize.

Economies of Scope

Statutory monopoly providers specialise in providing one insurance type. This specialisation denies the monopoly insurer access to economies of scope, whereas private insurers participating in competitive markets usually offer a range of insurance

products and can take advantage of the systems, human resources and insurance expertise that they have developed.

Choice and Innovation

There are costs of monopoly provision re choice and innovation. The lack of choice for consumers denies them the potential to compare the services and benefits offered by competing companies. Additionally, the competitive provision of insurance services would be more likely to result in innovative approaches to products whilst meeting the minimum requirements.

Prudential Supervision/Licensing

Monopolies typically require more regulation than required by competing companies. The challenges, costs and pitfalls associated with endeavoring to regulate a monopoly for both efficient pricing and quality service are well known to the Commission.

The HIH experience has been noted as adding to the costs of insurance in some of states where private insurers compete for CTP insurance business. It is also claimed to have resulted in a large bill to governments to meet HIH's liability. The relevant States imply that public monopoly insurers are more immune to such failures, however the history of financial calamities in insurance monopolies over the last decade suggests that this is wishful thinking. Political expediency remains an issue and the ability to shift costs inter-temporally in the long tail schemes is a serious risk.

Effective prudential supervision makes a substantial contribution to sound financial performance by insurers. It can be seen that this relationship has been belatedly recognised following HIH's collapse and appropriately acted upon.

APRA have been reviewing, with the industry and federal government, the appropriate prudential standards for the industry. These tend to be higher than those of the States (which has led to problems in the past with blowouts in unfunded liabilities). Stage II Reform is now in the process of being finalized and implemented.

With these rigorous prudential standards, APRA could be allowed to be a central regulator for general insurers providing CTP. This would remove regulatory overlap with the States, which creates confusion, jurisdictional discrepancies and improve insurers' confidence in how they price when underwriting.

If the State/Territory monopoly scenario continues, the States continue to regulate the consumer side of service provision. If the scheme were to become national, ASIC would be the obvious choice of regulator for consumer issues, as it is for all other insurance products that are under the Corporations Act 2001. CTP can be redefined under the Corporations Act as a retail product and consumer protection/disclosure can be aligned to that of all other retail insurance products (e.g. comprehensive motor). This in fact, could also happen under a State based privatised scheme.

Outsourcing

The monopoly providers in various states outsource some of their functions to private companies. To the extent that these companies are chosen after a competitive bidding process, outsourcing may allow the achievement of at least some of the cost savings likely to arise from the competitive provision of insurance.

AAMI would like to see a greater participation in outsourcing some of the functions – at the very least. For example, AAMI has a specialization in claims management that has been built up over many years. It would like the opportunity to apply its methodology on a national level, which should result in lower claims management costs, therefore lower premiums to the insured, without compromising the final outcome for the injured client. AAMI's claims management methodology concentrates on early intervention, which has been proved to be the most effective medically, and financially efficient way of case managing.

Cost/benefit Analysis

One of the issues facing Insurers and the National Competition Council is the difficulty that now exists in trying to ascertain which type of scheme provides greater consumer benefit. One reason for this is the markedly different benefits/thresholds available under different schemes, as well as different pricing structures. The lack of uniformity across the country has led to a dilution in available intelligence to be able to make informed decisions. If it is difficult for the industry to analyse, it is impossible for the community and the consumer.

Impact on Risk Credit Rating for the Jurisdictions

One of the often ignored consequences of jurisdictions retaining the ultimate risk of their compensation schemes is the potential for this additional risk to adversely impact the State Credit Rating. This potentially can cause significant increases in the cost of funding State debt and needs to be properly considered in any cost benefit analysis re the efficiency of a monopoly scheme.

Conclusions

For all of the reasons outlined above the National Competition Council needs to continue its work in looking at the area of CTP Insurance. From AAMI's view, the most effective and efficient scheme would be one that was national and privatised. At the very least claims management should be competitively tendered to allow for reduced overall costs, which could be passed onto consumers via cheaper premiums or better services.