SUBMISSION

REVIEW OF NATIONAL COMPETITION POLICY ARRANGEMENTS

Insurance Australia Group (IAG)

As the largest general insurer in Australia and New Zealand, Insurance Australia Group (IAG) has emerged as the leading player in Australian workers compensation and compulsory third party (CTP) motor vehicle accident insurance. The Group's companies operate as an insurer or claims agent in every Australian workers' compensation and CTP jurisdiction with private sector involvement.

IAG provides coverage for about 1.7 million workers, policies for 169,000 employers and injury and claims management services for about 43,000 claimants.

In compulsory third party insurance IAG currently has approximately 2 million policy holders in the three jurisdictions allowing private underwriting participation, and is currently managing 700 major claims (these being long duration claims and/or those involving a catastrophic injury or death) in addition to many more small claims.

The Group's involvement with workers compensation began in 1998 with the acquisition of SGIO Insurance Ltd (and SGIC), a leading provider of workers compensation in Western Australia, by NRMA Insurance Group Ltd. In 2000 NRMA Insurance applied for a NSW workers compensation licence and in March 2001 acquired the HIH workers compensation business.

In October 2002 IAG announced the acquisition of CGU/NZI, taking effect on 1 January 2003, and the following month also acquired Zurich's NSW workers compensation business. This made IAG a clear market leader in workers compensation in almost every jurisdiction.

Through these acquisitions more than 1000 highly skilled and experienced people have joined together to form Australia's largest workers compensation operation, consolidated under the CGU Workers Compensation brand since July 2003.

Overview

Workers compensation and to a lesser extent compulsory third party insurance are key drivers of economic prosperity and international competitiveness. While most of Australia's infrastructure has undergone substantial reform in recent times to support a single, open market economy, Australia's workers compensation and compulsory third party insurance markets remain testimony to a bygone age.

IAG strongly supports the reform agenda detailed in the Final Report of the Productivity Commission Inquiry on Worker's Compensation and Occupational Health and Safety Frameworks.

Fundamental to any consideration of reform initiatives in the area if workers compensation and compulsory third party insurance is an understanding and recognition of the most effective and competitive mechanisms that reward positive employment practices with affordable premiums and capitalises on the opportunities for reduced risk and accident prevention for injured workers and motorists in Australia.

A well-designed, administered and competitive national system for workers compensation can deliver fairer support for injured workers, by eliminating arbitrary differences in entitlements for many workplace and motoring injuries and better social and health outcomes through improved performance measures and better targeting of services inherent in competitive, privately funded schemes. A competitive national market will encourage and reward employment practices with affordable premiums and create real incentives to reduce risks and prevent accidents.

The reform necessary to create a nationally competitive workers compensation and third party insurance environment is long overdue and the costs of further delay in terms of Australia's international competitiveness and increased prosperity can no longer be ignored.

The Final Report of the Productivity Commission Inquiry on Worker's Compensation and Occupational Health and Safety Frameworks reaffirmed the view that Australia's existing workers compensation arrangements undermined competitiveness finding that differences in Australia's workers compensation arrangements resulted in a significant compliance burden for multi-State employers and uncertainty for employers and employees.

Competition and the Insurance Industry

The Australian general insurance industry is viewed as having low barriers to entry in short tail classes of insurance - limited to the national regulatory requirements, including Australian Prudential Regulatory Authority (APRA)'s minimum capital and solvency requirements.

Short tail insurance accounts for about 60 per cent of annual premiums paid by Australian consumers and businesses.

The market for comprehensive car, buildings and contents insurance products is serviced by a large number of insurers, providing an enormous range of offerings to customers.

In this market there is intensive price, service and product competition. Consumers have access to a healthy range of products from which to choose. They are able to take advantage of special features such as loyalty and multi-policy discounts.

This is in stark contrast with the market for long tail products, which account for the remaining 40 per cent of premiums.

There have been sporadic outbreaks of price competition in long tail classes, but these are often followed by large losses and wholesale withdrawal of insurers from the market.

This cycle was recently played out in the markets for public liability, medical indemnity and professional indemnity insurance. The impact of these crises on the community was amplified by the collapse of HIH, which was once active in these markets.

Governments have responded with laws designed to improve stability and certainty of future claims costs by more clearly defining negligence, and by moving to impose thresholds and caps on damages. Insurance pools have also emerged to plug gaps in capacity, in some cases with government support.

The drawn out processes involved in settling claims for long tail insurance means it may take many years before it is clear whether the latest legislative changes have improved access to key insurance products, or whether they have simply added further layers of complexity to an already distorted and inefficient regulatory framework.

The debate about the reform of long tail classes has overlooked the fact that the dominant player in the Australian marketplace is the public sector.

Government compulsory third party and workers' compensation insurers – predominantly State but also Federal – collectively account for more than half of all long tail insurance premiums collected in Australia. This is a very high proportion for a sector such as insurance.

These government insurers typically operate within statutory monopolies within the borders of a State and rigidly control any non-government participation within the schemes. Such control severely restricts the capacity of insurers (who may be active within such schemes as claims managers or scheme agents) to compete and therefore minimizes the benefits of competition available to consumers in the insurance sector.

The size of the market open to competition and private investment is even further reduced by the presence of specialist entities, such as local government mutuals and medical defense unions. These organizations operate via mechanisms such as discretionary trusts, outside the prudential regulatory framework in which private companies must operate.

The high number and variety of State and Territory government-owned and/or managed insurance schemes in a relatively small economy (by global standards) places Australia in a unique position internationally.

These compulsory third party and workers compensation schemes have developed in an ad hoc manner, largely independently of each other and are now so different that gradual change to a more uniform model is a long term strategy fraught with difficulties, both practical and political.

It is interesting to note that markets in which private insurers now underwrite the two major long tail classes generally enjoy strong levels of competition and, in historical terms, more affordable premiums. This contrasts with the experience of some public insurers in recent times.

Through its NRMA Insurance brand, IAG is the leading insurer in the largest competitive transport accident liability market – New South Wales. Through its CGU brand it is the largest private sector workers' compensation provider in Australia, particularly in the privately underwritten market of Western Australia.

In both jurisdictions, governments and regulators have, without exposing taxpayers to underwriting risk, built a body of experience working in partnership with insurers to achieve social policy outcomes.

But the majority of statutory state-based insurance in Australia continues to be written by government monopolies. In many cases insurers act as agents, but have no underwriting exposure. They therefore have no direct financial interest in the schemes, and often a strictly circumscribed ability to deviate from the directions of the regulator in terms of managing claims or otherwise competing and innovating within that market.

The public sector's domination of the long tail insurance business and the fragmented regulatory framework for the private sector has impeded the development of a viable, sustainable and large-scale market for long tail insurance in Australia. This has of itself impeded the development of capital accumulation within the Australian insurance market

Conversely, state monopoly insurance has imposed massive capital strain on the Australian public sector and indirectly has reduced its capacity to fund roads, schools, hospitals and other legitimate public services.

In contrast, the need to service private capital creates a natural commercial discipline to optimise efficient delivery of entitlements, quite apart from the APRA prudential and other regulatory requirements which private underwriters must observe, unlike their public counterparts.

This is due at least in part to the Commonwealth Insurance Act (1973) which specifically excludes State monopoly schemes from having to comply with a variety of Federal regulations, including those imposed through APRA. As a result, most publicly underwritten schemes do not comply with APRA's prudential requirements and carry large unfunded liabilities. This can often result in political pressure to legislatively reduce the benefits available to injured workers.

By contrast, private underwriters must comply with the insurance Act and are therefore adequately funded to pay claims. Their primary focus is on minimising the transaction costs and improving injury management and resolution, rather than minimising the benefits paid to claimants.

This also creates a natural incentive to work with individual employers to prevent injuries and therefore claims in the first place.

Disadvantages of Multi State Schemes

Data Issues

Crucial information about trends in key areas such as injury claims is scattered across a large number of public and private organisations. There are very large differences in recording and reporting standards, and the differences between schemes often mean that the similar data sets cannot be measured effectively between jurisdictions.

For example, in one jurisdiction the right to proceed at common law may accrue when a whole person impairment of 10% has been sustained, in another a whole person disability of 15% may be needed, while in a third the plaintiff may only need to make an election without sustaining any particular degree of impairment.

Such legislative differences make it virtually impossible to establish meaningful national benchmarks and performance standards or to identify and monitor emerging national trends, even within individual companies.

This has wider social policy implications, as well as implications for the insurance industry. For example, work at the national level on a comparative performance-monitoring model for occupational health and safety has suffered from a lack of standardised data.

Creating a single scheme with a single set of legislation laying out entitlements, defining the incidence and extent of cover and the benefits to be provided would also allow the creation of a national data set facilitating the development and improvement of national standards and strategies for Occupational Health and Safety (OH&S) and claims and injury management.

The new Australian Safety and Compensation Council has been charged with incrementally agreeing common standards between States for State Parliaments to enact, however the need for unanimity between 9 governments and legislatures makes this a long term project.

APRA and the Workplace Relations Ministerial Council have also attempted to develop national data sets to monitor schemes, but the possibility of success is strictly limited by the material differences in the information required by different scheme designs.

Depleted Insurance Skills

The long tail insurance business requires highly developed and specialised skills from the people working in it.

Claims managers must have a socially and commercially sensitive blend of legal, medical and financial knowledge, as well as strong negotiation and interpersonal skills.

Long tail underwriters need to exercise mature judgment about the qualitative and quantitative measures of risk, and develop a pragmatic but disciplined approach to the dynamics of the market.

Effective injury management to improve claims outcomes is a particular focus in best practice long tail claims operations.

However, there are no national standards or protocols for managing common injuries.

These skills are best developed in transport accident and workers' compensation where there is significant volume. The skills gained in these areas are then adapted to the more specialised liability classes.

Because the long tail market in Australia is so fragmented, career paths are limited and skills development tends to focus on the requirements of specific schemes or products rather than on Australian or international best practice.

In schemes where insurers are government agents rather than underwriters, the demands on insurers may be driven more by political factors than by sound insurance practice. This is also often reflected in the skills employed.

Sometimes, this results in unacceptably high staff turnover as people move out of the industry to seek better opportunities elsewhere. The small pool of talent also makes it difficult for insurers to enter new markets at home or offshore, or to expand their range of long tail offerings.

Multiple Systems

Efficiently managing long tail liabilities requires sophisticated computer systems to track development of individual claims, monitor payments and make sure estimates of outstanding liabilities are based on realistic and accurate data.

Public and private insurers generally use systems developed to meet the requirements of specific schemes. Changes to schemes – a regular event – require these systems to be updated, often at great cost.

An insurer operating in multiple jurisdictions may find itself operating as many different computer systems and shouldering all the associated development and support expenses as a cost of business.

IAG has been unable to move to a single national IT platform for all personal injury claims due to the complexity of attempting to integrate all the requirements of at least 10 different legislative and regulatory regimes.

National consistency in scheme design would mean substantial savings in systems and support.

It could also promote business investment in smaller jurisdictions by removing the extra costs involved in meeting different OH&S compliance standards when corporations wish to expand across borders.

Multiple Barriers to Enter Insurance Market

The small and highly fragmented long tail premium pool in Australia makes this country an unattractive market for insurance capital, compared to other global growth opportunities and other classes of business.

Poor data, limited opportunities in the two major long tail classes, a small and fragmented domestic skills base and the cost of disparate systems create significant barriers to entry for experienced global underwriters.

This has been reinforced by the most recent developments in monopoly schemes. The trend here has to been to replace insurers as agents with specialised third-party claims managers and to promote self-insurance as a viable alternative, reducing the size of the market and forfeiting the advantages of market specialisation as large, non-insurer employers get into the claims management business.

The result has been smaller operations for insurers in those jurisdictions and less capacity to support other products.

It is significant that the European Union, which is already well down the track of creating a single insurance market, has identified Australian insurance monopolies as a key competition and market entry issue to be addressed in global trade negotiations.

A Growing Divergence

The Review of National Competition and Policy Arrangements between State/Territory and Australian Governments provides an excellent opportunity to objectively assess the possible existence of community benefits resulting from these monopolies, and whether greater benefits could be obtained from their abolition.

However, earlier (State and Federal) reviews of compulsory third party motor vehicle and workers' compensation insurance were completed by the late 1990s. Subsequent reviews commenced in 1999 and some are still ongoing or the States are still in the process of implementing the results of these.

Extensive reform of the legislative framework of these schemes has been or still is being undertaken in most jurisdictions.

The result of legislative changes in the various jurisdictions however, although sharing some common features, has been to make these schemes more different from each other, rather than resulting in any type of convergence.

Future Reform Towards a Single National Market for Compulsory Third Party and Workers Compensation Insurance

It would not be possible to promote competition in the Australian market in these classes of insurance by breaking the territorial nexus between State monopoly schemes and the relevant State's legal jurisdiction (thus allowing the States schemes to compete with each other across Australia).

This is because among these Statutory classes of insurance the nature of the product offered (including the incidence and extent of the cover provided) and who may offer it is governed by the relevant legislation in each State. The products which may be offered are therefore no more transferable between jurisdictions than the Acts of the State Parliaments are.

The only realistic means of promoting competition in the Australian insurance market is to create a single national market for these insurance products, governed by either a single piece of Commonwealth legislation, or through identical pieces of State legislation in every jurisdiction.

In order to prevent future divergence of these schemes it would also be preferable for the States to refer the power to make future laws in respect of OH&S and workers compensation to the Commonwealth.

The creation of such a national market which covered all classes of employers would require the winding up of the old schemes in each State, and the issue of how the unfunded liabilities of those publicly funded schemes might be retired (for example by a levy on employers in the relevant State) would seem to be the most serious obstacle to the realisation of a single national scheme for each class of insurance.

The single workers compensation or compulsory third party insurance product could be sold across Australia in all jurisdictions by all underwriters. Such a national market would have collateral economic advantages such as reducing compliance and administrative costs for employers and insurers, allowing national employers to develop national strategies for risk management and rehabilitation requirements, etc all of which could drive down claims and associated costs and therefore significantly enhance Australia's' international competitiveness.

However, in order to obtain the maximum competitive advantages for Australian business, any national scheme should exhibit certain characteristics.

The Efficiency of Privately Underwritten Schemes

Publicly underwritten schemes would not be consistent with existing National Competition Policy Arrangements (NCPA) to date because the persistent under-funding of the liabilities of these schemes by State government regulators and the fact that the APRA standards do not apply to "State Insurance" under the Commonwealth Insurance Act, means that 'competitive neutrality' is not observed between State underwritten and privately underwritten schemes.

State schemes not subject to APRA regulation regularly under-fund their liabilities by charging insufficient premiums to cover them. This makes the publicly underwritten schemes seem cheaper at a superficial level, however they are subject to periodic blow outs in unfunded liabilities.

While State instrumentalities have a reasonably good record in imposing standards (such as financial standards) on other parties, they have a mixed record in observing such standards themselves.

It can also be shown that the existence of government guaranteed compulsory State schemes and their instability, including the periodic elimination and / or reintroduction of private underwriting has had a disastrous effect on private capital accumulation in Australia, by preventing the access of private, regulated insurers to the market.

The Prospect of Competition under the Commonwealth Constitution

A privately underwritten scheme for multi-State or 'National Employers' would clearly be supported by the Constitutional grant of power to the Commonwealth over "(xiv) insurance, other than State insurance; also State insurance extending beyond the limits of the State concerned;" and could be legislated for unilaterally by the Commonwealth.

The Commonwealth may not be able to unilaterally legislate to allow employers employing people in only one jurisdiction to have access to this system without State assistance in passing legislation to allow single-State employers to leave the State schemes, but expanding access like this might raise political issues for the Commonwealth in respect of the feared impact on premiums for those employers obliged to remain in the State scheme.

IAG notes that both South Australia and Victoria have recently commissioned actuarial studies into the impact on premiums for small employers of large employers leaving to self-insurance as a part of reviews they have independently held into such self-insurance arrangements within their own schemes. These studies show a negligible impact on such premiums, echoing the findings of a draft report into this issue commissioned by IAG which should be finalised shortly.

However, due to the political risks of such competition between State and Commonwealth schemes, a more collaborative approach might be considered more politically feasible.

The creation a national scheme of (privately underwritten) workers compensation insurance, open to multi-sate employers (and possibly to those whose employees must regularly cross State borders) would be consistent with the NCPA's to date and could be a vital interim step down the road towards a truly national workers compensation system.

Such a scheme would address the most important issue currently detracting from Australia's international competitiveness by allowing such multi-State employers to have to conform to only one set of Occupational Health and Safety (OH&S) requirements and only one set of compensation benefits.

Given the advantages of scale available for a national scheme however it is probable that any national scheme would address the most pressing need for national consistency , which is among Australia's large, multi-state employers. The national scheme would be able to compete very effectively with the cover offered by the various State schemes for these employers, and address the massive compliance costs that multiple State regimes add to their bottom lines.

States entry to the National Workers Compensation or Compulsory Third Party Scheme

The Commonwealth could therefore legislate to allow States to 'opt in' to a national scheme by passing the necessary complimentary legislation. The content of this legislation could be specified in the Commonwealth's own Act and would require three basic elements;

- that no new 'business' be written by the old State scheme and that this be wound up through a 'run off' of existing claims;

- that the cover offered by the national scheme be adopted by the State as the legislatively required means of meeting the obligation to obtain workers' compensation insurance; instead of the (now defunct) State scheme; and,

- that the State's power to legislate in future in respect of State schemes of workers compensation insurance and OH&S in the future be irrevocably referred to the Commonwealth Parliament.

Similar legislation could be used in respect of the various State compulsory third party schemes.

As well as allowing multi-State employers to address the multiple compliance issue immediately, this would remove a significant impediment to investment in smaller jurisdictions (as businesses will not have to master a new system of OH&S and compensation before entering such a State, reducing the costs of

entering that market). It would also enhance Australia's international competitiveness.

It would also mean that as soon as the premiums available under the national schemes were lower than those under the State schemes, there would be political pressure generated by single- State employers and motorists to have their State join the national system, to give them access to the lower premium rates.

This could be vital in overcoming the suspicion of certain stakeholders of a national workers compensation and/or compulsory third party insurance model (e.g. unions, plaintiff lawyers) and the reluctance of the State governments to cede such a major source of power, influence and responsibility to the Commonwealth.

It would also promote competition in the most literal sense, by allowing Commonwealth competition within the various State jurisdictions, as well as full formal competition between insurers offering these products in the national market.

Conclusion

To create a national market in workers compensation or compulsory third party insurance would therefore require the creation of a single national product in each class which might be sold in any jurisdiction by any underwriter to any person obliged or willing to have this cover. This would require either uniform legislation among all the States or a single Commonwealth Act to cover the field in this regard.

A single Commonwealth Act (for those employers it may already unilaterally legislate for under the Constitution) is probably going to be far more rapidly achievable that obtaining agreement between all Australian governments to enact uniform legislation.

Once a national scheme has been provided, then competition between insurers will be much better facilitated in the delivery of a standard insurance product across Australia, allowing for great economies of scale among insurers. This should further reduce costs and therefore the price of insurance and the impost these classes place upon employment, assisting in promoting the productivity and international competitiveness of Australian business.

This should be of lasting benefit to Australian business and the Australian people and provide an effective and economically attractive means of increasing Australian productivity in the decade to come.