



ICA submission in response to the Discussion Draft Report into National Competition Policy Arrangements

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January 2005

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1 Introduction

The Insurance Council of Australia (ICA) is the representative body of the general insurance industry in Australia. Its members account for over 90 per cent of total premium income written by private sector general insurers. ICA members provide non life insurance products ranging from those usually purchased by individuals (such as home and contents insurance, travel insurance, motor vehicle insurance) to those purchased by small businesses and larger organisation (such as product and public liability insurance, workers compensation, commercial property, and directors and officers insurance).

ICA members, both insurers and reinsurers, are regulated and licensed by the Australian Prudential Regulation Authority (APRA) and are a significant part of the financial services system. Recently published statistics from APRA show that the private sector insurance industry generates direct premium revenue of \$25.9 billion per annum and has assets of \$80.6 billion.¹ The industry employs about 25,000 people.

ICA members issue more than 41 million insurance policies annually and deal with 3.5 million claims each year. On average, insurers pay \$55 million in claims each day of the year.

2 Executive Summary

ICA was pleased to see the Commission acknowledge that reform in the areas of statutory insurance had been negligible and that even with reviews of monopoly insurers and premium controls, very little had been done to implement the recommendations arising from them.

Within the context of this disappointing progress, ICA proposes that in order to achieve meaningful and beneficial reform that there be a specific focus on statutory classes of insurance as a priority area of reform under a competitive neutrality program. ICA holds that it is only through a formal NCP arrangement, complete with payments and penalties, that reform can be accomplished.

ICA also continues to support a national approach to workers compensation, despite the decision not to implement the recommendations of the recent Inquiry into National Workers Compensation Frameworks. ICA proposes that HIH Royal Commission Recommendation No. 51 be adopted by this Inquiry – that the states and territories implement a process designed to reduce inconsistencies in their statutory schemes.

ICA agrees with the premise that it is important to promote competitive processes and that poorly designed regulation can actually impose more costs than benefits. ICA hopes that this logic can be applied, in particular to the statutory classes of insurance, but, in general, across the entire insurance spectrum.

ICA also supports the Interim Report recommendation that the Council of Australian Governments (COAG) initiate an independent public review of Australia's health care system.

¹ APRA, *Quarterly General Insurance Performance, September 2004*. Note: Premiums refer to direct insurance only and exclude reinsurance. Assets refer to total industry assets.

3 NCP Progress to date

ICA strongly supports the guiding principle of NCP that competitive markets do, in most cases, best serve the interests of consumers and the wider community, and that anti-competitive and distorted markets tend to only serve sectoral interests, to the detriment of most.

To date there has been apathy towards tackling the interests that keeps statutory insurance in some jurisdictions immune from competitive forces, thus depriving consumers, businesses and insurers of the benefits of dynamic insurance markets. As noted by a recent National Competition Council (NCC) report, public sector intervention in the premium setting process is commonplace and serves only to distort the incentives that risk-based pricing creates.² Indeed, in NSW and Victorian Workers' Compensation there has been an entrenchment of public monopoly rather than movement towards a competitively neutral outcome.

Despite the lack of reform there have been few formal findings and even where prima facie breaches to NCP have occurred, such as when the planned privatisation of NSW Workers Compensation was first deferred and then later cancelled without a formal review, there have been no penalties imposed.

ICA's initial submission emphasised the opportunity that presents itself for meaningful reform under NCP through the promotion of effective competitive neutrality and the removal of anti-competitive restrictions where applied to statutory classes of insurance in Australia.

At that time, ICA also recommended that broader microeconomic reform be initiated vis-à-vis the recognition of the Australian Prudential Regulation Authority as the sole prudential regulator of general insurance and the abolition of State and Territory taxes on insurance.

However, in responding now to the content and recommendations of the Interim Report, ICA wishes to focus on two main areas:

- the need for the principles of competitive neutrality to be applied to Government Business Enterprises operating in statutory classes of insurance, where they are not already doing so, and
- Consistent with the recommendations of both the HHH Royal Commission and the Inquiry into National Workers Compensation and Occupational Health and Safety Frameworks, a national programme aimed at increasing consistency across all jurisdictions in key areas statutory classes of insurance in Australia and, in particular, workers' compensation insurance

4 Competitive Neutrality as an NCP Priority

When all Governments agreed to NCP in 1994, the adoption of Competitive Neutrality Policy and Principles was a key component. According to clause 3 of the Competition Principles Agreement –

“The objective of competitive neutrality policy is the elimination of resource allocation distortions arising out of the public ownership of entities engaged in significant

² National Competition Council, 2003 NCP Assessment Report, page 2.2, available at: <http://www.ncc.gov.au/pdf/AST5Ov-003.pdf>

² Competition Principles Agreement, 11 April 1995, clause 3(6).

business activities: Government businesses should not enjoy any net competitive advantage simply as a result of their public sector ownership.”³

Under the Competition Principles Agreement, governments are required to adopt a corporatisation model for government business enterprises and apply full taxes or tax equivalent payments, debt guarantee fees and private sector equivalent regulation. An essential element of the obligations is that government business activities, like their private sector counterparts, set prices that enable them to earn sufficient revenue to cover their costs, including the cost of capital.⁴

The 2003 NCC Assessment Report on NCP outlines the benefits of competitive neutrality as follows:

“By placing government business activities on a similar competitive footing to that of their actual or potential private competitors, competitive neutrality establishes conditions for increased private sector participation in industries, thus promoting competition with flow-on benefits to consumers. Competitive neutrality also promotes a more dynamic culture within government businesses, partly as a result of the stronger discipline for transparency and accountability. Government businesses cannot rely on the advantages of public ownership, which often encourage complacency and reduce incentives to improve performance. The application of competitive neutrality principles thus contributes to greater efficiency, better services and cost-effective prices for users. In this way, competitive neutrality underpins and complements the performance monitoring regimes that many governments have introduced for their businesses in recent years.

With a competitive neutrality policy in place, governments can better assess the future of their businesses. Full attribution of costs, for example, often leads governments to reassess whether they wish to provide a good or service directly through a government business, allow competitive bidding for the provision of the good or service, or withdraw from the market.”⁵

While the Competition Principles Agreement does not require governments to implement competitive neutrality principles and policies where the cost of doing so would outweigh any benefits that would be realised from implementation⁶ - it does appear from the general thrust of the NCP obligations that the onus *is* on governments to implement competitive neutrality unless there are strong reasons for not doing so. For significant examples of where this is not being done, please refer to a paper that Dallas Booth, Deputy CEO of ICA, recently presented to a Institute of Actuaries Accident Compensation Seminar, and which has been provided to the Commission.⁷

But what does Competitive Neutrality mean for insurance?

The application of competitive neutrality principles to public sector organisations providing services similar to general insurance (for current purposes, organisations providing CTP and workers compensation insurance) would require observation of the following:

- Operational issues such as accurate and transparent reporting based on accepted accounting practices, effective asset management, and cost-based price setting that does not involve inter-generational or inter-departmental cost shifting;

³ Competition Principles Agreement, 11 April 1995, clause 3(1), available at: <http://www.ncc.gov.au/pdf/PIAg-004.pdf>

⁴ For further information on competitive neutrality, please refer to: <http://www.ncc.gov.au/articleZone.asp?articleZoneID=72>

⁵ National Competition Council, 2003 NCP Assessment Report, page 2.2, available at: <http://www.ncc.gov.au/pdf/AST5Ov-003.pdf>

⁶ Competition Principles Agreement, 11 April 1995, clause 3(6).

⁷ Booth, D, (2004), “Private vs. Public Underwriting”, Paper presented to the IAA Accident Compensation Seminar, available at: http://www.actuaries.asn.au/PublicSite/events/events_frameset.htm

- All relevant taxes and charges and duties, including for New South Wales, provision for the Insurance Protection Tax;
- Adherence to APRA General Insurance Prudential Standards⁸, being
 - Capital Adequacy
 - Assets in Australia
 - Liability Valuation
 - Risk Management, and
 - Reinsurance Arrangements; and
- Maintenance, and provision, of a commercial return on, notional capital.

While Competitive Neutrality is not a new concept, previous reforms have not worked and, in spite of numerous reviews in the area of workers' compensation (eg. the Stanley Report, Grellman Report), little progress has been made. Irrespective of the recommendations of each review, the government invariably finds that the system currently in place is that best suited to its particular jurisdiction.

This lack of progress was acknowledged in chapter 8 of the Interim report with the recommendation that:

"Continuing restrictions on competition in ... and insurance services should be re-examined sooner rather than later. Unless addressed in other review fora, these areas should be afforded priority under a modified legislation review program"

ICA sees the achievement of competitive neutrality an outcome in itself, but also an important and necessary step on the path to a privately underwritten market. Competitive neutrality is one of 7 steps on the path to privatisation that ICA has identified. If you start with the **status quo** and then have **effective reform**, you will eventually achieve **competitive neutrality**. Over time, this should lead to **stability** and then some indication of **profitability** which will give the providers of **capital** enough confidence to enter these markets and thus achieve **privatisation**.

The objective of competitive neutrality policy is the elimination of the pricing and resource allocation distortions arising out of the public underwriting of insurance. It is only after a competitively neutral outcome has been achieved that a proper and objective assessment of the merits of private underwriting can be made. Competitive neutrality is therefore both a significant milestone and a platform for future reforms as appropriate.

ICA cannot emphasise enough the importance to be placed on achieving true competitive neutrality and an environment that, to the extent possible, operates with a competitive dynamic and is devoid of anti-competitive restrictions. Competitive pressures foster innovation and efficiencies and in privately underwritten markets the allow price signals to best operate. This is of particular importance to workers' compensation where distortions in the application of risk-based pricing principles owing to price interventions or public underwriting blur, if not completely retard, the economic rewards and penalties for safe and risky workplace behaviour respectively.

Bearing in mind the lack of progress under previous legislative reviews of statutory classes, nothing short of an explicit NCP arrangement for competitive neutrality in statutory classes can bring much needed reform to these areas.

⁸ Full details of the APRA General Insurance Prudential Standards and Guidance Notes are available at: <http://www.apra.gov.au/General/General-Insurance-Prudential-Standards-and-Guidance-Notes.cfm>

4.1 ICA Recommendation for Competitive Neutrality

With workers compensation and CTP insurance being of national importance, and with the ongoing and systemic ambivalence towards meaningful reform in insurance, ICA proposes that a specific program be established under NCP aimed at promoting competitive neutrality in statutory classes of insurance.

ICA would like to see the NCC commit the states to achieving competitive neutrality in their statutory insurance schemes on or by 1 July 2007.

Success in implementing competitive neutrality should be rewarded with the receipt of NCP payments. Similarly, failure to achieve competitively neutral outcomes should be met with steep penalties under NCP.

ICA believes that without the carrot and stick approach that NCP can bring, the existing situation will continue and another opportunity for reform will have been lost. The interest groups that benefit from the retention of the status quo will have won, while Australian businesses, consumers and insurers will share the costs of this gross inefficiency.

5 National Consistency in Statutory Classes

ICA supports greater national consistency in the statutory classes of insurance. In addition to the equity arguments for the treatment of workers and third party persons in similar circumstances, ICA sees significant efficiencies to be gained in pursuing greater national consistency. The current arrangements impose a multitude of regulatory and compliance costs on multi-jurisdictional employers (for workers compensation) and insurers and ICA sees core consistencies as a means through which this can be mitigated.

ICA was, and remains, supportive of the recommendations of the recent Productivity Commission Inquiry into Workers' Compensation, in particular those that relate to "an alternative national workers' compensation scheme to operate in parallel to existing State and Territory schemes"⁹ and has a strong preference to see this and other such recommendations implemented, notwithstanding the Government's stated position on the matter. ICA has valid concerns that, as has been the case in the past, little progress in this area will be made unless a concerted national approach is undertaken.

5.1 ICA Recommendation for Statutory Classes

As a partial remedy to the myriad of workers' compensation arrangements in Australia, ICA again supports Recommendation 51 of the HIH Royal Commission:

*"that the states and territories implement a process designed to reduce inconsistencies in their statutory schemes. This is a task that would appropriately be overseen by the proposed ministerial council"*¹⁰

⁹ Productivity Commission 2004, "National Workers Compensation and Occupational Health and Safety Frameworks", Report No. 27, Canberra, March, p. XLI.

¹⁰ Recommendation 51 of the HIH Royal Commission. "The Failure of HIH Insurance – Volume 1 – A Corporate Collapse and its Lessons", p. lxxiii.

6 Other Areas for Reform

Trade Practices

ICA supports the report's discussion on trade practices and consumer protection regulation which acknowledges the importance of promoting competitive processes and that poorly designed regulation can actually impose more costs than benefits.

ICA hopes that this logic can be applied, in particular to the statutory classes of insurance, but, in general, across the entire insurance spectrum.

Health

Through various forms of general insurance (CTP, Workers' Compensation, Public Liability, etc) APRA licensed and regulated general insurers are (indirectly) significant contributors to the funding of health care in Australia.

ICA was pleased that the Interim Report recommended that the Council of Australian Governments (COAG) initiate an independent public review of Australia's health care system. This review would be a means through which long standing structural problems could be addressed, and greater national coordination of health care services could be achieved. ICA and its members would be pleased to participate in such a review.

Greater efficiencies which deliver cost savings in the delivery of health care services will, in a competitive insurance market, flow through the pricing mechanism and be passed onto consumers. This is, of course, yet another example of the benefits of applying the competitive insurance model to GBE's and reinforces the need for competitive neutrality in those jurisdictions and classes where it is not a reality.

In support of this proposition that lower costs can lead to lower premiums in a competitive market, ICA refers the Commission to the example of NSW CTP insurance. In that competitive marketplace reforms of recent years have led to falls in premiums.

7 Concluding Comments

ICA was disappointed at the Government's decision not to implement the recommendations of the recent Inquiry into National Workers Compensation and Occupational Health and Safety Frameworks, particularly those that would have been the precursor to a truly national solution for corporate employers.

However, this does not diminish the importance of pursuing greater national consistency in statutory classes of insurance. As such ICA proposes that HIH Royal Commission Recommendation No. 51 be adopted by this Inquiry – and that is that the states and territories implement a process designed to reduce inconsistencies in their statutory schemes. This is a task that would appropriately be overseen by the proposed ministerial councils.

ICA also proposes that there be a specific focus on statutory classes of insurance as a priority area of reform under the competitive neutrality program and that it is only through a formal NCP arrangement, complete with payments and penalties as appropriate, that meaningful reform can be achieved.

