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Economic Regulation Authority
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RE: INQUIRY INTO MICROECONOMIC REFORM IN WESTERN AUSTRALIA

I refer to the Inquiry into Microeconomic Reform in Western Australia Issues Paper (the Issues Paper) released for public consultation. Suncorp welcomes the opportunity to contribute to the Issues Paper.

The Suncorp Group

Suncorp Group Limited and its related bodies corporate and subsidiaries (collectively 'Suncorp') offer a range of financial products and services in banking (Suncorp Bank), general insurance, life insurance and superannuation (Suncorp Life) across Australia and New Zealand. Suncorp has over 15,000 employees and relationships with over nine million customers nationally.

Nationally, Suncorp is the largest personal injury insurer. This submission is made on behalf of the Suncorp Commercial Insurance division which operates Suncorp's statutory insurance products, including workers' compensation and compulsory third party (CTP) insurance. Suncorp has over 85 years of personal injury insurance experience, with our Suncorp, AAMI, GIO and Vero brands.

In respect to statutory classes of insurance, our community focused activity is centred on risk management, injury prevention, social participation and quality of care for those injured or with a disability.

We actively active support Wheelchair Sports, which encourages individuals back into the community, improving rehabilitation and work capacity. Our long-term association with Youngcare has created housing and support for young people with disability in Queensland and New South Wales and support the same benefits in Western Australia (WA). We are also interacting with State Treasuries and providing information for consideration in regard to implementing a National Disability Insurance Scheme (NDIS - now known as DisabilityCare Australia) and the National Injury Insurance Scheme (NIIS).

Sharing of ideas is part of our collaborative approach, and as Australia's largest personal injury insurer, Suncorp is often asked to undertake research and comment on industrial and societal issues. We also participate in wider industry matters through our involvement with the Insurance Council of Australia and relationships with Scheme Regulators and State Treasurers and Ministers.

The Inquiry

Suncorp wishes to commend and support the WA Government for the inquiry into microeconomic reform in WA. Suncorp welcomes the opportunity to participate in the discussion and nominates the accident compensation schemes within WA for discussion for microeconomic reform.

Our specific responses to the Issues Paper's questions for interested parties are provided in *Appendix A.*

Accident Compensation Schemes

In WA the workers compensation scheme is privately underwritten by approved insurers. The privately underwritten scheme is fully funded with insurers' financial positions being overseen by the prudential regulator, Australian Prudential Regulation Authority (APRA).

By contrast, the workers compensation scheme for Government Agencies (Risk Cover Fund)[1] and the compulsory third party (CTP) scheme remain government/publically underwritten and managed.[2] In the financial year ending 30 June 2012:

- RiskCover Fund sustained a $27.2 million loss[3]; and
- the CTP scheme reportedly sustained a total comprehensive loss of $102.6 million.[4]

In considering the position of the State Government's public of workers compensation scheme for Government Agencies and the CTP scheme, Suncorp would like to take this opportunity to elaborate on the elements it believes define an effective accident compensation scheme. Suncorp considers the three (3) key aims for effective accident compensation scheme are **fairness, outcomes** and **affordability.**

Further, Suncorp considers there are six (6) guiding principles which define an effective accident compensation scheme across all statutory classes. These principles guide our input into scheme design and improvement with each of our Regulators and Governments nationally and guide our input into our response in *Appendix A*.

These six (6) guiding principles are:

- *Social Outcomes* - The scheme's emphasis needs to be on the individual's health and social outcomes (wellbeing), with a reduced focus on compensation. The ideal scheme should seek to support individuals in becoming self-sufficient both socially and economically.
- *Sustainability* - The scheme should be self-sustaining and operated with sound pricing and capital management practices so that liabilities remain fully funded. The Suncorp paper titled *"How international financial markets impact personal injury insurance"* provides an extensive discussion of the impact that bond yields have on the premium rate and capital requirements of insuring in a long-tail scheme.[5]

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[1] The RiskCover Fund managed by the Insurance Commission is underwritten by the Government of Western Australia

[2] The Insurance Commission is primarily responsible for:

- Administering, underwriting and managing Western Australia's Compulsory Third Party (CTP) Insurance scheme for motor vehicle personal injuries; and
- Managing the Government of Western Australia's self-insurance and risk management enterprise, RiskCover on behalf of the Department of Treasury. RiskCover was established in 1997 as a business division of the Insurance Commission.

[3] Insurance Commission of Western Australia – Annual Report 2012 at page 37 - http://www.icwa.wa.gov.au/publications/annualreport12/downloads/2012%20Annual%20Report.pdf?bcsi_scan_2c9eab737c26cdb3=0&bcsi_scan_filename=2012%20Annual%20Report.pdf

[4] Insurance Commission of Western Australia – Annual Report 2012 at pages 11-14 - http://www.icwa.wa.gov.au/publications/annualreport12/downloads/2012%20Annual%20Report.pdf?bcsi_scan_2c9eab737c26cdb3=0&bcsi_scan_filename=2012%20Annual%20Report.pdf

[5] See Appendix B

- *Competition* – The benefits of competition include increased performance, service levels and innovation which can drive improved health outcomes and lower premiums. The introduction of private capital into the accident compensation market tends to drive deeper investment and commitment by scheme participants. Transferring Government liabilities to insurers protects public funds against adverse market movements and protects the Government's credit rating. It also frees up capital for other community investments, whether it be for physical infrastructure or social infrastructure, such as the implementation of the NIIS and supporting the implementation of DisabilityCare Australia. The advantages of scheme privatisation are discussed more extensively in another White Paper produced by Suncorp, titled *"Reflections on underwriting options for personal injury insurance".*[6]

- *Defined and Controlled Bene*fits - Benefits that are clearly defined by realistic timeframes, dollar amounts, caps and limits reduce ambiguity and inconsistent outcomes. This reduces complaints, disputes, litigation and volatility which would otherwise have adverse impacts on the scheme's affordability and financial viability. It also adds greater certainty in assessing outstanding claims liabilities.

- *National Consistency* – Progressing national harmonisation of personal injury schemes will see fair and consistent benefits for all individuals, regardless of their place of residence and/or location of the accident. Employers, consumers and insurers would also gain benefits from a consistent approach across jurisdictions. It would also help reduce the cost of unnecessary red tape and reduce barriers for businesses entering markets in other Australian jurisdictions, which would promote competition.

- *Dispute Resolution* – All decisions should be reviewable through a robust and cost effective dispute resolution system. It is important that all participants of the scheme, particularly claimants, have the opportunity to have their cases independently reviewed in a low cost, expedient and objective manner.

Suncorp contends that a scheme designed with these principles in mind will achieve the best possible outcome for its participants and claimants.

Increasing Workforce Participation Rates in WA

Apart from addressing age barriers that prevent senior Australians from entering or staying in the workforce, which is largely a Federal issue, disability reform has the potential to increase workforce participation rates.

The economic argument for disability reform is compelling.[7] One of the important aims of the full implementation of DisabilityCare Australia and the NIIS is an increase in workforce participation rates, which in turn would assist in raising tax revenue and increase productivity generally.

It would be in WA's interests to participate and take advantage of initiatives that seek to increase:

- the quality of life and independence of those who require care and support, which is likely to drive an increase in employment opportunities in this sector to meet the expected demand – an important growing industry as the resources boom recedes;

- increase workforce participation rates of those who have a disability and are currently under or unemployed and currently have or could have an employment capacity;

- increase the quality of life and workforce participation of carers, once they are released from their duties as consistent and reliable independent support services become available[8]; and

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[6] See Appendix C

[7] Productivity Commission – Disability Care and Support, Volume 2, chapter 20 –The benefits of reform - http://www.pc.gov.au/__data/assets/pdf_file/0018/111294/23-disability-support-chapter20.pdf

[8] Of the 2.6 million carers, almost 2 million are of workforce age: Source: Australian Bureau of Statistics 2006.

- workforce mobility to where the employment demand is located, once portability of disability services are assured[9].

It is acknowledged that WA will host three locations for disability reform from July 2014. One location will implement the DisabilityCare Australia model and the other two will implement the WA *My Way* model. Whichever model is ultimately adopted throughout WA there will be a need to reform the current accident compensation schemes to take into account compensable catastrophic injuries.

Conclusion

Suncorp recommends the introduction of private capital into the workers compensation scheme for Government Agencies and the CTP scheme to drive greater investment into these schemes and create competition to achieve stated scheme outcomes. It is timely to consider these reforms in conjunction with the national implementation of disability reform as a way to develop possible synergies between the schemes to achieve improved overall health outcomes.

The economic benefits of privatised accident compensation schemes include scheme efficiency; expediency and health outcomes for injured claimants. Greater scheme efficiency will drive a higher proportion of the premium directly back to the injured claimant as benefits.

Moving the workers compensation scheme for Government Agencies and the CTP scheme towards privatisation will, along with disability reform, drive increased workforce participation rates and has the potential to increase mobility of the workforce to where employment is available. If these outcomes are realised, the nation's overall tax base and disposable income of families will increase.

Suncorp has demonstrated expertise in accident compensation schemes and is available to work collaboratively with the WA Government and to discuss further the issues contained within this submission. If you wish to do so, please contact me on 02 8121 3708; 0421 050 926 or by email christopher.McHUGH@suncorp.com.au.

Alternatively please contact Mike Thomas - Manager, Group Government and Stakeholder Relations on 02 8121 3115; 0419 772 069 or by email - mike.THOMAS@suncorp.com.au.

Yours faithfully

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[9] The Productivity Commission is currently inquiring into *Geographic Labour Mobility*, with a draft report due in December 2013 and the final report due on 21 May 2014.

Appendix A

Suncorp Response to the Questions for Interested Parties
(set out in *Section 7* of the *Issues Paper*)

Submission to the Economic Regulation Authority (ERA)

Suncorp's Responses to Questions for Interested Parties

RESPONSE TO QUESTION 1

What sectors of the Western Australian economy are likely to benefit from the implementation of microeconomic reforms?

Structural challenges in the statutory insurance market are conducive to microeconomic reform

The statutory insurance market comprises Compulsory Third Party (CTP) and workers compensation in Australia. Statutory insurance is one of the largest risk insurance markets in Australia, with a market size of $4.1 billion or 13 per cent of total direct gross premiums of $31.3 billion.[1] It is a market where government plays a unique active role in driving real per capita income growth.

In Australia, some motor accident schemes are underwritten by the State or Territory Government. In these government schemes, compensation payments are funded by 'premiums' collected and managed by a government agency.

The motor accident schemes in New South Wales (NSW), Queensland (QLD) and the Australian Capital Territory (ACT) are underwritten by private sector insurers. These privately underwritten schemes are funded by insurance premiums collected by private sector insurers, and relieving the State or Territory Government from placing government capital at risk for the scheme.

The financial risk of the scheme is borne by private insurers, who in turn are prudentially supervised by APRA. Regulatory oversight remains with the Government.

The Financial and Insurance Services (FIS) sector has the following characteristics::

- largest share (11.5%) of aggregate output in the year ending 30 June 2012 on a national level; and
- average annual growth rate in multi-factor productivity (MFP) of -0.2% in the four (4) years to 30 June 2012.

It is noted that there may be productivity gains within individual segments of the FIS sector that an overall growth rate may mask, however, this is subject to further investigation by the Productivity Commission.[2] MFP is a widely used measure of productivity that attempts to account for all inputs into the production process, not just labour productivity.

MFP is typically a better measure of an economy's level of technology. Thus, the growth rate of multifactor productivity is an indicator of the underlying technological progress in an economy[3].

Given that the FIS sector is the largest sector on a national level, there is scope for the WA Government to contribute to improving overall productivity in this sector by addressing relevant opportunities at a State level. Since the Statutory Insurance sector is part of the FIS sector, any incremental improvement within this segment will likely lead to overall productivity improvement in the largest industry sector in Australia.

[1] APRA June 2012
[2] Productivity Commission - *Productivity Update*, May 2013, p16, 37. The Productivity Commission is committed to research MFP growth drivers as part of its future work program.
[3] Parliament of Australia - *Productivity Growth and Economic Policy in Australia*, 1997

Therefore it is worthwhile to examine the Statutory Insurance market in WA to determine if there are any reform opportunities that will result in longer term economic growth.

In respect of the Western Australian (WA) economy, short term opportunities relate to scheme design and scheme efficiency. In the medium term, moving towards privatisation of the CTP scheme should be considered, as the State Government would be able to leverage assets and expertise available in the private sector, such as underwriting, risk selection, claims management and technological investments, to drive long term economic growth through improved productivity.

It is acknowledged that moving directly to a privatised scheme may be problematic, and Suncorp suggests that there is an immediate opportunity to drive efficiencies by outsourcing claims management from the RiskCover Fund to private insurers with the aim to moving towards full privatisation in the medium term. The benefits of outsourcing claims management include:

- eliminating dependency upon one claims management service provider;
- spreading the operational and performance risks across multiple providers;
- fostering innovation and continuous improvement;
- improving fund performance;
- enabling performance comparisons between providers; and
- ensuring a contestable market in the future.

The benefits of introducing private capital into the scheme tends to drive deeper investment and commitment by scheme participants. Transferring government liabilities to insurers protects public funds against adverse market movements and protects the government's credit rating.

These opportunities also represent a strategic opportunity to improve productivity in the FIS sector for the WA economy, which may reduce the risks around relying predominantly on productivity improvements widely forecast by analysts to be derived from the mining and resource sector.

Reform of the statutory insurance market at a State level would deliver tangible results because any incremental benefit within the largest sector of the Australian economy would have a material impact on Gross State Product (GSP) output[4]. It would also promote a closer tripartite working relationship between the Federal Government, State Government and the private sector, enabling an exchange of best-practices for the benefit of the State economy.

Suncorp acknowledges the challenges in assessing the economic impact of potential State reforms on the national economy as stated in the Issues Paper[5]. Notwithstanding this, Suncorp observes the following key principles regarding productivity improvements in making this response:

- one of the primary objectives of microeconomic reforms is to drive economic growth with productivity being an important determinant of long-term economic growth and real per capita income growth[6]; and
- Suncorp supports the Reserve Bank of Australia definition of productivity - the efficiency with which an economy employs resources to produce economic output.

[4] WA contributes to 16.7% of Australian output in the year ending 30 June 2013.
[5] Economic Regulation Authority - *Microeconomic Reform in Western Australia Issues Paper (the Issues Paper)*, Section 3.2
[6] Productivity Commission - *Productivity Update*, May 2013, p6

The trend in productivity growth is determined by the development of new technologies and how efficiently resources are organised in the production process. These are factors that determine the capacity of the economy to supply goods and services.[7] Technology plays a key role in driving productivity in the personal injury insurance classes, as explained below in Suncorp's responses to questions three and four.

As explained in the response to question two below, there are performance indicators within the statutory insurance sector in WA which are ready for reform. Any proposed reform would be centred on scheme design and scheme efficiency.

RESPONSE TO QUESTION 2

What specific reforms might improve the efficiency, productivity or flexibility of those sectors, and why?

A balanced approach to reform…

Suncorp adopts a rational approach in seeking to understand and identify specific areas for industry sector reform. At the outset, it is important to understand the merits of potential reform and compare with actual experiences across relevant jurisdictions prior to considering specific reforms directed at improving productivity in the statutory insurance market in the FIS sector.

The merits for reform are identified below and should be considered.

- Microeconomic reform normally suggests corporatising State Government activities and establishing a competitively neutral operating environment between public and private sector enterprises. It does not necessarily imply privatisation, although privatisation has two advantages:
    - there is a clearer separation of interest between the regulator, the Government and the regulated activity; and
    - competition in capital markets such as mergers and acquisitions tends to make private companies more focussed on operating performance and shareholder value creation within compressed timeframes.
- In general, the goal of microeconomic reform is to allow the allocation of resources in Australia to better reflect market, as opposed to non-market, outcomes. Where there are clear examples of potential market failure, such as monopoly power, then microeconomic reform may involve redesigning and improving regulations, rather than deregulation or reducing government[8].
- Any scheme design reform is the prerogative of State Governments in terms of determination of whether a compulsory accident compensation scheme is fault based or not and the level of eligible benefits. However, the insurance industry is on the record for stating that *"members that underwrite or insure the motor accident schemes in NSW, QLD and the ACT have formed some consistent views about the most effective features of scheme design that can deliver a stable and efficient scheme and good outcomes for injured people. These views derive from their long-standing experience in underwriting compulsory State and Territory accident compensation schemes"*[9].

[7] Reserve Bank of Australia - *Australia's Productivity Performance and Real Incomes*, June Quarter 2012
[8] Parliament of Australia - *Productivity Growth and Economic Policy in Australia*, 1997
[9] Insurance Council of Australia - *NSW CTP Green Slip Insurance Scheme: Submission to the Consultation on the Proposed Reforms*, 5 April 2013

Based on the above considerations, Suncorp makes the following observations on specific reform opportunities within the statutory insurance market in WA.

…applied to major challenges evident in the Insurance sector…

The Insurance Commission of Western Australia (ICWA) plays an important role in the economy. However, there are common structural and scheme design challenges in statutory insurance markets across Australia, which also have relevance for WA.

The CTP scheme and RiskCover Fund have experienced a decline in financial performance due to increasing claims costs and a rise in outstanding claims liabilities (reduction in the risk free discount rate). Availability of common law entitlements within the existing scheme leaves the scheme at high risk for increasing claims costs, which in turn would put pressure on the financial sustainability of the scheme.

The priority of the ICWA in maintaining affordable and stable CTP insurance costs has meant that there has been no premium rate increases in the two (2) years up to 30 June 2012, and this strategy has exacerbated the decline in profits., as evidenced by the consolidated financial performance of the ICWA below:

Consolidated Financial Summary ($M)	FY10	FY11	FY12
Net premium revenue (NPR)	405.5	425.6	440.5
Net claims incurred (NIC)	(401.4)	(516.6)	(607.0)
Underwriting loss	(79.0)	(187.7)	(257.7)
Profit/ (loss) after tax attributable to Government of Western Australia	128.4	53.6	(102.6)
Net Assets	832.8	886.3	783.7
NIC/NPR %	99.0%	121.4%	137.8%
TPIF Efficiency Performance Indicators			
Net Loss Ratio %	97.6%	120.4%	136.8%
Net Expense Ratio %	9.7%	11.1%	10.1%
Proportion of Claims Costs paid for the Direct Benefit of Claimants (%)	89.0	89.0	89.8
Claims Administration Costs per Claim Administered ($)	2,258	2,618	2,587

(Source: ICWA, Annual Report 2012. NB: Consolidated results represent combined results of four (4) Funds which are State Government underwritten and managed (including the TPIF) and excludes the RiskCover Fund).

Third Party Insurance Fund (TPIF)

TPIF is part of the consolidated results. The key factors influencing financial performance of TPIF are:

- the underwriting loss of $225.1 million in the year ending 30 June 2012 (of the consolidated total of $257.7 million), driven by higher level of claims payments over the prior year and a significant increase in the provision for outstanding claims liabilities;
- claims payments of $420 million in in the year ending 30 June 2012 due primarily to a higher than normal number of claim finalisations and the settlement of a relatively large number of catastrophic injury claims over the prior year. Approximately 90% or $377.4 million of total claims payments were paid for the direct benefit of claimants by way of pecuniary and non-pecuniary losses, including $312.4 million for the combined heads of damages; and
- the average percentage of claims costs paid for the direct benefit of claimants was 89.1% in last three (3) years to the year ending 30 June 2012 is significantly below the 93.1% reported in the year ending 30 June 2008, is arguably impetus for further investigation into scheme reform.

RiskCover Fund

The RiskCover Fund reported an operating loss of $27.2 million in the year ending 30 June 2012 due mainly to a significant increase in the size and duration of workers compensation claims[10] and a strengthening of net outstanding claims provisions. Further investigation is required into the root causes of the deteriorating performance[11], with scope to consider scheme reform.

Suncorp contends that the introduction of defined and controlled benefits would create certainty in assessing the costs of claims and reserving for outstanding liabilities, and that defined and controlled benefits should be considered as part of the scheme reform. Even though RiskCover Fund remains in a marginally fully-funded position, with net assets of $1.0 million, this situation may continue to deteriorate without investigation into the root causes of increasing claims costs and outstanding claims liabilities.

...Enables identification of specific reform opportunities

Compulsory Third Party (CTP) scheme efficiency

Suncorp recommends that ICWA undertake an investigation into the root causes for increasing claims costs and outstanding claims liabilities. The ICWA Commission may wish to consider the six (6) guiding principles which define an effective personal injury insurance scheme across all statutory classes, as stated previously.

In most jurisdictions in Australia, CTP scheme efficiency is a key measure of scheme performance. One way of determining scheme efficiency is to assess the amount of each dollar paid in premiums that is returned to injured people as benefits.

Increasing scheme efficiency can be achieved by reducing transaction costs per policy within the scheme. In simple terms, scheme efficiency may be determined by the claims payments received by claimants including

[10] In the RiskCover Fund for workers compensation, the average estimated cost per claim has increased significantly: FY10: $12,807, FY11: $14,257, FY12: $16,568 (Insurance Commission of Western Australia – *Annual Report 2012*, p56)

[11] RiskCover data shows that there has been a 3.0% increase in recent years in the incidence of lost-time injuries across the public sector. Although there is no directly comparable data available for other public sector jurisdictions in Australia, the rise in WA does contrast with a general trend downwards across all Australian sectors according to the Office of Auditor General.

estimates of outstanding claims liabilities, relative to insurance premium charged to the policyholder, expressed in percentage terms.[12]

Given the ICWA's stated objective of maintaining competitive premium prices, a possible starting point would be to focus on claims efficiency or claims cost reduction to drive improvement in the CTP scheme profitability and to address the deteriorating operating performance.

To achieve scheme efficiency, specific reform measures should be focussed on:

- increased claims management performance – increasing claims outcomes;
- reducing disputation levels by adopting defined and controlled benefits, limiting access to common law, reducing legal costs and other transaction costs and delivering a higher proportion of premiums to claimants[13];
- directing benefits to the more seriously injured through a defined and controlled benefits model;
- pay benefits to claimants more quickly, which will also improve health outcomes by avoiding the need to 'stay injured' to obtain benefits; and
- moving to a managed scheme in the short term and then introducing private capital in the medium term.

Ultimately, the aim is to design a CTP scheme that is affordable for the WA community whilst providing a level of desired cover for eligible personal injuries. In working towards this aim, the there are a number of key factors to consider.

- Monitoring claims costs, which is the primary factor impacting premium prices. CTP premiums can fluctuate quarterly depending on the size of damages awards, the number of claims in the scheme and changing economic factors. Even if efficiencies can be achieved in terms of delivery of costs, increases in claims frequency and cost of claims will also put upward pressure on premiums.
- Price competition to the extent permitted within the scheme design is often cited as a key benefit for private underwriting of CTP schemes in Australia, as the introduction of private capital tends to drive greater investment into claims management. Of course, transferring claims liability from the Government to the private sector is another benefit for the State Government. Insurers are subject to prudential oversight by APRA, not available in the public arena, with the State Government becoming the insurer of last resort. There is also an opportunity to benchmark insurer performance.
- Privatisation can also give rise to competition issues. For example, the QLD Government had noted in respect to its CTP scheme in 2010:

  > *"The current underwriting model which was introduced with the aim of encouraging competition among insurers, has failed to generate the level of competition between insurers that was expected. Motor vehicle owners are not getting the full benefit of price competition which should result from private sector involvement".*[14]

[12] TPIF efficiency performance indicator is calculated differently: Claims Administration Costs per Claim Administered = Average Total Administration Costs/ Claims Administered
[13] Compared to the existing situation where all claims for personal bodily injury in WA are claims at common law where, for a claim to succeed negligence must first be established against the owner or driver of a WA registered motor vehicle) (ICWA). Also, as an example, the NSW CTP Reform will limit common law rights for claimants with whole person impairment greater than 10%
[14] Review of QLD CTP Insurance Scheme's Underwriting Model, 2010

The outcome of the review was to remove the payment of commissions and other inducements to intermediaries. This situation was readily resolved because it related to an inequitable distribution model, rather than the overall economic and structural benefits generated by a privatised CTP scheme.

It is worth observing the State Government's role in this matter was in providing regulatory oversight, as opposed to underwriter and manager of the scheme, which would involve addressing competing interests.

RiskCover Fund

In Australia, Suncorp contends that workers compensation schemes should promote premium affordability for employers, fairness and outcomes for injured workers whilst reducing funding exposure by Government, and separating regulatory oversight from scheme management to manage competing political, regulatory and scheme business management interests. Schemes that aim for fairness, outcomes and affordability would deliver a more effective personal injury insurance scheme that is financially sustainable.[15]

In relation to RiskCover Fund, there is an opportunity to investigate potential reform measures that are aligned with the six guiding principles, as discussed previously, which Suncorp believes define an effective personal injury scheme across all statutory classes.

RESPONSE TO QUESTIONS 3 AND 4

What economic and social benefits (and costs) might those specific reforms have for individuals, businesses and/or the State?

State-wide economic benefits can be achieved from application of a range of specific reforms to Statutory Insurance market…

Overall, specific reforms to the CTP and/ or RiskCover workers compensation scheme would have the following overall economic and social benefits:

- continued affordability of CTP for the WA community, contributing to real income per capital income growth assuming all other relevant factors remain the same; and
- achieving the stated social outcomes – early return of injured workers to safe, durable work contributes to productivity performance.

As stated in the Issues Paper, any reforms that have a positive net benefit will be candidates for further investigation. Determining the positive net benefits include consideration of the following elements:

- Computable General Equilibrium (CGE) economic modelling; and
- commentary of technical approaches or models that may be applicable to assessing likely benefits of reforms.

[15] NSW Workers Compensation Scheme Issues Paper April 2012, pp5-6

…which can be supported by an equilibrium modelling framework…

An in-principle basis[16]- summary of the likely net benefits of CTP scheme reform may be hypothesised under the CGE modelling framework. It is assuming that maintaining affordable CTP premiums, households have the potential to increase their disposable income and obviously there are benefits to this.

- In a privately underwritten CTP insurance market, it can be assumed that the more affordable the CTP premium price, the more income will accrue to the household, assuming that scheme efficiency remain high.
- Households will use their additional income to pay direct taxes, save, consume or make transfers to private companies, for retail product and service, Government or the community.
- Increased company revenues means that Governments collect more taxation and duties revenue.
- Household with greater available savings are likely to enter capital markets.
- Private insurers whilst seeking return on their capital would make greater investments in claims management practices through the development of skilled claims managers and information technology operating platform upgrades.
- Delivering greater scheme efficiency with a higher percentage of the premium returning to the eligible participant by introducing defined and controlled benefits, reducing common law entitlements and 'friction' or transaction costs.
- With private insurers entering the market, there will be greater competition in driving competitive premium calculation and claims management practices.
- A virtual cycle occurs where households will benefit from more affordable premiums. That is, an effective scheme that is properly managed and structured will ultimately benefit the policy holder in the longer term.
- Real per capita income would grow in the medium-to-longer term, assuming all relevant factors remain the same, which in turn would drive long term economic growth of the WA economy through an expected improvement in the current account balance of payments.

Suncorp is willing to provide an expanded and detailed CGE model upon request.

…that is consistent with the Compensation Principle

It is acknowledged that the above net benefit analysis under the CGE model does not take into account key groups at each individual level affected by any CTP scheme reform. The key groups include:

- registered motor vehicle owners;
- injured parties;
- owners of unregistered / uninsured motor vehicles;
- medical and allied health professionals;
- legal profession;

[16] It is worth noting that CGE modelling can be based on a set of simultaneous equations, many of which are non-linear. Therefore the example above is a description of the system of payments and receipts (ie. Social Accounting Matrix) that would be modelled in the CGE framework.

- licensed insurers
- re-insurers;
- WA Government; and
- agents for CTP insurers including motor vehicle dealers.

For example, certain groups such as the legal profession often cite potential adverse impacts and risks to that segment posed by proposed reforms, with no detailed analysis from the CGE modelling approach. However, the CGE model outlined above illustrates that the application of microeconomic reform can achieve overall economic benefit, consistent with the Compensation Principle, as articulated in the Issues Paper.[17]

Critical success factors

The success of any CTP scheme reform critically depends upon scheme design and the articulation of a clear set of policy objectives. Scheme design may allow for a range of objectives to be achieved, including but not limited to:

- reduction in the ultimate number of projected common law claims;
- reduction in the expected common law average settlement size; and
- lower risk margin reflecting stabilisation of claims experience.

Policy objectives may be designed to:

- continue and improve the system of CTP motor vehicle insurance;
- ensure financial sustainability of the CTP scheme;
- provide for the licensing and supervision of insurers providing insurance under policies of CTP motor vehicle insurance;
- encourage the timely resolution of personal injury claims resulting from motor vehicle accidents;
- promote and encourage, as far as practicable, the rehabilitation of claimants who sustain personal injury because of motor vehicle accidents;
- establish and maintaining a register of motor vehicle accident claims to help the administration of the statutory insurance scheme and the detection of fraud; and
- promote measures directed at eliminating or reducing causes of motor accidents and mitigating their results.

Limitation of CGE modelling

Suncorp understands that the CGE model essentially recognises that markets in real world economies are mutually interdependent. Profit maximisation behaviour on the part of households and enterprises is generally assumed.

[17] Economic Regulation Authority - *Microeconomic Reform in Western Australia Issues Paper (the Issues Paper)*, Section 4.2

In general, there is a case for using a CGE model if the proposed policy measures are likely to have an impact on the general equilibrium of the WA economy. An evaluation of policy proposals may include an examination of the magnitude of the impacts of proposed policy measures. The impacts should be examined on a relatively detailed sector level. Thus, in many instances there is a case for using CGE modelling for policy analysis.

As with any financial or economic model, the CGE model relies upon critical assumptions about optimising behavior of individuals, businesses and regulatory participants, competitive markets amongst private insurers and service providers, and flexible relative prices. In addition lack of consistent, periodic data usually prohibits econometric estimation of key supply and demand parameters.

In view of this, the validity and usefulness for policy evaluation of the results generated by CGE models is a widely recognised limitation.

RESPONSE TO QUESTION 5

Are you aware of any additional information that may assist the ERA in assessing the efficiency of the sector in question, or the costs and benefits of the proposed reforms?

No.

RESPONSE TO QUESTION 6

Are you aware of any examples of other jurisdictions (either in Australia or overseas) where similar reforms have been implemented? How effective were the reforms in those jurisdictions?

Yes. There are examples in Australia where similar reforms to statutory insurance markets have been implemented, and the NSW workers compensation scheme is a prime example, as discussed further below.

One possible approach would be to compare the net positive economic benefit pre-and post reform, including moving from Government monopolies to privatised markets based on a CGE model. However, as mentioned, this is a complex assessment due to the interdependency of multiple-factors and variables that drive economic and real per capita income growth.

Notwithstanding this, empirical evidence does exist to a varying degree on the level of effectiveness of these reforms in Australian statutory insurance markets. However, there are caveats.

At a Government level, the scheme design needs to be effective in driving economic and social benefits, as discussed in responses to questions three and four. Moreover, it must be highlighted that privatisation and government ownership are both intrinsically linked with regulation.

Government ownership only needs to be considered if there is a conflict between private profit-maximising behaviour and social welfare or benefit. The statutory insurance market is not one where a monopoly asset needs to exist at the State Government level (for example, an infrastructure asset) which if controlled by the private sector would be detrimental to individuals and businesses.

Government in conjunction with community and stakeholder consultation is at liberty to design the accident compensation schemes, by which private insurers or agents are regulated. At a market level, scheme design needs to incorporate defined and controlled benefits that incorporate efficiency, expediency, drive health outcomes and deliver a greater percentage of the premium back to the injured claimant, as benefits (as opposed to high transaction costs which reduce benefits returned to claimants). Defined and controlled benefits would also give greater certainty to premium determinations taking into account the need to fund the claims, provide a return on private capital and remain affordable for policy holders.

WORKCOVER NSW

The reforms to WorkCover NSW have been very positive for the NSW economy. Extensive reforms to the benefits regime in June 2012 have resulted in favourable revision to actuarial estimates of outstanding claims liabilities. Actuarial estimates have seen a reduction of the reported net deficit position of the scheme. The key outcomes are summarised below.

Reform Results

(1) Deficit Reduction

The scheme reported a net deficit of $4.1B with a funding ratio of 78% as at December 2011, an increase of $1.7B since 30 June 2011. As a result, a Joint Parliamentary Committee (the Committee) was established in 2012 to review the financial sustainability of the scheme and its success in returning injured workers back to work. The Committee's final report was published on 13 June 2012.

In response, the NSW Government announced a series of legislative reforms including:

- changes in the way a worker's pre-injury earnings are calculated;
- limits in weekly benefits paid to workers to five years from the date of claim (except for seriously injured workers);
- limits to medical benefits to one year after a worker ceases receiving weekly benefits (except for seriously injured workers);
- introduction of work capacity assessments which aims to return injured workers to work as soon as practicable to reduce claim costs; and
- new arrangements for journey claims, lump sum payments, nervous shock, heart attack, stroke and disease injury claims.

These reforms were implemented in stages from June 2012, with all new claims on or after 1 October 2012 subject to the new arrangements. Existing claims are being transitioned to the new arrangements during 2013.

The balance sheet dramatically improved from a reported net deficit of $4.1B as of December 2011, to a deficit of $1.5B as of June 2012.[18] The funding ratio correspondingly improved from 78% to 91%.

At the time of the reforms commencing, the scheme's actuary estimated that the scheme's deficit would improve mainly due to reduced net central estimate of outstanding claims liabilities. It is to be noted, however, this estimate is subject to significant uncertainty and the actual impact may be materially different. The final result will depend on a number of factors including the successful implementation of the reforms and behavioural attitudes of scheme stakeholders.

(2) Premium adequacy

Additionally, the June 2012 reform improved the margin between the charged premium rate and the breakeven premium rate. With an improvement in the deficit position, it is likely that the scheme premium levels could be significantly above the breakeven cost of the scheme.

If this is the case, it would enable rate reductions for employers while still allowing a reasonable profit margin for insurers. In fact, as of the financial year ending 30 June 2013 policy renewal year the following statistics are available:

- the estimated charged premium rate or total premium as a percentage of total wages was 1.7% of covered wages; and
- the estimated breakeven premium rate or actuarial estimate of required premium rate to meet expected cost of claims using an expected long-term investment return was 1.42% of wages.

The positive buffer between the charged premium rate and the breakeven premium rate can be used to reduce the deficit over time and return the scheme to a desired solvency position. In the absence of the June 2012 reforms, the breakeven premium would have been 1.7% of wages. That is, the collected premium would have been insufficient to meet the expected emerging costs of the scheme.

Economic Factors

Accident compensation schemes are best described as 'long tail' schemes. That is premiums are collected and held to fund future liabilities under the scheme. To ensure adequate funds to meet claims liabilities as they arise, some of the premiums collected are held in reserve. Typically the funds held in reserve are invested in low risk instruments, such as Australian Federal Government bonds.

The investment income produced is an important source of revenue to reduce initial premiums paid by customers. So where challenging economic environment cause the bond yields to fall, the investment income is reduced, creating a shortfall, requiring an increase in premiums, if all other factors remain equal.

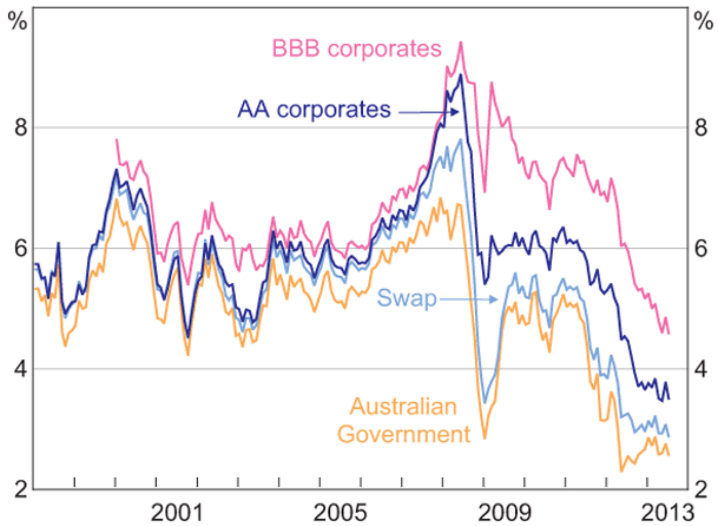
In these challenging economic environments, the risk stays with insurers in privately underwritten schemes. In turn, the insurers are prudentially supervised by APRA to ensure sufficient capital adequacy to meet outstanding liabilities. The benefit for government is the protection of its balance sheets and credit ratings. It

[18] NSW Auditor-General's Report to Parliament - Volume Five 2012 - Workers *Compensation Nominal Insurer (trading as the NSW WorkCover Scheme)*

also leaves the Government free to focus on the core role in regulating the scheme, without the need to underwrite and manage the scheme.

The Global Financial Crisis in late 2007 and the European debt crisis are examples of where bond yields declined, as shown in the graph below, which put pressure on the Government's books:

Australian Bond Yields*



* Australian Government yields and swap rates are for 3-year maturity. Corporate bond yields are a weighted average of senior bonds with remaining maturities of 1 to 5 years; they include financial and non-financial corporates.

Sources: Bloomberg; RBA; UBS AG, Australia Branch

Other Benefits of Privatisation

There is scope to improve the funding ratio on Government balance sheets by moving towards privatisation. These benefits include:

- industry and business risks are borne by insurers when they underwrite a privatised scheme (insurer returns are to some degree influenced by Government regulation, in addition to capital adequacy monitoring by APRA);
- privatisation promotes a competitive market amongst insurers which maintains affordability of premiums with policyholders; and
- existing insurers can leverage scale to maximise claims performance.

Privatisation enables the Government to transfer systemic and investment risks onto private insurers and claims agents in the following ways:

Government net benefit	Existing insurers in a scheme	Current agents (who are not APRA approved insurers)	Other insurers (not currently in a scheme)	Reinsurers
Improve capital management strategy by unlocking capital for reallocation to high priority State projects De-risk balance sheet Improve credit rating Remove exposure to investment market volatility (depressed bond yields) in the profit and loss	Underwrite within a privatised scheme	Provide claims management services to insurers underwriting within a privatised scheme	Underwrite within a privatised scheme	Provide capital support via quota share for insurers underwriting within a privatised scheme in addition to non-proportional cover
De-risk balance sheet Unlock significant capital/ asset base required to cover the tail Reduce long term liabilities	Buy the tail and manage the runoff of claims, or engage a third party provider to manage the claims, or provide claims management services to insurers or reinsurers who purchase the tail	Provide claims management services to insurers or reinsurers who purchase the tail	Buy the tail and manage the runoff of claims or engage a third party provider to manage the claims	Buy the tail and manage the runoff of claims liabilities or engage a third party provider to manage the claims

Disability Reform

The current agenda for disability reform represents a significant opportunity to improve current accident compensation schemes. First, the establishment of a ‘no fault’ scheme for traumatic catastrophic injuries or the national injury insurance scheme (NIIS) will ensure timely care and support of injured claimants to secure maximal functional abilities. In turn, this approach will maximise opportunities to assist severely injured claimants back to controlling their own lives, as soon as possible.

The insights learnt from DisabilityCare Australia (national disability insurance scheme) and the NIIS will also have the benefit of informing upon current accident compensation practices and procedures. There is potential of enhancing current best practices in:

- medical intervention, including early medical intervention;
- claims management, and
- consistent data collection to measure scheme outcomes.

RESPONSE TO QUESTION 7

Is the ERA's proposed use of the Compensation Principle appropriate or is there a more appropriate way to evaluate the net benefit of reforms?

Yes.

The Compensation Principle is an appropriate way to evaluate the net benefit of any proposed reforms from the perspective of the statutory Insurance market, as discussed in the context of the equilibrium impact under the CGE modelling framework in the response to Questions 3 and 4.

In addition, CTP insurance is an insurance class inherently based on the Compensation Principle. Since CTP is a statutory class of insurance, the premise on which it is sold is that it must be available to all individuals at a reasonable cost without insurance rate variations based on demographic characteristics such as age or gender.

This normally means that some groups of 'high risk' policy holders will be subsidised by other policy holders of with a 'lower risk' profile. This principle of community rating is a common feature of compulsory insurance schemes, and is consistent with the Compensation Principle. Therefore, any microeconomic reform to the statutory insurance market in WA would fundamentally be aligned to the Compensation Principle.

RESPONSE TO QUESTION 8

Is the ERA's framework for prioritising reform opportunities (that is, likely benefit versus ease of implementation) appropriate?

Yes.

Given the time and resource constraints indicated by the ERA, the proposed framework for prioritising reform opportunities is a pragmatic approach. There is a challenge in determining how to measure 'ease of implementation' in a simple and logical way.

Ease of implementation

Suncorp proposes that a simple way to determine the ease of implementation is by examining factors that impact the complexity and effort required to institute change such as:

- implementation timeframes;

- resource commitments;
- key stakeholders involved in the implementation of both the private and public sector;
- key inter-dependencies to implement the change; and
- set-up costs.

These factors can be rated and an aggregate and/or weighted average score can used to determine the total ease of implementation. Below is an illustrative example of options for reforming the CTP scheme in WA and how each reform option could be rated:

EASE OF IMPLEMENTATION Rating System	**Category Scores**				**Overall Rating**
	Time to implement (A)	**Stakeholders**	**Dependencies**	**Score**	**(B)**
Outsourced claims management	1	1	1	3	Easy
Privatised sole underwriter	1	2	1	4	Easy
Full privatisation	2	2	2	6	Moderate
Overall rating:					
(A)	Assuming no unforseen roadblocks from Parliamentary processes or from other key internal/ external stakeholders				
(B)	Indicates relative ease of implementation where: Easy = 3-4, Moderate = 5-7, Complex = 8-9				
Category Scores*			1	2	3
Time to implement			<12 months	1-2 years	>2 years
Stakeholders			1-5	6-20	>20
Dependencies			0-3	4-10	>10

**The higher the score, the more resources and time is required to implement*

Potential Benefits

Once the ease of implementation has been determined, the overall rating score could be linked to the net positive benefit of the proposed reform. An assessment of risks and mitigation strategies would be recommended. This would set the basis for prioritisation of the proposed reform consistent with the matrix outlined in section 4.3 of the Issues Paper.

An illustration is set out below.

Reform Option	Description of benefit	Economic impact* (A$M)	Key risks and risk mitigation strategy	Proposed action
Outsourced claims management	Reduce Net Incurred Claims Reduce claims costs Faster processing of claims	Amount	Manage outsourcing relationship. Service levels to be included in supply contract. Funding exposure/ capital at risk. Mitigated by active capital management decisions.	Implement reform: high priority (Straightforward implementation/ low net positive impact)
Privatised sole underwriter	Improve claims efficiency De-risk balance sheet	Amount	No competition between insurers. Mitigated by selection of right private insurer as partner.	Implement reform: high priority (Straightforward implementation/ moderate net positive impact)
Full privatisation	Competition between insurers drives claims performance and risk selection improvements De-risk balance sheet	Amount	Greater regulatory oversight required. Adopt scheme design and best practice from existing schemes in other jurisdictions in Australia.	Implement reform: high priority (Moderate ease of implementation/ highest net positive benefit)

**Derived from CGE model output*

RESPONSE TO QUESTION 9

Are there alternative frameworks that would provide a superior assessment?

No.

RESPONSE TO QUESTION 10

What do you consider to be the most appropriate method for assessing the economic value of a given reform? What are the significant advantages and disadvantages of this approach?

The CGE model is the most appropriate method for evaluating economic value of any proposed reform, as discussed in the questions three and four responses.

RESPONSE TO QUESTION 11

Can you provide any additional information that may assist the ERA in understanding microeconomic reform opportunities in Western Australia?

Suncorp is willing to collaborate with the ERA to engage in exploratory dialogue, provide value added input and relevant information regarding business insights and critical success factors in support of any microeconomic reforms into the statutory insurance market in WA upon request.

Appendix B

Suncorp White Paper

How international financial markets impact personal injury insurance

August 2012

Insurance Insights

When markets hit motorists

How international financial markets impact Compulsory Third Party insurance

August 2012
Chris McHugh
Executive General Manager
Statutory Portfolio
Commercial Insurance
Suncorp

Summary

When interest rates fall, many home owners enjoy the benefit of lower repayments on their mortgage.

But they are also likely to find that the cost of their Compulsory Third Party (CTP) insurance policy has increased.

It is not widely understood how and why the two events are related.

When insurers – be they private or publicly owned – collect premiums, they hold this money to pay future claims. This money is invested in order to generate income for the insurer.

The longer the investment period, the greater the significance of investment income as a source of revenue, and thus the insurer's ability to reduce the initial premium paid by customers.

CTP and Workers Compensation claims involve injured people and are therefore complex, often taking years to resolve as a person's medical condition must first stabilise.

On average, CTP claims are paid around five years after the premium is collected, making the investment income highly significant for CTP insurers.

As interest rates – or more specifically, bond rates – fall, the implications for insurers are material.

When economic conditions result in a drop in the yields of Australian Federal Government bonds, CTP and Workers Compensation premiums can be expected to rise.

This is precisely what has occurred in Australia in the 12 months from June 2011 to June 2012 as the three year bond yield has halved.

The nature of the global economy is such that seemingly unrelated external events can have an impact.

The Greek debt crisis may be half a world away but it's been pushing up the price of your CTP premium.

The degree to which premiums are able to respond to this price pressure is very much determined by the particular regulatory framework.

Background

Each state and territory government in Australia administers their own CTP scheme.

Many of Australia's CTP schemes are publicly underwritten, meaning the state or territory government sets the price, holds the risk and pays the claims.

Two of the largest, New South Wales (NSW) and Queensland, have private underwriting and multiple insurers operating within their CTP schemes.

The Australian Capital Territory (ACT) has a privately underwritten scheme but NRMA is currently the only provider.

All remaining jurisdictions are publicly underwritten.

The brands that offer CTP insurance in NSW or Queensland include Suncorp, GIO, AAMI, NRMA, RACQ, Allianz, Zurich and QBE.

Another class of insurance that involves personal injury claims is Workers Compensation.

CTP and Workers Compensation are referred to as 'long tail' classes as they take significantly longer on average for the claims to be finalised than 'short tail' classes such Motor and Home insurance.

Whilst only one of several factors that impact premium rates, investment income is far more significant for long tail insurance classes than short tail classes due to the average duration of the claims.

The dynamics discussed here regarding CTP insurance are equally relevant to Workers Compensation and Liability classes of insurance.

Whilst investment income is of greater importance to long tail classes due to longer average claims durations, it is relevant to all general insurance classes.

Investment income and premiums

CTP and Workers Compensation insurance classes are capital intensive. A single catastrophic claim can cost tens of millions of dollars and take decades to resolve.

This means that vast amounts of money (reserves) have to be held to pay future claims.

For example, Suncorp estimate that insurers operating in the Queensland and NSW CTP schemes currently hold around $15 billion in reserves, risk margin and capital.

Despite being largely invested in relatively low-risk and low yielding instruments, the revenue generated from this investment is significant.

This has a noticeable impact on CTP and Workers Compensation premiums.

In simple terms, if an insurer knows it needs to have $100 to pay a claim in five years' time, it only needs to put aside $78 if the relevant bond yields are 5%[1].

The investment by insurers of the money set aside to pay future claims reduces the premiums paid by CTP and Workers Compensation customers.

If insurers did not generate investment income, a CTP premium of $315 would cost $390[2], assuming a 5% bond yield and scheme dynamics similar to the Queensland CTP scheme.

What goes down…

A primary investment instrument for CTP and Workers Compensation reserves is Federal Government bonds.

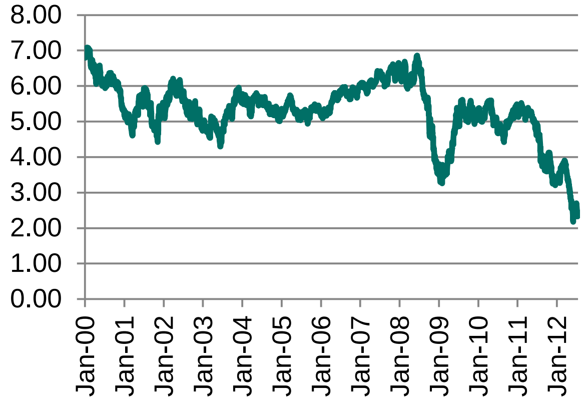
These bonds are also the benchmark used for accounting purposes when insurers calculate their reserves and future claims liabilities.

As bond yields change over time, so should CTP and other long tail premiums.

The actuarial rule of thumb is that for every 1% drop in bond yields, insurer premiums have to rise around 4% to remain sustainable.

If, as has occurred recently, bond yields slump from 5% to 2.5%, then rather than putting aside $78 to pay a $100 claim in five years, an insurer would have to put aside $88 – an increase of 13%.

The same drop in bond yields means that a $315 CTP premium would have to rise to $350 in order to remain sustainable – a $35 or 11% increase.



5-year bond yields (%) 2000 to 2012

This volatility is one of the core challenges faced by all CTP and long tail insurers.

A key mechanism to limit the ability for this volatility to dramatically affect the financial viability of an insurer is through 'locking in' investments so they mature when the claims costs are due.

This process is referred to as 'duration matching'.

Duration matching

Given that an insurer's reserves (money set aside to pay future claims) and liabilities (the estimate of future claims costs) are often in the billions of dollars, there's considerable risk that large holes can appear in the balance sheet when bond yields change.

For private insurers, the Australian Prudential Regulatory Authority (APRA) requires all liabilities to be fully funded, meaning that any hole in the balance sheet has to be filled immediately.

When reserves are insufficient to cover liabilities then this gap has to be filled, which is referred to as 'reserve strengthening'.

This reduces the profitability of an insurer, and the impact can be dramatic – hence the practice of duration matching.

[1] Bond yields vary depending on the length of maturity of the bond, with a longer maturity typically giving a high yield. The 'yield curve' can be simplified to a single rate commonly referred to as the 'discount rate'.

[2] The total paid by a CTP customer typically includes levies and taxes in addition to the insurer premium. This calculation refers to the insurer premium only.

In simple terms, if the insurer expects to have a $500 claims bill due in three years, they will purchase a bond that will mature on average in three years to a total value of $500.

By adopting an investment strategy of duration matching, insurers can protect their balance sheet and reduce the volatility of their year-on-year results.

An insurer that has a robust duration matching investment program will significantly reduce the impact of changing bond yields on their existing liabilities.

The issue for CTP and Workers Compensation insurers when bond yields drop is the fact that the premiums derived from policies being written today may be insufficient to cover future claims cost.

Of significance is the ability of private insurers to respond when bond yields change.

Changing the premium

CTP and Workers Compensation are highly regulated classes of insurance.

A key feature is that insurers cannot refuse to offer CTP insurance to a customer, which ensures that everyone can obtain insurance as long as they can pay the premium.

In the jurisdictions where CTP insurance is underwritten by private insurance companies (Queensland, NSW and the ACT) the government regulators maintain a high degree of control over premium rates.

The mechanism through which this control is exercised differs between Queensland and NSW.

Queensland

In Queensland the Motor Accident Insurance Commission (MAIC) manages a pricing process that is undertaken every three months.

The process begins with the MAIC inviting insurers to provide a submission outlining their analysis of the trends and factors influencing CTP premiums and providing recommendations on appropriate adjustments to pricing.

The MAIC also obtains independent actuarial advice, and then sets an upper and lower price limit for each of the 24 classes of vehicle.

All insurers are then required to file their rates for each vehicle class, ensuring that their rates are within the band as prescribed by the MAIC.

In Queensland, insurers nominate a single premium rate for each vehicle class.

This means that all customers owning the same class of vehicle will pay the same CTP premium regardless of their age, location or driving history.

Accompanying the price for each vehicle class, insurers also provide their projected profitability for the quarter.

NSW

The process in NSW is regulated by the Motor Accidents Authority (MAA).

Whilst the MAA does issue mandatory premium filings on occasion, an insurer can provide a submission to change their premium rates any time.

Most insurers tend to submit rate filings between two and four times a year.

Unlike Queensland, no upper and lower price limit is set, but a complex formula plays a critical role determining premium rates.

Insurers in NSW are able to charge different premium rates for the same class of vehicle.

Factors such as how old the vehicle is, where it is garaged, the age of the driver and their driving history can all be used to determine the level of risk.

Mature drivers with a clean record will tend to be charged less, while young drivers who have had accidents will have a higher CTP premium.

Insurers determine a base rate for each vehicle class and are then able to discount or increase the premium depending on their assessment of the risk.

The MAA formula restricts insurers in the degree of discount or loading they can apply in relation to their base rate.

A maximum of 15% discount[3] and loading of between approximately 25% and 45% can be applied, depending on what the formula stipulates.

The formula ensures that if an insurer wishes to reduce its rates to attract more low-risk drivers, it will also have to reduce rates for high-risk drivers.

Further, the proportion of customers to whom a particular insurer can offer discounts is limited by the formula to ensure each insurer is providing cover to a reasonable spread of both high and low risk drivers.

The result is a degree of correlation between the risk and the premium paid, whilst maintaining affordability for high-risk drivers by having them effectively subsidised by low-risk drivers.

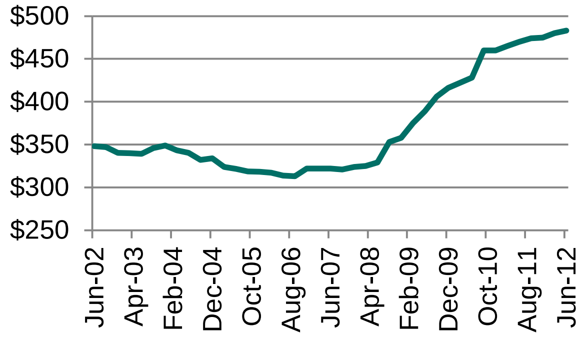
For an insurer to change its CTP premium rates it must submit its proposed rates to the MAA, accompanied by its projected profitability.

The MAA will then either approve or decline the new premium rates.

Premium trends

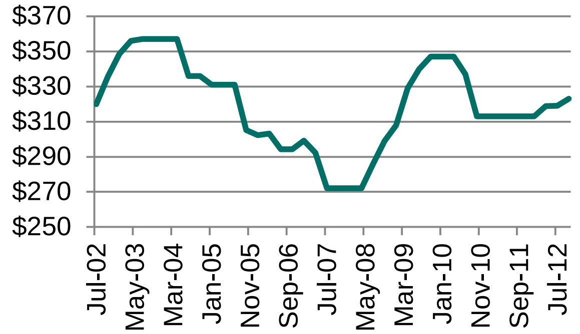
An examination of CTP premiums over the last decade presents an interesting story.

The average NSW Class metro 1 premium decreased for the first half of the last decade, but has increased significantly since the onset of the global financial crisis.



NSW average Class 1 metro CTP premium

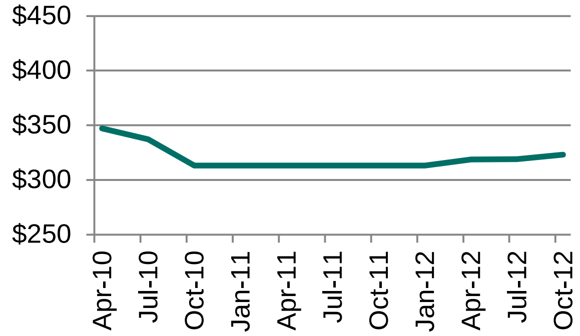
In Queensland the Class 1[4] upper price limit set by the MAIC has gone from $357 in 2003, down to $272 in 2007, up again to $347 in 2009 and then down again to $313 in 2011.



QLD CTP Class 1 Upper Price Limit (inclusive of levies and GST on insurer premiums)

Significantly, from October 2010 to March 2012, the upper price limit remained at $313 for six quarters, before rising $5 in April 2012 to $318.

In July 2012 an adjustment to fees and levies resulted in an 80 cent increase. A further $5 rise in the upper price limit to $323.80 has been approved for the October 2012 quarter.



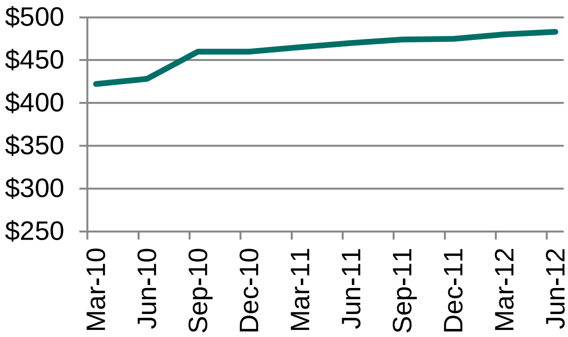
QLD CTP Class 1 Upper Price Limit (inclusive of levies and GST on insurer premiums)

This contrasts with the changes in the NSW average metro Class 1 premium for the period from March 2010 to June 2012 where the average Class 1 metro premium rose from $422 to $483[5].

[3] The 15% discount from the base rate is referred to as the 'headline rate' and applies to drivers under 55 years of age. Drivers 55 and over may be eligible for a maximum discount of 25%.

[4] Approximately 68% of vehicles registered in Queensland are Class 1.

[5] When comparing CTP premium rates between schemes, it is necessary to consider the benefits each scheme provides to injured people. Average CTP premiums are higher in NSW in comparison to Queensland, reflecting additional benefits such



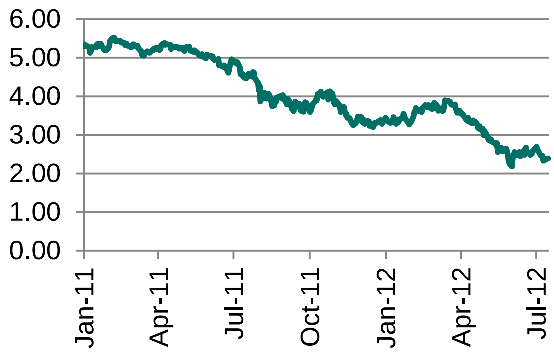
NSW average metro Class 1 CTP premium

Premiums and bond rates

Multiple factors influence CTP premiums including accident rates, inflation, scheme design and the efficiency of claims management.

Investment income is just one ingredient, but when bond yields change rapidly and significantly, it becomes a highly influential ingredient.

From January 2011 to July 2012, five-year bond rates have dropped from approximately 5.2% to 2.5%.



5-year bond yields (%) Jan 2011 to July 2012

Adopting the rule of thumb that stipulates a 1% drop in bond yields requires a 4% rise in premium to compensate, this 2.7% drop would necessitate approximately a 10.8% rise[6] to maintain profitability[7].

as the Lifetime Care Scheme that covers 'at fault' drivers in NSW. No equivalent exists in the Queensland scheme.

[6] The ACT CTP regulator approved a 10% rise in CTP premiums, effective September 2012.

[7] A partial offset to the upward pressure lower bond yields put on insurance premiums is the downward pressure that the

Over that same period the CTP upper price limit in Queensland has risen by $5.80 or 1.9%. The additional $5 rise that will take effect in October 2012 will take the total rise to $10.80 or 3.5%.

By comparison, in NSW from December 2010 to June 2012 the average metro Class 1 premium has risen by $23 or 5% from $460 to $483.

Further MAA-approved price rises have occurred since June, due in significant part to the dramatic decline in bond yields over the previous 18 months.

As bond yields have dropped, prices in NSW have steadily risen, yet in Queensland prices have remained relatively flat.

Competition

Given these statistics, it perhaps comes as no surprise that insurers in Queensland are becoming increasingly vocal in regard to the need to have premiums increase as investment returns drop.

There has consistently been minimal difference between the prices of various insurers in Queensland – far less variation than has occurred in NSW where no upper price limit is set and competitive market forces are able to operate more freely.

Since 2009 there has been a reduction in the degree to which insurers are filing rates below the upper price limit set by the MAIC.

From January 2011 to January 2012, of the six participating insurers, four consistently filed at the highest permissible Class 1 price, with AAMI and Allianz filing no more than $6 below this upper price limit.

For the last three quarters (April, July and October 2012) all six insurers have filed at the Class 1 upper price limit, meaning that there is effectively zero price competition in the Queensland CTP Class 1 market.

Since the first of April 2012, all Class 1 motorists have paid exactly the same CTP price regardless of which insurer they chose – the maximum price permitted by the MAIC.

same economic conditions that reduce bond yields put on average weekly earnings, which in turn reduces personal injury insurance premiums.

The MAIC policy of minimal rises in the CTP upper price limit has contained prices in Queensland, but it has come at the expense of competition.

Sustainability

State and territory governments have the power to determine how much motorists pay for their CTP insurance.

In publicly underwritten schemes, if the price is set too low, the scheme is at risk of falling into deficit and having a negative impact on the government's balance sheet.

This has occurred recently in the NSW Workers Compensation scheme, where a deficit of over $4 billion has emerged, due in significant part to a reduction in investment income from declining bond yields.

This unsustainable financial position has led the NSW Government to undertake reform and cut benefits in order to contain further premium rises.

In privately underwritten CTP schemes, it is insurance companies that hold the risk and have their balance sheets exposed to fluctuations in bond yields that can stem from both domestic and international financial conditions.

Given this exposure, private insurers arguably have a right to expect CTP premiums to respond to significant and sustained changes in bond yields.

Conclusion

The relationship between bond yields and CTP prices is well understood by insurance analysts.

It is a direct relationship and has a material impact on the financial sustainability of CTP insurers, both public and private.

Private insurers that participate in CTP schemes are required by the Australian Prudential and Regulatory Authority to have sufficient reserves to cover all future claims.

When bond yields drop, if premiums do not correspondingly rise then it's shareholders who pay to fill the gap between reserves and liabilities.

An unresponsive regulatory framework reduces competition and undermines confidence in a private insurer's ability to operate sustainably in a CTP scheme.

It is in the interests of the community to ensure that, even if bond yields crash, a viable CTP scheme is there to support Australian motorists who do the same.

Appendix C

Suncorp White Paper

Reflections on underwriting options for personal injury insurance

November 2012

Insurance Insights

What scheme works when people get hurt?

Reflections on underwriting options for personal injury insurance

November 2012

Anthony Day
Chief Executive Officer
Commercial Insurance
Suncorp

Summary

In 2004 the Productivity Commission concluded that private underwriting of Workers Compensation schemes was preferable to government underwriting.

Today, eight years later, many personal injury schemes around Australia continue to be underwritten by the public.

The New South Wales (NSW) Workers Compensation scheme is currently remediating a deficit greater than $4 billion, which has involved a Parliamentary Inquiry and controversial cuts to benefits designed to avoid projected premium rises of 28%.

Those in favour of government underwriting of the personal injury classes of Workers Compensation and Compulsory Third Party (CTP) insurance argue that it provides certainty and facilitates the broad pooling of risk, backed up by the strength of a state government balance sheet.

An argument for private underwriting is that it reduces the risk to state governments and ultimately to taxpayers by avoiding exposure to significant liabilities when schemes fall into deficit.

Further, a private scheme can arguably deliver better health outcomes to people who have been injured and provide incentive for policy holders to reduce risk.

In a well-regulated environment with a robust insurance industry like Australia, the case for private underwriting and claims management appears strong, but is it sufficiently compelling to prompt government schemes to transition to private underwriting?

This paper examines the question of public versus private underwriting of personal injury insurance schemes.

Background

Each state and territory in Australia has personal injury schemes for both their Workers Compensation and CTP insurance.

The scheme designs range from full state administration of underwriting, policy and claims management to fully privatised schemes with multiple insurers operating – with a number of variations in between. Federal schemes such as Comcare also exist.

Workers Compensation in NSW and Victoria are referred to as 'managed fund' schemes with state government underwriting the risk and providing the capital, whilst policy administration and claims management is outsourced to 'scheme agents' who are paid on a fee for service basis.

Scheme agents are often insurance companies and include GIO, QBE, Allianz and CGU. Third party administrators such as EML, Xchanging and Gallagher Basset also operate as scheme agents.

In South Australia, a single agent (EML) has provided all Workers Compensation policy and claims management. A second claims manager will commence on 1 January 2013[8].

Queensland Workers Compensation is entirely government run with no insurer or agent involvement[9].

Western Australia (WA), Tasmania (TAS), the Northern Territory (NT) and the Australian Capital Territory (ACT) have privately underwritten Workers Compensation schemes with multiple insurers operating within them.

In CTP, only NSW and Queensland have private underwriting and multiple insurers operating within their schemes.

The ACT has a privately underwritten scheme but NRMA is currently the only provider. Other insurers are reluctant to enter the market under the current legislation and procedures.

All other CTP schemes are entirely underwritten by government.

Comparing schemes simply on premium rates can be misleading as each jurisdiction has different benefit regimes for those who are injured.

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[8] The South Australian Government recently completed a tender process for claims management of its Workers Compensation scheme. A second claims manager, Gallagher Bassett, will enter the scheme on 1 January 2013.

[9] The Queensland Government has brought forward its five-yearly review and created a Parliamentary Committee to oversee the review.

For example, CTP prices are higher in NSW than in WA, but NSW has a lifetime care scheme for all catastrophic injuries while WA does not.

The Workers Compensation average premium rate is significantly lower in Queensland than in NSW, but income replacement in Queensland is capped at five years or $287,605, whilst in NSW income replacement can continue until retirement age for severely injured workers[10].

The underlying dynamics that are present in government and privately underwritten schemes provide a more accurate basis for consideration.

Liability management

State government underwriting means that the relevant government authority is directly able to set the exact premium for personal injury insurance policies.

Critics of the publicly underwritten model contend that a state government is compromised when it comes to the difficult task of managing liabilities for future claims cost in a personal injury scheme.

It is apparent there will always be the potential for a state government to be pressured to reduce premiums or moderate premium increases due to the impact on the electorate.

Business owners and motorists want lower premiums, whilst unions and lawyers who represent the injured advocate for increased benefits.

With no independent regulator requiring the scheme to remain fully funded, arguably there will always be a temptation for a state government to allow the scheme to go into deficit – as has occurred under all major political parties and for both Workers Compensation and CTP schemes.

As noted, the NSW Work Cover scheme is currently remediating a deficit of more than $4 billion. The Queensland Workers Compensation scheme has been on a sharp decline in recent years, managing a thin surplus in 2010/11.

The Transport Accident Commission (TAC) that manages the CTP scheme in Victoria recently reported an increase in net liabilities from $0.24 billion in 2010/11 to $1.40 billion in 2011/12.

In theory a government underwritten scheme is able to provide more consistent premiums by being less responsive to changing market conditions such as investment yields.

But if those premiums are consistently too low, the result can be dramatic.

Prior to privatisation in 1989, the NSW CTP scheme had deteriorated to an alarming degree.

At 30 June 1988 liabilities stood at $3 billion of which $1.87 billion was unfunded. Representing $4.7 billion in today's terms, the NSW deficit was enormous both in percentage and absolute terms.

Every NSW CTP policy had an additional $47 levy for the next 10 years to pay off the debt.

Personal injury claims can be very expensive. They incorporate significant medical, rehabilitation and care expenses, and can include income replacement as well as lump sums for permanent impairment and pain and suffering compensation.

These factors mean that sizable deficits can quickly materialise if liabilities are not monitored closely and urgent remediation undertaken.

Privately underwritten schemes are arguably more effective at discerning emerging trends and responding in a timely fashion, particularly during challenging economic times.

When deficits are allowed to accumulate, this effectively pushes the cost of injuries occurring today onto the employers and motorists of tomorrow.

In schemes that are privately underwritten – WA, ACT, NT and TAS Workers Compensation and NSW, ACT and QLD CTP – there are no deficits that can be carried forward into the future.

The Australian Prudential and Regulatory Authority (APRA) ensure insurance companies fully fund any future claims liabilities.

Any deficit requires an adjustment that has an immediate impact on the insurance company's results.

A failure to do so would result in close supervision from APRA with possible increased prudential

[10] Adjustments to the maximum duration of income replacement payments were legislated in NSW in June 2012. Prior to the new legislation, income replacement could continue until retirement age for workers without severe injuries.

capital requirements and damage to the insurance company's reputation and share price.

There is no APRA equivalent overseeing state government schemes and placing the same conditions on governments that APRA places on private insurers.

This lack of independent regulation allows government underwritten schemes to fall into deficit, with the end result being a significant impact on the state balance sheet and risk of a credit rating downgrade.

Risk, price and behaviour – the relationship

Government underwritten Workers Compensation schemes provide businesses – particularly small businesses – with a high degree of premium stability.

Premiums are determined by the business type and the price is identical regardless of which agent is managing the policy.

This is distinct from a privately underwritten Workers Compensation scheme where, when a policy is issued, an underwriter can look at the profile of the small business, determine the risk and set the premium accordingly – as per normal insurance principles.

A large business with poor safety procedures and un-maintained equipment is a higher risk and will be charged a higher premium. A large business that is serious about avoiding workplace accidents will attract a lower premium.

Insurance companies want to insure businesses that have good risk management practices and will offer a competitive premium to reflect this.

When it is time to renew the policy, the safety record of the business and the frequency and severity of claims they have made will have a direct impact on the premium. This is true for large and small businesses alike.

In a government underwritten Workers Compensation scheme like NSW WorkCover, employers paying less than $10,000 a year in premium – which usually means up to five employees – are immune from claims impacting on their premium.

Whilst this shields these employers from premium rises, the result is that safe business operators effectively subsidise negligent business operators.

Regardless of how many workers are injured at a business and the seriousness of the injuries, the negligent employer will pay the same premium as an equivalent business with a perfect safety record.

Critics point out that this is unfair and provides little incentive to change behaviour and invest in safety.

In a privately underwritten Workers Compensation scheme the same negligent business operators would see their premiums dramatically impacted, delivering a clear message that to stay competitive, safety must be improved.

Similarly in CTP, some insurers in the privately underwritten NSW scheme use risk rating factors such as the number of previous at-fault collisions to determine premium rates, which rewards those with a perfect driving record.

Risk managers and underwriters will tell you that having a clear and direct link between risk and price is essential if you are serious about changing behaviour to reduce risk and injury.

Investing in safety has multiple benefits – it saves lives, improves productivity and reduces insurance premiums. It also promotes a positive safety culture within the business.

One of the strengths of privately underwritten personal injury insurance schemes is that they can be more flexible and responsive, meaning they reward policy holders who look after themselves and the people in their care.

Managing rehabilitation

Personal injury claims management involves a remarkable confluence of objectives – everyone wants the same thing, which is for the injured person to recover as quickly as possible.

In the case of a workplace injury, a speedy return to work is good for the worker, the employer and the underwriter.

In privately underwritten schemes the claims manager is the underwriter, meaning there is a direct link between the quality of the claims management and the bottom line of the underwriter. The underwriter has real 'skin in the game'.

There is a strong incentive to be innovative and proactive in order to avoid a protracted – thus expensive – claim.

As Australia's largest personal injury insurer, the Suncorp Group (Suncorp) is highly cognisant of the fact that resolving a claim requires early intervention, the establishment of trust, empathy and the most effective treatment.

Delays, cutting corners and failing to actively monitor progress become very expensive.

In government schemes where the claims management is outsourced, the link between claims management and the bottom line is weakened if strong regulatory monitoring and aligned remuneration models are not in place.

For example, reports have shown that in some government underwritten schemes there has been inadequate monitoring of rehabilitation providers by claims managers.

These reports noted that rehabilitation providers were appointed, but there was insufficient follow-up to ensure actual positive results were being achieved.

This lack of monitoring can allow a protracted claim to develop, dramatically increasing the period of incapacity for the injured person and the cost of the claim.

Best-practice claims management is the key to minimising the negative impact of injuries on people, employers and underwriters.

Competition between independent insurers who underwrite and manage claims, generates a strong motivation for claims managers to be innovative and contain costs, rather than simply following a procedure without active pursuit of an outcome for the injured person.

Competition drives best practice and results in multiple parties working for the ongoing financial sustainability of the scheme.

Certainty and investment

A distinguishing feature of personal injury claims is that they are 'long tail' – they can last a lifetime. As they directly involve people and their families who are coping with physical injuries and financial stress, they're very complex to manage.

Personal injury claims management is a highly specialised industry and establishing the expertise, systems and processes required to do it well is a significant and ongoing investment.

For a business to invest in such an undertaking requires a high degree of certainty.

Managed fund schemes typically offer agents five year contracts to manage policies and claims. The state government authority is able to allocate and remove market share at will.

Over the years the authorities in NSW, Victoria and South Australia have increased and decreased the number of agents, resulting in reduced market share for existing agents when numbers increase, and in agents being removed from the scheme when numbers decrease.

This uncertainty can stifle investment.

By way of illustration, insurers like those within Suncorp who operate in privately underwritten jurisdictions with relative security have made significant investments in the latest claims management computer systems.

Compare that to other Australian jurisdictions where claims management is still paper-based.

The fact that agents operating in government underwritten schemes have less security of tenure is arguably a disincentive to invest.

In a privately underwritten jurisdiction an insurer – assuming they comply with their licence conditions and remain competitive – can expect to remain indefinitely.

This encourages investment in people and systems to build the quality and profitability of their business, and improves the scheme for all participants.

Role of government

Advocates of privately underwritten personal injury schemes argue that they allow government to focus on the critical role they have to play in order to deliver an effective and sustainable scheme – to regulate and provide oversight.

Effectively the scheme is defined by the regulator, which ultimately means the state government.

They set the conditions and dictate what constitutes reasonable and adequate care.

By controlling the benefit structure, the regulator decides if their scheme will have generous benefits and therefore higher premiums, or restricted benefits and lower premiums.

As currently occurs in privately underwritten schemes, premium increases are approved – although not dictated – by the regulator.

The regulator is also responsible for ensuring affordability and universal coverage.

As much as a direct relationship between risk and price has clear benefits in changing behaviour, there are instances where 'community rating' of premiums is appropriate.

For example, whilst an 18 year old should pay more for their CTP insurance, if they were charged the full price for the risk they represent it would be unaffordable, which would increase the likelihood of people driving without insurance.

A government underwritten scheme does give the regulator direct control over the prices consumers will be charged.

However, in privately underwritten schemes the regulator has a high degree of indirect control through setting ceiling prices and rejecting proposed premium increases – as occurred in the NSW CTP scheme in late 2011.

Regardless of whether the underwriter is public or private, the regulator is able to determine what constitutes an appropriate community rating in order to encourage the right behaviour, deliver affordable insurance to all parts of the community and reduce levels of uninsurance.

NDIS

Whilst proponents of private underwriting and claims management contend that this is the best option for over 99% of personal injury claims, it is not necessarily the case for the less than 1% that constitute catastrophic (severe and profound) claims.

Suncorp has consistently argued that insurers have an important role to play in the proposed National Disability Insurance Scheme (NDIS) for acquired disabilities and National Injury Insurance Scheme (NIIS) for disabilities from accidents.

However, that does not include private underwriting of catastrophic components of the NDIS or NIIS.

Catastrophic claims constitute approximately 20% of the total personal injury claims cost of CTP claims.

The capital required for these claims is enormous due to their size and duration, and is impacted by the volatility of investment markets.

If underwritten by entities that are owned by shareholders, these shareholders require a return on this capital, which increases premiums.

Further, the small number of catastrophic claims means that fragmenting the claims management by dividing them amongst several claims managers does not deliver sufficient scale. Aggregating these claims delivers economies of scale.

An NDIS and NIIS will allow a long-term, holistic approach to be taken to the rehabilitation, care and support of people with catastrophic disabilities.

They will be able to have their individual preferences catered for and long-term strategies implemented to maximise function and reduce the call on public medical and hospital resources.

An NDIS and NIIS will also ease the burden on carers, which in turn may increase workforce participation.

The cost benefits of this approach are far preferable to the current situation where insured people with catastrophic claims are generally given a lump sum, which may be inadequate, can be mismanaged and may not produce the desired outcomes.

A system that provides holistic, long-term care to the catastrophically injured is preferable to one that encourages litigation in order to maximise lump-sum payouts, which can hinder early medical and return-to-work intervention.

Underwriting and claims management of catastrophic injuries is best placed outside the private insurance industry due to the high capital requirements.

The benefits that will be derived from a centralised scheme that is underwritten by government will deliver better outcomes for all.

Conclusion

The conclusion of the Productivity Commission in 2004 that private underwriting of Workers Compensation is preferable to government underwriting also stated that the risk of insurer failure would be reduced by prudential supervision.

In the intervening years, prudential control of insurers has proved its worth.

Insurers are less at risk of failure than they were a decade ago due to strengthened capital requirements and greater prudential oversight.

This was evident during the recent global financial crisis where the insurance industry demonstrated its resilience.

Yet government underwritten personal injury schemes continue to dominate the Australian landscape, and no schemes have moved from public to private underwriting since the Productivity Commission made its recommendations in 2004.

The current unfunded liabilities in government underwritten schemes expose future policy holders to increased insurance costs as a result of today's political environment.

Australia has a mature and highly capable insurance industry where competition is delivering competitive pricing, innovation and a high focus on customer experience.

Insurers have the skills, capacity and appetite to underwrite personal injury schemes across the nation.

Moving from public to private underwriting would remove a significant liability or potential liability from the public, as well as arguably increasing efficiency, reducing costs and improving health outcomes for those who are injured.

Perhaps the next decade will see more state governments asking why they continue to be in the insurance business.

The Suncorp Group

Suncorp Group Limited and its related bodies corporate and subsidiaries (collectively 'Suncorp') offer a range of financial products and services including banking (Suncorp Bank), general insurance, compulsory third party (CTP) insurance, workers compensation insurance, life insurance and superannuation (Suncorp Life) across Australia and New Zealand. Suncorp has more than 15,000 employees and relationships with over nine million customers.