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25 November 2016

CTP Review
State Insurance Regulatory Authority
Level 25 580 George Street
Sydney NSW 2000

By email: ctp_review@sira.nsw.gov.au

Dear Sir/Madam,

Discussion Paper: Reforming Insurer Profit in Compulsory Third Party (CTP) Motor Vehicle Insurance

The legal profession appreciates the opportunity to provide submissions in response to the Government's Discussion Paper "Reforming Insurer Profit in Compulsory Third Party (CTP) Motor Vehicle Insurance" ("Discussion Paper").

We note that the submissions that follow have already been the subject of discussions between representatives of the legal profession and Mr Matthews, Chair of the State Insurance Regulatory Authority ("SIRA") Board, at a meeting on 17 November 2016.

The legal profession reiterates that it does not support the current direction of reform of the CTP scheme. While we acknowledge that the efficiency of the current scheme can and should be improved, the legal profession does not support turning the current scheme into a low benefit, defined benefits scheme modelled on elements of the harsh and unjust workers compensation scheme in NSW.

That said, the legal profession reiterates that it strongly supports efforts to rein in the excessive insurer profits that have been a feature of motor accident scheme performance for over a decade and a half.

We submit that it is critical to any efforts to address excessive insurer profits in the NSW scheme to understand why those excessive profits occur. It is not sufficient to identify elements of "uncertainty" in the insurance market and claim that moving to defined benefits will eliminate all super profits. We consider that 16 years of super profits is compelling evidence that the Motor Accidents Authority, and now SIRA, have been ineffective in restraining insurer profits.

We note that different explanations for excessive profits over the years have included:

- (a) The initial over-performance of the scheme in restraining benefits, as compared to expectations (approximately the first four years of super profits);

- (b) Falling accident numbers (the super profits between approximately 2004 and 2009); and
- (c) Lower than anticipated rates of superimposed inflation (from approximately 2009 to 2013).

The legal profession observes that what has not yet been addressed or explained are the anticipated super profits over the most recent accident years. The 2015 Scheme Performance Report shows that for the 2013 accident year, the projected profit margin in 2014 was 12% (\$214 million) and that only 12 months later, by June 2015, the figure was up to 19% (\$351 million).¹ The figures are even more stark for the 2014 accident year. The initial (2014) estimate was an 8% profit (\$166 million). This would be in accordance with the filings. Only one year later in June 2015, the anticipated profit for 2014 was up to 20% (\$408 million).² We query where the \$137 million and \$242 million in profits materialised from within these 12-month periods.

The legal profession notes that these profits have occurred during periods where the Government has expressed its concern that the CTP scheme is in grave danger of collapse due to a blow-out in claim numbers. We consider that the greater danger is insurers overestimating claims, with the consequential effect on green slip prices.

We note that extra powers to SIRA and the capacity to capture super profits is only of value if the insurers cannot “game” the system. We consider that the experience of the last 16 years with the disparity between premiums filed (projecting 8% profit) and the actual profit experience (an average of 20%) runs beyond mere coincidence or fortuitous circumstances. An integral part of measures to reduce insurer profits must be SIRA having the resources and capacity to adequately police the scheme.

On the specific matters raised in the Discussion Paper:

- (1) The legal profession supports giving enhanced regulatory powers to SIRA to ensure that the premium filed does not contain excessive padding to set up future super profits. SIRA should have the power to reject premium filings on the basis that the profit projections (or any other actuarial assumptions) are unrealistic.
- (2) The legal profession supports the abolition of the fully funded test if it is considered safe to do so.
- (3) The legal profession supports introducing measures to reduce any super profits that may be generated by locking new car dealers into long-term, exclusive contracts. This support is subject to the caveat that such changes should be designed only to enhance market efficiency and not to increase premium costs for those who drive older cars. We note that, given that SIRA intends to introduce a risk equalisation scheme in 2017 where the age of the vehicle is a factor to be used to redistribute profits between insurers, the cross subsidy referred to here, to the extent it currently exists, is likely to be largely eliminated.
- (4) The legal profession supports any measures to bring about increased disclosure and transparency on insurer profits.

¹ SIRA, ‘NSW Motor Accidents CTP Scheme: 2015 Scheme Performance Report’ (2015) 26.

² Ibid.

- (5) The legal profession encourages greater disclosure as to cross-subsidies within the CTP system. It is recognised that there is a cross-subsidy of younger drivers by older drivers, but that is socially justifiable on the basis that all motorists “take a turn” to be both older and younger motorists. Other cross-subsidies, such as that of motorcyclists under the Lifetime Care and Support (“LTCS”) Scheme / Medical Care and Injury Services (“MCIS”) levy, and on a move to a no-fault / first party scheme, ought to be disclosed so that there is transparency as to the degree of cross-subsidy between vehicle classes.
- (6) The legal profession strongly supports a cap on insurer acquisition and operating expenses. We submit that there should be no allowance within such cap for general brand promotion advertising. With a statutorily mandated and compulsory CTP product, NSW motorists should not be paying for any part of the branding of Allianz Stadium, the QBE Swans, the NRMA Western Sydney Wanderers FC or NSW Rugby League GIO Cup etc. The only allowance that should be incorporated in advertising/marketing expenses is where it informs the public about the product, preferably limited to competition on price. The legal profession supports a ban on the payment of commission or “business support” payments in respect of any CTP insurance policy. Further, business acquisition expense assumptions in premiums filed with SIRA should not be allowed to include any allowance for commission or “business support” payments of any kind.
- (7) The legal profession supports a risk equalisation mechanism to socialise the cost of poorer risk within the scheme and to introduce better competition on price amongst remaining policies.
- (8) The legal profession strongly supports the introduction of a profit normalisation or “clawback” mechanism to ensure that super profits are returned to the scheme. There is no realistic prospect of returning super profits to individual policy holders. Rather, future premiums can be reduced if super profits are paid into a fund that can reduce or eliminate the MCIS levy. The legal profession accepts that 8% of premium written is a reasonable return, but also accepts that there should be some incentive for insurers (if a privately underwritten scheme is to be maintained). A possible clawback scheme could see the following grading:
 - (a) Take 25% of super profits between 10% and 12%;
 - (b) Take 50% of super profits between 12% and 14%;
 - (c) Take 75% of super profits between 14% and 16%; and
 - (d) Take 100% of super profits over 16% (i.e. double the acceptable level).

It is accepted that the most pragmatic way to tax super profits is on an industry-wide basis. To avoid profits being “hidden” for a set period, the clawback needs to run over the life of the claim or premium collection years.

Further, the legal profession strongly opposes any efforts to time limit the profit clawback scheme. It will take the better part of a decade to finish clawing back profits from Year 1 after profit normalisation is introduced. The profit normalisation mechanism should not be maintained as a “reserve power”; rather, it should be a central feature of the scheme to manage and redress super profits.

Private underwriting

The legal profession notes that the continuation of private underwriting is an implied assumption within the Discussion Paper. However, with a low benefit, defined benefits scheme and with repeated SIRA assurances that such scheme will involve greater stability (despite the introduction of 7,000 new claimants per year), there should be much lower risk associated with scheme performance. In those circumstances, it is difficult to understand why private underwriting is being maintained. Private underwriting adds significantly to premiums paid by motorists.

We note that the TAC scheme has operated on a public underwriting basis in a safe and sensible fashion for decades. We submit that, if there is to be a move to a TAC-style system, then the retention of private underwriting at considerable cost to motorists needs serious consideration.

Answers to questions for consideration

1. What concerns or risks do you see with the proposed actions to reform the premium system?

The primary concern with the proposed actions is the probability that one or two of the four remaining insurers will decide that, without super profits, they no longer wish to remain in the market. The prospects of attracting additional entrants into the market are modest. Greater market concentration leads to less competition.

However, as addressed above, the real question is whether a defined benefits scheme should be privately underwritten or is more efficiently managed for the motorist by public underwriting.

2. What are your views on the proposed approach to profit normalisation?

The legal profession strongly supports profit normalisation. It should be a permanent feature of the scheme. Independent of whether the scheme is extensively reformed or whether the current scheme is maintained, a scheme of profit normalisation should be introduced immediately.

3. Should the definition of appropriate insurer profit levels be set by SIRA, and if so, what considerations should be included?

Yes – 8% of premium excluding LTCS levy and GST.

4. Which mechanism(s) do you believe are best to distribute premium super profits back to motorists? Why?

The legal profession submits that a pool should be created into which super profits are paid. That pool can be utilised to reduce the MCIS levy and thus reduce premiums for all motorists.

5. If insurers make a loss, should they be compensated in a profit normalisation framework? How?

In the legal profession's view, fairness would seem to dictate that if super profits are to be captured, then super losses should be underwritten. However, such underwriting should be in the form of credits as against the pool as a set-off against future super profits or super profits yet to be paid on previous years.

6. **Should a tolerance level (e.g. x%) above or below the targeted point be considered? If so, what would be an acceptable tolerance level?**

Yes – see above.

7. **What should be done for the insurer who adopts innovation, operates efficiently and makes extra profit as a result of their endeavours?**

The legal profession considers that, by having a ratchet increase in the degree of super profit being taxed and in taxing the industry as a whole, rather than individual insurers, the innovative are rewarded and the less innovative are not punished.

8. **What advantages/disadvantages do you see in annual reporting on individual insurer profit by SIRA?**

The legal profession considers that annual reporting would ensure greater transparency.

9. **What advantages/disadvantages do you see in increased transparency in the premium setting process, including making SIRA an approval authority?**

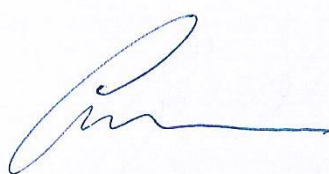
The legal profession strongly supports having SIRA as a transparent and effective regulator of premium. SIRA should be required to approve insurer's premium rates for NSW CTP.

10. **Should there be exclusions, caps, limits or controls on acquisition expenses, including commissions to intermediaries?**

Yes – see above.

Should you have any questions or require further information, please contact Meagan Lee, Policy Lawyer at the Law Society of NSW on (02) 9926 0214 or email Meagan.Lee@lawsociety.com.au.

Yours faithfully,



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