

# Insurance insights

**CHRONIC CONDITION**

**The need to reform the NSW CTP  
insurance scheme**

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# Executive summary

Compulsory Third Party (CTP) insurance legislation in New South Wales (NSW) is in need of reform.

Customers and injured people are paying the price and experiencing the negative consequences of the current structural issues.

Despite steady improvements in vehicle and road safety, premiums continue to rise above inflation.

Injured people only receive around 45 cents of every dollar in premiums due to high legal, medico-legal and insurer costs, making it one of the most inefficient CTP schemes in Australia.

As an 'at-fault' scheme, injuries to the driver are not fully covered by their vehicle's CTP insurance policy, meaning thousands of people injured in NSW each year are left disadvantaged.

The practice of paying lump-sum compensation provides an incentive for people making claims to exaggerate their injuries and delay their rehabilitation, because it will increase the size of their payout.

This encourages fraud that all customers pay for in higher premiums, which is inherently unfair.

The solution is to change from a CTP scheme focused on lump-sum financial compensation to rehabilitation of injured people by introducing defined benefits – an approach that works successfully in other Australian jurisdictions.

The increased efficiency this creates would allow the introduction of a fully no-fault CTP scheme, meaning everyone injured in a motor accident in NSW would be properly looked after.

The result of this reform will be a scheme that is sustainable, affordable and fair.

## NSW CTP status quo versus reform to introduce full *no-fault/defined benefits*

	With reform	Without reform
Scheme efficiency	Potential return of more than 70% of premiums to injured people	Continue to return ~45% of premiums to injured people
Cost of premiums	Potential premium savings	Premiums will continue to rise above inflation
Legal costs	Substantial reduction in legal costs, particularly solicitor-client costs	Legal costs continue to rise and persistence of large solicitor-client costs
Settlement times	Faster due to a more streamlined claims process	Claims can take five years to settle, even minor claims take 1.5 years
Rehabilitation	Insurers focus on supporting rapid rehabilitation rather than establishing negligence and negotiating lump sums with lawyers	Recovery is hampered because the focus is on establishing negligence and negotiating financial compensation, rather than rapid rehabilitation
At-fault drivers	Everyone injured is covered regardless of who, or what, caused the accident	~7000 people injured in NSW motor accidents each year will continue to not be fully covered for their injuries
First party v third party	First party insurance will drive competition and allow customers to decide who manages their personal injury claim	Injured people will continue to deal with the other party's insurer

# Introduction

Australians value their wellbeing and spend billions of dollars each year purchasing health and personal-injury insurance.

These classes of insurance – many of which are compulsory for motorists and employers – are heavily regulated by governments.

Customers are right to assume that these regulations will work to maximise coverage and promote efficiency<sup>1</sup>, while remaining affordable and fair.

How would a customer feel if they discovered that the regulatory design meant that a compulsory class of personal injury insurance had the following characteristics?:

- it did not cover them if they made a minor error of judgment, meaning around a quarter of all injured people found their insurance policy did not cover them fully
- insurance premiums were going up when they could be going down because of improved vehicle and road safety
- efficiency was poor, with less than half of every dollar paid in premiums ending up in the pockets of customers who were injured and made claims
- a rapid recovery and early return to work was discouraged because a delayed recovery and 'soft fraud' resulted in a higher cash payout
- recovery was hampered and the claims process lengthened because insurance company employees spent most of their time negotiating with lawyers rather than facilitating a customer's rehabilitation
- customers were left significantly out of pocket, potentially for years, until their claim was finalised

- intermediaries such as lawyers and medico-legal specialists were routinely pocketing one-third, and as much as one half, of a customer's insurance pay-out
- widespread advertising by legal firms encouraged injured people to claim with the promise of a large cash reward
- a disproportionate amount of total payouts were going to people with very minor injuries
- insurers could make profits in excess of what was predicted when the premium rates were submitted to the government's pricing regulator
- a customer's claim would probably not be managed by the insurance company of their own choosing.

These characteristics can be used to describe the current state of a number of personal injury schemes, with the Compulsory Third Party (CTP) insurance scheme in New South Wales (NSW) being a particularly chronic example.

A solution that would address these issues can be found, but implementing such a reform is a difficult political task and the most recent attempt in 2013 was not successful.

The status quo has resulted in an increasing trend of soft fraud by injured claimants, high levels of insurer profit due to embedded cost volatility and the establishment of a large and profitable business for legal and medico-legal firms across the state.

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<sup>1</sup> A simple definition of the 'efficiency' of a personal-injury insurance scheme is the proportion of every dollar in premium that goes directly towards injured people.

# Background

The current NSW CTP insurance regulatory framework (referred to as the CTP 'scheme') has its origins in tort law.

The concept of tort law is to redress a wrong done to a person, usually by awarding them money as compensation.<sup>2</sup>

The implications are that CTP insurance policies only respond when the driver of an insured vehicle can be found to be negligent (responsible for causing the accident) and, as a result, someone else is injured.

The usual insurance claim process is that the injured person goes to a lawyer who puts forward a claim to the insurer, where they list details of the extent of the injured person's 'loss' and claim financial compensation.

The components of this list will generally include care, medical expenses, lost income (if unable to work), out-of-pocket expenses and a payment for pain and suffering (for more severe injuries).

This will add up to a claim for a lump-sum payment from the insurer.

The insurer and the injured person's lawyer will then negotiate the amount of the lump sum.

The negotiation process for settlement can be characterised by the lawyer presenting an unrealistically inflated demand, while the insurer provides an unrealistically low offer.

The bargaining continues over a period of months or years until a final figure is agreed – an amount that is generally much lower than the lawyer's initial demand and much higher than the insurer's initial offer.<sup>3</sup>

The insurer then sends a cheque to the claimant's lawyer, who deducts their legal fees and passes the remainder of the money onto the injured person.

## The consequences of lump sums

The design of the current NSW CTP scheme where lump-sum payments based on the determination of fault are the mechanism by which injured people are compensated, has a number of profound implications.

### Legal firm business model

The payment of lump sums directly impacts the business model of personal injury lawyers.

The total legal fees that a lawyer will charge an injured person often dramatically exceeds the amount that is prescribed by legislation to cover legal expenses for a CTP claim.

In addition to the prescribed amount of legal fees (known as party-party costs), a lawyer is able to charge an injured person solicitor-client costs.

This means that the lawyer is able to take a substantial slice of the money that is allocated to the injured person to cover their loss, meaning the injured person does not actually receive the amount their lawyer has been arguing they need and deserve.

Generally the injured person does not know how much of their lump sum will ultimately go to their lawyer until they are presented with the bill for solicitor-client costs, once the claim is settled.

This practice reduces the proportion of every dollar of premiums that ultimately ends up in the pocket of injured people.

In March 2016, the NSW Government released a CTP scheme reform options paper that stated "only 45 cents in every Green Slip dollar ends up in the hands of injured road users".<sup>4</sup>

There are no publicly-available statistics that detail the proportion of lump sums that ultimately go toward paying legal fees, including a breakdown of solicitor-client costs.<sup>5</sup>

<sup>2</sup> Investopedia, Definition of 'Tort Law', <http://www.investopedia.com/terms/t/tort-law.asp> accessed 3 June 2015.

<sup>3</sup> If no agreement can be reached the matter is sent to the CTP scheme's dispute resolution mechanism for arbitration.

<sup>4</sup> On the road to a better CTP scheme - Options for reforming Green Slip insurance in NSW, p.3.

<sup>5</sup> In October 2015 the NSW Government CTP regulator (SIRA) began collecting solicitor-client cost data. To date it has not been made public.

An individual claim managed by one of the Suncorp CTP insurance brands resulted in a payment to the injured claimants of \$650,000. Despite not ever going to court, the bill from a prominent legal firm was \$240,000 – 37 per cent of the lump sum.

In this instance, the injured parties stopped using this legal firm just before the claim was settled and became direct claimants. This allowed Suncorp to review the bill for legal fees, ultimately resulting in an \$80,000 payment to the legal firm.

The substantial amounts that legal firms have been able to extract from the lump sums paid through CTP insurance claims has seen growth in the personal injury legal services industry and extensive advertising by this industry.



## CASE STUDY

In 2012, a 4WD with eight passengers was hit from behind. Police attended the scene and recorded that “no persons were injured or conveyed to hospital”.

The two adults and six children in the vehicle all lodged claims via their lawyer. The final settlement for all eight claimants was \$285,000. Of this, \$175,000 went to the claimants and \$110,000 went to the lawyer.

The certified injuries of the six week old claimant were “very unsettled at night and vomiting”. The clinical findings stated the “medical exam was normal”. This claimant was paid \$25,000, of which \$15,000 went to the lawyer.

The certified injuries of the two year old claimant were “unsettled overnight”. The clinical findings stated “normal examination”. This claimant was paid \$25,000, of which \$15,000 went to the lawyer.



### **Delays, exaggeration and fraud**

By offering large amounts of cash in the form of lump sums and increasing the amount on offer as an injured person’s incapacity increases, there is an incentive for an injured person to delay rehabilitation, exaggerate injuries and submit fraudulent claims.

As noted, a large component of a lump sum payment is generally for future care, medical expenses and lost income, based on a projection of the likelihood they will be required and an estimate of how much they will cost in the years ahead.

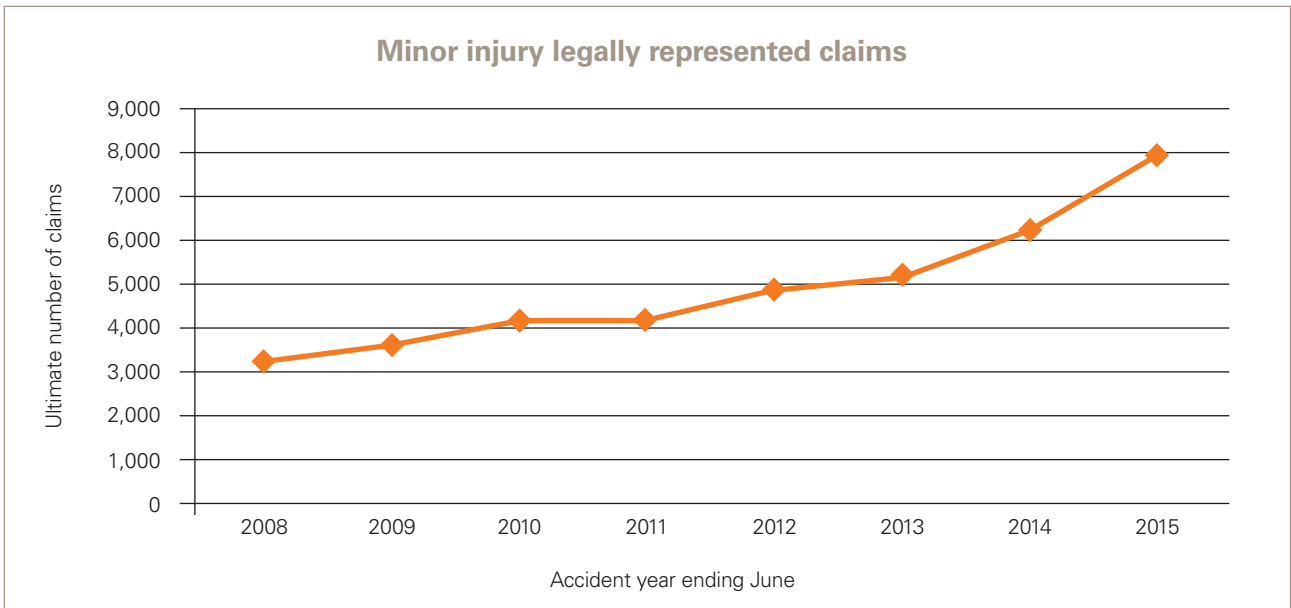
An injured person who goes back to work before their claim is settled will typically receive much less money than someone who remains off work and, on the basis they may not be able to work again, claims lost income for their future years of unemployment.

Someone who successfully exaggerates their physical and psychological incapacity can expect to increase the size of their lump sum.

Once they receive their lump sum, they are free to spend this money as they choose.

The impact of this is to effectively penalise those injured people who expedite their rehabilitation and return to work as quickly as possible, while rewarding those who delay their recovery, exaggerate their incapacity and submit fraudulent claims with large payments in cash.

As illustrated overleaf, NSW has recently seen a dramatic increase in legally represented CTP claims for minor injuries.



Source: On the road to a better CTP scheme - Options for reforming Green Slip insurance in NSW, p.11.

There has also been a rise in legally represented claims for people who have no physical injuries but have claimed for psychological injuries following a minor accident – particularly claims for children.

These factors are resulting in a spike in claims costs, which will contribute to increasing CTP premiums in NSW and exacerbate the issue of an excessive proportion of overall scheme cost being directed towards minor injuries.



## LUMP SUMS

### Windfall or Trojan horse for injured people?

Providing an injured person with a lump sum places the onus on them to manage this money in a way that will ensure it does the job it is designed to do, and lasts as long as it needs to last.

Pressure to divert the funds to other uses may arise, meaning the injured people will not get the treatment they need or have the necessary living expenses in the future.

An injured person who does not return to work as quickly as possible so they can maximise their pay-out, may find themselves inadvertently trapped in a state of unemployment.

While people who are off work for 20 days have a 70% chance of getting back to work, that figure drops to 50% for people off work for 45 days and only 35% for those off work for 70 days or more.<sup>6</sup>

<sup>6</sup> Johnson D, Fry T. Factors Affecting Return to Work after Injury: A study for the Victorian WorkSafe Victoria Authority. Melbourne: Melbourne Institute of Applied Economic and Social Research; 2002.

## Claim cost volatility and insurer profits

When insurers set their premiums, they have to predict what the claims will cost in the future.

CTP claims take an average of 630 days<sup>7</sup> to settle, which means these projections have to extend over several years when determining what price to charge for a CTP policy today.

If the future cost of claims is volatile, an insurer will increase premiums to account for the risk that claims costs will spike in the years ahead.

If future claims costs are relatively predictable, insurers do not have to add this 'risk premium' when they set their prices.

The lump-sum payments and escalating levels of legal representation – particularly for people with minor injuries – that characterise the NSW CTP scheme, make the future cost of claims volatile.

A legal precedent resulting in an increased lump-sum can quickly multiply across the industry as other lawyers replicate a particular claim for damages.

CTP insurers in NSW carry this risk. They have been consistently factoring this high level of claim-cost uncertainty into their pricing to cater for the need to pay all future claims.

In the past decade, NSW CTP claims costs have ultimately been below expectations, assisted by safer cars, safer road and effective safe-driving campaigns.

Dramatic spikes in costs have not occurred because there have been no significant legal precedents and wages and inflation have been lower than expected.

Insurers' profits have recently been on the 'right' side of the inherent claims cost volatility, but tomorrow they could be on the 'wrong' side and result in massive financial losses.

These factors have kept CTP prices relatively high in NSW when compared to other jurisdictions, despite some other states and territories providing more comprehensive cover.<sup>8</sup>

NSW CTP prices have risen more than 70 per cent since 2008. A recent State Insurance Regulatory Authority report on the NSW CTP scheme stated that "without reform, Green Slip premiums will continue to increase significantly more than the inflation rate each year".<sup>9</sup>

## The advantages of defined benefits

A well-established model exists that largely eliminates lump-sum payments and the inefficient distortions they create.

The 'defined benefits' model provides injured people with care, medical treatment and lost income as they require it, rather than a single cash payment based on future projections.

It is a model that currently operates in the Victorian CTP scheme and the NSW Workers Compensation personal injury insurance scheme.

For minor injuries, treatment and lost income is provided, but not indefinitely. A maximum time period of between two and five years (depending on the injury) can apply.

As a result, there is no incentive for an injured person to delay their rehabilitation or exaggerate their injuries. The incentive is to get better.

Injured people can still engage legal representation if they choose and this will be paid for by insurers on a fee-for-service basis, with limits placed on the proportion of claims costs allocated to legal fees.

Lawyers cannot take a slice of the money that is allocated to support an injured person.

<sup>7</sup> Average duration of Queensland CTP policies settled in 2014/15.

<sup>8</sup> Victoria, Tasmania and the Northern Territory have full no-fault CTP insurance schemes, meaning at-fault drivers are covered for their injuries.

<sup>9</sup> Compulsory Third Party 2014 Scheme Performance Report, State Insurance Regulatory Authority, November 2015, p. 5.



## “ — — ” REFORM IN THE UK

In the United Kingdom, the Cameron Government has implemented reforms to reduce fraudulent claims for minor motor vehicle injuries. In announcing the reform, Justice Minister Lord Faulks said:

“We are determined to crack down on the culture of fraud and exaggerated claims in the motor insurance industry, which means car owners are forced to pay higher premiums to cover the false claims of others. This culture is boosted by an industry that encourages exaggerated claims through cold calling and it is right that we tackle this.

“The government reforms are a significant breakthrough in tackling the UK’s compensation culture and are good news for motorists. Reforms to the Small Claims Track Limit and the end to cash compensation, for low value injuries, will help to bring down unnecessary costs in the motor insurance market and honest motorists should be the beneficiaries.”<sup>10</sup>

Following this announcement, shares in personal-injury law firm Slater & Gordon fell over 51.4 per cent.<sup>11</sup>

The law firm subsequently announced an \$814m write-down of the value of its UK assets.<sup>12</sup>

An additional benefit for injured people is that they receive payments for lost income immediately, rather than having to wait months, or years, for their lump-sum payment.

For people who are off work because of their injuries, being out-of-pocket for a long period while their lawyer and insurer negotiate the size of their lump sum can cause financial stress.

Insurance personnel do not spend most of their time in adversarial negotiations with lawyers but instead focus on supporting and co-ordinating a rapid recovery for the injured person.

Regardless of the severity of the injury, the longer a personal injury insurance claim goes on, the more it will cost.

Insurers have a strong incentive to provide maximum rehabilitation support as quickly as possible because they will directly benefit – as will the injured person, their family, employer and the community as a whole.

The net effect of moving from lump-sum payments to defined benefits is to increase the proportion of each dollar that goes to injured people, and allow a reduction in premiums.

All parties – insurers, injured people, employers and lawyers – have a strong incentive to work towards a rapid recovery and return to work.

Since defined benefits were introduced to the NSW Workers Compensation scheme in 2012, premiums reduced by 12.5% in 2013 and then a further 5% in 2014.<sup>13</sup>

<sup>10</sup> <https://www.gov.uk/government/news/insurers-vow-to-pass-on-whiplash-reform-savings>

<sup>11</sup> <http://www.smh.com.au/business/slater-and-gordon-plunges-44-per-cent-on-uk-injury-law-changes-20151126-gl8iwz.html>

<sup>12</sup> <http://www.abc.net.au/news/2016-02-29/slater-and-gordon-at-the-mercy-of-its-bankers/7207990>

<sup>13</sup> [http://www.workcover.nsw.gov.au/\\_data/assets/pdf\\_file/0019/19108/More-premium-cuts-on-the-way-for-business.pdf](http://www.workcover.nsw.gov.au/_data/assets/pdf_file/0019/19108/More-premium-cuts-on-the-way-for-business.pdf)



The savings that defined benefits would produce in the NSW CTP scheme would allow the introduction of a fully no-fault scheme, removing a risk that every person in NSW faces when they drive or ride a motor vehicle.

### **No-fault and compulsory first party**

One of the most dangerous things people in NSW do on a day-to-day basis is drive a car or ride a motorbike.

When they do have an accident and get injured many are horrified to learn that, despite having purchased both a CTP insurance policy and a Comprehensive Motor insurance policy, they are not covered for their injuries.

The reason is that NSW has an at-fault CTP insurance scheme, meaning that injuries to the driver of a vehicle are not covered by the CTP policy attached to that vehicle.<sup>14</sup>

It is a 'third-party' insurance policy and the driver is not a third party.

This absence of insurance cover for drivers is a huge gap in the NSW insurance landscape, and one that can have devastating consequences for individuals and their families.

It means that a driver who has a momentary lapse of judgement, or simply finds themselves in the wrong place at the wrong time, may well have to rely on Medicare and Centrelink to support their recovery.

Reforming CTP insurance into a no-fault scheme would extend full coverage to more than 7000 at-fault drivers who are injured every year in NSW.<sup>15</sup>

Everyone injured in a motor accident would be looked after – as occurs when someone crosses the border into Victoria.

Extending cover to this large cohort of injuries will increase overall claims costs, but the savings from the introduction of defined benefits would more than offset this increase.

The reforms proposed by the NSW Government in 2013 introducing defined benefits and a fully no-fault scheme were expected to also deliver a 15 per cent reduction in premiums.<sup>16</sup>

An additional benefit of a no-fault scheme is that it can provide customers with a guarantee that the insurance company they choose as their CTP insurer will manage the personal-injury claims of anyone in their vehicle, including the driver.

That guarantee cannot be provided with the current at-fault scheme, because all claims are managed by the insurance company of the driver who caused the accident.

A no-fault scheme would allow insurers to compete on the basis of their personal-injury claims service, as currently occurs in other classes of insurance.

Competition between insurers to attract and retain customers will drive innovation and higher levels of customer service for injured people.

**“ Overall, no-fault systems are likely to produce generally superior outcomes compared with fault-based systems. ”**

– Productivity Commission<sup>17</sup>

14 Drivers will be provided care for catastrophic injuries on a no-fault basis through the NSW Lifetime Care and Support Scheme and are able to access a maximum of \$5000 to cover medical expenses and lost income on a no-fault basis by lodging an Accident Notification Form (ANF).

15 Mike Baird, Treasurer and Minister for Industrial Relations speaking in NSW Parliament in relation to the Motor Accident Injuries Amendment Bill 2013, 22 May 2013.

16 Cheaper Green Slips for NSW motorists – media release issued by NSW Minister for Finance and Services, 8 May 2013 [http://www.maa.nsw.gov.au/\\_data/assets/pdf\\_file/0007/18709/Cheaper\\_Greenslips\\_for\\_NSW\\_Motorists1.pdf](http://www.maa.nsw.gov.au/_data/assets/pdf_file/0007/18709/Cheaper_Greenslips_for_NSW_Motorists1.pdf)

17 Productivity Commission Disability Care and Support – Productivity Commission Inquiry Report 2011, p.849.

## Productivity and statutory schemes

A statutory personal-injury insurance scheme removes or restricts an injured person's common-law rights to full financial compensation.

The primary purpose of having these rights removed or restricted by legislation is to avoid a situation where every injured person is taking the driver who caused the accident (represented by their insurer) to court.

This would be an extremely expensive and inefficient way for a community to manage an event that occurs more than 15,000 times every year in NSW.<sup>18</sup>

A statutory scheme restricts these rights in order to improve productivity and keep the cost of insurance affordable.<sup>19</sup>

The Productivity Commission's recommendations in regard to the National Disability Insurance Scheme (NDIS) referred to the increase in productivity that would result from the introduction of the NDIS.<sup>20</sup>

The objective of national disability reform was to create a system that is both affordable and fair.

The NDIS does not provide a 'gold plated' level of care but ensures that what is deemed reasonable and necessary is universally delivered.

The current NSW CTP scheme places some restrictions on the common-law rights of injured people, but remains highly inefficient.

Reforms that introduce defined benefits further restrict and remove the opportunity for injured people to claim a lump-sum payment, resulting in a scheme that focuses its resources on rehabilitation, rather than financial compensation.

This will reduce costs, putting downward pressure on insurance premiums.

More importantly, it can also be expected to lead to faster rehabilitation, which has a tangible positive impact on productivity.

This has been demonstrated by the 2012 reforms of the NSW Workers Compensation scheme, which resulted in a three per cent improvement in the return-to-work rate to 88 per cent – higher than the national average of 86 per cent.<sup>21</sup>

At a time when Australia's workforce is ageing, the productivity improvements that can be achieved by a more efficient personal-injury scheme are substantial.

Directing a far greater proportion of the \$2.2 billion<sup>22</sup> in annual premiums of the NSW CTP scheme towards helping injured people recover would assist the community and the economy.

18 There were 15,822 injury notifications in 2014/15. Motor Accidents Authority Annual Report 2014/15, p.5.

19 Professionals whose careers could be permanently impaired by a minor injury – such as a concert pianist – may be advised to purchase additional personal-injury insurance cover.

20 Why the NDIS makes economic sense - <http://www.everyaustraliancounts.com.au/ndis-makes-economic-sense/>

21 Safe Work Australia report for 2012/13, referenced in NSW Government media release: More premium cuts on the way for business – 17 June 2014.

22 Motor Accidents Authority Annual Report 2014-2015 p.4.

# Conclusion

The history of personal injury insurance has repeatedly shown that when schemes become inefficient, regulatory reform is the only real solution.

The recent reform of the British personal-injury insurance legislation has demonstrated this clearly.

The efficiency created by reform means benefits can be defined at generous levels, ensuring that those injured quickly receive all the necessary medical care and are not out-of-pocket for their lost income.

Benefits for those with severe injuries must be set appropriately, so they are not left having to fund ongoing medical expenses that are a direct result of the motor accident.

Time constraints for recovery from non-severe injuries need to be long enough to ensure that insurers invest in a rapid rehabilitation, rather than 'waiting-out' the claim to the detriment of the injured person.

The option to access legal advice and a robust, easily-accessible dispute-resolution mechanism are essential features, so injured people are able to verify they're receiving everything they're entitled to.

The savings that result when a CTP scheme moves from making lump sum payments to covering an injured person's expenses as they occur, are substantial.

These savings will allow the introduction of full no-fault cover, meaning everyone injured in a motor accident in NSW will be adequately covered.

The risk of financial ruin currently faced by everyone who gets behind the wheel of a car or on a motorbike, will be eliminated.

This multi-billion dollar insurance scheme can be transformed from an adversarial legal process focussed on lump-sum payouts to one that primarily directs its energy towards rehabilitation of injured people.

The result will be a fair, affordable and efficient CTP scheme that boosts productivity.

Change is never easy, but it is necessary.

# 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 across Australia and New Zealand. Suncorp has around 14,500 employees and relationships with over nine million customers.

