Insurance insights

STATES IN THE INJURY BUSINESS

The impact of privatising personal injury insurance schemes

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Introduction

An ongoing challenge for government policy is to change with the times. Policy settings that are necessary and effective in one era, may not be suitable in the next.

An important role for the state is to provide the economic framework and essential infrastructure to allow public and private enterprise to thrive.[1] Accessible and affordable insurance is part of this essential infrastructure. Without it, the community is more vulnerable to being devastated by misfortune.

Arguably it is the personal injury insurance classes that can have the most profound impact on people's lives. It is therefore understandable that motor vehicle and workplace accident insurance have such extensive and stringent government regulation.

This is entirely appropriate, as it ensures prices are affordable and injured people are dealt with fairly and receive adequate support. Personal injury insurance is a public good that requires strict government oversight.

What is more questionable is the need for governments to also be the provider of Compulsory Third Party (CTP) and Workers Compensation insurance – to be in the insurance underwriting business.[2]

Whilst monopoly state-owned enterprises are required when the private sector is unable to provide an essential service at an affordable price, that is not the situation in today's personal injury insurance market.

The private sector currently provides insurance in eight of Australia's 19 personal injury insurance schemes, accounting for around $5 billion in annual premiums.[3]

Operating as statutory monopolies, state-owned enterprises underwrite the remaining 11 schemes, collecting approximately $10 billion in premiums each year.[4]

The private sector has long had the capacity to underwrite schemes that are currently government enterprises, yet no schemes have transitioned from public to private underwriting since 1989.[5]

A recent PricewaterhouseCoopers (PwC) report has concluded that privatising Australia's statutory insurance schemes would potentially increase productivity and generate billions of dollars in additional economic output, resulting in significant tax revenue rises.[6]

The report concludes that privatised schemes have the ability to bring faster recovery times for injured people following an accident, reduce the burden on the health system and lower premiums in the long-run.

This paper raises the question of why so many governments continue to operate monopoly insurance businesses, and examines the impact of this policy upon customers, injured people and the economy.

1 *The Role of Government in Australia*, The Australian Collaboration, p. I

2 The terms 'publicly underwritten' and 'state-owned monopolies' are used interchangeably in this paper to refer to schemes where a government statutory authority is the sole provider of Workers Compensation or CTP insurance in a particular jurisdiction.

3 Each state and territory has one Workers Compensation and one CTP scheme, accounting for 16 schemes. The three national schemes are Comcare, Seafarers and the Military Rehabilitation and Compensation scheme (all Workers Compensation). This figure excludes companies that self-insure, which accounts for several billion dollars in additional annual costs.

4 Comcare and the Federal Government's Military Rehabilitation and Compensation scheme are publicly underwritten. Seafarers is underwritten by the private sector.

5 The South Australian Government has announced that its CTP scheme will transition to private-sector underwriting from 1 July 2016.

6 *Potential economic benefits of private underwriting of statutory insurance schemes – Non-catastrophic personal injury schemes*, PwC, November 2014. This report was commissioned by Suncorp.

Background

Australia's personal injury insurance schemes are currently a patchwork of private and public sector underwriting, with little by way of national consistency.

The distribution is such that it appears to have evolved more by accident than by design, with most jurisdictions having one publicly underwritten scheme and one privately underwritten.[7]

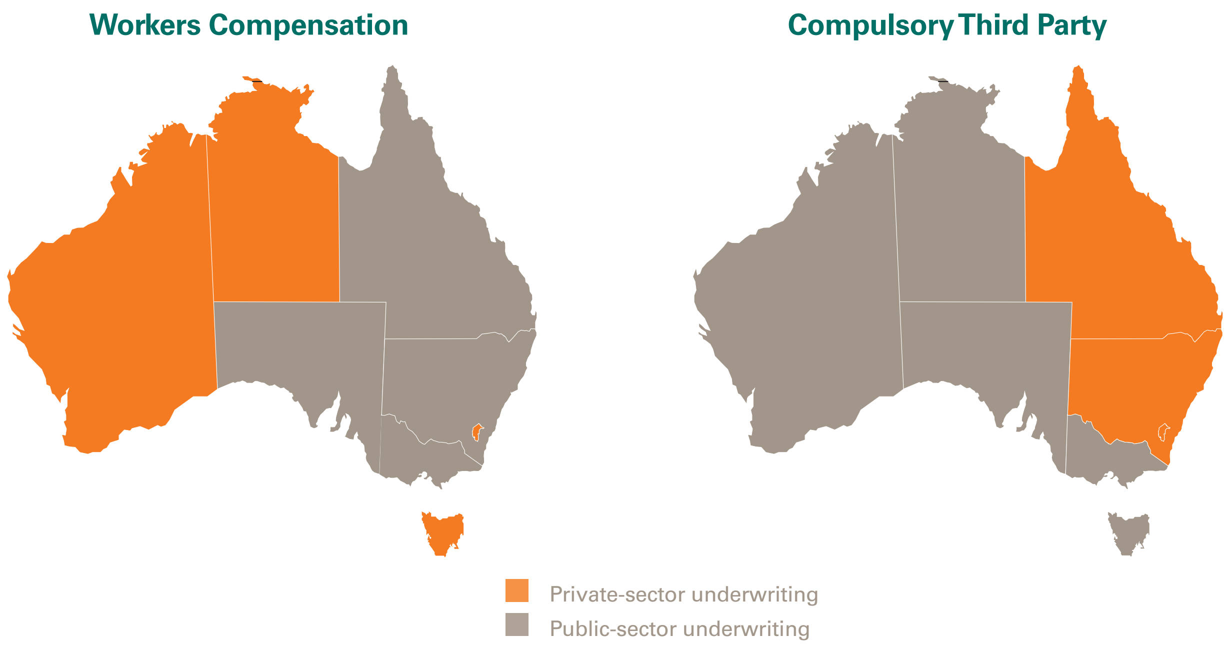
Some state-owned monopoly insurance operations elect to outsource the policy administration and claims management functions to the private sector. This means the government continues to set the price, bank the premiums and pay the claims.[8]

State-owned insurance enterprises

It may not be considered a glamorous industry, but insurance does provide a service that is essential for a caring and prosperous society.

Accidents do happen. A compassionate and necessary response is to help those affected so they can recover.

The rise of state welfare institutions in the 20th Century led many Australian governments to add the provision of personal injury insurance to their portfolio of public utilities, extending the benefits of insurance to the broader community.



7 In the Australian Capital Territory (ACT) both the Workers Compensation and CTP schemes are underwritten by the private sector. Victoria has both schemes publicly underwritten with Workers Compensation claims management outsourced. South Australia (SA) has both schemes publicly underwritten, with claims management outsourced for both. The SA Government has announced the CTP scheme will be privately underwritten from 1 July 2016.

8 Customers may assume incorrectly that their claims and policy manager is their insurer because that is who they communicate with, but the public underwriter is the actual insurer.

In subsequent decades, these government enterprises extended their business to include other general insurance products, often in competition with the private sector.[9]

As the 20th Century neared its end, governments began reconsidering the need to maintain these general insurance operations, when a regulated private sector could do the job.

Accordingly, much of the state-owned general insurance business was privatised.[10] Soon all jurisdictions, except the Northern Territory, had privatised their general insurance operations.[11]

However, this process tended not to include the personal injury classes of Workers Compensation and CTP, the bulk of which remain publicly underwritten.

Implications of the status quo

The experience in a number of industries has been that transitioning from a government monopoly to an open, competitive market brings positive change.

Whilst many qualitative arguments have been put forward advocating the privatisation of personal injury insurance schemes, little has been done to assess the quantitative economic impacts of such reform.

To address this, the Suncorp Group engaged PwC to assess the potential productivity and economic impact of having publicly-underwritten personal injury schemes transition to private-sector underwriting.

PwC report

Three case studies were examined by PwC: the New South Wales Workers Compensation scheme, the South Australian Workers Compensation scheme and the South Australian CTP scheme.

Drawing on previous Productivity Commission findings and using the Monash Multi Regional Forecasting Model, PwC concluded that privatising these schemes would increase economic growth, employment, productivity and tax revenue over a 10-year period.

Potential macroeconomic effects of privatisation by 2024-25, cumulative deviation from base case of no privatisation.[12]

	NSW Workers Compensation	SA Workers Compensation	SA CTP[12]
Real Gross State Product ($m)	3,067	530	308
Employment (persons)	804	194	95
Productivity ($GSP/worker)	691	531	311
Tax revenue ($m)	615	108	67

9 These general insurance products were primarily property insurance, such as Home, Motor, and business insurance.

10 For example, on 1 July 1926 the Government Insurance Office (GIO) came into existence in New South Wales (NSW). On 1 January 1992, GIO changed from a statutory authority to an incorporated company that was subsequently privatised. Source: NSW Government State Records.

11 The Northern Territory Government recently announced its intention to privatise its general insurance business, the Territory Insurance Office (TIO).

12 *Potential economic benefits of private underwriting of statutory insurance schemes – Non-catastrophic personal injury schemes*, PwC, November 2014, p.6

13 Productivity and other quantified economic benefits are lower for a CTP scheme than a Workers Compensation scheme predominately because some CTP claimants are not in the paid workforce. Faster return-to-work rates under privatised schemes would also benefit claimants who are not in the paid workforce, but these benefits are not captured in the PwC modelling.

These benefits flow predominantly from improvements in insurance capital management, better workforce participation and a reduction in the burden on the health system due to faster return-to-work rates for injured people.

PwC's modelling notes that the additional labour productivity and economic growth would be spread across several industry sectors.[14] Further, the majority of the increase in gross state product (GSP) expenditure would be directed to household consumption.[15]

As the PwC report demonstrates, the potential economic impact of privatising Australia's remaining state-owned personal injury schemes is substantial.

The NSW Workers Compensation scheme alone would increase NSW GSP by 0.48% or $3 billion over a 10-year period. This scheme accounts for approximately a quarter of the premiums collected by state-owned schemes nationally.

Oversight and financial risk

Publicly underwritten schemes are not subject to oversight from the Australian Prudential Regulation Authority (APRA), but insurers in the private sector are.

APRA supervision requires insurers to be 'fully funded', meaning they always have enough money put aside to pay all future claims.

The lack of APRA supervision for public-sector underwriters means these schemes can fall into deficit – when their financial assets are less than their liabilities.

This occurred in recent years in the NSW Workers Compensation scheme, when a $4.1 billion deficit was recorded.[16] For a private insurance company, this is the equivalent of trading insolvent.

The NSW Government was left in the difficult position of either having to increase premiums for employers or reduce benefits to injured workers, in order to fix the problem. They chose to reduce benefits.

The PwC report notes that the benefits of privatisation include the introduction of independent oversight by APRA, enhanced transparency, better capital management and a reduced probability that schemes will slide into deficit.

It goes on to state that there would be a reduced risk to government – and thus taxpayers – because the financial exposure associated with these schemes would be removed. This would protect the government's credit rating.[17]

14 *Potential economic benefits of private underwriting of statutory insurance schemes – Non-catastrophic personal injury schemes*, PwC, November 2014, p. 35-36, 48-49, 61, 64

15 *Potential economic benefits of private underwriting of statutory insurance schemes – Non- catastrophic personal injury schemes*, PwC, November 2014, p. 38, 52, 63

16 At 31 December 2011, the Independent Scheme Actuary calculated the deficit at $4.083 billion. NSW Workers Compensation Issues Paper p.7

17 *Potential economic benefits of private underwriting of statutory insurance schemes – Non-catastrophic personal injury schemes*, PwC, November 2014, p. 2

Competition

It is well established that when several providers of a product or service compete for market share, customers benefit. Insurance is no exception.

Competing insurers will continually seek to attract and retain customers by minimising the price, maximising the product offering and providing the best possible customer service.

In the Workers Compensation and CTP insurance classes, regulations stipulate that medical expenses and lost income must be paid to the injured person for their entire recovery period.[18]

Therefore, insurers have a strong incentive to act quickly in order to help people recover as soon as possible. A quick recovery is preferable for the customer, and it minimises the cost of the claim to the insurer.[19]

At the individual level, improved rehabilitation and return-to-work rates deliver a better outcome for the injured person and their families. But their communities and employers also benefit.

As the PwC report quantifies, improved productivity from faster return-to-work rates flows through to the broader economy.

The report states that in the competitive market of a privately underwritten scheme, it is reasonable to expect five per cent of injured people will return to work faster than in a publicly underwritten scheme.[20]

Competition also impacts customer service. The need for insurers to protect their brand reputation means issues and complaints are given urgent attention, particularly when these issues are publicised via written, broadcast and social media.[21]

Insurers will invest and innovate in order to improve efficiency and recovery rates for injured people, as this delivers them a competitive advantage with direct implications for their market position.

Scale

The global economy has numerous examples of how ‘economies of scale’ can increase productivity and reduce costs for consumers.

An argument that has been put forward in favour of maintaining state-owned monopoly insurers is that the market in a particular jurisdiction is too small to accommodate several private-sector insurers.

The reasoning is that if an insurer can only have a fraction of a small market, it’s not viable for them to operate, so they won’t.

The risk is that only one or two insurers will offer insurance in this market, meaning there will be insufficient competition to deliver benefits to customers.

However, Australia’s private sector insurers operate nationally, allowing them to generate economies of scale by operating in multiple jurisdictions.

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18 This assumes the injured people are covered by the policy. Payment can be made in advance in the form of a lump sum for future costs. For claimants with serious injuries, compensation beyond medical expenses and lost income is generally paid.

19 It is well understood in the personal injury insurance industry that providing injured people with high levels of rehabilitation support as quickly as possible generally reduces the length of the claim and the overall cost of the claim.

20 *Potential economic benefits of private underwriting of statutory insurance schemes – Non-catastrophic personal injury schemes*, PwC, November 2014, p. 33, 47, 59

21 An example of a claim that received wide publicity in broadcast and social media was Mr Nasser Zahr’s CTP claim with AAMI Insurance in 2014.

This is evident in the Workers Compensation schemes of Tasmania and the Australian Capital Territory (ACT), which are underwritten by the private sector.

Despite being small markets, both jurisdictions have seven insurers competing for business – all of which operate in multiple jurisdictions.[22] As in other privately underwritten schemes, price competition is fierce.

Increasing the number of schemes open to the private sector would allow Australia's insurers to realise further scale efficiencies, which ultimately benefits consumers.

Insurers that operate across Australia have an advantage over state-owned monopolies in their ability to achieve economies of scale and migrate innovative processes across state boundaries.

Regulation

An unregulated personal injury insurance market is not desirable. Strict controls will always be required to protect customers, injured people, insurers and the economy.

Workers Compensation and CTP are mandatory forms of insurance. They are essential for a productive economy and a fair society, so it's critical that they are appropriately licensed.

This government regulation includes setting minimum standards of care, prohibiting insurers from refusing to offer insurance cover and providing a mechanism to regulate the prices insurers can charge.[23]

The challenge for a government that is both the scheme regulator and the insurer is to resist pressure from the electorate to both reduce premiums and increase benefits to injured people. If they succumb to this pressure, the scheme risks falling into deficit.

Private-sector underwriting removes this challenge by providing a clear separation between the regulator and the activity being regulated.

This allows the government to set the benefit regime, oversee pricing via a robust approval process and provide an independent statutory ombudsman to arbitrate protracted disputes.

Personal injury insurance is an essential service and providing the community with this service is a privilege for which a provider must be licensed.

A regulator that is completely independent is best-placed to set the rules, enforce them and ensure that licensed insurers are conducting their operations in the public interest.

Catastrophic injuries

Whilst there are strong arguments against continued government underwriting of all personal injury insurance, the circumstances around the small number of accidents that result in catastrophic injuries are distinct.

Private insurers do have the ability to underwrite catastrophic injury claims, but the result is higher cost to customers and less desirable outcomes in terms of the provision of lifetime care for injured people.

Catastrophic claims are expensive and lengthy, meaning a private insurer must hold a large amount of capital for a considerable time to pay for the claim.

22 The insurers offering Workers Compensation in Tasmania and the ACT are GIO, QBE, Allianz, Zurich, CGU, Guild and CCI.

23 To ensure it is affordable for everyone, a degree of 'community rating' is needed in the price mechanism. Community rating effectively means low-risk customers subsidise high-risk customers. For more detail see *The Mechanics of Motor Injury Schemes*, Chris McHugh, October 2013.

Shareholders require an adequate return on this capital, and this is reflected in the cost to the customer.

Perhaps of more significance is that private insurers will pay a catastrophically injured person their financial compensation as a sizable lump sum in order to finalise the claim.

It can be very difficult for the injured person to estimate their care expenses for the rest of their life and manage this lump sum to match these needs.

Many people fail to do this successfully, and end up relying on public health and welfare to survive.

A far better outcome for the injured person is to be provided appropriate care and support by their insurer for as long as they live.

As this can be required for several decades, governments are best placed to underwrite this insurance and provide this care. This consolidates the small number of claims, which generates efficiencies.

A successful example is the New South Wales Lifetime Care and Support Authority, which has provided the template for the National Injury Insurance Scheme (NIIS).

Having the private sector provide an equivalent service to catastrophically injured people would be significantly more expensive for customers.[24]

Recent national disability reform has highlighted the need for all catastrophically injured people to be provided with adequate care for life.

As has been illustrated by the direction of the reform process, the public sector is the most efficient way to provide this particular service to the Australian community.

Transition

Implementing reform takes political will and inevitably carries a degree of risk.

For governments wishing to realise the economic benefits of transitioning their personal injury schemes to private sector underwriting, the experience and regulatory models of other jurisdictions can be drawn upon to reduce this risk.

For private-sector insurers, the barriers to entry under an appropriately designed and regulated scheme are minimal.

Australia's insurers already have the skills, systems and processes required. It is simply a matter of extending their existing operations to an additional scheme.

The benefits of competitive pricing, best-practice claims management and a focus on customer service can be provided without delay.

National disability reform is prompting governments to examine their personal injury schemes, improve cover for catastrophic injuries and increase alignment between jurisdictions.

This process provides an ideal opportunity for legislators to ask themselves if they wish to continue operating state-owned insurance enterprises.

24 For more information about lifetime care schemes see *Beyond Fault: Progressing to universal no-fault insurance for catastrophic motor injuries*, Chris McHugh, June 2014.

Conclusion

A vibrant and prosperous society requires a strong, well-resourced government to protect the interests of the public.

When circumstances require it, establishing government enterprises to provide essential services is appropriate.

However, when the private sector can deliver better outcomes for customers, injured people and the economy, it is difficult to justify maintaining state-owned monopolies.

The appropriate role for government in today's personal injury insurance schemes is to be an independent regulator of the private sector, allowing a competitive market to increase productivity and maximise value for the community.

Governments set the rules, regulate the pricing and arbitrate intractable disputes. APRA ensures that insurers do not become insolvent, providing stability and security.

Australia's patchwork of publicly and privately underwritten personal injury schemes tells a story of an incomplete process of reform.

Reinvigorating this reform process has the potential to deliver billions of dollars in additional economic output, increase employment and improve return-to-work rates for injured people.

The path of transition from public to private underwriting is already familiar to many governments, minimising the complexities of such a process. The risks are few and the benefits are many.

The nation's political leaders have demonstrated their willingness to act in order to improve the lives of people with disabilities and catastrophic injuries.

What remains is to build on this momentum and complete the transformation of Australia's personal injury insurance landscape.

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 around 14,500 employees and relationships with over nine million customers.

Suncorp Commercial Insurance (CI) provides a wide range of business insurance products to small and medium sized businesses as well as corporate customers. These products are distributed nationally both directly and indirectly through intermediaries. CI provides workers compensation insurance in Western Australia, the Northern Territory, the Australian Capital Territory and Tasmania, and operates in the managed fund scheme in New South Wales. CTP insurance is provided in New South Wales, the Australian Capital Territory and Queensland.

CI offers a wide range of insurance products and distributes them under the Suncorp, Vero, GIO, AAMI and Resilium brands.

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