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Thank you for the time today.

In response to some queries

1. Regarding how we might change the state-based CTP Schemes. My recent submission to the NSW Scheme is attached
  2. Regarding activities by insurers in Australia to encourage safety through technology
    - On telematics insurance.
      - QBE tried a telematics product but discontinued it  
<https://www.afr.com/companies/financial-services/why-qbe-put-the-brakes-on-its-smart-driving-unit-20180627-h11x48>
      - Mozo did a recent review of <https://mozo.com.au/insurance/car-insurance/guides/black-box-car-insurance> mentioned UbiCar and Youi
        - But UbiCar has since closed <https://ubicar.com.au/>
      - A new business has just been launched that uses telematics for rideshare drivers  
<https://www.rideprotect.com.au/>
      - Note: Telematics is often used for fleet management
    - IAG offer <https://saferjourneys.com.au/> which is telematics but I don't think it is linked to insurance
    - Other factors
      - NRMA offered a discount for autonomous emergency braking (referred to in Insurance and Road Safety report). I don't know current status
  3. On the evidence of the impact of rate regulation on insurance costs and safety
    - a. The Insurance and road safety paper (Appendix 3 last paragraph) documents some of the evidence
    - b. A more recent paper that reviewed the evidence is :  
Schwarcz, D. (2018). Ending Public Utility Style Rate Regulation in Insurance. Yale Journal on Regulation, 35(3). (p. 943). <https://digitalcommons.law.yale.edu/yjreg/vol35/iss3/7/>  
Which concluded  
*Extensive economics research suggests that these forms of insurance rate regulation are not in the public interest. In study after study, economists have documented that property-casualty insurance markets often flourish when states deregulate rates, and tend to experience limited success under many aggressive forms of rate regulation.*
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**Submission in response to the  
Statutory Review of Motor Accident Injuries Act 2017: Discussion Paper**

## Summary

Thank you for the opportunity to provide feedback on the Discussion Paper for the review of the *Motor Accident Injuries Act 2017* (the MAI Act).<sup>1</sup> I believe this review is an important opportunity to evaluate the role of insurers in managing the issues associated with motor vehicle accidents.

I wish to raise the following key points.

1. Motor vehicle insurers can have a very significant role in preventing death and injury; however, this is not reflected in the current legislation.
  - The MAI Act does not include an objective to encourage safe road-use.
  - Rather, the legislation does the reverse. It reduces the incentives and flexibility for insurers to innovate and improve road safety.
  - The consequences are severe and, conversely, the opportunity is great.
    - Reforming the insurance market appears to be the most significant, efficient means of improving road safety
    - Consistent with international evidence, insurance reforms aimed at improving road safety would also reduce claims costs and average insurance premiums.
2. There are issues with, and opportunities related to, the affordability objectives.
  - There is no objective measure of affordability. It is possible to compare the financial cost to transport users. On this basis, there are significant issues and opportunities.
  - The current scheme has interpreted the affordability objective in a way that requires the lowest-risk policy holders subsidise the highest risks. This interpretation:
    - has not been justified or tested through public consultation
    - has perverse implications – in effect, it involves subsidising high-risk activity
    - has significant adverse consequences for road-safety, scheme complexity, and average premiums.
  - Alternative interpretations/approaches appear practical that would address the adverse consequences without disadvantaging an age group (or other identifiable group of concern).

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<sup>1</sup> I make this submission as a private individual. I am a Director with the consulting firm Sapere ([www.srgexpert.com](http://www.srgexpert.com)) and an Adjunct Senior Lecturer with the Institute of Transport and Logistics Studies, the University of Sydney Business School. Of relevance to this review, I have experience and expertise in policy and regulation with respect to general insurance and have undertaken research on the potential for insurers to influence road-safety outcomes. My experience includes projects undertaken for the (then) NSW Motor Accidents Authority on matters relevant to this review.

3. Good practice has not been followed in developing much of the policy and regulation.
- Regulation have been designed and worded to address symptoms rather than underlying issues.
  - There is no evidence that consideration has been given to the abundant international literature on the effectiveness of motor vehicle insurance regulation.
  - Consistent with good practice policy development, the review would benefit from:
    - clearer articulation of the underlying problems
    - broader consideration of alternatives
    - leveraging international experience and research.

I expect, addressing the above points would lead to a much simpler and effective regulation, with better outcomes (most significantly less road trauma but also lower costs).

In the following sections, I elaborate on the first two points, provide a summary of recommended changes, and provide direct responses to relevant questions contained in the Discussion Paper.

I have also attached a research paper I have authored titled *Insurance influence on road-safety* (hereafter, the Attached Paper). This provides further background, literature, and analysis. The paper also includes indicative estimates of the road safety benefits of reforming motor vehicle insurance in Australia.

I would be happy to provide additional information on request.

Dr Richard Tooth

# 1 Key considerations and recommendations

## 1.1 Insurance and road safety

### **Insurers can do a lot to prevent road death and injury**

An important starting point for this review is to consider the potential role of compulsory third-party liability motor vehicle insurance. The role of insurers extends beyond that of pooling risk, and funding and managing claims.

Insurers can have a substantial role in preventing death and injury by influencing whether, what, and how people drive. For example, in the interests of reducing their expenditure on insurance people may choose not to drive, drive more carefully, and select vehicles or vehicle features that are cheaper to insure.

For a long time, motor vehicle insurers have rewarded safe driving with no-claim discounts and encouraged safer driving by requiring claimants to pay an excess.

The significance of what insurers can do has been increasing due to advances in technology. For example, the capability of insurers to influence how we drive and how much we drive has changed markedly with the introduction of telematics, in-vehicle technology that can be used by insurers to monitor vehicle usage. This has led to usage-based insurance (UBI) products whereby insurers offer policyholders rewards for driving less and more safely. With telematics, insurers can monitor, and reward, policyholders based on factors such as speed, breaking, acceleration and time of use.

Insurers can also reward customers for driving safer vehicles and using better safety features. For example, in the United Kingdom (UK), motor vehicle insurers provide substantial discounts to young drivers for driving vehicles equipped with autonomous emergency braking.

Furthermore, the liability for costs, encourages insurers to take a risk-based approach, whereby greatest encouragement for risk reduction is provided to the highest risk drivers. For example, in jurisdictions where UBI is common, it is predominantly sold to young drivers and other high-risk groups.

The Attached Paper provides a more detailed discussion and evidence of the influence of insurers on whether, what, and how people drive.<sup>2</sup>

### **The importance of the regulatory environment**

The incentive and ability of insurers to influence road-safety depends on the regulatory environment.

In most developed countries (including the United States, UK and other and other countries in Europe), vehicle owners purchase a single vehicle insurance product that includes

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<sup>2</sup> It also provides (Appendix 1) a discussion of the advantages of insurers (relative to a government body) in managing road safety.

(optional) vehicle damage cover and a compulsory level of third-party liability cover. With few exceptions, insurers in these jurisdictions are free to set insurance premiums based on their assessment of risk.

In NSW and other Australian jurisdictions, the regulatory environment is such that vehicle owners take out two broad types of insurance: insurance to cover property damage (commonly referred to as motor vehicle insurance), and compulsory third party (CTP) insurance to cover the human costs of road crashes. Consequently, customers may have insurance policies with two different companies, and the incentives for insurers to reduce crash risks are split.

The pricing of CTP insurance is heavily regulated, and some claims costs are shared. As a consequence of these measures, insurers in NSW have significantly less incentive and flexibility to encourage safe road use among their insureds.

Relative to a system in which premiums vary with the expected cost of claims, the rate regulation in NSW (and other Australian jurisdictions) has the effect of increasing premiums for the low-risk drivers (i.e. those with a low expected-claims cost) and reducing premiums for high risk drivers. As the schemes are designed to recover costs, the effect is to tax safe road-uses to subsidise unsafe road-uses.

### **Rate regulation is not in the public interest**

There is substantial international evidence that stringent rate regulation (such as that employed in NSW and other Australian jurisdictions) leads to worse outcomes.

There have been many studies analysing the effectiveness of insurance rate regulation, in particular from the United States where there is a variation in regulation across the many states and territories. On the topic of rate regulation, the results of this research appear conclusive. As US Law Professor, Daniel Schwarcz summarises in a recent paper<sup>3</sup>:

*Extensive economics research suggests that these forms of insurance rate regulation are not in the public interest. In study after study, economists have documented that property-casualty insurance markets often flourish when states deregulate rates, and tend to experience limited success under many aggressive forms of rate regulation.*

The findings of similar research include that rate-regulation leads to 'higher insured loss costs and in the end, higher premiums overall'.<sup>4</sup>

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<sup>3</sup> Schwarcz, D. (2018). Ending Public Utility Style Rate Regulation in Insurance. *Yale Journal on Regulation*, 35(3). (p. 943).

<sup>4</sup> Mary Kelly and Si Li. (2008). *The Impact of Rate Regulation on the Performance of the Canadian Property/Casualty Insurance Industry*. Wilfrid Laurier University Working Paper. (pp. 2–3)

These findings are also consistent with opinion of industry experts. A 2013 American survey of 161 members and former members of the American Risk and Insurance Association concluded that:<sup>5</sup>

*expert opinion strongly favors the idea that auto insurance prices should closely reflect a driver's accident risk and be determined by competitive market forces.*

## **The potential benefits of reform**

In the Attached Paper, I provide estimates<sup>6</sup> of the road-safety benefits across Australia of moving to a regulatory model similar to that in the UK, whereby motor vehicle insurers can bundle CTP and motor vehicle policies, are liable for costs, and are free to price according to risk. The estimated benefits in terms of reduced death and injury are substantial – around 7 per cent of the current road toll, which in NSW would equate to an annual reduction of 20 fatalities and 750 serious injuries.<sup>7</sup>

Of note, the incentives for insurers in the UK and other international jurisdictions to manage road safety are still less than optimal. Incentives for insurers to prevent road crashes come (primarily) from their liability to pay for claims. For vehicle damage, the claims liability relates to the cost of repair or replacement and thereby aligns closely to the value of preventing the crash. However, when considering risks to humans, the societal value of prevention is typically much greater than the claims liability. For example, the societal value of preventing a random road fatality used by Transport for NSW in evaluating investments is in excess of \$7 million<sup>8</sup> but the average claims costs associated with a fatality are around \$0.5 million.<sup>9</sup>

It appears feasible to align the incentives of insurers for road-safety with that of society.<sup>10</sup> Doing so would lead to a very substantial increase<sup>11</sup> in the interest of insurers in reducing

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<sup>5</sup> Insurance Research Council, *News Release: Expert Views of Auto Insurance Rate Regulation*. 21 August 2013. Available at <http://www.insurance-research.org/research-publications/expert-views-auto-insurance-rate-regulation>.

<sup>6</sup> The analysis aimed to provide unbiased estimates, based on the best available evidence. The paper (which includes the assumptions used for modelling) was provided for feedback to multiple road-safety researchers and stakeholders. No material concerns have been raised with the analysis. Nevertheless, there are many forecasting challenges, and the estimates should be considered indicative.

<sup>7</sup> In 2020, there were 297 lives lost on NSW roads and 10,806 serious injuries. Source: <https://roadsafety.transport.nsw.gov.au/statistics/index.html>

<sup>8</sup> The societal value of preventing a random road fatality is estimated from people's willingness to pay (either observed, or in response to surveys) to avoid small risks to life. The value used by Transport for NSW is published in Transport for NSW, *Transport for NSW Economic Parameter Values*. June 2020 | Version: 2.0, (pp. 28-29).

<sup>9</sup> The average claims payment for maximum severity claims in Queensland (which is primarily fatalities) was \$457,757 in 2017-18. Source, *Motor Accident Insurance Commission Annual Report 2017-18* (p. 28).

<sup>10</sup> There a range of possible models. For example, a model may involve a combination of penalties, rewards and rebates such that the average cost of insurance by age-group does not increase.

<sup>11</sup> I estimate that if insurers' financial incentives to prevent road-crashes in Australia were increased to match the societal value of prevention, their financial interest in preventing road-crashes would increase (roughly) by a factor of four and their financial interest in preventing road-crashes that cause death and injury would increase (roughly) by a factor of ten. See the Attached Paper (pp. 2-3).

death and injury. Accordingly, we would expect a large increase in innovation and activity by insurers to encourage road-safety and see greater road-safety benefits than simply adopting the UK regulatory model. I also model these benefits in the Attached Paper.

I have raised the potential for such reforms with multiple parties. The key concerns to changing incentives relate to the impact on affordability, which is discussed below.

## 1.2 Affordability

### Affordability is a vague measure

Affordability is a common stated objective of Government policy relating to insurance. However, it is a vague term that lacks an objective definition.<sup>12</sup>

Clearly, affordability relates to the cost of insurance premiums and that, all else being equal, it is desirable to have lower insurance premiums.

However, some affordability goals can involve trade-offs, whereby premium reductions for some policyholders are achieved by making others worse off. A simple example is that the regulation that limits the variation in premiums results in higher premiums for low-risk drivers. Given the potential trade-offs, it is important to be clear as to the reasons for, and implications of, any affordability objectives.

### The current interpretation of affordability has severe negative consequences

The *2015 Report of the Independent Review of Insurer Profit within the NSW Compulsory Third Party Scheme*<sup>13</sup> (hereafter the Matthews Report) provides additional insight into how affordability was considered within the (then) Motor Accidents Authority (MAA). It states (p. 8) that (emphasis added):

*... the MAA clarifies that one of its aims is to ensure that premiums are as affordable as possible for all NSW vehicle owners, **including those with the highest risks**. This is implemented through the MAA's regulation of CTP premiums, by constraining insurers to pricing within a predetermined band, **thereby requiring the lowest risk policyholders to cross-subsidise the highest risk policyholders**.*

The MAA's interpretation of the affordability objective relating to the highest risks has severe consequences.

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<sup>12</sup> The lack of clear definition and objective measure of 'affordability' has been raised in multiple government reports in Australia and overseas in connection with motor insurance and other types of general insurance. A key issue is that the cost of insurance is in large part determined by consumer choices. For example, in the absence of regulation, the cost of insurance will depend on the value and type of vehicle chosen and how it is driven.

<sup>13</sup> Available at <https://www.sira.nsw.gov.au/resources-library/law-and-policy-or-corporate/publications/Report-of-the-Independent-Review-of-Insurer-Profit-151015.pdf>

The interpretation drives much of the scheme complexity. As reflected in the quote, it drives the cross-subsidies implemented via the bonus/malus structure. These cross-subsidies create uncertainty for insurers (as to the mix of business)<sup>14</sup> which (I would expect) is a contributor to conservatively higher pricing by insurers. The cross-subsidies also drive the need for the risk equalisation adjustment and the requirement for insurer to write policies for 'all comers'. These regulations create a barrier to innovation (as I note above) and thus may have contributed to additional compensating regulation to attempt to stimulate innovation. Such regulations are also likely to be perceived as a barrier to entry that reduce competition.<sup>15</sup>

Most significantly, the regulations that stem from the interpretation of affordability remove the incentive and ability for insurers to proactively reduce the risk of death and injury from motor vehicles. As a result, lives have been lost and ruined and people have paid more for their insurance.

### **There is no public-stated rationale or analysis for the current interpretation of affordability**

Despite the significance of the MAA's interpretation of affordability with respect to high risks, there is no publicly stated rationale or analysis of the interpretation. Rather, it appears the policy of cross-subsidisation has simply been accepted without question.

The MAA's interpretation and implementation of affordability with respect to high risks might be questioned from a number of perspectives. These include the implications for road-safety and average premiums noted above. They also include the perspective of affordability itself. For example, implications of the current approach include that it *increases* the cost of insurance for those:

- who purchase safer and less aggressive vehicles
- who drive less
- who drive within the speed limit
- who drive less aggressively
- who drive at less dangerous times.

To my knowledge, the MAA/State Insurance Regulatory Authority (SIRA) has not:<sup>16</sup>

- conducted any (objective) analysis (including costs and benefits) on the implications of its affordability interpretation
- consulted with the public on the interpretation and its implications.

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<sup>14</sup> See Matthews Report (section 2.2.1).

<sup>15</sup> See Matthews Report (section 3.2.2).

<sup>16</sup> The statement also applies to other Australian third-party liability schemes. Of note, the Queensland Motor Accident Insurance Commission conducted customer research (noted in the 2012-13 Annual Report), which purported that consumers were against relaxing the pricing limitations. However, the survey was framed to suggest that doing so would reduce affordability (despite the international research that price regulation leads to higher premiums).



## Reasons to be concerned with 'affordability'

Given the significance, and lack of objective definition, of the 'affordability' to the scheme design, it useful to consider the rationale for its consideration.

My summary assessment as to reasons to be concerned with 'affordability' is as follows.

First, we may be concerned that, if premiums are too high, people will drive uninsured. While this is a valid concern, the issue does not appear significant. My assessment (based on research I've conducted) is that variations of rates in non-insurance across jurisdictions primarily vary with the enforcement approach and do not vary materially with insurance premiums. Furthermore, the increased deployment of Automatic Number Plate Recognition cameras should mean the risk of this issue should fall.

Second, high premiums may be a symptom of some inefficiency. This appears to be the rationale behind the sub-objectives in Objective d) (relating to profits and limiting benefits to minor injuries). In such cases, it is good policy practice to clearly articulate and target the underlying problem. That is, it is appropriate to target the cause and not the symptoms.

Third, we may be concerned with the cost of insurance for specific groups. In the absence of addressing an efficiency, this invariably involves a cross-subsidy whereby the premiums for one group are reduced at a cost (either through higher premiums or taxes etc) imposed on another.

A possible rationale for a cross-subsidy is to support disadvantaged groups (ie, provide welfare). However, regulating insurance premiums does not appear to an effective or efficient approach to addressing welfare concerns. For example, to address concerns of affordability for young or old people it would efficient and straight forward to provide subsidies based on age.

Another argument is that high insurance premiums may become a barrier to some people driving.<sup>17</sup> With risk-based pricing, an individual's insurance premium may be high because insurers assess that the individual/ vehicle is high risk. This may lead to high-risk individuals (eg, the very old) choosing not to drive because the costs of doing so outweigh the benefits they receive. This is generally a good outcome – in effect, the insurance premium is providing a signal to the individuals that the societal cost of their road use activity is high.

Conceivably, the premiums for some customers may be very high due to a lack of competition. However, such situations appear unlikely. My understanding is that there are no material (non-regulatory) barriers to insurers offering cover to any location of market in NSW.<sup>18</sup>

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<sup>17</sup> A policy of capped premiums plus a requirement to take all-comers is a means of addressing such concerns. However, there are alternative approaches including the use of targeted subsidies and residual insurance markets.

<sup>18</sup> See discussion in the Mathews Report.

There may be situations where there are additional societal benefits to some high-risk individuals driving. For example, there can be societal benefits to young people driving so they have more work opportunities, particularly in non-metropolitan areas where public transport is more limited. However, in such situations it would be more efficient and effective to provide targeted subsidies based on age.

### **Addressing affordability concerns**

As reflected in the discussion above, average premiums can be reduced by focussing on inefficiencies, most substantially by reducing the frequency and severity of road accidents.

There does not appear to be a compelling argument for continuing the current cross-subsidies that (as I estimate) lead to worse road-safety outcomes and higher average premiums. Nevertheless, to gain acceptance of change it may be desirable to maintain some form of cross-subsidy (at least for a transition period). In this regard possible reform scenarios are:

- begin with reforms to the commercial vehicle sector, for which there should be fewer affordability concerns
- replace the existing cross-subsidies, with age-based subsidies. For an interim period, these could be established based on claims costs estimates. Potentially, these could be implemented through a rebate system and established so as to not encourage driving over other forms of transport.

In assessing affordability concerns, it is also appropriate to consider the role of insurers alongside other means of regulating road use. For example, other road-use regulations appear to disproportionately impact poor households.<sup>19</sup>

### **1.3 Recommend changes**

In summary I recommend the following.

First, an objective should be introduced to 'encourage safe road use'.<sup>20</sup> I expect such an objective should not be controversial; rather, I expect that, given the significance of road safety as a societal issue, that there would be public support for such an objective. Such an objective should also not materially conflict with other reasonable policy goals, rather it:

- can be independent of how financial support, treatment and care are provided and the issue of early resolution of claims
- would complement the goal of improving affordability by reducing average premiums
- can be largely independent of matters relating to fraud, and collection and use of data

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<sup>19</sup> See for example, 'The Hidden Punitiveness of Fines' by Quilter and Hogg <https://www.crimejusticejournal.com/article/view/914>

<sup>20</sup> This might be alternatively expressed as 'encouraging efficient prevention of road accidents'.

- would lead to improved competition and innovation.

Second, the interpretation of, and policy relating to, affordability should be revisited. The current interpretation involves subsidising policyholders for poor decisions regarding whether, what and how they drive; decisions that contribute to greater road trauma and higher average premiums.

A review of the affordability objective should consider a breadth of factors including the range of options (including rebates based on age etc), the international experience, and the context of other costs imposed upon road-users.

I expect that (with rare exception) all drivers will be able to reduce their road-risk and in doing so keep their insurance premiums affordable. Nevertheless, it appears practical to design the scheme so that groups (identified by characteristics such as age and region) are not materially worse off. Transitional arrangements might also be considered.

Third, following on from the above, unnecessary rules and regulations should be removed. I expect this will involve removing regulations pertaining to:

- some licence conditions
- profit regulations
- the bonus/malus scheme
- the risk equalisation mechanism.

Fourth, following on from the safety objective, consideration should be giving to aligning insurer incentives for road-safety with that of society.

## 2 Responses to discussion paper questions

### 2.1 Objective (a) – To encourage early and appropriate treatment and care to achieve optimum recovery of persons from injuries sustained in motor accidents and to maximise their return to work or other activities.

I have no comments regarding this objective.

### 2.2 Objective (b) – To provide early and ongoing financial support for persons injured in motor accidents.

I have no comments regarding this objective.

### 2.3 Objective (c) – To continue to make third-party bodily insurance compulsory for all owners of motor vehicles registered in New South Wales.

#### **32. Does this objective remain valid?**

Yes - This objective appears valid.

There are strong arguments for compulsion. In most jurisdictions some level of motor third-party liability insurance is compulsory.<sup>21</sup> A key underlying issue is that vehicle owners can have insufficient incentive to take-out insurance because they can be 'judgement proof' against a large claim.<sup>22</sup>

Conceivably, some owners (individual or businesses) could self-insure. However, the benefits of this appear light.

#### **33. Are the terms of the Act, Regulations and Guidelines appropriate for securing this objective? If not, then in what respects and to what extent are those terms not appropriate for securing this objective?**

No comment.

#### **34. What is the evidence that the Scheme is, or is not, achieving this objective?**

No comment.

#### **35. What changes (if any) should be made for the Act, Regulations and Guidelines to secure, or better secure, this objective?**

No comment.

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<sup>21</sup> There are some exceptions. For example, Car insurance is not required in the New Hampshire, United States.

<sup>22</sup> That is, where at-fault party has insufficient assets to cover their liability. Other concerns are that drivers underestimate their risk and that a lack of insurance may lead to a lack of reporting.

## 2.4 Objective (d) - To keep premiums for third-party policies affordable by ensuring that profits achieved by insurers do not exceed the amount that is sufficient to underwrite the relevant risk and by limiting benefits payable for minor injuries.

### 36. Does this objective remain valid?

I have several concerns with this objective. In summary these are:

- The objective specifies a vague outcome. As discussed earlier, there is no objective definition of affordability.
- The objective is limited in how the outcome is to be obtained. There are other means to improve affordability. This is discussed in response to question 40 below.
- The methods to achieve affordability are poorly described and do not reflect the underlying issues.
- There does not seem to be a need for an ongoing objective and regulation pertaining to insurer profits.

#### *The methods to achieve affordability are poorly described*

Seemingly high profits are a symptom of an underlying issue. As described in the Matthews Report, the excessive profits that have been observed are most likely the result of conservatively high insurance pricing due to uncertainty over longtail claims costs. Consistent with this perspective, the profit measures (both transitory measures and section 2.2.5) include both a *lower* and upper bound on profit.

Similarly, large benefits payable for minor injuries is not an issue in itself.<sup>23</sup> Rather, I understand the reason for limiting the benefits payable was to improve the efficiency of the claims process by reducing dispute resolution costs and simplifying the claims process.

#### *The need for the insurer profit regulation*

The need for the insurer profit regulation was considered by the SIRA Board in 2017.<sup>24</sup> The Board found general acceptance of transitional measures but noted that insurers were resistant to long-term measures on the basis that 'profit normalisation may drive mediocrity by reducing the incentive for insurers to invest in efficiencies and innovation'. Nevertheless, the Board recommended that profit normalisation measures be 'maintained as a reserve power to be available to SIRA after transition. It would then be used if scheme experience warranted it at the time.'

My expectation is that, given the other 2017 reforms to reduce the claims cost uncertainty,<sup>25</sup> the profit measures are no longer required. My key concerns are that the profit measures

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<sup>23</sup> If there were no impact on behaviour, the impact of large benefits is simply to transfer wealth.

<sup>24</sup> These State Insurance Regulatory Authority Board. *Reforming insurer profit in compulsory third party (CTP) motor vehicle insurance*. January 2017 <https://www.sira.nsw.gov.au/resources-library/law-and-policy-or-corporate/publications/Reforming-insurer-profit-in-the-CTP-Green-Slip-Scheme-Broad-Report.pdf>

<sup>25</sup> Of note, the SIRA Board recognised as relating to uncertainties over longtail claims.

necessitate additional regulatory burden that hinder innovation and competition and add additional cost. I recommend this risk be fully and appropriately evaluated before retaining the profit measures. Regardless, if uncertainty was still considered an issue it would be more appropriate to consider reforms that address the uncertainty (the underlying issue) rather than profits (the symptom).

I note that the MAI Act (clause 1.3 (3) (d)) states:

*that insurers, as receivers of public money that is compulsorily levied, should account for their profit margins, and their records should be available to the Authority to ensure that accountability.*

In my opinion this clause should be removed. There are many products and services supplied by private companies that are (or in effect are) compulsory, for which such requirements are not imposed.

**37. Are the terms of the Act, Regulations and Guidelines appropriate for securing this objective? If not, then in what respects and to what extent are those terms not appropriate for securing this objective?**

As discussed above, I expect the profit measures are no longer required and are counterproductive.

**38. What is the evidence that the Scheme is, or is not, achieving this objective?**

As noted earlier, there is a body of international evidence which finds that stringent rate regulation leads to worse outcomes including higher premiums. Profit regulation contributes to this regulatory burden.

**39. What changes (if any) should be made for the Act, Regulations and Guidelines to secure, or better secure, this objective?**

As discussed above, I expect the profit measures are no longer required and are counterproductive.

**40. Objective (d) identifies two means of keeping premiums affordable – regulating insurer profits and limiting benefits for minor injuries.**

**(a) Should this objective be expanded to include other means of keeping premiums affordable?**

**(b) If so, what other means should be considered and why?**

As discussed above, the average cost of premiums could be reduced by introducing reforms that:

- provide insurers with flexibility and incentive to reduce the frequency and severity of road crashes, and
- reduce the regulatory burden.

**41. Does 8% exceed, or not exceed, the amount of profit that is sufficient to underwrite the relevant risk?**

No comment.

**42. Are any aspects of the TEPL mechanism not expected (when activated) to secure the objective of keeping premiums affordable by regulating insurer profits?**

As noted above there is abundant evidence that rate regulation leads to adverse outcomes.

**43. The profit regulation provisions in the Act require that excess profits returned by insurers be used to fund reductions in the cost of CTP insurance. An alternative that has been suggested is to use the excessive profits to fund road-related initiatives, thus effectively converting the excess profits into government revenue to be used for specific purposes. Should SIRA have the power to use excess profits returned by insurers in this way?**

No. I would expect this would lead to worse societal outcomes.

In my experience 'earmarking' (or 'hypothecating') a revenue source for specific purposes is rarely efficient. While there are some circumstances where it may be appropriate,<sup>26</sup> these do not appear to apply in this case. Furthermore, a key rationale for earmarking is to provide a stable revenue source and this does not apply in this case. If there is a case for the specific purpose to be funded, then the funding should not rely on volatile source of revenue (such as excess profits).

**44. Should section 2.25 of the Act be amended to align more closely with the way that insurer profits are regulated under Part 2 of Schedule 4 to the Act?**

No comment.

**2.5 Objective (e) To promote competition and innovation in the setting of premiums for third-party policies, and to provide the Authority with a role to ensure the sustainability and affordability of the compulsory third-party insurance scheme and fair market practices.**

## **General questions**

**45. Does this objective remain valid?**

It is a valid objective to promote competition and innovation. It is unclear why the clause 'in the setting of premiums for third-party policies' is required. A more general clause would be appropriate such as 'in the pricing and supply of third-party insurance.' This would reflect the broader role of insurers in managing accident risk.

The objective pertaining to 'affordability' is problematic. As discussed above there is no objective measure of affordability. Theory and evidence suggest that in the absence of some underlying market failure, attempts to address affordability will lead to worse outcomes.

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<sup>26</sup> Carling (2007) provides a useful discussion.

It's unclear why there should be an objective 'to provide the Authority with a role to ensure sustainability'. The Australian Prudential Regulation Authority (APRA) has responsibility of prudential monitoring of general insurers, and it is appropriate that the Authority support APRA in this function; however, it is not clear why the objective needs to be worded as providing the Authority with a role.<sup>27</sup>

**46. Are the terms of the Act, Regulations and Guidelines appropriate for securing this objective? If not, then in what respects and to what extent are those terms not appropriate for securing this objective?**

Many terms are not appropriate. See answer to question 48.

**47. What is the evidence that the Scheme is, or is not, achieving this objective?**

There is evidence that the Scheme is failing to achieve most elements of this objective.

- The level of competition in CTP (by any normal measure) is less than in (non-third party) motor vehicle insurance.
- Relative to comparable markets overseas, there has been negligible innovation. The most notable example is the lack of usage-based insurance.
- As noted above, there is substantial (and consistent) international evidence that rate regulation leads to higher overall costs and consequently higher premiums.

**48. What changes (if any) should be made for the Act, Regulations and Guidelines to secure, or better secure, this objective?**

In the interests of encouraging competition, innovation, and affordability (lower average premiums) as well as safety outcomes, a number of changes are required. It is desirable that:

- insurers can seamlessly bundle CTP and motor vehicle insurance into a single product
- insurers' incentives to prevent road crashes that cause death and injury align with that of society
- there are no barriers imposed by the scheme that prevent insurers from pricing for, and managing, risk (with minor qualification)<sup>28</sup>
- regulatory barriers to entry and exit are minimised.

Achieving these goals would require substantial changes to the Act, Regulations and Guidelines. These include:

- removal of unnecessary licence conditions
- removal of rate regulations (including bonus/malus) and the risk equalisation mechanism
- removal of premium filing requirements
- removal of the profit normalisation measures.

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<sup>27</sup> Regardless, it would be preferable to frame the objective in terms of an outcome that is desired. That is, it appears preferable the objective is stated as to 'help ensure the sustainability...' than 'provide the Authority with a role to ensure the sustainability ...'.

<sup>28</sup> There may be some valid exceptions (eg, to prevent pricing based on some immutable characteristics).



I will not provide more specific comment on changes at this stage, as there are potentially a variety of means to better secure the desirable objectives. I expect there would be some transition arrangements.

## **Specific questions**

### *Competition on premium*

#### **49. To what extent do CTP insurers compete on premium in the NSW market?**

No comment.

#### **50. How can the framework in the Act, Regulations and Guidelines better promote competition on premium in the NSW market?**

No comment.

### *Innovation in premium setting*

#### **51. What innovations in premium setting would benefit the Scheme?**

Significant innovations would include:

- risk-based pricing to encourage drivers (particularly high-risk drivers) to lower their risk
- risk-based discounts for safety features (eg, large premium discounts for young drivers selecting less aggressive vehicles)
- telematics-enabled usage-based insurance to reward safer driving.

These would be best achieved by removing rate-regulations and (to achieve further gains) modification of the insurers' incentives for road safety to align those with that of society.

In my opinion, it is not efficient for the Authority to attempt to identify and select innovations for safety management. Rather, it is preferable to enable insurers and provide them with the appropriate incentives to innovate.

#### **52. Does the framework in the Act, Regulations or Guidelines need to change to allow or encourage those innovations?**

Yes. Innovation would be best encouraged by enabling competition, removing constraining regulations and providing insurers with the appropriate incentives.

### *Point to point industry*

#### **53. Are there commercial disparities (particularly for small business operators) in the point to point industry?**

It is preferable that the legislative framework is neutral as to the type of business or vehicle. I expect that there should be no material need for the legislative framework to refer to taxis, ride-share or any other vehicle type or use.

**54. If so:**

**(a) to what extent will the current reforms to determination of CTP premiums for taxis and hire vehicles address them?**

**(b) are there innovations in premium setting that could further address them?**

See answer to question 53 above.

*SIRA's role in relation to sustainability, affordability and fair market practices*

**55. Is the framework which defines SIRA's role in relation to sustainability, affordability and fair market practices adequate and appropriate to enable SIRA to take steps to ensure that these aims are achieved?**

No comment.

**2.6 Objective (f) To deter fraud in connection with compulsory third-party insurance.**

I have no comments regarding this objective.

**2.7 Objective (g) – To encourage the early resolution of motor accident claims and the quick, cost effective and just resolution of disputes.**

I have no comments regarding this objective.

**2.8 Objective (h) To ensure the collection and use of data to facilitate the effective management of the compulsory third-party insurance scheme.**

I have no comments regarding this objective.

**2.9 Scheme Implementation: Key Performance Indicators**

In my opinion, there is limited value in determining scheme KPIs at this stage. Rather it is preferable, to firm up once the objectives have been reviewed.