Competition in Personal Injury Insurance

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Full Underwriting vs Nationalised Monopoly

Full underwriting means multiple insurers compete for business and are individually responsible for

- Rating (within any constraints), collection and investment of premium
- Management (in-house or outsourced) and payment of claims
- Maintaining adequate reserves and capital/reinsurance support

Examples include the temporary competitive market for workers compensation in NZ during 1999/00 and workers compensation in Western Australia since 1981.

Nationalised monopoly (more or less) means all the above is carried out by a single government-based insurer (e.g. ACC in NZ).

“Hybrid” models also exist (e.g. monopoly insurer that outsources claims management to third party administrators on a competitive basis such as workers compensation in NSW). We do not consider hybrids in any detail in this paper.

Theory….

Pros and Cons (Monopoly)

PROS

- Economies of scale are possible
- No profit loading
- Negligible probability of insolvency
- Greater influence on the market for medical and rehabilitation services.
- Ditto for reinsurance
- No “boundary” issues with claims
- Cross-subsidies can be implemented with no risk of loss of business or difficulties in obtaining cover.
- No “cherry picking”
- Simplicity.

CONS

- Less incentive for monopoly to perform or innovate
- Less incentive for insured to improve risk
- Cannot benchmark performance within the same jurisdiction
- Potential for premium/provision manipulation at key times
- No choice in the face of bad service
- Monopoly unrealistic about what they need to pay for skilled workers
- Potential to put pressure on external service providers
- Mismatching: short-term key appointments vs long-term nature of scheme
- Forced cross-subsidisation
- Political intervention

Pros and Cons (Competitive)

PROS

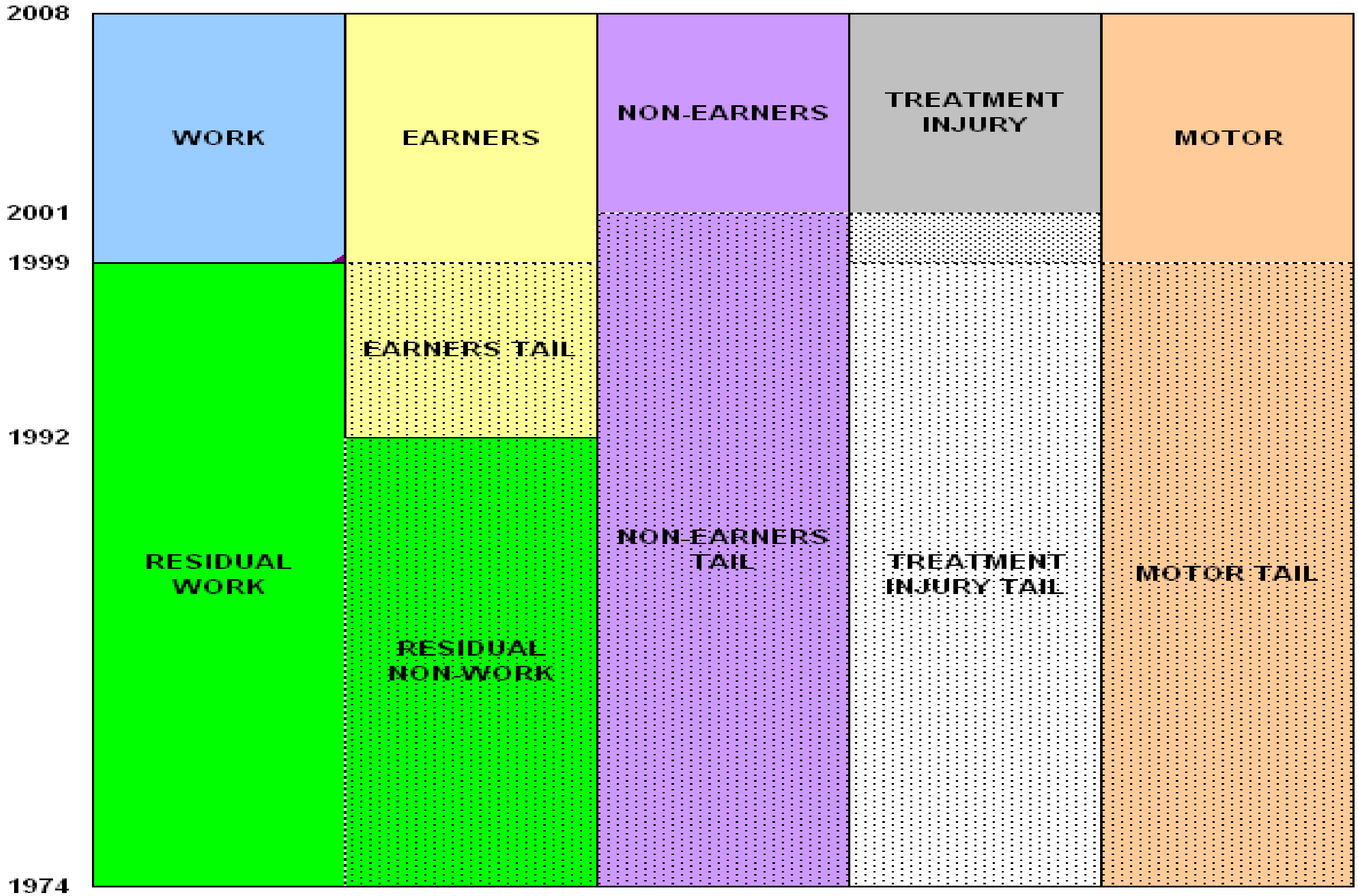
- See negation of Monopoly Cons.
- Strategic alliances between general insurers, health insurers and other specialist service providers may provide a more cost competitive and higher quality service.
- More rapid convergence to true and stable premium rate levels
- More views on what are adequate premiums, reserves and capital

CONS

- See negation of Monopoly Pros
- A new market will have inevitable “teething” problems – hard to foresee all of these (should be a short-term effect)
- More supervision required
- Potential for confusion if employer changes insurer regularly

Practice - the ACC Scheme performance…

ACC Scheme Accounts



Whole of Scheme - recent financial performance

$millions	2002	2003	2004	2005	2006	2007	2008	2002+	2005+
Levy Income	2,326	2,575	2,655	2,736	3,076	3,292	3,654	20,316	12,759
Rehab Claims Costs	865	951	998	1,153	1,305	1,485	1,691	8,447	5,633
Compensation Claim Costs	714	753	800	784	833	944	1,037	5,864	3,597
Change in prior year central estimate	-150	417	810	880	939	1,727	1,542	6,164	5,087
new claims+discount rate changes	510	1,237	-618	1,157	392	-707	721	2,693	1,564
Change in Risk Margin	0	0	0	0	0	0	2,008	2,008	2,008
Total Change in Claims Liability	360	1,654	192	2,037	1,331	1,020	4,271	10,865	8,659
Claims Incurred	1,939	3,358	1,990	3,974	3,469	3,448	6,999	25,176	17,889
Expenses	273	274	301	332	358	379	453	2,369	1,521
Underwriting Result	114	-1,056	365	-1,570	-750	-534	-3,798	-7,229	-6,652
Investment Income	118	437	489	777	1,070	802	-2	3,691	2,647
Insurance Result	232	-619	854	-793	320	267	-3,800	-3,538	-4,005
Opening Account Balance (A)	3,262	3,865	4,903	5,971	7,216	8,877	10,164		
Closing Account Balance (B)	3,865	4,903	5,971	7,216	8,877	10,164	10,020		
Opening OCL including CHE + RM	7,141	7,501	9,155	9,347	11,384	12,715	13,735		
Closing OCL including CHE + RM	7,501	9,155	9,347	11,384	12,715	13,735	18,006		
Closing Funding Ratio	52%	54%	64%	63%	70%	74%	56%		
Loss Ratio	83%	130%	75%	145%	113%	105%	192%	124%	140%
Expense Rate	12%	11%	11%	12%	12%	12%	12%	12%	12%
Combined Ratio	95%	141%	86%	157%	124%	116%	204%	136%	152%
Implied Rate of Investment Return (i)	3.4%	10.5%	9.4%	12.5%	14.2%	8.8%	0.0%		

Comments on scheme performance

- The Work Account is significantly overfunded (Assets = 129% of provision including risk margin) – Work is the only Account with risk rating (=> other IP initiatives just don't work?)
- All other Accounts are underfunded (Scheme funding ratio is 56%)
- Accounts with serious injuries (MV, NE and TI) have had the most unfavourable experience
- Underwriting losses accumulated over last 4 years = $6.7 billion
- Investment returns have been very favourable (aside from 2008)
- Insurance losses accumulated over last 4 years = $4.0 billion
- ACC has consistently underestimated claim liabilities (re-estimation has added $5.1 billion over last 4 years)
- Levies will (need to) increase dramatically (or funding horizons extended)
- Inter-generational inequity is occurring

NZ workers compensation in 1999

- 6 competitors (incl JVs)
- Prices dropped significantly from pre-competition levels (so competitive market was a “success” for all stakeholders)
- Momentum of price drops carried forward post-renationalisation (too far in the Work Account?)
- All insurers made a profit despite written off start up costs
- All residual liabilities now taken back by ACC (except for possibly one insurer)
- Market was mostly “win-win” despite some down-sides (opp.)

Some things did not go well

- Confusion for employees/claimants around who their employer’s insurer was
- We understand @Work struggled with broker network
- We understand insurers had major difficulties getting verifiable earnings information by ANZSIC classification and this may have led to last minute changes in insurer
- Credit rating and regulation very cumbersome

Western Australia workers compensation 1

- Existing scheme (legislation-wise) established in 1981
- No-fault with some common law access for more severe injuries
- Higher risk mix of industries (esp. mining) compared to NZ
- Higher benefit levels overall than NZ (higher weeklies plus common law)
- Average gazetted premium rate for 2008 is 1.58% of earnings with decreasing trend
- Insurers premium rates on average >20% lower than gazetted rates (latest estimate of average discount is 22.6% which means average premium rate is around 1.22%)
- Scheme is solvent (in 2006 A/L = 109%, no unfunded liabilities and no residual levies)
- Insurers' provisions are monitored annually and compared to an independently assessed "scheme" provision (good agreement for years)
- An example of a well functioning competitive market that is solvent

Western Australia workers compensation 2

	Accident Year ending 30 June ($m)							
	2003	2004	2005	2006	2007	2008	2002+	2005+
Gross earned premium	587	576	617	702	735	769	4,571	2,823
Paid claims	310	327	308	241	111	112	1,709	772
Outstanding claims	73	111	179	251	479	509	1,646	1,418
Commission	18	17	19	21	22	23	137	85
Other expenses	88	90	99	98	109	114	673	419
Underwriting result	99	31	13	91	14	12	406	129
Investment income	53	57	64	75	82	87	462	308
Insurance result	152	88	77	166	96	98	868	438
Loss ratio	65%	76%	79%	70%	80%	81%	73%	78%
Combined ratio	83%	95%	98%	87%	98%	98%	91%	95%

Monopoly vs Competition

- ACC overall performance has been unfavourable over a number of years (although investment returns have been very favourable)
- Only the Work Account shows favourable results
- Accounts with serious injuries have suffered most
- Australian competitive markets for Work and Motor CTP are currently healthy
- Previous competitive market for Work in 1999/00 was largely successful
- The few issues with 1999/00 market could be addressed if competition was introduced
- ACC's financial performance is a "heads up" to intending participants in a competitive market (esp. for Motor CTP)

Questions