9 Finance, insurance and superannuation services

The total financial assets of financial institutions are estimated at around $1400 billion (Hockey 2001). The scale of the industry underlines the importance of effective financial, insurance and superannuation regulation.

The financial sector

The Commonwealth Government is responsible for much of Australia's financial regulation, particularly regulation of trade, banking, insurance, bills of exchange, insolvency and foreign corporations. States and Territories regulate trustees and apply credit controls. Further information is provided on trustee legislation in this section and on credit controls in chapter 11.

Regulation of the financial sector is designed to facilitate the creation and movement of capital while ensuring market participants act with integrity and protecting consumers. Proponents of financial sector regulation argue that government intervention is warranted, given the complexity of financial products and the inherent information imbalance between financial service providers and consumers. Regulation takes several forms, including:

- licensing of individuals and businesses (which amounts to entry restrictions);
- conduct and disclosure requirements (which reduce information barriers and costs); and
- financial reserve requirements (which are related to prudential supervision).

The Commonwealth's major review of the financial system in 1996-97 led to the 1997 release of the Wallis Report, which found that Australia's regulatory system was unnecessarily costly and complex. It made 115 recommendations, suggesting changes to both Commonwealth and State and Territory legislation. The recommendations included regulatory changes, the standardisation of regulatory regimes to ensure consistency, and increased competition in many areas of the financial sector. In responding to the report, the Federal Treasurer categorised the proposed reforms as:

- rationalising the regulatory framework;

- balancing prudential and competition goals, which involves maintaining financial system safety while allowing flexible reactions to financial system developments and minimal effects on competition, competitive neutrality and efficiency;

- maintaining the protection of depositors;

- promoting efficiency, competition and confidence in the payments system; and

- promoting more effective disclosure and consumer protection (Costello 1997).

All levels of government have undertaken legislative reform in response to the Wallis Report. Each State and Territory enacted financial sector reform legislation in 1999 to transfer powers of regulation and supervision of certain financial institutions to the new Commonwealth regulators, the Australian Prudential Regulation Authority (which is concerned with the prudential regulation of banks, insurance companies, superannuation funds, credit unions and friendly societies) and the Australian Securities and Investments Commission (which enforces company and financial services laws to protect consumers, investors and creditors). This shift involved amending legislation in all jurisdictions and repealing several legislative instruments due for review under the National Competition Policy (NCP).

The *Financial Services Reform Act 2001* and the *Financial Sector Reform (Consequential Provisions) Act 2001* contain the most recent substantial Commonwealth reforms to the financial sector. This legislation represented a third major segment of the Commonwealth's legislative response to the Wallis Report. In introducing the Financial Services Reform Bill 2001 to Parliament, the then Minister for Financial Services and Regulation stated that the legislation introduces a harmonised regulatory regime for market integrity and consumer protection across the financial services industry, replacing the different frameworks that had applied to different financial sector services (Hockey 2001). The legislation provides for:

- a harmonised licensing, disclosure and conduct framework for all financial service providers;

- a consistent and comparable financial product disclosure regime; and

- a streamlined regulatory regime for financial markets and clearing and settlement facilities.

The Financial Services Reform (Consequential Provisions) Act provided for a transition to the new regulatory arrangements over a two-year period in most cases, with the general date for compliance commencement being 1 October 2003.

Assessment

Governments' review and reform activity in response to the Wallis report is consistent with NCP principles. A national NCP review of legislation relating to trustee corporations is under way. The Standing Committee of Attorneys General released a consultation paper and a draft uniform Bill in May 2001. Governments have not finalised their consideration of these documents. Some jurisdictions have removed minor restrictions in trustee legislation in recent years. The Council will finalise its assessment of trustee legislation in 2003.

Insurance services

The insurance industry offers a wide range of products. Information relating to premium revenue by class of insurance business indicates the relative importance of the different insurance products. The most important class is domestic motor vehicle insurance, which accounted for 22 per cent of total premium revenue reported to the Australian Prudential and Regulatory Authority in 2000-01; householder insurance accounted for 14 per cent, followed in significance by compulsory third party (CTP) insurance (10 per cent), fire and industrial special risks insurance (8 per cent), commercial motor vehicle insurance (6 per cent), workers compensation insurance (5 per cent), public and product liability insurance (5 per cent), other accident insurance (4 per cent) and professional indemnity insurance (3 per cent) (ACCC 2002, p. 39).

Insurance markets are experiencing considerable uncertainty and change, and governments are introducing or contemplating changes to legislative arrangements to reduce uncertainty and slow growth in the cost of premiums. Governments are particularly concerned with developments in the public liability and medical indemnity insurance markets. Governments' responses to liability and indemnity insurance issues will affect the wider industry, because most insurance companies offer a range of insurance products. Commonwealth, State and local governments are developing responses to the difficulties being experienced in the public liability and medical indemnity insurance markets. The 2002 National Competition Policy (NCP) assessment is prepared against these circumstances of change and uncertainty in the industry.

In many insurance markets, government legislation allows for competitive provision and competing private insurers are the principal underwriters. In the cases of CTP and workers compensation insurance, however, several governments have legislated for monopoly underwriting of at least one of these forms of insurance by government-owned entities. Governments also have legislated for monopoly provision of indemnity insurance for some professions (especially lawyers practising as solicitors). Under the National Cooperative Scheme for the Regulation of Travel Agents (the 'National Scheme'), the States and the ACT Government legislate for monopoly

provision by the Travel Compensation Fund of travel agents' indemnity insurance. This fund compensates travel consumers in the event of the financial failure of a travel agent. The National Scheme is subject to a national review commissioned by the Ministerial Council on Consumer Affairs; more information on this review is provided in Chapter 8.

CTP insurance for motor vehicles applies in all States and Territories. Governments are motivated to ensure all road accident injury victims, as well as relatives of those killed in traffic accidents, are compensated regardless of fault. The schemes in the States and Territories provide for coverage of parties injured in road accidents who are not required to take out insurance (for example, pedestrians and cyclists).

There is a similar universality for workers compensation insurance, which also is compulsory and under which employees receive entitlements reflecting the participation of their employers in the insurance market. Exceptions are minor, with some jurisdictions allowing employers over a certain size to self-insure (while conforming to regulatory requirements) and, in some cases, exempting very small companies from insuring. This universal coverage aspect of CTP and workers compensation insurance differentiates them from other forms of insurance.

The benefits paid under CTP and workers compensation schemes typically cover medical, hospital and rehabilitation expenses, legal costs, loss of earnings and, in many cases, compensation for pain and suffering. In some cases, the benefits are based on statutory formulas; in others, they are based on common law or statutory benefits and the common law. In the case of CTP insurance, access to the common law is unlimited in three jurisdictions (Queensland, Tasmania and the ACT), and restricted in four (New South Wales, Victoria, Western Australia and South Australia.) In Victoria and Tasmania, statutory no fault benefits are also available. In the Northern Territory, statutory benefits are available to residents only, while non-residents have unlimited access to the common law. In the case of workers compensation, statutory benefits are available in all jurisdictions. Common law access is unlimited in the ACT, and limited in New South Wales, Victoria, Queensland, Western Australia and Tasmania. The workers compensation schemes in South Australia and the Northern Territory provide access to statutory benefits only.

In most jurisdictions, there is only a muted connection between the riskiness of the insured party and the premium that party pays. This is particularly the case with CTP insurance, for which all motorists tend to pay the same regulated premium regardless of their driving history or the evidence of driving behaviour by their cohorts. Younger and inexperienced drivers typically face the same CTP premiums paid by more experienced drivers, despite incurring substantially higher premiums for non-CTP or comprehensive insurance. In workers compensation schemes, an employer's premium broadly reflects the nature of the employer's industry and the employer's experience. Industry ratings, however, tend to blunt the latter factor.

This 'community rating' aspect of CTP and workers compensation insurance diminishes the incentives for risk minimisation that could arise from differential premiums reflecting factors such as age, driver or workplace safety history, experience and measures taken to reduce risk. Governments argue that community rating contributes to the high proportion of drivers and employers taking out insurance.

Current insurance market environment

Over the past two to three years, public liability and professional indemnity insurance premiums have risen sharply, reflecting the growth in litigation (and courts awarding large payouts), insurers' underpricing of premiums during preceding years, a concurrence of catastrophes and other factors.[1] This rise has been exacerbated by the huge claims arising from the 11 September 2001 events in the United States, which have contributed to increased reinsurance costs, and by the collapse of HIH, which increased the demand on other insurance companies and encouraged them to be more cautious in setting premiums.

The Australian Competition and Consumer Commission (ACCC) found that the largest average premium increases across the Australian insurance industry in 2000-01 occurred in the areas of industrial special risks, professional indemnity and product and public liability insurance (ACCC 2002). It identified the following factors as the key drivers of these premium rises.

- Insurers have shifted from targeting business volume growth to focusing on return on equity.
- Insurers have recognised that low returns on capital have resulted from:
  - inadequate premium rates in these and other areas of insurance;
  - catastrophes such as the Sydney hailstorm in 1999, floods in New South Wales, Queensland and the Northern Territory in 1998, and the Longford gas plant explosion in Victoria in 1998;
  - realisation of the extent of past losses, as liability provisions are increased to reflect emerging claims experience in professional indemnity and public liability insurance;
  - low investment returns;

[1] According to a J.P. Morgan/Deloitte/Trowbridge survey (Trowbridge Consulting 2002, p. 26), public liability premiums rose by more than 15 per cent in each of 1999-2000 and 2000-01, and were expected to increase by an estimated 30 per cent in 2001-02.

- reinsurance premium increases which constitute part of the industry's strategy to recover from the recently low profitability of the international reinsurance market. (Reinsurance premiums reached their lowest point in 1999-2000.) The rise in reinsurance premiums, largely driven by international factors, coincided with the above Australian catastrophes; and

- the removal of a barrier to price increases after the HIH insurance group collapsed (ACCC 2002, pp. ii–iii).

The Commonwealth Government commissioned Trowbridge Consulting to prepare a report on public liability insurance for consideration by Commonwealth and State Ministers attending the 27 March 2002 Ministerial Meeting on Public Liability. The report (Trowbridge Consulting 2002) argues that there is a crisis in public liability insurance as indicated by a large number of people being able to obtain cover only at sharply increased premiums or not at all. Trowbridge believes the crisis is likely to persist for a year or two without government intervention. It argues that the crisis has been caused by:

- personal injury claims, which have risen in number and size of average compensation, driving up the cost of claims overall;

- underpricing by insurers during most of the 1990s;

- insurers now being more conscious of protecting shareholder value;

- difficulties that insurers are experiencing in assessing risks; and

- revised insurer attitudes and competitive conditions flowing from the HIH collapse. Trowbridge believes the demise of HIH has contributed to a lessening of competition in the public liability insurance market.

Trowbridge predicts that premium increases for public liability insurance in 2002 will be 30 per cent higher, on average, than in 2001 — even five to ten times as high in some cases (Trowbridge Consulting 2002, pp. i–ii, 10–11).

Governments are concerned about the rising costs of public liability and professional indemnity insurance. While these areas of insurance in total comprised just 8 per cent of total Australian premium revenue in 2000-01, the sharply increased premium costs have caused great concern to particular industries and community groups.[2]

[2] On 20 March 2002, the Senate asked the Senate Economic References Committee to report by 27 August 2002 on the impact of public liability insurance on small business and community and sporting organisations, and of professional indemnity insurance on small business, with particular reference to the cost of such insurance, reasons for premium increases, and reforms that could reduce the cost and better calculate and pool risk.

The Commonwealth, State and Territory governments have recently given some attention to the possibility of new national approaches to aspects of insurance. This attention has been in response to the HIH collapse, sharply increased premiums for public liability insurance, and recent adverse developments in builders warranty insurance and medical indemnity insurance. Government actions over the next several months are likely to affect the claims outlook and profitability of the industry. These effects will have implications for insurance generally and for CTP, workers compensation and professional indemnity insurance specifically. In these three insurance markets, government legislation affects the structure of the market and the extent of competition.

The 27 March 2002 Ministerial meeting agreed to remove the tax impost on structured settlements for personal injury compensation, and States agreed to examine tort reform, legal system costs and practices and possible targeted measures for specific areas, especially volunteer and community organisations. The meeting occurred against a background of media discussion of these and other possible initiatives, including capping legal costs, banning 'no win, no fee' advertising by lawyers, changing the professional negligence test to protect community groups, and disallowing lump sum payouts.

The meeting of the Council of Australian Governments (CoAG) on 5 April 2002 reinforced these discussions. CoAG initiated another Commonwealth–State Ministerial meeting on 30 May 2002. In addition, the Heads of Treasuries have coordinated national consideration of public liability and medical indemnity insurance reforms, reporting to Commonwealth–State senior officials in July 2002.

Following a meeting with the Australian Medical Association (AMA) on 30 April 2002, the Commonwealth's Assistant Treasurer announced that the Commonwealth has agreed to give priority to the development of a national scheme for the care and rehabilitation of severely injured patients. The Commonwealth has indicated that it is looking to the States and Territories to examine tort law reform to contain the costs of claims and deliver predictability for the pricing of insurance products.

Governments have begun to implement some of the initiatives agreed at the March summit. On 6 June 2002, the Commonwealth introduced the Taxation Laws Amendment (Structured Settlements) Bill 2002 which will exempt, from income tax, annuities and deferred lump sums paid as compensation to seriously injured persons under structural settlements.

The legislative changes introduced by the New South Wales Government in the Civil Liability Bill 2002 provide for limits on personal injury damages,

including caps on some categories of damages.[3] Lawyers run the risk of meeting court costs if their public liability insurance cases are shown to be unmeritorious. The Bill will also enable courts to agree to structured settlements.

Queensland introduced the Personal Injuries Proceeding Bill 2002 on 18 June 2002, and the Parliament passed the Bill on 20 June 2002. The Bill deals with awards other than those covered by the *Motor Accident Insurance Act 1994* and the *WorkCover Queensland Act 1996*. The Bill provides for a cap on economic loss claims, streamlined legal proceedings to reduce legal costs, expressions of regret not being used as an admission of liability, facilitation of structured settlements, and protection of volunteers from liability. The Bill also restricts lawyers from advertising personal injury services on a 'no win, no fee' basis[4].

Late in May 2002, Victoria's Finance Minister indicated the measures that are likely to be introduced in the Spring 2002 session of Parliament to address liability and indemnity insurance issues. The measures include: waivers allowing people to accept responsibility for participating in risky activities; protection of volunteers from being sued; allowance of damages payments in instalments; and assurance that apologies does not represent an admission of guilt.

Other States and Territories also recently announced measures to rein in claims costs, maintain the supply of public liability insurance, and protect voluntary and not-for-profit organisations.

At least one insurance company (Insurance Australia Group) has called for a nationally uniform approach to the 'long tail' insurance issue, arguing that the current framework of different arrangements adds to costs and encourages a 'culture' of compensation. The ACCC has indicated that it would review the competition implications of the Insurance Council's suggestion of pooling premiums for public liability insurance (if insurance companies take this idea towards an agreement stage). The Royal Australasian College of Surgeons has proposed the pooling of the insurance reserves and current liabilities of 'medical defence organisations', which offer medical indemnity insurance. The ACCC would probably review any such arrangement.

At the Ministerial meeting on public liability insurance on 30 May 2002, Commonwealth, State and Territory governments decided to appoint an

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[3] This Civil Liability Bill was passed on 7 June 2002 and received assent on 18 June 2002. The Bill applies to personal injury claims, subject to some exceptions such as those covered by New South Wales' *Motor Accident Compensation Act 1989* and the *Workers Compensation Act 1987* (which contain caps on common law access for CTP and workers compensation insurance).

[4] The Queensland Bill's restrictions on lawyers' advertising will apply to lawyers representing clients who have experienced motor vehicle and workplace injuries as well as lawyers representing other injured clients.

expert panel to examine the law of negligence, including its interactions with the *Trade Practices Act 1974*. The panel was announced by the Commonwealth Minister for Revenue and Assistant Treasurer on 2 July 2002. The panel will report on the terms of reference in two stages, with the first report to Commonwealth, State and Territory Ministers to be made by 30 August 2002, and the second report by 30 September 2002. The panel is asked to report on several matters, including:

- the operation of common law principles applied in negligence to limit liability from personal injury or death;
- principled options to limit liability and the quantum of awards;
- evaluate proposals to allow self assumption of risk;
- options to limit claims of negligence to within three years of an event; and
- options for a requirement that the standard of care in professional negligence matters accords with generally accepted practice of the relevant profession. (Coonan 2002a)

The governments also agreed at the second summit that:

- the ACCC will monitor market developments and premium prices and update its Insurance Industry Market Pricing Review every six months over a two-year period;
- a number of jurisdictions will introduce legislation to protect volunteers from being sued;
- jurisdictions will allow self-assumption of risk for people participating in inherently risky activities;
- all States and Territories will examine aligning damages under common law more closely with statutory third party insurance awards for other personal injury claims; and
- individual governments will consider limits on lawyers' advertising and legal fees. (Coonan 2002b)

On 27 June 2002, the Commonwealth introduced a Bill to Parliament to implement one of the measures agreed at the May summit. The Trade Practices Amendment (Liability for Recreational Services) Bill 2002 will provide the option to individuals participating in risky recreational and sports activities to voluntarily waive their right to sue.

On 20 June 2002, the Commonwealth Minister for Employment and Workplace Relations asked the Standing Committee on Employment and Workplace Relations in the Australian Parliament to report on matters relevant to Australian workers compensation schemes in respect of the incidence, cost and detection of fraudulent claims; employers' noncompliance with premium and other obligations; factors affecting different safety and

claims records among industries; and the adequacy of rehabilitation schemes. The findings of the Committee might cause jurisdictions to consider and potentially change their workers compensation arrangements. On 24 July 2002, the Minister for Employment and Workplace Relations and the Parliamentary Secretary to the Treasurer jointly announced that the Government will ask the Productivity Commission to inquire into more nationally consistent arrangements for workers compensation and occupational health and safety schemes.

Governments probably will consider a range of possible initiatives — further to those already introduced — with the objectives of reining in claims costs and providing for more certainty for insurance companies. They are aiming to check the growth in premium prices and ensure that insurance is widely available at reasonable prices.[5] Governments also are likely to encourage insurance companies to be more receptive to participation in some insurance markets (including medical indemnity and professional liability insurance).

The range of likely government initiatives may affect CTP, workers compensation and professional indemnity insurance by influencing the nature of benefits available to claimants, including seriously injured people with 'long tail' rehabilitation requirements. In addition, the government initiatives could change the landscape of the insurance industry generally. Changes in the circumstances of the insurance industry, particularly in the CTP, workers compensation and professional indemnity insurance sectors, could have significant implications for governments' attitudes to legislation on the monopoly provision of these forms of insurance.

Restrictions in legislation

Under clause 5 of the Competition Principles Agreement (CPA), governments undertook to review and, where appropriate, reform legislation that restricts competition. This section summarises the legislative restrictions that exist in the areas of CTP, workers compensation and professional indemnity insurance. Legislation relating to these areas of insurance was identified as containing restrictions that should be subject to NCP review.

[5] Governments are giving careful consideration to their initiatives, because they do not wish to introduce measures that have anticompetitive impacts or significantly affect the capacity of seriously injured people to claim compensation commensurate with their financial needs for care and rehabilitation.

Compulsory third party and workers compensation insurance

Mandatory insurance

In all jurisdictions, CTP insurance is mandatory and applies to the vehicle. Workers compensation insurance also is mandatory (for employers), except in the cases of self-insurance and very small employers.

Governments believe these requirements are important, ensuring all injured parties have access to insurance. NCP reviews have supported this argument, also noting that the mandatory nature of these forms of insurance ensures parties responsible for accidents cannot avoid contributing to the benefits available for affected individuals. The reviews have argued that there is a net community benefit from CTP and workers compensation insurance being mandatory, and the National Competition Council accepts this argument.

Premium controls

Governments tend to set CTP premiums in Australia according to community rating approaches. Workers compensation premiums reflect industry ratings and experience, but also a degree of centralised premium setting and a blunted approach to relating individual employer risk to price. Such premium controls reduce the role of price in influencing safety behaviour and increase premium costs for those employers and drivers who have good safety records. In this way, insurance holders are not rewarded for good historical performance. The Council believes that the benefits of risk-related premiums are potentially important and worthy of further consideration by jurisdictions.

Licensing of insurers

Licensing of insurers to offer CTP and workers compensation insurance allows governments to account for prospective insurers' financial viability and history. While the work of prudential authorities should assure governments, it is appropriate that governments undertake their own checks of prospective insurers, given the ramifications of insurance companies becoming unviable.

The capacity of governments to provide and withdraw licences is likely to serve as an incentive for insurers to conduct their finances and customer relations effectively and with probity. Governments' licensing role does not, however, ensure insurance companies perform well. Prudential authorities and the boards of insurance companies should retain the responsibility for monitoring the finances and probity of insurance companies.

Licensing also can enable governments to enforce particular requirements (for example, the contribution of a proportion of premium revenue to rehabilitation services or safety advertising campaigns).

The Council accepts that these roles for licensing are consistent with the CPA. Provided licensing criteria are not anticompetitive and are the minimum necessary to achieve government objectives, the Council considers that licensing is consistent with the CPA.

Monopoly provision

CTP and workers compensation insurance are provided in several jurisdictions by a government-owned monopoly under statute. This arrangement is the principal restriction with NCP implications. Table 9.1 summarises the provider arrangements in each jurisdiction.

Table 9.1: Provider arrangements for CTP and workers compensation insurance

Jurisdiction	*CTP insurance*	*Workers compensation insurance*
Commonwealth	Not applicable	Monopoly insurer for Commonwealth employees (Comcare)
New South Wales	Multiple private insurers	Monopoly insurer (WorkCover NSW)
Victoria	Monopoly insurer (Transport Accident Commission)	Monopoly insurer (Victorian WorkCover Authority)
Queensland	Multiple private insurers	Monopoly insurer (WorkCover Queensland)
Western Australia	Monopoly insurer (Insurance Commission of Western Australia)	Multiple private insurers
South Australia	Monopoly insurer (Motor Accident Commission)	Monopoly insurer (WorkCover Corporation of South Australia)
Tasmania	Monopoly insurer (Motor Accident Insurance Board)	Multiple private insurers
ACT	Legislative provision for licensing of multiple insurers – only one licensed insurer (Insurance Australia Group)	Multiple private insurers
Northern Territory	Monopoly insurer (Territory Insurance Office)	Multiple private insurers

A number of jurisdictions (New South Wales, Queensland, Western Australia, Tasmania and the Northern Territory) license multiple private companies to provide one of these two forms of insurance, but legislate for monopoly supply of the other form of insurance. This occurs despite the two types of insurance being similar in some key respects:

- both are concerned with accident insurance;
- both are mandatory; and
- in all instances (except workers compensation insurance in Tasmania, the ACT and the Northern Territory), premiums are set, regulated or subject to oversight.

The differential treatment of the two forms of insurance across and within jurisdictions reflects complex issues that governments have considered in deciding whether to provide for monopolistic or competitive provision.

Legal professional indemnity insurance

All States and Territories require lawyers practising as solicitors to take out professional indemnity insurance. Most jurisdictions require (generally by legislation) that practitioners insure through a monopoly provider. In New South Wales, professional indemnity insurance for solicitors is mandatory and must be arranged through the NSW Law Society, which is the statutory monopoly provider of this insurance under the *Legal Profession Act 1987*. In Victoria, the Legal Practitioners Liability Committee is the statutory monopoly provider of legal professional indemnity insurance. In Queensland, lawyers' public indemnity insurance must be taken through a Queensland Law Society master policy or an insurer approved by the law society. Monopolies also provide this insurance in Western Australia, South Australia, Tasmania and the Northern Territory, while the ACT allows for two providers.

Review and reform progress

Compulsory third party and workers compensation insurance

All governments completed reviews of their statutory monopoly insurers by early 2001 (some significantly earlier). In New South Wales, the Grellman Report into workers compensation insurance was finalised in 1998, and the State Government legislated for private underwriting to commence in October 1999. The Government subsequently deferred implementation of the legislation until an unspecified date; then in 2001, it repealed provisions that provided for competitive underwriting. New South Wales is now proposing a further review with a reporting deadline of the second half of 2003.

In Victoria, second reviews of CTP insurance and workers compensation were finalised in 1999 and 2000 respectively, reversing the first reviews' recommendations for multiple provision. As in its 2001 annual report to the

Council, the Victorian Government informed the Council in 2002 that it will review the scope for greater contestability in the provision of CTP and workers compensation insurance via further outsourcing ('market testing') by the Transport Accident Commission (the TAC) and the Victorian WorkCover Authority. The Government is still considering the mechanism for third party reviews of the TAC and the Victorian WorkCover Authority premiums, which was a recommendation of the 2000 reviews.

In Queensland, the review of workers compensation insurance was completed in early 2001, leading the Government to legislating minor changes in 2002. The monopoly insurance arrangements continue.

The review of CTP insurance in Western Australia was finalised in 2000, recommending multiple provision. Amending legislation was withdrawn in 2000, and no action has been taken since. The State Government is not considering changing the multiple provider arrangements in workers compensation insurance.

South Australia conducted a second review of CTP insurance in 1999, reversing the 1998 review's recommendation that multiple provision be introduced. The Government reaffirmed in September 2001 that the Motor Accident Commission remains the sole provider of CTP insurance in South Australia. South Australia's 2002 NCP annual report reiterates that the State has demonstrated a public interest case for retaining the single statutory provider of CTP insurance. In the case of workers compensation insurance, South Australia is preparing a final report for the Government's consideration.

The Tasmanian Government stated in its 2001 and 2002 NCP annual reports that it is examining the Victorian review of the TAC before making decisions about its Motor Accident Insurance Board. In the Northern Territory, the review of CTP insurance was completed in late 2000 and the Government is considering the recommendations. This review argued for retaining the monopoly arrangements, but suggested that the Government consider franchising out the operation of the CTP scheme. It recommended clarification of legislative objectives and replacing references in legislation to the Territory Insurance Office with 'the designated insurer.' The Northern Territory Government is also considering a review of workers compensation insurance. The ACT allows for multiple providers of both CTP and workers compensation insurance, so no issues with NCP compliance arise in that jurisdiction. The review of the monopoly compensation insurer for Commonwealth employees, Comcare, was completed in 1997, but no reforms have been introduced.

Tables 9.2 and 9.3 summarise legislative review and reform activity by jurisdictions in the areas of CTP and workers compensation insurance.

Legal professional indemnity insurance

Most governments have reviewed of the professional indemnity provisions of their legal practitioner legislation. New South Wales completed a review of its Legal Profession Act in 1998. The review recommended deregulating the market for professional indemnity insurance for solicitors, subject to the provision of appropriate protection for clients through minimum standards for policies, run-off cover and indemnity. The Government rejected this recommendation and instead proposes to establish a new mutual fund to cover all solicitors (except those with exemptions). It anticipates that the fund would be administered by an insurer selected by an independent Board. The Government envisages that commercial insurers would re-insure all or part of the fund's liabilities.

Victoria has conducted two professional indemnity insurance reviews. The first review, conducted by KPMG, recommended removing the Legal Practitioners Liability Committee's monopoly over the provision of professional indemnity insurance to solicitors. The second review, conducted by the Legal Practice Board, recommended retaining it. The Government released the Legal Practice Board report (and its draft response) for public comment in November 2000. It subsequently provided a supplementary report on professional indemnity insurance for solicitors to the Council in June 2001 and confirmed its decision to retain the monopoly arrangement.

Queensland released a green paper on legal profession reform in June 1999. The green paper recommended providing competition in the professional indemnity insurance market. It proposed specifying the objectives to be achieved by the professional indemnity insurance cover (for example, that the policy must include appropriate run-off cover) in legislation, but not prescribing whether the insurance should be through a master policy or open to the market. In December 2000, the Government announced that it would allow the professional bodies to select professional indemnity cover — subject to the cover meeting minimum standards — while also allowing the current arrangements to continue for a further three years. The Government subsequently commenced an NCP review of its legal practitioner legislation (including the professional indemnity insurance arrangements), releasing a discussion paper in November 2001.

Western Australia released the draft review report on the *Legal Practitioners Act 1983* in April 2002. The draft report recommended retaining requirements for legal practitioners to insure through the Law Society, but amending the Act to codify the Law Society's practice of allowing practitioners to opt out of the scheme where they give adequate notice and evidence of having made suitable alternative insurance arrangements.

South Australia completed a review of the *Legal Practitioners Act 1981* in October 2000. The review recommended maintaining the Law Society's monopoly over professional indemnity insurance for legal practitioners, provided premiums remain competitive. The Government accepted the review's recommendations.

Tasmania released a regulatory impact statement containing preliminary recommendations for the reform of its *Legal Profession Act 1993* in April 2001. The regulatory impact statement found that the requirement for legal practitioners to have professional indemnity insurance is in the public interest, but that legal practitioners should be able to arrange their own insurance rather than be required to use the Law Society scheme. This recommendation was conditional on the public benefits (guaranteed indemnity and run-off cover) being maintained. The review team completed its report in August 2001. The Government is re-considering the review's recommendations, given the decision by the Standing Committee of Attorneys General to prepare and adopt uniform national laws for the legal profession (see chapter 7 on legal services).

The ACT commenced a review of the *Legal Practitioners Act 1970* in 1999. As an interim measure pending the full NCP review, the ACT Government amended the Act to introduce a second approved insurance provider. Willis Corroun Professional Services Limited indicated that in its experience as the agent of insurers entering the market in the ACT, competition leads to broader cover, cheaper premiums and a higher level of service. The ACT subsequently ceased its NCP review, in light of the upcoming development of uniform national laws for the legal profession.

The Northern Territory has not completed its review of the *Legal Practitioners Act.*

Chapter 7 provides tables that summarise legislative review and reform activity by jurisdictions in the area of solicitors' professional indemnity insurance.

Public interest evidence

Compulsory third party and workers compensation insurance

The issue of monopoly versus multiple provision is central to the Council's consideration of whether jurisdictions' CTP and workers compensation insurance arrangements are consistent with the NCP. Governments have argued a public interest case that the benefits of monopoly provision outweigh the costs. The following sub-sections discuss some arguments that governments have made and about which the Council has been (and is) seeking additional information from governments.

Economies of scale

Some governments have argued that the size of the market in their jurisdictions does not justify the provision of insurance by more than one

supplier because economies of scale would not be realised. They have not provided sufficient evidence of the market size required to achieve economies of scale, but they have implied that costs would be higher if smaller, multiple suppliers were allowed in place of monopoly providers. Some governments with monopoly providers of CTP and workers compensation (for example, Victoria and South Australia) have acknowledged that the NCP reviews conducted could not be conclusive about economies of scale. The Council has noted that competitive insurance markets in some jurisdictions are smaller than the markets of other jurisdictions that retain monopoly providers.

The Council has sought assistance from the States over the past two years in considering the optimal scale of insurance provision. States have not yet provided sufficient information for the Council to ascertain likely scale economies. If those governments that argue for monopoly provision are correct, then insurance providers that are larger than the statutory monopolies in any jurisdiction (ultimately, perhaps, a single national entity) may reap further economies of scale. The Council will seek more information from the States on economies of scale over the period to the 2003 assessment.

Economies of scope

Statutory monopoly providers specialise in providing one insurance type. This specialisation denies the monopoly insurer access to economies of scope, whereas private insurers participating in competitive markets usually offer a range of insurance products and can take advantage of the systems, human resources and insurance expertise that they have developed. Private insurers can spread many of their costs over a range of insurance products and thus enjoy economies of scope.

Victoria's second NCP review of CTP insurance recognised that diseconomies of scope may occur with a monopoly insurance provider (Department of Treasury and Finance, Victoria, PricewaterhouseCoopers and MinterEllison Lawyers 2000, p. 86). Governments with monopoly providers argue that economies of scope can be gained by outsourcing certain functions (for example, premium collection, accident investigations, investment management, and information technology and claims management) to private insurers. There is merit in this argument, but the extent to which such outsourcing allows economies of scope is unclear. The Council will seek more information on this issue over the period to the 2003 NCP assessment.

Choice and innovation

The various reviews of the CTP and workers compensation schemes have identified costs of monopoly provision that relate to choice and innovation. The lack of choice for consumers denies them the potential to compare the services and benefits offered by competing companies. Monopolies typically require more price regulation than required by competing companies, so monopoly provision means that it is difficult to assess the reduction in average premiums that may arise from competition. In addition, the

competitive provision of insurance services would be more likely to result in innovative approaches to premiums that reflect the safety risks associated with individual drivers and workplaces. The Council has been unable to obtain sufficient information to assess the extent of these costs of monopoly provision.

Systems improvements, safety and rehabilitation, and high risk customers

Some States (especially Victoria and South Australia) have argued that private competing CTP and workers compensation insurers would have a reduced incentive to invest in systems improvements (for example, strategies to control litigation costs and fraud), public safety measures and rehabilitation technologies because there would be potential for leakage to other insurers. South Australia acknowledges that it is difficult to find evidence that multiple insurers would be less active than monopolies in these areas of investment.

The second Victorian review of CTP insurance concluded that private insurers seek to avoid high risk classes of customer, regardless of any legal requirement to insure, but the report did not offer data or anecdotal evidence to justify this conclusion, or provide examples of motorists failing to obtain insurance in other markets. The Northern Territory review of CTP insurance also argued that insurers in competitive market arrangements would seek to avoid high risk drivers, requiring regulatory responses. The extent and potential cost of private insurers' avoidance of high risk groups need to be considered, together with the additional costs of dealing with this avoidance (for example, a regulator taking complaints from motorists unable to obtain insurance, or an arrangement for covering 'bad risks'). The Victorian review did not consider ways of ensuring coverage of high risk groups other than through the monopoly. One alternative is a levy on insurers' premiums. Another possible approach is to allow higher premiums for high risk drivers.

The Council has sought more information on whether these perceived deficiencies occur in those jurisdictions with competitive provision, and whether regulation and levies could require and fund system improvements, safety and rehabilitation initiatives, and insurance of high risk parties. The Council has been unable to obtain sufficient information to assess whether monopoly provision holds inherent advantages in meeting these objectives.

'Long tail' liabilities

The recent discussion of public liability and professional (including medical) indemnity insurance has given much attention to the cost to the insurance industry of those accident victims who require benefits and special rehabilitation over a long period (so-called 'long tail' liabilities). In some cases, courts have awarded very large insurance lump sum payouts to such victims; some recipients have disabilities arising from medical complications many years ago. Some governments are concerned about the capacity of the

insurance industry to meet such uncapped lump sum payouts, especially if there is no constraint on the scope for litigation.

These recent developments reinforce the views of some States that the 'long tail' claims in workers compensation and CTP insurance increase the complexity of these areas of insurance. It is argued that provision by public monopolies is necessary to deal with the complexities and to provide the particular rehabilitation services (albeit through outsourcing) required by those with serious injuries.

Proponents of monopoly provision suggest that these features have welfare characteristics and that only public monopolies would be prepared to devote resources to such features. An alternative view is that private insurance companies participating in these insurance markets would undertake the necessary actuarial work to ensure they provide for the expected rate of 'long tail' claimants, and that they would have an incentive to contribute to community programs that aim to ensure the rate of severe injuries does not increase. Rehabilitation programs that are planned by governments and conducted under their supervision seem appropriate. Such programs appear equally compatible with monopoly insurance provision or with private provision coupled with levies to fund the rehabilitation schemes.

Victoria in particular has a strongly held position that public monopoly providers are more likely to meet 'long tail' commitments. A 'long tail' of seriously injured road or workplace accident victims occurs all around Australia, including in those jurisdictions where private insurers operate. Victoria points out that payments for economic loss as a result of a workplace accident can be made for a longer period in that State than in some other jurisdictions. The Northern Territory review of CTP insurance points out that provisions need to be made under competitive insurance arrangements to cover the long tail liabilities of insurers that become insolvent. This also would be necessary, however, under monopoly arrangements. The Council has argued, given the range of CTP and workers compensation insurance arrangements operating across Australia, that the evidence should be available to compare the performance of public and private schemes. Jurisdictions have not provided any such information, and the Council will be seeking comparative data from the States over the period to the 2003 NCP assessment.

The Council believes that more work is necessary on the extent to which the 'long tail' problem could be reduced by appropriate actuarially estimated premiums, and by government and insurer efforts to reduce accident rates and improve vehicle, road and workplace safety. This information would assist the Council's appraisal of whether multiple insurance provision is consistent with addressing the 'long tail' issue.

Prudential supervision

The HIH experience has been noted as adding to the costs of insurance in some of those jurisdictions where private insurers compete for CTP or

workers compensation insurance business. It also has been claimed to result in large bills to governments to meet HIH liabilities. The relevant States imply that public monopoly insurers are more immune to such failures, assuming that monopoly providers benefit from an extra layer of oversight.

Effective prudential supervision makes a substantial contribution to sound financial performance by insurers. This relationship has been belatedly recognised in the cases of HIH and UMP, the medical indemnity insurer that recently was placed in provisional liquidation. Some States appear reluctant to consider departing from monopoly provision of CTP and workers compensation insurance while they have concerns about national prudential supervision arrangements. Victoria argues that the nature of the CTP and workers compensation schemes in that State presents special barriers to prudential regulation, given the delayed onset of compensation claims, the gradual onset of injuries and the 'long tail' nature of compensation payments. The Council is not convinced that the Victorian schemes are markedly different from those in other jurisdictions. Prudential supervision of different insurance schemes and companies usually presents similar issues and difficulties.

States should provide more information about the extent to which their ownership of monopoly CTP and workers compensation insurance providers contributes to greater certainty about the financial positions of the providers. Such information may support Victoria's view that monopoly provision of CTP and workers compensation insurance in that State has protected the schemes from recent adverse developments in insurance markets. All jurisdictions, working together, should contribute to the development of improved national prudential supervision arrangements. The Australian Prudential Regulatory Authority commenced such development by announcing new prudential standards for general and life insurance companies (effective from 1 July 2002). It also met with medical defence organisations to develop options for bringing unregulated medical indemnity business under the authority's new prudential regime for general insurance.

Outsourcing

The monopoly providers in various jurisdictions outsource some of their functions to private companies (or, in some cases, 'panels' of companies). To the extent that these companies are chosen after a competitive bidding process, outsourcing may allow the achievement of at least some of the cost savings likely to arise from competitive provision of insurance. The realisation of some economies of scope seems likely.

In Victoria, the functions of the TAC that are outsourced (largely to private companies) include premium collection, information technology services and system development, mail and payroll services, investment and funds management, advertising and publicity, market research, and accident and other investigations. The Victorian WorkCover Authority also outsources several significant functions, including premium collection, claims management, premium audits, medical services, panel law and actuarial

services. South Australia provides another example of such outsourcing: the Motor Accident Commission outsources claims management, a large part of its investment management, and premium collection. The Territory Insurance Office in the Northern Territory outsources some claims management.

Governments have not provided any information on the extent to which outsourcing has led to cost savings, or compared such savings with potential cost savings under competitive provision of insurance. The Council will seek more information from States to form a view of the extent to which outsourcing by monopoly insurers, using a competitive bidding process, enables the reaping of cost savings (and thus premium reductions) that otherwise would be likely to be achieved only through multiple insurers.

Legal professional indemnity insurance

Governments require legal practitioners to hold professional indemnity insurance to ensure compensation for consumers suffering a loss as a result of negligent or deficient legal services. The following sections discuss reasons put forward by reviews and governments for requiring solicitors to obtain this insurance through a statutory monopoly provider. As with CTP and workers compensation insurance, the Council's consideration of NCP compliance mainly covers the issue of monopoly versus multiple provision.

Coverage of all registered practitioners

Some governments contend that monopoly provision of professional indemnity insurance ensures insurance is available to all practitioners, reinforcing the mandatory requirement for all solicitors to take out professional indemnity insurance. Under competitive arrangements, high-risk practitioners may have difficulty in finding insurance and thus be unable to practise. Some governments are concerned that such noncoverage would undermine the availability of solicitors and the financial protection afforded to solicitors' clients in the event of poor or improper performance by a solicitor. Monopoly insurance provision, however, dulls the signals — higher premiums or non-availability of insurance — that poorly performing or negligent legal practitioners are likely to receive under competitive arrangements. The South Australian review noted that the monopoly arrangements could be altered to exclude practitioners with a history of negligence (Legal Practitioners Act Review Panel, South Australia 2000, p. 67).

Some reviews have argued, however, that some competent solicitors would be denied insurance in a deregulated market for reasons unrelated to their professional performance and competence, leading to inefficiencies in the delivery of services and increases in the cost of legal services to the community. These reviews have argued that the premium income that insurers would receive from a small firm or sole practice would not justify a thorough risk assessment. Insurers would offer or deny insurance to small

firms and sole practitioners on the basis of rough indicators (for example, the number of claims made against a practitioner, regardless of their merit) rather than properly pricing risk (State Government of Victoria 2001c, p. 7). The Council is not convinced by these arguments. Competitive insurance markets are likely to include insurance companies that seek to expand their business by offering insurance to smaller legal firms and sole practitioners. Competition among these firms would be likely to contribute to appropriate risk assessment, competitive premiums and choice for lawyers.

The draft report of the Western Australian review suggested that individual insurers in a deregulated market may be unable to generate the comprehensive long-term actuarial data they require to accurately price risk. This lack of data would result in insurers being unwilling to offer cover to practitioners, not because they know the practitioners are a poor risk, but because they could not assess the probability of a claim occurring. The Western Australian review argued that a deregulated environment is thus unlikely to generate more efficient outcomes than those of a monopoly arrangement (Department of Justice, Western Australia 2002, p. 103). The Council does not believe this argument is strong. Private insurers bring to insurance markets their experience in risk assessment and actuarial analysis in similar markets in Australia (for example, insurance markets for other professionals) and overseas. Competitive pressures are likely to encourage them to offer legal professional indemnity insurance, especially given that most solicitors make few claims. Insurance companies would see most solicitors as a good risk.

KPMG pointed to New Zealand experience that suggests professional indemnity insurance would be available outside a monopoly scheme (KPMG Consulting 1996, p. 61). In Victoria, the Legal Practice Board (1998, p. 15) reported that commercial insurers had advised that nearly all practitioners would be able to secure cover in a commercial market.

Some insurers recently suggested, however, that a substantial number of solicitors may be unable to obtain insurance given the uncertainty in the world insurance markets following the events of 11 September 2001 and the HIH collapse (New South Wales Government 2002, p. 37). The Council finds it difficult to assess the likelihood of such nonprovision in the absence of competitive insurance markets for solicitors. Some insurance industry participants recently argued for tort law reform. Suggestions of potential supply shortfalls reinforce the pressures on governments to engage quickly in such reform. The current insurance market environment is not conducive to accurate prediction of market reactions to the end of monopoly provision. Governments' liability law reforms and the recently announced review of negligence laws may alter expectations of these reactions.

Some reviews proposed mechanisms to ensure solicitors who are poor risks are able to obtain insurance in a deregulated market. These mechanisms include:

- creating an assigned risk pool and requiring insurers to accept a certain number of high risk practitioners (Speedman 1994, appendix IV; Attorney-General's Department, New South Wales 1998); and

- requiring insurers participating in the market to accept any application for professional indemnity insurance, but limiting the differential between the minimum and maximum premiums that they offer (Hoffman and Masel 1997, p. 6; Attorney-General's Department, New South Wales 1998).

The Council believes that most solicitors would be able to obtain insurance cover under a competitive regime, and that market signals (higher premiums and reduced cover availability) for poorly performing solicitors would contribute to improving the overall quality of solicitors.

Cost-effective coverage

Some jurisdictions identified lower insurance premiums as a significant benefit of retaining statutory monopoly insurance arrangements. The South Australian review suggested that the promise of a significant market share under its master policy approach (which it characterises as compulsory collective bargaining scheme) may encourage insurers to compete for the work (Legal Practitioners Act Review Panel, South Australia 2000, p. 66).

Victoria provided actuarial evidence that its monopoly mutual fund offers 30 per cent lower premiums in the long term compared with those premiums offered by commercial insurance firms. The mutual fund does not have to pay advertising, brokerage and commissions. Further, as a nonprofit-making entity, the mutual fund does not need to include a profit margin in its premium rates (Trowbridge cited in Legal Practice Board, Victoria 1998). New South Wales also provided evidence that mutual funds offer the most cost-effective professional insurance model (New South Wales Government 2002, p. 38).

In some professional indemnity insurance markets, professional associations offer insurance products to their members, using their bargaining strength with the insurers to negotiate attractive premiums. Mutual funds also compete in a range of insurance markets.

Delivery of run-off cover

Professional indemnity insurance policies are generally written on a 'claims made' basis. They cover claims made during the life of the policy, regardless of the date of the events giving rise to the claims, but do not cover claims made after the policy expires, even if the event giving rise to the claim occurred while the policy was current. Professional indemnity insurance claims tend to have a 'long tail', so practitioners require 'run-off' cover for several years after they cease to practise, to insure against claims that may be made during this time.

Under monopoly insurance arrangements, the premium collected from current practitioners generally includes a component funding run-off cover for former practitioners: retirees do not need to purchase separate run-off cover. This arrangement ensures consumers will never be denied compensation due to the practitioner at fault being dead or lacking financial resources. In a commercial insurance market, former practitioners need to purchase run-off cover or have it purchased on their behalf. There is no mechanism for compelling former practitioners to purchase run-off insurance, however, because they no longer need a licence to practise (Trowbridge cited in Legal Practice Board, Victoria 1998).

Medium to large firms usually have enough practitioners to continue to exist indefinitely, so their professional indemnity insurance continues to cover their former partners and employees. Solicitors working in sole practice or small partnerships are most likely to require run-off cover. Some sole practitioners may not bother or be able to purchase run-off insurance in a commercial insurance market. Victoria provided evidence from other professions to suggest the commercial insurance industry may resist providing extensive run-off cover to former practitioners. The extent to which former practitioners would experience difficulties in obtaining run-off cover at reasonable prices in a competitive market is unclear. Private insurers could assess the risk of claims on retirees and set premiums accordingly. The Council requires more information on this issue to gauge the likely price and availability of run-off insurance for retired solicitors in a competitive market.

The significance of the run-off cover benefits of a statutory professional indemnity insurance monopoly depends on the number of potentially uninsured 'run-off' claims. Victoria provided some evidence about the number of run-off claims: it found that about 8 per cent of claims are run-off claims (and noted that this figure would rise if some practitioners ceased to practise because they could no longer afford or obtain compulsory insurance cover). Not all of these claims would be uninsured, however; some would be covered by run-off insurance that former practitioners voluntarily take out in view of the potential financial risks.

The significance of statutory insurance monopolies in providing run-off cover benefits also depends on the capacity of the monopoly insurer to fund the run-off claims. Provision of run-off insurance implies the need for a scheme that specifies minimum insurance coverage and has a secure funding base that is not subject to erosion (State Government of Victoria 2001c, p. 18). Many jurisdictions, however, allow national law firms to opt out of their insurance scheme if they have insured elsewhere. A few large firms moving from one scheme to another can significantly affect each scheme's premium base: in 2000, the transfer of four large national firms increased Victoria's premium pool by 23 per cent to 8403 practitioners (Legal Practitioners Liability Committee, Victoria 2001).

It may not be necessary to establish a professional indemnity insurance monopoly to ensure adequate run-off cover. The Queensland NCP review issues paper sought comments on whether the professional body could provide run-off cover under a master policy (paid for by a levy that is a condition for

practising certificates) but allow practitioners to negotiate their own current cover.

Prudential supervision

Some reviews have argued that a major benefit of statutory monopoly legal professional indemnity insurance schemes is greater confidence in the financial position on the insurance provider (Legal Practitioners Act Review Panel, South Australia 2000, p. 66; State Government of Victoria 2001c, p. 15). In a commercial market of competing insurers, the collapse or withdrawal of a major insurer would require substantial numbers of solicitors to find a new insurer, creating disruption and uncertainty while this occurs. The collapse of a statutory monopoly insurer, however, could have even worse effects.

The Council is not convinced that monopoly provision necessarily contributes to better prudential outcomes. States should provide more information about the extent to which statutory monopoly schemes provide greater prudential certainty. HIH underwrote the New South Wales' monopoly scheme, LawCover. The collapse of HIH led to delay and adjournment of trials of claims it was handling on behalf of New South Wales solicitors, and the delay of payment settlements (State Government of Victoria 2001c, p. 17). The monopoly provision in New South Wales did not provide any warning of the adverse events. Schemes based on mutual funds are unable to spread risk away from the profession and rely on a narrow base from which to draw their reserves (Legal Practice Board, Victoria 1998, p. 18).

Risk management

Some reviews have contended that monopoly arrangements facilitate risk management. They have argued that having access to information about all claims made or threatened against private practitioners in a State enables the monopoly providers to identify hazards of practice that may result in claims and to inform practitioners of emerging risks and encourage them to institute risk management practices. Reviews have provided evidence that proactive risk management by the monopoly providers has substantially reduced the numbers of some types of claim, thereby reducing the costs of legal services and the financial losses suffered by the community as a result of the negligent delivery of legal services (for example, State Government of Victoria 2001c, pp. 12–14).

These reviews have argued that these benefits would not arise under a commercial insurance market, because there may be little commercial incentive for insurers in an open market to encourage risk management initiatives that ultimately benefit their competitors if the insured person changes insurers. The New South Wales review, however, proposed a potential solution to this problem. It suggested placing a levy on commercial insurance premiums and using this to fund the profession's regulatory bodies to provide risk and practice management and training. In addition,

commercial insurers could be required to provide specified claims information to the regulatory bodies, to ensure these bodies are aware of emerging risks (Legal Practice Board, Victoria 1998).

Individual legal practitioners would have an increased incentive to improve their risk management practices under competitive insurance arrangements, because such practices would tend to reduce their premiums.

Reducing competition impacts of monopoly

There are several options for reducing the adverse effects of retaining professional indemnity insurance monopolies.

- Where it does not occur already, the monopoly schemes could provide for risk rating of premiums. This would reduce the extent to which clients of better performing practitioners subsidise solicitors facing payouts for negligence, thus increasing consumer welfare.

- The draft report of the Western Australian review (Department of Justice, Western Australia 2002, p. 15) noted that the Law Society has legislative discretion to exempt practitioners from its insurance scheme. It recommended amending the legislation to codify the Law Society's practice of allowing practitioners to opt out if they give adequate notice and evidence of having made suitable alternative arrangements for professional indemnity insurance cover.

- The New South Wales Government proposes to establish a monopoly mutual fund, given concerns that deregulation under present market conditions could lead to substantial numbers of solicitors being unable to obtain insurance. It intends, however, to review the mutual fund after two years operation, having regard to changing market conditions (New South Wales Government 2002, p. 37).

The Council will seek further information from jurisdictions to enable a more conclusive assessment of the impacts of competitive provision of legal professional indemnity insurance. The Council's assessment will also be influenced by developments in the regulatory environment as governments consider liability law reforms during 2002-03.

Assessing compliance

Need for further information

The restriction in any legislation that requires monopoly provision of CTP, workers compensation and/or solicitors' professional indemnity insurance is central to the Council's consideration of NCP compliance. The Council has sought information that supports monopoly arrangements. The arguments

and information presented to date (much drawn from NCP reviews) has greatly assisted the Council.

The issues that the Council and governments have raised are not easily resolved. Reviews and governments have not presented firm evidence of a public interest case for the monopoly restriction. The Council still does not have, for example, a clear view on the scale of enterprise that would reap economies of scale in providing CTP or workers compensation insurance. Despite the existence of multiple CTP and workers compensation insurers in several jurisdictions, governments operating statutory monopolies have not provided evidence that private insurers would neglect high risk customers and participate only weakly in systems improvements and safety initiatives. This information should be available, particularly where there is monopoly provision of one of the two forms of insurance, and multiple provision of the other form.

Governments need to provide more information about the extent to which their ownership of monopoly insurance providers gives them comfort about the financial positions of those providers. Governments should be able to indicate that the extent is substantial, because the financial failure of a monopoly provider would be arguably more serious than the failure of one of a number of private insurers.

Governments have not provided data to identify the cost savings from outsourcing. Some governments have informed the Council of the significant functions that their monopoly insurance providers have outsourced, but the extent to which this outsourcing has followed competitive bidding processes is unclear. More significantly, the Council has not received information that would allow it to assess the extent to which the savings from outsourcing approximate those that would be realised from competitive pressures and economies of scope if multiple insurers replaced the monopoly. The extent of these potential savings is still an open question to the Council, which will follow up this query with governments over the period to the 2003 assessment.

Finalising the assessment of NCP compliance

The insurance industry has experienced substantial change in recent times, with sharply increased premiums in particular insurance markets, concerns about insurers' willingness to supply some products to certain classes of customer, major catastrophes and cyclical factors increasing the cost of reinsurance, and the collapse of some major insurance companies. Premium costs have become a particular issue in public liability and professional indemnity insurance. Commonwealth, State and Territory governments have been discussing major changes to the regulatory environment in these two areas of insurance to rein in claims costs and increase the degree of market certainty. They are aiming to ensure insurance is available at premiums that are not greatly more expensive than previous rates.

Changes in the insurance industry and its regulatory environment are likely to continue over 2002-03, with ramifications for all insurance markets. Governments are likely to focus on the extent to which they should amend their laws to check the growth in liability and indemnity claim volumes and costs. This environment of heightened change in the insurance industry is not conducive to finalising in the 2002 NCP assessment how the Council and governments perceive the benefits and costs of changing from monopoly to multiple provision of CTP, workers compensation and professional indemnity insurance.

The Council proposes to defer until June 2003 its assessment of jurisdictions' compliance against the central NCP issue — that is, whether it can be shown that the community benefits of monopoly provision of insurance exceed the costs and that the objectives of governments' legislation can be achieved only by restricting competition. This deferral reflects the need for the Council to obtain more information on several issues (as described above), including the current heightened degree of change in the industry and its regulatory environment.

Case for a comprehensive interjurisdictional review

The Council believes that governments should consider a comprehensive review of the economics of the insurance industry and the various insurance markets. This review would help governments to decide the appropriate changes to address the difficulties in the public liability and professional indemnity insurance markets. The Council believes that such a review would:

- enhance understanding of the causes of the recent increases in premium prices. While the factors contributing to the premium increases have been described in the Trowbridge Consulting (2002) and ACCC (2002) reports, the relative importance of each contributory factor is unclear. For governments to decide on changes to the regulatory environment of the insurance industry, they must have a firm understanding of the extent to which recent premium increases have been driven by cyclical factors as opposed to factors that may be reversed only through government intervention;

- contribute to governments' introduction of measures that are similar;

- enhance governments' consideration of the complex issues of tort law (including negligence law) reform;

- increase knowledge of the links between insurance markets and thus the extent to which changes in public liability and professional indemnity markets will flow through to other insurance markets; and

- contribute to the Council's and governments' understanding of those factors that are pertinent to the monopoly provision issue, including:

- the economies of scale and scope in the industry;
- the extent to which competition would be likely to lead to a sustained fall in premiums;
- the approaches of private insurers to systems and safety improvements, high risk customers and 'long tail' liabilities;
- the contribution of variability in premiums to altering the behaviour of high risk insured parties;
- the design and importance of prudential supervision and government monitoring of CTP and workers compensation insurance providers; and
- the potential contribution of outsourcing to the achievement of cost savings.

The Council believes that the Productivity Commission may be the body best placed to undertake a review, drawing on its knowledge of the industry, other market participants and governments.

The Commonwealth Government announced on 26 July 2002 that it has asked the Productivity Commission to undertake a research study that will examine Australian insurers' claims management practices in public liability insurance and benchmark them against world's best practice. The Productivity Commission is to complete its report by 31 December 2002. This study will contribute to governments' understanding of a sector of the insurance market. The Council believes, however, that a comprehensive review of the wider insurance industry and markets, as suggested above, would greatly assist the Council's and governments' consideration of the issues surrounding monopoly provision of compulsory insurance.

Public sector superannuation

Some governments allow their public sector employees a choice of superannuation fund. New Victorian public servants, for example, can opt to make their superannuation contributions to VicSuper or a private fund. New South Wales, Tasmania and the Northern Territory also allow a choice of fund. Other governments require most, if not all public servants to contribute to a government monopoly fund. The Council has been discussing the monopoly approaches with relevant governments, some of which point out that their public servants can choose an investment strategy and that funds management is outsourced to one or more private funds managers. The Council is considering the extent to which the outcomes for superannuation contributors in these jurisdictions may be significantly different from the outcomes achievable if a choice of fund was allowed. Commonwealth legislation to allow a choice of fund for certain Commonwealth employees (with ramifications for ACT Government employees) was defeated in the

Senate in August 2001. The Commonwealth introduced the Superannuation Legislation Amendment (Choice of Superannuation Funds) Bill 2002 to Parliament on 27 June 2002. If passed, this legislation would facilitate the provision of choice of superannuation fund to certain Commonwealth employees, providing these employees the option of having their superannuation contributions paid to retail superannuation funds or their corporate or industry fund. (The legislation would also allow non-public sector employees the option of requesting their employers to make superannuation contributions to the superannuation fund of their choice.) Such changes would be effective from 1 July 2004.

The Commonwealth Government does not intend to introduce choice of fund for military personnel because the superannuation schemes operated under the *Defence Forces Retirement Benefits Act 1948* and the *Military Superannuation and Benefits Act 1991* contain benefit features that are unique to the nature of military service. The schemes are also unfunded defined benefit schemes and allowing choice of fund would concentrate fiscal impacts in a particular period.

The superannuation scheme operated under *Parliamentary Contributory Superannuation Act 1948* is very small (with minimal consequences arising from lack of competition) and is also an unfunded defined benefit scheme.

The Council will be making further queries of governments during 2002-03 and reach a final view on governments' NCP compliance in June 2003.

Table 9.4 summarises legislative review and reform activity in the area of public sector superannuation.

Table 9.2: Review and reform of legislation regulating compulsory third party motor vehicle insurance

Jurisdiction	*Legislation*	*Key restrictions*	*Review activity*	*Reform activity*	*Assessment*
New South Wales	*Motor Accidents Act 1988* *Motor Vehicles (Third Party Insurance) Act 1942*	Mandatory insurance, licensing of insurers, file-and-write premium setting	Review was completed in 1997, recommending changing scheme design and that insurers file premiums with the Motor Accidents Authority.	Legislation was passed in line with review recommendations.	Meets CPA obligations (June 1999).
Victoria	*Transport Accident Act 1986*	Mandatory insurance, monopoly insurer, centralised premium setting	Internal review was completed in 1998, recommending removing the statutory monopoly in favour of competitive provision. Second review was completed in December 2000, recommending maintaining the monopoly and centralised premium setting. Review also recommended a third party review of premiums and market testing.	The Government rejected the findings of the first review and accepted the findings of the second review.	Council to finalise assessment in 2003.
Queensland	*Motor Accident Insurance Act 1994*	Mandatory insurance, licensing of insurers, file-and-write premium setting	Review was completed in 1999, recommending retaining licensing of insurers, but removing restrictions on market re-entry and on motorists changing insurers. Review also recommended introducing greater competition in premium setting through a 'file-and-write' system.	The *Motor Accident Insurance Amendment Act 2000*, which commenced in October 2000, was passed in line with review recommendations.	Meets CPA obligations (June 2001).
Western Australia	*Motor Vehicle (Third Party Insurance) Act 1943*	Mandatory insurance, monopoly insurer, centralised premium setting	Review was completed in 1999-2000, recommending removing the monopoly provision of insurance and retaining Ministerial approval of premiums.	The Government is considering recommendations.	Council to finalise assessment in 2003.

(*continued*)

Table 9.2 continued

Jurisdiction	*Legislation*	*Key restrictions*	*Review activity*	*Reform activity*	*Assessment*
South Australia	*Motor Vehicles Act 1959*	Mandatory insurance, monopoly insurer, centralised premium setting	Review was completed in 1998, recommending removing the monopoly and controls on premiums. Second review was completed in 1999, rebutting previous review's recommendations. The Government issued both reviews for public consultation in early 2001.	The Government announced retention of mandatory insurance, the sole provision of insurance by the Motor Accident Commission and community rating.	Council to finalise assessment in 2003.
Tasmania	*Motor Accidents (Liabilities and Compensation) Act 1973*	Mandatory insurance, monopoly insurer, centralised premium setting	Review was completed in 1997, recommending retaining the monopoly provision of insurance. Following 1999 NCP assessment, the Government agreed to re-examine the issue.	The Government is considering the Victorian review of the TAC.	Council to finalise assessment in 2003.
ACT	*Road Transport (General) Act 1999*	Mandatory insurance, licensing of insurers	Not for review. Legislation allows the Government to approve multiple insurers.		Meets CPA obligations (June 1997).
Northern Territory	*Territory Insurance Office Act* *Motor Accidents (Compensation) Act*	Mandatory insurance, monopoly insurer, centralised premium setting	Review of Territory Insurance Office Act completed in 2000. Review of the Motor Accidents (Compensation) Act was completed in December 2000 and is under consideration by the Government.	The Territory Insurance Office Act was amended in December 2000, removing the requirement that the Territory Insurance Office be the sole administrator of the Motor Accident Compensation scheme. The Motor Accidents (Compensation) Act continues to enforce the monopoly.	Council to finalise assessment in 2003.

Table 9.3: Review and reform of legislation regulating workers compensation insurance

Jurisdiction	*Legislation*	*Key restrictions*	*Review activity*	*Reform activity*	*Assessment*
Commonwealth	*Safety, Rehabilitation and Compensation Act 1988*	Mandatory insurance, monopoly insurer, centralised premium setting	Review completed in 1997, recommending introducing competition to Comcare.	The Government has not responded to the review.	Council to finalise assessment in 2003.
New South Wales	*Workers Compensation Act 1987*	Mandatory insurance, monopoly insurer, centralised premium setting	Review was completed in 1997-98, recommending removing the monopoly insurer in favour of competitive underwriting. Further examination of the scheme in 2000-01 resulted in proposals for changing to scheme design. Further review has been proposed, with report to be completed in second half of 2003.	Legislation was passed to introduce private underwriting in October 1999. Subsequent legislation delayed implementation to a date to be determined by the Minister. Provisions for competitive underwriting were repealed in late 2001. Scheme design changes were introduced in 2001.	Council to finalise assessment in 2003.
Victoria	*Accident Compensation Act 1985* *Accident Compensation (Workcover Insurance) Act 1993*	Mandatory insurance, monopoly insurer, centralised premium setting	Internal review was completed in 1997-98, recommending competitive provision. Second review was completed in December 2000, recommending maintaining the monopoly and centralised premium setting, and a third party review of premiums and market testing.	The Government rejected the findings of the first review and accepted the findings of the second review.	Council to finalise assessment in 2003.
Queensland	*Workcover Queensland Act 1996*	Mandatory insurance, monopoly insurer, centralised premium setting	Review was completed in December 2000, recommending retaining mandatory insurance and public monopoly insurer, and creating Q-COMP as a separate regulatory entity.	The Government is legislating in 2002 to establish Q-COMP as a separate entity.	Council to finalise assessment in 2003.

(*continued*)

Table 9.3 continued

Jurisdiction	*Legislation*	*Key restrictions*	*Review activity*	*Reform activity*	*Assessment*
Western Australia	*Workers Compensation and Rehabilitation Act 1981*	Mandatory insurance, licensed insurers, centralised premium setting	Review was completed in early 2002.	Minor legislative amendments scheduled for Autumn 2003.	Council to finalise assessment in 2003.
South Australia	*Workers Rehabilitation and Compensation Act 1986*	Mandatory insurance, monopoly insurer, centralised premium setting	Review under way. Draft report completed in May 2000. Final report near completion.		Council to finalise assessment in 2003.
Tasmania	*Workers Rehabilitation and Compensation Act 1988*	Mandatory insurance, licensed insurers	Review by the Parliamentary Joint Select Committee of Inquiry was completed in 1997, recommended minor amendments.	Legislation was amended in March 2001 in line with recommendations.	Meets CPA obligations (June 2001).
ACT	*Workers Compensation Act 1951*	Mandatory insurance, licensing of insurers	Review was completed in July 2000, recommending changes to scheme design elements and a greater capacity to self-insure.	The *Workers Compensation (Amendment) Act 2001* was passed in August 2001 (effective from 1 July 2002). It retained no premium setting, and choice of provider.	Meets CPA obligations (June 2002).
Northern Territory	*Work Health Act*	Mandatory insurance, prescribed standards that insurers must meet.	Review was completed in September 2000 and released for public comment in June 2001, recommending that premiums remain unregulated and insurers remain unlicensed.		Council to finalise assessment in 2003.

Table 9.4: Review and reform of legislation regulating public sector superannuation

Jurisdiction	*Legislation*	*Key restrictions*	*Review activity*	*Reform activity*	*Assessment*
Commonwealth	*Superannuation Act 1976* *Superannuation Act 1990* *Superannuation Guarantee (Administration) Act 1992* *Defence Forces Retirement Benefits Act 1948* *Military Superannuation and Benefits Act 1991* *Parliamentary Contributory Superannuation Act 1948*	Limits on choice of funds	Following a review in 1997, legislation was introduced into Parliament to allow choice of fund for Commonwealth employees. The Government does not intend to provide choice of fund for military personnel because the superannuation schemes operated under the Defence Forces Retirement Benefits Act and the Military Superannuation and Benefits Act contain benefit features that are unique to the nature of military service. The schemes are also unfunded defined benefit schemes and allowing choice of fund would have a significant fiscal impact at a particular point in time. Review of the Parliamentary Contributory Superannuation Act was completed, concluding that administration costs are trivial and that there are efficiencies. The scheme operated under this Act is very small (with minimal consequences arising from lack of competition) and also an unfunded defined benefit scheme.	Amending legislation was defeated in the Senate in 2001. The Government has since restated its commitment to choice of fund for Commonwealth employees. Choice of fund legislation (for Commonwealth and other employees) was reintroduced to Parliament on 27 June 2002. Choice of fund will not apply to military personnel or parliamentarians.	Council to finalise assessment in 2003.

(*continued*)

Table 9.4 continued

Jurisdiction	*Legislation*	*Key restrictions*	*Review activity*	*Reform activity*	*Assessment*
Commonwealth	Superannuation Acts including: *Superannuation Industry (Supervision) Act 1993* *Superannuation (Self Managed Superannuation Funds) Taxation Act 1987* *Superannuation (Self Managed Superannuation Funds) Supervisory Levy Imposition Act 1991* *Superannuation (Resolution of Complaints) Act 1993* *Occupational Superannuation Standards Regulations Applications Act 1992* *Superannuation (Financial Assistance Funding) Levy Act 1993*	Legislation provides for prudential regulation and supervision of the superannuation industry and the imposition of certain levies on superannuation funds and approved deposit funds.	The Productivity Commission undertook a NCP review of this legislation and submitted its final report to the Government on 10 December 2001. The report made various recommendations relating to the prudential supervision and regulation of the superannuation industry.	The Minister for Revenue and Assistant Treasurer released the Commonwealth Government's interim response to the Productivity Commission report on 17 April 2002. The Government will complete its response after it has received the outcomes of other examinations of superannuation that are under way, including the report of the Superannuation Working Group chaired by Mr Don Mercer. The interim response noted (for further consideration) the Productivity Commission's recommendations with respect to strengthening the net tangible asset requirements of approved superannuation trustees, requiring trustees of superannuation entities regulated by the Australian Prudential Regulation Authority to prepare a risk management strategy, and other recommendations. The Government has agreed to various recommendations, including one relating to simplifying compliance requirements and enhancing capital adequacy requirements.	Council to finalise assessment in 2003.

(*continued*)

Table 9.4 continued

Jurisdiction	*Legislation*	*Key restrictions*	*Review activity*	*Reform activity*	*Assessment*
New South Wales	*Superannuation Administration Act 1987*	Limits on choice of funds		Legislation was passed in 1999 to corporatise the scheme regulator and market test the administration. Choice was introduced.	Meets CPA obligations (June 2001).
Victoria	*State Superannuation Act 1985* *Superannuation (Public Sector) Act 1992*	Limits on choice of funds	Review was completed in 1999.	Government employees have had a choice of fund since 1994: VicSuper or a private superannuation fund.	Meets CPA obligations (June 2001).
Queensland	*Superannuation (Government and Other Employees) Act 1988*	Limits on choice of funds	Review was completed in late 2000, concluding that the Act does not restrict competition.		Council to finalise assessment in 2003.
Western Australia	*State Superannuation Act 2000*	Limits on choice of funds	Review currently being considered by the Government.		Council to finalise assessment in 2003.
South Australia	*Southern State Superannuation Act 1987*	Limits on choice of funds	Full NCP review was not conducted. The Government considers the restrictions to be trivial.	No reform.	Council to finalise assessment in 2003.
Tasmania	*Retirement Benefits Act 1993*	Limits on choice of funds		Choice of funds was introduced for new and existing contributors. The Government moved to fund existing public scheme.	Meets CPA obligations (June 2001).
ACT	As for Commonwealth	As for Commonwealth		Reform depends on Commonwealth reforms. New entrants have a choice of funds.	Council to finalise assessment in 2003.

(*continued*)

Table 9.4 continued

Jurisdiction	*Legislation*	*Key restrictions*	*Review activity*	*Reform activity*	*Assessment*
Northern Territory	*Superannuation Act*	Limits on choice of funds	Review was completed in 1998, recommending that the Government close the unfunded scheme and introduce choice.	Reforms were implemented in line with review recommendations.	Meets CPA obligations (June 2001).