

# **Public liability and professional indemnity insurance**

Third monitoring report

July 2004



© Commonwealth of Australia 2004

ISBN 1 920702 53 9

This work is copyright. Apart from any use as permitted under the *Copyright Act 1968* no part may be reproduced without prior written permission from the Australian Competition and Consumer Commission. Requests and inquiries concerning reproduction and rights should be addressed to the Director Publishing, Australian Competition and Consumer Commission, PO Box 1199, Dickson ACT 2602.

Produced by the ACCC Publishing Unit 07/04.

# Contents

Abbreviations .....	v
Glossary of terms .....	vi
Summary .....	viii
<b>1 Introduction.....</b>	<b>1</b>
1.1 Background.....	1
1.2 Ministerial request.....	1
1.3 Previous ACCC insurance monitoring reports .....	2
1.4 Scope of the monitoring report .....	3
1.5 Approach to monitoring .....	4
1.6 Qualifications .....	4
1.7 Report outline .....	5
<b>2 Reforms affecting public liability and professional indemnity insurance .....</b>	<b>6</b>
2.1 Ministerial meetings .....	6
2.2 Commonwealth, state and territory tort law reforms implemented up to 31 December 2003 .....	7
2.3 Likely effect of reforms on claims costs .....	11
<b>3 Features of the public liability and professional indemnity insurance classes ..</b>	<b>13</b>
3.1 Insurance defined .....	13
3.2 Liability insurance .....	13
3.3 Public liability insurance .....	14
3.4 Professional indemnity insurance .....	17
3.5 Conclusion .....	20
<b>4 Costs of public liability insurance .....</b>	<b>21</b>
4.1 Introduction .....	21
4.2 Trends in claims .....	21
4.3 Reasons for recent claims cost increases .....	29
4.4 Trends in expenses .....	30
4.5 Conclusion .....	31
<b>5 Premiums and financial performance in public liability insurance.....</b>	<b>32</b>
5.1 Introduction .....	32
5.2 Trends in premiums .....	32
5.3 Reasons for recent premium increases .....	35
5.4 Terms and conditions of policies.....	35
5.5 Trends in financial performance .....	37
5.6 Conclusion .....	40
<b>6 Costs of professional indemnity insurance .....</b>	<b>41</b>
6.1 Introduction .....	41
6.2 Trends in claims .....	41
6.3 Reasons for recent claims cost increases .....	46
6.4 Trends in expenses .....	47
6.5 Conclusion .....	48

<b>7</b>	<b>Premiums and financial performance in professional indemnity insurance.....</b>	<b>49</b>
7.1	Introduction .....	49
7.2	Trends in premiums.....	49
7.3	Reasons for recent premium increases .....	52
7.4	Terms and conditions of policies.....	52
7.5	Trends in financial performance .....	54
7.6	Conclusion .....	56
<b>8</b>	<b>Impact of government reforms—insurers experience and expectations .....</b>	<b>57</b>
8.1	Introduction .....	57
8.2	The ACCC’s monitoring methodology.....	57
8.3	Impact of government reforms on public liability insurance .....	58
8.4	Impact of government reforms on professional indemnity insurance .....	62
8.5	Conclusion.....	64
<b>9</b>	<b>Conclusion .....</b>	<b>66</b>
	<b>Appendixes.....</b>	<b>69</b>
A	Regulatory arrangements .....	71
B	Insurers that participated in the ACCC’s monitoring program.....	74
C	Tort reforms as at 31 December 2003.....	75
D	Monitoring methodology for examining historical costs and expenses, premiums and financial performance .....	89
E	Public liability claims costs and premiums by industry .....	92
F	Professional indemnity claims costs and premiums by occupation.....	95
G	Public liability personal injury and death claims costs by heads of damage .....	98

## Abbreviations

ABS	Australian Bureau of Statistics
ACCC	Australian Competition and Consumer Commission
ACT	Australian Capital Territory
ANZSIC	Australian and New Zealand Standard Industrial Classification
APRA	Australian Prudential Regulation Authority
ASCO	Australian Standard Classification of Occupations
ASIC	Australian Securities and Investment Commission
AWE	average weekly earnings
CTP	compulsory third party
DOFI	direct offshore foreign insurer
IBNER	incurred but not enough reported
IBNR	incurred but not reported
ICA	Insurance Council of Australia
IEC	Insurance Enquiries and Complaints Limited
ISC	Insurance and Superannuation Commission
MDO	medical defence organisation
NSW	New South Wales
NT	Northern Territory
Qld	Queensland
SA	South Australia
Tas	Tasmania
the ministers	Commonwealth, state and territory ministers and the President of the Australian Local Government Association
the Act	the <i>Trade Practices Act 1974</i>
Vic	Victoria
WA	Western Australia

## Glossary of terms

This glossary contains a brief description of common terms used in the insurance industry that appear in this report.

<b>Term</b>	<b>Meaning</b>
agent	an insurance intermediary whose principal is an insurer
book of business	the number, size and type of accounts (policyholders) that an insurer underwrites
broker	an intermediary who places the risks of parties seeking insurance with insurers and whose principal is the insured
brokerage expenses	commissions, brokerage and similar charges paid or payable by the insurer to agents or brokers
claims payments	the payments that have been made on all claims at a particular date
claim reports incurred	the total number of claims reported to an insurer including those claims already reported but also IBNR claims
combined ratio	the sum of the loss ratio, the expense ratio and the reinsurance ratio; it shows the percentage of premium that is represented by the costs of writing the business including the cost of incurred claims
cover limit	the maximum amount an insurer will pay under a policy
earned premium	the total amount of gross written premium that is earned during the period, earned being that proportion of risk covered by the policy that has expired at the end of the reporting period. For example, although one year's premium may cover 12 months of risk, the insurer is said to have 'earned' six months worth of that premium after six months has elapsed
excess	the amount of the loss that will be paid by the insured party before the insurer pays the claim. An excess is similar to a deductible with the exception that an excess is a co-payment paid by the insurer upon settlement of a claim while a deductible is a limit on the cover offered, the amount below the deductible is paid directly by the insured. The differences are minor and as such this report refers to a deductible as an excess
expected future payments	the insurer's liability for outstanding claims recognising the potential cost to the insurer of settling claims that it has incurred at the reporting date but which have not been settled (i.e. expected future payments in relation to unpaid reported claims, IBNRs, IBNERs and costs that the insurer expects to incur in settling those claims)
expense ratio	the percentage of gross written premium that is represented by the costs of writing the business, including brokerage and underwriting expenses, but excluding claims costs, reinsurance costs and general expenses
gross written premium	the total premiums underwritten by an insurer during a period, before the deduction of reinsurance expense

incident	an incident resulting in a loss that may develop into a claim against the insured
incident year	the year in which an incident occurs
incurred claims	the total number of claims for any one incident year that may result in a liability for the insurer, this would include claims settled and claims outstanding (including IBNRs and IBNERs)
incurred but not enough reported claims (IBNERs)	a provision in an insurer's book that recognises that estimates for reported claims may be inadequate
incurred but not reported claims (IBNRs)	claims arising from incidents or losses that have taken place during the underwriting period but are expected to be reported to the insurer in subsequent periods
long-tail classes	classes of business that have claims that can be reported over many years after writing the policy, such as employers' liability, public liability and professional indemnity
loss ratio	the percentage of earned premium that is represented by the cost of claims payments in real terms and expected future payments (including IBNRs and IBNERs) in real terms attributable to that earned premium
net combined ratio	the combined ratio net of reinsurance expenses and recoveries
net written premium	gross written premium less reinsurance expenses
personal injury or death claims	a claim relating to an incident that results in the injury or death of a third party
property damage claim	a claim relating to an incident that results in the damage of third party property
reinsurance	the process by which an insurer cedes some of its premium underwritten in exchange for the reinsurer accepting some of the risk. Simply put, this is insurance for the insurers
reinsurance expense	the amount of premium ceded to reinsurers for reinsurance during a period
reinsurance ratio	the percentage of gross written premium that is represented by the cost of reinsurance
report	the notification of an incident or loss that may develop into a claim against the insured
report year	the year in which an insurer is notified of an incident or loss that may develop into a claim against the insured
settlement	when parties to a claim agree to finalise the claim or a court gives a verdict, the claim is said to have been settled
settlement year	the year in which a claim is settled
superimposed inflation	the rate of inflation of claims costs by reason of factors other than economic/investment factors, for example court awards and legislative amendments
underwriting expense	costs attributable to the underwriting of specific classes of insurance
underwriting year	the year in which the policy was issued or renewed

# Summary

## The ACCC's monitoring role

Throughout 2002 and 2003 Commonwealth, state and territory governments responded to consumer concerns about the size of increases in public liability and professional indemnity insurance premiums by establishing and progressively implementing a framework of reform aimed at containing claims costs in these classes of insurance.

In July 2002 the Australian Government asked the Australian Competition and Consumer Commission (ACCC) to monitor costs and premiums in the public liability and professional indemnity insurance classes on a six monthly basis over two years, and, to the extent possible, assess the impact of reforms on premiums.<sup>1</sup> This is the third of four ACCC monitoring reports.<sup>2</sup>

To fulfil this monitoring role, the ACCC obtained a range of quantitative and qualitative information from insurers<sup>3</sup> so as to examine:

- Trends in the number and cost of claims and average premiums for public liability and professional indemnity insurance from 1997 to 2003, and the financial performance of these classes from 2001 to 2003.
- Insurers' experience to date of the impact of reforms on their emerging claims experience for public liability and professional indemnity insurance, and their expectations of the impact of reforms on their costs and premiums for these classes of insurance in 2004 and subsequent years.

## Public liability and professional indemnity insurance

Public liability and professional indemnity insurance are two separate classes of liability insurance within the general insurance industry.

Public liability insurance protects individuals, businesses and organisations against the financial risk of being found liable to a third party for death or injury, loss or damage of property or pure economic loss resulting from negligence by the insured.

Professional indemnity insurance indemnifies professional people—accountants, architects, lawyers and others—for their legal liability to their clients and others relying on their advice and/or services. It provides indemnity cover if a client suffers a loss that is directly attributed to negligent acts of the professional.

---

<sup>1</sup> This role is different to that of other regulatory agencies in the insurance industry. The Australian Securities and Investment Commission (ASIC) is responsible for consumer protection within the general insurance industry. The Australian Prudential Regulation Authority (APRA) is responsible for the prudential regulation of general insurers.

<sup>2</sup> The government released the first ACCC public liability and professional indemnity insurance monitoring report on 4 August 2003. This report examined costs and premiums of major insurers between the years ending 31 December 1997 and 31 December 2002. It also outlined insurers' expectations regarding the impact of reforms on costs and premiums in 2003 and in the longer term.

The government released the second ACCC monitoring report on 23 February 2004. This report updated a subset of the information contained in the first report by including an additional six months of data from insurers, and presented updated information about insurers' expectations regarding the impact of reforms on costs and premiums in 2003 and in the longer term.

<sup>3</sup> There were eight insurers included in the ACCC's public liability insurance monitoring program. Their combined premium revenue represented 68 per cent of the public liability class of insurance, as measured by APRA data for the year ending 31 December 2003. Five of those insurers were included in the ACCC's professional indemnity insurance monitoring program. Their combined premium revenue represented 51 per cent of the professional indemnity class of insurance, as measured by APRA data for the year ending 31 December 2003.

At 31 December 2003 there were 42 authorised direct insurers supplying public liability insurance, with the largest four insurers earning 48 per cent of total premium revenue. There were 21 authorised direct insurers supplying professional indemnity insurance in Australia, with the largest four insurers earning 58 per cent of total premium revenue.<sup>4</sup>

## Key indicators of historical trends

The ACCC has examined trends in claim numbers, claims costs and average premiums in public liability and professional indemnity insurance for the period year ending 31 December 1997 to year ending 31 December 2003.

The ACCC examined claim numbers and costs because claims represent the largest cost component of premiums. Specifically, the ACCC examined the frequency of claims relative to the number of policies, and the average size of claims settled. The ACCC also examined the average premium as an indicator of movements in premiums paid by consumers over the period.

The ACCC found that for **public liability insurance**:

- **Average premiums** in real terms (adjusted to 31 December 2003 dollars) were stable between 1997 and 1999 at around \$620, then increased substantially between 1999 and 2002. In 2003 premiums continued to increase to \$1366, representing an increase of 17 per cent. This increase was lower than that observed in 2002 of 44 per cent.
- The **frequency of claims** reported decreased between 1998 and 2002, followed by a marginal increase in 2003.
- The **average size of claims settled** in real terms (adjusted to 31 December 2003 dollars) increased from \$10 800 to \$15 202 between 1997 and 2002. In 2003 the average size of claims settled further increased to \$17 768, an increase of 17 per cent.
  - The increase in the average size of claims settled appears to be driven by a trend towards an increasing number and cost of personal injury and death claims relative to property damage claims. Personal injury and death claims are typically larger in size than property damage claims.
  - The increase in the average size of claims settled may also have been driven by a trend towards medium and high cost claims (claims \$50 001 to \$500 000 and claims \$500 001 or greater) representing a greater proportion of total claim numbers and total claims costs.
- Generally, insurers considered that changes in the type of market segment they underwrote and increased levels of excess may be driving changes to the number and size of claims.

The ACCC found that for **professional indemnity insurance**:

- **Average premiums** in real terms (adjusted to 31 December 2003 dollars) decreased between 1997 and 1999 from \$4922 to \$3731. Premiums then increased each year to \$8494 in 2002, and increased a further 15 per cent to \$9778 in 2003. This compares to the increase in 2002 of 29 per cent.
- The number of claims reported increased over the period. However, the **frequency of claims** as a proportion of the number of policies written remained largely unchanged early in the period before decreasing in recent years.

<sup>4</sup> Based on unpublished data provided by APRA to the ACCC for the purpose of this report.

- The **average size of claims settled** in real terms (adjusted to 31 December 2003 dollars) increased each year across the period, from \$6067 to \$15 411 between 1997 and 2002. The average size of claims settled rose a further 41 per cent in 2003 to \$21 713.
- Some insurers suggested that recent changes made to their portfolios were the predominant driver behind changes in claims costs. However, changes to their underwriting practices, including the level of excess, had also had an impact.

## Financial performance

The ACCC collected data from insurers on the expected<sup>5</sup> financial performance<sup>6</sup> from underwriting public liability and professional indemnity insurance for the period year ending 31 December 2001 to year ending 31 December 2003.

The ACCC examined several ratios that indicate different components of underwriting performance. The sum of these ratios gives the 'net combined ratio', which shows whether the sum of all costs is greater than or less than total premium. A net combined ratio greater than 100 per cent indicates that insurers expect to make an underwriting loss, whereas a ratio less than 100 per cent indicates that insurers expect an underwriting profit.

The ACCC found that:

- For public liability insurance the **net combined ratio** decreased from 112 per cent in 2001 to 85 per cent in 2002. It further decreased to 79 per cent in 2003.
- For professional indemnity insurance the net combined ratio decreased from 113 per cent in 2001 to 91 per cent in 2002. It further decreased to 87 per cent in 2003.

## Impact of reforms

### Reform progress

During 2002 many consumers expressed concern about the size of increases in premiums for public liability and professional indemnity insurance (the ACCC found that in 2002 the average premiums rose by 44 and 29 per cent respectively), with some unable to obtain insurance at any price. In response, Commonwealth, state and territory governments have introduced a range of reforms to address the perceived crisis of rising premiums and reduced availability of these classes of insurance.

The reforms aimed at public liability insurance are intended to decrease the total cost incurred by insurers by reducing both the number and size of claims. The reforms are focused mainly on minimising personal injury claims costs by implementing caps and thresholds on court-awarded settlements, provisions for structured settlements, changes to negligence laws and minimising legal costs. Most jurisdictions began implementing these reforms in 2002, with some continuing to introduce further reforms in 2003.

<sup>5</sup> The ratios include a component for insurers' assessment of expected future claims payments—these are uncertain and the true profit or loss will only be known once all future payments have been made.

<sup>6</sup> The overall financial performance of insurance companies is determined by their underwriting and investment activities. In long-tail classes of insurance such as public liability and professional indemnity, insurers typically earn income on premiums invested before paying out claims. However, claims costs also tend to rise with normal (wage) inflation—so generally these two effects work in opposite directions. General expenses have also been excluded from the ACCC's methodology as they cannot be attributed to any one class of insurance. The ACCC's analysis of the financial performance of insurers does not include an assessment of either investment returns, future wage inflation (although it does include the effect of superimposed claims inflation) or general expenses because these components are not likely to be affected by government reforms, and were therefore deemed to be outside the scope of the ACCC's monitoring role.

The reforms targeted at professional indemnity insurance include proportionate liability for pure economic loss, and professional standards legislation. Some states and territories had progressed these reforms by the end of 2003. However, by 31 December 2003 these reforms had not been implemented at the Commonwealth level and had not commenced in many states and territories.

This report considers the impact of reforms implemented by 31 December 2003.

## Insurers' experience and expectation of the impact of reforms

In its first and second monitoring reports, the ACCC examined insurers' pricing expectations for public liability and professional indemnity insurance for 2003. Both reports concluded that in the absence of reforms, premiums were expected to rise for both classes of insurance. However, with reforms, some insurers expected rises in claims costs for public liability insurance would be constrained by around 5 per cent resulting in premium increases being constrained by about 3 per cent in 2003.

At the end of the 2003 calendar year the ACCC sought information from insurers on how these expectations of the effect of reforms on costs and premiums compared to the actual costs incurred and premiums charged at 31 December 2003. To do this, the ACCC compared the expectations regarding premiums and costs components, as indicated by insurers at 30 June 2003, with the actual premiums charged and cost components incurred. The ACCC found that the actual premiums for two insurers at 31 December 2003 were lower than they had expected, primarily due to lower than anticipated expenses. Premiums of the two other insurers' were higher than they had expected, mainly because of higher than anticipated claims costs.

With professional indemnity insurance, insurers had indicated in the first and second monitoring reports that they did not expect reforms to affect claims costs or premiums.

For this report, the ACCC asked insurers about their pricing expectations for public liability and professional indemnity insurance in 2004 and subsequent years. The ACCC also asked insurers about the actual impact of reforms on their emerging claims experience at 31 December 2003.

For **public liability insurance**, most insurers had observed a fall in claims frequency in their **emerging claims experience**. They noted that it was unclear to what extent this was due to the impact of reforms because of substantial changes made to their underwriting operations in recent years. Some insurers had increased the levels of excess, and some were no longer writing certain types of business.

Most insurers stated that they expected reforms to affect public liability insurance costs and premiums in the **short term**. Data from four insurers indicated that while costs and premiums were still expected to rise in 2004, the increase in claims costs would be constrained by 6 per cent, which would lead to a concomitant constraint on premium increases of 4 per cent. Four insurers also told the ACCC that on the basis of the reforms they had reduced their **outstanding claims provisions**.

All but one insurer expected reforms to have an impact on costs and premiums in the **medium term**, once the reforms begin to significantly affect their claims experience.<sup>7</sup> Also, some insurers commented that the savings expected in 2004 premiums were conservative, and that the reforms may have a larger impact in the medium term.

---

<sup>7</sup> Many insurers indicated that the reforms were not expected to have an immediate impact on their claims experience because public liability is a long-tailed class of insurance and the reforms were not retrospective.

However, five insurers commented that the level of any savings realised may be eroded, to an extent, in the **long term** through circumvention of the reforms. They generally cited their experience of reforms in other classes of insurance. Insurers noted that the impact of reforms may be eroded by plaintiffs shifting claims costs to other heads of damage, escalating claims costs within heads of damage, new types of claims emerging, and the shifting of claims to different jurisdictions.<sup>8</sup> The ACCC has not formed a view about the validity of these claims or whether this is likely to be the long-term outcome.

**Professional indemnity insurers** told the ACCC that the reforms enacted to 31 December 2003 focused specifically on personal injury and death claims,<sup>9</sup> and that reforms focused on professional indemnity insurance had not yet been implemented by the Commonwealth.<sup>10</sup> Therefore, none of the insurers had adjusted their **short-term** expectations of costs and premiums for 2004, or their **outstanding claims provisions**.

However, insurers noted that they expect the reforms aimed at professional indemnity insurance, when enacted, to have an impact on costs and premiums in the **medium term**.

## Conclusion

The Australian Government asked the ACCC to monitor costs and premiums in the public liability and professional indemnity classes of insurance on a six monthly basis over two years. The ACCC was asked to specifically consider measures taken by governments to reduce and contain legal and claims costs and to improve the data available to insurers to evaluate and price risk and, to the extent possible, assess the impact of these measures on premiums.

In this monitoring report, the ACCC found that although in recent years insurers have experienced a downward trend in the number of **public liability insurance** claims relative to the number of policies written, the average size of claims settled has increased. Also, while costs associated with public liability insurance generally increased each year over the monitoring period, premiums did not. The average premium charged was relatively stable between 1997 and 1999, followed by increases each year to 2003. However, the rate of increase in premiums fell substantially in 2003 (17 per cent) compared to 2002 (44 per cent).

Consistent with these trends, insurers' underwriting performance<sup>11</sup> was unprofitable in 2001<sup>12</sup> but returned to profitability in 2002 and 2003 because premiums rose faster than costs in these years.

---

<sup>8</sup> The Australian Government is introducing a number of complementary reforms to reduce the ability of plaintiffs to seek more favourable compensation in alternative jurisdictions, including under Commonwealth law.

<sup>9</sup> Professional indemnity claims typically relate to pure economic loss and, with the exception of policies written for medical malpractice, do not usually experience claims for personal injury and death.

<sup>10</sup> The Treasury Legislation Amendment (Professional Standards) Bill 2003 was introduced into parliament on 4 December 2003 and seeks to amend a number of acts to support the states and territories that implement professional standards legislation. The Bill was passed by the House of Representatives on 16 June 2004 and by the Senate on 25 June 2004. At 30 June 2004 it had not received royal assent. The *Corporate Law Economic Reform Program (Audit Reform and Corporate Disclosure) Act 2004*, which implements proportionate liability for economic loss and property damage, was passed by parliament and received royal assent on 30 June 2004.

<sup>11</sup> The ACCC's analysis of underwriting profitability examines premiums for each year compared to all costs, real and expected, associated with that year.

<sup>12</sup> Anecdotal evidence in the ACCC's first monitoring report found that before 2001 insurers were significantly more unprofitable than in 2001.

The ACCC also found that seven insurers had experienced a fall in claims frequency for public liability insurance. However, many of these insurers had made changes to the types of risk written and their levels of excess, so that they were unable to determine what impact tort reforms had had on this emerging trend.

Most insurers expect reforms to affect public liability insurance costs and premiums in the short term. Data from four insurers shows that reforms were expected to constrain rises in claims costs and other costs so that increases in premiums were anticipated to be constrained in 2004 by an average of 4 per cent. All but one insurer expected reforms to affect claims costs and premiums in the medium term. Some commented that the savings expected in 2004 were conservative, and that the reforms may have a larger impact.

With **professional indemnity insurance**, the ACCC found that the frequency of claims reported remained stable until 2001, after which it began to fall. Although insurers have not received proportionally more claims, total costs have escalated because the average size of claims settled has risen each year since 1997, with the largest increase in 2003. However, at the same time average premiums fell between 1997 and 1999, and then increased each year to a high in 2003.

The ACCC found that the underwriting profitability of insurers from underwriting professional indemnity insurance was unprofitable in 2001. Financial performance then improved substantially in 2002 and again marginally in 2003.

Insurers told the ACCC that most reforms enacted to 31 December 2003 focus on personal injury and death claims, and that the Commonwealth had not yet implemented reforms focused on professional indemnity insurance. Therefore, none of the insurers have adjusted 2004 premiums or their outstanding claims provisions as a result of tort reforms enacted as at 31 December 2003. However, insurers noted that they expect proportionate liability and professional standards legislation, when enacted, to have an impact on costs and premiums.

The ACCC will examine developments in costs and premiums for public liability and professional indemnity insurance in the first half of 2004 as part of its next monitoring report.



# 1 Introduction

## 1.1 Background

Throughout 2002 and 2003 Commonwealth, state and territory governments pursued a framework of reform in response to the perceived crisis of rising premiums and reduced availability of public liability and professional indemnity insurance. As part of this framework, the Australian Competition and Consumer Commission (ACCC) is required to monitor particular aspects of these reforms.

The reforms agreed to by governments were designed to satisfy one or more of the following objectives:

- cost reduction
- cost containment
- increasing certainty and predictability of costs of claims for insurers, which was considered to be critical in containing premium increases in the short to medium term
- managing community expectations about personal responsibility and risk.<sup>13</sup>

Commonwealth, state and territory ministers and the President of the Australian Local Government Association (the ministers) agreed to implement reforms. The reforms, aimed at public liability, focus mainly on minimising personal injury claims costs by implementing caps and thresholds on court-awarded settlements, providing for structured settlements, changing negligence laws and minimising legal costs. The professional indemnity reforms include proportionate liability for economic loss and professional standards legislation. The reform process started in 2002 and continued throughout 2003.

This report is the third of four ACCC reports to the Australian Government on monitoring costs and premiums for public liability and professional indemnity insurance.

## 1.2 Ministerial request

At the 30 May 2002 ministerial meeting on public liability insurance, all participating ministers unanimously agreed to an ongoing role for the ACCC in monitoring the insurance industry. They agreed that the ACCC's role was crucial to monitoring the progress of reforms designed to address the problems of rising public liability and general insurance premiums.<sup>14</sup>

On 5 July 2002 the then Parliamentary Secretary to the Treasurer, Senator the Hon. Ian Campbell, asked the ACCC to monitor costs and premiums in the public liability and professional indemnity classes of insurance on a six monthly basis over a two year period. He asked the ACCC to consider the impact on insurance premiums of measures taken by governments to reduce and contain legal and claims costs and to improve the data available to insurers to evaluate and price risk. Senator Campbell indicated that this ongoing work would contribute to a greater understanding of market developments and premium pricing in long-tail classes of insurance.<sup>15</sup> The ACCC's role was not a direction under the prices surveillance provisions of the *Trade Practices Act 1974*.<sup>16</sup>

Within the general insurance industry several other regulatory bodies also oversee the activities of insurance companies. Detail on these regulatory arrangements is in appendix A.

<sup>13</sup> The then Minister for Revenue, Senator the Hon. Helen Coonan, joint communiqué ministerial meeting on public liability, 30 May 2002, p. 2.

<sup>14</sup> *ibid.*, p. 1.

<sup>15</sup> Public liability and professional indemnity insurance are typically referred to as long-tail classes of insurance. This is because many years may pass between the period for which cover was provided and the date at which claims arising from incidents during that period are finally settled.

<sup>16</sup> Part VIIA of the Trade Practices Act enables the ACCC, where the Australian Government declares products or services, to formally monitor prices with the objectives of promoting competitive pricing wherever possible and restraining price rises in markets where competition is less than effective. Part VIIA replaces the *Prices Surveillance Act 1983* which was repealed and incorporated into the Trade Practices Act on 1 March 2004.

### 1.3 Previous ACCC insurance monitoring reports

On 4 August 2003 the Australian Government released the ACCC's first monitoring report into public liability and professional indemnity insurance. It examined changes in costs and premiums in both classes of insurance between the years ending 31 December 1997 and 31 December 2002. It also outlined insurers' expectations about movements in costs and premiums in 2003 and in the longer term. The report generally found that costs, including claims and other expenses (such as reinsurance, brokerage and underwriting) increased in both classes of insurance between 1997 and 2002. It also found that premiums increased between 2000 and 2002. The financial performance of insurers in both classes of insurance as a result of these premium increases improved between 2001 and 2002.

The government released the ACCC's second monitoring report on 23 February 2004. It updated a subset of the information contained in the first report by including an additional six months of data from insurers, examining costs and premiums to 30 June 2003. It also presented updated information about insurers' expectations regarding the impact of reforms on costs and premiums in 2003 and subsequent years.

The second report found that:

- For **public liability insurance**, average premiums rose marginally (by 4 per cent) for the first six months of 2003 compared to 2002. In contrast, the average size of settled claims in real terms was 10 per cent lower for the first six months of 2003 than that observed for the full 2002 settlement year.
- For **professional indemnity insurance**, average premiums rose by 5 per cent in the first six months of 2003. The average size of settled claims rose by 19 per cent in real terms over this same period.

The report also examined the financial performance of those insurers underwriting these classes of insurance. For public liability insurance, underwriting performance improved in 2003, with insurers expected to make an underwriting profit in the first six months of 2003. The net combined ratio (which shows whether the sum of all costs is greater or less than premiums) was estimated to be 90 per cent in 2002 and decreased to 88 per cent in the first half of 2003.<sup>17</sup> For professional indemnity insurance, insurers were expected to make a small underwriting profit in the first half of 2003, with a net combined ratio estimated to be 98 per cent compared with 92 per cent in 2002.

The ACCC also surveyed insurers' expectations about the impact of reforms on costs and premiums. Generally, the responses provided by insurers did not vary greatly to those provided in the first monitoring report, despite the additional six months of reforms progress and claims experience.

- For **public liability insurance**, some insurers expected that the reforms enacted at 30 June 2003 would lead to growth in claims costs being constrained by around 5 per cent and premium increases being constrained by about 3 per cent in 2003. Other insurers continued to believe that it was too early to quantify the impact of reforms on premiums in the absence of reliable claims experience data. Most insurers expected premiums to increase in 2004, with expectations ranging between 5 and 15 per cent or an average of 11 per cent. In the longer term, some insurers continued to suggest that the impact of reforms on costs and premiums was uncertain.

---

<sup>17</sup> The net combined ratio is an indicator of an insurer's underwriting performance. If the net combined ratio is less than 100 per cent, an insurer expects to make a profit on its underwriting business. If the net combined ratio is greater than 100 per cent, the insurer expects to make an underwriting loss.

- For **professional indemnity insurance**, insurers indicated that growth in claims costs would continue regardless of the reforms passed to 30 June 2003 and that there would be no corresponding constraint on premiums. Several reasons were cited by insurers, including that the reforms passed to date were mainly directed at personal injury claims which are generally not incurred in the professional indemnity class and that the effect of the reforms passed to date was unknown. Most insurers expected premiums to rise in 2004, with expectations ranging between 15 per cent and 23 per cent, or by an average of around 17 per cent.

## 1.4 Scope of the monitoring report

Senator Campbell's request indicated that the ACCC would not be expected to form a view about the adequacy or appropriateness of reform measures, as this is a matter for state and territory governments.

The scope of the ACCC's monitoring analysis relates to public liability and professional indemnity insurance written in Australia. Consumers seeking insurance cover in Australia can also access cover from insurers located in overseas countries. Insurance business written outside Australia is not included in the scope of the ACCC's monitoring framework.<sup>18</sup>

In Australia, public liability insurance is usually provided to household consumers as part of their home and contents insurance policies. The public liability component of these policies is relatively small. It is the stand alone public liability insurance policies provided to individuals and organisations for commercial purposes that have raised major problems of affordability and availability. The ACCC is therefore only monitoring commercial public liability policies. In most industries, and especially for smaller businesses, public liability and products liability insurance have been sold as a combined product with a single premium.<sup>19</sup> Discussion about public liability insurance in this report, including data, refers to public and products liability combined, except where otherwise indicated.

Within professional indemnity insurance, there is a sub-class relating to medical indemnity. Before 1 July 2003 medical defence organisations (MDOs) offered medical indemnity to medical practitioners. They were not classified as insurance companies and therefore were not regulated by the Australian Prudential Regulation Authority (APRA). Under the Australian Government's medical indemnity framework introduced on 1 July 2003, MDOs can no longer offer medical indemnity insurance to medical practitioners. Instead, only an insurer authorised by APRA to conduct insurance business can offer such insurance. The ACCC has excluded medical indemnity insurance policies written previously by MDOs from this report because this form of indemnity insurance is part of a separate ACCC monitoring program.<sup>20</sup> However, some general insurers provide medical indemnity to hospitals and ancillary staff, such as midwives, nurses and other medical staff, as part of their professional indemnity business and this is included within the scope of this report.

<sup>18</sup> On 12 September 2003 the Federal Treasurer, the Hon. Peter Costello MP, announced the government's response to the HIH Royal Commission's final report. In this report, Justice Owen raised some issues associated with direct offshore foreign insurers (DOFIs) but made no specific recommendation. A part of the government's response was a review into the role of DOFIs in the Australian insurance industry and their contribution to overall insurance capacity. The review's recommendations were released on 27 May 2004. The review recommends allowing DOFIs marketing insurance in Australia to be exempt from prudential regulation in Australia if they are domiciled in a country the Australian Prudential Regulation Authority (APRA) considers to have comparable prudential regulation, subject to a market significance threshold to prevent established authorised insurers moving offshore. DOFIs not meeting this test would be able to market insurance in Australia as an authorised insurer, through a branch or subsidiary. The Federal Treasurer announced in his press release of 27 May 2004 that government intends to implement the review's recommendations.

<sup>19</sup> Trowbridge Consulting, 'Public Liability Insurance, analysis for meeting of ministers on 27 March 2002', March 2002, p. 2.

<sup>20</sup> As part of the Prime Minister's press release, 'A New Medical Indemnity Insurance Framework', of 23 October 2002 it was announced that the ACCC would monitor medical indemnity premiums to assess whether they are actuarially and commercially justified.

## 1.5 Approach to monitoring

The ACCC approached a number of general insurers identified as major participants in the public liability and professional indemnity insurance markets in Australia and requested information on their cost and premium structures.

For its first report, the ACCC included nine insurers in its monitoring program for public liability insurance. Seven of these were also asked to provide information on their professional indemnity business.

For the second and third reports, the ACCC requested updated information from most of these insurers, with eight insurers monitored in the case of public liability insurance and five monitored for professional indemnity insurance. The ACCC altered its monitoring sample after the first report with one insurer being excluded from both the public liability and professional indemnity monitoring programs because its book of business in both classes was deemed to be outside the scope of the ACCC's monitoring program. Another insurer was excluded from the professional indemnity monitoring program because it had ceased writing this class in 2003. All historical analysis contained in later sections of this report has been updated to reflect these changes.<sup>21</sup> A list of the insurers included in this report can be found in appendix B.

The premium revenue of the eight insurers that provided information on public liability insurance represented 68 per cent of the public liability class, as measured by APRA statistics for the year ending 31 December 2003. The five insurers that provided information on professional indemnity insurance represented 51 per cent of that class, as measured by APRA statistics for the year ending 31 December 2003.

The ACCC's third information request asked insurers to provide an update of information about policies, premiums and costs as well as qualitative information about their product. In addition, insurers were asked about the impact of reforms on their emerging experience as well as their expectations of the impact of reforms on cost and premiums in 2004 and subsequent years.

This report is based on information provided by insurers that was current at 31 December 2003. Similarly, the ACCC focused on reforms that were announced and implemented by the Commonwealth, state and territory governments up to 31 December 2003.

The ACCC engaged a consultant, Ernst and Young ABC Pty Limited, to provide technical actuarial assistance as required.

## 1.6 Qualifications

The information that insurers provided is presented in this report at an aggregated level. The ACCC recognises that insurance companies do not operate in a uniform manner. Each company has its own profit targets, capital structure, distribution channels, policy terms and conditions, target markets and objectives. Where necessary, the ACCC qualifies certain aspects of its analysis throughout the report.

The historical analysis in this report may not be directly comparable with that in the first two reports as a result of updating of incident year data<sup>22</sup> for the period between 1997 and 2003.

<sup>21</sup> Both of these insurers were excluded from the historical analysis contained in this report. However, this is unlikely to distort the results from those found in the first monitoring report because of the relatively small market shares of these two insurers.

<sup>22</sup> Some of the information collected by the ACCC was on an incident year basis; that is, the data is allocated back to the corresponding year in which the incident leading to a claim occurred. As incident year data evolves over time because of claims arising and being settled in the years following the incident year, the ACCC sought an update of this data.

## 1.7 Report outline

This report contains nine chapters and seven appendixes.

Chapter 2 outlines the reform process of Commonwealth, state and territory governments in public liability and professional indemnity insurance and identifies those reforms that were implemented up to 31 December 2003. Further details of these reforms can be found in appendix C.

Chapter 3 summarises the features of the public liability and professional indemnity insurance classes.

Chapters 4 to 7 examine **historical trends** in costs, expenses and premiums between the years ending 31 December 1997 and 31 December 2003, they also examine underwriting performance between the years ending 31 December 2001 and 31 December 2003 based on data provided by insurers.

- Chapter 4 examines trends in costs and expenses in the public liability class of insurance.
- Chapter 5 examines changes in premiums and financial performance of insurers in the public liability class of insurance.
- Chapter 6 examines trends in costs and expenses in the professional indemnity class of insurance.
- Chapter 7 examines changes in premiums and financial performance of insurers in the professional indemnity class of insurance.

Chapter 8 looks at the **impact of government reforms** by examining insurers' emerging claims experience as well as their expectations of how the reforms will affect costs and premiums for 2004 and in subsequent years.

Chapter 9 forms the conclusions of this report.

Appendix A outlines regulatory arrangements associated with providing insurance in Australia.

Appendix B outlines the insurers that participated in the ACCC's monitoring program.

Appendix C outlines all Commonwealth, state and territory government tort reform affecting public liability and professional indemnity insurance as at 31 December 2003.

Appendix D outlines the ACCC's monitoring methodology for examining historical costs and expenses, premiums and financial performance.

Appendix E examines public liability claims costs and premiums for the year ending 31 December 2003, broken down by industry classification.

Appendix F examines professional indemnity claims costs and premiums for the year ending 31 December 2003, broken down by occupation classification.

Appendix G examines public liability personal injury and death claims' costs by heads of damage.

## 2 Reforms affecting public liability and professional indemnity insurance

Commonwealth, state and territory governments participated in several joint ministerial meetings during 2002 and 2003 and agreed to a series of reforms to address the perceived problems of affordability and availability of public liability and professional indemnity insurance. The reforms included changes to the application of tort law, the use of structured settlements, legal system reforms, data collection and risk management strategies.

The ACCC's first report examined those reforms implemented by governments up to 31 December 2002. The second report incorporated those reforms implemented up to 30 June 2003. This report examines reforms implemented for the full year up to 31 December 2003. The ACCC determined that reforms announced but not implemented before 31 December 2003 fell outside the scope of this report. For completeness these reforms are listed in appendix C.

### 2.1 Ministerial meetings

Commonwealth, state and territory ministers and the President of the Australian Local Government Association (the ministers) held four meetings during 2002 to address the problems of rising premiums and reduced availability of public insurance.

In 2003 the ministers first met on 4 April to examine the difficulties faced by professionals in obtaining reasonably priced professional indemnity insurance. The ministers agreed to work towards developing a nationally consistent model for proportionate liability for economic loss and professional standards legislation. They considered professional indemnity insurance for doctors, and agreed that reforms addressing limitation periods, standard of care and caps/thresholds on damages should be implemented as soon as possible.<sup>23,24</sup>

Another ministerial meeting was held on 6 August 2003. At this meeting, the ministers agreed that reform of professional indemnity insurance required a package of measures, including professional standards legislation, proportionate liability, amendments to the *Trade Practices Act 1974* and amendments to the *Insurance Contracts Act 1984*. They also agreed to proceed to the second stage of analysis of a national scheme for the long-term care of the catastrophically injured, and that officials should urgently prepare a report on tort law reforms to date for distribution in the international insurance centres.<sup>25</sup>

Most recently, the ministers met on 27 February 2004 and agreed that further work should be done to assess the viability of a long-term care scheme for the catastrophically injured and indicated that a report about it would be presented to the next ministerial meeting in September 2004. They also agreed to examine the operation of medical assessment panels, aimed at reducing legal costs and enhancing consumer outcomes. They also reaffirmed their commitment to implement reforms, including the introduction of professional standards legislation, proportionate liability, and amendments to the *Trade Practices Act 1974* and the *Insurance Contracts Act 1984*. The meeting concluded with the launch of a promotional booklet outlining the reform of liability insurance within Australia. It will be used to promote the Australian insurance market to overseas insurers.<sup>26</sup>

<sup>23</sup> The ACCC's separate monitoring role of medical indemnity insurance examines the impact of tort law reform on medical indemnity costs and premiums.

<sup>24</sup> The then Minister for Revenue, Senator the Hon. Helen Coonan, joint communiqué ministerial meeting on public liability, press release, 4 April 2003.

<sup>25</sup> The then Minister for Revenue, Senator the Hon. Helen Coonan, joint communiqué ministerial meeting on public liability, 6 August 2003.

<sup>26</sup> The then Minister for Revenue, Senator the Hon. Helen Coonan, joint communiqué ministerial meeting on public liability, 27 February 2004.

## 2.2 Commonwealth, state and territory tort law reforms implemented up to 31 December 2003

This section summarises the tort law reform measures implemented by Commonwealth, state and territory governments up to 31 December 2003.

Table 2.1 identifies the major initiatives implemented by respective governments at 31 December 2003. Reforms implemented in the six months to 31 December 2003 have been highlighted to identify what changes occurred during the year. A detailed summary of reforms is in appendix C.<sup>27</sup>

The table shows that the major types of reforms implemented by 31 December 2003 include the capping of damages for economic loss (i.e. loss of past and/or future income), non-economic loss (i.e. pain and suffering) as well as the capping of legal costs. Other reforms include the introduction of minimum thresholds of impairment for access to non-economic loss, limitation periods for personal injury claims, provision for contributory negligence, provision for structured settlements, provision for good Samaritans and volunteers, and also the provision that saying 'sorry' is not an admission of guilt. Waivers for risky activities and provisions disallowing exemplary or punitive damages have also been introduced.

---

<sup>27</sup> For completeness, the summary of reforms in appendix C also presents other tort law reform initiatives that were announced but not implemented up to 31 December 2003. Introduction of private members bills into Commonwealth, state and territory parliaments are excluded from this summary as they do not constitute government legislative reforms.

**Table 2.1 Major reforms implemented by governments—as at 31 December 2003 (shaded reforms implemented post 1 July 2003)**

Major reforms	C'th	NSW	VIC	QLD	SA	ACT	NT	WA	TAS
<b>Cap on general damages (e.g. pain and suffering)</b>		✓ \$350 000 indexed to AWE	✓ \$371 380 indexed to CPI	✓ \$250 000	✓ \$241 500 indexed to CPI		✓ \$350 000 indexed to AWE		
<b>Minimum threshold of impairment to access general damages</b>		✓ 15% of a most extreme case	✓ For injury impairment > 5%. (Psychiatric injury impairment > 10%)	✗ No threshold, assessed on sliding scale	✓ If a person suffers 7 days of significant impairment or \$2750 medical expenses assessed on a sliding scale		✓ Degree of permanent impairment of 5%	✓ \$12 000 indexed	✓ \$4000 for claims less than \$20 000
<b>Cap on damages for economic loss (e.g. loss of past and/or future income)</b>		✓ 3 times rate of AWE, discount rate (5%) on lump sums	✓ 3 times rate of AWE, discount rate (5%) on lump sums	✓ 3 times rate of AWE, discount rate (5%) on lump sums	✓ \$2.2m indexed to CPI, discount rate (5%) on lump sums	✓ 3 times rate of AWE	✓ 3 times rate of AWE, discount rate (5%) on lump sums	✓ 3 times rate of AWE, discount rate (6%) on lump sums	✓ 4.25 times rate of AWE, discount rate (7%) on lump sums
<b>Limitation period for personal injury cases</b>		✓ 3 years from discovery, 12 years from occurrence (exceptions for minors and disability)	✓ 3 years from discovery, 12 years from occurrence (exceptions for minors and disability)	n/a <sup>b</sup>	n/a <sup>c</sup>	✓ 3 years from cause of action, notice of claim must be given before filing within 9 months of occurrence or 4 months of consulting a lawyer	n/a <sup>d</sup>		n/a <sup>e</sup>
<b>Waivers for risky activities</b>	✓	✓	✓	✗ <sup>f</sup>	✓	✓ <sup>g</sup>		✓	✗ <sup>h</sup>
<b>No exemplary or punitive damages</b>	✓			✓			✓		

Cap on award of legal costs	✓ The greater of 20% or \$10 000 for personal injury damages <\$100 000	✓ Nil for claims <\$30 000; \$2500 for claims <\$50 000 if certain circumstances are met	✓ For claims <\$50 000 max costs are greater of 20% of amount recovered or \$10 000	✓ <sup>i</sup>	n/a <sup>i</sup>
<b>Provision for contributory negligence</b>	✓	✓	✓ <sup>k</sup>	✓	✓
<b>Protection for volunteers or 'good Samaritans'</b>	✓	✓	✓	✓	✓
<b>Provision for structured settlements</b>	✓	✓	✓	✓	✓
<b>Protection for expression of regret/apology</b>	✓	✓	✓	✓	✓
<b>Provisions for quick resolution of claims</b>		✓	✓	✓ <sup>m</sup>	
<b>Proportionate liability (economic loss)</b>	n ✓ <sup>o</sup>	✓	✓ <sup>p</sup>		✓ <sup>q</sup>
<b>Professional standards legislation</b>	r ✓	✓			✓ <sup>s</sup>

<sup>a</sup> Damages less than \$12 000 no award for general damages; damages between \$12 000 and \$36 500 award is amount by which damages exceed \$12 000; damages greater than \$36 500 but less than \$48 500 award is \$12 000 (damages assessed –\$36 500).

<sup>b</sup> Existing limitation period of 3 years from cause of action under s. 11, *Limitation of Actions Act 1974*.

<sup>c</sup> Existing limitation period of 3 years from cause of action under s. 36, *Limitations of Actions Act 1936*.

<sup>d</sup> Existing limitation period of 3 years from date on which cause of action accrues under s. 12, *Limitation Act 2000*.

- <sup>e</sup> Existing limitation period of 3 years from date on which cause of action accrues under s. 5, *Limitation Act 1974*.
- <sup>f</sup> While Queensland has no provisions for waivers of risky activities, the *Civil Liability Act 2003* provides no proactive duty to warn of obvious risks and no liability for harm suffered from obvious risks of dangerous recreational activities (ss. 15, 19).
- <sup>g</sup> Liability may be limited only in relation to equine activities as defined in the *Civil Laws (Wrongs) Amendment Act 2003*. The Act also contains general principles in relation to precautions against risk.
- <sup>h</sup> While Tasmania has no provisions for waivers of risky activities, the *Civil Liability Act 2003* provides that there is no proactive duty to warn of obvious risks (s. 17); no liability for harm suffered from obvious risks of dangerous recreational activities (s. 20) and a public authority has no duty of care in relation to recreational activities if there is a risk warning (s. 39).
- <sup>i</sup> Specific provisions in the *Personal Injuries (Civil Claims) Act 2003* dealing with caps on legal costs (ss. 18 and 20) have not yet commenced.
- <sup>j</sup> Maximum legal fees chargeable by lawyers are set by the Legal Costs Committee under the *Legal Practice Act 2003*.
- <sup>k</sup> Further amendments are being made to contributory negligence provisions in Law Reform (lpp Recommendations) Bill 2003.
- <sup>l</sup> Provisions for volunteers, but no specific provisions for good Samaritans. However, legislation does provide protection of persons performing first aid or other aid or assistance to a person in distress.
- <sup>m</sup> Certain provisions in the *Personal Injuries (Civil Claims) Act 2003* relating to obligations of parties for the quick resolution of claims have not yet commenced.
- <sup>n</sup> The *Corporate Law Economic Reform Program (Audit Reform and Corporate Disclosure) Act 2004*, which implements proportionate liability for economic loss and property damage was passed by parliament and received royal assent on 30 June 2004.
- <sup>o</sup> *Civil Liability Amendment (Personal Responsibility) Act 2002* contains provisions regarding proportionate liability. The provisions have received royal assent but by 30 June 2004 had not yet commenced.
- <sup>p</sup> Provisions relating to proportionate liability are contained in the *Civil Liability Act 2003*. These provisions have received royal assent but by 30 June 2004 had not yet commenced operation.
- <sup>q</sup> Provisions relating to proportionate liability are contained in the *Civil Liability Amendment Act 2003*. These provisions have received royal assent but by 30 June 2004 had not yet commenced. Further provisions with respect to proportionate liability are contained in the *Civil Liability Amendment Bill 2004* (Bill No. 275), introduced into parliament on 6 April 2004.
- <sup>r</sup> The Treasury Legislation Amendment (Professional Standards) Bill 2003 was introduced into parliament on 4 December 2003 and seeks to amend a number of Acts to support the states and territories that implement professional standards legislation. The Bill was passed by the House of Representatives on 16 June 2004 and by the Senate on 25 June 2004. By 30 June 2004 it had not received royal assent.
- <sup>s</sup> The *Professional Standards Act 1997* commenced on 18 September 1997. On 30 June 2004 the government introduced the Professional Standards Amendment Bill 2004 to make that legislation consistent with the New South Wales *Professional Standards Act 1994*.

## 2.3 Likely effect of reforms on claims costs

This section is intended to provide a broad overview of the ways in which specific public liability reforms might be expected to affect claims costs.

In July 2002 the Australian Government, in conjunction with state and territory governments, appointed a panel to review the law of negligence. The final report, *The Review of the Law of Negligence* (Ipp report), contained a number of recommendations aimed at reforming tort law.

Following the Ipp report, Commonwealth, state and territory governments commissioned PricewaterhouseCoopers (PwC) to provide an actuarial assessment of the recommendations of the Ipp report. This report, *Report to the Insurance Issues Working Group of Heads of Treasuries—Actuarial assessment of the recommendations of the Ipp Report* (PwC report) was released by the Australian Government on 15 November 2002.

The PwC report estimated the potential financial effects of reforms recommended by the Ipp report to estimate the cost and premium savings that might be expected when those reforms were implemented by the Commonwealth, state and territory governments. To do this, PwC examined how individual reforms were expected to affect an assumed sample of claims, presuming all other factors remained constant.

The ACCC has not examined the estimated financial effects proposed by PwC. Rather, the following shows how specific reforms would be expected to affect claims, based on PwC's analysis. The ACCC has divided the reforms' expected impact into two categories:

- those which are expected to have an impact on the **number** of claims incurred
- those which are expected to have an impact on the **size** of claims incurred.

However, it should be noted that in some cases reforms might be expected to affect both the number and size of claims. For example, the PwC report states that legal cost restrictions are expected to decrease both the size of claims as well as the number of claims. In these cases the ACCC has categorised the reform where it was expected to have a more pronounced effect. Also, not all reforms identified in table 2.1 are outlined below because PwC did not conduct detailed analysis of these reforms.<sup>28</sup> This is because PwC found that many of the reforms were not easily costed and in some cases were not expected to have a financial impact.

PwC identified the following reforms as potentially reducing the **number** of claims:

- minimum threshold of impairment to access general damages
- cap on award of legal costs
- limitation periods for personal injury cases.

PwC identified the following reforms as potentially reducing the **size** of claims:

- caps on general damages
- caps on damages for economic loss
- increases in the discount rate on lump sum payments
- no exemplary or punitive damages
- provision for contributory negligence.

<sup>28</sup> These include: protection for volunteers or 'good Samaritans'; protection for expressions of regret/apology; provision for quick resolution of claims; provision for structured settlements; and waivers for risky activities. Also, as the PwC report only focused on public liability reform, reforms aimed at professional indemnity are not discussed (specifically proportionate liability and professional standards legislation).

These reforms are intended to reduce claims costs by reducing both the number and size of claims for the public liability class of insurance. However, it is difficult to determine what the overall impact of reforms (and the timing of such an impact) on the number and costs of claims might be.

Several factors will determine what the overall impact of reforms will be. First, the likely effect of individual reforms is interdependent and the combined overall impact may be different to that expected for individual reforms. Second, the actual impact of individual reforms may not be equally weighted and some may have a greater impact on claims costs than others, with the extent of the overall interaction largely uncertain. Third, the combined impact of individual reforms on claims costs may not happen simultaneously—some reforms may affect claims earlier, while others may do so in later years.

There are also external factors that will influence the overall impact of reforms, including the type of business that insurers underwrite and the overall exposure to particular types of claims, insurers underwriting policies (e.g. the terms and conditions of policies and levels of excess), and the differing timeframes in which individual jurisdictions have implemented reforms.

## **3 Features of the public liability and professional indemnity insurance classes**

### **3.1 Insurance defined**

Insurance provides protection against the unfortunate consequences of future events, by transferring the possible risk of loss from a person or organisation (the insured) to the insurer. To gain this benefit, the insured pays the insurer a sum of money known as a premium (the cost of insurance cover).<sup>29</sup>

There are many individual classes of insurance. Public liability and professional indemnity insurance are two 'liability' classes within the broader insurance industry.

### **3.2 Liability insurance**

Liability for personal injury and death, loss or damage of property or pure economic loss can arise in various contexts, including in the workplace, for a matter covered by a contract, or as a result of a motor vehicle or other accident. Various types of liability insurance are available to reduce the exposure of organisations and individuals to such risks. Within the general insurance industry, the five main types of liability insurance are:

- motor vehicle third party
- workers' compensation
- public liability
- product liability
- professional indemnity.

These categories of liability insurance are distinguished from first party cover, which may cover similar risks but which will be for the benefit of the person insured. For example, accident and disability policies may cover persons who also have claims against persons liable for the injury done.

Motor vehicle third party and workers' compensation liability insurance are typically referred to as 'statutory schemes' because insurance is made compulsory by state-based legislation and the statutes define many aspects of the schemes including benefit entitlements and how insurance claims are handled.<sup>30</sup> In contrast, the remaining three types of liability insurance are generally considered voluntary, as there is virtually no specific legislation governing how claims are dealt with and how compensation is determined. However, there are some exceptions, as discussed below in sections 3.3.1 and 3.4.1.

---

<sup>29</sup> ICA, background paper no. 8 to the HIH Royal Commission, 'A Profile of the General Insurance Industry', November 2001, p. 3.

<sup>30</sup> Trowbridge Consulting, 'Public Liability Insurance, analysis for meeting of ministers on 27 March 2002', March 2002, p. i.

Liability insurance is often referred to as 'long-tail' insurance, as many years may pass between the period for which cover was provided and the date when claims arising from incidents during that period are finally settled. The delay may occur because, for example, injured people may wait until their injury stabilises before making a claim. Once it receives a claim, the insurance firm will typically investigate it, negotiate with the client and either settle or seek an outcome through the legal system.<sup>31</sup> In contrast, most claims for damage to motor vehicles or homes tend to be made in the year in which cover is provided, with final settlement usually occurring soon after the claim is lodged.

The remaining part of this section focuses specifically on the public liability and professional indemnity classes. The accompanying analysis is based on unpublished data sourced from APRA for the year ending 31 December 2003.

### 3.3 Public liability insurance

#### 3.3.1 What is public liability insurance?

Public liability insurance protects individuals, businesses or organisations against the financial risk of being found liable to a third party for death or injury, loss or damage of property or 'pure economic' loss resulting from negligence by the insured.<sup>32</sup>

This protection may relate to a particular location, to the use of movable property, or to the activities of a group or individual. Because the policy is intended to cover unexpected events, most are limited by exclusion, rather than attempting to specify the perils which are covered. The exclusions are the perils for which the insured would normally be expected to have more specific insurance. Known hazardous activities may also be excluded, as are criminal actions by the insured.<sup>33</sup>

For household consumers, public liability insurance tends to be part of their home and contents insurance policies. Stand-alone public liability insurance policies are provided to individuals and organisations for commercial purposes. These commercial policies are the focus of the ACCC's monitoring exercise. In most industries, and especially for smaller businesses, public liability and products liability have been sold as a combined product with a single premium. Therefore, statistics are usually only available for public and product liability combined.<sup>34</sup>

The nature of public liability insurance is an important consideration in the following discussion about premium setting arrangements. There are several major features of public liability insurance policies.

---

<sup>31</sup> Productivity Commission, 'Public Liability Claims Management Research Report', December 2002, p. 13.

<sup>32</sup> *ibid.*, p. 9.

<sup>33</sup> Institute of Actuaries of Australia, 'Submission to the Public Liability Forum', March 2002, p. 4.

<sup>34</sup> Trowbridge Consulting, 'Public Liability Insurance, analysis for meeting of ministers on 27 March 2002', March 2002, p. 2.

### 3.3.1.1 Voluntary insurance

Public liability insurance is considered a voluntary form of insurance although there are several exceptions, such as certain public events and facilities, where a licensing authority may require public liability insurance. Many organisations that operate on a voluntary basis, typically with the support of local councils, must also hold public liability insurance. This protects the supporting body (the council) from any call on its own public liability insurance.<sup>35</sup> Contracts issued by governments to businesses for government work have required businesses to take out public liability insurance since 1997. Such insurance is effectively compulsory, although not mandated by legislation.<sup>36</sup>

### 3.3.1.2 Long-tail insurance

Public liability insurance is considered a form of long-tail insurance. Depending on the statutes of limitations, which vary between each state and territory, claims can be made for some years after an accident, even if the policy has expired. For example, the Insurance Council of Australia (ICA) commented that:

If a child of one year of age in NSW was injured, legal action could be commenced some 25 years after a policy has expired. There is no need to commence legal action until the child achieved majority at 18 years of age when the Statute of Limitations of 3 years applies. A further extension of 5 years may also be granted. (ICA, 'Public Liability Submission to Ministerial Forum', March 2002, p. 10)

This long-tail characteristic is cited as one of the reasons why insurers may experience difficulty in accurately estimating future claims costs, and in turn setting appropriate premiums. The ICA commented that:

This creates uncertainty for liability insurers who may pay a claim in future years based on a premium charged years before. The type and amount of claim may have increased substantially based not only on inflation, but also on the current developments. (ICA, 'Public Liability Submission to Ministerial Forum', March 2002, p. 10)

Trowbridge Consulting also noted that:

It takes three to five years before a reasonably accurate estimate can be made of the cost of claims for a given year of insurance. (Trowbridge Consulting, 'Public Liability Insurance—analysis for meeting of ministers 27 March 2002', 2002, p. 3)

With respect to pricing, the Productivity Commission found that:

Setting premiums for public liability insurance is very difficult because of its 'long-tailed' nature (claims costs occur over many years) and the wide range of risks it covers. Since the mid 1990s, public liability insurance has operated at a loss. (Productivity Commission, 'Public Liability Claims Management Research Report', December 2002, p. 14)

### 3.3.1.3 Unpredictable risks

Public liability risks may vary from a largely predictable number of, for example, 'frequency' events (such as 'slip and fall' accidents in a supermarket) to the highly unpredictable, such as claims arising from a major accident. This is cited as a further reason for insurers experiencing problems in accurately estimating future claims costs. The Institute of Actuaries of Australia commented that:

<sup>35</sup> Institute of Actuaries of Australia, 'Submission to the Public Liability Forum', March 2002, p. 4.

<sup>36</sup> ACCC, 'Second insurance industry market pricing review', September 2002, p. 44.

There is a long history of substantial losses by insurers writing various forms of liability insurance. In some cases, there is an issue of incompetent (or even no) underwriting, but mostly it reflects the extreme difficulty of assessing the probable cost of public liability risks. Despite a long history of such things, insurers continue to be surprised by the new and inventive ways in which people can injure themselves and others, and to be caught by the extent to which acceptable standards change over time. (Institute of Actuaries of Australia, 'Submission to the Public Liability Forum', March 2002, p. 11)

#### 3.3.1.4 Claims-occurring policies

Public liability policies are typically written on a 'claims-occurring' basis. This type of policy covers claims for incidents which occur during the policy period, regardless of when the claim is reported to the insurer.

### 3.3.2 Industry structure

In addition to insurers factoring in those characteristics mentioned above when setting public liability premiums, insurers must also consider the competitive environment in which they operate. The following section discusses the number of authorised direct public liability insurers currently operating in the Australian market, and provides information about market shares. It also examines the relative size of state and territory markets.

#### 3.3.2.1 Industry participants

APRA provided the ACCC with unpublished data for the year ending 31 December 2003 which indicated that there were 42 direct insurers active in the public liability class during this period.

These statistics also showed that the largest 10 insurers earned about 75 per cent of total premium revenue for the whole public liability class of insurance in Australia, with the largest four earning about 48 per cent. The largest 10 companies are listed below:

- Allianz Australia Insurance Limited
- CGU Insurance Limited
- Chubb Insurance Company of Australia Limited
- GIO General Limited<sup>37</sup>
- Liberty Mutual Insurance Company
- Lumley General Insurance Ltd
- Mercantile Mutual Insurance (Australia) Limited
- QBE Insurance (Australia) Limited
- Vero Insurance Limited
- Zurich Australia Insurance Limited.

The industry shares of these companies ranged between 3 per cent and 18 per cent of premium revenue. The remaining 25 per cent was spread among 32 insurers with each having industry shares of 3 per cent or less.

---

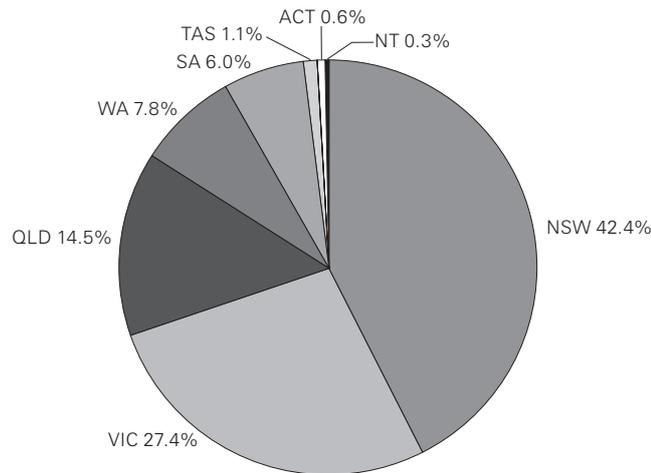
<sup>37</sup> GIO is a part of the Suncorp Metway group. However, APRA statistics as at 31 December 2003 record GIO and Suncorp Metway as two separate insurance companies. Data supplied to the ACCC as part of the monitoring program included statistical history of three of its companies—GIO, AMP and Suncorp Metway.

### 3.3.2.2 Distribution of premium revenue by state and territory

Chart 3.1 shows the percentage of total premium revenue underwritten by all insurers for public liability insurance by jurisdiction in the year ending 31 December 2003.

The largest share of premium revenue was written in New South Wales (42.4 per cent), followed by Victoria (27.4 per cent) and Queensland (14.5 per cent).

**Chart 3.1 Proportion of premium revenue by state or territory—public liability—year ending 31 December 2003**



Source: Unpublished data provided by APRA to the ACCC for the year ending 31 December 2003.

## 3.4 Professional indemnity insurance

### 3.4.1 What is professional indemnity insurance?

Professional indemnity insurance indemnifies professional people—accountants, architects, lawyers and others—for their legal liability to their clients and others relying on their advice and/or services. It provides indemnity cover if a client suffers a loss, either material, financial or physical which is directly attributable to negligent acts of the professional. This liability principally arises from negligent breach of contract but may arise in simple negligence or under statute (under the *Trade Practices Act 1974* for example). Malpractice insurance is another name for professional indemnity but this title has generally been reserved for the medical professions.<sup>38</sup>

The nature of professional indemnity claims differs according to profession. Accountants, lawyers, investment advisers and valuers, for example, are usually sued for economic loss resulting from advice provided. Claims against architects and engineers often relate to some physical damage leading to economic loss. Personal injury may also be involved.<sup>39</sup>

<sup>38</sup> ICA, 'Submission to Ministerial Forum, Addressing the Issues in Professional Indemnity Insurance', March 2002, p. 1.

<sup>39</sup> *ibid.*

### 3.4.1.1 Voluntary insurance

Like public liability insurance, professional indemnity insurance is also considered to be a voluntary form of insurance with several exceptions. Although no specific legislation governs how claims are dealt with or how compensation is determined, some professions are required by legislation to hold professional indemnity insurance in some states and territories and/or nationally. The main professions that are required to hold such insurance are the legal profession, insurance brokers and medical practitioners. The Australian Council of Professions claims that about 95 per cent of professionals have professional indemnity insurance.<sup>40</sup>

Professional indemnity insurance may also be a requirement for membership of a professional body. For instance, although accountants are not required by law to hold professional indemnity insurance, the Institute of Chartered Accountants in Australia requires its members to hold professional indemnity insurance to a specified level.<sup>41</sup>

In recent years, while it has not been compulsory for many professional groups to hold professional indemnity insurance, requirements by government agencies and others for professionals to hold indemnity cover has led to an increase in cover. Government contracts specifying the need for insurance cover gained prominence in the mid-1990s and coincided with substantial outsourcing of contracts to the private sector.<sup>42</sup> Again, while it may not generally be compulsory to hold professional indemnity insurance, it has become a requirement for professionals tendering for government work.

### 3.4.1.2 Claims-made policies

Professional indemnity is usually written on a 'claims-made' basis. This means that an insurer indemnifies the insured against claims that are notified in the policy year and that occurred during that year. In some cases, retrospective cover may also be offered by insurers, which means the policy would then cover claims notified in the year of cover that may arise from incidents that occurred before the policy began.

This contrasts with public liability insurance which, as outlined in section 3.3.1, is usually written on a claims-occurring basis.

## 3.4.2 Industry structure

The following section discusses the number of professional indemnity insurers currently active in the sector, and also provides information about market shares and the relative size of state and territory markets.

### 3.4.2.1 Industry participants

APRA's unpublished data for the ACCC for the year ending 31 December 2003 indicated that 21 direct insurers were active in the professional indemnity insurance class during this period.<sup>43</sup>

---

<sup>40</sup> Australian Council of Professions Ltd, 'Submission to Senate Economics References Committee', May 2002, p. 4.

<sup>41</sup> Institute of Chartered Accountants website, [www.icaa.org.au](http://www.icaa.org.au).

<sup>42</sup> ACCC, 'Second insurance industry market pricing review', September 2002, p. 50.

<sup>43</sup> The ACCC has excluded from this analysis the premium revenue of medical indemnity providers as these insurers are the focus of another of the ACCC's monitoring roles and they do not typically underwrite insurance other than medical indemnity. These insurers are Australasian Medical Insurance Limited, MDA National Insurance Pty Ltd, Health Professionals Insurance Australia Pty Ltd, Medical Insurance Australia Pty Ltd and the Professional Indemnity Insurance Company of Australia Pty Ltd.

The data also showed that the largest 10 insurers earned about 93 per cent of total premium revenue for the professional indemnity class of insurance in Australia, with the largest four earning about 58 per cent. The largest 10 companies are:

- Ace Insurance Limited
- Allianz Australia Insurance Limited
- American Home Assurance Company
- CGU Insurance Limited
- Chubb Insurance Company of Australia Limited
- Guild Insurance Limited
- Liberty Mutual Insurance Company
- QBE Insurance (Australia) Limited
- Vero Insurance Limited
- Zurich Australia Insurance Limited.

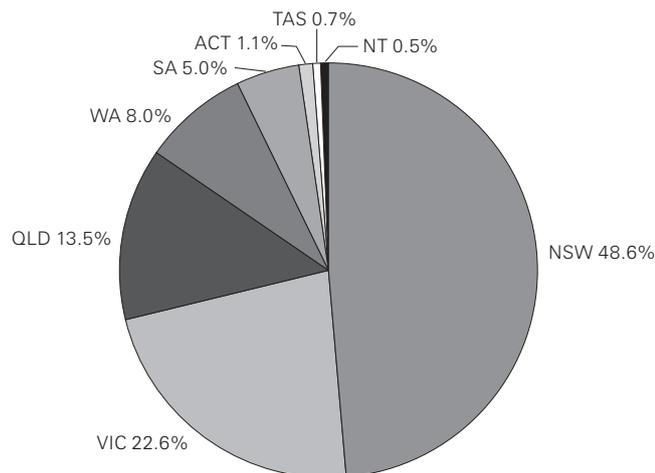
The size of the industry shares ranged between 3 per cent and 18 per cent. The remaining 7 per cent of the premium revenue earned in the professional indemnity insurance class comprised 11 insurers, each having shares of less than 2 per cent.

### 3.4.2.2 Distribution of premium revenue by state and territory

Chart 3.2 shows the percentage of total premium revenue underwritten by all insurers for professional indemnity insurance on a state and territory basis in the year ending 31 December 2003.

The largest share of premium revenue was written in New South Wales (48.6 per cent), followed by Victoria (22.6 per cent) and Queensland (13.5 per cent).

**Chart 3.2 Proportion of premium revenue by state or territory—professional indemnity—year ending 31 December 2003**



Source: Unpublished data provided by APRA to the ACCC for the year ending 31 December 2003.

### 3.5 Conclusion

Public liability and professional indemnity are forms of liability insurance. Although providing such insurance is not required by statute, in many cases cover is considered necessary. The inherent characteristics of public liability and professional indemnity insurance, in particular, their 'long-tail' and the unpredictability of large claims occurring, add to the complexity of insurers' pricing decisions.

A brief industry analysis shows that there are a large number of authorised direct insurers in both the public liability and professional indemnity insurance classes in Australia, with the largest four insurers in each class earning 48 per cent and 58 per cent respectively of premium revenue in 2003.

## 4 Costs of public liability insurance

### 4.1 Introduction

In 2002 the Australian Government asked the ACCC to monitor costs and premiums in public liability and professional indemnity insurance. To do this, the ACCC has requested quantitative and qualitative information from insurers in its monitoring program. This chapter presents the ACCC's findings on historical trends for public liability insurance costs between the years ending 31 December 1997 and 31 December 2003. Insurers' responses about the perceived drivers of claims costs in 2003 are also presented.

Chapter 5 examines trends in, and drivers of, premiums, and the financial performance of the insurers.

Chapters 6 and 7 examine costs and expenses, premiums and financial performance relating to professional indemnity insurance.

The ACCC's monitoring methodology for examining costs and other expenses, premiums and financial performance is outlined in appendix D.

### 4.2 Trends in claims

#### 4.2.1 Claim reports and claims frequency

The ACCC examined the number and frequency of claims reported as indicators of changes in the number of claims received by insurers. Claims frequency shows the number of claims reported by incident year as a proportion of the total number of policies for the corresponding underwriting year.

In the first monitoring report, the ACCC analysed the frequency of claims reported within the same year as incident. This indicator looks specifically at those claims which have been reported to the insurer in the same year as when the incident occurred which led to the report.<sup>44</sup> Because claims relating to one incident year can be reported to an insurer over a number of subsequent years the total number of claims incurred in more recent years is based on a combination of actual reports and an estimate of future reports. Looking at only those claims reported within the same year as incident means that the analysis is based on an actual number of claims reported as opposed to an estimate.

In this report, the ACCC also examines a second indicator of claims frequency. The ACCC examines the number of claim reports incurred, which includes not only claims already reported but also IBNR claims<sup>45</sup>, as a proportion of the total number of policies for the corresponding underwriting year. In more recent incident years, this indicator includes a greater number of IBNRs than actual reports, meaning that a greater weighting is placed on expectations as compared to actual experience. However, this indicator shows the way in which insurers expect each incident year to develop, not only for claims reported within the year of incident, but for all claim reports that the insurer is expected to receive until the book of business is closed.

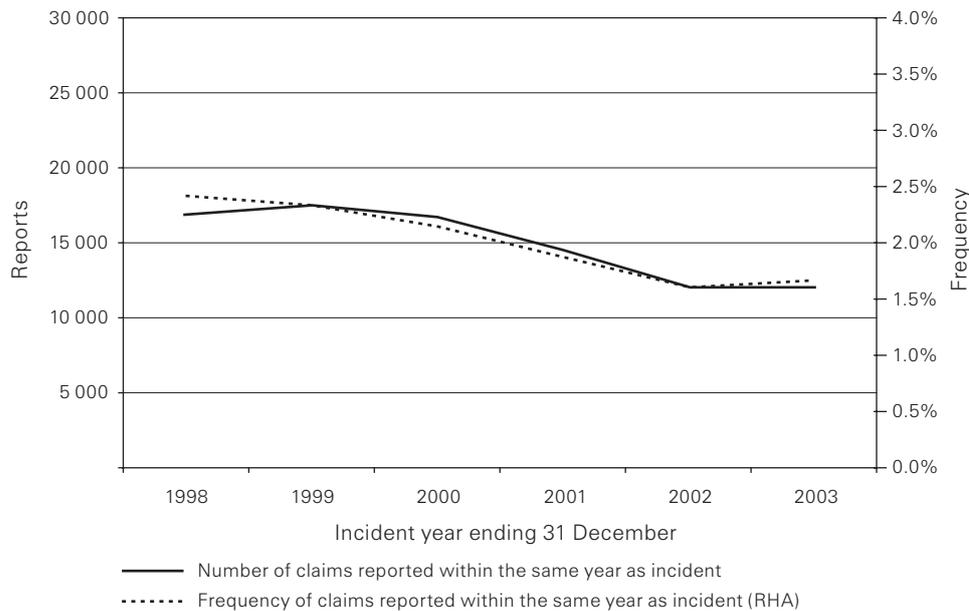
<sup>44</sup> To indicate what proportion of claims reported within the same year as incident represents of total claims incurred, the ACCC examined a sample of data provided by six insurers for the seven year period. It showed that the number of claims reported within the same year as incident represents, on average, 66 per cent of total claims incurred in that incident year, with this figure remaining relatively constant over the period and across the six insurers.

<sup>45</sup> Incurred but not reported claims (IBNRs) are claims arising from incidents or losses which have taken place during the underwriting period but are expected to be reported to the insurer in subsequent periods.

#### 4.2.1.1 Frequency of claims reported within the same year as incident (compared to total policies)

Chart 4.1 examines the number of claims reported to insurers within the same year as the incident occurred (reported within the same year as incident), and the frequency of claims reported within the same year as incident when compared to total policies over the incident year period 1998 to 2003.

**Chart 4.1 Total number of claims reported within the same year as incident and frequency of claims reported within the same year as incident (compared to total policies)—public liability—1998 to 2003**



Source: Derived by ACCC from responses provided by seven insurers.

The number of claims reported within the same year as incident increased from 16 978 to 17 439 between 1998 and 1999 (an increase of 3 per cent). However, between 1999 and 2002, the number of claims reported within the same year as incident declined to 11 934 (a decrease of 32 per cent). In 2003 the number of claims reported within the same year of incident was 11 945, similar to the level observed in 2002.

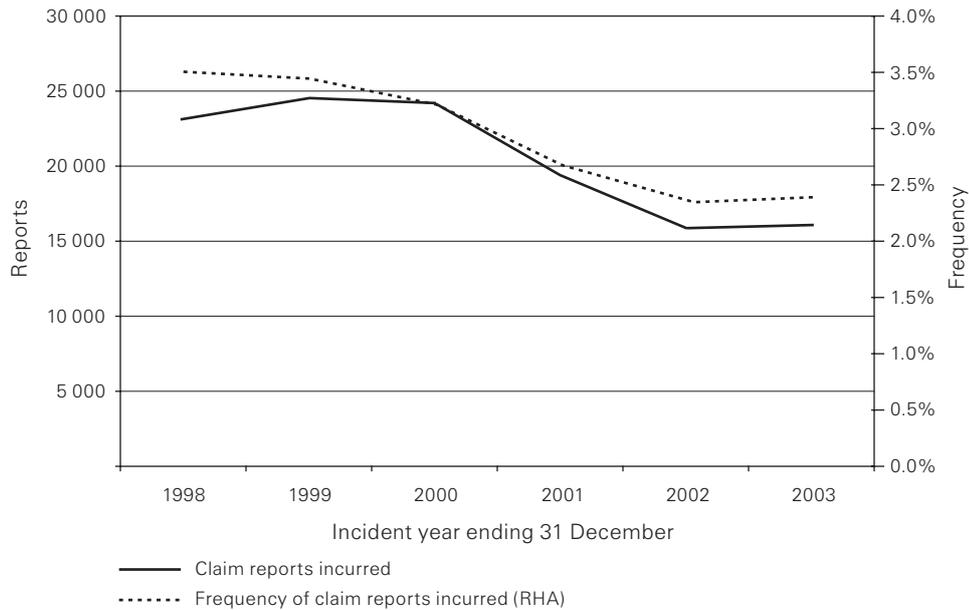
The frequency of claims reported within the same year as incident when compared to total policies decreased from 2.4 per cent in 1998 to 1.6 per cent in 2002. There was a marginal increase in 2003.<sup>46</sup>

<sup>46</sup> It should be noted that there are a number of potential drivers of a falling claims frequency including changes made to excesses or changes made to the market segment being underwritten by insurers. These drivers may lead to a changing claims frequency but not necessarily a fall in claims costs.

#### 4.2.1.2 Frequency of claim reports incurred (compared to total policies)

Chart 4.2 examines the total number of claim reports incurred for each incident year, including both reported claims and IBNRs, and the frequency of claim reports incurred when compared to total policies. The chart covers the incident year period 1998 to 2003.<sup>47</sup>

**Chart 4.2 Claim reports incurred and the frequency of claim reports incurred (compared to total policies)—public liability—1998 to 2003**



Source: Derived by ACCC from responses provided by six insurers.

The number of claim reports incurred by incident year increased from 23 124 in 1998 to 24 559 in 1999 (an increase of 9 per cent), before declining to 15 894 in 2002 (a decrease of 35 per cent). In 2003 the number of claim reports incurred rose marginally to 16 105 (an increase of 1 per cent).

The frequency of claim reports incurred when compared to total policies decreased from 3.5 per cent in 1998 to 2.3 per cent in 2002. In 2003 this figure rose marginally to 2.4 per cent.

The overall trends observed in charts 4.1 and 4.2 in terms of the number of claims reported within the same year as incident and the number of claim reports incurred are relatively similar, with an overall downward trend between 1998 and 2002, before rising marginally in 2003. The trend observed in terms of the frequency of claims reported within the same year as incident (compared to total policies) and the frequency of claim reports incurred (compared to total policies) also followed similar patterns.

*In summary:*

*The frequency of claims reported within the same year as incident and the frequency of total claim reports incurred when compared to total policies decreased between 1998 and 2002 before rising marginally in 2003.*

<sup>47</sup> It should be noted that chart 4.1 is based on data provided by seven insurers, while the analysis in this section is based on data from six insurers (due to one insurer included in chart 4.1 not providing an estimate of IBNRs). For consistency the ACCC analysed data provided by the six insurers in the context of chart 4.1 and found that the general trend was the same compared with the analysis of the seven insurers. This suggests that the analyses are broadly comparable.

## 4.2.2 Average size of claims settled

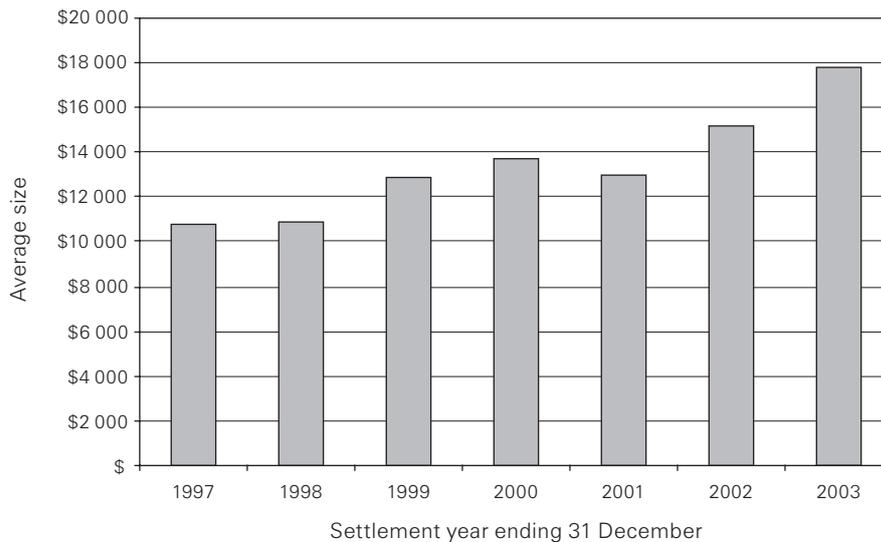
A lower number of claims will not necessarily result in lower claims costs for an insurer if the average size of those claims is increasing.

The ACCC examined trends in claims costs by looking at a number of indicators. The main indicator is the average size of claims settled, which shows the total amount of settlement costs divided by the total number of claims settled in any one year adjusted to 31 December 2003 values.

It should be noted that this, and other claims cost indicators examined in section 4.2, are considered to be trailing indicators because they are examined on a settlement year basis. Settlements from any one year may arise from claims reported to the insurer and lodged with a court a number of years before. Regardless of the settlement date, the legislation that applies to settlements is that at the time of lodgment. Therefore, as a number of claims settled in recent years may have been lodged with a court before the implementation of reforms, changes in the average size of claims in 2002 and 2003 may not be representative of the effect of reforms.

Chart 4.3 shows the average size of all claims settled in real terms.

**Chart 4.3 Average size of claims settled—real terms—public liability—1997 to 2003**



Source: Derived by ACCC from responses provided by seven insurers.

Note: Data adjusted to 31 December 2003 values using the AWE index.

In real terms, the average size of claims settled has increased across the period, with the exception of a small decrease in 2001. The average size of claims settled increased from \$10 800 in 1997 to \$15 202<sup>48</sup> in 2002, representing a 41 per cent increase over the period. The average size of claims further increased in 2003 to \$17 768, an increase of 17 per cent.

<sup>48</sup> The average size of claims settled for 2002 was reported in the first and second monitoring reports at \$17 906 and \$18 436 respectively (with the difference between these two figures attributable to inflating into real dollars using different bases). This figure has been revised down to \$15 202 in this report due to revised data being provided by insurers. As such, the results in this report are not directly comparable with those in previous reports for the average size of claims settled in 2002.

*In summary:*

*The average size of claims settled (i.e. those claims settled in any one year which may arise from incidents or reports from previous years) increased from \$10 800 in 1997 to \$15 202 in 2002. The average size of claims settled further increased in 2003 to \$17 768, an increase of 17 per cent.*

### 4.2.3 Increasing average size of claims—supplementary analysis

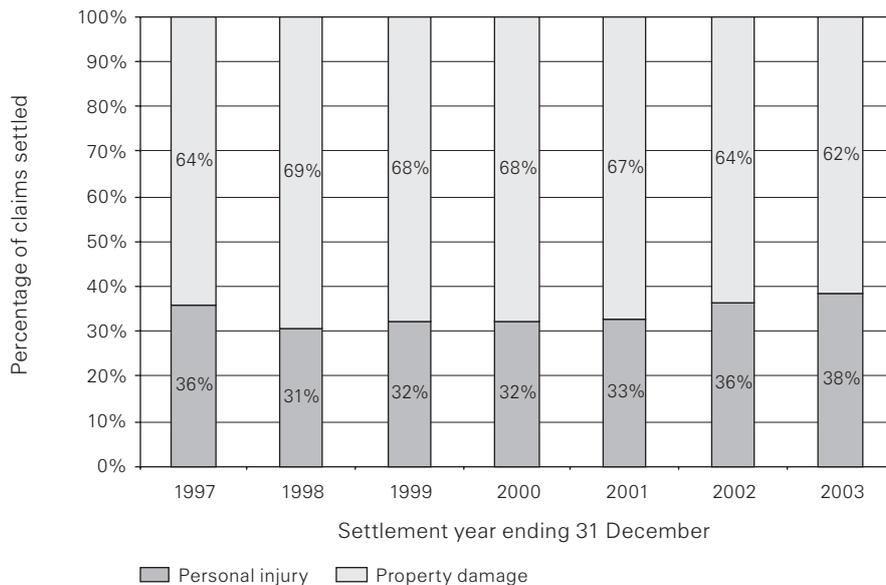
Section 4.2.2 showed that the average size of claims settled in real terms increased in most years between 1997 and 2003. This section examines some of the causes for the increase.

#### 4.2.3.1 Types of claims—property damage versus personal injury and death claims

The ACCC examined the number of claims and related costs attributed to personal injury and death claims and property damage claims.<sup>49</sup>

Chart 4.4 shows the proportion of the total **number of claims** settled between 1997 and 2003 that were personal injury and death claims and those that were property damage claims.

**Chart 4.4 Proportion of total number of claims settled that are personal injury and death settlements or property damage settlements—public liability—1997 to 2003**



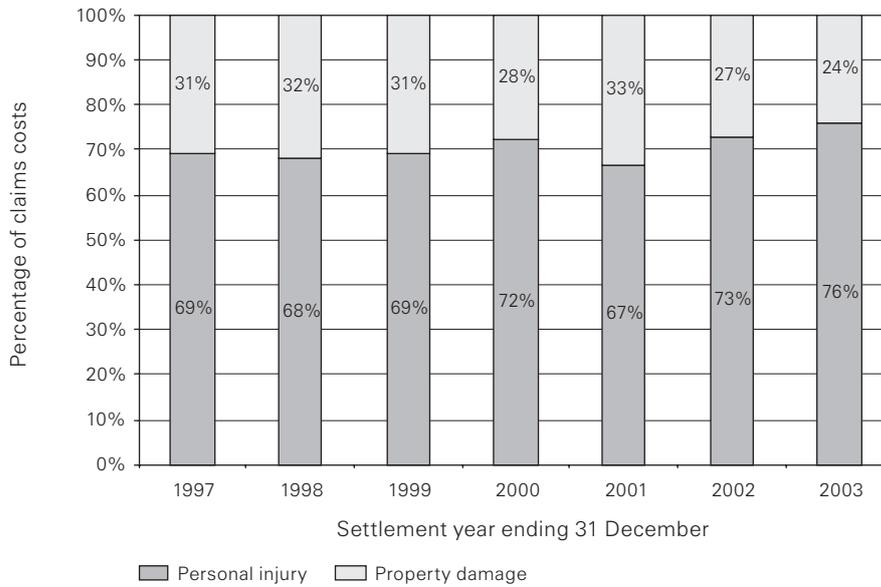
Source: Derived by ACCC from responses provided by five insurers.

There were a greater number of property damage claims than personal injury and death claims between 1997 and 2003. Over the period, the percentage of total claims settled that were property damage claims ranged between 62 per cent and 69 per cent, decreasing since 1998. The percentage of settlements relating to personal injury and death ranged between 31 per cent and 38 per cent, with an increasing trend since 1998.

<sup>49</sup> Not all eight insurers included in the ACCC's monitoring program provided this information as some indicated it was not produced in their reporting systems. Other insurers only provided some of the information for part of the time period specified by the ACCC. It should be noted that the analysis in chart 4.3 was based on data provided by seven insurers, while analysis in this section is based on data from five insurers. For consistency the ACCC analysed data provided by the five insurers in the context of chart 4.3 and found that the general trend was the same compared with the analysis of the seven insurers. This suggests that the analyses are broadly comparable.

Chart 4.5 shows the proportions of the total **costs of claims** settled between 1997 and 2003 that were personal injury and death claims and those that were property damage claims.

**Chart 4.5 Proportion of total claims settlement costs that are property damage settlements or personal injury and death settlements—public liability—1997 to 2003**



Source: Derived by ACCC from responses provided by five insurers.

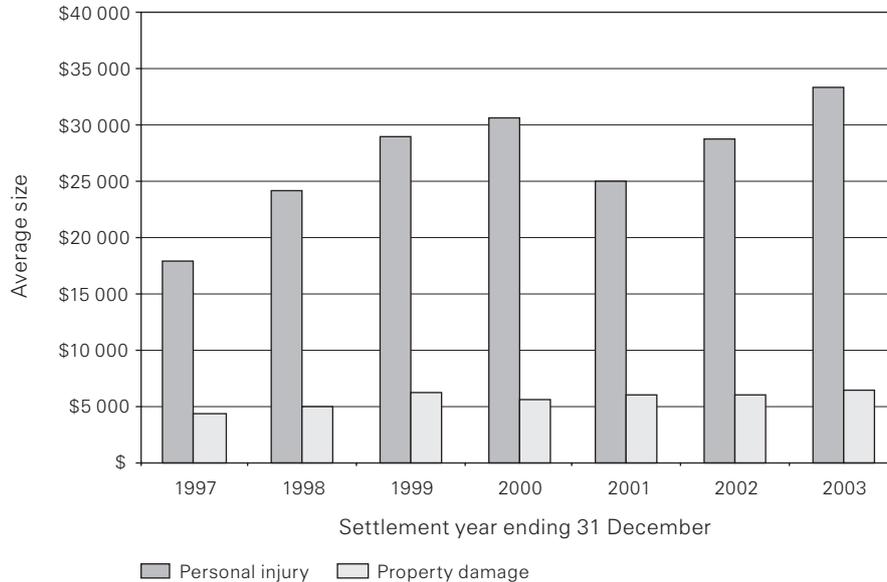
Personal injury and death claims represented a significantly larger proportion of settlement costs than property damage claims across the period. Between 1997 and 2003 the proportion of settlement costs comprising personal injury and death claims ranged between 67 per cent and 76 per cent. The proportion of settlement costs comprising property damage claims ranged between 24 per cent and 33 per cent. With the exception of a decrease in 2001, the proportion of total claims costs represented by personal injury and death claims increased between 1998 and 2003, from 68 per cent in 1998 to 76 per cent in 2003.

*In summary:*

*Compared to property damage claims, personal injury and death claims are lower in number but higher in cost, and have become an increasing proportion of both claim numbers and claims costs over recent years.*

Chart 4.6 shows in real terms the average size of claims settled for personal injury and death claims and for property damage claims for the period 1997 to 2003.

**Chart 4.6 Average size of claims settled—real terms—personal injury and death and property damage claims—public liability—1997 to 2003**



Source: Derived by ACCC from responses provided by five insurers.

Note: Data adjusted to 31 December 2003 values using the AWE index.

Chart 4.6 shows that the average size of personal injury and death claims is significantly higher than for property damage claims.

Between 1997 and 2003 the average size of personal injury and death claims rose by 87 per cent, from \$17 924 in 1997 to \$33 447 in 2003. However, most of this increase was observed between 1997 and 2000.

The average size of property damage claims increased over the period from \$4443 in 1997 to \$6519 in 2003 (an increase of 47 per cent).<sup>50</sup>

*In summary:*

*Personal injury and death claims as a proportion of total claim numbers and claims costs have increased over the period. This, combined with the overall increasing average size of these claims, suggests that this type of claim has been a major influence on the increase in average size of all claims settled over the period.*

<sup>50</sup> The average size of claims is a trailing indicator as it is examined on a settlement year basis. It should be noted that not all claims settled in the years after the reforms were implemented will be affected by the reforms. This is because the legislation that applies to claims is the legislation in place at the time the claim was lodged in court. Therefore, claims lodged before reforms were implemented, but settled after, are not expected to be affected by the reforms. As such, movements in this indicator may not be representative of the impact of reforms.

#### 4.2.3.2 Claims settlement distribution by size bands

In assessing the changes in the average size of claims settled, it is also important to examine the cost and number of claims settled by band size as a proportion of total claims costs and total claim numbers.<sup>51 52</sup>

The total number of public liability claims settled fluctuated over the period, ranging from a low of 21 975 in 1998 to a high of 25 089 in 2001. For this reason the ACCC looked at how the proportions of the total number of claims falling within different size bands has changed. Similarly the ACCC also examined the proportion of total cost of claims settlements in each of the different size bands.

Table 4.1 shows the proportion of total claims settlement costs and total numbers of claims settled within specified settlement band sizes for the settlement years 1997 to 2003.

**Table 4.1 Proportion of total claims settled—by number and by cost—settlement year ending 31 December—public liability—1997 to 2003**

Claim size band		Proportion of total claims settled (%)						
		1997	1998	1999	2000	2001	2002	2003
\$50 000 or less	By number	97	96	96	96	95	93	92
	By cost	45	44	36	33	35	31	27
\$50 001 to \$500 000	By number	3	4	4	4	5	7	8
	By cost	41	46	44	42	50	51	53
\$500 001 or more	By number	0.1	0.1	0.2	0.2	0.2	0.3	0.3
	By cost	14	10	20	25	15	18	20

Source: Derived by ACCC from responses provided by seven insurers.

The table shows that for the individual size bands:

- The number of claims settled for *\$50 000 or less* (i.e. low cost claims) as a proportion of the total number of claims settled decreased from 97 per cent in 1997 to 92 per cent in 2003.
  - The proportion of total claims settlement costs represented by this band also decreased over the period from 45 per cent in 1997 to 27 per cent in 2003.
- The number of claims settled for amounts *\$50 001 to \$500 000* (i.e. medium cost claims) as a proportion of all claims settled, increased from 3 per cent in 1997 to 8 per cent in 2003.
  - Similarly, in terms of settlement costs, claims within this band represented 41 per cent of total settlement costs in 1997, increasing to 53 per cent in 2003.
- The number of settlements for amounts *\$500 001 or more* (or high cost claims) as a proportion of the total number of claims settled also increased from 0.1 per cent in 1997 to 0.3 per cent in 2003.

<sup>51</sup> A common argument for increases in claims costs is that the size and number of 'high cost claims' has increased, leading to increased pressure on premiums. Data on size bands can be analysed to see if the number of claims is increasing across all size bands, or if the number of claims is getting higher in the higher bands—that is, if there is any bracket creep. Bracket creep can occur for several reasons such as higher court awards, the ability to sue for other damages or court precedents. Bracket creep can also occur due to claims costs increasing in line with normal inflation. The information collected from insurers by the ACCC on size bands was on a nominal basis and as such there may be some small degree of bracket creep for this reason.

<sup>52</sup> The average size of claims is a trailing indicator as it is examined on a settlement year basis. It should be noted that not all claims settled in the years after the reforms were implemented will be affected by the reforms. This is because the legislation that applies to claims is the legislation in place at the time the claim was lodged in court. Therefore, claims lodged before reforms were implemented, but settled after, are not expected to be affected by the reforms. As such, movements in this indicator may not be representative of the impact of reforms.

- The cost of claims settled in this band as a proportion of total settlement costs did not show a clear trend. However, the data for claims settled for amounts \$500 001 or more indicates that although there are relatively few high cost claims, the magnitude of such claims has a significant impact on the total cost of claims settled, and thus the average size of claims settled in any one year.

*In summary:*

*The proportion of the total number of claims settled that are medium and high cost claims (\$50 001 to \$500 000 and \$500 001 or more respectively) have increased, whereas the number of low cost claims (\$50 000 or less) have reduced by proportion.*

*Although medium and high cost claims have both grown in number over the period, the major increase in total settlement costs appears to be in medium cost claims.*

### 4.3 Reasons for recent claims cost increases

Insurers included in the ACCC's monitoring program were asked to determine what factors had been major drivers to changes in the number and size of public liability claims in 2003. This section examines their responses.

One insurer commented that it had not observed any major changes in the number and size of public liability claims over this period, and suggested that as a long-tailed insurance class, it would be a number of years before any inferences could be made regarding the number and size of claims.

Among the remaining insurers, a number of potential drivers were identified. Several insurers noted that they had changed their business focus over recent years and were now underwriting a different segment of the market and that this change was a key driver of changes observed in their claim numbers and costs. Some insurers also indicated that higher levels of excess in their portfolios had had some effect on claims frequency and costs.

Other insurers noted that the tort reforms may be having a possible impact on claims costs. One insurer suggested that there was now increased community awareness of the cost of liability and that this might result in improved risk management, thereby reducing the number of claims. However, another insurer commented that it had observed rising claims costs and numbers, and that the key driver of this was an increasingly litigious society.

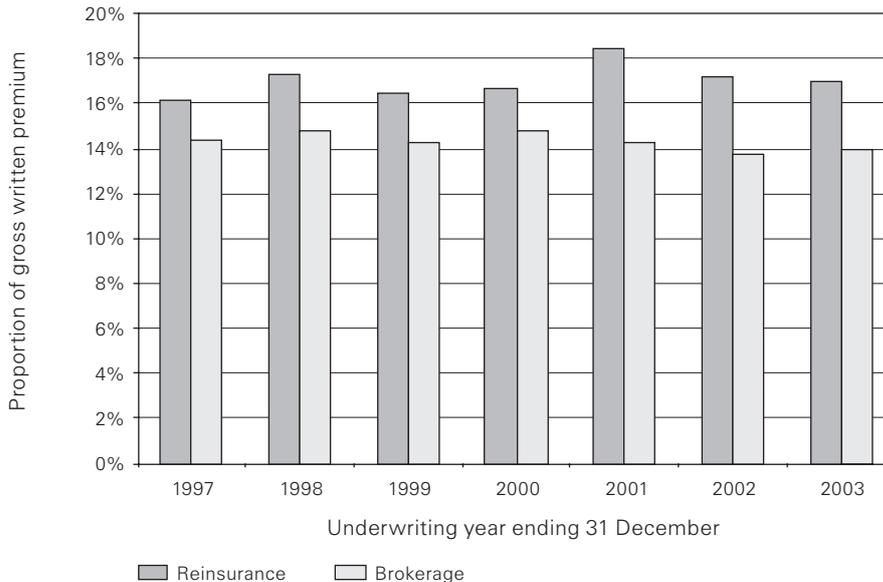
*In summary:*

*Generally, insurers believed that changes in the type of market segment they underwrote and increased levels of excess are most likely driving observed changes to the number and size of claims.*

## 4.4 Trends in expenses

This section examines the other cost components of public liability insurance by looking at trends in reinsurance, brokerage and underwriting expenses. Chart 4.7 shows reinsurance and brokerage expenses as a proportion of gross written premium over the period 1997 to 2003.<sup>53</sup>

**Chart 4.7 Reinsurance expense and brokerage expense as a proportion of gross written premium—public liability—1997 to 2003**



Source: Derived by ACCC from responses provided by five insurers.

The chart shows that reinsurance expenses as a proportion of gross written premium remained fairly constant over the period, ranging between 16 and 19 per cent. Brokerage expenses as a proportion of gross written premium also remained fairly constant over the period, ranging from just below 14 per cent to almost 15 per cent.<sup>54</sup>

Although reinsurance costs have remained relatively stable compared to gross written premium, this does not take into account changes in the amount of cover being received for the reinsurance. As a part of its third monitoring request the ACCC asked insurers with specific regard to their reinsurance coverage, what their retention had been for the four years to 2003. The retention is the amount of risk that the insurer keeps on its own accounts before the reinsurer provides coverage. It is similar to the excess applied in standard insurance policies.

<sup>53</sup> The expenses are compared with the gross written premium because the premium written in any one year will be used to pay for all costs of acquiring, writing and servicing insurance business.

<sup>54</sup> The ACCC understands that brokerage expenses are typically a fixed percentage of premium written and generally range from 15 to 20 per cent. However, as insurance policies can also be issued directly to the insured, the amount of brokerage paid in any one year will not equal exactly the fixed percentage.

For the five insurers included in the sample in chart 4.7, two indicated that their retention had not changed over the period. However, retention rates for the remaining three insurers had increased by between 50 per cent and 100 per cent over the four years. This indicates that for some insurers, although reinsurance costs have remained relatively constant in line with gross written premium, the amount of cover received for their reinsurance premium has decreased.

Most of the insurers did not provide historical data on underwriting expenses in enough detail to allow the ACCC to conduct similar trend analysis on underwriting expenses. However, five insurers provided partial data for the period 2001 to 2003. This showed that underwriting expenses as a proportion of gross written premium was 12 per cent in 2001, 9 per cent in 2002 and 8 per cent in 2003.<sup>55</sup>

*In summary:*

*As a proportion of gross written premium, brokerage and reinsurance expenses remained fairly constant over the period. However, for some insurers the amount of reinsurance coverage received decreased over the four years to 2003.*

*Underwriting expenses have decreased as a proportion of gross written premium over the three years to 2003.*

## 4.5 Conclusion

Based on data provided by insurers with respect to **public liability insurance**, the ACCC found that over the period year ending 31 December 1997 to year ending 31 December 2003:

- The frequency of claims reported within the same year as the incident and the frequency of claim reports incurred when compared to total policies decreased between 1998 and 2002, followed by a marginal increase in 2003.
- The average size of claims settled increased from \$10 800 in 1997 to \$15 202 in 2002. The average size of claims further increased in 2003 by 17 per cent to \$17 768.
  - The increase appears to be due in part to a general trend towards a greater number and cost (by proportion) of personal injury and death claims. Personal injury and death claims are typically larger in cost than property damage claims.
  - The increase may also be due to an increase in the cost and number of all medium cost claims (claims settled for amounts greater than \$50 001 but less than \$500 000), and possibly also large cost claims.
- Generally, insurers considered that changes in the type of market segment being underwritten and increased levels of excess are most likely driving the observed changes to the number and size of claims.
- As a proportion of gross written premium, brokerage and reinsurance expenses remained fairly constant over the period. However, for some insurers the amount of reinsurance coverage received decreased over the four years to 2003. Underwriting expenses have decreased as a proportion of gross written premium over the three years to 2003.

<sup>55</sup> Underwriting expense as a proportion of gross written premium may have decreased between 2001 and 2003 due to fixed costs being spread across a larger premium base.

## **5 Premiums and financial performance in public liability insurance**

### **5.1 Introduction**

Chapter 4 examined trends in the costs of public liability insurance between the years ending 31 December 1997 and 31 December 2003.

This chapter examines trends in premiums during the same period and the financial performance of insurers supplying the public liability class of insurance between 2001 and 2003.

It also examines the potential drivers behind changes in premiums in 2003. The extent to which non-price factors have changed in recent years, such as the levels of excess, cover limits and exclusions, is also examined.

The ACCC's monitoring methodology for examining historical costs and expenses, premiums and financial performance is outlined in appendix D.

### **5.2 Trends in premiums<sup>56</sup>**

This section examines trends in average premiums between 1997 and 2003. This is used as an indicator of how premium rates charged by insurers have changed over the period. However, it should be noted that it may also reflect changes in the insurers' portfolios. The average premium will not exactly reflect changes in the premiums paid by all consumers.

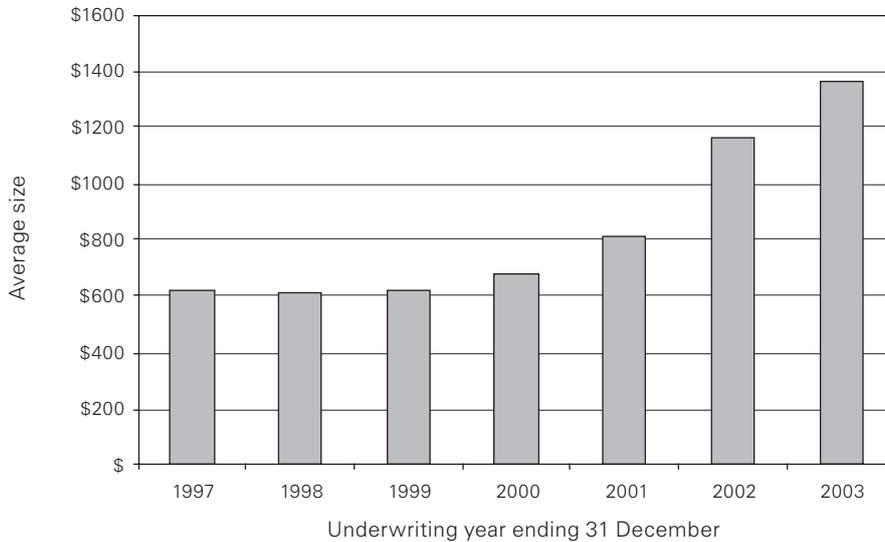
#### **5.2.1 Average premium**

Chart 5.1 shows the average premium in real terms between 1997 and 2003. Average premium is derived by dividing the gross written premium by the number of policies.

---

<sup>56</sup> The premium analysis may not be directly comparable to the claims trend analysis. This is because premium and policy data was collected on an underwriting year basis while claims data was typically collected on an incident year and settlement year basis. Therefore, information contained in section 5.2 below may not correspond directly with the information in section 4.2.

**Chart 5.1 Average premium—real terms—public liability—1997 to 2003**



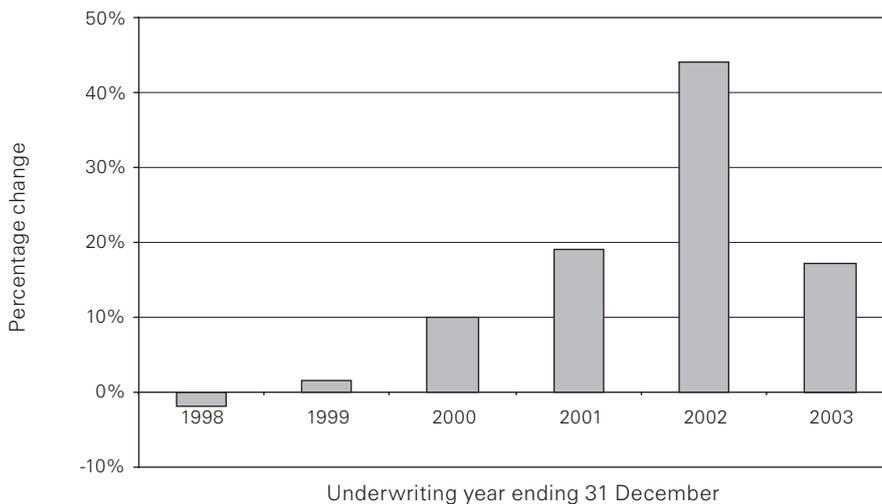
Source: Derived by ACCC from responses provided by seven insurers.

Note: Data adjusted to 31 December 2003 values using the AWE index.

The average premium in real terms was stable at around \$620 from 1997 to 1999, before increasing substantially since then to \$1366 in 2003.

The increase is illustrated again in chart 5.2 which shows the percentage change in average annual premium in real terms from 1998 to 2003.

**Chart 5.2 Percentage change in average premium on previous year's premium—real terms—public liability—1998 to 2003**



Source: Derived by ACCC from responses provided by seven insurers.

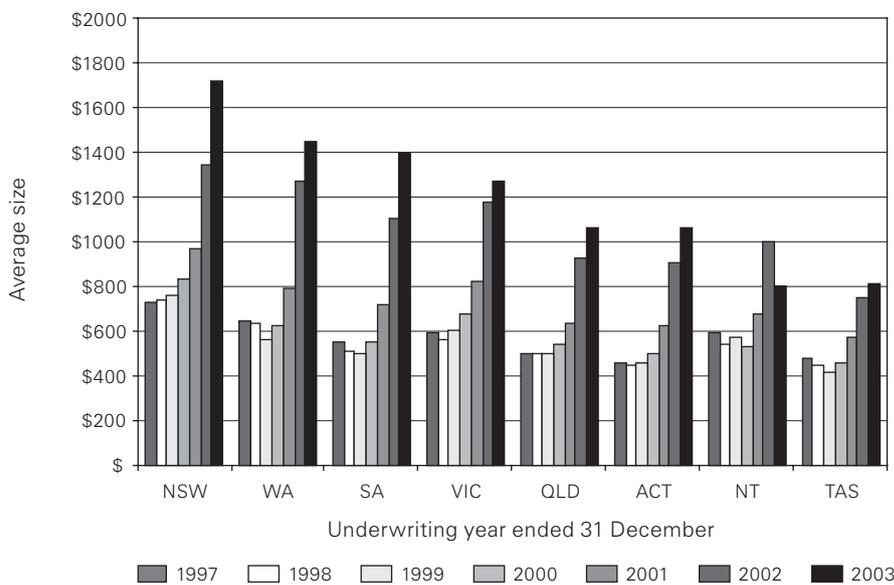
Note: Data adjusted to 31 December 2003 values using the AWE index.

Chart 5.2 indicates that the percentage change in average premium in 1998 and 1999 was relatively small. However, from 2000 onwards, average premiums in real terms started to rise, with the largest increase of 44 per cent in 2002. In 2003 the rate of increase fell, with the average premium growing by 17 per cent.

## 5.2.2 Average premium by state and territory

Chart 5.3 shows the average premium in real terms, on a state and territory basis, for the period 1997 to 2003.

**Chart 5.3 Average premium by state and territory—real terms—public liability—1997 to 2003**



Source: Derived by ACCC from responses provided by seven insurers.

Note: Data adjusted to 31 December 2003 values using the AWE index.

Chart 5.3 shows that New South Wales consistently had the highest average premium during the period. Tasmania has had the lowest average premium since 1999.

Generally, all states and territories showed a similar trend in average premiums across the period, with either small increases or marginal decreases in average premium between 1997 and 2000, followed by increases in 2001 and then further steep increases in 2002. In 2003 premiums continued to rise in all states and territories (with the exception of the Northern Territory), although the increase was less than that observed in 2002.

*In summary:*

*Nationally, the average premium remained stable between 1997 and 1999 before premiums increased significantly between 2000 and 2002. This trend generally occurred in most states and territories.*

*In 2003 the average premium continued to rise, but to a lesser extent than was observed in 2002. This trend was also observed in all states and territories, with the exception of the Northern Territory where the average premium decreased in 2003.*

### 5.3 Reasons for recent premium increases

Insurers were asked to provide the key reasons for changes in public liability premiums in 2003.

Most insurers cited increasing costs as the key driver of changes in public liability premiums. The predominant cost was rising claims costs with some insurers suggesting that normal and superimposed inflation<sup>57</sup> were increasing claims costs, thereby leading to higher premiums, while others suggested that both the number and size of claims was increasing.

Most insurers also indicated that increased reinsurance rates were leading to higher premiums. One insurer noted that the cost of raising and servicing the capital required under APRA's new capital requirements had led to increased premiums, while another indicated a need to increase premiums to maintain profitability.

One insurer also stated that increasing its level of excess had placed downward pressure on its premiums.

*In summary:*

*Insurers reported that recent changes to public liability insurance premiums have primarily been caused by increased costs including claims costs, reinsurance and increased capital requirements.*

### 5.4 Terms and conditions of policies

Insurers can compete not only on price but also on the terms and conditions of policies. Therefore, under the ACCC's monitoring program the nature of public liability policies offered is also examined to see whether the terms and conditions of policies have changed.

The ACCC examined:

- changes in the minimum, maximum and average cover limits offered in standard policies between years ending 31 December 2002 and 31 December 2003<sup>58</sup>
- changes in the minimum, maximum and average levels of excess offered in standard policies between years ending 31 December 2002 and 31 December 2003<sup>59</sup>
- changes made to the exclusions specified in the standard policy between years ending 31 December 2002 and 31 December 2003.

#### 5.4.1 Standard policy

All eight insurers in the monitoring sample offered a standard policy for public liability insurance in 2002 and 2003.

In 2003 this standard policy was generally available to all sectors in which the insurer wrote business (with the exception of one insurer). Typically all insurers used the standard policy for the majority of their business, with seven insurers indicating that they wrote more than 76 per cent of their book of business under the standard policy (the remaining insurer indicated it wrote between 51 and 75 per cent of its book of business under the standard policy).

<sup>57</sup> Superimposed inflation is the rate of inflation of claims costs by reason of factors other than economic/investment factors, for example court awards, legislative amendments etc.

<sup>58</sup> Cover limits are limits set by the insurer on the amount of compensation it will pay in the event of a claim or series of claims arising within the period of insurance. It is the maximum amount of compensation that will be paid by the insurer, with any portion of any claims above this limit falling back to the insured.

<sup>59</sup> An excess, set by the insurer or selected by the insured, is the amount of the claim that the insured is required to pay if a claim arises within the period of insurance.

#### 5.4.1.1 Cover limits

The ACCC asked insurers to specify the minimum and maximum cover limits on standard policies written for 2002 and 2003.

In 2002 the minimum cover limits on standard policies generally ranged from \$1 million to \$5 million. The maximum cover limits on standard policies ranged from \$30 million to \$100 million. Between 2002 and 2003 no insurer changed its minimum cover limit and only one insurer reduced its maximum cover limit (from \$100 million to \$50 million due to the inability to purchase reinsurance coverage).

As a part of the third monitoring request, the ACCC also asked insurers to indicate the average cover limit on their standard policies for 2002 and 2003. In 2002 across seven insurers the average cover limit was approximately \$11.3 million. For 2003 the average cover limit increased by 3 per cent to approximately \$11.7 million. The change in the average cover limit ranged between insurers with one experiencing a decrease of 9 per cent, while the remaining six experienced an increase in their average cover limit of up to 18 per cent.

Therefore while the minimum and maximum cover limits offered by insurers did not change significantly over the period, the average cover limit offered by most insurers increased. This indicates that those insured may, on average, be receiving a greater amount of coverage through increased cover limits.<sup>60</sup>

#### 5.4.1.2 Excesses

The ACCC asked insurers to specify the minimum and maximum levels of excess for standard policies written for 2002 and 2003.

The minimum levels of excess on standard policies in 2002 varied across insurers, with some reporting no minimum excess and others a minimum excess of \$500. The maximum levels of excess on standard policies for 2002 also varied across insurers, ranging from no maximum excess up to \$1 million. In 2003 three insurers indicated that they had changed either their minimum or maximum levels of excess. This led to the minimum level of excess for 2003 ranging from no minimum excess up to \$2500. Changes made to the maximum levels of excess were within the range specified for 2002.

Insurers were also asked to indicate the average level of excess on their standard policies for 2002 and 2003. In 2002, across six insurers, the average level of excess was approximately \$6900. By 2003 this had increased by 64 per cent to approximately \$11 300. The change in the average level of excess varied between insurers, with two insurers indicating no change, while the remaining four insurers indicated that their average level of excess increased by between 18 per cent and 71 per cent.

Therefore, although only three insurers in the ACCC's monitoring program made changes to the minimum and maximum levels of excess available on their standard policies, the average levels of excess applied increased substantially for four insurers. This indicates that insureds may, on average, be receiving a lower amount of coverage due to higher levels of excess.

---

<sup>60</sup> It should be noted that as many claims never exceed the cover limit, increases in its level are unlikely to significantly impact on the amount of coverage that the insured receives.

### 5.4.1.3 Exclusions

The ACCC also requested information from insurers on what additional exclusions had been incorporated into their standard policy in 2003. Of the eight insurers, seven indicated that they had made changes, generally relating to asbestosis, terrorism and information technology exclusions. Several of the insurers indicated that these changes were in keeping with their reinsurance arrangements.

This indicates that generally insureds may be receiving a lower level of coverage for their policies as a result of these additional exclusions.<sup>61</sup>

*In summary:*

*During 2003 the standard public liability insurance product offered by insurers in the ACCC's monitoring program underwent some significant changes. The cover limits on these policies generally increased. However, at the same time there have also been increases in some insurers' levels of excess and the introduction of new exclusions by the majority of insurers. The degree to which these factors will interact and lead to more or less coverage will depend on the particulars of insureds' individual policies.*

## 5.5 Trends in financial performance

The ACCC examined the underwriting performance of insurers to determine how these classes performed financially. The ACCC used a number of ratios commonly used in the insurance industry to determine how classes have performed. These ratios provide an estimate of whether or not underwriting performance<sup>62</sup> is improving over time.

### 5.5.1 Ratios

The ratios used by the ACCC can be calculated both gross and net of reinsurance expenses and recoveries.

The ACCC examined gross ratios because reinsurance costs and revenues (known as recoveries) may change substantially from one year to the next, which means that an insurer's net ratio could fluctuate from year to year. Net ratios are also examined because they show the financial performance directly experienced by the insurers, and therefore are more representative of the costs that they will pay and the premium they will retain.

The ACCC examined underwriting performance in terms of the loss ratio, the expense ratio, the reinsurance ratio and the combined ratio. These terms are defined in appendix D. Financial performance indicators could not be calculated before 2001 because of a lack of available historical data from insurers.

The following ratios are constructed on an aggregate basis, and therefore represent total ratios for six insurers in aggregate.

<sup>61</sup> It should be noted that many exclusions are for incidents that are typically unlikely to occur and therefore would not be expected to affect significantly the amount of coverage that the insured receives.

<sup>62</sup> The ACCC's analysis of underwriting performance may not necessarily be indicative of an insurer's overall profit because of a number of factors:

- The exclusion of general expenses from the ACCC's methodology—these were excluded as they cannot be attributed to any one class of insurance and will not be directly affected by tort law reform.
- The use of uninflated and undiscounted expected future payments estimates—which exclude the insurer's expectations of normal 'wage' inflation (but **include** an estimate of superimposed inflation) and future investment income on their future payments provisions. The ACCC used uninflated and undiscounted expected future payments because insurers' expectations regarding normal 'wage' inflation and investment income will not be directly affected by tort law reform.

### 5.5.1.1 Loss ratio

The loss ratio can be calculated gross or net of reinsurance costs and recoveries. The gross loss ratio is—claims payments by incident year (past payments adjusted into 31 December 2003 dollars using AWE, plus expected future payments in 31 December 2003 dollars on an uninflated and undiscounted basis)<sup>63</sup> divided by earned premium inflated to 31 December 2003 dollars by AWE.<sup>64</sup>

The net loss ratio effectively takes reinsurance and other recoveries out of the claims payments and takes the outwards reinsurance expenses away from the earned premium.

Because the calculation of the loss ratios by incident year takes into account both past claims payments and expected future payments (payments that will be made on claims that the insurer has incurred at the reporting date but which have not yet been settled), these ratios are still largely uncertain. This is because the expected future payments are based on an actuarial estimate of not only unfinalised reported claims costs, but also IBNR claims costs. Therefore this estimate may change as experience emerges, which can result in the loss ratios becoming more or less favourable for insurers.<sup>65</sup>

Table 5.1 shows the gross and net loss ratios for 2001 to 2003.

**Table 5.1 Gross loss ratio and net loss ratio—year ending 31 December—public liability—2001 to 2003**

	Gross loss ratio	Net loss ratio
2001	81%	80%
2002	59%	56%
2003	55%	53%

Source: Derived by ACCC from responses provided by six insurers.

The gross loss ratio decreased from 81 per cent in 2001 to 55 per cent in 2003. Similarly the net loss ratio decreased from 80 per cent in 2001 to 53 per cent in 2003. This means that for every dollar of premium earned in 2003, insurers expected to pay, on average, 55 cents in claims, or 53 cents if reinsurance is taken into account.

### 5.5.1.2 Expense ratio

The expense ratio can also be calculated gross or net of reinsurance expenses. The gross expense ratio is—underwriting and brokerage expenses by underwriting year divided by the gross written premium by underwriting year. The net expense ratio is—the underwriting and brokerage expenses divided by the net written premium (which is the gross written premium less reinsurance expenses).

Table 5.2 shows the gross and the net expense ratios for 2001 to 2003.

<sup>63</sup> That is, not taking into account normal 'wage' inflation (but **including** an estimate of superimposed inflation) or investment returns.

<sup>64</sup> The data used to prepare the loss ratios includes an allowance for claims administration expenses in past payments and the expected future payments. This estimate was not included in data used to prepare the loss ratios for the first monitoring report.

<sup>65</sup> This also means that the historical loss ratios change as experience emerges. Over time, expected future payments will become actual claims, be finalised and become actual payments. Deviations between the estimate and the actual amount finalised can lead to loss ratios changing over time until all claims are finalised.

**Table 5.2 Gross expense ratio and net expense ratio—year ending 31 December—public liability—2001 to 2003**

	Gross expense ratio	Net expense ratio
2001	28%	32%
2002	25%	29%
2003	23%	26%

Source: Derived by ACCC from responses provided by six insurers.

The gross expense ratio decreased from 28 per cent in 2001 to 23 per cent in 2003. A similar trend was observed in the net expense ratio, which fell from 32 per cent in 2001 to 26 per cent in 2003.

Section 4.4 showed that brokerage expenses remained generally constant over the period, while underwriting expenses fell from 12 per cent in 2001 to 8 per cent in 2003. This suggests that decreases in the expense ratio are mainly attributable to falling underwriting expenses.<sup>66</sup>

### 5.5.1.3 Reinsurance ratio

The reinsurance ratio is—the reinsurance expense by underwriting year divided by gross written premium by underwriting year. Reinsurance is calculated as a separate ratio because reinsurance is a different type of expense to underwriting and brokerage in that it is somewhat discretionary, and because it is a major component of expenses.

Table 5.3 shows the reinsurance ratio for 2001 to 2003.

**Table 5.3 Reinsurance ratio—year ending 31 December—public liability—2001 to 2003**

	Gross reinsurance ratio
2001	13%
2002	12%
2003	12%

Source: Derived by ACCC from responses provided by six insurers.

The table shows that the reinsurance ratio decreased marginally between 2001 and 2002 and then stabilised in 2003.<sup>67</sup>

### 5.5.1.4 Combined ratio

The gross combined ratio is calculated by adding together the gross loss ratio, the gross expense ratio and the reinsurance ratio. The net combined ratio is the sum of the net loss ratio and the net expense ratio.

<sup>66</sup> The expense ratio is calculated using the same insurers as those contained in the loss and reinsurance ratios for consistency purposes when calculating the combined ratio (the sum of the three ratios). As such the ACCC has used a different sample to that used for chart 4.7. Although this means that the results are not comparable in terms of absolute numbers, it is comparable in terms of general trends.

<sup>67</sup> This is generally consistent with the trend shown in chart 4.7 which, although based on different insurers, showed that the reinsurance expense remained constant for the period 2001 to 2003. The reinsurance ratio is calculated using the same insurers as those contained in the loss and expense ratio for consistency purposes when calculating the combined ratio (the sum of the three ratios). As such the ACCC has used a different sample to that used for chart 4.7. While this means that the results are not comparable in terms of absolute numbers, it is comparable in terms of general trends.

If a combined ratio is greater than 100 per cent, then the premium charged may not be sufficient to cover costs implying an underwriting loss. Conversely, if the combined ratio is less than 100 per cent then premiums are greater than the sum of all costs, implying an underwriting profit.

Table 5.4 shows the gross and net combined ratios for 2001 to 2003.

**Table 5.4 Gross combined ratio and net combined ratio—year ending 31 December—public liability—2001 to 2003<sup>68</sup>**

	Gross combined ratio	Net combined ratio
2001	121%	112%
2002	96%	85%
2003	90%	79%

Source: Derived by ACCC from responses provided by six insurers.

The table shows that the gross combined ratio fell significantly from 121 per cent in 2001 to 96 per cent in 2002, and then decreased again to 90 per cent in 2003. Similarly, the net combined ratio fell from 112 per cent in 2001 to 85 per cent in 2002, and then fell by a lesser amount to 79 per cent in 2003.

This suggests that there were expected improvements in the underwriting performance of insurers in 2002 and again in 2003. The improvement in underwriting performance in 2002 was largely driven by lower claims costs increases relative to rising premiums. In 2003 the improvement in the combined ratios was attributable to a combination of lower expenses and claims costs increases relative to premium increases.

*In summary:*

*The gross combined ratio and the net combined ratio decreased between 2001 and 2003. The source of the decrease was predominantly lower claims costs increases relative to rising premiums over the period. However, lower expenses relative to higher premiums also contributed to the improved performance.*

*This indicates improved underwriting performance by insurers in the public liability insurance class.*

## 5.6 Conclusion

Based on data provided by insurers with respect to **public liability insurance**, the ACCC found that:

- The average premium remained relatively constant between 1997 and 1999, before increasing between 2000 and 2002. In 2003 the average premiums increased by 17 per cent, although this was less than the 44 per cent increase observed in 2002.
  - Insurers perceive the 2003 premium increases to have been driven by increased costs including claims costs, reinsurance and increased capital requirements.
- The cover limits on the standard policy offered by insurers generally increased between 2002 and 2003. However, at the same time there have also been increases in some insurers' levels of excess and the introduction of new exclusions by the majority of insurers.
- The combined ratio, that is, expenses (including claims costs) compared to total premiums, decreased significantly between 2001 and 2002, and decreased further in 2003, indicating improved underwriting performance.

<sup>68</sup> In cases where the combined ratio is not equal to the sum of its component ratios, this is because of rounding.

## **6 Costs of professional indemnity insurance**

### **6.1 Introduction**

This chapter examines professional indemnity insurance costs between the years ending 31 December 1997 and 31 December 2003, based on information provided by insurers as part of the ACCC's monitoring program. Perceived drivers of claims costs, based on information provided by insurers, are also examined.

For professional indemnity insurance, the ACCC adopted a methodology similar to that used for examining costs in public liability, as outlined in appendix D.

Chapter 7 examines trends in, and drivers of, premiums and the financial performance of insurers in the professional indemnity insurance class.

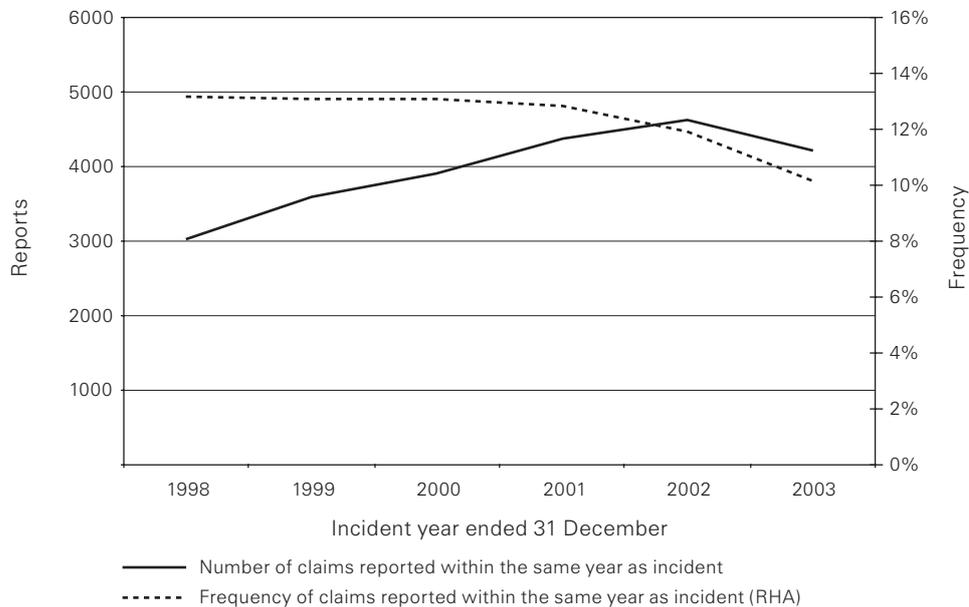
### **6.2 Trends in claims**

#### **6.2.1 Claim reports and claims frequency**

##### **6.2.1.1 Frequency of claims reported within the same year as incident (compared to total policies)**

Chart 6.1 shows the number of claims reported within the same year as incident and the frequency of claims reported within the same year as incident over the incident year period 1998 to 2003. The number of claims and the claims frequency are calculated the same way as for chart 4.1 in chapter 4.

**Chart 6.1 Total number of claims reported within the same year as incident and frequency of claims reported within the same year as incident (compared to total policies)—professional indemnity—1998 to 2003**



Source: Derived by ACCC from responses provided by five insurers.

The number of claims reported within the same year as incident consistently increased between 1998 and 2002 from 3023 to 4620 (an increase of 53 per cent). However, between 2002 and 2003 the number of claims reported within the same year as incident decreased to 4217 (a decrease of 9 per cent).

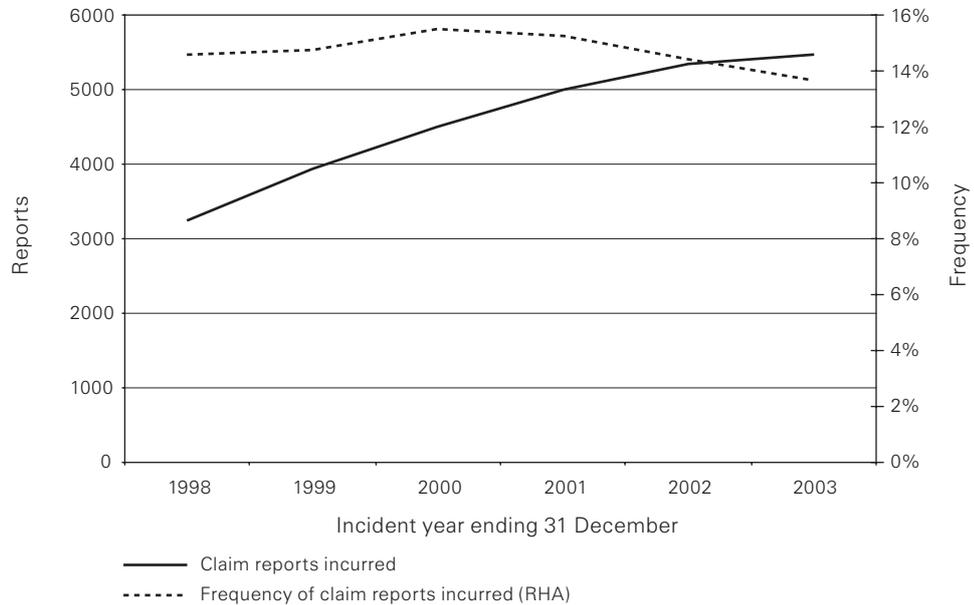
The frequency of claims reported within the same year as incident remained constant at 13 per cent between 1998 and 2000, before decreasing between 2001 and 2003, to 10 per cent.

### 6.2.1.2 Frequency of claims reports incurred (compared to total policies)

Chart 6.2 examines the total number of claim reports incurred per incident year, including both reported and IBNR claims, and the frequency of claim reports incurred between 1998 and 2003.<sup>69</sup> This is similar to the analysis conducted in section 4.2.1.2.

<sup>69</sup> It should be noted that chart 6.1 is based on data provided by five insurers, while the analysis in this section is based on data from four insurers. For consistency, the ACCC analysed data provided by the four insurers in the context of chart 6.1 and found that the general trend was the same compared with the analysis of the five insurers. This suggests that the analyses are broadly comparable.

**Chart 6.2 Claim reports incurred and the frequency of claim reports incurred (compared to total policies)—professional indemnity—1998 to 2003**



Source: Derived by ACCC responses provided by four insurers.

The number of claim reports incurred per incident year has risen consistently, from 3251 claims in 1998 to 5471 claims in 2003 (an increase of 68 per cent).

Despite an increasing number of claim reports incurred, the frequency of these claims remained relatively stable, at around 15 per cent over the period 1998 to 2001. The frequency of claim reports incurred then declined marginally over 2002 and 2003 to 14 per cent.

This suggests that while the number of claim reports incurred has risen over the period this is due to more policies being written as opposed to more claims being received for the same amount of policies.

*In summary:*

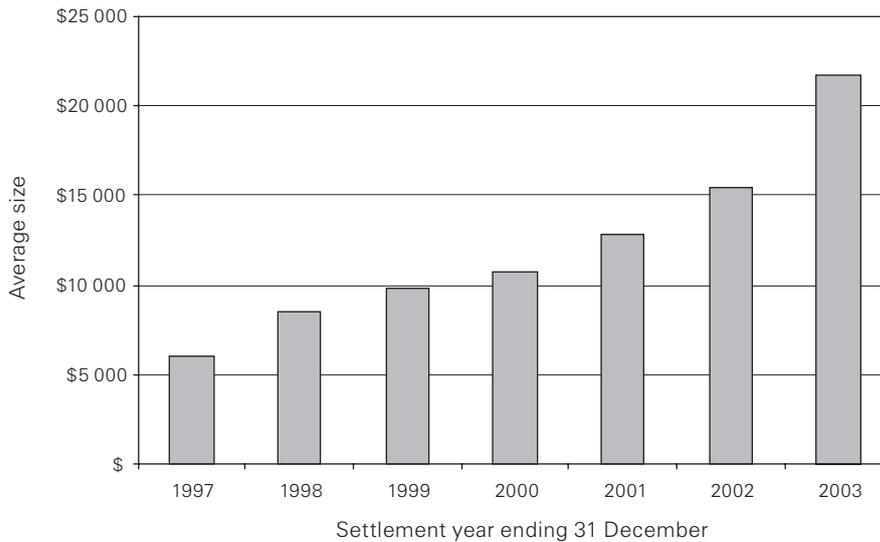
*The number of claims reported within the same year as incident and the number of claim reports incurred has generally increased over the period. However, this rise is due to an increase in the number of policies written because both the frequency of claims reported within the same year as incident and frequency of claim reports incurred remained largely unchanged early in the period and decreased in recent years.*

## 6.2.2 Average size of claims settled

It is also important to assess the extent to which the average size of claims settled has changed over time. This is because fewer claims will not necessarily result in lower claims costs for an insurer if the average size of those claims is increasing.

Chart 6.3 shows the average size of all claims settled per settlement year in real terms.

**Chart 6.3 Average size of claims settled—real terms—professional indemnity—1997 to 2003**



Source: Derived by ACCC from responses provided by five insurers.

Note: Data adjusted to 31 December 2003 values using the AWE index.

The average size of claims settled has consistently increased over the monitoring period, from \$6067 in 1997 to \$21 713 in 2003 (an increase of 258 per cent). The largest increase of 41 per cent was observed in 2003 (from \$15 411 in 2002<sup>70</sup> to \$21 713 in 2003).

*In summary:*

*The average size of claims settled increased steadily over the period from \$6067 in 1997 to \$15 411 in 2002. The average size of claims settled rose a further 41 per cent in 2003 to \$21 713.*

<sup>70</sup> In the first and second monitoring reports the average size of claims settled for 2002 was \$18 885 and \$19 492 respectively (with the difference between these two figures attributable to inflating into real dollars using different bases). The figure for 2002 has been revised down to \$15 411 in this report due to revised data being provided by insurers. As such, the results in this report are not directly comparable with those in previous reports for the average size of claims settled in 2002.

## 6.2.3 Increasing average size of claims—supplementary analysis

Section 6.2.2 showed that the average size of claims settled significantly increased in real terms between 1997 and 2003. This section examines the distribution of claim numbers and costs between claims size bands to determine if particular bands are driving the increase in the average size of claims settled.

### 6.2.3.1 Claims settlement distribution by size bands

The total number of professional indemnity claims settled increased significantly over the period, from 2331 in 1997 to 4118 in 2003 (an increase of 77 per cent). Similarly the total cost of claims settled increased significantly over the period from just over \$11 million in 1997 to more than \$87 million in 2003 (an increase of 692 per cent). Increases in the number and cost of claims settled were generally observed in all claims settlement size bands.<sup>71</sup>

For this reason, the ACCC looked at how the proportion of the total number of claims settled and total cost of claims settled falling within different size bands changed over the period.

Table 6.1 shows the proportion of total claims settlement costs and total numbers of claims settled within specified settlement band sizes for the settlement years 1997 to 2003.

**Table 6.1 Proportion of total claims settled—by number and by cost—settlement year ending 31 December—professional indemnity—1997 to 2003**

Claim size band		Proportion of total claims settled (%)						
		1997	1998	1999	2000	2001	2002	2003
<b>\$50 000 or less</b>	By number	89	91	94	95	96	95	94
	By cost	10	11	16	18	18	21	16
<b>\$50 001 to \$500 000</b>	By number	11	8	6	5	4	4	6
	By cost	57	46	45	51	36	41	39
<b>\$500 001 or more</b>	By number	0.1	0.1	0.3	0.2	0.4	0.6	0.5
	By cost	33	43	39	31	47	38	44

Source: Derived by ACCC from responses provided by five insurers.

The table shows that for the individual size bands:

- The number of claims settled for *\$50 000 or less* (i.e. low cost claims) as a proportion of the total number of claims settled increased from 89 per cent in 1997 to 94 per cent in 2003.
  - The proportion of total claims settlement costs falling within this band also increased over the period, from 10 per cent in 1997 to 16 per cent in 2003.
- The number of claims settled for amounts *\$50 001 to \$500 000* (i.e. medium cost claims) as a proportion of all claims settled decreased from 11 per cent in 1997 to 6 per cent in 2003.
  - Similarly, in terms of settlement costs, claims within this band fell from representing 57 per cent in 1997 to 39 per cent in 2003.
- The number of settlements for amounts *\$500 001 or more* (i.e. high cost claims) as a proportion of total number of claims settled increased from 0.1 per cent in 1997 to 0.5 per cent in 2003.
  - The cost of claims settled within this band as a proportion of total settlement costs varied over the period, with a low of 31 per cent in 2000 and a high of 47 per cent in 2001.

<sup>71</sup> As discussed in footnote 51, the information collected from insurers on size bands was on a nominal basis and as such some degree of bracket creep would be expected in line with normal inflation.

However, the data in table 6.1 shows that there were no strong trends in the distribution of the number and cost of claims settled within various claims size bands.

*In summary:*

*The number and cost of professional indemnity insurance claims settlements increased over the period. This increase occurred in all size bands.*

*However, there were no strong trends in the distribution of the number and cost of claims settled within various claims size bands. That is, no one claims size band appears to be driving increases in the average size of claims settled.*

### 6.3 Reasons for recent claims cost increases

Insurers in the ACCC's monitoring program were asked what factors had been the major drivers of change to the number and size of professional indemnity claims in 2003. This section examines their responses.

Of the five insurers, only three provided the ACCC with detailed answers. These insurers generally stated that they had changed their business focus over recent years and were now underwriting a different segment of the market and that this was a key driver of changes observed in their claim numbers and costs. One insurer also noted that changes in its underwriting policy, combined with increased levels of excess and a tightening of claims handling practices, had also contributed to a lower frequency of claims.

It was also suggested by one insurer that one possible driver of claims costs is that tort law reform may be influencing judicial decisions. It suggested that there are trends towards 'pro defendant' awards, in that courts are now taking greater account of the fact that plaintiffs should be aware of the risks involved. The same insurer also noted that the stability of the economy and interest rates was having an impact on claims costs.

*In summary:*

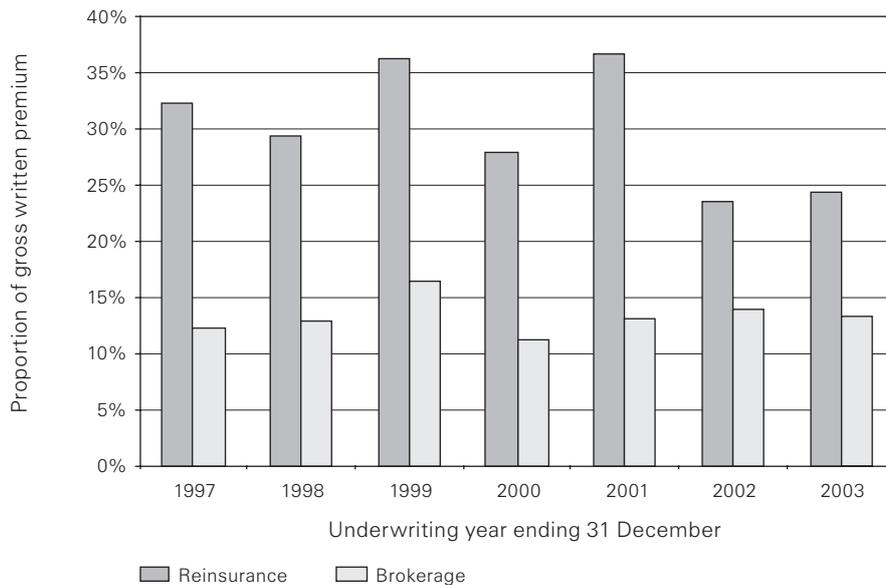
*Of the insurers that provided detailed responses, insurers generally suggested that changes made to their portfolio was the predominant driver behind the change in the number of claims. However, changes to their underwriting practices, including levels of excess, had also impacted on the number of claims received.*

## 6.4 Trends in expenses

This section examines the other cost components of professional indemnity insurance by examining trends in reinsurance, brokerage and underwriting expenses.

Chart 6.4 shows reinsurance and brokerage expenses as a proportion of gross written premium from 1997 to 2003.

**Chart 6.4 Reinsurance expense and brokerage expense as a proportion of gross written premium—professional indemnity—1997 to 2003**



Source: Derived by ACCC from responses provided by five insurers.

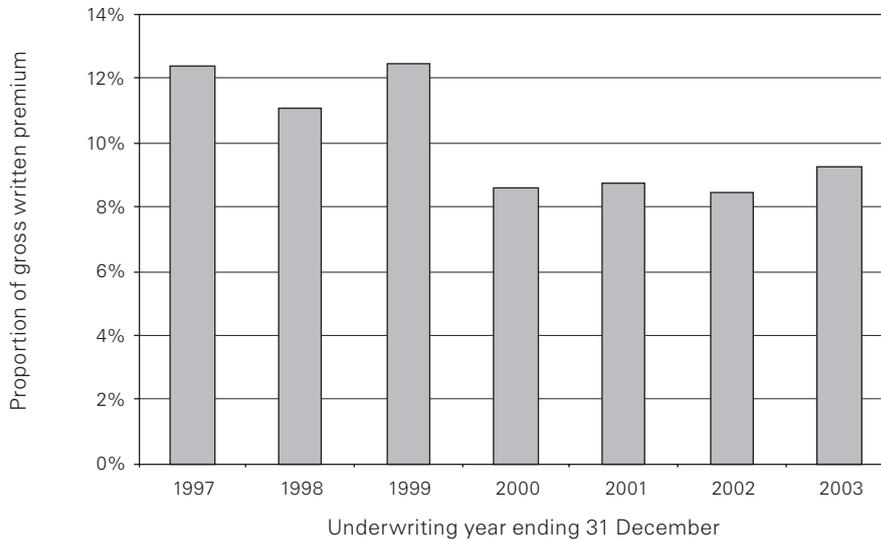
Reinsurance expense as a proportion of gross written premium fluctuated over the period, ranging from 24 per cent to 37 per cent. The reinsurance expense in 2002 and 2003 was somewhat lower compared with previous years. Brokerage expenses as a proportion of gross written premium also fluctuated early in the monitoring period, ranging from 11 per cent to 16 per cent. Since 2001, it has remained relatively constant at 13 per cent to 14 per cent.

Changes in reinsurance costs relative to gross written premium do not take into account changes in the amount of cover being received for the reinsurance. The ACCC asked insurers, with specific regard to their reinsurance coverage, what their retention<sup>72</sup> had been for the four years to 2003. Of the five insurers included in chart 6.4, two indicated that their retention had not changed over the period. However, the remaining three had seen their retention rates increase by between 50 per cent and 100 per cent over the four-year period. This indicates that for some insurers the amount of cover received for their reinsurance premium has decreased.

Chart 6.5 shows the trend in underwriting expense as a proportion of gross written premium from 1997 to 2003.

<sup>72</sup> Retention is the amount of risk that the insurer keeps on its own accounts before the reinsurer provides coverage. It is similar to the excess applied in general insurance policies.

**Chart 6.5 Underwriting expense as a proportion of gross written premium—professional indemnity—1997 to 2003**



Source: Derived by ACCC from responses provided by four insurers.

The chart shows that underwriting expense as a proportion of gross written premium decreased from approximately 12 per cent in the years to 1999 to just under 9 per cent in 2000, and has remained at approximately 9 per cent since that time.

*In summary:*

*There was no discernable trend in reinsurance and brokerage expenses as a proportion of gross written premium over the monitoring period. However, the level of reinsurance coverage received by some insurers decreased between 2000 and 2003.*

*Underwriting expenses as a proportion of gross written premium decreased in 2000, and have remained relatively constant since that time.*

## 6.5 Conclusion

Based on analysis of data provided by insurers with respect to **professional indemnity insurance**, the ACCC found that over the period year ending 31 December 1997 to year ending 31 December 2003:

- The number of claims reported within the same year as incident and the total number of claim reports incurred generally increased over the period. However, the frequency of these claims as a proportion of the total number of policies remained largely unchanged early in the period before decreasing in recent years.
  - Most insurers considered that recent falls in the number of claims was in response to changes to underwriting practices, including the market segment written and the level of excess.
- The average size of claims settled increased steadily over the period from \$6067 in 1997 to \$15 411 in 2002. The average size of claims settled rose a further 41 per cent in 2003 to \$21 713.
- Other costs, namely reinsurance and brokerage expenses, as proportions of gross written premium, varied across the period. Some insurers saw a fall in the amount of reinsurance coverage received for their reinsurance premium. Underwriting expenses as a proportion of gross written premium decreased in 2000, and have remained relatively constant since.

## **7 Premiums and financial performance in professional indemnity insurance**

### **7.1 Introduction**

Chapter 6 examined trends in the costs of professional indemnity insurance between the years ending 31 December 1997 and 31 December 2003.

This chapter examines trends in premiums across the same period and the financial performance of insurers supplying professional indemnity insurance between 2001 and 2003.

It examines the potential drivers behind changing premiums in 2003. The extent to which non-price factors, such as excess amounts, cover limits and exclusions, have changed in recent years is also examined.

The monitoring methodology adopted by the ACCC is outlined in appendix D.

### **7.2 Trends in premiums<sup>73</sup>**

This section examines trends in the average premium between 1997 and 2003, demonstrating how premiums charged by insurers have changed over the period. However, it should be noted that it may also reflect changes in the insurers' portfolios. The average premium will not be exactly indicative of changes in the premiums paid by all consumers.

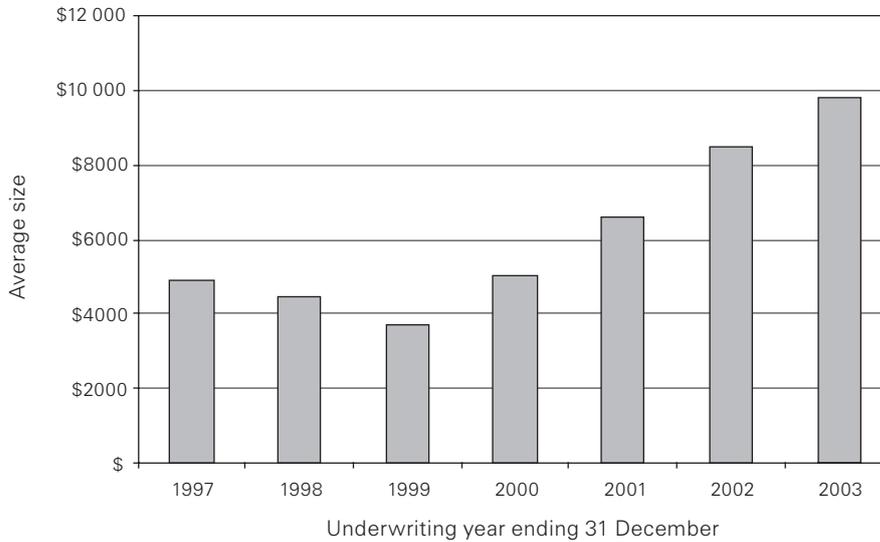
#### **7.2.1 Average premium**

Chart 7.1 shows the average premium for professional indemnity insurance in real terms between 1997 and 2003. Average premium is derived by dividing gross written premium by the number of policies.

---

<sup>73</sup> The premium analysis, similar to that in chapter 5 for public liability insurance, may not be directly comparable to the claims trend analysis. This is because premium and policy data was collected on an underwriting year basis whereas claims data was typically collected on an incident or settlement year basis. Therefore, information contained in section 7.2 below may not correspond with the information in section 6.2.

**Chart 7.1 Average premium—real terms—professional indemnity—1997 to 2003**



Source: Derived by ACCC from responses provided by five insurers.

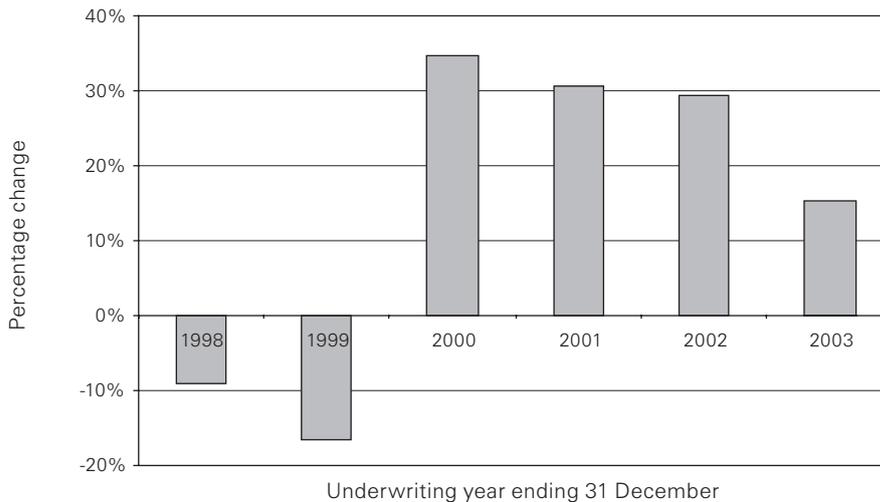
Note: Data adjusted to 31 December 2003 values using the AWE index.

The average premium in real terms decreased between 1997 and 1999 from \$4922 to \$3731 (a decrease of 24 per cent).

However, the average premium increased each year after 1999, reaching \$8494 in 2002 (an increase of 128 per cent on 1999). Premiums increased further in 2003 to \$9778.

Chart 7.2 shows the percentage change in the annual average premium between 1998 and 2003.

**Chart 7.2 Percentage change in average premium on previous year's premium—real terms—professional indemnity—1998 to 2003**



Source: Derived by ACCC from responses provided by five insurers.

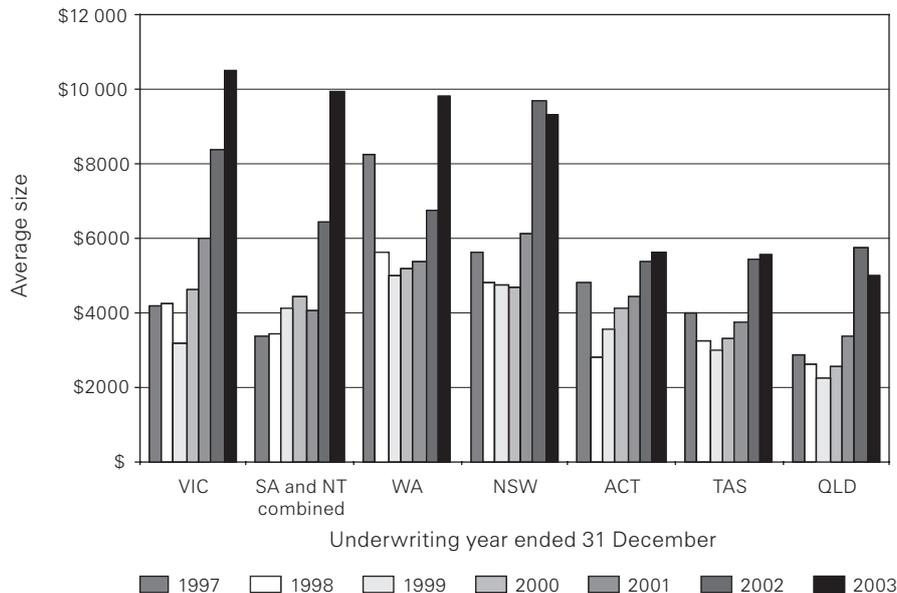
Note: Data adjusted to 31 December 2003 values using the AWE index.

This chart indicates that between 1997 and 1999, premiums decreased. However, premiums increased by 35 per cent in 2000 and continued to grow, albeit at a decreasing rate, between 2001 and 2003. In 2003 premiums grew by 15 per cent as opposed to 29 per cent in 2002.

## 7.2.2 Average premium by state and territory

Chart 7.3 shows the average premium in real terms, on a state and territory basis, for the period 1997 to 2003.

**Chart 7.3 Average premium by state and territory—real terms—professional indemnity—1997 to 2003**



Source: Derived by ACCC from responses provided by five insurers.

Note: Data adjusted to 31 December 2003 values using the AWE index. Data for South Australia and the Northern Territory have been combined due to the way in which data was provided by some insurers.

Chart 7.3 shows that:

- Premiums in most states and territories generally displayed similar trends in average premium across the period, with some decrease in the first three years followed by an increase in premiums over the three years to 2002, with the increase in 2002 being relatively sharp.
- The combined average premium for South Australia and the Northern Territory displayed an alternate trend, with the average premium increasing between 1997 and 2000, followed by a marginal decrease in 2001. This was then followed by a sharp increase in 2002. Similarly, the Australian Capital Territory also demonstrated a different trend with an initial decrease in average premium between 1997 and 1998, before increasing each year thereafter.
- In 2003 Victoria, South Australia and the Northern Territory combined and Western Australia all experienced similar sharp premium increases as they did in 2002. The remaining jurisdictions however, only saw minor increases (the Australian Capital Territory and Tasmania), with two experiencing decreases on 2002 premiums (New South Wales and Queensland).

Chart 7.3 also shows that Western Australia had the highest average premium between 1997 and 2000, New South Wales had the highest in 2001 and 2002 and Victoria the highest in 2003. Queensland generally experienced the lowest premiums across the period (with the exception of 2002 when the Australian Capital Territory had the lowest average premium).

*In summary:*

*Average premiums decreased between 1997 and 1999 and then increased up to 2003. This trend was evident across most states and territories. However, the increase in average premium in 2003 was not observed in all jurisdictions with the Australian Capital Territory and Tasmania experiencing only minor rises and New South Wales and Queensland experiencing a small decrease in average premium.*

### 7.3 Reasons for recent premium increases

Insurers in the ACCC's monitoring program for professional indemnity insurance were asked to provide key reasons for changes in premiums in 2003, similar to that for public liability in section 5.3.

One insurer stated that premiums had generally remained unaltered over the period. The other four insurers typically cited increasing costs as specific drivers of changes to premiums. These costs were attributable to claims costs, including an increased level of exposure to a higher number and cost of claims, claims handling expenses, normal and superimposed claims inflation and the lack of reforms addressing rising claims costs (one insurer mentioned the negative impact that judicial interpretations of the *Insurance Contracts Act 1984* were having on their portfolio). Other costs cited included increased capital requirements (the cost of raising and servicing the additional capital required under APRA's capital requirements) and reinsurance costs. One insurer noted that premiums had increased to allow them to return to sounder underwriting practices.

*In summary:*

*Recent increases to premium levels have primarily been driven by increasing costs, including both claims costs and other costs.*

### 7.4 Terms and conditions of policies

Similar to section 5.4, the ACCC asked insurers in its professional indemnity monitoring program about the nature of the policies offered to determine whether insurers have recently changed their terms and conditions. Specifically, the ACCC examined changes in the standard policy with regards to cover limits, levels of excess and exclusions.

#### 7.4.1 Standard policy

All five insurers in the monitoring sample offered a standard policy for professional indemnity insurance in 2002 and 2003.

In 2003 this standard policy was generally available to all sectors in which the insurers wrote business (with the exception of one insurer). Typically all insurers used the standard policy for the majority of their business, with four insurers indicating that they wrote more than 76 per cent of their book of business under the standard policy.

#### **7.4.1.1 Cover limits**

The ACCC asked insurers to specify the minimum and maximum cover limits on standard policies written for 2002 and 2003.

In 2002 the minimum cover limit on standard policies generally ranged from \$500 000 to \$1 million (with one insurer not specifying a minimum cover limit). The maximum cover limit on standard policies ranged from \$10 million to \$60 million. Between 2002 and 2003 one insurer changed its minimum and maximum cover limits which reduced the range of minimum cover limits to \$250 000 to \$1 million, but had no impact on the range of maximum cover limits compared to 2002.

The ACCC also asked insurers to specify the average cover limit on their standard policies for 2002 and 2003. In 2002, across four insurers, the average cover limit was approximately \$4.2 million. In 2003 this decreased by 8 per cent to \$3.9 million. The change in the average cover limit varied across insurers from a decrease of 10 per cent to no change at all.

Therefore, generally insurers did not change their minimum and maximum cover limits over the period. However, the majority of insurers experienced a decrease in the average cover limit offered meaning that the level of cover received by insureds may have diminished.

#### **7.4.1.2 Excesses**

The ACCC also asked insurers to specify the minimum and maximum levels of excess for standard policies written in 2002 and 2003. The minimum levels of excess on standard policies in 2002 varied across insurers, with some specifying excess as a percentage of fee income, ranging from 0.5 per cent to 1 per cent, while others specified a dollar amount ranging from \$0 to \$5000. Of the insurers who specified a maximum dollar amount excess, the amount ranged from \$250 000 to \$5 million. None of the five insurers indicated that they had altered their minimum or maximum levels of excess in 2003.

Insurers were also asked to indicate the average level of excess on their standard policies for 2002 and 2003. In 2002 the average level of excess across four insurers was approximately \$26 900. By 2003 this had decreased by 20 per cent to \$21 447. The major cause of this decrease was due to one insurer, who in 2002 underwrote a large policy with a large excess, but then ceased to write this business in 2003, leading to a decrease in their average excess of 58 per cent. The change in the average level of excess across the other three insurers was significantly less with one insurer seeing an increase of 2 per cent in the average level of excess, another no change, and the remaining insurer a fall of 7 per cent.

Therefore, given that no insurer altered the minimum or maximum level of excess, and that there were only marginal or no increases (and even some decreases) in the average level of excess, insureds are likely receiving a similar level of cover in 2003 compared to 2002 in terms of excess.

#### **7.4.1.3 Exclusions**

The ACCC also asked insurers to specify what additional exclusions had been incorporated into their standard policy in 2003. Of the five insurers, one indicated that it had not added any new exclusions. The remaining four had incorporated additional exclusions. In two cases, insurers indicated that the exclusions were aimed at correcting ambiguity in the current policy wording. Another insurer indicated it was excluding deliberate corporate acts, and the remaining insurer incorporated an asbestosis exclusion in line with its reinsurance arrangements.

*In summary:*

*During the 12 months to 31 December 2003, the nature of the standard professional indemnity insurance product did not change substantially. While the average cover limit decreased, the level of excess remained relatively constant and there were no significant exclusions made to the standard policy.*

## 7.5 Trends in financial performance

As in section 5.5, the ACCC examined the underwriting performance of the professional indemnity class of insurance using several ratios.

### 7.5.1 Ratios

The ACCC examined underwriting performance in terms of the loss ratio, the expense ratio, the reinsurance ratio and the combined ratio. These terms are defined in appendix D. Most insurers did not provide enough data for the ACCC to reliably construct all ratios for the entire period from 1997 to 2003. The ACCC has instead calculated the ratios for the period 2001 to 2003, based on data provided by four insurers.

The following ratios are constructed on an aggregate basis, and therefore represent the total ratio for all four insurers.

#### 7.5.1.1 Loss ratio

Table 7.1 shows the gross and net loss ratios for 2001 to 2003.<sup>74</sup>

**Table 7.1 Gross loss ratio and net loss ratio—year ending 31 December—professional indemnity—2001 to 2003**

	Gross loss ratio	Net loss ratio
2001	75%	81%
2002	62%	63%
2003	55%	58%

Source: Derived by ACCC from responses provided by four insurers.

The gross loss ratio fell from 75 per cent in 2001 to 55 per cent in 2003. Similarly the net loss ratio fell from 81 per cent in 2001 to 58 per cent in 2003.

This effectively means that in 2003 insurers were expecting to pay 55 cents in claim expenses for each dollar of premium or, if reinsurance is taken into account, 58 cents.

<sup>74</sup> Because the calculation of the loss ratios by incident year takes into account both past claims payments and expected future payments (payments which will be made on claims that the insurer has incurred at the reporting date but which have not yet been settled) these ratios are still uncertain. This is because the expected future payments is based on an actuarial estimate of not only unfinalised reported claims costs, but also IBNR claims costs. Therefore this estimate may change as experience emerges, which can either result in the loss ratios becoming more or less favourable for the insurers. This also means that the historical loss ratios change as experience emerges. Over time, expected future payments will become actual claims, be finalised and become actual payments. Deviations between the estimate and the actual amount finalised can lead to loss ratios changing over time until all claims are finalised.

### 7.5.1.2 Expense ratio

Table 7.2 shows the gross and net expense ratios for 2001 to 2003.

**Table 7.2 Gross expense ratio and net expense ratio—year ending 31 December—professional indemnity—2001 to 2003**

	Gross expense ratio	Net expense ratio
2001	22%	32%
2002	23%	29%
2003	23%	29%

Source: Derived by ACCC from responses provided by four insurers.

The table shows that both the gross and net expense ratios were reasonably stable over the period 2001 to 2003.

### 7.5.1.3 Reinsurance ratio

Table 7.3 shows the reinsurance ratios for 2001 to 2003.

**Table 7.3 Reinsurance ratio—year ending 31 December—professional indemnity—2001 to 2003**

	Reinsurance ratio
2001	33%
2002	21%
2003	22%

Source: Derived by ACCC from responses provided by four insurers.

The table shows that the reinsurance ratio fell significantly from 33 per cent in 2001 to 21 per cent in 2002, then remained stable in 2003 at 22 per cent.<sup>75</sup>

### 7.5.1.4 Combined ratio

Table 7.4 shows the gross and net combined ratios for 2001 to 2003.

**Table 7.4 Gross combined ratio and net combined ratio—year ending 31 December—professional indemnity—2001 to 2003**

	Gross combined ratio	Net combined ratio
2001	130%	113%
2002	106%	91%
2003	100%	87%

Source: Derived by ACCC from responses provided by four insurers.

<sup>75</sup> This is generally consistent with the trend shown in chart 6.4 which, although based on different insurers, showed that the reinsurance expense as a proportion of gross written premium remained stable in 2003 after a significant reduction in 2002. The reinsurance ratio is calculated using the same insurers as those contained in the loss and expense ratio for consistency purposes when calculating the combined ratio (the sum of the three ratios). As such the ACCC has used a different sample to that used for chart 6.4. While this has meant the results may not be comparable in terms of absolute numbers, it is comparable in terms of trends.

The table shows that the gross combined ratio decreased from 130 per cent in 2001 to 106 per cent in 2002. The gross combined ratio then fell again, albeit to a lesser extent, to 100 per cent in 2003. Similarly, the net combined ratio also decreased over the period from 113 per cent in 2001 to 91 per cent in 2002, followed by a smaller decrease in 2003 when it fell to 87 per cent. These combined ratios suggest that insurers expect more favourable levels of underwriting performance throughout the period, achieving expected net underwriting profits in 2002 and 2003.<sup>76</sup>

The significant driver of the falling gross and net combined ratios over the period was proportionally lower claims costs increases relative to premium increases. This was generally true for the decreases observed in both 2002 and 2003. However, some of the decrease observed in the gross combined ratio in 2002 was also driven by lower reinsurance costs relative to rising premiums.

*In summary:*

*The gross combined ratio and the net combined ratio decreased significantly between 2001 and 2002, mainly driven by lower claims cost increases relative to rising premiums. This was also true of the marginal decrease in the gross and net combined ratios observed in 2003.*

## 7.6 Conclusion

Based on the data analysis provided by insurers with respect to **professional indemnity insurance** the ACCC found that over the period year ending 31 December 1997 to year ending 31 December 2003:

- Average premiums fell from \$4922 in 1997 to \$3731 in 1999 (a decrease of 24 per cent) and then increased to \$8494 in 2002 (an increase of 128 per cent on 1999). Average premiums rose by a further 15 per cent in 2003 to \$9778.
  - Insurers generally considered that the key drivers of recent increases in premium levels were rising costs, including claims and other costs.
- The terms and conditions of the standard product, in terms of the excess, cover limits and exclusions, did not change significantly in 2003.
- The combined ratio, that is, expenses (including claims costs) compared to total premiums, decreased significantly between 2001 and 2002, and then decreased again marginally in 2003 indicating improved underwriting performance.

<sup>76</sup> Appendix D notes that if a combined ratio is greater than 100 per cent then this would imply an underwriting loss. If a combined ratio is less than 100 per cent this would imply an underwriting profit. The combined ratio does not take into account normal inflation (but does take into account superimposed inflation) or discounting (for investment returns).

## 8 Impact of government reforms— insurers' experience and expectations

### 8.1 Introduction

The Australian Government asked the ACCC to monitor premiums in public liability and professional indemnity insurance to assess the impact of measures taken by governments to reduce and contain legal and claims costs and improve the data available to insurers to evaluate and price risk.

Governments have previously indicated that they expect savings as a result of the reforms and also expect insurers to pass these savings on to consumers in the form of more affordable insurance premiums.

The ACCC asked insurers participating in its monitoring program about the impact of the reforms on their pricing expectations for public liability and professional indemnity insurance premiums in 2004, as well as in the medium to long term. The ACCC also asked whether there was evidence of the reforms having an impact on their emerging claims experience, and if so, to what extent they had reflected this and their expectations of the likely impact of reforms in their outstanding claims provisions.<sup>77</sup> This chapter summarises insurers' responses.

A summary of tort reforms to 31 December 2003, at the Commonwealth, state and territory level, is at appendix C.

### 8.2 The ACCC's monitoring methodology

To identify the expected impact of government reforms on costs and premiums, the ACCC asked insurers to provide a breakdown of the actual cost components as a proportion of premiums for public liability and professional indemnity insurance as at 31 December 2003. It also asked insurers to provide an estimate of how these components were expected to change at 31 December 2004, both **without** taking into account government reforms, and **with** taking into account the reforms.

The ACCC asked insurers whether the expected short-term impact of reforms on costs and premiums was expected to be the same in the medium to longer term. Insurers were also asked about the impact of reforms on their outstanding claims provisions.

In addition, the ACCC specifically sought new information as part of its third monitoring request as to whether any significant patterns had begun to emerge in insurers' recent claims experience that may be attributable to tort law reform.

---

<sup>77</sup> Insurers maintain provisions to pay for outstanding claims. While a proportion of the claims estimated to be within the outstanding claims provision may have been lodged with a court before the implementation of reforms, the remaining portion of claims (including IBNRs, claims reported but not lodged with a court and unfinalised claims lodged with a court after the implementation of reforms) are likely to be affected by the reforms if and when they are finally settled.

## 8.3 Impact of government reforms on public liability insurance

This section summarises insurers' responses to the ACCC's third public liability monitoring request. It first examines insurers' emerging claims experience, and then provides a summary of insurers' expectations of the short-term impact of reforms. The insurers' medium and longer term expectations of reforms are then discussed. Finally, the ACCC examines the impact of reforms on insurers' outstanding claims provisions.

### 8.3.1 Emerging claims experience

The ACCC asked insurers whether any significant patterns that may be attributable to tort law reform had emerged in their recent claims experience.

Of the eight insurers, all but one indicated that they had observed a fall in their claims frequency. However, all seven of these insurers indicated that the falling claims frequency was more likely attributable to factors other than the reforms.

Most of these insurers indicated they had made significant changes to their portfolio and underwriting practices in recent years. A number of insurers suggested that they had specifically moved away from writing business that typically has higher frequency but smaller claims costs risks. Other insurers noted that they had increased their levels of excess, which also has the effect of reducing the number of small claims received. Insurers therefore indicated that they would expect claims frequency to decline due to the removal of smaller claims from their claims liabilities.

Insurers also noted that as a result of the changes to their portfolios or levels of excess, the decrease in the number of small claims had not only led to a fall in the claims frequency, but also an increase in the average claims size.

Some insurers noted that the changes to their book of business or levels of excess made it difficult to determine what impact, if any, the reforms may be having on their claims experience.

*In summary:*

*Most insurers indicated that they had begun to notice a decline in claims frequency in their emerging claims experience. However, a large number of insurers had recently made changes to the types of risk they write and to the levels of excess. Accordingly, insurers believe that it is difficult to tell the extent to which the decline in claims frequency is the result of tort reforms or of underwriting policy changes.*

### 8.3.2 Expected short-term impact of reforms on costs and premiums

Of the eight insurers, five indicated that they expected the reforms enacted as at 31 December 2003 to have an impact on costs and premiums in 2004. However, only four of these insurers provided the ACCC with detailed quantitative information about the expected short-term impact on premiums both **without** and **with** reforms for 2004. The remaining insurer did not provide detailed quantitative information and therefore was not included in this analysis.

## Responses at the national level

Two insurers responded at a national level about expected changes in premiums for 2004 both 'with reform' and 'without reform'. Two others provided state-based breakdowns. To ascertain the overall expected national impact on premiums in 2004, the ACCC established a broad, indicative estimate of insurers' expectations of the impact of reforms by analysing the information from the four insurers.<sup>78</sup> By doing this, the ACCC estimated that across the four insurers, on a national basis:

- **'without reform'**, insurers expected premiums to increase by an average of 9 per cent in 2004 compared to 2003 levels. This was largely driven by:
  - expected increases in claims costs of around 12 per cent in 2004 compared to 2003 levels and
  - expected increases in other costs of around 7 per cent in 2004 compared to 2003 levels
- **'with reform'**, insurers still expected premiums to increase in 2004, although less than the expected increase 'without reforms'. With reforms, insurers expected premiums in 2004 to increase by an average of 5 per cent compared to 2003 levels. This was largely driven by:
  - expected increases in claims costs of around 6 per cent in 2004, compared to 2003 levels and
  - expected increases in other costs of around 4 per cent in 2004, compared to 2003 levels.

Comparing insurers' expectations for costs and premiums in 2004 (both 'without reforms' and 'with reforms'), the ACCC found that insurers expected reforms to constrain increases in claims costs in 2004 by approximately 6 per cent on average, and constrain increases in other costs by around 3 per cent on average. This was expected to lead to a corresponding constraint on premium increases of approximately 4 per cent in 2004.

It is important to note that these aggregated estimates are based on the expectations of the four insurers that quantified the impact of reforms on premiums in 2004.

The first and second ACCC monitoring reports found that the reforms enacted at 31 December 2002 and 30 June 2003 respectively, were expected to constrain increases in claims costs by 5 per cent, and increases in premiums by 3 per cent in 2003.

## Responses at the state and territory level

As noted previously, two insurers provided the ACCC with responses about expected changes in costs and premiums for 2004 both 'without reform' and 'with reform' at a state and territory level. The ACCC found for these insurers that:

- **'without reform'**, premiums were expected to rise in all jurisdictions as a result of expected increases to both claims costs and other costs.
- **'with reform'**, premium rises were expected to be constrained in nearly all jurisdictions, with the largest constraint in New South Wales, Queensland, South Australia and the Northern Territory.

---

<sup>78</sup> This estimate is the average of responses provided by the four insurers weighted by the relative size of each insurer in terms of the amount of gross written premium of all four insurers included in the average. For the two insurers that provided responses by state and territory, these have been converted to a national basis by weighting their individual state and territory responses by the premium written in each jurisdiction.

## Other responses

As noted above, another insurer indicated that it expected the impact of government reforms to be incorporated into 2004 insurance premiums. However, it did not provide sufficient detail to be included in the above analysis.

The remaining three insurers indicated that they did not expect to adjust premiums in 2004 in response to tort reform. One reason provided was that the mix of business underwritten by some of these insurers was unlikely to be affected by reforms. Another reason was that insurers considered it still too early to quantify the impact of government reforms in the absence of reliable claims experience data that would indicate claims costs were constrained as a result of reform.

*In summary:*

*The majority of insurers expected to make some allowance for the impact of reforms by lowering the size of public liability insurance premium increases in 2004 on the basis of lower expected increases in claims costs. On a national basis, four insurers anticipated savings in claims costs of approximately 6 per cent as a result of reforms. This would correspond to an overall constraint on premium increases of approximately 4 per cent in 2004 when compared to insurers expectations for premium increases in 2004 'without reform'. Another insurer, while not quantifying its expectations, indicated it had factored some anticipated cost savings into 2004 premiums.*

*Other insurers did not expect to adjust public liability insurance premiums in 2004 in response to government reforms enacted at 31 December 2003.*

### 8.3.3 Actual costs and premiums in 2003 compared to insurers' initial expectations

To identify the expected impact of government reforms on costs and premiums the ACCC asked insurers in its first monitoring report to provide a breakdown of the cost components as a proportion of premiums for public liability and professional indemnity insurance as at 31 December 2002. It also asked insurers to provide an estimate of how these components were **expected** to change as at 31 December 2003 both with and without taking into account government reforms. For the second monitoring report the ACCC asked insurers to provide an update of their expectations of costs and premiums for 31 December 2003.

The ACCC now has information on insurers' **actual** costs and premiums for 31 December 2003 for four insurers on a national basis. This has allowed the ACCC to determine whether insurers' expectations outlined in the second monitoring report were above or below what actually occurred.

The ACCC found that two insurers had actually experienced lower than expected premium increases, with premiums 3 and 4 per cent lower than expected. The reduction predominantly arose from lower than expected expenses (including reinsurance, brokerage and claims handling expenses). The remaining two insurers had premiums higher than originally expected, with premiums 3 and 14 per cent higher than expected. In these cases the driving factor behind the higher premiums was a larger than anticipated increase in claims costs.

*In summary:*

*The cost and premium **expectations** outlined in the ACCC's second monitoring report for public liability insurance were largely similar to that which **actually** occurred.*

*Two insurers had actual premiums lower than expected due to lower than anticipated expenses. Premiums for two other insurers were higher than expected, predominantly due to higher than anticipated claims costs.*

### 8.3.4 Expected medium-term impact of reforms on costs and premiums

In their responses to the ACCC, insurers indicated that their public liability insurance claims experience had not shown any direct indication of reforms having had an impact. Furthermore, any savings in 2004 premiums as a result of reforms were based on an expectation rather than actual impact.

Several insurers commented that this lack of actual experience to date was due to the long-tailed nature of public liability insurance, and further indicated that it may be some time yet before evidence of the impact of reforms becomes apparent in claims experience.

However, the majority of insurers indicated that they do expect the reforms to have an impact in the medium term. Some insurers expect that the impact of reforms will begin to become apparent in 2005, while others expect that evidence of savings will be realised over the next three to five years. Further, some insurers noted that anecdotal evidence of reforms having an impact was already emerging, with one insurer pointing to a reduction in the number of plaintiff lawyers in New South Wales.

Among those insurers that indicated reforms are expected to constrain premiums in 2004, some suggested that these expectations are conservative. Further savings may be realised, and a number of insurers noted that they are monitoring their claims experience in anticipation of possible further premium reductions if evidence of the impact of reforms becomes apparent.

A number of insurers commented that there was new capital entering the market, which may result in increased competition and a downwards push on premiums.

*In summary:*

*Most insurers indicated that they expect reforms to impact on public liability claims costs and premiums over the medium term. Insurers noted that they intend to continue to monitor their claims experience and will further adjust premiums as cost savings are realised.*

### 8.3.5 Expected longer term impact of reforms on costs and premiums

Five insurers commented that, in the long run, there may be some erosion of the level of any cost savings realised in the short and medium term through circumvention of the intent of reforms.

A number of these insurers cited the long-term outcomes of reforms to compulsory third party insurance (CTP) in New South Wales in the mid-1990s as an example. Insurers believe that these reforms, aimed at reducing claims costs and premium increases, were unsuccessful, requiring further legislative reform in 1999. One insurer commented that in its view, the CTP reforms introduced in the mid-1990s were in many respects similar to those now being introduced for public liability insurance.

Insurers indicated that the level of costs savings realised due to the impact of reforms may be eroded by plaintiffs shifting claims costs to other heads of damage, escalating claims costs within heads of damage, the emergence of new types of claims, and the shifting of claims to different jurisdictions (with one insurer noting that a lack of suitable reforms at a federal level would allow this to occur).<sup>79</sup>

*In summary:*

*Although the majority of insurers expect that reforms will have some impact in the medium term, there still remains a level of uncertainty as to the long-term impact of reforms. Five insurers noted that the level of savings realised in the short to medium term as a result of public liability insurance reform may be eroded to some extent in the long term by plaintiffs circumventing the intent of the reforms.*

### 8.3.6 Impact of reforms on outstanding claims provisions

Insurers were asked whether they had made explicit allowance in their outstanding claims provisions for public liability insurance due to legislative change.

Outstanding claims provisions are reserves set aside by an insurer to pay for all unfinalised claims that it has incurred to date. While a proportion of the claims estimated to be within the outstanding claims provisions may have been lodged with a court before the implementation of reforms, the remaining proportion (including IBNRs, claims reported but not lodged with a court and unfinalised claims lodged with a court after the implementation of reforms) are likely to be affected by the reforms if and when they are finally settled. As such, any insurer expecting the reforms to have an impact may choose to reduce its outstanding claims provisions.

Four insurers indicated to the ACCC that they had revised down their outstanding claims provisions as a result of reforms. This represents an increase of one insurer since the second monitoring report. Of these four insurers, three have reduced provisions by between 5 and 9 per cent, while the remaining insurer revised down its outstanding claims provisions by between 0 and 4 per cent.

Of the four remaining insurers that have not made an explicit allowance, the main reason cited was a reluctance to adjust outstanding claims provisions while the actual impact of reforms remained uncertain.

*In summary:*

*Four of the eight insurers have revised down their outstanding claims provisions for public liability insurance as a result of legislative reform.*

## 8.4 Impact of government reforms on professional indemnity insurance

This section summarises insurers' expectations of the impact of government reforms on professional indemnity insurance premiums in the short and medium term, as well as any changes made to insurers' outstanding claims provisions as a result of the reforms.

As with public liability insurance, the ACCC asked insurers whether there were any significant patterns emerging in their recent claims experience.

The responses provided by insurers for this report do not differ significantly to those given for the first two ACCC monitoring reports.

<sup>79</sup> The Australian Government is introducing a number of complementary reforms aimed at reducing the ability of plaintiffs to seek more favourable compensation in alternative jurisdictions, including under Commonwealth law.

### 8.4.1 Emerging claims experience

The ACCC asked insurers whether there were any significant patterns emerging in their recent claims experience for professional indemnity insurance that may be attributable to tort law reform.

All five insurers indicated that there had been no change in their professional indemnity claims experience as a result of tort law reform enacted to date.

*In summary:*

*All insurers indicated that there had been no change in their emerging claims experience that may be attributable to tort law reform.*

### 8.4.2 Expected short-term impact of reforms on costs and premiums

All five insurers responded to this part of the ACCC's monitoring request, with three providing a response on a national basis and two providing state and territory breakdowns. However, this information has not been presented as all five insurers indicated in their responses that they did not expect reforms to have any impact on claims costs, expenses or premiums in 2004.

The major reason cited was that reforms enacted thus far have focused predominantly on personal injury and death claims and are therefore unlikely to have any impact on professional indemnity insurance. Although reforms directed at this class of insurance have been progressed by some jurisdictions (though were still awaiting commencement), complementary reforms had not been enacted at the Commonwealth level as at 31 December 2003.<sup>80</sup>

*In summary:*

*No insurer made adjustments to professional indemnity premiums in 2004 as a result of tort reforms enacted to 31 December 2003.*

*The main reason cited was that the tort reforms passed to date have been predominantly directed at personal injury and death claims which are unlikely to have any impact on professional indemnity insurance claims costs. Although reforms have been progressed at a state and territory level that are directed at professional indemnity insurance, complementary reforms at the Commonwealth level had not been passed as at 31 December 2003.*

### 8.4.3 Expected medium-term impact of reforms on costs and premiums

The ACCC asked insurers what they expected the impact of reforms would be in the medium term. Generally, insurers indicated that the reforms directed at professional indemnity were expected to have a positive impact when enacted.

Insurers noted that proportionate liability reforms and professional standards legislation are generally expected to have a positive impact on their claims experience.

<sup>80</sup> The Treasury Legislation Amendment (Professional Standards) Bill 2003 was introduced into parliament on 4 December 2003 and seeks to amend a number of acts to support the states and territories that implement professional standards legislation. The Bill was passed by the House of Representatives on 16 June 2004 and by the Senate on 25 June 2004. As at 30 June 2004 it had not received royal assent. The *Corporate Law Economic Reform Program (Audit Reform and Corporate Disclosure) Act 2004*, which implements proportionate liability for economic loss and property damage, was passed by parliament and received royal assent on 30 June 2004.

However, one insurer commented that due to the fact that it typically underwrites policies that do not generate high cost claims, the professional standards legislation was expected to have limited impact on its current book of business. Similarly, another insurer also commented that reforms directed at professional indemnity insurance are focused on certain professions that the insurer did not underwrite, and therefore these reforms, even when enacted, are not expected to affect the insurer's portfolio.

Some insurers stated that they expect changes to the Commonwealth *Insurance Contracts Act 1984*<sup>81</sup> to have an impact on professional indemnity costs and premiums in the medium to longer term.

*In summary:*

*Most insurers expect proportionate liability and professional standards reforms to have some impact in the medium term when such reforms are enacted across all jurisdictions.*

#### 8.4.4 Impact of reforms on outstanding claims provisions

Insurers were asked about the impact of government reforms on their outstanding claims provisions for professional indemnity insurance.

All five insurers said that they had not made any adjustments to their outstanding claims provisions in response to legislative changes. As in section 8.4.2, the major reason insurers gave for not adjusting down their outstanding claims provisions was that the reforms enacted thus far by governments have focused predominantly on personal injury and death claims and therefore are unlikely to have any impact on professional indemnity insurance.

*In summary:*

*None of the five insurers had made any adjustment to their outstanding claims provisions for professional indemnity insurance as a result of tort reforms enacted as at 31 December 2003.*

### 8.5 Conclusion

The ACCC's role is to assess the extent to which insurers have factored in the impact of recent government reforms when determining public liability and professional indemnity insurance premiums. For this report, the ACCC based its assessment on insurers' emerging experience and expectations of reforms as at 31 December 2003.

For **public liability insurance**, the ACCC found that seven insurers had begun to see a fall in claims frequency. However, as a large number of these insurers had made changes to the types of risk written and to their minimum levels of excess, they were unable to tell what impact tort reforms have had on this emerging trend. When insurers were questioned about what effect they expected reforms to have on their premiums in the short term, four insurers provided detailed responses. These showed that, at the national level, reforms were expected to constrain both increases in claims costs and other costs so that premium increases in 2004 were anticipated to be constrained by 4 per cent.

<sup>81</sup> On 10 September 2003 the Australian Government announced that it would undertake a comprehensive review of the *Insurance Contracts Act 1984*. One part of this review is to examine the use of section 54 to obtain cover under claims made policies (which professional indemnity is typically written) despite a failure of the insured to notify the claim during the policy period (required under claims made policies).

All but one insurer expected reforms to impact on public liability insurance claims costs and premiums in the medium term. Furthermore, some insurers commented that the savings expected in 2004 premiums were conservative, and that the reforms may have a larger impact in the medium term.

Further, since the second monitoring report, an additional insurer had adjusted down its outstanding claims provisions, bringing the total number of insurers that had reduced their provisions in response to tort reforms to four.

However, a number of insurers commented that they are uncertain as to the long-term impact of reforms. The level of savings realised in the short and medium term may be eroded to some extent in the long-term by plaintiffs circumventing the intent of the reforms. The ACCC has not formed a view about the validity of these claims or whether this is likely to be the long-term outcome.

With regard to **professional indemnity insurance**, insurers commented that most reforms enacted to 31 December 2003 focus on personal injury and death claims, and that reforms focused on professional indemnity insurance had not yet been implemented at a Commonwealth level. As such, none of the insurers had made any adjustment to 2004 premiums or to their outstanding claims provisions as a result of tort reforms enacted as at 31 December 2003. However, insurers noted that they expect proportionate liability and professional standards legislation, when enacted, to have an impact on costs and premiums.

## 9 Conclusion

The Australian Government asked the ACCC to monitor costs and premiums in the public liability and professional indemnity classes of insurance on a six monthly basis over two years. The ACCC was asked to give specific consideration to measures taken by governments to reduce and contain legal and claims costs and to improve the data available to insurers to evaluate and price risk, and, to the extent possible, assess the impact on premiums made by these measures.

### Public liability insurance

The ACCC has identified some significant **historical** trends during the period 1997 to 2003.

While the number of public liability **claims** relative to the number of policies generally decreased, the average size of claims settled increased over the period. The reason for the increase appears to be due to an increasing proportion of total claims (both numbers and costs) being personal injury and death claims.

However, the impact of reforms on claims costs may not be apparent, as the claims settled in these years may be unaffected by the reforms. The average size of claims is examined on a settlement year basis and not all claims settled in the years following the implementation of reforms will be affected by reforms. This is because the legislation that applies to claims is that which is in place at the time the claim is lodged with a court. Therefore, claims lodged before the reforms were implemented, but settled after, are not expected to be affected by the reforms. This means that movements in the average size of claims settled may not represent the impact of reforms.

At the same time as claims costs were rising, **expenses** (including brokerage and reinsurance) as a proportion of gross written premium have remained fairly constant.

While costs associated with public liability insurance generally increased each year over the period, **premiums** did not. The ACCC found that the average premium charged was relatively stable between 1997 and 1999, followed by minor increases in 2000 and 2001. In 2002, and to a lesser extent in 2003, premium increases were more pronounced, at 44 and 17 per cent respectively.

The ACCC also examined the underwriting **profitability** of insurers by analysing the insurers' premiums for each year compared to all costs, real and expected, associated with that year. The ACCC found that insurers' underwriting performance had been unprofitable in 2001<sup>82</sup> but had returned to profitability in 2002 and 2003 with premiums rising faster than costs in these years.

Having established the historical experience of this class of insurance the ACCC then asked insurers about their emerging experience and expectations of the **impact of reforms**.

In this report insurers were asked about the actual impact of reforms on their emerging claims experience, their expectations of 2004 costs and premiums and their medium and long-term expectations of costs and premiums. Insurers were also asked about whether they had adjusted their outstanding claims provisions as a result of tort law reform.

---

<sup>82</sup> Anecdotal evidence in the ACCC's first monitoring report found that before 2001 insurers were significantly more unprofitable than observed in 2001.

Insurers indicated that the impact of reforms on their **emerging claims experience** was distorted due to substantial changes to their portfolios in recent years. Some insurers had increased their levels of excess, while others were no longer writing certain types of business. This had meant that while most had observed a fall in claims frequency they could not identify what affect the reforms had had.

Some insurers indicated that they expected reforms to have an impact on costs and premiums in the **short term**. Four insurers told the ACCC that while costs and premiums were still expected to rise in 2004, the increase in claims costs would be constrained by 6 per cent, which would lead to a concomitant constraint on premiums of 4 per cent.

Four insurers also indicated to the ACCC that on the basis of the reforms enacted they had reduced their **outstanding claims provisions**.

All but one insurer indicated that the reforms were expected to have an impact on premiums in the **medium term**, once they began to impact significantly on their claims experience. Furthermore, some insurers commented that the savings expected in 2004 premiums were conservative, and that the reforms may have a larger impact in the medium term. Many insurers indicated that because this was a long-tailed class of insurance and the reforms were not retrospective, the reforms were not expected to have an immediate impact on their claims experience.

However, five insurers also expressed concerns that the level of any short to medium-term impact of reforms may, to some extent, be eroded in the **long term** by plaintiffs circumventing the intention of reforms. Some insurers pointed to their similar experience in other classes of insurance such as the New South Wales reforms to compulsory third party insurance. The ACCC has not formed a view about the validity of these claims or whether this is likely to be the long-term outcome.

## Professional indemnity insurance

The ACCC found the number of **claims** reported for professional indemnity insurance increased over the period 1997 to 2003. However, relative to the number of policies, the frequency of these claim reports remained stable until 2001, after which the frequency began to fall. As with public liability, despite this fall in the frequency of claims, the average size of claims settled increased each year over the period, with the largest increase observed in 2003. Brokerage, reinsurance and underwriting expenses as a proportion of gross written premium have generally fluctuated over the period, although underwriting and reinsurance expenses were lower as a proportion of gross written premium in 2002 and 2003 than earlier in the period.

Professional indemnity insurance average **premiums** fell between 1997 and 1999, and then increased each year to a high in 2003.

In terms of the underwriting **profitability** of insurers, the ACCC found that when comparing costs to premiums in 2001 the premiums written had been unprofitable. This then improved significantly in 2002 and again marginally in 2003. However, while underwriting profitability had generally returned to professional indemnity insurance by 2003, it was not to the same extent as that observed for public liability insurance.

The ACCC also asked insurers about their expectation of the **impact of reforms**. The general response was that the reforms enacted to 31 December 2003 focused on personal injury and death claims,<sup>83</sup> and that reforms focused on professional indemnity insurance had not yet been implemented at the Commonwealth level.<sup>84</sup> Because of this, none of the insurers had made any adjustment to their **short-term** expectations for 2004 costs and premiums to their **outstanding claims provisions**. However, in the **medium term** insurers noted that they expect the reforms aimed at professional indemnity insurance, when enacted, to have an impact on costs and premiums.

---

<sup>83</sup> Professional indemnity claims typically relate to pure economic loss and, with the exception of policies written for medical malpractice, do not usually include claims for personal injury and death.

<sup>84</sup> The Treasury Legislation Amendment (Professional Standards) Bill 2003 was introduced into parliament on 4 December 2003 and seeks to amend a number of Acts to support the states and territories that implement professional standards legislation. The Bill was passed by the House of Representatives on 16 June 2004 and by the Senate on 25 June 2004. As at 30 June 2004, it had not received royal assent. The *Corporate Law Economic Reform Program (Audit Reform and Corporate Disclosure) Act 2004*, which implements proportionate liability for economic loss and property damage was passed by parliament and received royal assent on 30 June 2004.

## **Appendixes**



## **A Regulatory arrangements**

This appendix briefly describes the regulatory arrangements associated with providing insurance in Australia.

### **A.1 Role of the Australian Competition and Consumer Commission**

The ACCC is an independent statutory authority, set up in 1995 as part of the national competition policy reform program.

Its primary responsibility is to ensure that individuals and businesses comply with competition, fair trading and consumer protection laws, in particular the *Trade Practices Act 1974*.

The ACCC applies these laws without fear or favour, helping to make sure that competition in the marketplace is efficient and fair.

As an integral part of its work, the ACCC:

- promotes effective competition and informed markets
- encourages fair trading and protects consumers
- regulates infrastructure service markets and other markets where competition is restricted.

Part VIIA of the Act enables the ACCC, when the government declares products or services, to examine prices with the objectives of promoting competitive pricing wherever possible and restraining price rises in markets where competition is less than effective. Inquiries into products under the Act require a direction from the Parliamentary Secretary to the Treasurer. However, the ACCC can also monitor prices and costs on an informal basis (i.e. not specifically under Part VIIA).

The ACCC's public liability and professional indemnity insurance monitoring role is not a direction under Part VIIA of the Act.

### **A.2 Role of the Australian Securities and Investments Commission**

The Australian Securities and Investments Commission (ASIC) is an independent Commonwealth government body established by the *Australian Securities and Investments Commission Act 1989*. It began operation on 1 January 1991 as the Australian Securities Commission, with responsibility for administering the Corporations Law. It replaced the National Companies and Securities Commission (NCSC) and the Corporate Affairs offices of the states and territories. In July 1998 ASIC received new consumer protection responsibilities and its current name.

ASIC's consumer protection capacity was further enhanced in 2001 and 2002 with financial services reform legislation that sets out new consumer protection requirements for both disclosure and conduct in the financial services sector, including the insurance industry.

ASIC is one of three Commonwealth government bodies, along with the Australian Prudential Regulation Authority (APRA) and the Australian Taxation Office, that regulate financial services. Its responsibilities encompass protecting investors, superannuants, depositors and insurance policy holders, and regulating and enforcing laws that promote honesty and fairness in financial markets, products and services and in Australian companies.

The consumer protection responsibilities of ASIC that are particularly relevant to general insurance regulation include:

- consumer disclosure requirements including disclosure of terms and conditions (including exclusions), disclosure of premiums and other fees, disclosure of risks, and the disclosure of complaints handling arrangements. This includes disclosure in the paper-based form, on the web or through telephone sales
- dispute resolution procedures
- oversight and approval of the operation of codes of conduct and the operation of the Insurance Enquiries and Complaints Scheme
- the conduct of sales representatives, including their disclosure obligations and training requirements. This includes telesales staff as well as brokers and agents.

### A.3 Role of the Australian Prudential Regulation Authority

The Australian Prudential Regulation Authority (APRA) was established on 1 July 1998. It is responsible for the prudential regulation of banks, life insurers, general insurers, superannuation funds, building societies, credit unions and friendly societies.

Before APRA's formation, the Insurance & Superannuation Commission (ISC) undertook prudential supervision of the general insurance industry. The Australian Government established the Financial System Inquiry in 1996, chaired by Mr Stan Wallis. In its final report, released in March 1997, the Wallis Inquiry recommended, among other things, a reorganisation of the regulatory agencies overseeing the financial sector. This included establishing a single prudential supervisor governing deposit-takers, insurance companies and superannuation funds. APRA's establishment required the integration of supervisory resources from the Reserve Bank of Australia, the ISC and seven state-based organisations.<sup>85</sup>

APRA seeks to meet its prudential and market supervision objectives in relation to the insurance industry by:

- monitoring the solvency and operational activities of general insurers
- providing policy advice to the government on general insurance issues
- promoting improved industry standards
- maintaining close contact with the insurance industry about issues affecting the industry and policyholders.

---

<sup>85</sup> APRA, *Submission to the HIH Royal Commission, Future policy directions for the regulation and prudential supervision of the general insurance industry*, September 2002, p. 4.

## A.4 Role of the General Insurance Enquiries and Complaints Scheme<sup>86</sup>

The General Insurance Enquiries and Complaints Scheme (IEC) is a national scheme developed by the ICA to handle inquiries and complaints and to resolve claims disputes that come within the terms of reference of the scheme.

It began operations in December 1993 and is approved by ASIC in accordance with ASIC Policy Statement 139 'Approval of external complaints resolution schemes'.

The scheme operates on a two-tier system. At the first level, consumer consultants provide advice in response to inquiries and assistance in encouraging resolution of complaints by promoting conciliation between claimants and insurance companies.

If a claims dispute falling within the scope of the scheme's terms of reference remains unresolved following an insurer's internal dispute resolution process or review, it can be referred to the second tier of the scheme. At this tier, a panel, referee or adjudicator offers claimants an impartial and authoritative alternative to litigation. An adjudicator can make binding determinations on participating insurers for amounts not exceeding \$5000 and by a panel or referee for amounts not exceeding \$150 000. A panel or referee may also make recommendations, for an amount greater than \$150 000 but not exceeding \$290 000 when the claim does not exceed \$290 000.

Claimants are not bound by any panel, referee or adjudicator's determination and retain their right to legal action or other forms of redress if they are dissatisfied with a determination.

These dispute-handling arrangements are essentially for the benefit of claimants who are natural persons, not corporations. This restriction is intended to exclude large commercial concerns, which are likely to have the resources to pursue disputes by other means. Small business organisations may refer disputes to the scheme.

The scheme also allows consumers, who are natural persons and who are seeking to make a claim for motor vehicle property damage against an insured or against a person to whom a policy of insurance extends, to access the dispute handling arrangements. The claim is limited to an amount not exceeding \$3000.

All participating insurers sign an agreement signifying their compliance with the terms of reference, including the procedures to be followed to resolve disputes within the periods set down in the terms of reference. The agreement also means that members undertake to comply with binding determinations of a panel, referee or adjudicator.

---

<sup>86</sup> Insurance Enquiries and Complaints Scheme, *Terms of reference, effective 1 January 2004*, p. 2.

## **B Insurers that participated in the ACCC's monitoring program**

This appendix lists the insurers that participated in the ACCC's monitoring program for this third report.<sup>87</sup>

The insurers in alphabetical order are:

- ACE Insurance Limited
- Allianz Australia Insurance Limited
- CGU Insurance Limited
- QBE Insurance (Australia) Limited
- QBE Mercantile Mutual Limited
- Suncorp Metway Insurance Limited<sup>88</sup>
- Vero Insurance Limited<sup>89</sup>
- Zurich Australia Insurance Limited.

All eight insurers were included in the ACCC's public liability insurance monitoring program. Their combined premium revenue represented 68 per cent of the public liability class of insurance, as measured by APRA data for the year ending 31 December 2003.

Five of these insurers were included in the ACCC's professional indemnity insurance monitoring program.<sup>90</sup> Their combined premium revenue represented 51 per cent of the professional indemnity class of insurance, as measured by APRA data for the year ending 31 December 2003.<sup>91</sup>

The ACCC acknowledges that all insurers responded (to varying degrees) to the ACCC's information request, although there was no statutory requirement for them to comply.

---

<sup>87</sup> The ACCC altered its monitoring sample from the first monitoring report in that one insurer was excluded from both the public liability and professional indemnity monitoring programs because its book of business in both classes was deemed to be outside the ACCC's monitoring program scope. Another insurer was excluded from the professional indemnity monitoring program because it ceased writing this class of insurance in 2003. All historical analysis contained in this report has been updated to reflect these changes.

<sup>88</sup> Data supplied by Suncorp Metway Insurance Limited to the ACCC included statistical history of three of its companies—GIO, AMP and Suncorp Metway.

<sup>89</sup> Formerly known as Royal and Sun Alliance Insurance Australia Limited.

<sup>90</sup> Three of the eight companies (Allianz, QBE Mercantile Mutual and Suncorp) were not included in the ACCC's monitoring program of professional indemnity insurance.

<sup>91</sup> This excludes medical malpractice premium revenue written by medical indemnity insurers.

## **C Tort reforms as at 31 December 2003**

### **C.1 Introduction**

This appendix outlines tort reforms introduced by respective Australian, state and territory governments up to 31 December 2003, and the progress of these reforms to 30 June 2004.

### **C.2 Initiatives announced by governments introduced as at 31 December 2003**

#### **C.2.1 The Australian Government**

The Taxation Laws Amendment (Structured Settlements and Structured Orders) Bill 2002 was introduced on 6 June 2002. It received royal assent on 19 December 2002 and commenced on that day. It amended the *Income Tax Assessment Act 1997*, the *Income Tax Assessment Act 1936*, the *Income Tax (Transitional Provisions) Act 1997* and the *Life Insurance Act 1995*. The amendments provide an income tax exemption for annuities and certain deferred lump sums paid under structured settlements to seriously injured people.

The Trade Practices Amendment (Liability for Recreational Services) Bill 2002 was introduced into parliament on 27 June 2002. It received royal assent on 19 December 2002 and commenced on the same day. It amended the *Trade Practices Act 1974* such that in the case of 'recreational services' it is possible to contract out of the statutory warranty to provide due care and skill. It allows individuals who participate in recreational or sporting activities to waive their rights under the Trade Practices Act if they suffer personal injury as a consequence of the provider's failure to supply the service with due care and skill.

The *Commonwealth Volunteers Protection Act 2003* was introduced into parliament on 23 October 2002. It was given royal assent on 24 February 2003 and commenced on 24 August 2003. The Act protects volunteers from civil liability for acts that the volunteer has done in good faith in doing voluntary work organised by and for the Commonwealth or a Commonwealth authority.

The Trade Practices Amendment (Personal Injuries and Death) Bill 2003 was introduced into parliament on 27 March 2003. The Bill is intended to prevent individuals or the ACCC from bringing actions for damages for personal injuries or death resulting from contraventions of Division 1 of Part V of the Trade Practices Act. The Bill passed the House of Representatives on 25 June 2003 and was amended by the Senate before being passed on 1 December 2003. The House of Representatives subsequently did not accept the Senate amendments on 2 December 2003. The Senate in turn has insisted on these amendments in a message to the House on 11 February 2004. As at 30 June 2004 the Bill had yet to be finalised and passed.

The Corporate Law Economic Reform Program (Audit Reform and Corporate Disclosure) Bill 2003 was introduced into parliament on 4 December 2003. The Bill seeks to amend the *Trade Practices Act 1974*, the *Corporations Act 2001* and the *Australian Securities and Investment Commissions Act 2001* to allow proportionate liability to apply to claims for damages from economic loss or property damage arising from misleading or deceptive conduct. The Bill was passed by the House on 16 February 2004 and introduced to the Senate on 1 March 2004. The Senate passed the Bill with proposed amendments on 22 June 2004. The House subsequently agreed to some amendments but did not accept others. The Senate did not insist on amendments disagreed to but made further amendments on 24 June 2004. The House agreed to further Senate amendments on 25 June 2004. As at 30 June 2004 the Bill had not received royal assent.

The Treasury Legislation Amendment (Professional Standards) Bill 2003 was introduced into parliament on 4 December 2003. The Bill seeks to amend the *Trade Practices Act 1974*, the *Corporations Act 2001* and the *Australian Securities and Investment Commission Act 2001* to support those states and territories that implement professional standards legislation. The Bill was passed by the House on 16 June 2004 and by the Senate on 25 June 2004. As at 30 June 2004 the Bill had not received royal assent.

The Trade Practices Amendment (Personal Injuries and Death) Bill (No. 2) 2004 was introduced into parliament on 19 February 2004. The Bill seeks to ensure that a nationally consistent approach is taken so that limitation periods and caps on damages arising from personal injury or death apply consistently across Australia. It introduces an indexed cap of \$250 000 on damages for non-economic loss. The Bill was passed by the House on 25 March 2004 and by the Senate (with amendments) on 11 May 2004. The Senate amendments were not accepted by the House on 21 June 2004. The Senate did not insist on the amendments, but made further amendments on 25 June 2004. The House agreed to the further Senate amendments on 25 June 2004. As at 30 June 2004 the Bill had not received royal assent.

## C.2.2 New South Wales

The *Civil Liability Act 2002* was introduced on 28 May 2002. It has been in force retrospectively since 20 March 2002. The main provisions of the Act relate to implementing caps on damages and thresholds for personal injury damages claims. The Act provides:

- general damages capped at \$350 000, indexed to AWE for NSW
- a threshold for general damages of 15 per cent impairment of the most extreme case then assessed on a sliding scale
- damages for economic loss capped at three times the rate of AWE for NSW
- a claimant must prove realistic future earnings
- a discount rate of 5 per cent to apply to lump sum payments for future economic loss
- limitations on damages for gratuitous attendant care services
- no interest be awarded on general damages or damages for gratuitous attendant care services
- damages claims under the *Compensation to Relatives Act 1987* may be reduced to incorporate contributory negligence of the deceased person
- no exemplary or punitive damages
- facilitation of structured settlements for payment of damages
- limits on legal cost claims to the greater of \$10 000 or 20 per cent for amounts recovered for personal injury claims that are less than \$100 000
- new requirements on lawyers and penalties apply when the court finds the claim or defence to be unmeritorious
- costs be awarded on an indemnity basis if incurred after the failure to accept an offer of compromise.

The *Civil Liability Amendment (Personal Responsibility) Act 2002* was introduced into NSW Parliament on 23 October 2002, and received assent on 28 November 2002. The Act commenced, with the exception of parts of schedules 1[1], 1[4] and 1[5], on 6 December 2002. Those parts of schedule 1[1] and 1[4] which did not commence 6 December 2002 commenced on 10 January 2003. The remaining amendments not in

force are concerned with proportionate liability provisions. The Act amends the *Civil Liability Act 2002*, the *Limitation Act 1969*, the *Dust Diseases Tribunal Act 1989*, the *Environmental Planning and Assessment Act 1979*, the *Fair Trading Act 1987*, the *Health Care Liability Act 2001*, the *Legal Profession Act 1987*, the *Motor Accidents Compensation Act 1999*, the *State Emergency and Rescue Management Act 1989* and the *Motor Accidents Act 1988*. The Act provides:

- general principles for standard of care<sup>92</sup>
- general principles in relation to causation
- no proactive duty to warn of obvious risk
- no liability for materialisation of inherent risk
- no liability for harm suffered from obvious risks of dangerous recreational activities
- no duty of care for recreational activity where there is a risk warning
- waiver of contractual duty of care for recreational activities
- standard of care for professionals
- no liability if a professional acted in a manner widely accepted by the profession as competent professional practice (peer opinion)
- liability based on non-delegable duties
- standard of contributory negligence for apportioning liability
- contributory negligence can reduce damages by 100 per cent
- damages may be awarded for future superannuation entitlements
- courts may have reference to previous court decisions when determining amounts for general damages
- further amendments in relation to facilitation of structured settlements for payment of damages
- damages may be recovered for personal injuries arising from mental or nervous shock
- limitation of recovery for pure mental harm arising from shock
- standard of duty of care in relation to mental harm
- proportionate liability for economic loss (not in force)
- outline of liability of public authorities
- effect of intoxication on duty and standard of care
- no civil liability for acts in self defence against unlawful conduct
- exclusion of liability for criminal activity
- protection from liability for volunteers and good Samaritans who act in good faith
- expression of regret not an admission of liability
- amendments to limitation periods
  - three years from date of discoverability
  - 12 years from date of occurrence (which may be extended by the court)

---

<sup>92</sup> Based on recommendations in the Ipp Review of the Law of Negligence.

- specific provisions in relation to minors injured by close relatives and those with disabilities (minors and/or those with incapacity).

The *Civil Liability Amendment Act 2003* was introduced into parliament on 13 November 2003. It was given assent on 10 December 2003. The Act commenced, with the exception of Schedule 2, on 19 December 2003. The Act amends the *Civil Liability Act 2002* and the *Mental Health Act 1990*. The amendments provide:

- no civil liability for acts in self defence if the conduct to which the person was responding would have been unlawful if that person had not been suffering a mental illness at the time
- criminals not to be awarded damages
- limitation of damages if loss results from serious offence committed by a mentally ill person
- damages may be awarded for the birth of a child but only in certain circumstances
- amendments concerning proportionate liability for economic loss (not in force)
- limits liability of police officers and health care officials exercising functions in good faith under the *Mental Health Act 1990*.

The *Professional Standards Act 1994* was given royal assent on 12 December 1994. The Act establishes limited liability for professionals prefaced on provisions aimed at:

- minimising claims against professionals by improving professional standards
- requiring risk management strategies and compulsory insurance cover
- providing for appropriate complaint and disciplinary mechanisms.

### C.2.3 Victoria

The *Wrongs and Other Acts (Public Liability Insurance Reform) Act 2002* was introduced into the Victorian Parliament on 12 September 2002, and given royal assent on 22 October 2002. It commenced, with the exception of ss. 8 and 11 and Part V, on 23 October 2002. Section 8 (structured settlement provisions) commenced on 14 February 2003. Section 11 (volunteer protection provisions) commenced on 15 March 2003. Part V (amendments to the *Goods Act 1958*) commenced on 1 May 2003. The Act amends the *Wrongs Act 1958*, the *Food Act 1984*, the *Goods Act 1958*, the *Essential Services Commission Act 2001*, the *Country Fire Authority Act 1958*, the *Coroners Act 1985* and the *Metropolitan Fire Brigades Act 1958*. The amendments provide:

- in establishing a breach of the duty of care the court must consider whether the injured person was intoxicated or engaged in illegal activity
- an expression of regret does not represent an admission of liability
- a cap on general damages of \$371 380 indexed to Melbourne CPI
- a cap on damages for economic loss of three times the rate of AWE for Victoria
- a discount rate of 5 per cent to apply to lump sum payments for future economic loss
- facilitation of structured settlements for payment of damages
- protection from liability for volunteers and good Samaritans who act in good faith
- food donors are protected from liability where they have donated food to charities in good faith
- waivers limiting liability in relation to the supply of recreational services

- new powers under the *Essential Services Commission Act 2001* for the Essential Services Commission to collect insurance data to ensure transparency and fairness in the pricing of premiums.

The *Limitation of Actions Amendment Act 2002* was introduced into the Victorian Parliament on 16 October 2002. It was given assent on 4 November 2002 and commenced on 5 November 2002. The Act amends the *Limitations of Actions Act 1958*. The amendments provide:

- to limit the period within which certain actions for damages for personal injury and death can be brought
- limitation period set at:
  - three years after cause of action accrued, and
  - six years for a person under a disability.

The *Wrongs and Limitation of Actions Acts (Insurance Reform) Act 2003* was introduced to the Victorian Parliament on 20 May 2003, and received assent on 16 June 2003. The Act commenced retrospectively on 21 May 2003 with the exception of ss. 3, 17 and 18. These sections commenced on 1 January 2004. The Act amends the *Wrongs Act 1958*, the *Limitation of Actions Act 1958*, the *Building Act 1993*, and the *Accident Compensation Act 1985*. The amendments provide:

- proportionate liability for economic loss
- a 5 per cent impairment threshold for general damages, with certain exceptions<sup>93</sup>
- a 10 per cent psychiatric impairment threshold for general damages
- no threshold where the fault concerned is, or relates to, an intentional act that is done with intent to cause death or injury or sexual assault/misconduct
- procedures for assessment of impairment
- procedures for claims for general damages
- procedures of medical panels for assessing impairment
- limits on awards for damages for provision of gratuitous attendant care services
- amendments to limitation periods:
  - three years from date of discoverability
  - six years from date of discoverability in the case of a person under a disability
  - 12 years from date of occurrence (with court discretion to extend this period)
  - specific provisions in relation to minors injured by close relatives and those with disabilities (minors and/or those with incapacity).

On 28 October 2003 the *Wrongs and Other Acts (Law of Negligence) Act 2003* was introduced into parliament, and received royal assent on 2 December 2003. It amends the *Wrongs Act 1958*, the *Wrongs and Limitations of Actions Acts (Insurance Reform) Act 2003* (in relation to proportionate liability), the *Victorian Managed Insurance Authority Act 1996* and the *Building Act 1993*. The Act commenced, with the exception of ss. 6, 14(2) and Part V on 3 December 2003. Section 6 (transitional provisions) came into operation retrospectively on 1 October 2003. Section 14(2) (psychological or psychiatric injury arising from the loss of a child) is deemed to have come into operation on 21 May 2003. Part V (amendments to the *Building Act 1993*) came into operation on 1 January 2004. The amendments provide:

<sup>93</sup> Loss of a foetus or loss of a breast is automatically considered 'significant injuries'.

- general principles in relation to duty of care<sup>94</sup>
- general principles in relation to causation
- limits liability in relation to obvious risks and voluntary assumption of risks
- no liability for materialisation of inherent risk
- standard of care for professionals and those professing to have a particular skill
- no liability if a professional acted in a manner widely accepted by the profession as competent professional practice (peer opinion)
- limits liability based on non-delegable duty
- standard of care for contributory negligence
- contributory negligence can reduce damages by 100 per cent
- standard of duty of care in relation to mental harm
- limitation on recovery of damages for pure mental harm arising from shock
- liability for economic loss for mental harm
- limits liability for public authorities
- limits on damages for provision of gratuitous care
- courts may have reference to previous court decisions when determining amounts for general damages
- revises and extends procedures applying to determination of whether a claimant's injury satisfies the threshold requirements for eligibility (should negligence be proved) for awarding of general damages.

The *Professional Standards Act 2003* was introduced on 14 October 2003 and was given royal assent on 2 December 2003. It became effective on 9 June 2004. The Act provides:

- limitation of liability for members of occupational associations in certain circumstances
- facilitation of improvement in the standards of services provided by those members
- establishment of the Professional Standards Council
- requires risk management strategies for Council approval of occupational associations and allows associations to require compulsory insurance for members
- complaint and disciplinary mechanisms.

## C.2.4 Queensland

The *Personal Injuries Proceedings Act 2002* was introduced into the Queensland Parliament on 18 June 2002, and given royal assent on 20 June 2002. It commenced retrospectively from 18 June 2002. The Act provides:

- pre-court procedures for speedy resolution of personal injury claims
- a requirement for the mandatory early notification of claims following an injury or the appearance of symptoms
- a requirement for the mandatory exchange of information (including medical reports) to facilitate early settlement and avoid litigation

<sup>94</sup> Based on recommendations in the Ipp Review of the Law of Negligence.

- special provisions for notification of claims in relation to injuries to children arising from medical treatment
- outline of obligations on parties in relation to exchange of information
- requirements for compulsory conferences
- provision for non-compliance if urgent proceedings needed
- restrictions on legal advertising, including the banning of 'no win–no fee' advertising
- limits on legal costs that can be awarded in specified circumstances
- facilitation of structured settlements<sup>95</sup>
- provides that expressions of regret made before court proceedings have started are inadmissible<sup>96</sup>
- cap on damages for economic loss of three times AWE for Qld<sup>97</sup>
- exclusion of jury trials in personal injury claims<sup>98</sup>
- no exemplary, punitive or aggravated damages<sup>99</sup>
- liability does not attach to a person rendering first aid or other assistance to person in distress in an emergency<sup>100</sup>
- sets out that future economic loss be discounted by 5 per cent.<sup>101</sup>

The *Personal Injuries Proceedings Amendment Act 2002* was introduced into parliament on 30 July 2002, and received royal assent on 29 August 2002. Ss. 4 and 8 of the Act commenced retrospectively on 18 June 2002. The remainder of the Act commenced on the date of royal assent. The Act contains transitional provisions in relation to the *Personal Injuries Proceedings Act 2002*.

The *Civil Liability Act 2003* was introduced into parliament on 11 March 2003 and received royal assent on 9 April 2003. The commencement of the Act was in three stages, with ss. 1–2, Ch. 2 Pt 1 Div. 7, Pt 3 Div. 2, Pt 4, Ch. 3 Pts 2, 4, ss. 53–54 and 56–60, Ch. 4 Pts 1–2, Ch. 5, Ch. 6 Sch 1 commenced on 9 April 2003. Chapter 2, Part 2 (proportionate liability) is not yet in force. The remaining section commenced retrospectively on 2 December 2002. Provisions from the *Personal Injuries Proceedings Act 2002* were relocated to this Act so as to bring all relevant (similar) provisions together. The main provisions of the Act provide:

- general principles for standard of care<sup>102</sup>
- general principles for causation
- no proactive duty to warn of obvious risk
- no liability for materialisation of inherent risk
- no liability for personal injury suffered from obvious risks of dangerous recreational activities

<sup>95</sup> Subsequently replaced by provisions in the *Civil Liability Act 2003*.

<sup>96</sup> *ibid.*

<sup>97</sup> *ibid.*

<sup>98</sup> *ibid.*

<sup>99</sup> *ibid.*

<sup>100</sup> *ibid.*

<sup>101</sup> *ibid.*

<sup>102</sup> Based on recommendations in the Ipp Review of the Law of Negligence.

- proactive and reactive duty of doctor to warn of risk
- standard of care for professionals
- no breach of duty if professional acted in a manner widely accepted by the profession as competent professional practice (peer opinion)
- standard of care in relation to contributory negligence
- contributory negligence can reduce damages by 100 per cent
- protection for persons and entities performing duties to enhance public safety
- provisions in relation to proportionate liability (not yet in force)
- limitations on liability of public authorities
- protection for volunteers who undertake community work in good faith<sup>103</sup>
- limits on liability for damages for injuries sustained during criminal activity
- presumption of contributory negligence if person who suffers harm is intoxicated or relied on care and skill of person known to be intoxicated
- damages for economic loss following failed sterilisation or contraceptive procedures or contraceptive advice
- no exemplary, punitive or aggravated damages<sup>104</sup>
- a cap on general damages based on an assessment of injury, with a maximum of \$250 000
- no interest on general damages
- a cap on damages for economic loss of three times the rate of AWE for Qld<sup>105</sup>
- facilitation of structured settlements<sup>106</sup>
- expressions of regret do not represent admission of liability.<sup>107</sup>

### C.2.5 South Australia

The *Statutes Amendment (Structured Settlements) Act 2002* was introduced to the South Australian Parliament on 12 September 2002, and commenced on 1 December 2002. It provides for facilitation of structured settlements for payment of damages.

The *Recreational Services (Limitation of Liability) Act 2002* was introduced on 5 September 2002 and came into operation on 1 July 2003. It provides that:

- the duty of care owed by providers of recreational services may be modified and governed by registered code
- after two years the South Australian economics and finance committee must investigate and report to the South Australian Parliament on how this Act affects the availability and cost of insurance for providers of recreational services.

<sup>103</sup> Relocating and expanding the provisions of the *Personal Injuries Proceedings Act 2002*.

<sup>104</sup> Replacing those provisions of the *Personal Injuries Proceedings Act 2002*.

<sup>105</sup> *ibid.*

<sup>106</sup> *ibid.*

<sup>107</sup> *ibid.*

The *Wrongs (Liability and Damages for Personal Injury) Amendment Act 2002* was introduced on 14 August 2002. It received assent on 28 November 2002 and commenced on 1 December 2002. The Act amended what was then known as the *Wrongs Act 1936*.<sup>108</sup> The amendments provide:

- a threshold for general damages of at least seven days impairment or medical expenses incurred of \$2750
- a cap on general damages at \$241 500 (indexed to Adelaide CPI) and assessed on a sliding scale
- damages may be awarded for mental or nervous shock only in certain circumstances
- a cap on damages for future economic loss of \$2.2 million (indexed to Adelaide CPI)
- a discount rate of 5 per cent to apply to lump sum payments for future economic loss
- no interest to be awarded on general damages or damages for future economic loss
- limits on awards for damages for provision of gratuitous services
- limits on liability for damages for injuries sustained during criminal activity
- a presumption of contributory negligence where an injured person was intoxicated or a person relied on the care and skill of a person known to be intoxicated
- a presumption of contributory negligence if a person was not wearing a seatbelt or safety helmet as required by law
- damages able to be reduced where contributory negligence is present
- protection for a good Samaritan who acts in good faith
- an expression of regret does not represent an admission of liability.

The *Law Reform (Ipp Recommendations) Act 2003* was introduced to the South Australian Parliament on 2 April 2003, and became effective on 1 May 2004. It amends the *Wrongs Act 1936*, the *Limitation of Actions Act 1936* and the *Motor Vehicles Act 1959*. Specifically it changes the name of the *Wrongs Act 1936* to the *Civil Liability Act 2003*. The amendments incorporate recommendations of the Ipp Review of the Law of Negligence and provide:

- general principles for standard of care
- provisions regarding precautions against risk
- standard of duty of care in relation to mental harm
- general principles in relation to causation
- no duty to warn of obvious risk
- standard of care for professionals and those professing to have a particular skill
- no liability if a professional acted in a manner widely accepted by the profession as competent professional practice (peer opinion)
- limitation of liability for road authorities
- exclusion of liability for criminal conduct (replacing previous amendments contained in the *Wrongs (Liability and Damages for Personal Injury) Amendment Act 2002*)
- standard of contributory negligence for apportioning liability
- limitations on damages for mental harm

<sup>108</sup> The name of the *Wrongs Act 1936* was subsequently changed to the *Civil Liability Act 2003* by the *Law Reform (Ipp Recommendations) Act 2003* discussed later.

- limitations on the award of damages for the costs of raising a child in certain circumstances
- special provisions regarding extending limitation periods for children
- general powers to extend limitation periods.

The Professional Standards Bill 2003 was introduced to the South Australian Parliament on 12 November 2003. The Bill has not yet passed parliament. It provides:

- establishment of a Professional Standards Council
- provisions for establishment of occupational associations
- limitation of liability for members of occupational associations in certain circumstances
- occupational associations may compel their members to insure
- risk management strategies may be required for approval of an association by the Council.

### C.2.6 Western Australia

The *Civil Liability Act 2002* was introduced into parliament on 14 August 2002, and received royal assent on 20 November 2002. It commenced on 1 January 2003, and provides for:

- a cap on damages for economic loss of three times AWE for WA
- facilitation of structured settlements for payment of damages
- a threshold for general damages of \$12 000 (indexed to the Wage Cost Index for WA)
- a threshold of \$5000 on damages for gratuitous care services (indexed to the Wage Cost Index for WA)
- a cap on damages for gratuitous care services to three times the rate of AWE in WA
- restrictions on advertising by lawyers of personal injury services.

The *Volunteers (Protection from Liability) Act 2002* was introduced on 19 June 2002 and commenced upon royal assent on 1 January 2003. It provides:

- protection for volunteers from civil liability when undertaking community work
- community organisations may incur the civil liability on behalf of the volunteer.

The *Civil Liability Amendment Act 2003* was introduced into parliament on 20 March 2003, and received royal assent on 30 October 2003. It commenced on 1 December 2003 (except for ss. 9 and 14, the proportionate liability provisions, which have yet to be proclaimed). The Act provides:

- general principles for duty of care
- general principles in relation to causations
- no liability for harm from obvious risks of dangerous recreational activities
- no liabilities for recreational activity where there is a risk warning
- waiver of contractual duty of care for recreational activities
- a presumption of contributory negligence when a person who suffers harm is intoxicated
- no duty to warn of obvious risk
- no liability for harm from inherent risk
- duty of care in relation to mental harm

- liability relating to carrying out public functions
- protection for good Samaritans who act in good faith
- an expression of regret does not represent an admission of liability
- provisions in relation to proportionate liability for economic loss (not yet in force)
- courts may have reference to previous court decisions when determining amounts for general damages.

Western Australia introduced the Professional Standards Bill 1997 on 12 March 1997. It received royal assent on 18 September 1997 and commenced on that day. The Act provides for the limitation of liability of members of occupational associations in certain circumstances and to facilitate improvement in the standards of services provided by those members. On 30 June 2004 the government introduced the Professional Standards Amendment Bill 2004 to make that legislation consistent with the New South Wales' *Professional Standards Act 1994*.

### C.2.7 Tasmania

The *Civil Liability Act 2002* was introduced into the Tasmanian Parliament on 1 October 2002. It received assent on 19 December 2002 and commenced on 1 January 2003. The Act provided:

- a presumption of contributory negligence when a person is intoxicated
- limits on liability for damages for injuries sustained during criminal activity
- facilitation of structured settlements for payment of damages
- an expression of regret does not represent an admission of liability.

Tasmania's *Civil Liability Amendment Act 2003* implemented recommendations from the Ipp Review. The Act amended the *Civil Liability Act 2002*. The amendments commenced on the date of royal assent, 4 July 2003. The amendments provide:

- general principles for standard of care
- general principles in relation to causation
- no duty to warn of obvious risks
- no liability for harm suffered from obvious risks of dangerous recreational activities
- specification of proactive and reactive duty of registered medical practitioner to warn of risk
- standard of care for professionals and those professing to have a particular skill
- no liability if a professional acted in a manner widely accepted by the profession as competent professional practice (peer opinion)
- standard of contributory negligence for apportioning liability
- damages may be awarded for loss of future superannuation entitlements
- damages for future economic loss capped at 4.25 times AWE for Australia
- threshold for general damages of \$4000 (indexed to Hobart CPI), if amount assessed is between \$4000 and \$20 000 (both indexed to Hobart CPI) then general damages awarded are calculated by formula
- courts may have reference to previous court decisions when determining amounts for general damages

- damages may be awarded for mental or nervous shock
- limitations on recovery for pure mental harm arising from shock
- standard of duty of care in relation to mental harm
- general principles of duty of care for public authorities
- a public authority does not owe a duty of care for recreational activities where a risk warning was given
- protection for volunteers who do community work.

### C.2.8 Australian Capital Territory

The *Civil Law (Wrongs) Act 2002* was introduced to the ACT Legislative Assembly on 20 August 2002. Sections 1 and 2 of the Act commenced on 10 October 2002, and Chapter 10 began on 1 January 2003. The remainder of the Act commenced on various dates between 1 November 2002 and 1 July 2003. The Act provides:

- protection for volunteers and good Samaritans who act in good faith
- outlines the effect the death of the plaintiff or defendant may have on a cause of action
- outlines proceedings against and contributions between wrongdoers
- outlines liability and damages for a person's death in relation to a wrongful act or omission that causes death
- damages may be awarded for injuries from mental harm or nervous shock
- a presumption of contributory negligence if an injured person is intoxicated or relied on a person who is intoxicated
- exclusion of liability for criminal activity
- presumption of contributory negligence for not wearing a seatbelt or safety helmet
- cap on damages for economic loss of three times AWE for the ACT
- damages may be awarded for loss of capacity to perform domestic services
- apportionment of liability for contributory negligence
- facilitation of structured settlements for payment of damages
- replaces common law rules regarding the standard of care that an occupier of premises must show to people entering the premises in relation to the state of the premises
- limits on legal costs; for claims \$50 000 or less, the maximum costs allowed is the greater of 20 per cent of the amount recovered or \$10 000
- establishes a regime for neutral evaluation of cases to resolve disputes more quickly and cheaply
- requires insurers to report annually to the ACT Government.

The *Civil Laws (Wrongs) Amendment Act 2003*<sup>109</sup> commenced 28 March 2003. It amended the *Civil Law (Wrongs) Act 2002*. The amendments provide:

- temporary exclusion of liability for terrorism-associated risks
- limitation of liability for acts of terrorism.

<sup>109</sup> The *Civil Law (Wrongs) Amendment Act 2003* was repealed, however, the repeal of an amending law does not affect the continuing operation of the amendments.

The *Civil Law (Wrongs) Amendment Act 2003 (No. 2)*<sup>110</sup> commenced on 9 September 2003 and 8 March 2004. It amended the *Civil Law (Wrongs) Act 2002*. The amendments provide:

- an expression of regret does not represent an admission of liability
- standard of duty of care in relation to mental harm
- general principles for duty of care for negligence
- general principles in relation to precautions against risk
- general principles in relation to causation
- contributory negligence can reduce damages by 100 per cent
- outlines pre-court procedures in relation to notice of claim, obligations on parties to give documents and information, need for urgent proceedings and expert medical evidence
- courts may have reference to previous court decisions when determining amounts for general damages
- outlines liability for public authorities
- provisions regarding costs in damages claims if there is no reasonable prospect of success
- includes mediation to be an option along with neutral evaluation of cases
- limitation of liability for injury or death of participant in equine activity
- amends the *Limitation Act 1985* so that the limitation period is three years from the cause of action
- special provisions apply in relation to limitation periods for injuries to children
- a limitation period of six years applies for injuries to children as a result of provision of health services.

The *Civil Law (Wrongs) (Thresholds) Amendment Bill 2003* was introduced to the ACT Legislative Assembly on 11 December 2003, but has not yet been passed. It proposes to amend the *Civil Law (Wrongs) Act 2002*. The provisions in the Bill restrict the awards that may be made for general damages for a personal injury from the provision of a health service by a doctor. The Bill sets maximums for such general damages.

## C.2.9 Northern Territory

The *Consumer Affairs and Fair Trading Amendment Act 2003* was introduced to the Northern Territory Legislative Assembly on 20 August 2002. It received assent on 18 March 2003 and commenced 1 May 2003. It amends the Consumer Affairs and Fair Trading Act to replicate changes being made to the *Trade Practices Act 1974*. The amendments provide waivers limiting liability in relation to supply of recreational services.

The *Personal Injuries (Liabilities and Damages) Act 2003* was introduced to the NT Legislative Assembly on 17 October 2002 and commenced 1 May 2003. The Act provides:

- protection for volunteers and good Samaritans who act in good faith
- limits on liability for damages for injuries sustained during criminal activity
- an expression of regret does not represent an admission of liability

---

<sup>110</sup> The *Civil Law (Wrongs) Amendment Act 2003 (No. 2)* was repealed, however, the repeal of an amending law does not affect the continuing operation of the amendments.

- a presumption of contributory negligence if an injured person was intoxicated or relied on a person who was intoxicated
- damages may be reduced if contributory negligence is established
- no awards for aggravated or exemplary damages in respect of a personal injury
- cap on damages for economic loss of three times AWE for NT
- a discount rate of 5 per cent to apply to lump sum payments for future economic loss
- damages may be awarded for provision of gratuitous services
- cap on general damages of \$350 000 adjusted by the percentage change in AWE for NT
- a threshold so that general damages may only be awarded if a person suffers permanent impairment of 5 per cent or more
- general damages may be awarded on a sliding scale depending on the degree of impairment
- no interest to be awarded on general damages or damages for gratuitous services
- facilitation of structured settlements for payment of damages.

The *Personal Injuries (Civil Claims) Act 2003* was assented to on 29 May 2003. Sections 1–4, 6, 12–15 and 22 commenced on 1 July 2003. The remaining provisions have not yet commenced. The Act provides:

- further facilitation of structured settlements for payment of damages
- judges of the Supreme Court of the Northern Territory may make rules for regulating and prescribing practice and procedures in relation to claims and other specified topics.

The *Legal Practitioners Amendment (Costs and Advertising) Act 2003* received assent on 29 May 2003 and amends the Legal Practitioners Act. Sections 1–6 commenced on 1 July 2003; sections 7–11 commenced on 1 June 2004. It amends the Legal Practitioners Act. The amendments provide:

- the Law Society may make rules regulating or prohibiting legal advertising
- further detail in relation to the costs provisions in the Legal Practitioners Act regarding disclosure of, recovery of and agreements as to costs.

## D Monitoring methodology for examining historical costs and expenses, premiums and financial performance

Chapters 4 to 7 examined trends in the major cost components, that is, claims costs and expenses, as well as trends in premiums. This information was also used to assess the recent financial 'underwriting performance' of insurers in each insurance class.

The ACCC used several indicators to examine costs, premiums and financial performance, as outlined below.

### D.1 Claims

The ACCC examined trends in claims costs and numbers using a range of indicators:

- *Claims frequency*—the ACCC examined two indicators of claims frequency:
  - the number of claims reported in the same year as incident expressed as a proportion of the total number of policies for the corresponding underwriting years.<sup>111</sup> This indicates whether insurers are receiving more or fewer claims reported in the same year as incident for the same number of policies over time.
  - the number of claim reports incurred<sup>112</sup> by incident year as a proportion of the total number of policies for the corresponding underwriting years. This indicates whether insurers incur (i.e. have received and expect to receive) more or fewer claim reports for the same number of policies over time.
- *Average size of claims*—this shows the average size of settled claims in real terms,<sup>113</sup> that is, the total amount of settlement costs divided by the total number of claims settled in any one year, adjusted to 31 December 2003 values. It shows how the average size of claims in real terms has changed over time.
- *The mix of claims settled*—for public liability insurance it is important to examine the types of claims settled, as the cost of personal injury and death claims is typically higher than those for property damage claims. Therefore, the ACCC examined three indicators:
  - *the proportion by settlement numbers of the two types of claims*—whether the proportion of personal injury and death claims settlements had increased over the period

---

<sup>111</sup> The incident year data are not directly comparable with the underwriting year data. This is overcome by converting underwriting year data to an incident year basis by taking the incident year B and comparing it to the average of underwriting year A and underwriting year B. This is because one underwriting year may incur incidents across two years depending on when the policy is written (i.e. a policy written on 1 July year A effectively covers incidents occurring in the second half of year A and the first half of year B).

<sup>112</sup> The total number of claim reports for any one incident year that may result in a liability for the insurer. This includes both reported and unreported claims (IBNRs).

<sup>113</sup> The average weekly earnings index (AWE) published by the Australian Bureau of Statistics (catalogue number 6302.0) has been used throughout this report to convert nominal dollars into real dollars for data on premiums and claims. AWE is considered an appropriate measure of claims inflation as claims costs for this class of insurance generally increase at a rate different to prices. AWE is also considered an appropriate measure for adjusting premiums given that claims costs are a large component of premiums charged by insurers.

- *the proportion by settlement costs of the two types of claims*—whether the proportion of settlement costs attributable to personal injury and death claims had increased over the period
- *the average size of personal injury and death claims settlements and the average size of property damage settlements in real terms*<sup>114</sup>—the trend in average size of each of these claim types is examined over time.
- The distribution of settlement numbers and costs between settlement size bands—whether changes in the distribution of settlements across various size bands are leading to changes in the average settlement size or whether the change can be attributed to all size bands.

## D.2 Expenses

The ACCC examined trends in major categories of expenses—brokerage, reinsurance and underwriting expenses—by comparing them to gross written premium (i.e. shown as a proportion of gross written premium). This indicates how much each of these expenses represents as a proportion of written premium and whether this has changed over time. The expenses are compared with gross written premium because the premium written in any one year will be used to pay for all costs of acquiring, writing and servicing insurance business.

The ACCC also examined the reinsurance expense in terms of the reinsurance coverage by looking at insurers' retention of risk. This indicator shows the level of coverage that insurers are receiving for their reinsurance premium.

## D.3 Premiums

To examine trends in premiums, the ACCC used one main indicator—the *average premium*. The average premium is the total gross written premium written in one underwriting year, divided by the number of policies for that year, in real terms.<sup>115</sup>

This indicates the average premium that was paid across the period by policyholders.

## D.4 Underwriting performance

The overall financial performance of insurance companies is determined by their underwriting and investment activities. However, the ACCC's monitoring role relates specifically to monitoring costs and premiums rather than investment activities, and therefore it focuses on the underwriting performance of insurers in each class of insurance. Also, general expenses are excluded from the ACCC's methodology as they can not be attributed to any one class of insurance and will not be directly affected by tort law reform. Finally, it should be noted that the ACCC uses uninflated and undiscounted expected future payments as insurers' expectations regarding normal (wage) inflation and investment income will not be directly affected by tort reforms.

<sup>114</sup> Using the average weekly earnings index (AWE) published by the Australian Bureau of Statistics (catalogue number 6302.0).

<sup>115</sup> *ibid.*

Insurers' underwriting performance was examined using a number of ratios:<sup>116</sup>

- *Loss ratio*—the total amount of claims costs (including the claims administration expenses<sup>117</sup>) paid or payable (including expected future claims costs) on all incurred claims<sup>118</sup> in current dollar values (i.e. before inflating<sup>119</sup> or discounting expected future payments provisions) as a proportion of earned premium. This ratio shows the proportion of premiums that claims costs represent.
- *Expense ratio*—the sum of brokerage expenses and underwriting expenses as a proportion of gross written premium. This ratio shows the proportion of premiums that these expenses represent. It is similar to the expenses analysis outlined in section D.2.
- *Reinsurance ratio*—reinsurance expense as a proportion of gross written premium. This ratio shows the proportion of premiums that the reinsurance expense represents.
- *Combined ratio*—the sum of the loss ratio, the expense ratio and the reinsurance ratio. This ratio shows whether the sum of all costs (claims costs and expenses) is greater or less than premiums.<sup>120</sup> For example, if the combined ratio is greater than 100 per cent, premiums are insufficient to cover costs implying an underwriting loss. If the ratio is less than 100 per cent, premiums are greater than the sum of all costs implying an underwriting profit.<sup>121</sup>

<sup>116</sup> These ratios, excluding the reinsurance ratio, are calculated both gross and net of reinsurance expenses and recoveries. As reinsurance effectively passes off a portion of risk from the insurer to the reinsurer, examining the net ratios indicates the direct performance that the insurer expects to achieve. Calculating the ratios net of reinsurance means deducting the reinsurance expense from premiums, and deducting reinsurance recoveries from the claims payments.

<sup>117</sup> Claims administration expenses were not included in the ACCC's analysis of loss ratios in the first monitoring report. However, it was included in the second monitoring report, as well as in this report, and historical data has been updated to reflect this. Insurers previously indicated to the ACCC that claims handling expenses represent approximately 5 per cent of public liability premiums and 2 per cent of professional indemnity premiums.

<sup>118</sup> The total number of claims incurred for any one incident year that may result in a liability for the insurer. This includes claims paid and claims outstanding (including IBNRs and IBNERs)

<sup>119</sup> Before inflating to real dollars using normal (wage) inflation. This estimate of expected future payments provisions, however, does include superimposed inflation.

<sup>120</sup> The loss ratio is calculated using earned premium, while the expense ratio and the reinsurance ratio are calculated using written premium, so there is a small timing inconsistency in adding them together for the combined ratio. However, this is not considered material to the ACCC's conclusions.

<sup>121</sup> The ACCC has calculated the combined ratio both gross and net of reinsurance. The net combined ratio is the sum of the net loss ratio and the net expense ratio. This calculation is explained in more detail in section 5.5.

## **E Public liability claims costs and premiums by industry**

### **E.1 Introduction**

At the beginning of the ACCC's monitoring role, the ACCC determined a range of information that it would seek from insurers. The ACCC determined that claims and premiums information broken down by the Australian and New Zealand Standard Industrial Classification (ANZSIC) system would be useful.<sup>122</sup>

However, insurers indicated that in many cases they had not previously collected data on this basis, which meant firstly that they could not provide this information historically and secondly, to enable future data provision, they would have to establish systems to collect the data.

This meant the ACCC was unable to examine trends in claims costs and premiums by ANZSIC as a part of its detailed analysis in chapters 4 and 5. However, seven insurers have now been able to provide premium and claims data broken down by ANZSIC for the 2003 underwriting and settlement years.

While this information was not fed into the analysis of costs and premiums, the data provides interesting information regarding claims costs and premiums by industry.

---

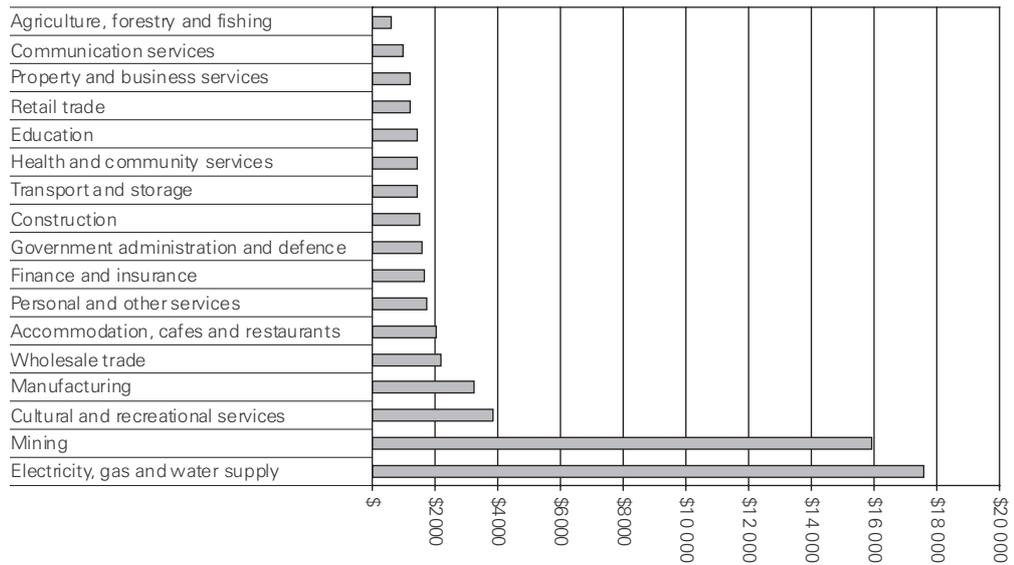
<sup>122</sup> The ACCC nominated the Australian and New Zealand Standard Industrial Classification (ANZSIC) system for industry classification as the ACCC understood that this was generally the direction that the industry was moving towards in terms of claims and policies data collection. Further to this, APRA has now nominated the ANZSIC system for the public and product liability codes for its public liability and professional indemnity national claims and policies database.

## E.2 Average premium by ANZSIC

The ACCC examined trends in premium by ANZSIC, looking at the average premium in real terms for 17 industry classifications. The methodology adopted was the same as that used in chart 5.1 and outlined in appendix D.

Chart E.1 shows the average premium for public liability insurance by ANZSIC for 2003.

**Chart E.1 Average premium by ANZSIC—real terms—public liability—2003**



Source: Derived by ACCC from responses provided by seven insurers.

Note: Data adjusted to 31 December 2003 values using the AWE index.

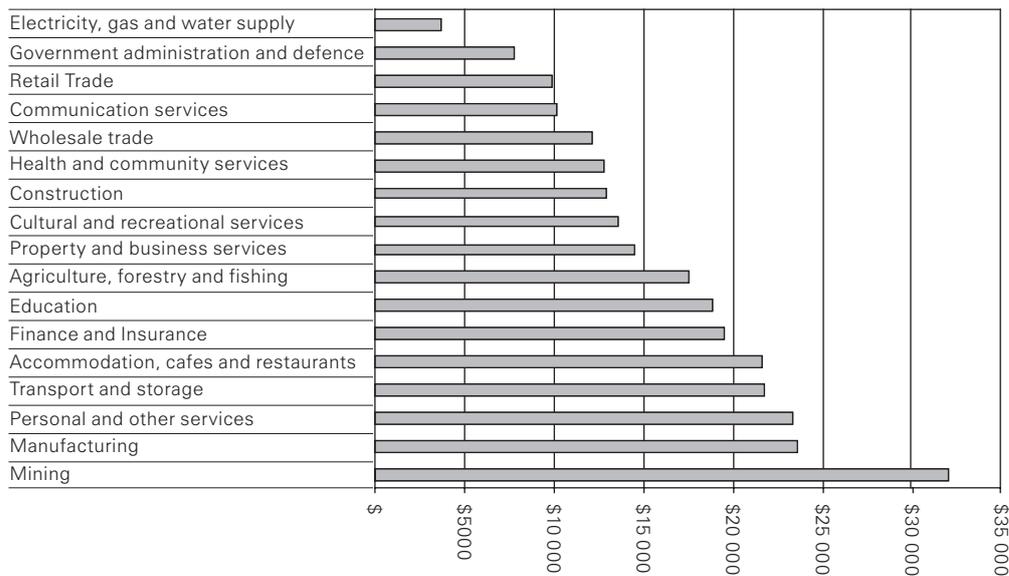
The majority of industries had average premiums of around \$2000 or less in 2003, ranging from \$575 for agriculture, forestry and fishing to \$2137 for wholesale trade. The manufacturing, and cultural and recreational services industries had average premiums of \$3211 and \$3808 respectively, while the mining, and electricity, gas and water supply industries, had premiums of \$15 912 and \$17 544 respectively.

### E.3 Average size of claims settled by ANZSIC

The ACCC examined trends in claims costs by ANZSIC examining the average size of claims settled in real terms for the same 17 industry classifications. The methodology adopted was the same for that used in chart 4.3 and was outlined in appendix D.<sup>123</sup>

Chart E.2 shows the average size of claims settled for public liability insurance by ANZSIC for 2003.

**Chart E.2 Average size of claims settled by ANZSIC—real terms—public liability—2003**



Source: Derived by ACCC from responses provided by seven insurers.

Note: Data adjusted to 31 December 2003 values using the AWE index.

The chart above shows that the average size of claims settled varied across industries, ranging from a low of \$3723 in the electricity, gas and water supply industry to \$32 036 in the mining industry.

<sup>123</sup> The average size of claims settled analysis may not be directly comparable to the premium analysis. This is because premium and policy data was collected on an underwriting year basis while claims data was collected on a settlement year basis. Therefore, information in section E.3 may not correspond directly with the information in section E.2.

## **F Professional indemnity claims costs and premiums by occupation**

### **F.1 Introduction**

Similar to public liability insurance, as a part of establishing its monitoring framework the ACCC determined that claims and premium information broken down by the Australian Standard Classification of Occupations (ASCO) system would be useful for its analysis.<sup>124</sup>

However, insurers indicated that in many cases they had not previously collected data on this basis, meaning firstly that they could not provide this information historically and secondly, to provide data in the future, they would have to establish new data collection systems.

This meant the ACCC was unable to examine trends in claims costs and premiums by ASCO as a part of its detailed analysis in chapters 6 and 7. However, three insurers have provided premium and claims data broken down by ASCO to the ACCC for the 2003 underwriting and settlement years.

While this data was not fed into the detailed analysis of costs and premiums, it provides information regarding claims costs and premiums by occupation.

---

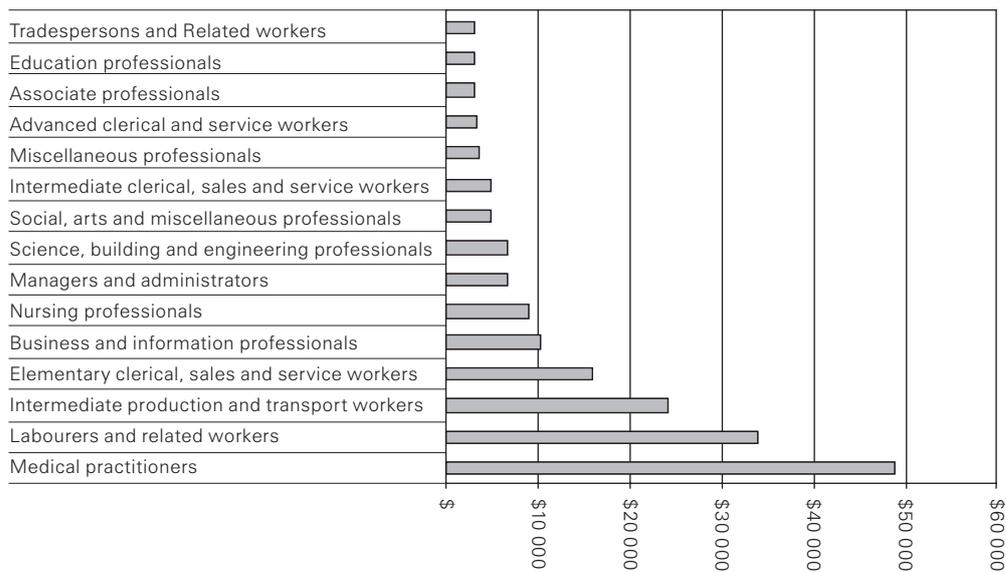
<sup>124</sup> The ACCC nominated the Australian Standard Classification of Occupations (ASCO) system for occupation classification as the ACCC understood at the time of establishing its monitoring framework that there was no uniform use of a particular occupation classification system. Two insurers were not able to provide information using the ASCO system while others who did provide data in this form suggested that they had needed to translate their internal classification system across to ASCO. This indicates that at this stage ASCO is not the preferred occupation classification system. Further to this, APRA has now nominated its own internal classification system for the professional indemnity occupation codes for its public liability and professional indemnity national claims and policies database.

## F.2 Average premium by ASCO

The ACCC examined trends in professional indemnity insurance premiums by ASCO by examining the average premium in real terms for 15 occupation classifications. The methodology adopted was the same as that used in chart 7.1 and outlined in appendix D.

Chart F.1 shows the average premium for professional indemnity insurance by ASCO for 2003.

**Chart F.1 Average premium by ASCO—real terms—professional indemnity—2003**



Source: Derived by ACCC from responses provided by three insurers.

Note: Data adjusted to 31 December 2003 values using the AWE index.

The majority of occupations had average premiums of around \$10 000 or less in 2003, ranging from \$2900 for tradespersons and related workers to \$10 315 for business and information professionals. The remaining four occupation classifications had premiums ranging from \$15 818 for elementary clerical, sales and service workers to \$48 877 for medical practitioners.

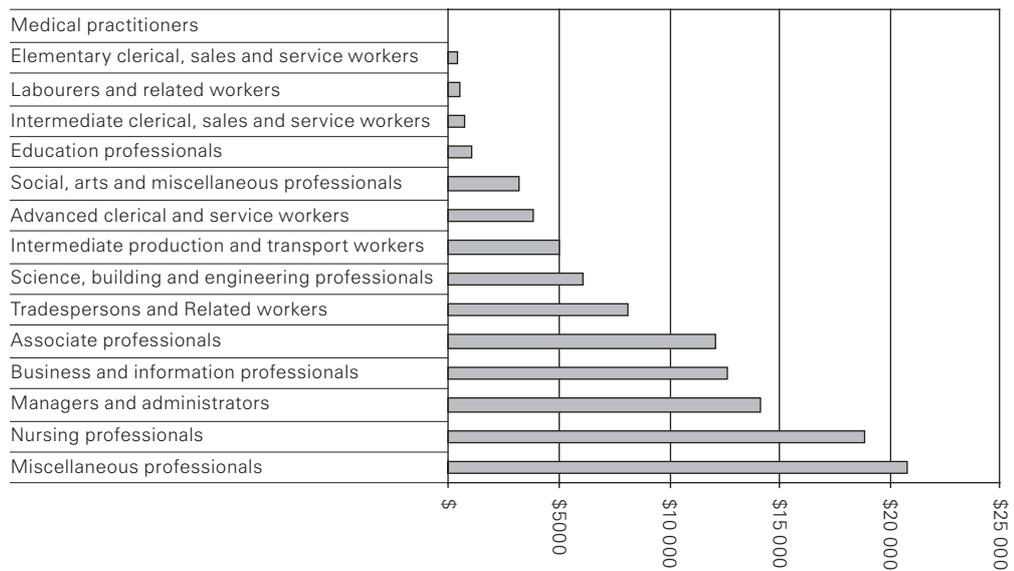
However, it should be noted that these average premiums may be representative of group policies where a number of individuals are jointly insured. Therefore, data in chart F.1 may not be representative of the amount that individuals in different occupations pay for professional indemnity insurance.

### F.3 Average size of claims settled by ASCO

The ACCC examined trends in claims costs by ASCO examining the average size of claims settled in real terms for the same 15 occupation classifications. The methodology adopted was the same for that used in chart 6.3 and was outlined in appendix D.<sup>125</sup>

Chart F.2 shows the average size of claims settled for professional indemnity insurance by ASCO for 2003.

**Chart F.2 Average size of claims settled by ASCO—real terms—public liability—2003**



Source: Derived by ACCC from responses provided by three insurers.

Note: Data adjusted to 31 December 2003 values using the AWE index.

The chart shows that the average size of claims settled across occupations ranged from zero for medical practitioners (as no claims were settled in this occupation classification) to \$20 782 for miscellaneous professionals.

<sup>125</sup> The average size of claims settled analysis may not be directly comparable to the premium analysis. This is because premium and policy data was collected on an underwriting year basis while claims data was collected on a settlement year basis. Therefore, information in section F.3 may not correspond directly with the information in section F.2.

## **G Public liability personal injury and death claims costs by heads of damage**

### **G.1 Introduction**

At the outset of the ACCC's monitoring role, the ACCC determined what information it would seek from insurers as part of its public liability monitoring framework. One set of information related to claims costs broken down by heads of damage for personal injury and death claims.

However, insurers indicated to the ACCC at that time that in many cases they had not previously collected claims data on this basis. This meant firstly that they were unable to provide this information historically and secondly, to enable future data provision, they would have to establish systems to collect the data.

As a result, the ACCC was unable to examine trends in personal injury and death claims costs broken down by heads of damage as a part of its detailed historical analysis in chapter 4. However, six insurers have provided the ACCC with this information for the 2003 settlement year.

Insurers also provided the ACCC with information on the breakdown of total claims settlements in 2003 by litigation stage, that is, claims settled with no litigation, partial litigation or full litigation. Information on the number of structured settlements was also collected.

While not feeding directly into the claims analysis of chapter 4, information about heads of damage and settlements by litigation stage provides an interesting snapshot of public liability claims in 2003.

### **G.2 Claims by heads of damage**

The ACCC collected information on claim settlement amounts broken down by the following nominated heads of damage:

- general damages payments (*non-economic loss*)—including compensation for pain and suffering, loss of amenities or enjoyment of life and loss of expectation of life
- special damages payment (*past economic loss*)—for loss of wages and expenditure incurred before the date of judgment but excluding payments for medical and other health care costs
- payments for lost earning capacity (*future economic loss*)—that amount awarded for lost earning capacity including the loss of employer superannuation contribution benefits
- payments for cost of gratuitous services (*gratuitous care*)—according to the principle in *Griffiths v Kerkemeyer (1977) 139 CLR 161*, if the plaintiff needs care and that care has been provided by a relative, friend or stranger (anyone except government) the plaintiff can claim the reasonable cost of the reasonable care actually provided (this also includes the plaintiff's loss of capacity to provide gratuitous services for others)
- payment of plaintiff's legal costs (*plaintiff legal*)—either by consent or as ordered by a court
- payments for medical and other health care costs (*medical costs*)—medical and other health care expenses, reasonably incurred in the past or the future

- other costs (*other costs*)—costs that cannot be attributed to any of the heads of damage listed above but which make up a part of the claim’s settlement costs.

The ACCC also collected information on the insurers’ own internal costs incurred in managing these claims. These included:

- legal and investigation costs (*internal legal costs*)—the total cost incurred by the insured or insurer in defending and investigating those claims
- other costs (*other internal costs*)—costs incurred by the insured or insurer in managing those claims.

The ACCC sought this information from insurers on two types of personal injury and death claims settlements:

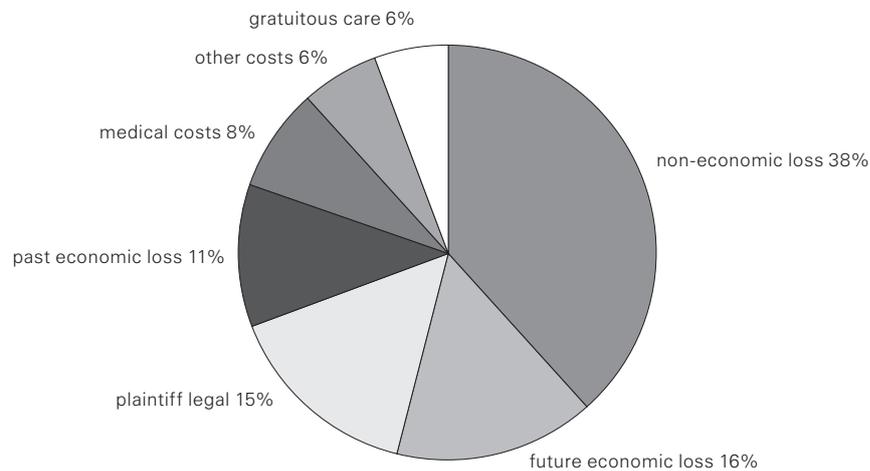
- all finalised claims where the final settlement had been determined by a court (*court awarded claim settlements*)
- all finalised claims settled before a final judgment was issued by the court, where the final settlement amount was greater than \$50 000 (*non-court award claim settlement*).<sup>126</sup>

## G.2.1 Court awarded claim settlements

### G.2.1.1 Heads of damage by proportion of total settlement amount for court-awarded claim settlements

Chart G.1 examines court-awarded claim settlements showing the breakdown of heads of damages by proportion of total settlement amount.

**Chart G.1 Heads of damage by proportion of total settlement amount—court-awarded claim settlements—2003**



Source: Derived by ACCC from responses provided by six insurers.

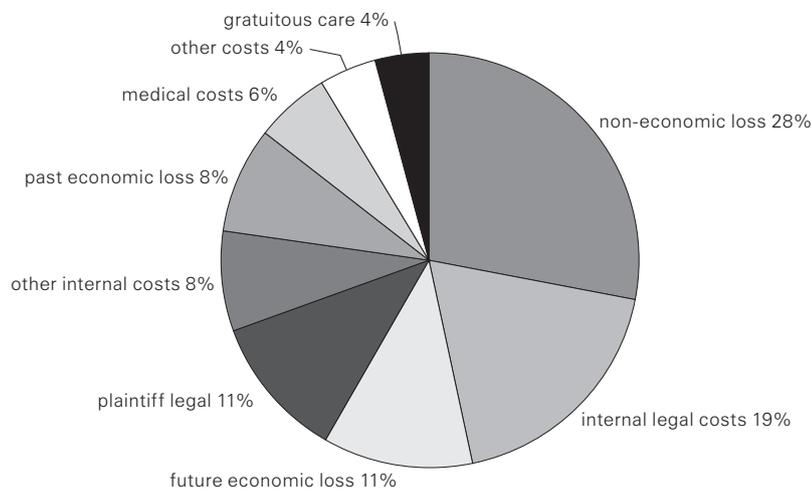
<sup>126</sup> When claims are settled out of court, the settlement amount awarded may not be specifically broken down into the heads of damage. Therefore insurers may have to make a judgment on how the claim settlement was divided among the various heads of damage. This is typically easier to do for claims settlements of a larger size as the plaintiff may have specifically been seeking certain heads of damage and the final settlement can be broken down using these original proportions. For this reason the ACCC chose to collect heads of damage information from insurers only for claims settled for amounts greater than \$50 000.

Non-economic loss makes up the largest proportion of the total settlement amount, representing 38 per cent. Future economic loss and plaintiff legal represent 16 and 15 per cent of the total settlement amount respectively. Gratuitous care and other costs represent only a small proportion of the total settlement amount for court-awarded claim settlements, at 6 per cent each.

### G.2.1.2 Heads of damage by proportion of total settlement cost for court-awarded claim settlements

The ACCC also examined the heads of damage breakdown of court-awarded claim settlements by proportion of the total settlement cost (i.e. the total settlement amount and also all associated internal costs). This is shown in chart G.2.

**Chart G.2 Heads of damage by proportion of total settlement cost—court-awarded claim settlements—2003**



Source: Derived by ACCC from responses provided by six insurers.

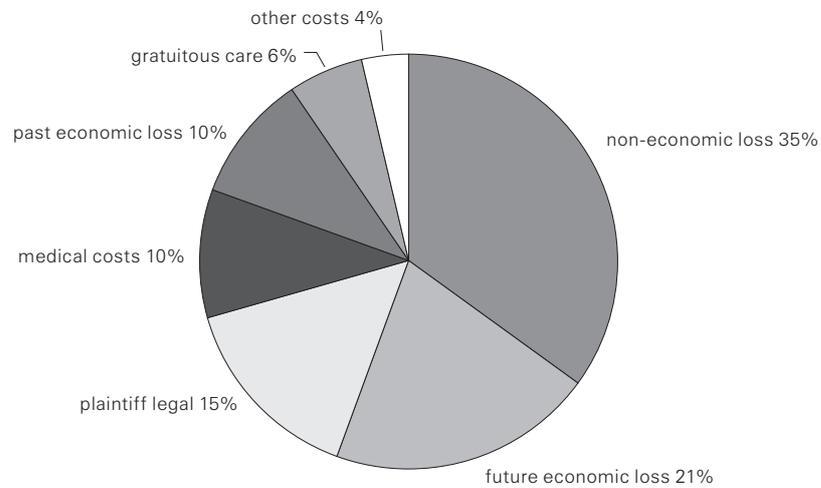
Chart G.2 shows that when internal costs are taken into consideration, non-economic loss falls to 28 per cent of total settlement costs, and internal legal costs are the second largest proportion at 19 per cent. Other internal costs represent 8 per cent of total settlement costs.

## G.2.2 Non-court award claim settlements

### G.2.2.1 Heads of damage by proportion of total settlement amount for non-court award claim settlements

The ACCC examined the breakdown of heads of damage for non-court award claim settlements (i.e. all finalised claims settled before a final judgment is issued when the final settlement amount is greater than \$50 000), by proportion of the total settlement amount (i.e. excluding internal costs). This is shown in chart G.3.

**Chart G.3 Heads of damage by proportion of total settlement amount—non-court award claim settlements—2003**



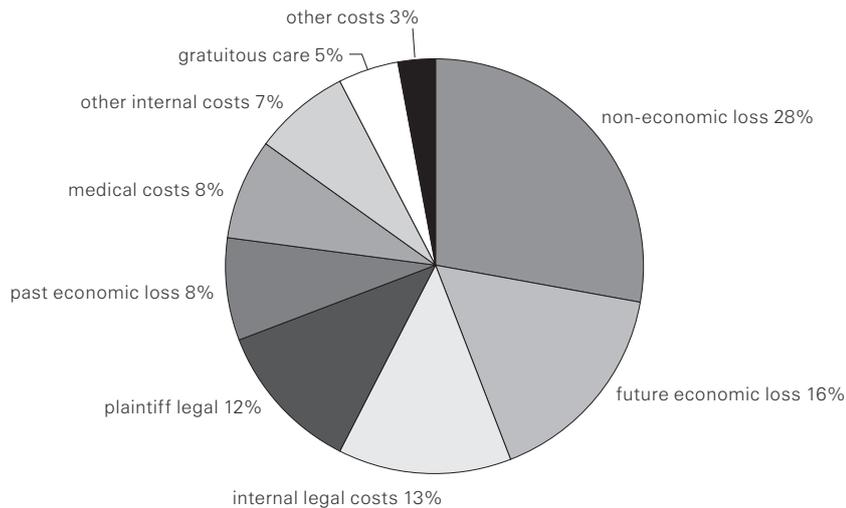
Source: Derived by ACCC from responses provided by six insurers.

Chart G.3 is generally consistent with chart G.1 and shows that for non-court award claim settlements, non-economic and future economic loss represent the largest proportions of the total settlement amount, at 35 and 21 per cent respectively. Gratuitous care and other costs are proportionately the smallest costs, being 6 and 4 per cent respectively.

### G.2.2.2 Heads of damage by proportion of total settlement cost for non-court award claim settlements

Chart G.4 examines heads of damages as proportions of total settlement cost (i.e. including internal costs) for non-court award claim settlements.

**Chart G.4 Heads of damage by proportion of total settlement cost—non-court award claim settlements—2003**



Source: Derived by ACCC from responses provided by six insurers.

Chart G.4 shows that when internal costs are taken into consideration, non-economic loss falls to 28 per cent and future economic loss to 16 per cent of the total settlement cost. Internal legal costs represent 13 per cent and other internal costs 7 per cent of the total settlement cost. This breakdown is generally consistent with that observed in chart G.2.

*In summary:*

*By proportion of the total settlement amount, non-economic loss represented the largest proportion of cost, followed by future economic loss and plaintiff legal costs.*

*When the insurers' internal claims costs were included as part of the total settlement cost, non-economic loss still represented the largest proportion. However, internal legal costs represented a significant proportion of total settlement costs, larger than that for plaintiff legal.*

*These results were observed for both finalised claims when there had been a court award, and for claims when a settlement was reached before a court award (and the settlement amount was greater than \$50 000).*

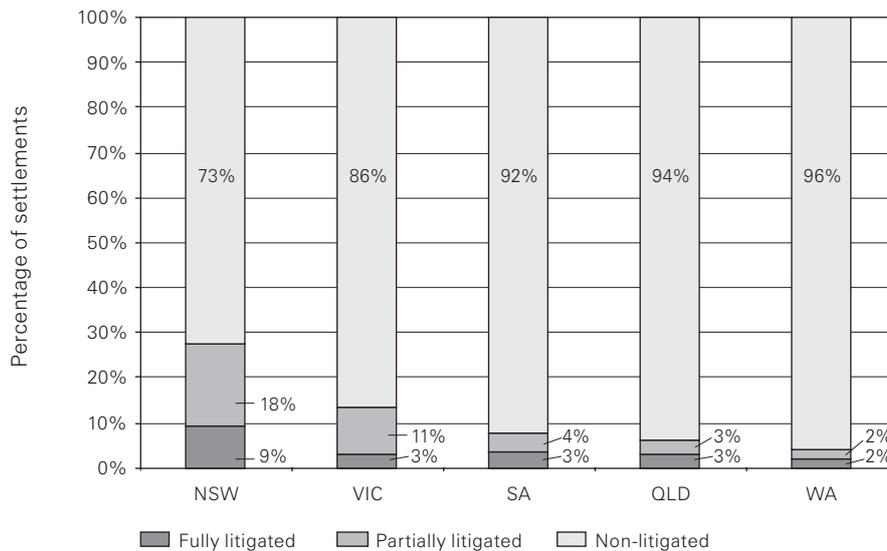
### G.3 Settlements by litigation stage

The ACCC also collected information on the number of finalised settlements in 2003 by litigation stage. The ACCC defined the litigation stages as:

- fully litigated settlements—the total number of claims finalised in the reporting period in which a final court judgment was issued
- partially litigated settlements—the total number of claims finalised in the reporting period that were partially heard by a court but where no final court judgment was issued
- non-litigated settlements—the total number of claims finalised in the reporting period that were not heard by a court. This may include settlements where mediation had taken place, provided the claim was never heard at any stage by a court.

This information was examined on a state-by-state basis and is shown in chart G.5. There were insufficient claims in the Australian Capital Territory, Tasmania or Northern Territory to draw any reliable conclusions on these jurisdictions and as such they have been excluded from the analysis.

**Chart G.5 Number of settlements by litigation stage—public liability—2003**



Source: Derived by ACCC from responses provided by five insurers.

Chart G.5 shows that New South Wales had a larger proportion of fully litigated and partially litigated claims than the other jurisdictions (9 and 18 per cent respectively). In Victoria, South Australia and Queensland, 3 per cent of claims were fully litigated. However, 11 per cent of claims in Victoria were partially litigated compared to 4 per cent and 3 per cent in South Australia and Queensland respectively.

Western Australia had the lowest proportion of fully litigated and partially litigated claims, at 2 per cent each.

## G.4 Structured settlements

The ACCC requested information on the number of settlements in 2003 when a structured settlement was used. A structured settlement is when there is an agreement under which damages are not paid as a lump sum, but progressively over a number of years.

Of the six insurers that provided this information to the ACCC, none indicated that they had settled any claims using a structured settlement.