

Chapter 5

Understanding the insurance market

Introduction

5.1 In the report, the Committee has considered a number of proposals aimed at containing the increasing cost of insurance cover for public liability and professional indemnity. This chapter continues this theme but turns its attention to the regulatory framework of the insurance market.

5.2 Mr Duncan West from Royal and SunAlliance Insurance told the Committee that hard and soft markets are not good for anybody. He stated:

They are not good for the consumer and they are not good for the industry—they ruin the industry's credibility. For business and the individual to have massive changes in their insurance costs, year on year, is just not good news. Consistency has got to be the way that things should happen.¹

5.3 While recognising that the insurance industry moves through phases of soft and hard periods in the market, the Committee looks at ways to temper or moderate severe shifts in the cycle.

5.4 In this chapter, the Committee considers the importance of having a comprehensive and reliable database readily accessible so that industry and governments can be better informed about the market and better able to respond to any shifts. Such a database would lay the foundations for a more stable and predictable market.

The quality of available data

5.5 The section of the report that looked at risk management underlined the role of sound data collection and analysis in identifying risk and suggesting remedies to help minimise loss or damage. This section looks at the importance of data management in the broader context of understanding the forces in the market place that influence the pricing of premiums.

5.6 Some attribute the current situation, in part, to the failure of the insurance industry to recognise the danger signs in the public liability and professional indemnity insurance market until the problem was full blown. As noted earlier in the report, insurance companies during the second half of the 1990s failed to take account of changing conditions in the market, such as increasing claims costs, and consequently underpriced premiums for certain classes of insurance. According to the

1 *Committee Hansard*, 9 August 2002, p. 360.

Treasury, it also appeared that in some cases insurance companies were more intent on increasing market share than on maintaining profitability.²

5.7 APRA, the industry's prudential regulator, was also slow to respond to the emerging problem. Indeed, the report of the Senate Select Committee on Superannuation inquiring into prudential supervision of superannuation and other financial institutions expressed concern at APRA's apparent laxity in its monitoring role. The Select Committee found that there was scope for APRA to improve its performance in detecting signs of trouble in the industry:

There may not be sufficient warning signals of institutional and fund failure and that those signals which do occur appear to be overlooked at times by the regulator...Although it was not one of the committee's case studies, the collapse of HIH Insurance is yet another example where early warning signals seem to have been ignored by the regulator.³

5.8 Clearly, the early identification of a problem allows a more orderly and coordinated approach to address the difficulty. At the moment, the insurance industry and the State and Commonwealth governments, confronted with escalating premiums, are looking to the available statistics to help them analyse the problem and understand the causes. The available statistics, however, are not providing the information needed to obtain a clear and sound appreciation of what is happening in the insurance market.

5.9 The Insurance Council of Australia informed the Committee that it does promote the collection of data from everyone in the industry through the work of Insurance Statistics Australia (ISA). This collection of information, however, is voluntary and represents around 22 per cent of the market. The Council admitted that it, on behalf of the insurance industry, had not collected enough data and that was one of the major problems. The Council told the Committee that it was developing arrangements for 'an improved official data set on insurance'.⁴

5.10 The Committee welcomes the steps being taken by the Insurance Council of Australia to improve its data collection processes. It recognises, however, the limitations placed on ISA to compel insurance companies to provide data and the reluctance of such companies to make available information, particularly commercially sensitive material.

5.11 Currently, people working in this field of insurance premiums and claim costs use data gathered and published by APRA to gain an understanding of how the market is performing. A number of recent studies, however, have questioned the quality of these statistics. For example in providing actuarial advice on public liability,

2 See for example evidence presented by Mr Nigel Ray, Acting Executive Director, Department of the Treasury, *Committee Hansard*, 8 August 2002, p. 319.

3 Senate Select Committee on Superannuation, *Prudential Supervision and Consumer Protection for Superannuation, Banking and Financial Services*, First Report, August 2001, p. 45.

4 Mr R. Jones, President, Insurance Council of Australia, *Committee Hansard*, 8 July 2002, p. 48.

Cumpston Sarjeant Pty Ltd maintained that APRA figures were unreliable. In his report, Mr Cumpston stated:

I asked (the CEO, APRA) for reasons for some extraordinary increases in claim numbers for four classes of insurance. These claim numbers are set out in the table below, together with revised figures advised to me by APRA.

| Class | 1998 original | 1999 original | 2000 original | 1998 revised | 1999 revised | 2000 revised |
|--------------------------|---------------|---------------|---------------|--------------|--------------|--------------|
| Professional indemnity | 14,000 | 19,000 | 166,000 | 12,000 | 17,000 | 30,000 |
| Public/product liability | 55,000 | 72,000 | 88,000 | 48,000 | 69,000 | 89,000 |
| Mortgage | 1,000 | 0 | 114,000 | 1,000 | 1,000 | 1,000 |
| Consumer credit | 37,000 | 85,000 | 284,000 | 77,000 | 90,000 | 142,000 |

5.12 Mr Cumpston stated further that ‘APRA revised its statistical system in December 1997, and it appears as if the subsequent claim number statistics are deeply flawed. Unfortunately, some of these claim numbers have been widely used to argue for sweeping changes’. In brief, he maintained:

I do not think that recent APRA figures on public liability claim numbers are reliable enough to allow any conclusions to be safely drawn.⁵

5.13 Mr Nigel Ray, Department of the Treasury, agreed that the available data, particularly on claims, is inadequate.⁶ APRA itself recognised the weaknesses in its statistics. It informed the Committee:

We would note that there are presently some serious data gaps in the publicly available information on premium trends, which we understand the Insurance Council of Australia is addressing. We would certainly caution against drawing conclusions from APRA’s own public liability and professional indemnity insurance data over the past year or so (or any other short-term period) because of the inevitable attendant statistical quirks.⁷

5.14 Consistent with these findings, a number of submissions suggested that there needs to be more information made available on the insurance industry in Australia to facilitate an informed debate on the issues now confronting the industry.

5.15 The Institute of Actuaries expressed the concerns of many witnesses that the public liability insurance system is hampered by a lack of good quality data and technical analysis. It argued that, because of insufficient data, it is difficult for insurers

5 Attachment to submission 132, Actuarial advice on public liability, Cumpston Sarjeant Pty Ltd, p. 4-5.

6 *Committee Hansard*, 8 August 2002, p. 329.

7 Submission 127, p. 3.

and their actuaries to set appropriate rates for individual risks and to set aside appropriate claim reserves.

5.16 It noted that there has been a long history of substantial losses by insurers writing various forms of liability insurance. In some cases, according to the Institute, 'this is an issue of incompetent (or even no) underwriting'. It goes on to state, however, that mostly the losses reflect the extreme difficulty of assessing the profitable cost of public liability risks. It explained further:

Given adequate data, the matching of price to insured benefits is a basic actuarial skill. Until adequate data is collected, it is difficult to quantify the problem...

As better data becomes available, actuaries will be better able to advise on appropriate premium levels at both an aggregate and individual policy level. However, because individual risks are highly diverse, underwriting judgement will remain a critical ingredient.⁸

5.17 Mr Michael Playford from the Institute of Actuaries explained to the Committee that one of the problems with insurance companies is that they can only look at the data for their own portfolio, which may be very small in some cases. They would certainly benefit from having access to a wider body of data to help them with their pricing.⁹ He maintained that collecting data on an industry level would help in identifying which practices produce claims and which practices have fewer claims.¹⁰

5.18 A number of other witnesses from the broader business community also commented on their inability to effectively analyse the underlying causes of increased premiums simply because of the lack of adequate data. Mr Michael Potter, Chief Executive Officer, Council of Small Business Organisations of Australia, told the Committee that more facts and figures are needed. He stated:

Getting the facts and figures out of the industry to actually relate them to what the real cause is would help small business to understand whether the increase in premiums is only due to reinsurance, or whether it is due to the bad management of local companies that have been basically underpricing themselves and not having enough reserves.¹¹

5.19 The Committee met the same difficulties during its inquiry. It could not obtain figures to ascertain, with any degree of accuracy or certainty, relatively straightforward information on the ratio of the number of annual claims made and

8 Submission 103, p. 12.

9 *Committee Hansard*, 8 August 2002, p. 282.

10 *Committee Hansard*, 8 August 2002, p. 285.

11 *Committee Hansard*, 9 July 2002, pp. 92, 93. The Victorian Employers' Chamber of Commerce and Industry suggested that the insurance industry maintain a detailed up-to-date incident database that provides business and the insurance industry with a better risk profile of industry segments. Victorian Employers' Chamber of Commerce and Industry, submission 98, p. 7.

settled to the number of premiums. So in determining whether the number of claims had risen, the Committee was presented with data not only incomplete but subject to a range of qualifications and interpretations. A similar problem emerged when the Committee sought information on the costs of claims. This lack of comprehensive and reliable data frustrates attempts to gain an understanding of the precise nature and extent of the root causes of the current problem.¹²

5.20 Clearly, this lack of adequate data has implications for insurance companies assessing costs and setting premiums, for consumers seeking to understand and manage the price rises, and for governments looking to address the problem of rising premiums.

Committee's view

5.21 The Committee accepts that not only insurance companies but the market place as well should have access to industry-wide data so they can better assess risk and premium pricing. The Committee believes that a well-informed market is far better equipped to anticipate shifts, to adjust to trends in the industry and to plan future strategies.

Central database

5.22 The Institute of Actuaries suggested that a detailed central database is required before any comprehensive analysis can be undertaken. It noted that because some claims are reported a long time after the incident and because some claims take time to settle, it would take considerable time to build up such a database. It stressed that it is 'essential for the database to include adequate exposure information and that, as far as possible, information from different sources be captured in consistent form'. The Institute noted that there is a similar need for good data for decision making in all forms of liability insurance.¹³ The Institute provided a list of the main items that it believed should be included in a database (see appendix 6).

5.23 The Insurance Australia Group Limited endorsed the proposal to establish a comprehensive national database for personal injury and possibly other types of liability claims. It concluded that this would provide, for the first time, a complete picture of the economic cost base for liability insurances and emerging trends in particular areas.¹⁴

5.24 Australian Business Ltd also argued for co-ordinated national action. It suggested that the Commonwealth seek to obtain the necessary information from

12 See the introductory sections of chapters 3 and 4.

13 Submission 103, pp. 21–22. In recommending that a national database of policy and claim information be established, the Institute of Actuaries proposed that a system similar to that of the US Insurance Services Office should be created; and that governments be involved jointly to commission an actuarial study of this data.

14 Submission 143, p. 4.

insurers that would enable further analysis of the reasons for the current increase. It stated that ‘the insurance community should redouble efforts to provide clear and candid information for the community’.¹⁵ Royal & SunAlliance maintained that it was time to make the collection of essential statistical information mandatory. Many witnesses supported this view.¹⁶

5.25 The Committee notes that the National Insurance Brokers Association (NIBA) in a submission to the Parliamentary Joint Committee on Corporations and Financial Services drew attention to a relaxation of reporting requirements on unauthorised foreign insurers. It stated:

At the present time insurance brokers and other intermediaries that place general insurance business with unauthorised foreign insurers are required, as part of their annual return to ASIC under the Insurance (Agents and Brokers) Act, to provide details of the amount and nature of such business. There is, however, no such requirement under the FSR arrangements, as a result the limited information that is currently available will be lost. NIBA considers that this information is vital for the effective monitoring of insurance in Australia and urges appropriate provision be made within FSR for the collection of information about insurance being placed with unauthorised foreign insurers.¹⁷

5.26 According to the Association this information is not available from any other source and is vital to an understanding of the insurance market in Australia.

Committee’s view

5.27 The Committee maintains that the present system for the collection of data is far from satisfactory and requires prompt attention. It fully endorses the establishment of a comprehensive central database and believes that statistical information about unauthorised foreign insurers should be a necessary component of this database. The Committee also believes that reporting obligations for insurance companies should be made mandatory.

15 Submission 115, para 3.2.

16 See for example Queensland Government, Report, *Liability Insurance Taskforce*, February 2002 in Queensland Government, submission 79, p, xi; Victorian Employers’ Chamber of Commerce and Industry, submission 98, covering letter and executive summary: ‘The ‘Commonwealth Government has a key role to play in ensuring that there is an appropriate level of data collection, competition and prudential regulation of the Australian insurance industry’.

17 National Insurance Brokers Association, submission 33 to the Inquiry into the regulations and ASIC Policy Statements made under the Financial Services Reform Act, Parliamentary Joint Committee on Corporations and Financial Services.

Responsibility for the database

5.28 This proposal to establish a comprehensive database then raises the question of who should have responsibility for it. As noted earlier, APRA already collects statistics from the insurance industry. APRA explained, however, that it:

...does not collect information on the individual components of claims expense, such as policy benefit amounts and details of direct and indirect claims settlement costs, as there is no prudential need for the imposition of the additional reporting burden. Also, the extent to which detailed components of claims expense are captured by insurers themselves is not uniform across the industry. For example, there are different approaches to recording the number and cost of claims that are litigated. In other words, the data needed to make a detailed assessment of product line cost drivers is not available and would not add value to the conduct of prudential supervision; nor would it be complete, as APRA does not collect data from unregulated state insurers, mutual insurers or unauthorised foreign insurers.

Finally, it is important to remember that much of this data is complex and difficult to collect, collate and verify. The collection of such data would place a heavy respondent burden on the insurers. Nonetheless, if the government were to ask us to collect more detailed data for this purpose, we would of course do so. This would, however, take time and resources to put in place and it would be years before reliable and useful trends became apparent.¹⁸

5.29 Ms Lorraine Allan, Acting Manager, Financial Systems Division, Department of the Treasury, reinforced this point about the focus of APRA's work. She explained that APRA's data collection is designed for prudential supervision, so its main concern is with the solvency and capital adequacy of companies. She told the Committee:

It does not drill down into claims, so it would be a change for them to collect claims data.¹⁹

Committee's view

5.30 The Committee notes the explanations for the approach taken by APRA to gathering information on the insurance industry. It appreciates APRA's view that data on detailed components of claims and costs is 'complex and difficult to collect, collate and verify'. But the Committee is also fully cognisant of the call from many quarters of the insurance industry for the collection of better quality statistics.

18 Dr Darryl Roberts, *Committee Hansard*, 9 July 2002, p. 133.

19 *Committee Hansard*, 8 August 2002, p. 329. Ms Lynne Curran, Acting Manager, Financial Systems Division, Department of the Treasury restated the point (p. 339): 'As Ms Allan said earlier, the focus of the APRA data is prudential concerns, so it is not looking at claims data at an individual or disaggregated level'. Section 38, *Insurance Act 1973*, sets down APRA's functions in monitoring prudential matters.

New data collection system

5.31 In the Joint Communique issued after the Ministerial Meeting on Public Liability, 30 May 2002, ministers agreed that the lack of comprehensive data on claims was a significant constraint in the appropriate pricing of premiums by the insurance industry for not-for-profit, adventure tourism and sporting groups. It stated further that the ‘paucity of data is also inhibiting the development of insurance products suitable for these sectors.’

5.32 Senator Coonan announced in the Communique that the Commonwealth had agreed to use the *Financial Sector (Collection of Data) Act 2001* to require all authorised insurers operating in Australia to submit claims data to APRA for analysis and publication.²⁰

5.33 Mr Duncan West from Royal and SunAlliance Insurance would like to see a ‘more robust proposal’. He told the Committee:

Unless you start getting down to a much more micro level of data and you force insurers to collect data at that micro level—as would be the case in workers compensation, where most workers authorities force you to collect and submit data at a much more detailed level—unless you get right down to minute trade specifications and you have consistent trade specifications and consistent accident types, so that you can start measuring the accident type and the cause of that accident type, and unless you mandate those at a much more detailed level than currently APRA, ISA or anybody else is proposing, the data will stay at a macro level.²¹

5.34 The Committee notes APRA’s advice that it has been undertaking a major project to modernise its data collection technology and forms. According to APRA, the new system will apply to the general insurance industry from the September quarter 2002 onwards. General insurance covers property, liability and personal injury.²² APRA told the Committee:

The primary focus of our data collection is to monitor the overall prudential soundness of regulated insurers. This does not automatically encompass pricing considerations for individual product lines. Product pricing is a commercial decision for each insurer and may reflect a variety of considerations that go beyond, for example, claims history and administration expense.²³

20 Joint Communique, Ministerial Meeting on Public Liability, Melbourne, 30 May 2002, p. 6 of 12, <http://assistant.treasurer.gov.au/atr/content/pressrelease/2002/900.asp> (13 August 2002).

21 *Committee Hansard*, 9 August 2002, p. 352.

22 Background Paper No. 1, *A profile of the General Insurance Industry*, Prepared by the Insurance Council of Australia for the HIH Royal Commission, November 2001, p. 4. The *Insurance Contracts Act 1984* defines ‘general insurance’ as insurance that is not life insurance: section 11.

23 Dr Darryl Roberts, *Committee Hansard*, 9 July 2002, p. 133.

5.35 Dr Roberts stated ‘I think that the new regime will do a lot to make the reporting and the accounts of the industry more transparent’.²⁴

Committee’s view

5.36 The Committee agrees with the view that a comprehensive central database is needed. It believes that such a resource is essential to bring stability and some predicability to an industry subject to cyclical movements and a degree of uncertainty because of long term claims. It is also of the opinion that APRA is best placed to collect and analyse information on the insurance industry and to assume responsibility for establishing and maintaining that database.

5.37 The Committee understands that APRA’s primary responsibility is with ensuring the prudential soundness of insurance companies. It notes, however, the advice from the Institute of Actuaries and other witnesses that underlines the need for a comprehensive database that extends well beyond the narrow range of data collection and analysis currently undertaken by APRA. Although APRA is introducing a new regime, the Committee is unsure whether it intends to collect the range of data that some hope is to be collected. Further, the Committee is not convinced that APRA has the resources to meet such expectations.

5.38 In light of these findings, the Committee makes the following recommendations.

Recommendation 7

The Committee recommends that the Government:

- **make a commitment to the development of a comprehensive national database on the insurance industry in Australia;**
- **put beyond doubt that APRA is to be given the responsibility for developing and maintaining this database;**
- **ensure that APRA has the statutory authority to require insurance companies and other relevant bodies to provide information; and**
- **ensure that it is adequately funded so that it has the resources and level of expertise to effectively collect, collate and analyse data on the insurance industry.**

Further, the Committee recommends that APRA:

- **look carefully at the evidence presented to the Committee on the nature and extent of information that is required to fully understand the insurance industry especially the pricing of premiums;**

24 Dr Darryl Roberts, *Committee Hansard*, 9 July 2002, p. 146.

- **make available a draft discussion paper that provides details of the data that it intends to collect and the procedures to be adopted in collecting this material;**
- **follow-up the publication of this paper with industry-wide consultation with a view to determining whether the new regime is going to meet the expectations of the insurance industry; and**
- **report to Parliament on its findings.**

Court data

5.39 In 1997, the Australian Law Reform Commission, prompted by concerns about the lack of data about the operation of the civil litigation system in Australia, produced an issue paper entitled *Review of the adversarial system of litigation*. In outlining its view on court statistics, it stated:

The lack of relevant qualitative and quantitative data about the operation of the civil justice system is a significant barrier to reform. Debate about reform options needs to be informed appropriately by an empirical understanding of key justice system performance indicators including cost and delay, satisfaction, compliance with outcomes and the nature of disputes (who is litigating, and in what types of proceedings). This information is important in assisting to evaluate reforms and enable informed decisions to be made about the allocation of resources to different dispute resolution processes. It also enables reform processes to build upon existing strengths where possible.

5.40 In summary, the Commission found that ‘while almost all Australian courts and tribunals now have some form of data collection and analysis of matters commenced in their jurisdiction the data lacks comparability because of the lack of uniform information standards’.²⁵

5.41 The most recent report by the Productivity Commission on Government Services highlighted this apparent ongoing difficulty in obtaining data of high quality. It stated:

Differences in court jurisdictions and the allocation of cases between courts across States and Territories affect the comparability of efficiency and effectiveness data. The different methods undertaken to collect the data can also have an impact on the data consistency and quality.

5.42 The Report noted that the Commonwealth, States and Territories had recently signed a Memorandum of Understanding with the Australian Bureau of Statistics (ABS) to improve the quality of statistical data within the court administration data collection, and to improve the standard of statistical comparability across jurisdictions.

25 Australian Law Reform Commission, *Review of the adversarial system of litigation*, Issues Paper 20, 1997, <http://www.austlii.edu.au/au/other/alrc/publications/issues/20/04nature.html> (27 August 2002).

The ABS is providing advice and contributing to the development and refinement of the *Court Administration Data Manual* which includes the development of civil data standards dealing with matters such as definitions, classifications, coding and recording and reporting procedures.²⁶

5.43 The ABS and the Court Administration Working Group are developing a new performance indicator framework which, however, is still in an initial stage.

5.44 The Committee in chapters 3 and 4 noted that the problems created by the lack of good data management of court records throughout Australia frustrates any detailed analysis of the underlying causes for premium increase. The data was merely indicative of trends such as the number of claims lodged and the types of settlement as well as the costs associated with processing a claim through the courts. Clearly, there is much scope for improvement.

Committee's view

5.45 The Committee notes that the Commonwealth, the states and territories with the ABS have signed a memorandum of understanding that should lead to improving the standard of reporting and data collection of court proceedings. The Committee notes, however, that this problem of poor quality data is long standing.

5.46 The Committee also acknowledges the work being done by the ABS and the Administration Working Group in developing performance indicators but again understands that this project is in its infancy.

5.47 Although the Committee's concern in this report is with obtaining data on litigation, it appreciates that for the sake of uniformity and efficiency any data gathering system should take account of both civil and criminal proceedings.

Recommendation 8

- **In light of this ongoing problem of the lack of good quality, nationally comparable court data, the Committee recommends that the Commonwealth give high priority to the work being done by the Australian Bureau of Statistics in developing performance frameworks.**
- **It also recommends that the Attorneys-General treat this matter with urgency and, under the leadership of the Commonwealth Government, work together to ensure that good court data management systems are put in place throughout the country. The main objective is to have national standards apply so that the data across all jurisdictions is compatible, comprehensive and allows for consistency in interpretation.**

26 Productivity Commission, *Report on Government services 2002*, chapter 9 'Court administration, section 9.5 'Future directions in performance reporting', p. 500.

