> not satisfied that the trade practices compliance program was being properly implemented, the Commission would then move the Court for an order that the non-complying party would be dealt with for contempt of Court. It should not be a means of empowering the Commission to negotiate privately about the proper means of implementing the order of the Court.

The cases discussed indicate significant uncertainty about the ability of courts to order comprehensive compliance programs, the appropriate standard for such programs, and the Commission's role in the development and auditing of programs.

However, the Commission does not see that it is in conflict with the courts on the orders that it has sought regarding compliance programs. As you know, we are always trying to get clarification of the law and to improve overall compliance of the Trade Practices Act. One should ask: would there be such a big, and growing, compliance industry if not for the actions of the Commission and previously the Trade Practices Commission in pushing compliance issues to the forefront of the courts and boardrooms around the country?

The recent matter of *ACCC v Wizard*[26] concerned some advertising of a particular loan product which the Commission alleged (and the court found) was misleading. Between the time of the advertising and the time of the hearing, Wizard had taken some steps to improve its compliance program.

However, Justice Wizard did not produce any documents backing up its claims and Justice Merkel stated that:

> I regard Wizard's reliance on generalities, rather than specifics, and its failure to provide any internal documentation concerning its 'trade practices compliance' program as evidence of an unsatisfactory and inadequate response to the Commission's legitimate concern to prevent a repetition of the contravening conduct.[27]

However, Justice Merkel did not order a compliance program or program audit. Instead, he determined that an 18-month injunction was an appropriate remedy.

Justice Merkel observed that he may well not have granted an injunction, had he been satisfied about the adequacy of Wizard's compliance program.

On one level the Commission was disappointed not to get an order for a compliance program. However, on another, it is pleased. The judgment still serves to demonstrate the importance courts can attach to effective compliance programs.

Conclusion

The Commission is committed to working with the compliance industry to secure improvements to the way compliance programs are implemented, audited and measured.

In the Commission's submission to the ALRC on its Discussion Paper 65, *Securing compliance: civil and administrative penalties in Australian federal regulation* we stated that we would support proposals that would enhance the profile of compliance programs as part of any codification of the French factors.[28]

The Commission believes that there is a case for amending the Trade Practices Act to further recognise the importance of compliance programs and to clarify that they are empowered to order firms to undertake them.[29] This would heighten awareness of the importance of trade practices compliance programs, and therefore increase the general level of compliance within the community.

Looking forward, I must say that it is difficult to see that the importance of compliance will diminish over time. Just as environmental compliance has become an issue for shareholders, I foresee that trade practices compliance issues will make their way onto a broader stage. I am reminded of the Biblical proverb—faithful in little, faithful in much. If you can't get your processes right—your advertising, your sales pitches, your dealings with competitors—how can you get the big things right and be trusted with shareholder funds.

Insurance in Australia: the role of the ACCC

*The following is a summary of a presentation by Commissioner Jennifer McNeill to the Australian Competition and Consumer Commission to the AFR (*Australian Financial Review*) Insurance Summit on 28 November 2002.*

Public dissatisfaction over what some see as excessive increases in premiums, and limited

[26] *ACCC v Wizard Mortgage Corporation Limited* (2002) FCA.

[27] At paras 21 and 22.

[28] See the judgment of Justice French in *TPC v CSR Limited* (1991) ATPR 41-076.

[29] ACCC submission to ALRC report 65, 14 October 2002 (unpublished).

availability of cover for public liability and professional indemnity insurance has been widely reported. Also the Commission has received numerous complaints from the community about the size of premium increases. For example, two Victorian tourism operators indicated that they faced premiums rises in the order of 980 per cent for 2002. Yet perspectives on the causes of, and extent of, the perceived crisis vary dramatically.

The Commission's role

Under the Trade Practices Act, two areas of Commission activity that are particularly relevant to recent developments in the insurance industry are:

- mergers and acquisitions
- authorisations (adjudications).

Under s. 50 of the Act the Commission can take court action to prevent mergers and acquisitions that may result in a substantial lessening of competition in an industry. For example, the Commission recently considered IAG's acquisition of Aviva's Australian insurance assets, CGU. It decided not to oppose the acquisition because IAG will continue to face vigorous competition from other significant players including Suncorp, Royal & Sun Alliance, QBE and Allianz.

The Commission is currently considering an application lodged by Allianz Australia Insurance Limited, QBE Insurance and NRMA Insurance seeking authorisation of a co-insurance (or pooled selling) arrangement. The applicants have submitted that the co-insurance arrangement will provide non-profit organisations with improved access to public liability insurance. In November 2002 the Commission granted an interim authorisation with conditions.

There has been no declaration of insurance pricing under the Prices Surveillance Act. Instead, the federal government has asked the Commission to examine the impact of various law reforms on public liability and professional indemnity insurance premiums over the course of the next two years. This is a new and challenging task for the Commission, which I will discuss in more detail later.

The Commission has also been asked by the federal government to monitor medical indemnity insurance to assess whether they are 'actuarially and commercially justified'.

The Commission previously reported to the government on the general insurance industry. It released the Insurance Industry Market pricing review in March 2002 and, at the government's request, updated this in September 2002.

In these assessments of the general insurance industry by class of insurance the Commission noted some of the key drivers behind the current perceived crisis. The September 2002 review also provided some preliminary views on some aspects of reforms currently being undertaken around Australia. This work is quite separate from our monitoring role. I will cover these pricing reviews in more detail later.

The Australian insurance crisis

It has often been said recently that liability insurance in Australia is in crisis. The insurance crisis is blamed for everything from the death of fun—to the death of Santa.

However, the extent of the crisis is unclear. Liability losses are said to have soared to a disastrous $500 million. Yet:

- the Commission's pricing review reports a positive outlook for the industry—with only professional indemnity, product and public liability and travel insurance regarded as having a low profit outlook (where low is –5 to 10 per cent)
- insurers themselves point to outstanding results. For example, in the half year to 30 June 2002, QBE reported record cash-flow and 'a record insurance profit (before tax) up 27 per cent to $160 000 000'.[30]

Whatever is happening, governments at both the state and federal levels propose to respond with a series of far-reaching law reforms. What is the nature of this crisis? What are its causes? What response is appropriate?

Historical changes in premiums and costs

[Commissioner McNeill then presented data derived from the Trowbridge Report which was commissioned by Federal Treasury to brief ministers before a summit on public liability insurance in Canberra in May 2002.[31]]

Classifying personal injury claims into various types (i.e. heads) of damage shows that the proportions

[30] QBE Insurance Group Limited results and outlook for the half year ended 30 June 2002 28 August 2002.

[31] Estelle Pearson and Geoff Atkins, Trowbridge Report 2002.

of each head of damage have remained roughly the same, with two exceptions. The costs of 'future economic loss' and 'future needs' appear to be increasing.

This observation raises some initial doubts about the view that 'court generosity' is a key driver in the increase in claims. It is arguable that future economic loss payments are less discretionary than other damages components, such as non-economic loss payments (i.e. pain and suffering) and less closely linked to generosity.

Views vary considerably when it comes to naming the alleged drivers behind the current insurance crisis in Australia. The insurance industry tends to focus on external factors such as the litigiousness of society, legal practices and global events. Lawyers, perhaps not surprisingly, disagree and focus more attention on the insurance industry's own conduct.

Other countries have experienced, or are currently experiencing, similar insurance industry problems.

USA

In the USA, there has been no federal tort reform response to the liability insurance crisis of the 1980s. There was some state law reform but it was by no means uniform in approach or extent. The single most important state reform has been abolishing punitive damages in some jurisdictions. But some other measures, similar to those now proposed in Australia, such as below, were also taken:

- capping of awards for non-economic damages
- abolishing or limiting joint and several liability
- waiving for inherent risk.

Despite these reforms, premium levels, especially from medical malpractice, are currently at a perceived crisis point in the US. *The Florida Times-Union* on 18 March 2001 reported that the average premium for nursing homes rose by 109 per cent from 1999 to 2000, and for one home, had risen from $37 000 to $1.5 million from 1993 to 2001.

Premiums for liability insurance for medical malpractice have increased markedly in the past few years, especially for specialists. *American Medical News* reported on 3 December 2001 that the average premium paid by Philadelphian orthopaedic surgeons for the two previous years was US$65 000—by 2001, it had doubled to an average of $130 000.

As in Australia, there is disagreement about the cause of increasing premiums. Some of the identified factors, such as low investment returns and underpricing, have also been suggested as causes of the Australian rises.

Canada

Canada experienced a public liability insurance crisis during the 1980s. Canadian jurisdictions did not pursue comprehensive tort law reform in response. The only major change appears to have been the introduction of contractual waivers.

The Supreme Court of Canada had already capped damages awards for non-economic loss. This cap, adjusted for inflation, now equates to about Can$270 000 (A$315 000) for non-economic loss.

One Canadian response was to move towards pooled buying arrangements—especially for municipal authorities. This has also been suggested for Australian organisations.

Otherwise, the crisis appears to have passed.

UK

The UK is currently experiencing a crisis similar to Australia's.

A study published by the International Underwriters Association in 1999, the *Second Bodily Injury Study*, shows that claims have been steadily increasing over the past 15 years.

Notable changes to the law in recent years include the Woolf Reforms introduced in April 1999. These were designed to improve the handling of cases and stem what was seen to be a rising culture of litigation.

Notwithstanding these procedural reforms, however, the *Daily Telegraph* reports that public liability premiums for some organisations have been rising by up to 600 per cent, and on average have risen by 300–450 per cent. Rates for professional indemnity had also risen by around 50 per cent on average.

The Association of British Insurers has said that rates have risen for all liability products because of underpricing in recent years.

It is unclear whether the British Government will respond to the UK crisis with comprehensive tort law reform. My own dealings with the Office of Fair Trading lead me to think that such law reform is unlikely. Moreover, the treasury has said that there should be clear evidence of market failure before the government will intervene.

Australian governmental responses

Given the nature of the Australian crisis, governments have been under enormous pressure to find a fix. Two key problems needing to be attended to urgently are the price and availability of cover—for both public liability and professional indemnity insurance.

Organisations most vulnerable appear to be not-for-profit groups, community groups, adventure tourism operators and other special interest or high risk categories. However, many professional groups also say they are suffering and that the services they provide are in jeopardy as a result. If these groups perform vital services to the community and need insurance to provide them, they may have to be helped.

There have been four ministerial meetings on a nationally consistent approach to reform to address the perceived crisis. These have called for and considered several reports on the current insurance situation.

In the lead up to the first two ministerial meetings, Trowbridge Consulting was engaged to prepare two major reports. The first analysed the depth and extent of the current crisis, its drivers and general market performance and the second canvassed several proposals for reform.

Reviews

As a result of continued concern at all levels of government, several reviews have been commissioned by the government to help policy-makers with reform. Notable examples include the Review of the Law of Negligence chaired by Justice Ipp and the Commission's pricing reviews.

Underpinning the negligence review was an assumption that awards of damages for personal injury had become unsustainable and unaffordable. The review appeared to concentrate on ways in which such damages awards could be reduced.

Awards of damages for personal injury are currently available under or by reason of the Trade Practices Act, for example:

- the Act implies a statutory warranty into service contracts that the service will be provided with due skill and care. If the services are not provided with due skill and care, and you are injured as a result, you are entitled to sue for damages. The Act also provides that this warranty cannot be excluded.
- the Act also prohibits misleading or deceptive conduct. If, as a result of misleading or deceptive conduct, you are injured, you are entitled to sue for damages.

One issue the negligence review considered was whether the Act should be amended to reduce or eliminate such rights, either:

- by allowing people to waive the implied warranty of due care and skill
- by reducing the damages that people could claim for personal injury
- by abolishing the right to sue for personal injury damages resulting from a breach of the Act.

The Commission is concerned about reforms that water down consumer rights and shift the risk of activities from the person best placed to judge and control those risks to the person most poorly placed to judge and control them.

The Commission made two submissions to the negligence review. The first was provided in August 2002, the second in September. The first dealt predominantly with the proposal to allow consumers to waive their right to 'due care and skill' for risky recreational services. The second was far more broad-ranging, and recorded the Commission's view on the 'least harmful' of the reform options being considered. The Commission also noted there was no evidence that awards of personal injury damages under the Trade Practices Act have caused or contributed to the current insurance problems. The fact that the Act itself is not the cause of the current crisis is one reason for exercising caution about reforming it.

The Commission's insurance industry market pricing reviews

In its March 2002 Insurance Industry Market Pricing Review, the Commission examined a range of data provided by Australia Prudential Regulation Authority (APRA) and sought information directly from several larger general insurers. The findings of the March review were updated in the September one.

Broadly, these reviews assessed:

- profitability—industry profitability was assessed by class of insurance
- class performance—the reviews covered the financial performance of all classes, and the September report examined the crisis areas of public liability and professional indemnity in greater detail

- cost drivers—the Commission outlined key cost drivers behind the current premium increases
- options for reform—the September review outlined some of the options for addressing the problems, including some considered views on reform proposals.

The March and September reviews used the same method to measure profitability. Taylor Fry Consulting Actuaries help construct the reviews.

The September 2002 review found that while the insurance industry performed poorly for the 2001–02 financial year, its outlook is generally more positive than at the time of the March review. Large and sustained increases in premiums over the past three years had returned most classes to profitability.

However, the September review found that three sectors were still experiencing very low returns, namely travel, professional indemnity, and public and product liability insurance. These latter two classes are those most widely perceived to be in crisis, and therefore it is appropriate to examine the findings of the Commission's reviews in relation to these two areas in more detail.

Professional indemnity

The professional indemnity class of insurance is one of the smaller classes. It represents 3 per cent of gross written premium, less than 1 per cent of policies written, yet accounts for 7 per cent of the total general insurance industry's outstanding claims provision. The disproportionately large provision for professional indemnity reflects the high uncertainty of loss in this class, which is characterised by infrequent but potentially extremely large losses.

There are three aspects of the findings of the Commission's reviews in relation to this class that I will now cover in greater detail: profitability, policies and settlements, and competition.

Profitability

Loss ratios have generally been increasing with spikes caused by infrequent, but substantial losses on individual claims. But the increase appears to have been caused mainly by provisions for outstanding claims. The return on capital in this class has correspondingly been erratic, ranging from over 20 per cent in 1997, to about –40 per cent in 1999.

The Commission's March 2002 review estimated that premiums may have to increase by around 20 per cent to restore this class to 'low' profitability (–5 to 10 per cent)—and given the average increase over 2001–02 was 24 per cent, this class of insurance was expected to have returned to profit in 2002.

The potential for unprofitable years to occur as a result of the nature of claims in this class will not be diminished by a return to general profitability. The recent Senate Economics References Committee report reviewing public liability and professional indemnity, contained recommendations on the capping of liability of some professionals. These reforms would limit the ability of plaintiffs to recover economic damages caused to them by the professions, and mirror existing legislation in NSW and WA.

While this would return some measure of predictability to claim payouts, and therefore loss ratios in this class, it is not clear why other measures—such as improved data collection and risk management—are not better ways to address the problems.

Policies and settlements

Ten of the insurers sampled by the Commission wrote in this class, representing 54 per cent of the total written premium for 2001 as measured by APRA.

The number of policies written for the years 1996–2001 has grown steadily. A key driver of this has been the requirement by the public sector for consultancies to have adequate cover.

Premium increases have not increased significantly in the past two years, and this trend is set to continue. The lack of premium increases through 1996 to 1999 contributed to the deterioration in the return on capital for this class during this period.

The number of settlements has steadily increased through this period but this increase can largely be attributed to more policies being written in this class. With the notable exception of 1997, the average settlement size has remained reasonably constant.

Insurers have indicated a major driver for increasing premiums has been the substantial increases in outstanding claims provisions. This has been attributed to the uncertainty surrounding claim frequency and size, as well as an allowance for poor corporate performance in recent years.

Outstanding claims provisions rose nearly 30 per cent in 2001 to $1 billion, which drove the poor return on capital result shown earlier despite a return to reasonable profitability for 2001.

Competition

The Herfindahl-Hirschman index, or HHI, is a measure of industry concentration which economists use to assess market structure. The more concentrated a market is, the less likely it generally is for participants in the market to compete vigorously.

The HHI has been reasonably high in the past, although not high enough to cross the 'concentrated' threshold of 1800. It is currently increasing, even without the recent push for consolidation through mergers and acquisitions in the industry being reflected.

Public and product liability

Public liability and product liability insurance are generally bundled together by insurers, hence the referral to both in this class of business.

Public and product liability premiums represent 5 per cent of total gross written premium, and 6 per cent of policies written. One of the most notable aspects of it was that the number of policies written in this class more than doubled from 1.1 million in 1999–2000 to 2.59 million in 2000–01. The September review noted that this number had subsequently declined to around 2.44 million during 2001.

Profitability

The loss ratios in the public and product liability class for the years 1997–2001 have been extremely high peaking at around 135 per cent in 1999. These extremely high loss ratios throughout this period were contributed to by the behaviour of the industry itself, not solely or predominantly by an increasingly adverse litigious environment.

Competition in this class was fierce from 1993. Emphasis was placed on obtaining market share in this class, rather than pricing premiums on a cost-based methodology

More recently, the industry has begun to return to cost-based pricing, and loss ratios have subsequently begun to decline, down to 113 per cent in 2001. Profitability, while beginning to show signs of recovery in this class, is still considered by the Commission to be very low (<–5 per cent), however it is expected to recover to low profitability in the future.

Policies and settlements

The insurers surveyed by the Commission wrote 63 per cent of the total premium for public and product liability in 2001.

From 1996 to 2001 the number of policies being written steadily increased, but total premium did not increase until 1999. This supports the contention that strong competition in the industry was keeping premiums low through this period.

Data tend to refute current views that an explosion in claims is driving the current crisis. The rate of increase in claims is lower than that of policies, therefore the number of claims per policy is currently decreasing.

The average size of claims has also been increasing. With no corresponding increase in premium revenue, substantial pressure is now being placed on premiums to rise to compensate insurers for their past underwriting losses.

If the industry's pricing behaviour is a key driver of the current crisis, it suggests that the crisis is simply an upswing in the cyclical behaviour of the insurance market. This raises doubts about the need for reforms that restrict consumers' access to appropriate compensation. Reforms aimed at improving the risk management and prudential behaviour of insurers may be more appropriate.

Competition

The strong competitive push for market share through the late 1990s helped contribute to the higher HHI in 1998. With the return to cost-based pricing, the HHI has steadily declined, presumably as smaller players with lower reserves are being attracted back into the market by the return to profitability.

These increasing competitive pressures should constrain the ability of the market to recoup past losses, however the current cyclical upswing indicates that the market is focusing on restoring profitability to this class. Signals currently being sent by the market to insurers support continued premium rises, and it may not be until profitability is fully restored that competitive constraints will again act to rein in premiums.

Responses to the Commission's pricing reviews

The Commission has received feedback on its reviews from a variety of sources. Governments, both federal and state, have welcomed both reviews.

The Insurance Council of Australia (ICA) also strongly welcomed the findings of the March 2002 review. However, on the release of the September review, the ICA criticised some aspects of the

review methods and findings, despite the fact that the methods were the same as those previously approved by the ICA.

The Commission has considered the concerns raised by the ICA. The issues raised do not appear to alter the general findings of the September one. In particular, we stand by our conclusion that the insurance industry is returning to profitability.

Do the pricing reviews support reform?

Public liability and professional indemnity insurance have been characterised in the past by poor data collection, which is compounding the current problem. Insurers and governments have recognised this issue, and reforms aimed at correcting this are vital. Many of the issues relating to unavailability of cover could be resolved by the insurers improving data collection to enable them to more appropriately assess and price the risk.

If rising premiums result in rapid increases in profits and an inflow of new capital, this would tend to suggest the crisis has arisen because of the substantial deterioration in capital caused by the sustained under-pricing of the late 1990s.

A return to profitability will attract new capital into the market, which should alleviate the availability issues currently facing many businesses as capacity will be increasing. In other words, the market will correct itself and there is little justification for long term government intervention.

If so, the current reform process should be undertaken cautiously, as the crisis may merely be a short-run phenomenon. The Commission formed the view that competitive forces are reasonably strong in both classes of concern. Once the market has adjusted, premiums and availability may well return to competitive levels.

If, however, rising premiums do not increase profits and capital inflow, this would indicate the factors driving the crisis are more long-term and pervasive. If the risks associated with these classes have indeed increased substantially in recent years, there may well be a case for limiting liability, or creating special arrangements protecting the more vulnerable and valuable community groups and professions.

So far, little concrete evidence has been advanced to indicate this.

The Commission's September review also acknowledged the difficulties faced by insurers in these two classes, especially the problems of moral hazard, adverse selection, and the fat and long tails associated with these classes.

Capital market imperfections have compounded the problems faced by insurers in the aftermath of the HIH collapse and September 11. These events resulted in a substantial and instantaneous decrease in capital.

Resupplying capital from the external capital market can be expensive and problematic. Insurers, faced with constrained capacity, have restricted supply and raised prices to rebuild financial capital.

This adjustment process may take time. The Commission considers that recent premium rises have been necessary for both the public liability and professional indemnity, and future rises may be needed to return profitability to sustainable levels. Just as the problems the insurance industry now finds itself in have developed over an extended period, the problems may not be resolved quickly.

The proposals for reform

The Commission acknowledges that there are various proposals for reforms that are currently being considered by governments around Australia.

Tort law reform proposals have been placed high on the reform agenda. In-principle agreements on reform have arisen from a series of ministerial meetings held between state and federal ministers throughout this year. Several jurisdictions have already enacted reforms.

They generally include one or more of the following elements:

- capping of compensation pay-outs
- self-assumption of risk
- structured settlements
- restrictions on legal costs
- moving to proportional liability from joint and several liability
- minimum claim amount thresholds
- protection of volunteers and 'good Samaritans' from litigation.

Reforms along these lines are currently progressing in all jurisdictions in Australia. Reforms have been enacted in NSW, Victoria, Queensland and the ACT, with reforms at various stages in all other jurisdictions. I note, however, that the reforms are not consistent across the states.

In addition, the Commonwealth has introduced legislation to amend the taxation laws to encourage structured settlements, and is currently proposing to alter the Trade Practices Act to allow for waiving of liability for recreational activities.

In its two submissions to the negligence review the Commission set out its concerns that amending the Trade Practices Act in this way will result in the risks of recreational and other activities being inappropriately allocated to consumers.

In the Commission's view, law reform should be driven by policy that can promote the welfare of all Australians. For negligence and Trade Practices Act law reform, that policy should focus on reducing accidents and the costs of the resulting injuries. Potential liability is generally best placed on the person most able to avoid the accident most easily and cheaply in the first place. This is both sensible and fair.

In addition, the Commission sees no case for excluding particular community organisations or professional groups from the operation of the Act or other liability laws. It sees as inappropriate, proposals to amend the Act such that only the Commission could bring actions claiming damages for personal injury and death (on behalf of others) under the Act. It expressed grave concern about any reform of the product liability regime in Part VA of the Act and relaxing the norms of commercial conduct specified in Parts IVA and V generally. The Commission can conceive of no circumstance in which it is or should be acceptable for a supplier to mislead or deceive consumers or to behave unconscionably.

Governments have clearly indicated that they expect cost savings from these reforms. On 7 November 2002 a report to the Insurance Issues Working Group of Heads of Treasuries by Pricewaterhouse Coopers predicted that comprehensive law reform would result in a drop in insurance premiums by more than 13.5 per cent.

Industry stakeholders, such as the ICA, have publicly stated they do not believe the current package of tort law reform will necessarily result in premium reductions, or increases in availability. The president of the ICA, Raymond Jones, stated to the Senate inquiry in August that:

> It is certainly a move in the right direction, but by no means is it going to mean an instant reduction in the cost of public liability

and that:

> there is a belief that in many cases this will not reduce premiums—it will slow them down, but it will not reduce them.

Even if premium rises are only held back by 13.5 per cent and not reduced, that is still a saving most people would welcome. However, it should be noted that a 13.5 per cent saving will probably not help people and businesses who say they have been hit by premium rises exceeding 100 per cent or 1000 per cent. Nor will it make insurers insure unacceptable risks.

A one-off 13.5 per cent increase in premium, while unwanted, is a cost most businesses can bear. If that will be the one-off saving which results from law reform, what will be the cost?

The Commission believes the recommendations for tort reform appear to generally result in restricted consumers' rights. The purpose of damage awards is to restore a victim to the position they would ordinarily have been in without the accident. To restrict compensation effectively forces victims to subsidise the reduction in premiums for those who caused them harm. Not only is this an inequitable outcome, it also shifts part of the burden of care for victims from the insured to the public health system, as victims may not receive enough compensation to ensure their ongoing care.

Given that the causes and extent of the current crisis are yet to be fully realised, such restrictions to consumers' rights without appropriate justification is of concern to the Commission. If a rise in tort claims is not responsible for the current problems, then there will be little or no benefits from reform—but the cost to society may be very great indeed.

In any case, it seems to me that there are options that could improve the performance of the troubled classes of insurance and that should be explored before cutting back on consumer rights.

Risk management through information collection

Data collection in both public liability and professional indemnity has long been inadequate. Little information has been collected by insurers on risk management, particularly on heads of damage of claims, industry risk, or other rating variables.

The lack of information has been reflected in industry-wide aggregate data. Apart from APRA data requirements, little industry-specific information has been collected.

Reforms to encourage improved data collection and risk management will benefit all insurance-market participants. Availability should improve for those areas which are proven to be of low risk, and

insurers will be better able to price appropriately and provide against future losses more accurately.

Insurers have openly recognised the need to improve data collection. Insurers, through the ICA, appointed Insurance Statistics Australia in September 2002 to compile public liability data and report on various trends to APRA. This will provide more up-to-date and comprehensive data for state and federal governments.

The monitoring work of the Commission, as well as significant changes to APRA's role, should help. APRA's reform proposals took effect on 1 July 2002, and involve upgraded, risk-based capital adequacy requirements, and improved risk management. To fulfil their requirements under these and other reforms, insurers will need to improve their internal data collection methods to be able to adequately and appropriately manage their risk.

The Commonwealth has agreed to use the *Financial Sector (Collection of Data) Act 2001* and require all authorised insurers operating in Australia to submit claims data to APRA for analysis and publication.

The Productivity Commission has also been asked to review the claims management practices of Australian public liability insurers, and benchmark these against world's best practice.

One way to improve risk management for professional indemnity is by using professional standards legislation as in NSW and Western Australia. This requires professional associations to commit to compulsory indemnity insurance, risk management programs and complaints and discipline procedures, in return for limiting their liability in service provision.

But there are concerns about this kind of legislation similar to those about tort law reform.

The need to limit liability implies that, in a free situation, claims against an association would exceed this limit. Again, limiting liability restricts the payment of appropriate compensation to victims, penalising them to the benefit of the insured.

Aggregation of buyers

Many of the benefits that flow from professional standards legislation could equally be achieved via aggregation of buyers of insurance.

Group purchasing of insurance will tend to decrease transaction costs for insurers, and promotes risk management on the part of the insured parties.

Aggregated buyers will tend to impose internal discipline within the group on each other to achieve the best possible premiums.

Submissions to the Senate inquiry noted several successful such arrangements.

Aggregation of sellers

The aggregation of sellers, or pooling arrangements, is an idea that is currently gaining momentum. As outlined earlier, the Commission has recently received an application seeking authorisation of a public liability co-insurance arrangement from Allianz Australia, QBE Insurance and NRMA Insurance.

The applicants have claimed that, as a result of the proposed co-insurance arrangement, public liability insurance will be available to some types of non-profit organisations previously unable to obtain cover.

Government assistance

A range of proposals and schemes are currently being brought into operation in various jurisdictions to help the groups identified as being most vulnerable.

These include:

- government-run, group insurance schemes
- risk management and advisory services for these groups
- reductions in stamp duty payable by these groups.

These are particularly important if the crisis is determined to be only a short-run phenomenon requiring short-run solutions.

Once the market has returned to some measure of equilibrium, the return of capacity and availability should enable these measures to be phased out as the private sector will again be able to write in a sustainable fashion for these groups.

The state of the market and competition going forward

As the Commission pricing reviews have shown, profitability has been returning to the general insurance industry as a whole.

In some sectors, profitability is extremely high. In others, such as the areas of primary concern—public liability and professional indemnity—profitability is still low but is in the process of being restored to sustainable levels.

Solutions must be balanced between the need for appropriate government action to secure the outcomes we expect as a society, and the need to manage the costs of doing so. The aim is to arrive at an outcome that gets the settings right to ensure the market works more effectively.

The Commission supports improved competition in the insurance industry. While capacity is relatively constrained in public liability and professional indemnity at this stage, returning profitability is likely to attract new entrants to these markets.

It has been suggested that the Commission should be given the power to control the price of premiums in public liability and professional indemnity. Although there is a role for price control in some instances, the Commission does not think such controls are likely to be useful. While the Commission may be able to restrain prices, it cannot force insurers to write unprofitable business. Such controls would likely be counter-productive in improving availability. It may be that better outcomes will be achieved by allowing the market to determine its own prices.

The Commission's role

The Commission will be monitoring costs and premiums in the public liability and professional indemnity sectors of the insurance market on a six-monthly basis over the next two years. It was asked to consider the effect on insurance premiums of governmental measures to reduce and contain legal and claim costs and to improve the data available to insurers to evaluate and price risk. The Commission's future monitoring reports will assess the effect of these measures.

In its 30 May 2002 joint communicue the Commonwealth also signalled that it would review the Commission's involvement, including more formal processes, if it becomes clear that cost savings are being realised but not passed on to consumers.

The Commission will need to seek information directly from the insurance industry. Earlier this month it asked the larger providers of public liability and professional indemnity insurance detailed questions about cost allocations, pricing methods and their expectations about the effect of government reforms.

So far, the Commission is extremely pleased with the level of cooperation that insurers have provided. The information requested by the Commission comes at a difficult time for insurers, who are currently under pressure for data and other information from other regulators such as APRA, and peak bodies such as the ICA. The Commission has worked with the industry to seek to minimise the burden on insurers by coordinating where possible the information we are requesting with other bodies. However, the Commission does have its own specific needs and must fulfil these to produce the first of its monitoring reports next year.

For medical indemnity insurance the Prime Minister announced on 23 October 2002 that as part of the government's reform package the Commission will monitor medical indemnity premiums to assess whether premiums are actuarially and commercially justified.

The drivers behind the crisis in medical indemnity are somewhat different to those of the rest of professional indemnity and public liability. The proposed solutions vary accordingly.

The package of reforms recently announced by the government reflects this. The collapse of United Medical Protection Limited, the underfunding of IBNRs (incurred but not reported losses) by medical defence organisations and the increasing cost of premiums for high risk practitioners, are all factors that the government has attempted to address.

While the more general tort law reforms currently proposed and/or being enacted will influence this area, they are somewhat peripheral to the problems facing the medical profession.

The monitoring work of the Commission will necessarily differ substantially from that being undertaken for public liability, and other professional indemnity.

Concluding remarks

Finding appropriate solutions to the current crisis will be challenging and will require public and private stakeholders to work together. It is important work and in this work, an appropriate balance must be struck between the interests of those likely to be affected by the 'solutions'.