Insurance Market Incentives and constraints and complementary public policies

... a policy practitioners' perspective

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First

... response to some burning issues raised yesterday



Australia Road Toll leading to 1978 f(n) population



Statutory Insurance - Product

CTP

Workers' Compensation



Statutory Insurance - Delivery

CTP

Workers' Compensation



Claims and Policy Administration Outsourced

Rudimentary Scheme Assessment: Road Trauma

Road death rates by State/Territory

	NSW	Vic	Qld	SA	WA	Tas	NT	ACT	Australia
Per capita ^a									
2008	5.54	5.72	7.66	6.18	9.66	8.03	34.10	4.07	6.80
2003	8.08	6.70	8.14	10.25	9.22	8.58	26.49	3.38	8.15
Per vehicle [▷]									
2008	0.85	0.77	1.03	0.84	1.20	1.02	6.10	0.58	0.95
2003	1.37	0.94	1.21	1.46	1.25	1.21	5.08	0.52	1.23

a Annual deaths per 100,000 population: 2008 at June 30 (preliminary data); 2003 at June 30 (revised data) taken from ABS catalogue 3201.0

b Annual deaths per 10,000 registered motor vehicles at 31 March taken from ABS catalogue 9309.0.

Rudimentary Scheme Assessment: Road Trauma



History of CTP Scheme Premium Rates (% AWE)



Explaining Difference Between NSW and Victorian CTP Premiums

Average Premium per vehicle Dec Qtr 1999 (Illustrative, not to scale)





Purpose

- Present a policy practitioners' perspective
- Framework to help structure informed debate
- Seed discussion co-operative/ collaborative opportunities to align efforts to improve road safety outcomes

Qualifications

Basic policy practitioner's "tool-kit"

- Not a dissertation, some over-simplification
- suggestions to improve paper welcome

Metaphors used to stimulate thinking

Valid comparisons between systems can be made, but with caution due to statutory differences and variations in local practice. Raw comparisons can be "more misleading than informative, however, comparisons at the broadest aggregate level may be meaningful" (Hunt 1998)

Characteristics of Insurance



Risk Management

- Control the risk... likelihood/consequences
- Avoid the risk
- Retain the risk
- Transfer (or redistribute) the risk
 ... whole or part

Features of Insurance

- Risk Transfer legally enforceable
- Consideration generally, premium related to risk/benefits
- Risk pool created if many parties
- Distribution of benefits from the pool

Insurance: Spectrum of Adequacy Objectives



Individual Adequacy

Premiums largely determined on an actuarial basis

Redistributive amongst insurees

Standard model for competitive insurance market

Social Adequacy

Public tax-transfer system Benefits related to needs Social assistance/welfare

Public Monopolies may integrate societal objectives



Typical Objectives

Profit Maximisation

•Subsidiary Objectives that are aligned to profit maximisation (eg injury prevention) **Typical Objectives**

- Long term [financial] viability
- Injury prevention and trauma reduction
- Fair and equitable benefits
- · Speedy, sustainable and cost effective rehabilitation
- Affordable premiums

Community Rating in CTP Insurance, Australia

With Compulsion (with inability to contract out), it is possible to redistribute the premium pool in means other than risk to achieve social objectives, eg

- Rural discounts (Victoria, SA)
- Pensioner discounts (Vic, NT)
- Flat premium by vehicle class irrespective of age/risk (Vic, Tas, NT, WA, NZ)
- Subsided rate for certain vehicle classes such as MCycles (Vic, Qld, WA, Tas, NT)

Community rating difficult to attain in a competitively underwritten markets in absence of strong regulation to control market practices.



Varied Nature of Australian Insurance Schemes

Segment / Characteristic	General (Motor) Insurance	Auto Liability (CTP) Insurance	Workers' Compensation Insurance	Public Liability Insurance	Private Health and Disability Insurance	Social Health Insurance	Unemployment Insurance
Adequacy Objective	Individual	Hybrid	Hybrid	Individual	Individual	Social	Social
Funding	Fully Funded	Fully Funded	Fully Funded	Fully Funded	Fully Funded	PAYG	PAYG
Community Rating	No	Partial	No	No	No	Yes	Yes
Underwriting	Private	Blend	Blend	Private	Private	Public	Public
Typical Exposure	Short Tail	Long Tail	Long Tail	Med-Long Tail	Short Tail	Long Tail	Long Tail
Beneficiary Party	First	Third + First	Third + First	Third	First	First	First
Claim Order	First Resort	First Resort	First Resort	First Resort First call on CTP/WC	First Resort First call on CTP/WC	Last Resort Means Tested First call on CTP/WC	Last Resort Means Tested First call on CTP/WC
Participation	Discretionary	Compulsory	Compulsory	Discretionary	Discretionary	Universal	Universal



CTP Insurance Evolution

Historical Epoch

- Dramatic growth in injury rates, associated with vehicle population growth and increased travel speed
- Injurers ability to fully compensate injured third parties limited in cases of catastrophic injuries

Motives for Compulsion

 Third party externality (aspects of judgment proof argument)

Judgment Proof problem ... potential policy responses:

Policy Response	Injurer's excessive engagement in risky activity & dulling of incentives to take adequate care	Inadequate compensation by injurers (to victims)
Mandate purchase liability [third party] insurance	\checkmark	\checkmark
Prohibition to purchase liability [third party] insurance	\checkmark	
Minimum level of assets to engage in a [risky] activity	\checkmark	\checkmark
Extension of liability to parties related to the injurer (e.g employer liability, vicarious liability, joint & several action)	✓	✓
Safety Regulation	\checkmark	
Civil and Criminal penalties	\checkmark	
Prohibition of risky activities	\checkmark	
Victims mandated to obtain [first party] insurance		\checkmark

Other Issues confronting regulators

MORAL HAZARD

 Insured has an economic incentive to cause the situation he is insured against, an incentive that is not present when he is not insured

ADVERSE SELECION

- information asymmetry between the insured and insurer
- Cross subsidisation may weaken or be in conflict with price signalling incentives

MARKET IMPERFECTIONS

- Missing markets
- Lack of economies leading to high transactional costs

CONSUMER IGNORANCE AND IRRATIONALITY

Reasons why persons do not purchase insurance, or undertake risky activities

Other Issues confronting regulators

COMPETITIVE DYNAMICS

- Benefit shareholders in the short-term as a key priority
- incentive to maintain/encourage information asymmetries

BASIS OF DETERMINING BENEFITS AND COSTS ?

Insurance system = Income/Capacity + Health/Medical + Pain Suffering + Legal/Admin

- + Societal = Health/medical & Unemployment (not funded by insurer) + Lost Opportunity = Loss of productivity and contribution to society by injured & carers + Internalisation = Internalised grief of injured & carers (non-economic) +/- Other Offsets
 - = Contribution of insurance sector to economy (employment/taxes)?

Competitive Federalism Metaphor



in theory, schemes are free to adapt and respond to needs specific to the jurisdiction, <u>and this</u> provides the opportunity to act as "*policy laboratories*" that over time jurisdictions may identify and gravitate to policies that demonstrate success (*Osborne 1988*) and learn from policy failures in other jurisdictions (*Jewett 2001*)

A <u>key challenge</u> under "*competitive federalism*" is to minimize the risk of destructive competition and coordination failure.

To this extent, Australia has developed extensive and varied array of intergovernmental cooperative arrangements including:

- mutual recognition regimes
- harmonisation of regulation
- adoption of national standards
- integrated inter-jurisdictional frameworks to develop and oversee the implementation of various reform measures
- promotion of benchmarking

Ideas to open discussion

Cooperative/Collaborative efforts among stakeholders to improve Road Safety Outcomes



embracing new technologies....

- clear accountabilities within the road safety system
- integrated cooperative frameworks to implementation of reform measures
- improve the accessibility of information to the public to make informed [safety] choices
- public education where ignorance or irrationality of risk assessment may be present
- pooling of scheme data to assist with risk identification, policy development, public education and informed consumer choice
- benchmarking activities/projects
- coordination of micro-activities among road safety stakeholders to amplify impact of initiatives

Open for Questions



If it helps, I can email you these publications



A PERSPECTIVE ON BENCHMARKING THEORY

- PART A BENCHMARKING TERMINOLOGY, APPLICATION AND KEY ISSUES: REVIEW OF MANAGEMENT LITERATURE
- PART B NEW ANALYTIC FRAMEWORKS FOR CATEGORISING BENCHMARKING TYPES & BENEFITS, LIMITATIONS, BARRIERS AND CRITICAL SUCCESS FACTORS