Actuaries Institute

The AGA and government intervention in insurance markets – a few case studies

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Overview

- Market economics 101

- Case studies

Market economics 101

Well-being is often best served by a market-based economy.
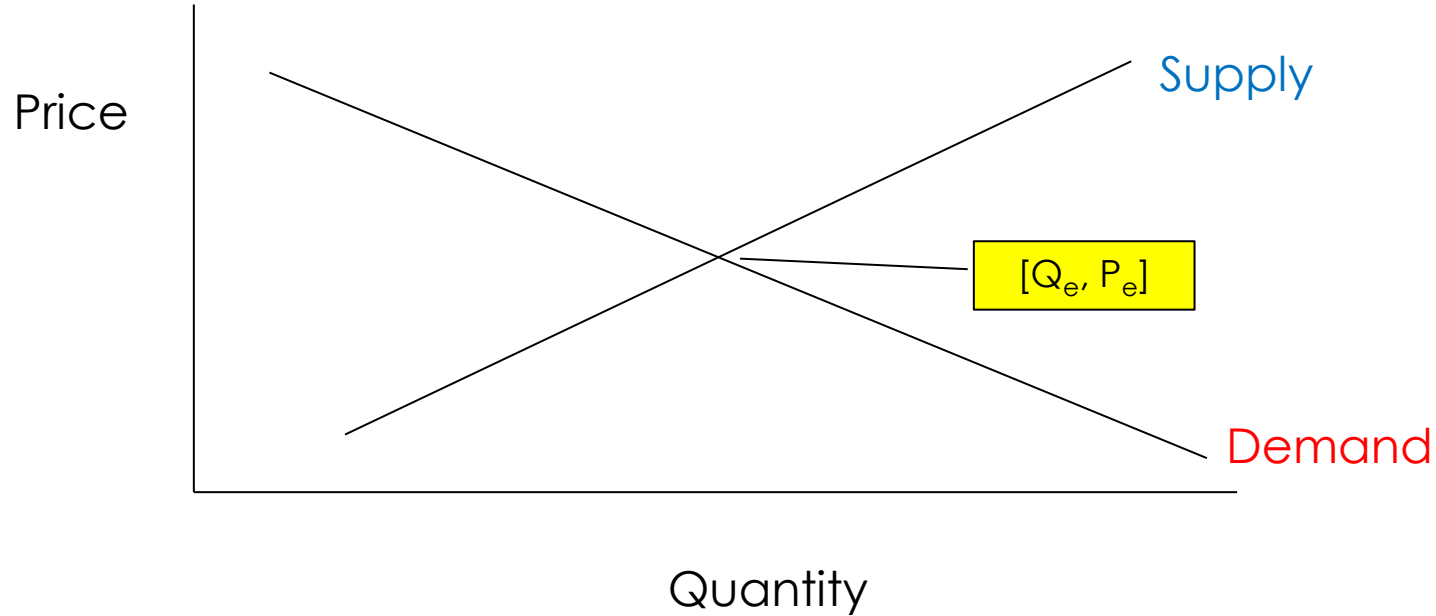
Market economics 101

Market-based economy:

Resources owned and traded voluntarily by individuals.

Needs a system of well-defined property rights.

Governed by interaction of supply and demand.

Market Economics 101

Price

Quantity

Supply

Demand

[Q_e, P_e]

Market economics 101

Efficient markets feature:

- Many buyers and sellers

- No barriers to entry or exit

- Information symmetry

- Well defined property rights

- No significant externalities

Market economics 101

Market failure:

- Markets don't form
- Monopoly
- Information failure
- Instability
- Inadequately defined property rights
- Negative externalities

Market economics 101

Market failure:

- Efficiency not the same as equity

- Eg, unaffordable insurance prices don't imply market failure

- A broader view might consider when commercial market reality cannot co-exist with social desirability

Market economics 101

Government intervention in markets:

- Market rules

- Price

HIH

Australia's second largest insurer collapsed in 2001.

The aftermath saw steep increases in liability insurance premiums.

Then, a review of liability laws in all states.

This was not, however, an intervention in the insurance market. Rather, a revision to property rights.

HIH

Regulation of general insurers tightened.

This was an intervention in the insurance market.

HIH

HIH was 'allowed' to collapse.

The collapse of HIH was followed soon after by the collapse of Ansett Airlines.

Both were very significant participants in their respective markets.

Neither was 'rescued' despite loud calls from many sectors.

Medical indemnity

In 2002, United Medical Protection collapsed.

UMP was a little-known provider of specialist professional indemnity insurance to doctors.

Unlike HIH and Ansett before it, the government decided to rescue UMP.

This represented a major intervention in an insurance market.

Medical indemnity

The collapse of UMP along with rising premiums threatened withdrawal of private medical services.

This was a negative externality. Thus, the insurance market had a negative effect on third parties not involved in the market (future patients).

Aim of the intervention was to ensure continuation of private medical services

Medical indemnity

The government:

- 'Rescued' UMP
- Tightened regulation of the medical indemnity industry
- Established a number of programs to put downwards pressure on prices

Aim of the intervention was to ensure continuation of private medical services (address a negative externality).

Terrorism insurance market

Supply withdrawn following September 11.

Potential negative effect on the economy (risk of lenders not financing commercial property development). An externality.

The government judged that this externality justified a market intervention. And so came the Terrorism Insurance Act.

Conclusion

Intervention is often intended to increase market efficiency.

Other reasons for intervention (eg to address inequity) are less likely to have an economic basis.

AGA involvement

AGA advice has been sought and acted upon by government on a range of issues associated with each of these policy conundrums.

AGA involvement

5 commandments

Understand and support the strategic direction (and be alive to opportunities to shape it):

- learn the language and the way of thinking
- find out who's who
- find out what's what
- know your actuarial stuff
- and know how your actuarial skills might/could/should/do fit into the environment that you are working in

5 commandments

Engage with risk:

- Means more than just 'blindly take risks'
- Means more than just 'defensively manage risks'
- Be resilient
- Show personal integrity

5 commandments

Achieve results:
- Deliver
- Close out
- Follow up/evaluate
- Build a track record

5 commandments

Cultivate relationships:
- Fit in/don't take over
- Authoritative not aggressive
- Responsive but also sensitively pro-active
- Value and leverage other skillsets, frameworks and ideas

5 commandments

Communicate with influence:
- Know and believe your message
- Prepare, shape and test your message
- Convince a non-believer and you're good to go