

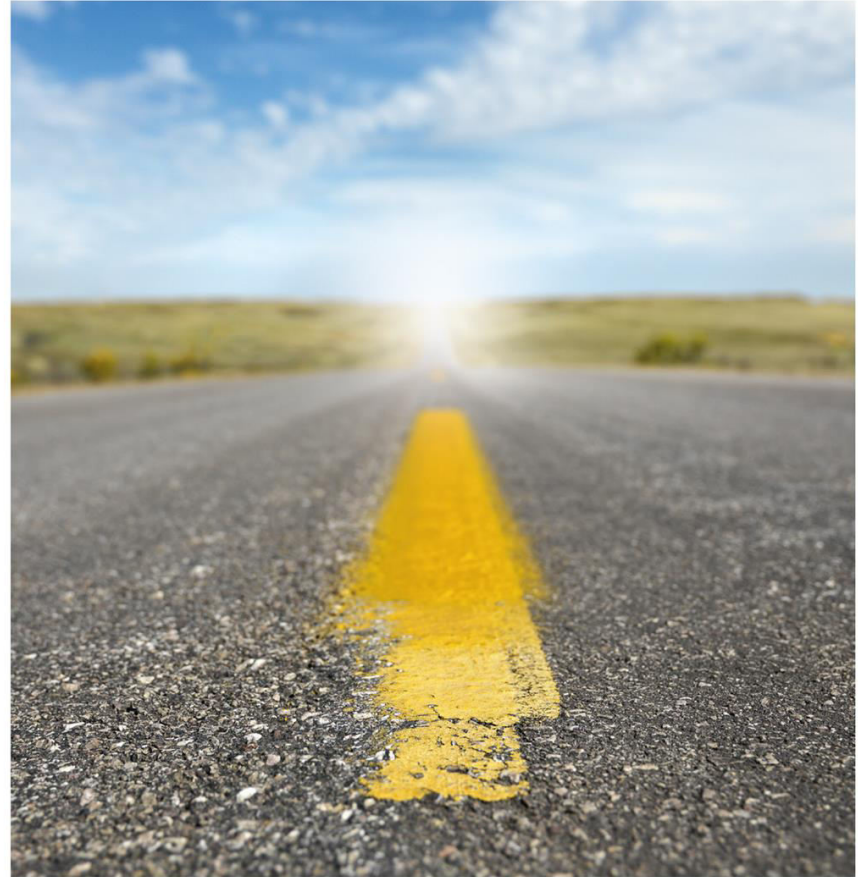
Injury Schemes Seminar

Road to Recovery



**Actuaries
Institute**

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Competitive and monopoly underwriting models

Assessment of arguments

Peter McCarthy and Kenneth Chua

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Injury Schemes Seminar.*

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Overview

1. Introduction and purpose
2. Objectives, unique features and functions
3. Overview of underwriting models
4. Documented arguments
5. Some key pieces of evidence
6. Conclusions

1. Introduction and purpose

- A topic that elicits polarising views
- Has been receiving increased attention by stakeholders and government
- Many reviews/reports/investigations over many years
- Only considering personal injuries for workplace and motor vehicles

1. Introduction and purpose

- Today we
 - Summarise the models
 - Review arguments and evidence
 - Consider additional arguments
 - Consider the key issues that need to be addressed in each model for success
- Today's discussion is not about benefit design, premium systems, etc.
- We leave it for the audience to make up their minds which is better

2. Objectives, unique features and functions

- Some common objectives of schemes
 - Return to pre injury condition or return to work
 - Affordability
 - Sustainability
 - Efficiency
 - Premiums based on risk (i.e. claims experience) – no deliberate cross subsidies
 - CTP schemes are different
 - Incentives to reduce claim costs and minimise the impact of injury
- There is a dynamic tension between these objectives (not mutually exclusive)

2. Objectives, unique features and functions – key ones

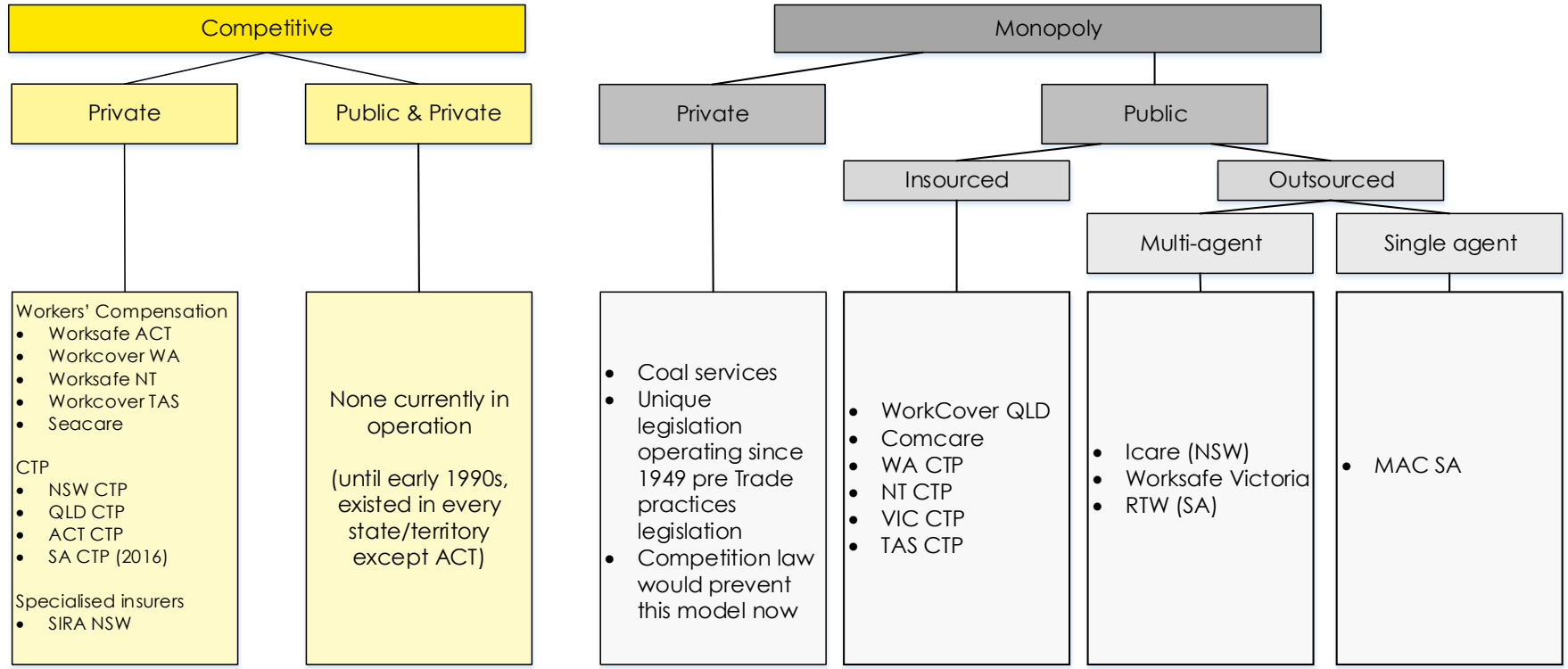
Feature	Comments
Compulsory	<ul style="list-style-type: none"> • Must purchase insurance cover • Insurer must accept risk (limits ability to control portfolio)
Third party	<ul style="list-style-type: none"> • Main beneficiary is not the policyholder (exceptions in some CTP schemes)
Legislated minimum benefits	<ul style="list-style-type: none"> • Benefits enshrined in legislation with limited additional benefits offered – benefits are homogenous
Governments are effectively insurer of last resort	<ul style="list-style-type: none"> • In cases of insurer insolvency • But cost is normally passed onto other premium payers

- Consequently
 - Require a regulator to regulate the market and to ensure compliance
 - Public interest test (e.g. efficiency, affordability, fair, sustainability, etc.)
 - Are politicised
 - Many service providers earn significant income and profits from schemes
 - A “culture” grows around each scheme

2. Objectives, unique features and functions

- The key function is **claims management** including
 - Assessment of claims
 - Paying claims
 - Rehabilitation
 - Return to work
- Other important functions:
 - Underwriting of risks
 - Setting, calculating and collecting premiums
 - Investment management
- Stakeholders are claimants and premium payers
 - Everyone else is a service provider
 - Governments which set the rules!

3. Overview of underwriting models



All workers' compensation schemes allow large employers to self-insure

4. Documented arguments

Insurer failure is not a concern

Greater efficiency due to competition

Lack of knowledge sharing in competitive models

More innovation due to competition

Specialised insurer premiums can be very volatile

Regulatory efficiency/effec tiveness

Strong price signals and incentives to improve claims costs

Premiums will be more affordable/stable to small business

Market characteristics cause volatility in premiums

Public capital is not at risk

Efficiency due to expertise of private insurers

Public schemes are not subject to prudential regulation

Innovation of practice due to competition

Shareholder accountability

Private insurers are incentivised to focus on financial gains at the expense of health outcomes

Better health outcomes

More choice for consumers

Monopolies can drive economies of scale

No requirement for profit margin

Government method of setting premiums can lead to significant unfunded liabilities in some schemes

4. Documented arguments – some observations

- The same arguments are used for both sides of the debate
- Some arguments don't take into account the objectives of the scheme
- Limited/no evidence produced to support the argument

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WorkCover NSW, in its submission to the 2004 Productivity Commission's report on National Workers' Compensation and Occupational Health and Safety Frameworks, in the context of competitive private provision

4. Documented arguments – key themes

- Broadly speaking the documented arguments seem to fall into 5 groups:
 - Appropriate price signals and accurate pricing
 - Efficiency and expertise
 - Affordability and stability of premiums
 - Sustainability and solvency
 - Better health outcomes

4. Documented arguments – key themes

Theme	Details
Appropriate price signals and accurate pricing	<ul style="list-style-type: none"> • Policyholders are paying a fair premium for the risk • Pricing of premiums reflects the risk providing incentives to reduce incidence and severity of claims
Efficiency and expertise	<ul style="list-style-type: none"> • Is the scheme operating efficiently – low costs • Having the right expertise enables efficiency and good management
Affordability and stability of premiums	<ul style="list-style-type: none"> • Costs of the scheme should not create undue burden on premium payers • Burden is the absolute cost as well as the variability
Sustainability and solvency	<ul style="list-style-type: none"> • A fully funded scheme or solvent insurers continue to operate without legislative change • Stable financial status provides guarantee for policyholders as well as the public purse
Better health outcomes	<ul style="list-style-type: none"> • Schemes exist to help those who are hurt • Quick return to work rates • Restoration to pre-injury conditions (where possible) • Better health outcomes reduce costs of the scheme, which in turn lower premiums

4. Documented arguments - other arguments

Competitive models	Monopoly models
Inbuilt structural circuit breakers	Private insurers will not pay (i.e. have incentives to reduce financial costs at the expense of other stakeholders)
Resourcing with appropriate staff in a government monopoly scheme is difficult	
Lower claims leakage	

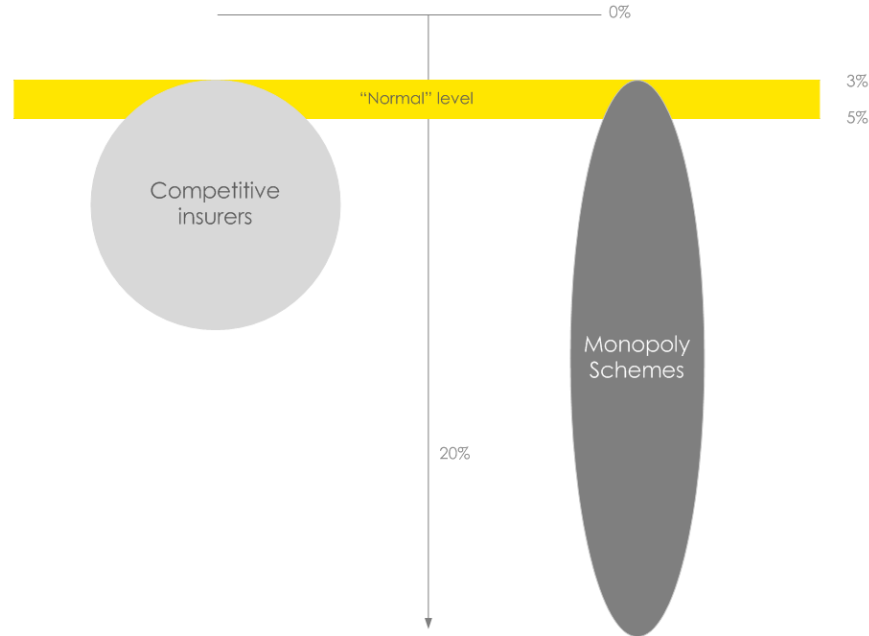
5. Some key pieces of evidence

- Claims leakage
- Economies of scale
- Simple economics - inbuilt structural circuit breakers
- Resourcing of key staff

5. Key pieces of evidence - claims leakage

- Impacts all of the key themes
 - Appropriate price signals and accurate pricing
 - Affordability and stability of premiums
 - Efficiency and expertise
 - Sustainability and solvency
 - Better health outcomes
- It is MIA in the arguments!

5. Key pieces of evidence - Claims Leakage



- EY claims leakage reviews over many schemes and insurers indicates
 - Higher leakage is likely to be present, higher and persist for longer periods in monopoly schemes
 - Higher leakage results in poorer health outcomes, poorer RTW, lower efficiency, higher premiums, poorer scheme financial status, etc.
 - But there are some notable exceptions over long periods for monopoly schemes

5. Key pieces of evidence - Economies of scale

- Complete public information not available to do a complete analysis
 - Claims handling allowance in outstanding claims liabilities are generally publicly available in accounting disclosures
 - Actuarial reports are publicly available for some schemes
- Small competitive schemes have low expenses
 - Insurers having multiple products and therefore access to economies of scale

5. Key pieces of evidence - Economies of scale

Scheme	CHE % of Outstanding claims liabilities
Monopolies	
1 - insourced	15
2 - outsourced	12
3 - outsourced	10
4 – insourced	10
5 - outsourced	9
6 – insourced	8
Competitive markets	
Small multi-product insurer	6
WA scheme	5
Large insurer 1 and 2	5

- Sources:
 - CHE available from accounting disclosures in annual reports of monopolies
 - WA, Tasmanian & ACT scheme from scheme actuary reports
 - Insurer's CHE from EY information

Simple economic example – effectiveness of claims management

Competitive

Monopoly

Simple economic example – effectiveness of claims management

Competitive

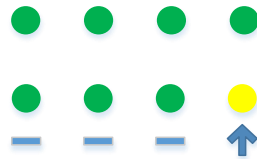


Monopoly



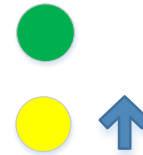
Simple economic example – effectiveness of claims management

Competitive



Claim costs
change

Monopoly



Increase in claims
leakage

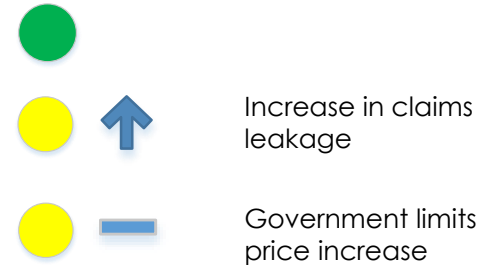
Simple economic example – effectiveness of claims management

Competitive

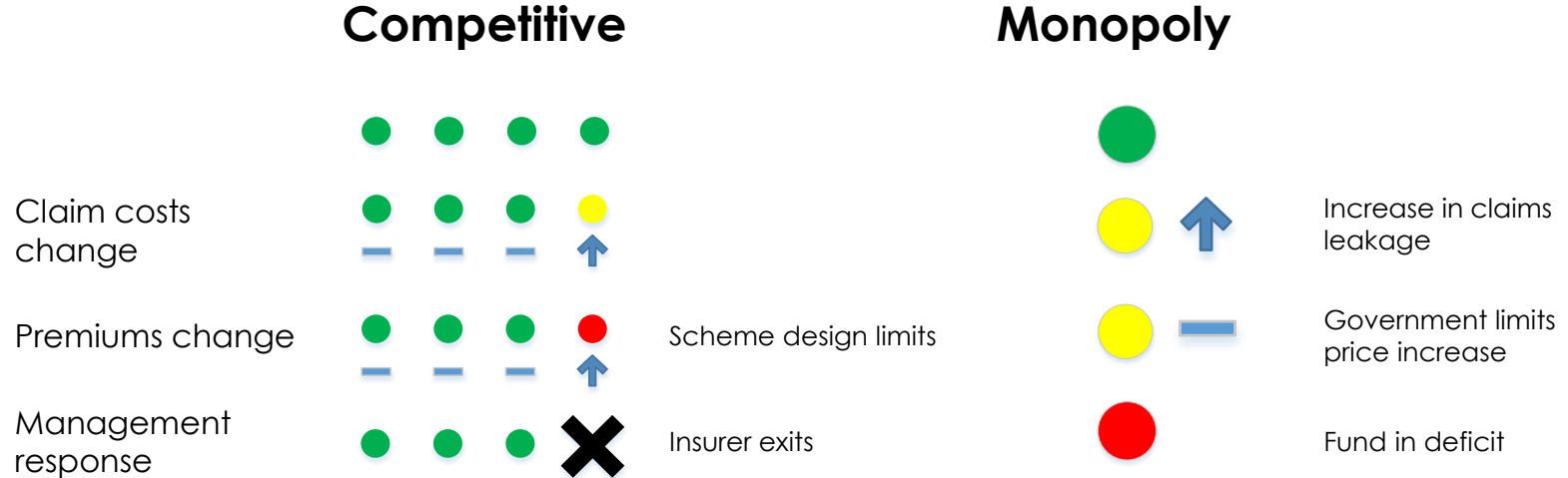


Scheme design limits

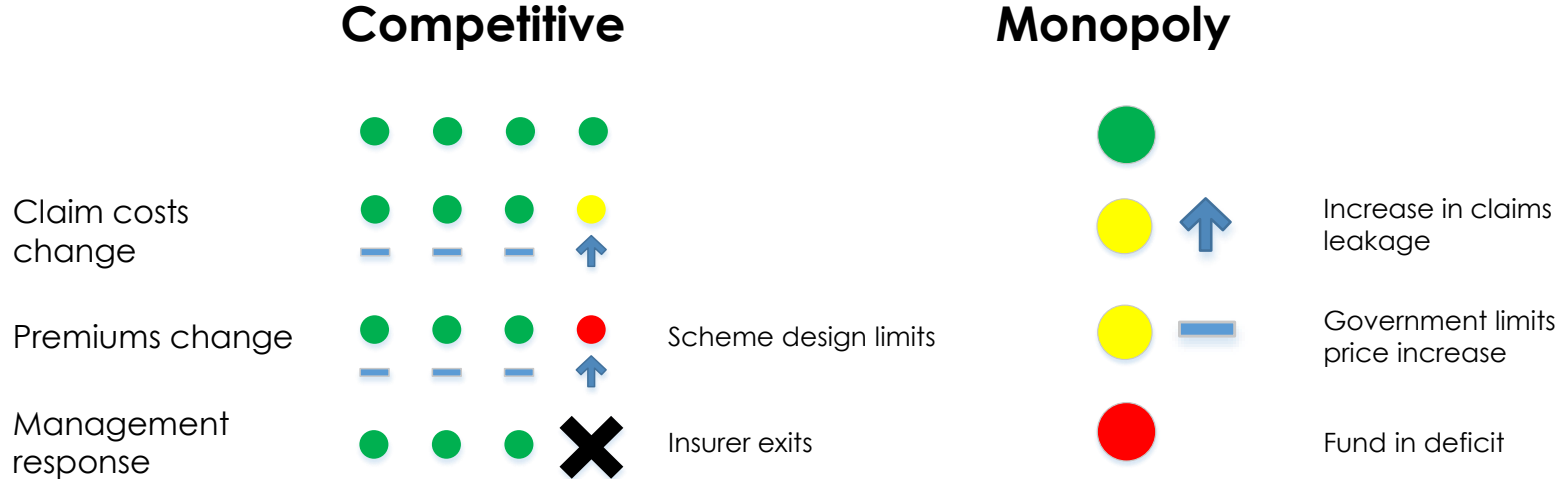
Monopoly



Simple economic example – effectiveness of claims management

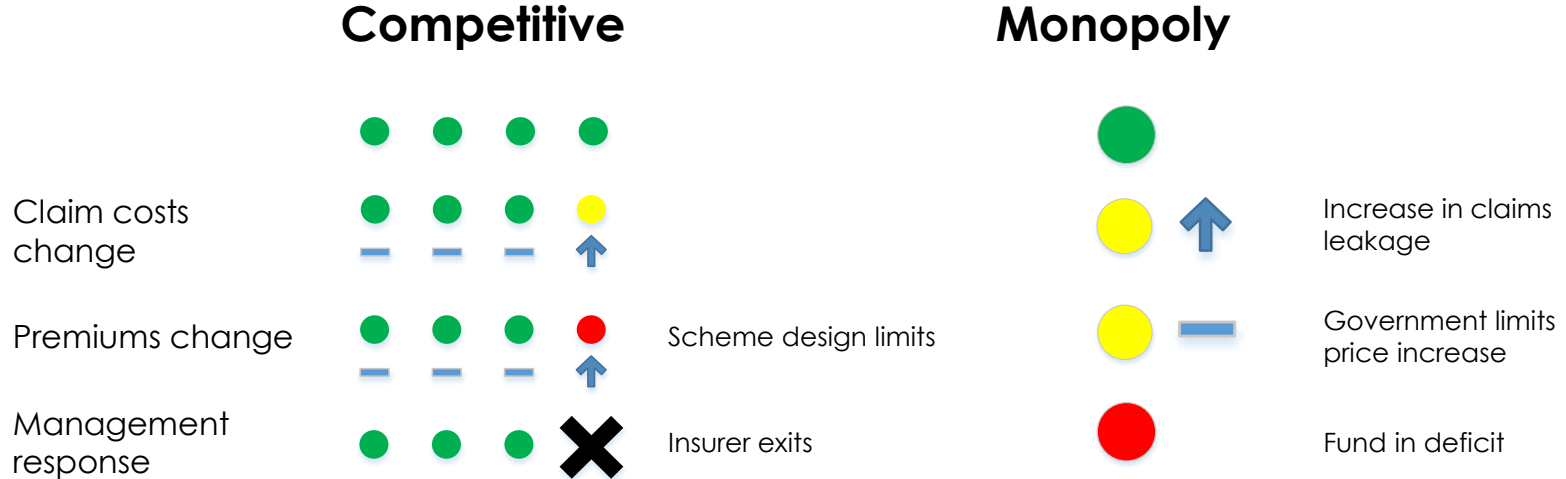


Simple economic example – effectiveness of claims management



Overall average of claims management in a competitive market changes very little in contrast to the monopoly

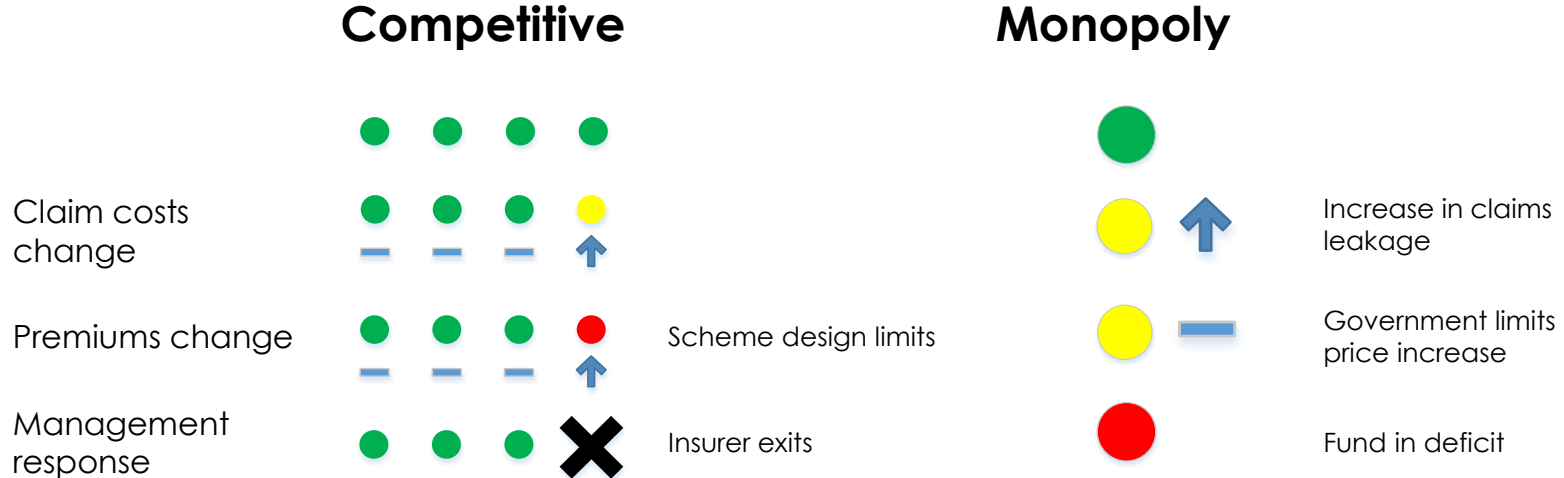
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Overall average of claims management in a competitive market changes very little in contrast to the monopoly

Difference is presence (or absence) of inbuilt structural circuit breakers

Simple economic example – effectiveness of claims management



Overall average of claims management in a competitive market changes very little in contrast to the monopoly

Difference is presence (or absence) of inbuilt structural circuit breakers

There are examples historically and this is happening right now

5. Key pieces of evidence - Resourcing

- Need to employ (especially at CEO and next level down) good quality staff who have extensive and successful experience managing personal injury claims in workers compensation or CTP
- The schemes that have not taken this route have performed poorly over many years

6. Conclusions - Key challenges for each model

Model	Comments
Monopoly	<ul style="list-style-type: none"> • Need to employ (especially at CEO and next level down) good quality staff who have extensive and successful experience managing personal injury claims in workers compensation or CTP • The schemes that have not taken this route have performed poorly over many years • Conduct regular claims leakage studies and make the results public! • Depoliticise schemes – do not use them as a political football • Enable schemes to be better managed (both financially and non financially)
Competitive	<ul style="list-style-type: none"> • Requires a risk-based pro-active regulator that works with stakeholders and service providers
	<ul style="list-style-type: none"> • Competitive CTP schemes have a significant challenge dealing with substantial cross-subsidies which reduces/distorts competition in the market and may reduce long term sustainability • There needs to be a solution to this issue

6. Conclusions - Closing remarks

- Effective claims management is the key basis of many arguments
 - But it seems largely ignored
 - The evidence is confidential but it does exist!
- No model is perfect!