INSURANCE PREMIUMS AND LAW REFORM — AFFORDABLE COVER AND THE ROLE OF GOVERNMENT

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The impact of the past year's dramatic increases in insurance premiums and the reduced availability of cover across a range of insurance classes has caused widespread concern for all areas of the Australian community. There is a widely held view that the current problems in the insurance market are due in large part to the operation of the legal system. It is clear that the broader community is dissatisfied with the seemingly random nature of court awards. There is also a strong perception that an increasing culture of blame has emerged within our society. This has led individuals to seek redress through the legal system, where in similar circumstances in the past, the individual would have been more prepared to assume responsibility for the consequences of their own actions.

It is not difficult to see how this perception has arisen given the number of high profile claims that have attracted attention in recent times. To the general public, many of these claims appear frivolous and the outcome out of step with reasonable community expectations.

I THE ROLE OF GOVERNMENT

Governments are elected to address the concerns of the community. The far-reaching consequences of the current conditions in the insurance market affecting community groups through to professional organisations, recreational activities to essential services, compels governments into action.

To assist in this process, the Government has commissioned a number of reports to determine the drivers of rapid premium increases. The Australian Consumer and Competition Commission ('ACCC'), in its first *Insurance Market*

* Minister for Revenue and Assistant Treasurer. Senator Coonan is the Commonwealth minister responsible for driving reform to address the reduced availability and increasing cost of public liability, medical and professional indemnity insurance. In this capacity, Senator Coonan has convened four ministerial meetings with her State and Territory counterparts. At the third ministerial meeting held on 2 October 2002 in Sydney, an historic in-principle agreement was reached to develop a nationally consistent law of negligence. At the time of submitting this article for publication, the fourth ministerial meeting (to be held on 15 November in Brisbane) had not yet taken place.

Pricing Review released in March 2002,[1] identified a range of factors impacting on the cost of public liability and professional indemnity insurance. These factors include general wage inflation, insurance companies restoring premiums to adequate levels in light of heavy losses in these classes over recent years, continuing increases in the cost of claims and the increasing costs of reinsurance.

In the ACCC's second report,[2] released by Government on 20 September 2002, the ACCC identified some additional factors influencing premiums. These additional factors include the downturn in international investment markets which has curtailed the ability of insurance companies to make up underwriting losses on the back of high investment returns. In addition, the events of 11 September 2001 in the United States which caused large losses within the international insurance market has led to insurers withdrawing their capital from risky, less profitable classes of business.

In consideration of these drivers, it has been necessary for governments to consider which cost drivers can realistically be contained within the Australian context. The state of the international reinsurance or investment markets is not a matter that Australian governments can do very much to influence. It is the Commonwealth Government's view that the area in which it can make the largest contribution to resolving the current state of the insurance market is by providing leadership to State and Territory Governments to encourage reform of the law to stabilise the level of litigation.

II THE RELATIONSHIP BETWEEN CLAIMS COSTS AND PREMIUMS

The existing system of compensation for negligence through the courts proceeds on the basis that generous court awards are ultimately paid for by insurance companies with deep pockets. Insurance operates through the pooling of a large number of uncorrelated risks. For an individual, there can be great uncertainty about the occurrence and potential size of a loss in any given period. The pooling of risk through insurance reduces the uncertainty of losses within the pool.[3] In simple terms, insurance companies have three sources through which to meet the cost of claims: premiums charged to policyholders, investment returns earned through assets purchased with policyholder or shareholder funds and capital contributed by shareholders.

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1 Australian Competition and Consumer Commission, *Insurance Industry Market Pricing Review* (2002), <http://www.accc.gov.au/pubs/publications/industry/finance/insur_ind_price_review_1.pdf> at 17 November 2002.

2 Australian Competition and Consumer Commission, *Second Insurance Industry Market Pricing Review* (2002), <http://www.accc.gov.au/pubs/publications/industry/Insurance%20report_Sept2002.pdf> at 17 November 2002.

3 Australian Prudential Regulation Authority, *Study of the Prudential Supervisory Requirements for General Insurers in Australia* (1999), <http://www.apra.gov.au/RePEc/RePEcDocs/Archive/discussion_papers/dp0003.pdf> at 17 November 2002.

Advice to the ministerial meeting on public liability insurance in May indicated that bodily injury claims have been increasing Australia-wide on average by 10 per cent per annum over the past decade.[4] To the extent that claims costs increase, and where these costs are not offset by reduced administrative expenses or investment returns, insurance premiums must increase. The alternative is to repair losses out of shareholder funds.

Over the latter part of the 1990s, there is clear evidence that across the entire Australian insurance market, poor underwriting performances were impacting on insurance company shareholder returns. Australian Prudential Regulation Authority ('APRA') statistics indicate that the return on equity for the insurance industry averaged about 7 per cent from 1993–2001. The return was less than 5 per cent in 1998–99 and 1999–2000. This is considerably lower than the 13 per cent return achieved by the Australian equity market over the same period.[5] The returns illustrated for the insurance market are similar to the returns that would have been received by investments in risk free government bonds. The returns in 1998–99 and 1999–2000 were lower than the cash rates.[6]

For the year 2001, the return on equity for the general insurance industry was 5.5 per cent. This figure excludes the impact of the liquidation of HIH and only partly reflects the impact of the events on 11 September 2001. Had HIH been included in the APRA statistics, reported losses would have been substantial, reducing the industry's return on equity to a negative 30 per cent.[7]

Insurance companies compete for capital within the international capital markets. In order to sustain this capital, it is essential that insurers collect sufficient premium in order to pay claims. In addition, shareholder funds are limited. Losses absorbed by way of capital have the potential to jeopardise seriously the solvency of insurance companies.

III EVOLUTION OR REVOLUTION?

It is true to say that there are indications that the courts are moving to remedy the perceived bias toward plaintiffs with a growing body of High Court decisions in favour of defendants. There are enlightened judges[8] who have provided lucid arguments for comprehensive reform. However, the community cannot wait for the courts to turn the trend around. Nor can we wait for the insurance cycle to soften or for plaintiffs to be more responsible for their actions. Community activities and sporting events are being cancelled. Highly trained medical

4 Trowbridge Consulting, *Public Liability Insurance: Practical Proposals for Reform* (2002), Report to the Insurance Issues Working Group of the Heads of Treasuries, 30 May 2002.

5 Australian Competition and Consumer Commission, *Insurance Industry Market Pricing Review*, above n 1, 22.

6 Ibid.

7 Australian Competition and Consumer Commission, *Second Insurance Industry Market Pricing Review*, above n 2, 9.

8 See, eg, Chief Justice Spigelman, 'Negligence: The Last Outpost of the Welfare State' (2002) 76 *Australian Law Journal* 432; *Richmond Valley Council v Standing* [2002] NSWCA 359 (Unreported, Handley, Sheller and Heydon JJA, 4 November 2002) (Heydon JA).

specialists such as neurosurgeons, procedural general practitioners and obstetricians are withdrawing their services because they cannot get affordable insurance. There is no doubt that the problem is real and it must be addressed now.

In recognition of the need to act quickly, a series of ministerial meetings have been convened by the Commonwealth with State and Territory ministers responsible for insurance. The purpose of these meetings has been to examine a range of issues and possible solutions to the current situation. The rationale for the meetings has been the recognition that we have a national problem requiring coordinated action. Each of the federal, State and Territory governments should own and be responsible for reform in its respective jurisdiction. Law reform is central to dealing with the problem. At the third meeting of ministers on 2 October 2002, there was an historical, unanimous in-principle agreement to adopt a model law of negligence or, at least, to achieve conformity in all jurisdictions.[9]

IV THE IPP REPORT

The basis for these far-sighted reforms are recommendations contained in the reports of the Review of the Law of Negligence[10] chaired by Justice Ipp of the NSW Supreme Court ('Ipp Report'). A Panel was commissioned to undertake the review and was asked to provide a principled review of the existing law as a blueprint to assist governments to achieve comprehensive reform. The Panel sought to strike a balance between the interests of injured people and those of the community at large and to impose a reasonable burden of responsibility on individuals to take care of others and to take care of themselves.

The Panel made 61 recommendations on specific changes that could be made to the law of negligence. The common thread running through the recommendations is a need for clearer rules as to what conduct will trigger liability and what standards will govern compensation. The Panel's overarching recommendation was that the reforms should apply to any claims for personal injury resulting from negligence, regardless of whether the claim is brought in tort, contract, under statute or any other cause of action.

While most of the recommendations relate to amendment of the law within the jurisdiction of the States and Territories, this overarching recommendation has important implications for Commonwealth law, in particular, the *Trade Practices Act 1974* (Cth) ('*TPA*'). The Commonwealth is considering the implications of State and Territory law reform for the *TPA*. It is essential that legislative restrictions at the State level are not rendered irrelevant by lawyers seeking an alternative cause of action.

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9 Commonwealth of Australia, *Joint Communique Ministerial Meeting on Public Liability, Sydney 2 October 2002* (2002), <http://assistant.treasurer.gov.au/atr/content/publications/2002/20021002.asp> at 17 November 2002.

10 Panel of Eminent Persons, *Review of the Law of Negligence Final Report* (2002).

Ministers will be meeting once again on 15 November in Brisbane to move from the in-principle agreement to a formalised position to move all States and Territories toward a national scheme of negligence law. If implemented, these harmonised reforms to the law of negligence would have far reaching implications for medical indemnity, professional indemnity and public liability insurance. This position will be put to the meeting of the Council of Australian Governments for endorsement in late November.

V WILL REFORM WORK?

One important question that must be asked is whether these reforms will work. If governments, public authorities and professions work together to implement these reforms, there are good prospects that premiums should be stabilised and that there will be downward pressure on premiums in the mid to longer-term. The Government is as concerned as the community to see that this occurs.

With this aim in mind, the Commonwealth Government has provided the ACCC with an ongoing monitoring role over the insurance industry to ensure that premiums are being adjusted to take account of cost savings generated through law reform. The Government's brief requires the ACCC to monitor the situation for premiums in both the public liability and professional indemnity markets over two years.

VI PLAINTIFFS' RIGHTS

Understandably, concerns have been raised about whether proposals such as those contained in the Ipp Report will impact unfairly on plaintiffs' rights. In considering this question, it is important to note that relatively speaking, personal injury law provides very generous compensation to a very small proportion of the population at considerable expense to the rest of the community.

There is an overwhelming consumer interest in restoring the balance in a system where, at present, the benefits disproportionately favour the few. Only a very small proportion of deaths or injury result in the payment of compensation. The vast majority of those who are injured have to rely on their own resources and on other sources of assistance, notably social security.

This observation has important implications for proponents of no-fault schemes for compensation. A scheme of this nature would be expected to cost billions of dollars. The much touted New Zealand Accident Compensation Scheme, for example, currently has unfunded liabilities of NZ$9.3 billion.[11] A scheme to provide care to catastrophically injured people would cost many

11 Accident Compensation Corporation, *Annual Report 2002* (2002), <http://www.acc.org.nz/about-acc/annual-report-2002/> at 21 November 2002.

billions of dollars per year. Those injured must be adequately cared for — but in the most appropriate, cost effective way.

Solutions to these crises must be balanced between the need for appropriate government action to secure the outcomes society expects and the need to manage the costs of doing so. No government has an appetite for socialising high-cost claims whilst allowing profits to flow to insurers. A better outcome is getting the settings right to ensure the market works more effectively. Ultimately rights are a relative concept, they are not absolute. There is little use in having rights if there are no services, no playgrounds, no recreational activities and no doctors. Rights must be balanced with responsibilities and rights must not be asserted to the disadvantage of the community as a whole.

VII CONCLUSION

Insurance is a vital thread running through the fabric of our society. The comprehensive package of tort law reforms recommended by the Ipp Report provides the framework to restore credibility to a liability system where the benefits have become lopsided. There are now major incentives for States and Territories to adopt a national law of negligence. The momentum for reform is substantial with the risk of insurers making unfavourable comparisons against those jurisdictions that do not embrace these reforms. National consensus on the approach to this problem has required determination, commitment and difficult decisions by all governments. Once implemented, a nationally consistent negligence law will provide a more efficient system for the allocation and management of risk. Lower and less frequent claims will redistribute benefits to the broader community.