20 Finance, insurance and superannuation services

Financial services, superannuation and insurance are important parts of the economy, with a combined value of almost $2000 billion. The scale of the industry emphasises the importance to Australia of effective financial, insurance and superannuation regulation.

The financial sector

The Commonwealth Government is responsible for much of Australia's financial regulation, particularly in the areas of trade, banking, insurance, bills of exchange, insolvency and foreign corporations. States and Territories also regulate financial markets, including via trustee legislation and credit controls. Regulation of the financial sector is designed to facilitate the creation and movement of capital while ensuring that market participants act with integrity and that consumers are protected. Proponents of financial sector regulation argue that government intervention is warranted, given the complexity of financial products and the inherent information imbalance between financial service providers and consumers. Regulation takes many forms, for example:

- licensing of individuals and of businesses (entry restrictions);
- conduct and disclosure requirements (reducing information costs); and
- financial reserve requirements (prudential regulation).

The Commonwealth Government commissioned a major public review, chaired by Mr Stan Wallis, of Australia's financial system in 1996-97. The Wallis Report, released in 1997, found that Australia's regulatory system was unnecessarily costly and complex. It made 115 recommendations, suggesting changes to both the Commonwealth legislation and State and Territory legislation. The recommendations included regulatory changes, standardisation of regulatory regimes to ensure consistency, and increased competition in many areas of the financial sector. In responding to the report, the Federal Treasurer categorised the proposed reforms as:

- rationalising the regulatory framework;
- balancing prudential and competition goals;
- maintaining the protection of depositors;

- promoting efficiency, competition and confidence in the payments system; and
- promoting more effective disclosure and consumer protection (Costello 1997).

All levels of government have undertaken legislative reform in response to the Wallis Report. Each State and Territory enacted financial sector reform legislation in 1999 to transfer powers of regulation and supervision of certain financial institutions to the new Commonwealth regulators, the Australian Prudential Regulation Authority and the Australian Securities and Investments Commission. This shift has involved amending legislation in all jurisdictions and repealing several legislative instruments due for review under the NCP.

The most recent Commonwealth reforms are contained in the Financial Services Reform Bill introduced in April 2001. This legislation arose from the Wallis recommendations and the related Corporate Law Economic Reform Program. The Commonwealth circulated a position paper in December 1997, followed by a consultation paper in March 1999. An exposure draft of the Bill was circulated in February 2000. The Bill includes:

- a harmonised licensing, disclosure and conduct framework for all financial service providers;
- a consistent and comparable financial product disclosure regime; and
- a streamlined regulatory regime for financial markets and clearing and settlement procedures.

Assessment

Governments' review and reform activity is consistent with NCP principles. Further review and reform in financial services legislation — for example the regulation of trust funds — is underway in all jurisdictions. The National Competition Council will further consider governments' progress in the 2002 assessment.

Compulsory third party and workers compensation insurance

Compulsory third party (CTP) motor vehicle insurance, often known as motor accident (personal injury) insurance, is designed to ensure that compensation is available to those injured or killed in motor vehicle accidents. CTP insurance is compulsory in all States and Territories.

Workers compensation insurance is designed to ensure that workers receive just compensation for injuries sustained at work, including the cost of medical care, rehabilitation services and lost earnings, and that they have access to adequate rehabilitation services. Workers compensation insurance also provides benefits to dependants of those killed in the course of their work. Such insurance is compulsory in all States and Territories.[1]

Governments have made these products compulsory because of the high cost of accidents (to both individuals and the community) and the difficulty that individuals have in assessing risk. In addition, many of the risks in these insurance markets are borne by people other than the person paying the premium (that is, other than the employer or the motorist). For example, making workers compensation insurance compulsory ensures workers rights to compensation do not depend on their employer's decision to take out insurance.

Characteristics of CTP and workers compensation insurance

Benefits

Benefits under CTP and workers compensation schemes are payable for medical and hospital expense, legal costs, loss of earnings and, in many cases, compensation for pain and suffering. They may be based on statutory formulae or derived from common law, and they may be periodic payments or lump sums.

Unlike most insurance markets, a number of the CTP and workers compensation systems in place in Australia do not require that premiums are collected for benefits to be paid. Instead, all injured workers or road accident victims are eligible for compensation regardless of whether insurance premiums have been paid. Universal access introduces a welfare element to what is, at first sight, an insurance market. Scheme objectives, such as universal access, are matters for governments to determine.

A second key dimension of benefits is whether they are based on common law rights or statutory entitlements. Historically, benefit payments in all schemes were based on common law rights only. However, some jurisdictions have codified entitlements in statute to provide greater certainty of outcomes for the injured and to reduce legal costs.

[1] Commonwealth and ACT Government employees are covered by the Comcare workers compensation insurance scheme.

All CTP systems except the Northern Territory include access to common law. This access is restricted in three jurisdictions (Victoria, Western Australia and South Australia), while it is unlimited in the remaining four (see table 20.1).

Two workers compensation systems rely on statutory benefits entirely (South Australia and the Northern Territory), while five (New South Wales, Victoria, Queensland, Western Australia and Tasmania) have limited access to common law claims and the ACT has unlimited access to common law. Comcare, which covers Commonwealth and ACT Government employees, provides statutory benefits with limited access to common law (see table 20.1).

Table 20.1: Benefits payable in mandatory insurance schemes

Types of benefit	*CTP*	*Workers compensation*
Statutory benefits only	Northern Territory	South Australia Northern Territory
Limited access to common law	Victoria Western Australia South Australia	New South Wales Victoria Queensland Western Australia Tasmania Comcare
Unlimited access to common law	New South Wales Queensland Tasmania ACT	ACT

In general, systems with restricted access to common law limit eligibility to take common law actions to people who are seriously injured; for example, the Victorian Workcover scheme provides access to common law for workers who have suffered a 'whole person impairment' of at least 30 per cent (Department of Treasury and Finance, PricewaterhouseCoopers and MinterEllison Lawyers 2000, appendix C1). Some systems (for example, those in New South Wales and Western Australia) provide for injured workers in some circumstances to choose between statutory and common law rights.

Links with non-insurance objectives

Governments link CTP and workers compensation schemes to non-insurance objectives, notably reducing injury and death. In general insurance markets risk is fully priced in premium rates, providing clear incentives to modify behaviour to reduce premiums. However, in CTP and workers compensation

insurance the manipulation of premium rates reduces the incentives that promote risk-reducing behaviour.

In the case of CTP, community rating means that there is no direct link between claims history and premium paid. Therefore, there is no financial sanction for risky behaviour, other than the element of accident costs that is inadequately compensated by the insurance scheme. In relation to workers compensation, most schemes provide for limited 'experience rating' and thus some link between behaviour and premiums. However, the incentives are blunted (especially for smaller employers) to the extent that industry ratings influence premiums. Further, employers pay premiums, while safety performance is determined by the actions of both employers and employees. Thus, behaviour changes by one party may not of itself reduce risk.

Some governments argue that only monopoly insurers have sufficient incentives to invest in education and other risk-reducing programs, and to collect the data necessary to underpin such activities. These arguments are more cogent in community-rated insurance schemes, given the muted premium-based incentives to change behaviour. However, there are alternative ways of achieving the desired outcomes in education and risk reduction. Governments may, for example, levy insurers or the insured to fund educational activities. Access to insurers' databases could inform such programs.

Legislative restrictions on competition

Mandatory insurance

CTP insurance is mandatory in all jurisdictions. It follows the vehicle in Australia, whereas cover normally applies to the driver in most European countries and most of North America. Purchase of a workers compensation insurance policy is also mandatory in all jurisdictions, with two minor exceptions. First, most schemes include limited provision for employers to become 'self-insurers'. These employers do not seek commercial insurance and assume the insurance risk themselves, but they must conform to regulatory requirements for the payment of claims. Second, employers with very small payrolls can be exempted from the insurance requirement, although provisions exist in some cases for claims costs to be recovered from them.

Mandatory insurance requirements recognise the frequency and severity of injury and death in both workplaces and on the roads. In both cases, a high proportion of injuries and deaths occur as the result of the behaviour of a third party; that is, the injured person is often not a contributor, or at least not the sole contributor, to their injury. The financial consequences of workplace or roads accidents can be significant. In the absence of insurance, the injured party may not receive the care they need.

NCP reviews have supported compulsory CTP motor vehicle and workers compensation insurance as providing a net community benefit. They have noted that mandatory insurance reduces transaction costs and ensures the appropriate parties bear the costs of injuries and death. The Council is satisfied that the arguments demonstrate a net community benefit in mandatory insurance in these areas.

Monopoly provision

Many CTP and workers compensation schemes are based on a government-sector monopoly provider of insurance services. There have been moves from competitive provision to monopoly and from monopoly to competitive provision in recent decades. In this assessment, the Council focused on governments' public interest arguments (including those raised by NCP reviews) supporting monopoly provision of CTP or workers compensation insurance.

Arrangements for workers compensation and CTP insurance are complex, given they are characterised by long term benefit payments and complex rehabilitation needs. One argument put for public monopoly provision is that this is necessary to deal with these complexities. Other benefits of monopoly provision of mandatory insurance products outlined by reviews include:

- consistent treatment of claims and benefits;
- better data collection; and
- incentives to invest in system wide improvements.

The key cost of monopoly provision is the lack of choice for consumers, who are forced to purchase a mandatory product from a single insurer. Other costs identified by reviews include:

- risk exposure for taxpayers, as governments are responsible for scheme deficits;
- lesser incentives to invest in targeted safety initiatives; and
- failure to take advantage of economies of scope.

Even where there is a strong public benefit case for monopoly provision, there may be opportunities for schemes to use agents to perform various functions ('hybrid' schemes). Some reviews identified the use of agents in areas such as claims management as being able to capture the benefits of competition, particularly by creating incentives for greater efficiency.

Licensing of insurers

All competitive CTP and workers compensation schemes include provisions for the licensing of insurers. 'Hybrid' schemes, where the monopoly insurer uses private agents to carry out certain functions are also characterised by what are effectively licensing provisions.

Licensing can constitute a significant restriction on competition, with the scale of the restriction being a function of the criteria employed to determine applications for licensing. In general, CTP and workers compensation licensing arrangements are based on two key principles. The first principle is financial viability. Given the 'long tail' characteristics of many claims in both markets, it is essential that insurers are able to meet claims liabilities in the longer term. A key question in considering regulation in this area is the extent to which licensing duplicates the functions performed by the Australian Prudential Regulation Authority, as opposed to adding value. The second principle is the proper delivery of services to claimants. The licensing requirement can function as a discipline on providers, enabling the regulator to enforce quality requirements.

The Council accepts that public interest arguments may justify licensing arrangements. However, the CPA requires that governments demonstrate that licensing criteria are the minimum necessary to meet the objectives of the legislation and that licensing is not used in an anticompetitive fashion.

Premium controls

Premiums are determined in different ways, including:

- directly by insurers who are free to set premiums without regulatory constraints, based on their assessment of risk and the extent of competition in the market;
- file and write, whereby insurers give a regulator advance notice of intended premiums and the regulator exercises some form of approval or control over the premium;
- premium-setting principles, whereby a 'file and write' approach is combined with the use of explicit premium-setting principles, to which all proposed premium structures must conform. The additional control implied by such a system is a function of the complexity and prescriptiveness of the principles adopted; and
- centralised premium setting, which can be used in either a monopoly insurer context or in a more competitive market. A number of variations are possible, ranging from determination by a monopoly insurer — with or without approval requirements by a Minister or independent regulator (equivalent to a 'file and write' system) — through to premium setting by a regulator in a partly competitive context, in which approved insurers

compete on service standards and, possibly, on the administrative cost element of the premium (as opposed to the underwriting cost).

CTP markets are characterised by community rating in premium setting. Workers compensation markets generally have premiums that are based on a combination of multiple industry ratings with experience-based loadings and discounts. Community rating is essentially a welfare-based scheme, predicated on ensuring universal access to the market at an affordable price. Thus, government requirements that community rating be used in determining premiums (usually combined with a requirement to accept all requests for coverage) are generally based on ensuring all members of society have reasonably affordable access to (compulsory) insurance. Governments also seek to restrict premium setting to achieve stability of premiums, notwithstanding that this works against the objective of having 'fully funded' schemes.

All forms of premium control may have costs in terms of reducing innovation and less satisfactorily meeting client needs, as well as reducing incentives for better performance by the insured. Overall, the cost of premium controls is that someone, at some time, pays too much for insurance. The benefits of premium controls must be balanced against these costs.

Consideration of the virtues of market-based premium setting is also relevant. Market-based premiums ensure that the incentives for improving safety performance are maximised (because they more directly related to risk) and that the costs of production are properly distributed, both across and within industries. These benefits are potentially important and must be weighed carefully against any costs attributed to market premium setting in terms of affordability and equity.

Public sector superannuation

All Australian workers and their employers are required by legislation to contribute to superannuation. Most employees are provided with a choice of superannuation fund, but in some jurisdictions public sector employees' choice of fund is constrained by legislation. Limiting employees to a particular superannuation fund limits options (for example, by preventing consolidation of funds) and prevents access by alternative providers to a significant component of the superannuation market.

Review and reform activity

Review and reform activity in mandatory insurance and public sector superannuation is outlined in the following tables.

Table 20.2: Review and reform activity regulating compulsory third party motor vehicle insurance

Jurisdiction	*Legislation*	*Key restrictions*	*Review activity*	*Reform activity*	*Assessment*
New South Wales	*Motor Accidents Compensation Act 1999*	Mandatory insurance, licensing of insurers, file and write premium setting	Review completed in 1997-98, recommending scheme design changes and insurers filing premiums with the Motor Accidents Authority.	Legislation passed in line with review recommendations.	Meets CPA obligations (June 1999).
Victoria	*Transport Accidents Act 1986*	Mandatory insurance, monopoly insurer, centralised premium setting	Internal review completed in 1997-98, recommending removing the statutory monopoly in favour of competitive provision. Second review completed in December 2000, recommending maintaining the monopoly and centralised premium setting, although the review recommended a third party review of premiums.	Government rejected the findings of the first review, and accepted the findings of the second review.	Council to assess progress in 2002.
Queensland	*Motor Accidents Insurance Act 1994*	Mandatory insurance, licensing of insurers, file and write premium setting	Review completed in 1999, recommending retaining licensing of insurers, but removing restrictions on market re-entry and on motorists changing insurers. Further, the review recommended introducing greater competition in premium setting through a 'file and write' system.	*Motor Accident Insurance Amendment Act 2000*, which commenced in October 2000, passed in line with review recommendations.	Meets CPA obligations (June 2001).
Western Australia	*Motor Vehicle (Third Party Insurance) Act 1943*	Mandatory insurance, monopoly insurer, centralised premium setting	Review completed in 1999-2000, recommending removing the monopoly provision of insurance and retaining Ministerial approval of premiums.	Drafting of legislation underway.	Council to assess progress in 2002.
South Australia	*Motor Accident Commission Act 1992*	Mandatory insurance, monopoly insurer, centralised premium setting	Review completed in 1998, recommending removing the monopoly and controls on premiums. Second review completed in 1999, rebutting previous review's recommendations. Government issued both reviews for public consultation in early 2001.	Government announced retention of mandatory insurance, the sole provision of insurance by the Motor Accident Commission and community rating. Drafting of legislation underway.	Council to assess progress in 2002.

(*continued*)

Table 20.2 continued

Jurisdiction	*Legislation*	*Key restrictions*	*Review activity*	*Reform activity*	*Assessment*
Tasmania	*Motor Accidents (Liabilities and Compensation) Act 1973*	Mandatory insurance, monopoly insurer, centralised premium setting	Review completed in 1997, recommending retaining the monopoly provision of insurance. Following second tranche NCP assessment, Tasmania agreed to re-examine the issue.		Council to assess progress in 2002.
ACT	*Road Transport (General) Act 1999*	Mandatory insurance, licensing of insurers	Not for review. Legislation allows the Government to approve multiple insurers.		Meets CPA obligations (June 1997).
Northern Territory	*Territory Insurance Office Act* *Motor Accidents (Compensation) Act*	Mandatory insurance, monopoly insurer, centralised premium setting	Review of Territory Insurance Office Act completed in 1999. Review of the Motor Accidents (Compensation) Act completed in December 2000 and under consideration by the Government.	Territory Insurance Office Act amended in December 2000, removing the requirement that the Territory Insurance Office be the sole administrator of the Motor Accident Compensation scheme. (The Motor Accidents (Compensation) Act continues to enforce the monopoly).	Council to assess progress in 2002.

Table 20.3: Review and reform activity regulating workers compensation insurance

Jurisdiction	*Legislation*	*Key restrictions*	*Review activity*	*Reform activity*	*Assessment*
Commonwealth	*Safety, Rehabilitation and Compensation Act 1988*	Mandatory insurance, monopoly insurer, centralised premium setting	Review completed in 1997, recommending introducing competition to Comcare.		Council to assess progress in 2002.

(*continued*)

Table 20.3 continued

Jurisdiction	*Legislation*	*Key restrictions*	*Review activity*	*Reform activity*	*Assessment*
New South Wales	*Workers Compensation Act 1987*	Mandatory insurance, monopoly insurer, centralised premium setting	Review completed in 1997-98, recommending removing the monopoly insurer in favour of competitive underwriting. Further examination of the scheme in 2000-01 resulted in proposals for changes to scheme design elements.	Legislation passed to introduce private underwriting in October 1999. Subsequent legislation has delayed implementation to a date to be determined by the Minister. Scheme design changes introduced in 2001.	Council to assess progress in 2002.
Victoria	*Accident Compensation Act 1985* *Accident Compensation (Workcover Insurance) Act 1993*	Mandatory insurance, monopoly insurer, centralised premium setting	Internal review completed in 1997-98, recommending competitive provision. Second review completed in December 2000, recommending maintaining the monopoly and centralised premium setting, although the review recommended a third party review of premiums.	Government rejected the findings of the first review, and accepted the findings of the second review.	Council to assess progress in 2002.
Queensland	*Workcover Queensland Act 1996*	Mandatory insurance, monopoly insurer, centralised premium setting	Review completed in December 2000. Cabinet is due to consider the report in mid-2001.		Council to assess progress in 2002.
Western Australia	*Workers Compensation and Rehabilitation Act 1981*	Mandatory insurance, licensed insurers, centralised premium setting	Review underway.		Council to assess progress in 2002.
South Australia	*Workers Rehabilitation and Compensation Act 1986*	Mandatory insurance, monopoly insurer, centralised premium setting	Review underway.		Council to assess progress in 2002.

(*continued*)

Table 20.3 continued

Jurisdiction	*Legislation*	*Key restrictions*	*Review activity*	*Reform activity*	*Assessment*
Tasmania	*Workers Rehabilitation and Compensation Act 1988*	Mandatory insurance, licensed insurers	Review by the Parliamentary Joint Select Committee of Inquiry completed in 1997.	Act amended in March 2001 in line with recommendations.	Meets CPA obligations (June 2001).
ACT	*Workers Compensation Act 1988*	Mandatory insurance, licensing of insurers	Review completed in July 2000, recommending changes to scheme design elements and a greater capacity to self-insure.	Draft exposure Bill released in December 2000.	Council to assess progress in 2002.
Northern Territory	*Work Health Act*	Mandatory insurance, insurers must meet prescribed standards	Review completed in September 2000, and released for public comment in June 2001. Review recommends that premiums remain unregulated and insurers remain unlicensed.		Council to assess progress in 2002.

Table 20.4: Review and reform of legislation regulating public sector superannuation

Jurisdiction	*Legislation*	*Key restrictions*	*Review activity*	*Reform activity*	*Assessment*
Commonwealth	*Superannuation Act 1976* *Superannuation Act 1990* *Defence Force Retirement and Death Benefits Act 1948* *Military Superannuation and Benefits Act 1991* *Parliamentary Contributions Superannuation Act 1948*	Limits on choice of funds	Reform proposed to give choice of fund to contributors for employees covered by federal awards. Review of the Parliamentary Contributions Act completed, concluding that administration costs are trivial and that there are efficiencies.	Legislation introduced. Still to be considered by the Senate.	Council to assess progress in 2002.

(*continued*)

Table 20.4 continued

Jurisdiction	*Legislation*	*Key restrictions*	*Review activity*	*Reform activity*	*Assessment*
New South Wales	*Superannuation Administration Act 1987*	Limits on choice of funds		Legislation passed to corporatise the scheme regulator and to market test the administration. Choice introduced.	Meets CPA obligations (June 2001).
Victoria	*State Superannuation Act 1985* *Superannuation (Public Sector) Act 1992*	Limits on choice of funds	Review completed in 1997.	Choice expanded and management restructured. Market testing of administration due in 2001.	Meets CPA obligations (June 2001).
Queensland	*Superannuation (Government and Other Employees) Act 1988*	Limits on choice of funds	Review completed in late 2000, concluding that the Act does not restrict competition.		Council to assess progress in 2002.
Western Australia	*Government Superannuation Act 1987*	Limits on choice of funds	New *Superannuation (Public Sector Employees) Act 1999* under review.		Council to assess progress in 2002.
South Australia	*Southern State Superannuation Act 1987*	Limits on choice of funds	No full NCP review following preliminary investigation. South Australia considers restrictions trivial.	No reform.	Council to assess progress in 2002.
Tasmania	*Retirement Benefits Act 1993*	Limits on choice of funds		Choice of funds for new and existing contributors introduced. Move to fund existing public scheme.	Meets CPA obligations (June 2001).
ACT	As for Commonwealth	As for Commonwealth		Reliant on Commonwealth reforms. New entrants have choice of funds.	Council to assess progress in 2002.
Northern Territory	*Superannuation Act*	Limits on choice of funds	Review completed in 1998, recommending the Government close the unfunded scheme and introduce choice.	Reforms implemented in line with recommendations.	Meets CPA obligations (June 2001).