# 6 Finance, insurance and superannuation services

Banks and other finance companies provide services that are vital to the ability of individuals and companies to accumulate savings and expand their assets and businesses. Insurance companies offer individuals and companies coverage against the cost of possible adverse events, and superannuation funds contribute to the capacity of individuals to provide for retirement. Governments should ensure that the regulation of these important services markets is consistent with the Competition Principles Agreement (CPA) clause 5 guiding principle — that is, that restrictions on competition should arise only if the benefits to the community exceed the costs, and that the objectives of the legislation can only be achieved by restricting competition. This chapter details the complex issues that governments have had to consider in weighing the costs and benefits of regulation in finance, insurance and superannuation markets.

## The finance sector

Regulation of the finance sector endeavours to balance the interests of consumers of financial services and the efficient functioning of capital markets. Given the complexity of financial products and the inherent information imbalance between financial service providers and consumers, a degree of government intervention is warranted. Regulation takes several forms, including:

- licensing of individuals and businesses that restricts market entry;
- conduct and disclosure requirements that raise compliance costs in order to reduce information barriers; and
- financial reserve requirements that constrain the financial freedom of businesses to protect consumers from insolvency.

The Commonwealth Government is responsible for much of Australia's financial regulation, particularly the regulation of trade, banking, insurance, bills of exchange, insolvency and foreign corporations. States and Territories regulate trustees and apply credit controls.

The Wallis inquiry into the financial system was established in June 1996 to make recommendations to the Commonwealth Government on 'the nature of regulatory arrangements that will best ensure an efficient, responsive, competitive and flexible financial system to underpin stronger economic performance, consistent with financial stability, prudence, integrity and fairness' (Wallis report, Foreword). The inquiry's final report sought 'an appropriate balance between achieving competitive outcomes and ensuring financial safety and market integrity' (Wallis report, p. 2).

The Wallis report used a premise similar to the guiding principle in CPA clause 5, stating that:

> *Regulation is necessary only to the extent that markets may fail, and then only where it can be demonstrated that the benefits of intervention outweigh the costs.* (Wallis report, p. 15)

It found that Australia's regulatory system was unnecessarily costly and complex. It made 115 recommendations for reform of Commonwealth and State and Territory legislation in several areas, including:

- the conduct of, and disclosure by, financial institutions;
- the establishment of a single prudential regulator;
- the regulation of mergers and acquisitions in the financial sector; and
- foreign investment, the choice of funds for superannuation members, modernisation and uniform national application of trustee company regulation, and the regulation of electronic commerce.

The Commonwealth Government made its formal response to the report on 2 September 1997. The key elements of the Government's reform package involved:

- promoting efficiency and greater competition, including by rationalising the regulatory framework;
- balancing prudential and competition goals — that is, maintaining financial system safety while allowing financial institutions to respond with greater flexibility to market developments and encouraging competitive equivalence in regulatory mechanisms across newly emerging market structures;
- maintaining the protection of depositors;
- promoting efficiency, competition and confidence in the payments system; and
- promoting more effective financial company disclosure and consumer protection (Costello 1997).

In response to the Wallis report, each State and Territory enacted legislation in 1999 to transfer powers of regulation and supervision of certain financial institutions to the new Commonwealth regulators:

- the Australian Prudential Regulation Authority (APRA), which is concerned with the prudential regulation of banks, insurance companies, superannuation funds, credit unions and friendly societies; and
- the Australian Securities and Investments Commission (ASIC), which enforces company and financial services laws to protect consumers, investors and creditors.

This shift involved amending legislation in all jurisdictions and repealing several legislative instruments due for review under the National Competition Policy (NCP).

The *Financial Services Reform Act 2001* and consequential amendments contain substantial Commonwealth reforms to the financial sector. This legislation represented another major segment of the Commonwealth's legislative response to the Wallis report. In introducing the Financial Services Reform Bill 2001, the then Minister for Financial Services and Regulation stated that the legislation would enable financial service providers to reap the efficiencies and cost savings identified in the Wallis report. The Financial Services Reform Act 2001 introduced a harmonised regulatory regime for market integrity and consumer protection for all financial service providers, replacing the multiplicity of frameworks that had applied to different financial sector services (Hockey 2001). The legislation provides for:

- a harmonised licensing, disclosure and conduct framework for all financial service providers;
- a consistent and comparable financial product disclosure regime;
- a streamlined regulatory regime for financial markets and clearing and settlement facilities; and
- the removal of regulatory barriers to the introduction of technological innovations.

The Commonwealth Government continues to reform this sector. The Financial Services Reform Act commenced on 11 March 2002, although in recognition of the scope of the changes, existing participants will have two years to opt into the new regime. The Government is facilitating the transition to the new financial services regime by 11 March 2004 through guidance by the Australian Securities and Investments Commission and legislative amendments to clarify the operation of the law. The *Financial Services Reform (Consequential Provisions) Act 2002* included amendments to correct errors in the Financial Services Reform Act 2001. The *Financial Sector Legislation Amendment Act (No. 1) 2002* continued legislative amendments arising from the Wallis report, involving minor amendments to legislation relating to life and general insurance, APRA, the Reserve Bank and the superannuation industry. The Financial Sector Legislation Amendment Bill (No. 2) 2002, still to be passed as at mid-2003, involves largely minor amendments that aim to improve APRA's ability to monitor the financial industry and the capacity of the Superannuation Complaints

Tribunal to fulfil its functions. The Financial Services Amendment Bill 2003 was referred to the Senate Economics Legislation Committee, which is due to report by 19 August 2003. This Bill aims mainly to improve the capacity of the Australian Securities and Investment Commission to undertake its tasks.

State and Territory governments are yet to complete all facets of financial sector reform. While some jurisdictions have removed minor restrictions in trustee legislation in recent years, a national NCP review of legislation relating to trustee corporations is under way, with New South Wales acting as the lead jurisdiction. The Standing Committee of Attorneys-General released a consultation paper and a draft uniform Bill in May 2001. The draft Bill was premised on the assumption that APRA would be responsible for the supervision of trustee companies, but the Commonwealth Government decided in early 2003 that it would not give the authority this role. This decision could have major implications for the national review and the draft Bill. (The national review is discussed in chapter 14, volume 2.)

## Assessment

The thrust of the Wallis report is consistent with the objectives of improving competition in the financial services sector and ensuring regulation is aimed at rectifying market failure. Accordingly, governments' review and reform activity in response to the Wallis report has generally been consistent with NCP principles. The Council notes, however, that the national review and reform of trustee corporation legislation has not been completed.

# Insurance services

There is a wide range of insurance products. Information relating to premium revenue indicates the relative importance of the various classes of insurance business. In 2000-01, domestic motor vehicle insurance accounted for 22 per cent of total premium revenue reported to APRA. Householder insurance accounted for 14 per cent, followed by compulsory third party (CTP) insurance (10 per cent), fire and industrial special risks insurance (8 per cent), commercial motor vehicle insurance (6 per cent), workers compensation insurance (5 per cent), public and product liability (5 per cent), other accident insurance (4 per cent) and professional indemnity insurance (3 per cent)[1] (ACCC 2002a, p. 39).

1 The other 23 per cent of premium revenue was generated in the fields of inward treaty, marine, aviation, mortgage, travel, consumer credit and other insurance.

# Legislative restrictions on competition

This section focuses on four key legislative restrictions on competition that are prevalent in the areas of CTP, workers compensation and legal professional indemnity insurance. These are:

- mandatory cover;
- monopoly provision;
- premium controls; and
- licensing of insurers.

## Mandatory insurance

In all States and Territories, CTP insurance is mandatory and applies to the vehicle. In establishing CTP schemes, governments were motivated to ensure all road accident injury victims, as well as relatives of those killed in traffic accidents, are compensated regardless of fault. Some jurisdictions allow unlimited access to the common law, while others allow limited access. Some States also allow access to statutory no fault benefits. This coverage includes parties injured in road accidents who are not required to take out insurance (for example, pedestrians and cyclists).

Workers compensation insurance too is compulsory. Employees receive entitlements reflecting the participation of their employers in the insurance market. Exceptions are minor, with some jurisdictions allowing employers over a certain size to self-insure and, in some cases, exempting very small companies from insuring. This universal coverage aspect of CTP and workers compensation insurance differentiates them from other forms of insurance.

NCP reviews have noted that the mandatory nature of these forms of insurance ensures parties responsible for accidents cannot avoid contributing to the benefits available for affected parties. The reviews have thus argued that there is a net community benefit from the CTP and workers compensation insurance being mandatory. The National Competition Council accepts this argument.

All States and Territories require lawyers practising as solicitors to take out professional indemnity insurance.

## Monopoly provision

In many insurance markets, government legislation allows for competitive provision, and competing private insurers are the principal underwriters. For CTP and workers compensation insurance, however, several governments have legislated for monopoly underwriting by a government-owned entity of at least one of these forms of insurance. This arrangement is the principal restriction with NCP implications.

A number of jurisdictions (New South Wales, Queensland, Western Australia, Tasmania and the Northern Territory) license multiple private companies to provide one of these two forms of insurance, but legislate for monopoly supply of the other form of insurance (table 6.1). This arrangement occurs despite the two types of insurance being similar — both are concerned with accident insurance and both are mandatory.

**Table 6.1:** Provider arrangements for CTP and workers compensation insurance

| *Jurisdiction* | *CTP insurance* | *Workers compensation insurance* |
|---|---|---|
| Commonwealth | Not applicable | Monopoly insurer for Commonwealth employees (Comcare) |
| New South Wales | Multiple private insurers | Monopoly insurer (WorkCover NSW) |
| Victoria | Monopoly insurer (Transport Accident Commission) | Monopoly insurer (Victorian WorkCover Authority) |
| Queensland | Multiple private insurers | Monopoly insurer (WorkCover Queensland) |
| Western Australia | Monopoly insurer (Insurance Commission of Western Australia) | Multiple private insurers |
| South Australia | Monopoly insurer (Motor Accident Commission) | Monopoly insurer (WorkCover Corporation of South Australia) |
| Tasmania | Monopoly insurer (Motor Accident Insurance Board) | Multiple private insurers |
| ACT | Legislative provision for licensing of multiple insurers – but only one licensed insurer (Insurance Australia Group) | Multiple private insurers |
| Northern Territory | Monopoly insurer (Territory Insurance Office) | Multiple private insurers |

In all instances (except workers compensation insurance in Tasmania, the ACT and the Northern Territory), premiums are set, regulated or subject to oversight.

Governments also have legislated for the monopoly provision of indemnity insurance for some professions. Most jurisdictions require (generally by legislation) that legal practitioners insure through a monopoly provider. In New South Wales, professional indemnity insurance for solicitors is mandatory and must be arranged through the New South Wales Law Society, which is the statutory monopoly provider of this insurance under the *Legal Profession Act 1987*. In Victoria, the Legal Practitioners Liability Committee is the statutory monopoly provider of legal professional indemnity insurance. In Queensland, lawyers must take out professional indemnity insurance through a Queensland Law Society master policy or an insurer approved by the law society. Monopolies also provide this insurance in Western Australia, South Australia, Tasmania and the Northern Territory, while the ACT allows for two providers. This chapter and chapter 4 of volume 2 discuss review and reform activity in the area of solicitors' professional indemnity insurance.

Under the National Cooperative Scheme for the Regulation of Travel Agents, the States and the ACT Government legislated for the Travel Compensation Fund's monopoly provision of travel agents' indemnity insurance. This fund compensates consumers in the event of the financial failure of a travel agent. The national scheme is subject to a national review commissioned by the Ministerial Council on Consumer Affairs (see chapter 14, volume 2).

## Premium controls

In most jurisdictions, there is only a muted connection between the riskiness of the insured party and the premium that party pays. This is particularly the case with CTP insurance, for which all motorists tend to pay the same regulated premium regardless of their driving history or driving behaviour by their cohorts. Younger and inexperienced drivers typically face the same CTP premiums paid by more experienced drivers, despite incurring higher premiums for comprehensive motor vehicle insurance. In workers compensation schemes, an employer's premium broadly reflects the nature of the employer's industry and the employer's experience. Industry ratings, however, tend to blunt the latter factor.

Governments argue that this 'community rating' aspect of CTP and workers compensation insurance contributes to the high proportion of drivers and employers taking out insurance. Community rating, however, diminishes the incentives for risk minimisation that could arise from differential premiums reflecting factors such as age, driver or workplace safety history, experience and measures taken to reduce risk.

## Licensing of insurers

Licensing of CTP and workers compensation insurance providers allows governments to account for their financial viability and history, and also provides a form of agreement on certain aspects of each licensee's operations. The capacity of governments to provide and withdraw licences is likely to serve as an incentive for insurers to conduct their finances and customer relations effectively and with probity. Governments' licensing roles do not, however, ensure insurance companies perform well. Prudential authorities and the boards of insurance companies should retain the responsibility for monitoring the finances and probity of insurance companies.

Licensing also can enable governments to enforce particular requirements (for example, the contribution of a proportion of premium revenue to rehabilitation services or safety advertising campaigns). For such reasons, and provided licensing criteria are not anticompetitive and are the minimum necessary to achieve government objectives, the Council considers that licensing is consistent with the CPA clause 5.

# Review and reform activity

## Compulsory third party and workers compensation insurance

All governments completed reviews of their statutory monopoly insurers by early 2001. In New South Wales, the Grellman Report into workers compensation insurance was finalised in 1998, and the State Government legislated for private underwriting to commence in October 1999. The Government subsequently deferred implementation of the legislation until an unspecified date; then, in 2001, it repealed provisions that provided for competitive underwriting. New South Wales commissioned a further review by McKinsey and Co., which has been asked to make recommendations on the optimal underwriting/insurance arrangements that will deliver workers compensation scheme objectives and achieve better scheme outcomes in terms of: price, service, efficiency, injury and claims management, risk management, funds management and premium collection. This review, which has a reporting deadline of the second half of 2003, will account for the guiding principle in the CPA clause 5.

In Victoria, second reviews of CTP and workers compensation insurance were finalised in 1999 and 2000 respectively, reversing the first reviews' recommendations for multiple provision. In its 2003 NCP annual report, the Victorian Government informed the Council that in 2003 it will review the scope for greater contestability in the provision of CTP and workers compensation insurance via further outsourcing ('market testing') by the Transport Accident Commission and the Victorian WorkCover Authority. The Government considered for some time the mechanism for third party reviews of the Transport Accident Commission and Victorian WorkCover Authority premiums, which was a recommendation of the 2000 NCP reviews. In March 2003, the Government requested the Essential Services Commission to provide advice on whether the expected premium revenue associated with the Transport Accident Commission's proposed premium for 2003-04 is consistent with the solvency of the transport accident compensation scheme (the Essential Services Commission reported in April 2003 that it is so consistent). Victoria informed the Council that it is likely that the Essential Services Commission will review the 2004-05 premiums of the Transport Accident Commission and the Victorian WorkCover Authority.

In Queensland, the review of workers compensation insurance was completed in December 2000, leading the Government to legislate minor changes in 2002. These legislative changes will be completed during 2003. The monopoly insurance arrangements continue.

In Western Australia, the previous Government endorsed the legislation review of CTP insurance in 2000, which recommended multiple provision. Amending legislation was withdrawn in 2001 by the current Government and it has since taken no further action. Western Australia's 2003 NCP annual report noted that the current Government is accounting for recent crises in other parts of the insurance sector in its consideration of the review's recommendation for multiple provision. The Government is not considering changing the multiple provider arrangements in workers compensation insurance. Following the completion of the NCP review of workers compensation in early 2002, the Government expects to introduce minor legislative amendments to Parliament in spring 2003.

South Australia conducted a second review of CTP insurance in 1999, reversing the 1998 review's recommendation that multiple provision be introduced. The Government confirmed in September 2001 that the Motor Accident Commission would remain the sole provider of CTP insurance in South Australia. South Australia's 2003 NCP annual report reiterated the State's public interest case for retaining the single statutory provider of CTP insurance — that is, that its statutory monopoly scheme allows cheaper premiums and that only such arrangements can achieve objectives such as universal coverage, affordability and fair claims settlements. Some minor legislative amendments came into force in October 2002.

In the case of workers compensation insurance in South Australia, an interagency steering committee completed an NCP review in mid-2002 that identified restrictions to competition but recommended only minor changes to the *Workers Rehabilitation and Compensation Act 1996*. The review argued that statutory monopoly provision has net public benefits. The Government is considering the review in the context of two separate investigation reports provided to the Government in late 2002 and early 2003 — one relating to governance arrangements in the WorkCover Corporation and one relating to workers compensation and occupational health and safety systems.

The Tasmanian Government stated in its 2001 and 2002 NCP annual reports that it was examining the Victorian review of the Transport Accident Commission before making decisions about its Motor Accident Insurance Board. The 2003 NCP annual report stated that the Government had completed this examination and decided to make no changes to the legislation.

The ACT allows for multiple providers of both CTP and workers compensation insurance.

In the Northern Territory, the review of CTP insurance was completed in late 2000 and the Government is considering the recommendations. This review argued for retaining the monopoly arrangements, but suggested that the Government consider franchising out the operation of the CTP scheme. It recommended clarifying legislative objectives and replacing references in legislation to the Territory Insurance Office with 'the designated insurer'. The Government stated in its 2003 NCP annual report that this recommendation will be considered as part of a wider review examining options for future ownership and management of the motor accidents scheme. This review will be completed in the second half of 2003. The Northern Territory Government also considered a review of workers compensation insurance, which is provided by multiple insurers. It introduced legislative amendments relating to benefits and compensation. The Council considers that the Northern Territory has met its CPA obligations in relation to the review and reform of the regulation of workers compensation insurance.

Commonwealth employees are covered by the monopoly compensation insurer, Comcare. The review of this arrangement was completed in 1997, but no reforms have been introduced.

Tables 6.2 and 6.3 summarise jurisdictions' progress in their legislative review and reform activity in the areas of CTP and workers compensation insurance.

## Legal professional indemnity insurance

Most governments reviewed the professional indemnity provisions of their legal practitioner legislation. New South Wales completed a review of its *Legal Profession Act 1987* in 1998. The review recommended deregulating the market for professional indemnity insurance for solicitors, subject to the provision of appropriate protection for clients through minimum standards for policies, run-off cover and indemnity. The Government rejected this recommendation and, in 2002, proposed to establish a new mutual fund to cover all solicitors (except those with exemptions). It anticipated that an insurer selected by an independent board would administer the fund. The Government envisaged that commercial insurers would re-insure all or part of the fund's liabilities. APRA advised, however, that the entity managing such a mutual arrangement would require a licence under the Commonwealth Government's *Insurance Act 1973* and would be required to meet APRA's capital adequacy requirements. New South Wales is also awaiting the outcomes of the consideration by the Standing Committee of Attorneys-General of a national scheme.

Victoria conducted two professional indemnity insurance reviews. The first review, conducted by KPMG, recommended removing the Legal Practitioners Liability Committee's monopoly over the provision of professional indemnity insurance to solicitors. The second review, conducted by the Legal Practice Board, recommended retaining it. The Government released the Legal Practice Board report (and its draft response) for public comment in November 2000. It subsequently provided a supplementary report on professional indemnity insurance for solicitors to the Council in June 2001 and confirmed its decision to retain the monopoly arrangement.

Queensland released a green paper on legal profession reform in June 1999. The green paper recommended providing competition in the professional indemnity insurance market. It proposed legislating the objectives to be achieved by the professional indemnity insurance cover (for example, that the policy must include appropriate run-off cover), but not prescribing whether the insurance should be through a master policy or open to the market. In December 2000, the Government announced that it would allow the professional bodies to select professional indemnity cover — subject to the cover meeting minimum standards — while also allowing the current arrangements to continue for a further three years. The Government subsequently commenced an NCP review of its legal practitioner legislation (including the professional indemnity insurance arrangements), releasing a discussion paper in November 2001. Consideration of the issue has been overtaken by the approval by the Standing Committee of Attorneys-General of the drafting of national model laws for legal profession regulation, including the regulation of professional indemnity insurance.

Western Australia released the review report on the *Legal Practitioners Act 1893* in June 2002. The report recommended retaining requirements for legal practitioners to insure through the Law Society, but amending the Act to codify the Law Society's practice of allowing practitioners to opt out of the scheme where they give adequate notice and evidence of having made suitable alternative insurance arrangements.

South Australia completed a review of the *Legal Practitioners Act 1981* in October 2000. The review recommended maintaining the Law Society's monopoly over professional indemnity insurance for legal practitioners, provided premiums remain competitive. The Government accepted the review's recommendations.

Tasmania released a regulatory impact statement containing preliminary recommendations for the reform of its *Legal Profession Act 1993* in April 2001. The regulatory impact statement found that the requirement for legal practitioners to have professional indemnity insurance is in the public interest, but that legal practitioners should be able to arrange their own insurance rather than have to use the Law Society scheme. This recommendation was conditional on the public benefits (guaranteed indemnity and run-off cover) being maintained. The review team completed its report in August 2001. The Government is re-considering the review's recommendations, given the decision by the Standing Committee of Attorneys-General to prepare and adopt uniform national laws to regulate the legal profession.

The ACT commenced a review of the *Legal Practitioners Act 1970* in 1999. As an interim measure pending the full NCP review, the ACT Government amended the Act to introduce a second approved insurance provider. Willis Corroun Professional Services Limited indicated, from its experience as the agent of insurers entering the market in the ACT, that competition leads to broader cover, cheaper premiums and a higher level of service. The ACT subsequently ceased its NCP review, given the development of uniform national laws to regulate the legal profession. The ACT is working with other jurisdictions on the Standing Committee of Attorneys-General to develop these national laws.

The Northern Territory delayed its NCP review of the *Legal Practitioners Act* provisions that relate to professional indemnity insurance because the Government is considering recent insurance market developments and capacity to deliver such insurance. The Government expects to receive the review report during 2003 but any legislative reform would follow the completion of the new national laws under the Standing Committee of Attorneys-General.

Chapter 4 of volume 2 provides tables that summarise jurisdictions' legislative review and reform activity in the area of solicitors' professional indemnity insurance.

## The Council's approach for the 2003 NCP assessment

The Council cannot complete its assessment of the two key restrictions in legislation relating to compulsory insurance — monopoly provision and premium controls. There are several reasons for this decision.

First, jurisdictions are continuing to adjust their legislation relating to public liability and professional indemnity insurance following the sharp rise in insurance premiums in recent years. The adjustments relate particularly to limiting benefits. On 4 April 2003, Commonwealth, State and Territory Ministers meeting at the fifth insurance 'summit' agreed to legislate caps on professionals' liability and to introduce proportionate liability for professionals. At the sixth insurance summit on 6 August 2003, jurisdictions agreed to develop nationally consistent professional standards linked to caps on professional liability. Some States had already introduced proportionate liability legislation before the April summit, although Queensland is considering alternative approaches. These changes may have implications for CTP, workers compensation and legal professional indemnity insurance.

Second, the Commonwealth Government asked the Productivity Commission in mid-March 2003 to assess possible models for establishing national frameworks for the provision of workers compensation and occupational health and safety. The report (due 13 March 2004) is likely to include recommendations that have implications for jurisdictions' workers compensation insurance arrangements. Given the similarities between these arrangements and CTP schemes, which are also mandatory and concerned with personal injury, it would be premature for the Council to finalise its assessment at this juncture. Similarly, workers compensation insurance presents issues that are closely related to those affecting legal professional indemnity insurance, which is also the focus of a potential national approach via the Standing Committee of Attorneys-General.

Some of these developments have occurred since the 2002 NCP assessment, although most were anticipated at that time. The Council highlighted issues about which it sought more information from jurisdictions to help it understand the advantages and disadvantages of monopoly provision and premium controls. The Council wrote to jurisdictions in November 2002, seeking information on:

- whether private insurers in deregulated markets would seek not to offer insurance to high risk drivers and employers, despite the mandatory nature of these insurance types;
- for 'long tail' insurance claims, whether jurisdictions believe that competing insurance companies are less motivated than monopoly providers to make careful actuarial assessments of the likelihood of serious accidents;
- whether competing private insurers contribute less to accident reduction and rehabilitation; and
- for legal professional indemnity insurance, whether private companies would be attracted to participating in this market, whether the failure of a monopoly insurance provider would be more disruptive to solicitors than the failure of a private provider, whether data indicate that monopoly providers are more cost-effective in this market and whether private insurers would neglect run-off cover for retired solicitors.

Some jurisdictions responded to these matters in their 2003 NCP annual reports. These responses helped the Council's consideration of the key NCP issues of monopoly provision and premium controls. The following section provides a discussion of economic and policy considerations surrounding the arguments for and against monopoly provision of compulsory insurance.

## The nature of insurance markets

Insurance markets have key characteristics, some of which may help to identify why governments view CTP, workers compensation and legal professional indemnity insurance as being different from other insurance markets and thus requiring different policy responses.

### Cover for adverse events

Companies and individuals enter insurance contracts to provide them with compensation for losses arising from adverse events. Most areas of insurance are voluntary, reflecting that people can often determine a trade-off between the perceived risk of adverse events and the cost of insurance. Those opting to insure usually have a choice of insurance companies and can shop for the premium and benefits package that suit them best. By contrast, CTP, workers compensation and legal professional indemnity insurance are mandatory and often available only through a monopoly established by legislation.

## Different risk profiles

In any insurance market, different policyholders have varying degrees of risk of experiencing an adverse event. Younger drivers are much more likely than experienced older drivers to have motor accidents, and older people are more likely than young people to experience health concerns. Typically, there is a relationship between the perceived risk and the magnitude of insurance premiums.

Insurance companies undertake actuarial assessments of potential policyholders to estimate the probability of them experiencing adverse events. Insurance companies usually know less than the party seeking insurance about that party. Known as ‘information asymmetry’, this is a source of market failure in insurance (see below). In many instances, insurance companies do not assess individuals or companies in detail but according to the risk profile of the cohort to which they belong. All young drivers, for example, are deemed to present above-average risks and thus face higher comprehensive insurance premiums than paid by other drivers.

## Multiple product offerings

Private insurance companies typically offer a range of insurance products, bringing to one product the expertise, experience and resources that they apply across their range. The resulting cost reductions and, often, innovative product service provision are defined in the literature as ‘economies of scope’. In competitive markets, insurance customers are likely to enjoy at least some of the benefits of these economies.

Government-owned insurance monopolies are usually charged with providing just one insurance product, restricting their capacity to directly reap economies of scope. Nevertheless, if monopoly insurers outsource certain functions (for example, premium collection or claims management) after a competitive bidding process, then they may be able to harness some economies of scope enjoyed by the bid winners.

## Long tail liabilities

Long tail liabilities are cases of severe injury leading to a requirement of income and rehabilitation support over a long period. The phrase is also used to refer to claims not made for several years after the event that led to injury or illness. Asbestos-related illnesses, for example, may not arise for some years after exposure to asbestos, and back injuries may become debilitating only some years after an accident. Long tail liabilities have always been a feature of workers compensation and CTP motor vehicle insurance.

## Regulating in the public interest

Where markets cannot operate efficiently, reflecting sources of 'market failure', government intervention may be needed to improve the working of the market or provide a product that the market fails to provide. Such government intervention is not automatic, however, because the costs of the intervention need to be tested against the costs of the market failure that it seeks to overcome. Potential sources of market failure include the existence of public good/externality factors, information asymmetry and a natural monopoly.

### *Public goods/externalities*

When an insurance company expends on measures that reduce the riskiness of its policyholders (for example, advising customers on ways in which to reduce the risk of burglaries, fire or accidents), the insurance company runs the risk of competing insurers 'free-riding' on its achievements in reducing these risks.

In its 2003 NCP annual report, Queensland argued that competing companies offering workers compensation insurance may focus on employers with good claims performance and leave poorer performing employers exposed to increased difficulty and cost in obtaining insurance cover. A contrary view, however, would be that such an outcome would send appropriate signals to those employers with a poor safety record.

There may be a disincentive for insurance companies to individually devote resources to accident prevention, given the fear that competitors will enjoy the benefits at no cost and thus compete more vigorously on premiums. As a result, there is a strong case for the government sector to be responsible for the provision of accident prevention services, either by government bodies directly or by contracted private entities. The issues are similar in the cases of accident research and occupational health and safety research, which are both means of improving accident prevention.

The rehabilitation of accident victims is costly, especially for people who require treatment and support over a long period. The insurance industry as a whole benefits from research into, and application of, new rehabilitation techniques that reduce rehabilitation timelines and costs. The individual insurance company, however, does not have an incentive to spend significantly on such research, because its competitors would free ride on the benefits in terms of reduced claims costs.

Competing insurance companies may be prepared, however, to establish rehabilitation programs for accident victims, because successful rehabilitation allows their injured policyholders to stop making claims. Western Australia's 2003 NCP annual report stated that private insurers participating in the workers compensation scheme in that State (where there are 11 insurance providers) often pay more than the prescribed amount for rehabilitation to bring forward employees' return to work. Perhaps not all insurance companies would provide rehabilitation services, however; many are likely to rely on the capacities of hospitals and specialist rehabilitation centres. Despite the efforts of regulatory authorities, rehabilitation facilities run by some insurance companies might seek to discharge patients before rehabilitation was complete to reduce claims costs. Further, the running of rehabilitation centres and rehabilitation research are inextricably mixed, which supports the view that the government sector should provide rehabilitation services and research as public goods.

Provision by monopoly insurers, however, may not be the optimal approach for government to provide these public goods. A conflict of interest may exist between the insurance objective of minimising claims and the social objective of ensuring accident victims obtain optimal rehabilitation. The conflict would be compounded if the monopoly insurer were also the regulator of rehabilitation standards, because regulatory practice may favour reducing claims costs at the expense of patients' welfare.

An alternative approach could involve a government regulator, separate from the insurance providers, determining the appropriate rehabilitation standards. Rehabilitation services and research would thus be provided by entities that are separate from the insurance industry. These entities could be government owned or commissioned by the government, and funded transparently from the Budget or by a levy on CTP and workers compensation premiums. New South Wales uses this funding method for CTP insurance: the competing insurance companies collect the levy to be used on accident prevention, rehabilitation and research, and pass it on to the Government. Alternatively, the government could establish an ongoing industry pool for funding accident prevention, rehabilitation and research. (If insurers left the market, then their funds would remain in the pool.)

### *Information asymmetry*

Because insurance companies usually do not have the detailed information about potential policyholders that the policyholders have ('information asymmetry'), they tend to price premiums at a higher level than they would otherwise. This pricing approach tends to cause 'adverse selection', whereby some lower risk parties reassess the trade-off between the price of the premium and the likelihood of a costly event that would be covered by insurance. Potential policyholders who present a lower risk than is normal for members of their cohort (for example, safe young drivers or businesses that undertake strong fire prevention measures) may be required nonetheless to pay a premium that is the average for their cohort, leading some to choose not to take out insurance. As these parties drop out of the insurance market, insurance companies are left with a smaller number of higher risk customers, leading over time to higher than expected claims and further rises in premiums.

Where governments regulate insurance markets, including CTP and workers compensation insurance, they tend to restrict benefits progressively to maintain the financial viability of insurance companies, rather than allow premium flexibility. Compared with three to four decades ago, accident victims' statutory access to common law has become more restricted.[2] In some instances, governments' desire to keep premiums steady has prevented insurance companies from responding to changed market circumstances, thereby contributing to the exit of insurance companies from the market.

The phenomenon of insurance premiums generally being more expensive than if insurance companies had full information about customers is an issue for both monopoly providers and competing providers. Monopoly providers of CTP insurance (for example) may have some advantage in having a more comprehensive database of insured parties, which might allow those monopoly providers to better understand the average risk profile of certain cohorts, such as drivers under 25 years or drivers domiciled in certain metropolitan areas. On the other hand, monopoly providers of CTP insurance will not have information about the risks that individual policyholders present in nondriving activities. Private insurers can often, therefore, develop a good 'picture' of a client when they sell more than one insurance product to that client.

When governments set premiums for compulsory insurance products at uniform or nearly uniform levels across the community, there is little or no variation in premiums to reflect the different risks of different cohorts, and low risk parties do not have the option of not taking out insurance. The result is that all low risk parties are required to subsidise high risk parties. When multiple insurers are allowed to compete on price, their competition tends to mitigate the upward pressure on premium levels arising from the information asymmetry.

Governments sometimes express concern that fraud prevention may be another case of market failure. They argue that an individual insurance company's efforts to detect fraudulent practices would result in fewer claims generally and benefits for free-riding competing insurers. The experience with CTP insurance in New South Wales suggests, however, that competing insurance companies have a mutual advantage in sharing information on fraudulent customers (with government having a facilitation role). Such customers may move between insurers and seek insurance cover from any of them. If insurers share information, then they maximise the pool of available data and thus the awareness of potential customers with a history of fraud. The Motor Accident Authority in New South Wales facilitates the collection of data relevant to the detection of fraud. It contracts a private company to collect data from insurers and maintain a fraud database; all insurers bear the costs of maintaining the database. The Motor Accident Insurance Commission in Queensland maintains a database of all CTP claims which assists insurance companies to detect fraud.

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2 Payouts awarded under common law are paid by the insurance company (public or private) of the party found to be at fault.

*Natural monopoly*

Natural monopoly occurs where cost conditions allow a single company to produce the particular output(s) at a lower cost than that of any other market arrangement. As a result, only one company operates in the market.

The fixed costs of establishing an insurance business, however, are not great. Capital costs are essentially buildings and office equipment, together with the minimum capital requirements imposed by APRA. Historical evidence indicates the relative ease of entry to the industry, especially given that most new entrants into a particular insurance market made their underlying capital investments to establish in other insurance markets — that is, they are existing insurance companies.

A large provider in a particular insurance market may enjoy savings by being able to spread risk over a larger pool of funds. Multiple providers would probably reduce risks by participating in a number of insurance markets.

The participation of several companies in those compulsory insurance markets in which competition is allowed indicates that economies of scale are achieved at quite low output sizes. There are six licensed providers of CTP insurance in Queensland, and 11 and nine licensed providers of workers compensation insurance in Western Australia and Tasmania respectively. While the differences in scheme design (especially benefit arrangements) make comparison difficult, and while benefit limits may contribute to the financial stability of industry participants, the viability of multiple providers in small markets suggests that economies of scale are not a significant issue in insurance markets.

Some governments consider, nonetheless, that a regulated monopoly may be appropriate. Queensland argued that insurers with a large market share and thus large size have better opportunities for minimising administrative costs and maintaining affordable premiums. Queensland further concluded that the existence of a number of insurance providers could increase premiums as a result of insurance companies' losses in other markets.

*Financial position of statutory monopolists*

Victoria contended in its 2003 NCP annual report that statutory monopoly schemes tend to provide greater prudential certainty because:

- they price according to risk and have superior risk information than that of competing private insurers;
- they are single-purpose operations that are not vulnerable to the range of risks confronting private companies; and
- their operations are more transparent.

An insurance company experiences financial difficulties if it does not generate sufficient premium revenue and investment income to cover underwriting and other liabilities. Some of the 'strengths' of a statutory provider (as described by Victoria) could become weaknesses — for example, if the managers of statutory scheme are incompetent and respond inappropriately to risk information, or if the lack of diversity in a statutory scheme inhibits natural 'hedges' against adverse developments. Both government and private insurers in Australia have experienced financial difficulties. In some cases, this problem has been due to mismanagement; in others, it has been due to government regulation of premiums to keep them 'affordable' (a judgement that inevitably involves a degree of subjectivity) and stable over time.

*Universal coverage*

Achieving the objective of universal coverage in CTP and workers compensation insurance does not require the provision of insurance by government-owned monopolies. This objective can be (and is) achieved by mandating insurance, making the payment of annual CTP premiums a condition for renewing vehicle registration, and monitoring employers for compliance with the workers compensation insurance mandate.

In the case of legal professional indemnity insurance, some governments argue that monopoly provision is necessary to ensure coverage of all practitioners. They are concerned that practitioners in high risk areas of the law may be unable to find insurance under competitive arrangements and therefore, may no longer offer services (undermining social goals).

In its 2003 NCP annual report, Victoria argued that several factors in a competitive insurance market would be likely to undermine the coverage of all legal practitioners for professional indemnity insurance.

- An insurer considering entry to the market would need to ensure it would have a large premium pool, because the number of legal practitioners in a jurisdiction is not great and thus there is a risk that one practitioner could incur large claims. Victoria referred to the recent difficulties experienced in various insurance markets where premium pools are small and volatility is substantial.

- Advice provided to Victoria by a large international insurance broking company in 2001 suggested that Victorian solicitors, including competent solicitors, would be unlikely to obtain insurance in a competitive market. It was argued that competent lawyers and those in rural areas would not be covered because insurance companies estimate their risk not as individuals but according to cohorts and arbitrary risk factors.

- Victoria argued that competing insurers would not have complete information about underlying risk and that some insurers would be likely to underprice and underprovide on a sustained basis, leading to their failure (as happened recently with HIH and UMP) and the consequent lack of cover for many insured parties. A monopoly provider of legal professional indemnity insurance is much less likely to fail, because it can increase premiums when claims or other costs increase; further, in some jurisdictions, it may have the power to levy practitioners if concerned that funds are insufficient to meet liabilities.

Western Australia commented in its 2003 NCP annual report that only two insurance companies are willing to provide quotes to the Law Society, which coordinates the provision of legal professional indemnity insurance in that State through a competitive tendering process. This limited number of providers willing to quote points to a lack of depth and competition in the indemnity insurance market.

These concerns about multiple providers of legal professional indemnity insurance need to be considered against the observed behaviour in competitive markets. In competitive insurance markets, some companies seek to expand by finding new customers, and some would probably consider the legal profession overall to be a ‘good risk’. The Legal Practice Board told the 1998 review in Victoria that nearly all practitioners would obtain cover in a competitive market. Moreover, it would be constructive for those high risk legal practitioners to receive a signal through higher premiums (or difficulty in obtaining insurance) to encourage improved practices or, in extreme cases, to leave the industry. This market signalling may enhance the overall quality of services by solicitors and their risk management practices. Some jurisdictions, including Victoria, argued in their 2003 NCP annual reports that circumstances have changed in recent years, however, and that many insurers now would be unwilling to enter a competitive market for legal indemnity insurance. Victoria also pointed out that its monopoly legal insurance provider rates practitioners according to risk and past experience.

### *Long tail liabilities*

Some governments argued that:

- only publicly owned monopoly insurers are capable of looking after (or willing to look after) the particular rehabilitation requirements and costs of those injured people who require lengthy and intensive treatment; and

- private insurance companies may not make appropriate actuarial assessments that account for the probability of claims being made a long time after an accident that causes injury.

Injuries that require long-term rehabilitation are a subset of all injuries that require rehabilitation. Long tail liabilities do not provide a compelling case for monopoly provision. There would seem to be no barrier to a government regulator, separate from insurers, commissioning rehabilitation services from government or private providers.

To ensure all long tail liabilities are covered if insurers leave the market, governments could require insurers to direct a small proportion of premium revenue (sufficient to cover expected long tail liabilities) to the regulator to finance its commissioning of long tail rehabilitation services. This proportion could be transparently shown on premium notices, calculated by the regulator in consultation with insurers. In this context, regulation rather than ownership could provide an appropriate remedy.

### *Run-off cover*

Some claims against legal practitioners are made after they cease to practise (and no longer pay premiums to professional indemnity insurance schemes). The issue of run-off cover in legal professional indemnity insurance is similar to that of delayed liabilities in CTP and workers compensation insurance. Some governments have argued that private insurance companies may be unwilling to provide run-off cover to sole practitioners or small legal partnerships. Information provided by the Victorian Government suggests that run-off claims comprise around 8 per cent of all claims against lawyers. Some insurance companies are likely to undertake actuarial assessments and provide insurance for such claims, but generally there appears to be a risk of underprovision. Victoria comments in its 2003 NCP annual report that the premium pool is likely to be small and volatile, thus diminishing the attractiveness to commercial insurers of providing run-off cover. The experience of Victorian barristers is that private insurers are unlikely to provide run-off insurance to retired practitioners whom they did not previously insure. Western Australia commented in its 2003 NCP annual report that the large law firms' difficulty in obtaining 'top-up' insurance cover suggests that the availability of run-off cover to large and small solicitors would not be good.

These concerns, while substantial, do not constitute an automatic case for government monopoly provision. An alternative approach which is worth exploring would involve the government establishing a pool in which a levy of all solicitors' insurance premiums would be paid. The pool of funds would meet run-off claims, while allowing a choice of insurer for cover. Such arrangements would require careful design because an insurance company might seek to withdraw cover from a small legal firm or sole practitioner that it believes is facing large claims, in a bid to force the firm or practitioner into retirement and thus transfer the claim to the run-off insurance fund. The incentive for such strategic behaviour could be reduced or eliminated by regulation that allows the run-off fund to legally challenge any insurance company withdrawing cover in such circumstances.

### *Cost of reinsurance*

Insurance companies reduce their risks by taking out their own insurance policies with reinsurance companies, which are typically large companies based overseas. It is sometimes argued that the cost of reinsurance may be greater when multiple insurers provide compulsory insurance products, because a monopoly provider is aware of the full range of risks, thus diminishing risks to the reinsurer. This argument is not strong, however, because private insurers in multiple provider markets usually have access to other risk-related information about insured parties. Further, many private insurance companies are major players in the insurance market, with a long history of dealing with reinsurers. These factors may even give private insurers an advantage (compared with monopolies) in dealing with reinsurers.

### *Outsourcing*

Some governments have argued that monopoly providers of insurance can capture some of the cost reductions that private insurance companies achieve through their access to economies of scope. Government-owned monopoly providers of CTP and workers compensation insurance, for example, outsource certain activities (such as premium collections, information technology, accident investigations and investment management), via a competitive bidding process. It is important to consider, however, the extent to which such cost savings are passed on to insurance consumers. While competitive pressures among multiple private consumers, and the constant threat of entry, would be likely to lead competing private insurers to pass on the benefits of economies of scope (through lower premiums and other pricing mechanisms such as premium discounts and bonuses for policyholders with good records), the absence of competition for monopoly providers could mean that they are less likely to pass on savings.

### *Not-for-profit insurers*

In the case of legal professional indemnity insurance, some governments argue that some monopoly insurance bodies associated with law societies have cost advantages arising from their not-for-profit status and their inclusion of some voluntary staff among their employees. Governments also note that the bodies' monopoly and mutual status means that they do not have to advertise or pay brokerage and commissions. Victoria has actuarial evidence that its monopoly fund's premiums are 30 per cent lower over the long term than those that would be offered by competing private providers. Victoria argued that monopoly mutual insurance funds can also offer greater premium stability than that of insurers in a competitive market, because they predict their premium pool quite accurately.

Some jurisdictions argued that professional associations or legal practice boards can use their bargaining strength to negotiate attractive premiums with insurers or ensure insurance is available to all when some insurers are vacating the market. In Victoria, the Legal Practice Board appointed the Victorian Bar Council to conduct a competitive tender in autumn 2003 for the provision of professional indemnity insurance for Victoria's barristers. While barristers had expressed concern about losing their freedom to choose their own insurer, the board considered that the tender was necessary to ensure barristers obtained insurance in the current difficult market for indemnity insurance. Following the tender, a company was selected in early May 2003 to provide a master professional indemnity insurance policy to all barristers.

These perceived benefits need to be examined in light of whether:

- such monopolies might become inefficient over time;
- voluntary staff (to the extent they are used) offer the best possible expertise;
- advertising (accompanied by choice of fund) could provide more information and facilitate better service to policyholders; and
- private insurance companies can offer competitive professional indemnity premiums arising from their experience and economies of scope.

**Table 6.2:** Review and reform of legislation regulating compulsory third party motor vehicle insurance

| *Jurisdiction* | *Legislation* | *Key restrictions* | *Review activity* | *Reform activity* | *Assessment* |
|---|---|---|---|---|---|
| New South Wales | *Motor Accidents Act 1988*<br>*Motor Vehicles (Third Party Insurance) Act 1942* | Mandatory insurance, licensing of insurers, file-and-write premium setting | Review was completed in 1997. It recommended changing the scheme design and requiring insurers to file premiums with the Motor Accidents Authority. | Legislation was passed in line with review recommendations. | Meets CPA obligations (June 1999) |
| Victoria | *Transport Accident Act 1986* | Mandatory insurance, monopoly insurer, centralised premium setting | Internal review was completed in 1998. It recommended removing the statutory monopoly in favour of competitive provision. Second review was completed in December 2000, recommending the retention of monopoly and centralised premium setting. Review also recommended a third party review of premiums and market testing. | The Government rejected the findings of the first review and accepted the findings of the second review. The Government is considering the scope for market testing (outsourcing) and the Essential Services Commission reviewed the Transport Accident Commission's proposed premium for 2003-04. | Review and reform incomplete |
| Queensland | *Motor Accident Insurance Act 1994* | Mandatory insurance, licensing of insurers, file within bands set by the regulator | Review was completed in 1999. It recommended retaining the licensing of insurers, but removing restrictions on market re-entry and on motorists changing insurers. It also recommended introducing greater competition in premium setting by filing within bands set by the regulator. | The *Motor Accident Insurance Amendment Act 2000*, which commenced in October 2000, was 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 was completed in 1999-2000, recommending removing the monopoly provision of insurance and retaining Ministerial approval of premiums. | The Government is considering the review recommendations. | Review and reform incomplete |

(*continued*)

**Table 6.2** continued

| *Jurisdiction* | *Legislation* | *Key restrictions* | *Review activity* | *Reform activity* | *Assessment* |
|---|---|---|---|---|---|
| South Australia | *Motor Vehicles Act 1959* | Mandatory insurance, monopoly insurer, centralised premium setting | Review was completed in 1998. It recommended removing the monopoly and controls on premiums. Second review was completed in 1999, rebutting the previous review's recommendations. The Government issued both reviews for public consultation in early 2001. | The Government announced the retention of mandatory insurance, the sole provision of insurance by the Motor Accident Commission and community rating. Minor legislative amendments were passed in October 2002. | Review and reform incomplete |
| Tasmania | *Motor Accidents (Liabilities and Compensation) Act 1973* | Mandatory insurance, monopoly insurer, centralised premium setting | Review was completed in 1997. It recommended retaining the monopoly provision of insurance. Following the 1999 NCP assessment, the Government agreed to re-examine the issue. | The Government completed its examination of the Victorian review of the Transport Accident Commission and has decided not to alter the legislation. | Review and reform incomplete |
| ACT | *Road Transport (General) Act 1999* | Mandatory insurance, licensing of insurers | Act was not for review. Legislation allows the Government to approve multiple insurers. | | Meets CPA obligations (June 1997) |
| Northern Territory | *Territory Insurance Office Act*<br><br>*Motor Accidents (Compensation) Act* | Mandatory insurance, monopoly insurer, centralised premium setting | Review of Territory Insurance Office Act was completed in 2000. Review of the Motor Accidents (Compensation) Act was completed in December 2000 and is being considered by the Government. Review recommended that the legislation be amended to allow an insurer other than the Territory Insurance Office to operate or underwrite the motor accident compensation scheme (on a monopoly basis). | The review recommendation is being considered as part of a wider review. The Motor Accidents (Compensation) Act continues to enforce the monopoly. | Review and reform incomplete |

**Table 6.3:** Review and reform of legislation 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 was completed in 1997. It recommended introducing competition to Comcare. | The Government has not responded to the review. | Review and reform incomplete |
| New South Wales | *Workers Compensation Act 1987* | Mandatory insurance, monopoly insurer, centralised premium setting | Review was completed in 1997-98. It recommended removing the monopoly insurer in favour of competitive underwriting. Further examination of the scheme in 2000-01 resulted in proposals for changing the scheme design. A further review is being conducted, with the report to be completed in the second half of 2003. | Legislation was passed to introduce private underwriting in October 1999. Subsequent legislation delayed implementation to a date to be determined by the Minister. Provisions for competitive underwriting were repealed in late 2001. Scheme design changes were introduced in 2001. | Review and reform incomplete |
| Victoria | *Accident Compensation Act 1985*<br>*Accident Compensation (Workcover Insurance) Act 1993* | Mandatory insurance, monopoly insurer, centralised premium setting | Internal review was completed in 1997-98, recommending competitive provision. Second review was completed in December 2000, recommending the maintenance of the monopoly and centralised premium setting, a third party review of premiums and market testing. | The Government rejected the findings of the first review and accepted the findings of the second review. The Government is considering the scope for market testing (outsourcing) and Essential Services Commission reviews of premiums. | Review and reform incomplete |
| Queensland | *Workcover Queensland Act 1996* | Mandatory insurance, monopoly insurer, centralised premium setting | Review was completed in December 2000. It recommended retaining mandatory insurance and public monopoly insurer, and creating Q-COMP as a separate regulatory entity. | The Government legislated in 2003 to establish Q-COMP as a separate entity from 1 July 2003. | Review and reform incomplete |

(*continued*)

**Table 6.3** continued

| *Jurisdiction* | *Legislation* | *Key restrictions* | *Review activity* | *Reform activity* | *Assessment* |
|---|---|---|---|---|---|
| Western Australia | *Workers Compensation and Rehabilitation Act 1981* | Mandatory insurance, licensed insurers, centralised premium setting | The review was completed in early 2002. | Minor legislative amendments are scheduled for spring 2003. | Review and reform incomplete |
| South Australia | *Workers Rehabilitation and Compensation Act 1986* | Mandatory insurance, monopoly insurer, centralised premium setting | Interagency review was completed in mid 2002, recommending minor changes. | The Government is considering the review in the context of two other reviews that are considering WorkCover governance and the workers compensation and OH&S systems. | Review and reform incomplete |
| Tasmania | *Workers Rehabilitation and Compensation Act 1988* | Mandatory insurance, licensed insurers | Review by the Parliamentary Joint Select Committee of Inquiry was completed in 1997, recommending minor amendments. | Legislation was amended in March 2001 in line with review recommendations. | Meets CPA obligations (June 2001) |
| ACT | *Workers Compensation Act 1951* | Mandatory insurance, licensing of insurers | Review was completed in July 2000, recommending changes to scheme design and a greater capacity to self-insure. | The *Workers Compensation (Amendment) Act 2001* was passed in August 2001 (effective from 1 July 2002). It retains no premium setting and allows a choice of provider. | Meets CPA obligations (June 2002) |
| Northern Territory | *Work Health Act* | Mandatory insurance, prescribed standards that insurers must meet | Review was completed in September 2000 and released for public comment in June 2001, recommending that premiums remain unregulated and insurers remain unlicensed. | Amendments have been introduced relating to benefits and compensation. Multiple insurers remain. | Meets CPA obligations (June 2003) |

# Superannuation services

The principal CPA clause 5 issue pertaining to the regulation of superannuation services is the legislative requirement in several jurisdictions that public sector employees contribute to a government monopoly superannuation fund. Such restrictive legislation can have adverse implications, including:

- making it difficult for new (or diversifying) service providers to enter the superannuation market;
- reducing the pressure on incumbents to compete with other funds, which may deny consumers access to improved services and better tailored or more innovative superannuation products; and
- imposing costs on those contributors who move from the government to the private sector (or vice versa) or who work in both sectors, because such employees may be forced to fragment their contributions across separate funds.

Proscribing a lack of consumer choice in superannuation legislation is anticompetitive, but the overall impact of such restrictions can be difficult to gauge. Government funded defined benefit schemes tend to be more generous to contributors than are private sector funds. Moreover, some government funds provide limited options for investment strategies, which moderates somewhat the negative impact on contributors of a lack of choice (but not on alternative service providers). There is also a view that disclosure rules and financial standards may not be sufficient to allow contributors to make informed choices if they had the option, potentially resulting in contributors directing their contributions to poorly run funds.

Table 6.4 summarises jurisdictions' legislative review and reform activity in the area of public sector superannuation.

## Review and reform activity

Public sector employees in New South Wales, Victoria, Tasmania and the Northern Territory are entitled to choose their superannuation fund. The Council assesses, therefore, that these jurisdictions' review and reform of superannuation legislation complies with CPA clause 5 obligations. The following section considers the review and reform activity of the Commonwealth Government, Queensland, Western Australia, South Australia and the ACT.

## The Commonwealth

Based on a review of Commonwealth superannuation legislation in 1997, the Government introduced legislation to allow a choice of fund for certain Commonwealth employees in 2001, but this legislation was defeated in the Senate and has not been reintroduced. The Government also introduced choice-of-fund legislation for the wider community in 1997, 1998 and 2002. The legislation was defeated in the Senate in 2001. Subsequently, the Superannuation Amendment (Choice of Superannuation Funds) Bill 2002 was introduced in June 2002, but has not yet been passed.

The Commonwealth Government does not intend to introduce a choice of fund for military personnel because the superannuation schemes operated under the *Defence Forces Retirement Benefits Act 1948* and the *Military Superannuation and Benefits Act 1991* contain benefit features that are unique to the nature of military service. The Commonwealth contends that:

- military personnel are exposed to greater risks of invalidity and death than is faced by the broader community;
- relatively generous in-service death and invalidity benefits are necessary to attract and retain defence force personnel; and
- the schemes are unfunded defined benefit schemes and allowing choice of fund may concentrate fiscal impacts in a particular period.

The superannuation scheme operated under the *Parliamentary Contributory Superannuation Act 1948* is very small. The review of this scheme concluded that the administration costs were trivial. Further, the generosity of this unfunded defined benefit scheme is well ahead of community expectations, so there appear to be minimal, if any, consequences arising from the lack of competition.

In February 2001, the Commonwealth Government requested that the Productivity Commission inquire and report on other superannuation acts and associated legislation, including the *Superannuation Industry (Supervision) Act 1993* and the *Superannuation (Self Managed Superannuation Funds) Taxation Act 1987*. The inquiry terms of reference noted that the Productivity Commission review fulfils a Commonwealth commitment to undertake NCP reviews of these Acts. The Government asked the Productivity Commission to focus on those parts of the legislation that restrict competition, and referred it to requirements for regulation assessment (including those set out in the CPA).

The Productivity Commission finalised its report in December 2001 and made more than 20 recommendations about the prudential supervision and regulation of the superannuation industry. Among the recommendations were that:

- the Government should strengthen the net tangible assets requirement for trustees of superannuation funds;

- all trustees of funds regulated by APRA should be required to prepare a risk management strategy; and
- the legislation should be simplified and amended to increase competition among providers of services to superannuation funds.

The Government released its interim response to the Productivity Commission report on 17 April 2002, agreeing to certain recommendations and delaying its final decisions on other recommendations until the report of the Superannuation Working Group, chaired by Mr Don Mercer, was finalised. The completion of the Mercer Report enabled the Government to issue its final response to the Productivity Commission report on 20 June 2003. In this response, the Minister for Revenue and Assistant Treasurer noted that the Government had begun to implement some of the inquiry recommendations. Exposure draft legislation has been circulated to the superannuation industry, covering the licensing of all trustees of superannuation funds and the requirement for trustees to submit a risk management plan to APRA. In the final response, the Government agreed to many of the Productivity Commission's recommendations, and noted most of the others. In these cases, the Government generally undertook action broadly equivalent to the recommendation, including reviews of specific matters.

### Assessment

The Commonwealth Government has been unable to gain sufficient support in the Senate to implement choice-of-fund legislation. It currently has legislation before Parliament. The Council thus assesses that the review and reform of the Superannuation Acts 1976 and 1990 and the Superannuation Guarantee (Administration) Act is incomplete.

The Council accepts the Commonwealth Government's public interest arguments in relation to the Defence Forces Retirement Benefits Act and the Military Superannuation and Benefits Act. It also accepts that the restriction on competition arising from the Parliamentary Contributory Superannuation Act is trivial, but it does not consider that the Commonwealth has provided a robust public interest case for retaining the status quo.

The Council notes that the Commonwealth Government's review and reform activity following the Productivity Commission's NCP review of other superannuation legislation is well advanced but not yet complete. The Government's responses have been largely consistent with the Productivity Commission's recommendations.

## Queensland

Queensland's public sector employees are required to hold a superannuation account with the government-owned superannuation provider, QSuper.

Contributors can choose between an accumulation account, which is a fully funded superannuation account, and a defined benefit account, which offers a fixed retirement income. The *Superannuation (State Public Sector) Act 1990* allows QSuper to use multiple investment fund managers. To date, QSuper has chosen to use just one manager — the Queensland Investment Corporation — which in turn outsources some funds management to private funds.

Queensland reported to the Council that the Government Superannuation Office examined the effects on competition of the Superannuation (State Public Sector) Act and associated Regulations. The review was conducted in accordance with Queensland Treasury's public benefit test guidelines, whereby existing arrangements are compared with less restrictive alternatives. The review accounted for:

- Queensland's view that the Senate's refusal to pass the Commonwealth Government's choice-of-fund legislation demonstrates the complexity of the choice issue;

- a 2001 review of Queensland's local government superannuation scheme, which is similar to the QSuper arrangements, concluded that the monopoly arrangements are necessary to achieve the scheme's objectives; and

- a major review of Queensland public sector superannuation in recent years resulted in public servants being given the choice of the defined benefits scheme or an accumulation account with investment choice.

The Government Superannuation Office's review described the overriding objective of the current legislation as being to ensure equitable access of public sector employees to a superannuation scheme that maximises benefits to members. It considered two alternative models for the government to meet its objectives.

- One model would allow individual Government agencies to remain with QSuper as the superannuation provider for their employees, or make alternative superannuation arrangements. Queensland believes that few, if any, agencies would move away from QSuper.

- The second model would be a variation on the first, but allow private sector employees to join QSuper. The review argued that this would add to QSuper's marketing and distribution costs.

The public benefit test found that QSuper can offer higher than average benefits to members because it is a not-for-profit body, has small marketing requirements and enjoys economies of scale as a result of its large guaranteed membership (which also allows QSuper to take a long-term investment approach). Queensland argued that the first alternative model would lead to:

- employers and contributors who leave QSuper incurring transitional costs and increased fees;

- QSuper losing some economies of scale as some members leave the scheme; and
- the potential for the Queensland public sector to experience difficulty in attracting staff if they believe that QSuper is weakened.

It contended that the second alternative model would add to QSuper's costs.

The review concluded that the benefits of QSuper's monopoly provision of superannuation for public servants outweigh the costs, especially for public sector employees who are the primary stakeholders. The review considered that the effect of the current restriction on competition and the economy generally is negligible. Queensland noted that QSuper accounts for a small proportion of superannuation funds under management in Australia, and that employees leaving the public sector can transfer their superannuation funds to another superannuation provider, and vice versa.

### Assessment

The fact that Queensland public servants do not have a choice of superannuation provider is a restriction on competition. Queensland's reviews appear to focus on the cost–benefit calculus for QSuper and its members, rather than on the broader market impact for the provision of superannuation services. The Council therefore questions the extent to which the review considered the interests of other parties and the community as a whole. The public benefit test indicates, however, that the restriction on competition identified by Queensland offers benefits for QSuper and its members. Further, the overall impact of the restriction is difficult to determine and the capacity of QSuper to use multiple investment fund managers means that the legislation contains potential for some contestability. Nevertheless, the Council assesses Queensland as not complying with CPA clause 5 in its regulation of public sector superannuation arrangements.

## Western Australia

In February 2003, the Western Australian Government endorsed the recommendations of a review of the *State Superannuation Act 2000*. The review confirmed that the main restriction on competition in the Act is the requirement that employer contributions for public servants' superannuation be paid solely to the Government Employees Superannuation Board. The review recommended that the board's status as sole superannuation provider should be maintained on public interest grounds. Western Australia did not provide details of its public interest arguments, but indicated in its 2003 NCP annual report to the Council that the introduction of superannuation choice would have an adverse financial impact on the State Government.

The Government introduced, from 1 July 2001, a choice of investment type for members of West State Super (the main public sector superannuation fund) for both employer and voluntary contributions; members can choose from a portfolio of products offered by the Government Employees Superannuation Board. The board, in turn, outsources the management of the assets in its superannuation fund. The board selects specialist fund managers in a competitive process and regularly reviews their performance.

Western Australia submitted that it intends to further examine the implications of introducing choice for members of defined benefit schemes. A review that is under way is considering choice of funds for the three superannuation schemes administered by the Government Employees Superannuation Board. The review is restricted to examining how choice of fund could affect the financial rights and obligations of the State.

### Assessment

Western Australia did not demonstrate a public interest case for not having a choice of superannuation provider. The Council acknowledges that the net impact of the lack of choice is difficult to estimate, that Western Australia introduced choice of investment type for members of the Government Employees Superannuation Fund, and that a further review is under way. Western Australia has not complied with its CPA clause 5 obligations in this area, however, because it has not completed its review and reform activity.

## South Australia

The *Southern State Superannuation Act 1994* establishes the public sector superannuation arrangements in South Australia. Under the Act, public sector employees cannot choose their superannuation provider for employer contributions under the Commonwealth's superannuation guarantee legislation. The Superannuation Funds Management Corporation of South Australia (which uses the business name Funds SA) invests and manages public sector superannuation funds on behalf of Super SA. Funds SA uses external funds managers that it considers offer expertise in investment decisions. Members of the public sector superannuation scheme can choose between different investment strategies: balanced, growth, conservative or cash.

Contributors' benefits are portable. Employees transferring to the South Australian public sector can roll over funds into the Southern State Superannuation Fund, and employees leaving the sector can transfer accumulated funds to other schemes. This portability avoids a constraint in some other restricted public sector superannuation schemes — that is, the inability to consolidate superannuation funds. The main outcomes of the restricted choice of fund provider are that contributors cannot take advantage of higher returns that they believe other superannuation funds could provide, and the market presence of alternative service providers is constrained.

South Australia's Crown Solicitor advised the Government in 1999 that the anticompetitive effect of the restriction on fund provider is negligible because Funds SA allows competition for funds management. South Australia has since commented that Super SA/Funds SA offer advantages in the areas of insurance cover, low administration fees, death and invalidity benefits and choice of investment strategy. It considers that the outsourcing of funds generates benefits from the competition between funds managers to obtain good returns, and referred to the recent above-average returns of the Southern State Superannuation Fund.

### Assessment

South Australia has not established that the benefits of the restriction on choice of superannuation fund for providers and members exceed the costs, or that the competition restriction is necessary to achieve its objectives for government sector superannuation. Nevertheless, the Government does not intend to change the arrangements. While South Australia has not complied with its CPA clause 5 obligations, the Council notes the complexity of gauging the impact of the restriction and acknowledges that the current arrangements generate certain benefits.

## The ACT

ACT Government policy requires its permanent employees to be members of the Commonwealth's superannuation scheme. They are treated as 'eligible employees' under the Commonwealth Government's *Superannuation Act 1976*. The ACT's *Public Sector Management Act 1994* allows appointees to the senior executive service of the ACT Public Service to join any approved superannuation fund within the meaning of the Commonwealth Government's *Superannuation (Productivity Benefit) Act 1988*, unless they are already members of the Commonwealth scheme. The ACT Government has not reviewed its public sector superannuation arrangements.

### Assessment

The ACT is constrained in its capacity to consider offering a choice of superannuation provider to its permanent public servants until the position of the Commonwealth's superannuation legislation becomes clearer. Review and any subsequent reform is unlikely to commence until the Commonwealth legislation is settled.

**Table 6.4:** Review and reform of legislation regulating public sector superannuation

| *Jurisdiction* | *Legislation* | *Key restrictions* | *Review activity* | *Reform activity* | *Assessment* |
|---|---|---|---|---|---|
| Commonwealth | *Superannuation Act 1976*<br>*Superannuation Act 1990*<br>*Superannuation Guarantee (Administration) Act 1992* | Limits on choice of funds | Review was completed in 1997. | Following the 1997 review, legislation was introduced to Parliament to allow a choice of fund for Commonwealth employees. Amending legislation was defeated in the Senate in 2001 and has not been reintroduced. The Government has since restated its commitment to a choice of fund other than for Commonwealth employees. Choice-of-fund legislation (for Commonwealth and other employees) was reintroduced to Parliament on 27 June 2002. This legislation has not yet been passed. | Review and reform incomplete |
| | *Defence Forces Retirement Benefits Act 1948*<br>*Military Superannuation and Benefits Act 1991* | Limits on choice of funds | The Government does not intend to provide a choice of fund for military personnel. The superannuation schemes operated under the Defence Forces Retirement Benefits Act and the Military Superannuation and Benefits Act contain benefit features that are unique to the nature of military service. | Military personnel are exposed to greater risk than are other members of the community, and the Commonwealth argues that attractive in-service death and invalidity benefits are required to attract and retain Defence Force personnel. The Government does not propose to alter defence sector superannuation arrangements. | Meets CPA obligations (June 2003) |

(*continued*)

**Table 6.4:** continued

| *Jurisdiction* | *Legislation* | *Key restrictions* | *Review activity* | *Reform activity* | *Assessment* |
|---|---|---|---|---|---|
| Commonwealth | *Parliamentary Contributory Superannuation Act 1948* | Limits on choice of funds | Review of the Parliamentary Contributory Superannuation Act was completed, concluding that administration costs are trivial and that there are efficiencies. The scheme operated under this Act — an unfunded defined benefit scheme — is small (with minimal consequences arising from lack of competition). | Choice of fund will not apply to parliamentarians. | Does not meet CPA obligations (June 2003) |

(*continued*)

**Table 6.4** continued

| *Jurisdiction* | *Legislation* | *Key restrictions* | *Review activity* | *Reform activity* | *Assessment* |
|---|---|---|---|---|---|
| Commonwealth | Superannuation Acts, including:<br>*Superannuation Industry (Supervision) Act 1993*<br>*Superannuation (Self Managed Superannuation Funds) Taxation Act 1987*<br>*Superannuation (Self Managed Superannuation Funds) Supervisory Levy Imposition Act 1991*<br>*Superannuation (Resolution of Complaints) Act 1993*<br>*Occupational Superannuation Standards Regulations Applications Act 1992*<br>*Superannuation (Financial Assistance Funding) Levy Act 1993* | Provision for prudential regulation and supervision of the superannuation industry, and the imposition of levies on superannuation funds and approved deposit funds | Productivity Commission undertook an NCP review of this legislation and submitted its final report to the Government on 10 December 2001. The report made various recommendations relating to the prudential supervision and regulation of the superannuation industry. | The Commonwealth Government released its interim response to the Productivity Commission report on 17 April 2002. The Government agreed to various recommendations, including one relating to simplifying compliance requirements and enhancing capital adequacy requirements. The Government subsequently released its response to another report of the Superannuation Working Group chaired by Mr Don Mercer. This paved the way for the Government to issue its final response to the Productivity Commission report on 20 June 2003. The Government began to implement recommendations that all superannuation fund trustees be licensed and required to submit a risk management plan to APRA. It also agreed to implement most of the Productivity Commission's other recommendations (or to take action that is largely consistent with those recommendations). | Review and reform incomplete |

(*continued*)

**Table 6.4** continued

| *Jurisdiction* | *Legislation* | *Key restrictions* | *Review activity* | *Reform activity* | *Assessment* |
|---|---|---|---|---|---|
| New South Wales | *Superannuation Administration Act 1987* | Limits on choice of funds | | Legislation was passed in 1999 to corporatise the scheme regulator and market test the administration. Choice was introduced. | Meets CPA obligations (June 2001) |
| Victoria | *State Superannuation Act 1985*<br>*Superannuation (Public Sector) Act 1992* | Limits on choice of funds | Review was completed in 1999. | Government employees have had a choice of fund since 1994: VicSuper or a private superannuation fund. | Meets CPA obligations (June 2001) |
| Queensland | *Superannuation (State Public Sector) Act 1990* | Limits on choice of funds | Following a 2000 review, a second review completed in 2003 argued that current arrangements are superior to alternatives in maximising benefits for public sector members. | The Government has not changed QSuper's position as the sole provider of superannuation to public servants. | Does not meet CPA obligations (June 2003) |
| Western Australia | *State Superannuation Act 2000* | Limits on choice of funds | Review recommended retaining the restrictions on fund choice for public benefit reasons. The Government endorsed the review recommendations in February 2003. | The Government introduced choice of investment type for West State Super members on 1 July 2001. Another review of choice of fund has commenced, but it is limited to financial impacts on the State. | Review and reform incomplete |
| South Australia | *Southern State Superannuation Act 1987* | Limits on choice of funds | Full NCP review was not conducted. The Government considers the restrictions to be trivial. | No reform | Does not meet CPA obligations (June 2003) |
| Tasmania | *Retirement Benefits Act 1993* | Limits on choice of funds | | Choice of funds was introduced for new and existing contributors. The Government moved to fund the existing public scheme. | Meets CPA obligations (June 2001) |

(*continued*)

**Table 6.4** continued

| *Jurisdiction* | *Legislation* | *Key restrictions* | *Review activity* | *Reform activity* | *Assessment* |
|---|---|---|---|---|---|
| ACT | *Public Sector Management Act 1994*<br>(Commonwealth's *Superannuation Act 1976)* | Requirement that permanent ACT government employees join the Commonwealth Superannuation Scheme as 'eligible employees' under the Commonwealth's Superannuation Act. (The Public Sector Management Act allows appointees to the ACT Senior Executive Service to join any approved superannuation fund, unless already members of the Commonwealth scheme.) | | Introduction of choice for permanent appointees depends on Commonwealth reforms. | Review and reform incomplete |
| Northern Territory | *Superannuation Act* | Limits on choice of funds | Review was completed in 1998, recommending that the Government close the unfunded scheme and introduce choice. | Reforms were implemented in line with review recommendations. | Meets CPA obligations (June 2001) |