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31 August 2012

The Research Director
Finance and Administration Committee
Parliament House
George Street
BRISBANE QLD 4000

By email: fac@parliament.qld.gov.au

**RE: PARLIAMENTARY INQUIRY INTO THE OPERATION OF QUEENSLAND'S WORKERS
COMPENSATION SCHEME**

I refer to the Finance and Administration Committee's *Inquiry into the Operation of Queensland's Workers Compensation Scheme* open for public consultation (the Inquiry). Suncorp welcomes the opportunity to contribute to the Inquiry.

The Suncorp Group

Suncorp Group Limited and its related bodies corporate and subsidiaries (collectively 'Suncorp') offer a range of financial products and services in banking (Suncorp Bank), general insurance, life insurance and superannuation (Suncorp Life) across Australia and New Zealand. Suncorp has around 16,000 employees and relationships with over nine million customers nationally.

Suncorp offers statutory insurance products, including workers' compensation and compulsory third party (CTP) insurance through our brands: AAMI, GIO, Suncorp and Vero. This submission is made on behalf of the Suncorp Commercial Insurance division.

The Inquiry

Suncorp welcomes the review into the Queensland Scheme. As a leading personal injury insurer, Suncorp is well placed to play a positive role in the process of improving the Queensland Scheme and is committed in doing so. Attached is Suncorp's submission with the main themes of:

- curbing common law costs;
- harmonisation of key scheme design aspects; and
- improved competition and innovation.

Further, Suncorp supports the overarching principles in the submission lodged by the Insurance Council of Australia on behalf of the insurance industry.

Suncorp is keen to work collaboratively with the Committee and the broader Queensland Government to discuss the issues contained in this submission. If you wish to do so, please contact me or [REDACTED] alternatively contact [REDACTED]

Yours faithfully

Chris McHugh
Executive General Manager
Statutory Portfolio & Underwriting Management
Commercial Insurance



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Parliamentary Inquiry into the Operation of Queensland Workers' Compensation Scheme

Suncorp Response

3 September 2012

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About Suncorp

Suncorp Group Limited and its related bodies corporate and subsidiaries (collectively 'Suncorp') offer a range of financial products and services in banking (Suncorp Bank), general insurance, life insurance and superannuation (Suncorp Life) across Australia and New Zealand. Suncorp has around 16,000 employees nationally and relationships with over nine million customers.

This submission is made on behalf of the Suncorp Commercial Insurance division which operates Suncorp's statutory insurance products, including workers' compensation and compulsory third party (CTP) insurance. Suncorp has over 85 years of personal injury insurance experience, with our Suncorp, AAMI and GIO brands.

Suncorp has a proud Queensland heritage and can trace its history back to 1916. We remain a large and committed employer across the state with over 6,200 staff currently employed in both metro and regional Queensland. Suncorp is the largest insurer in Queensland and maintains deep local personal injury management knowledge and expertise through our dominant presence in the state's CTP scheme.

Suncorp maintains strong ties to the Queensland community through our involvement with Queensland Police Service, Rotary Youth Driver Awareness (RYDA) and our road safety advocacy program. Our commitment to the state has also been demonstrated in the recent Brisbane floods with \$100,000 donated to the Queensland Premier's Flood Relief Appeal, assistance and information provision to those impacted. To date, Suncorp has received over 40,000 claims and paid over \$1 billion dollars to customers affected by the natural disaster.

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Executive Summary

Suncorp welcomes the review into the Queensland workers' compensation scheme (the scheme) and supports the efforts of the Government in ensuring that the scheme remains fair, sustainable and nationally competitive. As Australia's leading personal injury insurer and significant part of the Queensland community, Suncorp is well placed to play a positive role in improving the scheme and is committed in doing so.

The Queensland scheme has some strong features which allows it to maintain a positive funding ratio despite facing challenges from superimposed inflation and the global financial crisis (GFC) – namely, the short-tail nature of the scheme and the well designed system of benefit step-downs. These features provide strong incentives for injured workers to return to employment, however opportunities for improvement exist in the management of common law entitlements and claims as well as in alignment with other jurisdictions. Other areas for improvement include curbing common law costs, harmonisation of key design aspects and competition.

Curbing Common Law Costs

The Queensland Government's effort in responding to the rapid increase in common law costs is commendable. Unrestricted and uncapped common law entitlements, however, remain a fundamental financial risk to the scheme as entitlements cannot be accurately predicted or costed.

Without clearly defined benefits for the majority of claimants, the scheme remains exposed to a potential blow-out in common law payments as a result of superimposed inflation. In order to provide greater certainty, mechanisms operating in other jurisdictions should be considered, namely the restriction of common law access through the implementation of a whole person impairment (WPI) threshold. As a key scheme design principle, benefits that are clearly defined by realistic timeframes, dollar amounts, caps and limits reduce ambiguity and inconsistent outcomes. This, in turn, reduces complaints, disputes, litigation and volatility which would otherwise have an adverse impact on the scheme's affordability and financial viability.

Harmonisation of Key Design Aspects

Harmonisation will provide multiple advantages for stakeholders. Areas appropriate for harmonisation include aligning:

- data consistency and assessment tools to simplify management for national employers and provide the Queensland Government with benchmarking data;
- key aspects of the Queensland compulsory third party scheme with the workers compensation scheme, such as the adoption of the American Medical Association Impairment Guidelines 5th Edition (AMA V) and Injury scale values (ISV) outlined in the *Civil Liability Regulation 2003*; and
- key scheme design benefits in other workers compensation jurisdictions nationally.

Competition

The movement from a government managed fund to a more competitive model should be considered. The introduction of private companies and a competitive open market allows for greater innovation and customer value, and the maintenance of competitive premiums. Various scenarios should be considered in the ongoing review and future planning of the scheme, ensuring there is sufficient flexibility to manage emerging national reforms, market impacts and stakeholder needs.

These themes are considered more fully in this submission.

Scheme Review Considerations

In this response and as a general view, Suncorp advocates a scheme environment that drives optimal social outcomes whilst allowing the flexibility to support and manage future improvements, innovation and agility in response to external drivers.

Major factors that are likely to impact the scheme in the foreseeable future include, but are not limited to:

- the national push for scheme harmonisation;
- implementation of the National Disability Insurance Scheme and National Injury Insurance Scheme;
- the fall in bond yields further impacting investment income earnings;
- scheme deficits and funding liabilities;
- the competitiveness of Queensland compared to other states for business investment and operations;
- ongoing pressure on the cost of living in Queensland.

The current combination of environmental, legislative and competitive factors has created an unprecedented pace of change in the national statutory insurance landscape. An increased intensity or combination of these factors could result in the need for major reform, and as any type of reform or change will impact workers, employers and providers, the flexibility of the scheme design should be a consideration for each review.

Private sector organisations continuously evolve to meet customer demands and expectations and invest in infrastructure to support constant change. This capability can be equally leveraged by governments by implementing legislative and operational changes whilst maintaining consistency of performance and service. As such, it is recommended that the introduction of private insurers be considered as part of a longer-term scheme design, to manage claims performance, maintain competitive premiums and reduce the State's liabilities.

A staged approach may minimise transition impact to stakeholders, commencing with the introduction of insurers to manage claims and premium collection on behalf of the government, then the conversion of agent licences into underwriting licences with the existing tail managed separately as run-off.

To maintain flexibility of available options, the structure and design of the scheme needs to be attractive to potential participants, which influences our presented views in regards to common law management, harmonisation and the introduction of competition.

Suncorp's interest in the Queensland workers' compensation scheme is driven by social responsibility and potential commercial opportunity. As Australia's largest personal injury insurer, Suncorp supports those who suffer from injury and help them return to a quality of life. We constantly seek to ensure our customers, staff and the community at-large benefit from statutory schemes that deliver the best possible health and wellbeing outcomes. Our involvement in road safety, risk management, disability care and reform demonstrates our commitment to working with governments and communities to achieve sustainable positive social outcomes.

Suncorp has expertise and capability to add significant value to the Queensland Government, employers and the broader community. Our investment in Queensland to date has been extensive and we will continue to support the state in terms of employment, provision of quality, affordable products and services, and community sponsorship.

Claims management is a core competency for Suncorp, and as such we are equipped to advise in regards to supporting injured workers and managing down liability whilst maintaining an efficient cost base. Removing this cost (and potentially liabilities) from the government's operations will free up funds (and capacity) to invest in other parts of Queensland infrastructure and communities and we encourage the Queensland Government to consider the benefits of this over the long term.

Response to Terms of Reference – 1

The performance of the scheme in meeting its objectives under section 5 of the Act

Chapter 5 of the Act permits broad access to common law damages for workplace injuries that can be attributed to employer negligence. Such access has given rise to high levels of litigation compared to other Australian jurisdictions and has created a situation where the frequency and cost of claims threaten the scheme's sustainability. There has been an average increase in common law costs of 10% per year between 2007 and 2011 with increases of 20% and 40% in 2009 and 2010 respectively. Recent legislative and policy changes have seen some improvement, however, significant barriers remain.

Previously, the policy was to encourage earlier resolution of common law claims to the detriment of appropriate and timely investigation and due diligence of claims. Consequently, common law claims increased as lodgement and generous payouts were easily available. Aligning the *Workers' Compensation and Rehabilitation Act 2003* to the *Civil Liabilities Act 2003* has had a positive effect, reducing both the number of claims and the average claims size. With more appropriate, timely investigation and due diligence processing of claims further reductions in frequency and claims size will continue to be seen. Despite this positive trend these changes do not address the fundamental risk to the scheme's financial viability that unrestricted common law entitlements present.

Access to common law under the scheme that is not restricted by a level of impairment threshold remains a significant issue. It is important to note that for all common law claims lodged in 2010/11 less than 6% had work related impairment (WRI) greater than 15%. The number of claims lodged without a significant level of impairment has the potential to increase superimposed inflation within the scheme due to the higher cost of common law versus statutory payments.

In order to address this threat to the scheme's solvency Suncorp recommends mechanisms be implemented to control access to common law entitlements. The introduction of a whole person impairment (WPI) threshold to common law eligibility, in addition to defined benefits for those who do not qualify, will provide greater certainty when costing the scheme's payments and provide clarity for injured workers around their entitlements.

Mechanisms to be considered should include:

- benefit thresholds which provide greater certainty for employees around the benefits they will receive as well as for the scheme in regards to the costing of benefits to be paid out;
- American Medical Association Impairment Guidelines 5th Edition (AMA V) are successfully used in the Queensland CTP scheme and courts in determining damages. These should be adopted by the workers' compensation scheme to increase simplicity and consistency; and
- Injury scale values (ISV) outlined in the *Civil Liability Regulation 2003* are used to determine damages in the CTP scheme. The workers' compensation scheme should adopt the same scale as a guide in determining compensation payments.

Implementation of these assessment tools will reduce ambiguity and the unlimited nature of entitlements. It will also increase alignment with the Queensland CTP scheme and other jurisdictions.

Response to Terms of Reference – 2

How does the Queensland workers' compensation scheme compare to the scheme arrangements in other Australian jurisdictions?

The Queensland workers' compensation scheme performs comparatively well, however, there are elements of scheme design in other jurisdictions which would add value to the operation and performance of the scheme. Areas for improvement include the introduction of defined benefits to ensure certainty for injured workers, harmonisation to increase simplicity and consistency, competition to drive greater innovation and privatisation of the scheme's capital to drive deeper investment and protect public funds against adverse market movements.

Benefit Design

The scheme is particularly strong in its use of benefit step downs and the use of a WRI assessment to determine the injured worker's capacity. The step downs are some of the strongest in Australia and the starting point of 85% of pre-injury earnings is the lowest of any jurisdiction. The use of a WRI assessment at two years post injury is similar to the adoption of work capacity testing in Victoria, South Australia and New South Wales (following recent legislative changes). Both of these factors provide strong incentives to return to work and assist in driving the short-tail nature of this scheme.

Harmonisation

There are numerous benefits in aligning Queensland with other schemes wherever possible. Alignment is likely to reduce costs and complexity for various stakeholders including the legal profession, service providers, workers and businesses that operate across multiple jurisdictions. For example, the use of the WPI in all other jurisdictions, as opposed to the WRI in Queensland, to assess permanent impairment makes operating in Queensland more costly for businesses who want to enter the Queensland market due to the need for additional staff training and systems adjustment for this nuance.

Alignment allows for more accurate benchmarking to assess scheme performance. Direct performance comparisons between jurisdictions are crucial to identifying emerging trends and best practice responses. Queensland should consider involvement in the National Insurance Data Set (NIDS) initiative. This initiative, undertaken by the privately underwritten jurisdictions, seeks to align datasets and terminologies to permit more accurate comparison of performance between states. It also reduces the compliance costs of businesses and insurers in providing data to the regulator.

Other emerging trends should be considered, such as the management of catastrophic claims and the ageing workforce. With some states removing retirement ages, the current Australian Law Reform Commission review into *Grey Areas – Age Barriers to Work in Commonwealth Laws* and the 2009 Federal Budget announcement of an increase in the national pension age, the expected impact on workers' compensation schemes will manifest in a change in claims profile and potential increase in costs and frequency.

Competition

The Queensland scheme is the only workers' compensation scheme nationally that remains closed to competition, with all other states having implemented a multi-agent privatised or managed fund model. The benefits of competition include increased performance, service levels and innovation which can drive improved health outcomes and lower premiums.

A multi-agent model, combined with the capture of consistent data is useful to measure both scheme and individual agent performance trends and variations. For example, deteriorating performance of one agent is likely to signify internal issues, however poor performance across multiple scheme agents is likely to signify a systemic issue that needs to be addressed holistically.

Privatisation

The introduction of private capital to the workers' compensation market would drive deeper investment and commitment by scheme participants. Transferring government liabilities to insurers protects public funds against adverse market movements and protects the government's credit rating.

Reserving and subsequent guarantee of claim payments by private insurers is heavily regulated by the Australian Prudential Regulatory Authority (APRA). This strong regulation, combined with private insurers' advanced capital management capabilities, ensures that future liabilities are fully funded at all times and prevents premium shortfalls from effecting future scheme participants.

With the introduction of private capital there is more incentive to effectively estimate and manage claims and link risk closely with premiums. It also encourages the focus to remain on the safety of workplaces, timely and effective claims management, and customer satisfaction.

The private sector has demonstrated considerable innovation in risk rating the premium levels of worker's compensation schemes in Australia. The use of an effective risk rating system that rewards positive risk behaviour and loads the premium of employers that demonstrate poor performance is a powerful signal to the market capable of driving change in risk behaviour.

The advantages of scheme privatisation are discussed more extensively in the white paper produced by Suncorp, titled '*Reflections on underwriting options for personal injury insurance*'.¹ Transferring the scheme's liabilities to private insurers frees up capital for other community investment, namely the implementation of the National Injury Insurance Scheme (NIIS) and supporting the National Disability Insurance Scheme (NDIS).

¹ See Appendix A

Response to Terms of Reference – 3

Discuss WorkCover's current and future financial position and its impact on the Queensland economy, the State's competitiveness and employment growth

Historically, Queensland WorkCover has held a very strong financial position which has deteriorated significantly since 2007 with the funding ratio declining from 183% to 112%. This decrease can be attributed to increases in the scheme's liabilities from rising common law costs and the impact of the GFC on investment markets.

It should be noted that rises in workers' compensation costs significantly impede business competitiveness nationally and internationally. Premium increases have seen Queensland lose its place as the lowest priced workers' compensation scheme nationally for the first time in many years with a 23% increase in premium since 2009.

Increasing costs have the greatest impact on small businesses, which can opt to hold off or cancel plans to employ more staff. The NSW Business Chamber submission in response to the recent NSW Parliamentary Inquiry into the NSW Workers Compensation Scheme provides details of a survey of over 500 respondents where *"58.4 per cent of respondents said there would be employment impacts if premiums were to rise by 10 per cent."*²

Although the rates in Queensland are currently lower than NSW, significant increases in the cost of doing business will have negative consequences on small businesses and their ability to employ and maintain staff. If the government hopes to achieve its target of 4% unemployment within the next six years artificial burdens placed on businesses will need to be reduced. As small businesses make up 95% of employers in the state, it is imperative that an environment conducive to employing staff is created.

The nature of the industry mix in Queensland is also an important consideration. There has been a significant increase over recent years in higher risk industries driven primarily from growth in the resources sector. This has generated a high demand for labour, pushing up average salaries and driving economic growth. However this has increased risk exposures through the potential for injuries as lesser trained workers fill manual roles.

Whilst the legislative and policy changes implemented in July 2010 to arrest the blow-out in common law costs appear to have had the desired impact for the present, it is important to note that the scheme still remains exposed to superimposed inflation and adverse movements in the investment markets. If the Queensland scheme experiences another period of increasing costs and diminishing investment returns as they did in 2008 and 2009 during the height of the GFC, Queensland Workcover will not have the same level of reserves to draw upon in order to maintain a positive funding ratio. The scheme would be restricted in its ability to further increase premium levels without having adverse impacts on the Queensland economy.

The Suncorp paper titled *'How international financial markets impact personal injury insurance'* provides an extensive discussion of the impact that bond yields have on the premium rate and capital requirements of insuring in a long-tail scheme.³

² Report tabled by the Joint Select Committee on the NSW Workers' compensation Scheme - 13 June 2012 – (pg. 39 ref: 2.172)

³ See Appendix B

Response to Terms of Reference – 4

Have the reforms implemented in 2010 addressed the growth in common law claims and claims cost that was evidenced in the scheme from 2007-08?

The changes made to the *Workers' Compensation and Rehabilitation Act 2003* appear to have had a positive impact on the financial status of the scheme in 2011, however their full impact will not be known for a number of years. Common law costs increased by 108.4% between 2004 and 2010. Following the changes in 2010, there was a fall in claims costs of 7.3% which can be attributed, at least partly, to these legislative changes.

The most profound impact appears to have been on the average size of payouts as a result of the alignment with the *Civil Liabilities Act 2003*. The average claims cost fell from \$134,389 to \$117,933, which represents a material reduction of 12.2%.

It is important to note that although the scheme appears to have reduced the growth of common law costs, the risk of superimposed inflation will always exist in a scheme where eligibility to common law entitlements is not restricted. A scheme with well defined benefits provides financial certainty to accurately manage the cost of future claims.

The introduction of a common law threshold based on a person's WPI would allow the scheme to provide appropriate compensation based on the level of injury and the requirements of the individual. The implementation of any threshold should be combined with increased payments for those workers who do not qualify for common law entitlements. The restriction to common law entitlements through the use of thresholds has been successfully implemented in other jurisdictions such as New South Wales, Victoria and South Australia.

Risk management and prevention can have a significant impact on the frequency and severity of claims. Therefore, greater focus and collaboration from the industry and government is required to educate employers, particularly small businesses. Further resources should be provided to insurers and regulators for education, prevention and investigation to drive better workplace safety and lower claims rates. As an insurer in several underwritten states, Suncorp provides risk management solutions and advice to its clients, to assist them to drive safer workplaces and improve the claims experience.

Suncorp's experience in other schemes has shown that a positive culture of safety and wellbeing for workers, as well as timely and effective management of a claim can reduce an injured worker's desire to pursue common law and will reduce the size of the claim if they do pursue damages. Capability and empathy of claims staff is critical. Suncorp supports the professional development of the industry, and recognises the value in supporting staff to undertake Certificate III, Certificate IV and Diplomas in Personal Injury as well as provide opportunities for internal career development.

Response to Terms of Reference – 5

Does the current self-insurance arrangements legislated in Queensland continue to be appropriate for the contemporary working environment?

The current self-insurance arrangements are largely appropriate for the contemporary working environment by ensuring that ongoing financial obligations are covered and the employer has sufficient scale to provide effective management of claims and liabilities.

At present, self-insurance eligibility in Queensland is appropriately restricted by evidence of capitalisation, profitability and liquidity. Additionally, the requirements for a guarantee (the greater of \$5million or 150% of the estimated claims liability), an excess of loss policy and a minimum number of employees remain appropriate criteria.

Suncorp provides excess of loss cover for self-insurers and acknowledges that when administered well, self-insurance can provide significant benefits for all scheme participants. Self-insurance makes the employer liable for the cost of their own claims and as such will align their management focus to ensure return to work and workplace safety practices are a high priority within the organisation.

When an employer has good claims management expertise and knowledge of the scheme they should be able to achieve excellent results within their workers' compensation practice. Smaller self-insurers, however, are unlikely to have either the knowledge or expertise to properly manage the disparate and potentially complex claims. This can potentially lead to poor health and wellbeing outcomes for injured workers.

Therefore it is appropriate to have a minimum number of employees to make self-insurance a viable option. The requirement of at least of 2,000 Queensland employees to be eligible for self insurance will facilitate significant economies of scale and investment, but is likely to limit entry to only those businesses with sufficient capability and capital. Consideration should be given to lowering this threshold as long as an appropriate threshold remains.

Response to Terms of Reference – 6

In conducting the inquiry, the committee should also consider and report on implementation of the recommendations of the Structural Review of Institutional and Working Arrangements in Queensland's Workers' Compensation Scheme

The following general comments are made regarding the Terms of Reference from the Structural Review, based on our insights into the Queensland community and personal injury schemes of other jurisdictions.

Roles and functions in the workers' compensation scheme

Suncorp applauds the efforts made by the Queensland Government and regulators to promote greater unity and clarity of the organisations that administer the scheme. Clearly defined roles and responsibilities are conducive to a successful scheme. This is critical where there are multiple stakeholders and requires ongoing monitoring and review to maintain alignment.

Transparency

Transparent processes, entitlements, support services and data quality are mandatory for any highly regulated statutory scheme. Participants and regulators all have a vested interest in receiving timely, accurate and usable information. Providing access to information and meaningful data, transparent processes and the opportunity to contribute to regular public review create an environment that is more collaborative and less adversarial which facilitates a focus on positive outcomes.

Strategies to improve efficiency and effectiveness

Efforts by scheme operators to increase efficiency should be an ongoing aspect of the Queensland scheme. Gaining increased efficiencies improves customer experience, reduces operating costs and minimises premium increases. Suncorp have achieved a series of improvements over the last year through systems automation and process efficiency which has lessened the administrative burden on claims managers and increased the quality of case management, whilst containing costs to ensure competitive premium levels are maintained.

Legal costs and management of the legal profession

The legal profession has an important role to play in protecting the rights of seriously injured workers in compensation schemes nationally. The recommendations to monitor the cost of the legal profession should be viewed with consideration of how much it costs the scheme in comparison to the benefits to the scheme and injured parties. The legal profession should be subject to the same level of scrutiny and given incentives to support scheme objectives like any other participants to ensure that there is no deterioration in the cost/benefit their participation provides. In this regard, the recommendations relating to ongoing monitoring of the legal costs in the scheme are justified and should be part of any future reviews.

Rehabilitation and return to work

As the core competency of any workers' compensation scheme the ongoing revision of the scheme's methods to achieve rehabilitation and return to work should be encouraged on a regular basis. Specific recommendations around the education and engagement on return to work and rehabilitation issues should continue to be developed to further improve performance in the workplace. There is opportunity to consider national best practice and learnings from other schemes. As a national insurer, Suncorp routinely shares best practice between schemes. Suncorp believes that this raises the level of performance in every scheme and increases the quality of outcomes for stakeholders.

Conclusion

We appreciate the difficult task that the Committee has to distil information from multiple stakeholders to determine the best future for the scheme. The complexity and subjective nature of personal injury management should not be underestimated, as we operate in an environment with multiple stakeholders and while they all have the best intent it creates complexity and volatility.

Therefore the operating and legislative framework needs to be robust and clearly defined to achieve positive outcomes for injured workers, while meeting the needs of stakeholders and ensuring scheme sustainability. It also needs to allow for constant evolution and improvement to meet these objectives.

Suncorp welcomes the opportunity for further consultation and contribution to the ongoing continuous improvement of the scheme, including the development of various options for consideration.



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Appendix A

Suncorp White Paper: *'Reflections on underwriting options for personal injury insurance'*, September 2012

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Reflections on underwriting options for personal injury insurance

September 2012

Introduction

There are many different schemes in place globally that insure, rehabilitate and compensate people who suffer personal injury as a result of accidents in the workplace or in vehicles.

Equally, there are many regimes and thresholds within these different schemes that dictate the levels of any compensation and benefits.

It is clear from this variety of approaches that there is no one scheme that is believed to comprehensively address every complex facet of personal injury management and compensation.

Australia and its state and territory jurisdictions have equally disparate approaches to personal injury management and compensation schemes.

This paper aims to further an understanding of some of the different schemes in use within Australia and some of the features of these schemes.

Summary

In 2004 the Productivity Commission concluded that private underwriting of Workers Compensation schemes was preferable to government underwriting.

Today, eight years later, the majority of personal injury schemes around Australia continue to be underwritten by the public.

The New South Wales (NSW) Workers Compensation scheme currently has a deficit greater than \$4 billion, which has resulted in a Parliamentary Inquiry and controversial cuts to benefits that are designed to avoid projected premium rises of 28%.

Those in favour of government underwriting of the personal injury classes of Workers Compensation and Compulsory Third Party (CTP) insurance argue that it provides certainty and facilitates the broad pooling of risk, backed up by the strength of a state government balance sheet.

An argument for private underwriting is that it reduces the risk to state governments and ultimately to taxpayers by avoiding exposure to significant liabilities when schemes fall into deficit.

Further, a private scheme can arguably deliver better health outcomes to people who have been injured and provide incentive for policy holders to reduce risk.

In a well-regulated environment with a robust insurance industry like Australia, the case for private underwriting and claims management appears strong, but is it sufficiently compelling to prompt government schemes to transition to private underwriting?

This paper examines the question of public versus private underwriting of personal injury insurance schemes.



Background

Each state and territory in Australia has personal injury schemes for both their Workers Compensation and CTP insurance.

The scheme designs range from full state administration of underwriting, policy and claims management to fully privatised schemes with multiple insurers operating – with a number of variations in between. Federal schemes such as Comcare also exist

Workers Compensation in NSW and Victoria are referred to as ‘managed fund’ schemes with state government underwriting the risk and providing the capital, whilst policy administration and claims management is outsourced to ‘scheme agents’ who are paid on a fee for service basis.

Scheme agents are often insurance companies and include GIO, QBE, Allianz and CGU. Third party administrators such as EML, Xchanging and Gallaher Bassett also operate as scheme agents.

In South Australia, a single agent (EML) is contracted to provide all Workers Compensation policy and claims management.¹

Queensland Workers Compensation is entirely government run with no insurer or agent involvement.²

Western Australia, Tasmania, the Northern Territory and the ACT have privately underwritten Workers Compensation schemes with multiple insurers operating within them.

In CTP, only NSW and Queensland have private underwriting and multiple insurers operating within their schemes.

The ACT has a privately underwritten scheme but NRMA is currently the only provider. Other insurers are reluctant to enter the market under the current legislation and procedures.

All other CTP schemes are entirely underwritten by government.

Comparing schemes simply on premium rates can be misleading as each jurisdiction has different benefit regimes for those who are injured.

¹ The South Australian Government recently completed a tender process for claims management of its Workers Compensation scheme. A second claims manager, Gallagher Bassett, will enter the scheme on 1 January 2013.

² The Queensland Government has brought forward its five-yearly review and created a Parliamentary Committee to oversee the review.

For example, CTP prices are higher in NSW than in Western Australia, but NSW has a lifetime care scheme for all catastrophic injuries while WA does not.

The Workers Compensation average premium rate is significantly lower in Queensland than in NSW, but income replacement in Queensland is capped at five years or \$287,605, whilst in NSW income replacement can continue until retirement age for severely injured workers.³

The underlying dynamics that are present in government and privately underwritten schemes provide a more accurate basis for consideration.

Liability management

State government underwriting means that the relevant government authority is directly able to set the exact premium for personal injury insurance policies.

Critics of the publicly underwritten model contend that a state government is compromised when it comes to the difficult task of managing liabilities for future claims cost in a personal injury scheme.

It is apparent there will always be the potential for a state government to be pressured to reduce premiums or moderate premium increases due to the impact on the electorate.

Business owners and motorists want lower premiums, whilst unions and lawyers who represent the injured advocate for increased benefits.

With no independent regulator requiring the scheme to remain fully funded, arguably there will always be a temptation for a state government to allow the scheme to go into deficit – as has occurred under all major political parties and for both Workers Compensation and CTP schemes.

As noted, the NSW WorkCover scheme currently has deficit of more than \$4 billion. The Queensland Workers Compensation scheme has been on a sharp decline in recent years, managing a thin surplus in 10/11.

In theory a government underwritten scheme is able to provide more consistent premiums by being less responsive to changing market conditions such as investment yields.

³ Adjustments to the maximum duration of income replacement payments were legislated in NSW in June 2012. Prior to the new legislation, income replacement could continue until retirement age for workers without severe injuries.



But if those premiums are consistently too low, the result can be dramatic.

Prior to privatisation in 1989, the NSW CTP scheme had deteriorated to an alarming degree.

At 30 June 1988 liabilities stood at \$3 billion of which \$1.87 billion was unfunded. Representing \$4.7 billion in today's terms, the NSW deficit was enormous both in percentage and absolute terms.

Every NSW CTP policy had an additional \$47 levy for the next 10 years to pay off the debt.

Personal injury claims can be very expensive. They incorporate significant medical, rehabilitation and care expenses, and can include income replacement as well as lump sums for permanent impairment and pain and suffering compensation.

These factors mean that sizable deficits can quickly materialise if liabilities are not monitored closely and urgent remediation undertaken.

Privately underwritten schemes are arguably more effective at discerning emerging trends and responding in a timely fashion, particularly during challenging economic times.

When deficits are allowed to accumulate, this effectively pushes the cost of injuries occurring today onto the employers and motorists of tomorrow.

In schemes that are privately underwritten – WA, ACT, NT and TAS Workers Compensation and NSW, ACT and QLD CTP – there are no deficits that can be carried forward into the future.

The Australian Prudential and Regulatory Authority (APRA) ensure insurance companies fully fund any future claims liabilities.

Any deficit requires an adjustment that has an immediate impact on the insurance company's results.

A failure to do so would result in close supervision from APRA with possible increased prudential capital requirements and damage to the insurance company's reputation and share price.

There is no APRA equivalent overseeing state government schemes and placing the same conditions on governments that APRA places on private insurers.

This lack of independent regulation allows government underwritten schemes to fall into deficit, with the end result being a significant

impact on the state balance sheet and risk of a credit rating downgrade.

Risk, price and behaviour – the relationship

Government underwritten Workers Compensation schemes provide businesses – particularly small businesses – with a high degree of premium stability.

Premiums are determined by the business type and the price is identical regardless of which agent is managing the policy.

This is distinct from a privately underwritten Workers Compensation scheme where, when a policy is issued, an underwriter can look at the profile of the small business, determine the risk and set the premium accordingly – as per normal insurance principles.

A large business with poor safety procedures and un-maintained equipment is a higher risk and will be charged a higher premium. A large business that is serious about avoiding workplace accidents will attract a lower premium.

Insurance companies want to insure businesses that have good risk management practices and will offer a competitive premium to reflect this.

When it is time to renew the policy, the safety record of the business and the frequency and severity of claims they have made will have a direct impact on the premium. This is true for large and small businesses alike.

In a government underwritten Workers Compensation scheme like NSW WorkCover, employers paying less than \$10,000 a year in premium – which usually means up to five employees – are immune from claims impacting on their premium.

Whilst this shields these employers from premium rises, the result is that safe business operators effectively subsidise negligent business operators.

Regardless of how many workers are injured at a business and the seriousness of the injuries, the negligent employer will pay the same premium as an equivalent business with a perfect safety record.

Critics point out that this is unfair and provides little incentive to change behaviour and invest in safety.

In a privately underwritten Workers Compensation scheme the same negligent business operators



would see their premiums dramatically impacted, delivering a clear message that to stay competitive, safety must be improved.

Similarly in CTP, some insurers in the privately underwritten NSW scheme use risk rating factors such as the number of previous at-fault collisions to determine premium rates, which rewards those with a perfect driving record.

Risk managers and underwriters will tell you that having a clear and direct link between risk and price is essential if you are serious about changing behaviour to reduce risk and injury.

Investing in safety has multiple benefits – it saves lives, improves productivity and reduces insurance premiums. It also promotes a positive safety culture within the business.

One of the strengths of privately underwritten personal injury insurance schemes is that they can be more flexible and responsive, meaning they reward policy holders who look after themselves and the people in their care.

Managing rehabilitation

Personal injury claims management involves a remarkable confluence of objectives – everyone wants the same thing, which is for the injured person to recover as quickly as possible.

In the case of a workplace injury, a speedy return to work is good for the worker, the employer and the underwriter.

In privately underwritten schemes the claims manager is the underwriter, meaning there is a direct link between the quality of the claims management and the bottom line of the underwriter. The underwriter has real 'skin in the game'.

There is a strong incentive to be innovative and proactive in order to avoid a protracted – thus expensive – claim.

As Australia's largest personal injury insurer, Suncorp Group (Suncorp) is highly cognisant of the fact that resolving a claim requires early intervention, the establishment of trust, empathy and the most effective treatment.

Delays, cutting corners and failing to actively monitor progress become very expensive.

In government schemes where the claims management is outsourced, the link between claims management and the bottom line is

weakened if strong regulatory monitoring and aligned remuneration models are not in place.

For example, reports have shown that in some government underwritten schemes there has been inadequate monitoring of rehabilitation providers by claims managers.

These reports noted that rehabilitation providers were appointed, but there was insufficient follow-up to ensure actual positive results were being achieved.

This lack of monitoring can allow a protracted claim to develop, dramatically increasing the period of incapacity for the injured person and the cost of the claim.

Best-practice claims management is the key to minimising the negative impact of injuries on people, employers and underwriters.

Competition between independent insurers who underwrite and manage claims, generates a strong motivation for claims managers to be innovative and contain costs, rather than simply follow a procedure without active pursuit of an outcome for the injured person.

Competition drives best practice and results in multiple parties working for the ongoing financial sustainability of the scheme.

Certainty and investment

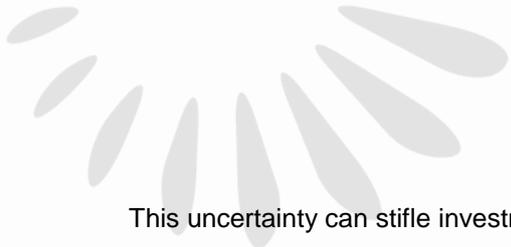
A distinguishing feature of personal injury claims is that they are 'long tail' – they can last a lifetime. And as they directly involve people and their families who are coping with physical injuries and financial stress, they're very complex to manage.

Personal injury claims management is a highly specialised industry and establishing the expertise, systems and processes required to do it well is a significant and ongoing investment.

For a business to invest in such an undertaking requires a high degree of certainty.

Managed fund schemes typically offer agents five year contracts to manage policies and claims. The state government authority is able to allocate and remove market share at will.

Over the years the authorities in NSW, Victoria and South Australia have increased and decreased the number of agents, resulting in reduced market share for existing agents when numbers increase, and in agents being removed from the scheme when numbers decrease.



This uncertainty can stifle investment.

By way of illustration, insurers like those within the Suncorp who operate in privately underwritten jurisdictions with relative security have made significant investments in the latest claims management computer systems.

Compare that to other Australian jurisdictions where claims management is still paper-based.

The fact that agents operating in government underwritten schemes have less security of tenure is arguably a disincentive to invest.

In a privately underwritten jurisdiction an insurer – assuming they comply with their licence conditions and remain competitive – can expect to remain indefinitely.

This encourages investment in people and systems to build the quality and profitability of their business, and improves the scheme for all participants.

Role of government

Advocates of privately underwritten personal injury schemes argue that they allow government to focus on the critical role they have to play in order to deliver an effective and sustainable scheme – to regulate and provide oversight.

Effectively the scheme is defined by the regulator, which ultimately means the state government. They set the conditions and dictate what constitutes reasonable and adequate care.

By controlling the benefit structure, the regulator decides if their scheme will have generous benefits and therefore higher premiums, or restricted benefits and lower premiums.

As currently occurs in privately underwritten schemes, premium increases are approved – although not dictated – by the regulator.

The regulator is also responsible for ensuring affordability and universal coverage.

As much as a direct relationship between risk and price has clear benefits in changing behaviour, there are instances where ‘community rating’ of premiums is appropriate.

For example, whilst an 18 year old should pay more for their CTP insurance, if they were charged the full price for the risk they represent it would be unaffordable, which would increase the likelihood of people driving without insurance.

A government underwritten scheme does give the regulator direct control over the prices consumers will be charged.

However, in privately underwritten schemes the regulator has a high degree of indirect control through setting ceiling prices and rejecting proposed premium increases – as occurred in the NSW CTP scheme in late 2011.

Regardless of whether the underwriter is public or private, the regulator is able to determine what constitutes an appropriate community rating in order to encourage the right behaviour, deliver affordable insurance to all parts of the community and reduce levels of uninsurance.

NDIS

Whilst proponents of private underwriting and claims management contend that this is the best option for over 99% of personal injury claims, it is not necessarily the case for the less than 1% that constitute catastrophic (severe and profound) claims.

Suncorp has consistently argued that insurers have an important role to play in the proposed National Disability Insurance Scheme (NDIS) for acquired disabilities and National Injury Insurance Scheme (NIIS) for disabilities from accidents.

However, that does not include private underwriting of catastrophic components of the NDIS or NIIS.

Catastrophic claims constitute approximately 20% of the total personal injury claims cost of CTP claims.

The capital required for these claims is enormous due to their size and duration, and is impacted by the volatility of investment markets.

If underwritten by entities that are owned by shareholders, these shareholders require a return on this capital, which increases premiums.

Further, the small number of catastrophic claims means that fragmenting the claims management by dividing them amongst claims managers does not deliver sufficient scale. Aggregating these claims delivers economies of scale.

An NDIS and NIIS will allow a long-term, holistic approach to be taken to the rehabilitation, care and support of people with catastrophic disabilities.

They will be able to have their individual preferences catered for and long-term strategies



implemented to maximise function and reduce the call on public medical and hospital resources.

An NDIS and NIIS will also ease the burden on carers, which in turn may increase workforce participation.

The cost benefits of this approach is far preferable to the current situation where insured people with catastrophic claims are generally given a lump sum, which may be inadequate, can be mismanaged and may not produce the desired outcomes.

A system that provides holistic, long-term care to the catastrophically injured is preferable to one that encourages litigation in order to maximise lump-sum payouts, which can hinder early medical and return-to-work intervention.

Underwriting and claims management of catastrophic injuries is best placed outside the private insurance industry due to the high capital requirements.

The benefits that will be derived from a centralised scheme that is underwritten by government will deliver better outcomes for all.

Conclusion

The conclusion of the Productivity Commission in 2004 that private underwriting of Workers Compensation is preferable to government underwriting also stated that the risk of insurer failure would be reduced by prudential supervision.

In the intervening years, prudential control of insurers has proved its worth.

Insurers are less at risk of failure than they were a decade ago due to strengthened capital requirements and greater prudential oversight.

This was evident during the recent global financial crisis, where the insurance industry demonstrated its resilience.

Yet government underwritten personal injury schemes continue to dominate the Australian landscape, and no schemes have moved from public to private underwriting since the Productivity Commission made its recommendations in 2004.

The current unfunded liabilities in government underwritten schemes expose future policy holders to increased insurance costs as a result of today's political environment.

Australia has a mature and highly capable insurance industry where competition is delivering competitive pricing, innovation and a high focus on customer experience.

Insurers have the skills, capacity and appetite to underwrite personal injury schemes across the nation.

Moving from public to private underwriting would remove a significant liability or potential liability from the public, as well as arguably increasing efficiency, reducing costs and improving health outcomes for those who are injured.

Perhaps the next decade will see more state governments asking why they continue to be in the insurance business.

The Suncorp Group

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CI offers a wide range of insurance products and distributes them under the Suncorp, Vero, GIO and AAMI brands.

Appendix B

Suncorp White Paper: *'How international financial markets impact personal injury insurance'*, September 2012



How international financial markets impact personal injury insurance

September 2012

Summary

When interest rates fall, many home owners enjoy the benefit of lower repayments on their mortgage.

But they are also likely to find that the cost of their Compulsory Third Party (CTP) insurance policy has increased.

If they are employers, they may also find they're paying more for Workers Compensation insurance.

It is not widely understood how and why the events are related.

When insurers – be they private or publicly owned – collect premiums, they hold this money to pay future claims. This money is invested in order to generate income for the insurer.

The longer the investment period, the greater the significance of investment income as a source of revenue, and thus the insurer's ability to reduce the initial premium paid by customers.

CTP and Workers Compensation claims involve injured people and are therefore complex, often taking years to resolve as a person's medical condition must first stabilise.

On average, CTP claims are paid around five years after the premium is collected, making the investment income highly significant for CTP insurers.

Workers Compensation claims also take several years to resolve on average.

As interest rates – or more specifically, bond rates – fall, the implications for insurers are material.

When economic conditions result in a drop in the yields of Australian Federal Government bonds, CTP and Workers Compensation premiums can be expected to rise.

This is precisely what has occurred in Australia in the 12 months from June 2011 to June 2012 as the three year bond yield has halved.

The nature of the global economy is such that seemingly unrelated external events can have an impact.

The Greek debt crisis may be half a world away but it's been pushing up the price of your CTP and Workers Compensation premiums.

The degree to which premiums are able to respond to this price pressure is very much determined by the particular regulatory framework.



Background

Each state and territory government in Australia administers their own CTP and Workers Compensation schemes.

Many of Australia's CTP schemes are publicly underwritten, meaning the state or territory government sets the price, holds the risk and pays the claims.

Two of the largest, New South Wales (NSW) and Queensland, have private underwriting and multiple insurers operating within their CTP schemes.

The Australian Capital Territory (ACT) has a privately underwritten CTP scheme but NRMA is currently the only provider.

All remaining CTP jurisdictions are publicly underwritten.

The brands that offer CTP insurance in NSW or Queensland include Suncorp, GIO, AAMI, NRMA, RACQ, Allianz, Zurich and QBE.

The Workers Compensation schemes in NSW and Victoria are referred to as 'managed fund' with state government underwriting the risk and providing the capital, whilst policy administration and claims management is outsourced to 'scheme agents' who are paid on a fee for service basis.

Scheme agents are often insurance companies and include GIO, QBE, Allianz and CGU. Third party administrators such as EML, Xchanging and Gallaher Basset also operate as scheme agents.

In South Australia, a single agent (EML) is contracted to provide all Workers Compensation policy and claims management.¹

Queensland Workers Compensation is entirely government run with no insurer or agent involvement.²

Western Australia, Tasmania, the Northern Territory and the ACT have privately underwritten Workers Compensation schemes with multiple insurers operating within them.

CTP and Workers Compensation are referred to as 'long tail' classes as they take significantly longer on average for the claims to be finalised than 'short tail' classes such as Motor and Home insurance.

Whilst only one of several factors that impact premium rates, investment income is far more significant for long tail insurance classes than short tail classes due to the average duration of the claims.

Whilst investment income is of greater importance to long tail classes due to longer average claims durations, it is relevant to all general insurance classes.

Investment income and premiums

CTP and Workers Compensation insurance classes are capital intensive. A single catastrophic claim can cost tens of millions of dollars and take decades to resolve.

This means that vast amounts of money (reserves) have to be held to pay future claims.

For example, Suncorp estimate that insurers operating in the Queensland and NSW CTP schemes currently hold around \$15 billion in reserves, risk margin and capital.

Despite being largely invested in relatively low-risk and low yielding instruments, the revenue generated from this investment is significant.

This has a noticeable impact on CTP and Workers Compensation premiums.

In simple terms, if an insurer knows it needs to have \$100 to pay a claim in five years' time, it only needs to put aside \$78 if the relevant bond yields are 5%³.

The investment by insurers of the money set aside to pay future claims reduces the premiums paid by CTP and Workers Compensation policy holders.

If insurers did not generate investment income, a CTP premium of \$315 would cost \$390⁴, assuming a 5% bond yield and scheme dynamics similar to the Queensland CTP scheme.

¹ The South Australian Government recently completed a tender process for claims management of its Workers Compensation scheme. A second claims manager, Gallagher Bassett, will enter the scheme on 1 January 2013.

² The Queensland Government has brought forward its five-yearly review and created a Parliamentary Committee to oversee the review.

³ Bond yields vary depending on the length of maturity of the bond, with a longer maturity typically giving a high yield. The 'yield curve' can be simplified to a single rate commonly referred to as the 'discount rate'.

⁴ The total paid by a CTP customer typically includes levies and taxes in addition to the insurer premium. This calculation refers to the insurer premium only.



What goes down...

A primary investment instrument for CTP and Workers Compensation reserves is Federal Government bonds.

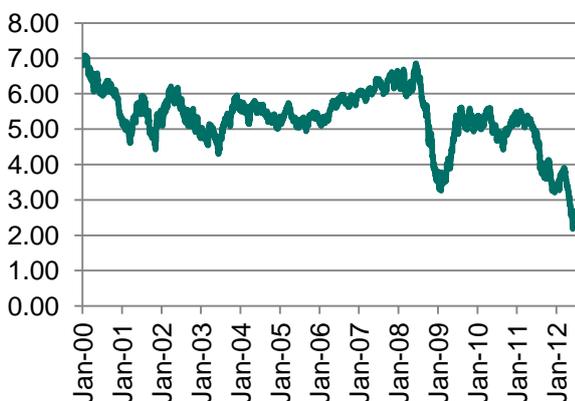
These bonds are also the benchmark used for accounting purposes when insurers calculate their reserves and future claims liabilities.

As bond yields change over time, so should CTP, Workers Compensation and other long tail premiums.

The actuarial rule of thumb is that for every 1% drop in bond yields, insurer premiums have to rise around 4% to remain sustainable.

If, as has occurred recently, bond yields slump from 5% to 2.5%, then rather than putting aside \$78 to pay a \$100 claim in five years, an insurer would have to put aside \$88 – an increase of 13%.

The same drop in bond yields means that a \$315 CTP premium would have to rise to \$350 in order to remain sustainable – a \$35 or 11% increase.



5-year bond yields (%) 2000 to 2012

This volatility is one of the core challenges faced by all CTP and long tail insurers.

A key mechanism to limit the ability for this volatility to dramatically affect the financial viability of an insurer is through 'locking in' investments so they mature when the claims costs are due.

This process is referred to as 'duration matching'.

Duration matching

Given that an insurer's reserves (money set aside to pay future claims) and liabilities (the estimate of future claims costs) are often in the billions of dollars, there's considerable risk that large holes

can appear in the balance sheet when bond yields change.

For private insurers, the Australian Prudential Regulatory Authority (APRA) requires all liabilities to be fully funded, meaning that any hole in the balance sheet has to be filled immediately.

When reserves are insufficient to cover liabilities then this gap has to be filled, which is referred to as 'reserve strengthening'.

This reduces the profitability of an insurer, and the impact can be dramatic – hence the practice of duration matching.

In simple terms, if the insurer expects to have a \$500 claims bill due in three years, they will purchase a bond that will mature on average in three years to a total value of \$500.

By adopting an investment strategy of duration matching, insurers can protect their balance sheet and reduce the volatility of their year-on-year results.

An insurer that has a robust duration matching investment program will significantly reduce the impact of changing bond yields on their existing liabilities.

The issue for CTP and Workers Compensation insurers when bond yields drop is the fact that the premiums derived from policies being written today may be insufficient to cover future claims cost.

Of significance is the ability of private insurers to respond when bond yields change.

Changing the premium

CTP and Workers Compensation are highly regulated classes of insurance.

A key feature is that insurers cannot refuse to offer CTP or Worker Compensation insurance to a customer, which ensures that everyone can obtain insurance as long as they can pay the premium.

In the jurisdictions where CTP insurance is underwritten by private insurance companies (Queensland, NSW and the ACT) the government regulators maintain a high degree of control over premium rates.

In the privately underwritten Workers Compensation jurisdictions of WA, the ACT and Tasmania, the regulator publishes the average premium rate for each occupation, referred to as 'industry gazetted rates'.



Insurers charge an appropriate rate based on certain risk assessed conditions.

In WA, insurers are required to present a business case if the rate assessed is higher than 75% of the gazetted rate.

Sustainability

State and territory governments have the power to determine how much motorists pay for their CTP and Workers Compensation insurance.

In publicly underwritten schemes, if the price is set too low, the scheme is at risk of falling into deficit and having a negative impact on the government's balance sheet.

This has occurred recently in the NSW Workers Compensation scheme, where a deficit of over \$4 billion has emerged, due in significant part to a reduction in investment income from declining bond yields.

This unsustainable financial position has led the NSW Government to undertake reform and cut benefits in order to contain further premium rises.

In privately underwritten CTP and Workers Compensation schemes, it is insurance companies that hold the risk and have their balance sheets exposed to fluctuations in bond yields that can stem from both domestic and international financial conditions.

Given this exposure, private insurers arguably have a right to expect CTP and Workers Compensation premiums to respond to significant and sustained changes in bond yields.

Conclusion

The relationship between bond yields and personal injury insurance premiums is well understood by insurance analysts.

It is a direct relationship and has a material impact on the financial sustainability of CTP and Workers Compensation insurers, both public and private.

Private insurers that participate in CTP and Workers Compensation schemes are required by the Australian Prudential and Regulatory Authority to have sufficient reserves to cover all future claims.

When bond yields drop, if premiums do not correspondingly rise then it's shareholders who pay to fill the gap between reserves and liabilities.

An unresponsive regulatory framework reduces competition and undermines confidence in a private insurer's ability to operate sustainably in a CTP or Workers Compensation scheme.

It is in the interests of the community to ensure that, even if bond yields crash, viable CTP and Workers Compensation schemes are there to support injured Australian.

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