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MIIAA Conference
Ongoing Impact of the Global Economy on the Australian Insurance Landscape. What does it mean to MDOs and Premium Setting?

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Anticipated Impact of Post GFC Factors

- Overall effect of an economic downturn has the ***potential to harden the insurance and reinsurance market***
- Funding for cover is reduced
- Investment opportunity to sustain funding decreases
- The availability of cover is reduced
- In the case of professional/medical indemnity there may be an associated increase in claims against professionals
- **The combined effect of these factors would drive premium prices up**

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Effect on MI Premiums

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Potential upward pressure on MI premiums has been counterbalanced by a number of factors which work to stabilise:

- the premium models, and
- individual premium levels in the short term

These stabilising factors are largely a product of historical changes to the foundation of MI

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Historical Foundation

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The following trigger events in 2001 served to change the MI structure going forward:

- ***The collapse of HIH Insurance*** **-** provided reinsurance to MDOs
- ***The impact of September 2001*** - substantial reduction in reinsurance capacity and premium increases

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Historical Foundation

- ***Substantial increase in the frequency of negligence claims against medical practitioners*** - notifications being brought forward *as a result of* announcement of tort reform under the Health Care Liability Act 2001 (NSW)
- ***An increase in the size of damages awards*** - Simpson v Diamond set a new threshold of $14.2 million

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Historical Foundation

- ***A new accounting requirement for IBNRs*** - MDO’s to account for IBNR liability on their balance sheet
- ***Insufficient premium pricing and reserving*** - potentially spiralling damages awards and no regulatory prudential parameters

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The New Model - What Changed

Medical Indemnity Cover

Before July 2003	After July 2003
Cover by MDO	Insurance Contract by Insurer
• Mutuals	• Independent Insurer
• Not for Profit	• Owned by MDO
• Discretionary Cover	• Profit/Surplus
• No Prudential Regulation	• Prudentially Regulated by APRA
• IBNR Uncertainty	• Accounting for IBNR

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The New Model - What Changed

Reform programs were instituted to support premium cost and subsidise the impact of claims:

- Exceptional Claims Scheme (ECS)
- Run-Off Cover Scheme (ROCS)
- UMP Support Payment (UMPSP)
- High Cost Claims Scheme (HCCS)
- Premium Support Scheme (PSS)

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The New Model

Market and Prudentially Driven Pricing

Insurers make use of the following metrics in formulating their premium pricing:

- actuaries in their premium liability assessments
- pricing reports
- funding plans
- financial forecasts [*see ACCC's medical indemnity insurance monitoring reports*]

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The New Model

Market and Prudentially Driven Pricing

ACCC found each insurer had:

- incorporated all major cost implications for premium pricing
- determined their aggregate premium before having considered advice from the actuary (despite the use of different pricing models by those actuaries)
- appropriately considered the HCCS and ROCS in their premium determinations
- taken into account of the HCCS in their reinsurance programs.

As a Consequence Premium Pools Stabilised

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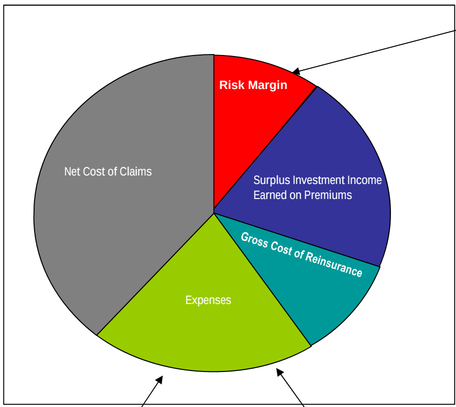
What are the levers in Pricing

Medical Indemnity Insurance
Aggregate Premium Pool

Risk Margin on Expected Claims Cost (to reflect the uncertainty in expected Claims cost)



- Risk Margin
- Surplus Investment Income Earned on Premiums
- Gross Cost of Reinsurance
- Expenses
- Net Cost of Claims

Operating Business and Expenses Incurred in Current Underwriting Period

Future Expenses Required to Administer Claims Arising in Future Years

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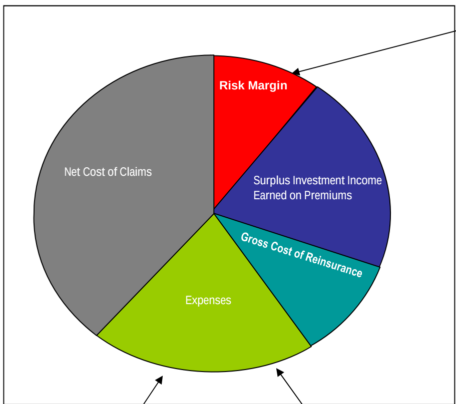

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Impact of Legislative Reforms

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Tort Law Reform & Net Cost of Claims

Tort law reform - progressively introduced by Federal, State and Territory Governments

The major reforms to tort law include:

- Caps on damages for economic loss (i.e. loss of past and/or future income) and non-economic loss (i.e. compensation of pain and suffering)
- Minimum thresholds of impairment to access damages for non-economic loss settlement awards
- Changes in the limitation periods for personal injury cases
- Increases in discount rates that apply to claims payouts

All insurers implicitly take into account tort law reform when setting premiums ***as they reflect on assumptions for average sized claims and frequency based on past experience***

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Impact of Legislative Reforms

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Commonwealth Government Schemes

Run-Off Cover Scheme

Capacity of doctors to pay for run-off Cover when they no longer earn any income

The ROCS scheme is expected to affect premiums by:

- taking claims from medical practitioners off the books of the insurer and reducing the pure risk premium

BUT

- premiums will increase by an amount which the Australian Government charges to cover the cost of the Scheme

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Impact of Legislative Reforms

High Cost Claims Scheme

- To address upward movement in medical indemnity premiums by reducing the cost of large claims to insurers
- Reimbursing insurers 50% of the cost of medical indemnity claims above a threshold

What are the Current Variables Affecting Pricing

Retention of risk

What is the impact of a sizeable retention of risk by insurers ?

- Minimises exposure to the market and hence market fluctuations
- Should be able to utilise it as a buffer depending on whether the insurer adopts the proper underwriting approach to risk
- If current retentions are higher (say $1M) then impact of reinsurance is reduced

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What are the Current Variables Affecting Pricing

Interest rate

What is the effect of a reduction in interest rates

- Less investment return and therefore less investment income
- As interest decreases then the provision for claims must go up
- Emerging Surplus - Poor Investment Earnings

What are the Current Variables Affecting Pricing

Capitalisation

What is the effect of high Australian rates of capitalisation ?

- MCR's of 150%
- Medical indemnity insurers are well capitalised above the minimum capital reserves
- Most insurers no longer include an explicit loading in their premiums for additional capital
- Capital is a buffer against economic fluctuations
- Net Assets Improved

What are the Current Variables Affecting Pricing

Reinsurance

What is the impact of a soft reinsurance market ?

- The current market for reinsurance is soft
- This is contrary to market expectations and therefore a positive
- Impact will depend on the extent to which Reinsurance is included in Premium Rates
- Lower than Expected Reinsurance Expenses

What are the Current Variables Affecting Pricing

Claims and Legal Developments

What is the claims trend ?

- PI claims generally have reduced
- There is no trending to suggest a spike
- Medical indemnity claims experience is benign
- This is further evidence that tort reform is having an effect and contrary to expectations has stuck
- Super inflation through judgements and judicial decisions pushing the cost of claims up has not occurred

Premium Support Scheme – Federal Government has introduced a new premium support scheme coverage from 80% to 70% in July this year

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The Future

Both positive and negative factors but potential upward pressure

Winding Down of Government Schemes Will Impact

- High Cost Claims Subsidy – Federal Government is considering increasing the higher costs claims subsidy threshold from $300,000 to $500,000. [This is currently under comment from industry]

Interest Rates and Investment Return

- As interest rates fall this has an exponential effect on potential premium rate increases as interest rates and investment returns have declined over time.

Long Tail Character Prevails

Balance between being more commercially driven & fiscal responsibility

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The Future

GFC Influenced which Factors ?

- Reinsurance
- Investments
- Operating Costs

Counter Balanced by

- Reinsurance Exposures
- Capital Adequacy
- Actuarial Forecasting
- More Disciplined Loss Analysis

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