Actuarial perspective on tort reform

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Summary

The unavailability or very high price of some insurance largely reflects the present shortage of capital by the insurance industry. This shortage has resulted from the past incompetence of insurers, inadequate supervision, the failure of HIH, September 11 2001, sharemarket falls and increased statutory capital requirements.

Insurers have responded by increasing premiums, and withdrawing from types of insurance requiring high capital. Small businesses and community groups have found it particularly difficult to obtain public liability or professional indemnity insurance.

Insurers have persistently sought to blame the injured and their lawyers for the insurance crisis. But public liability policy numbers increased by about 145% in the 7 years to 30/6/00, while claim numbers increased by about 81%. Much of the claim number growth appears to reflect the transfer of risky activities, such as education, transport, electricity and council services, from the government to the private sector.

A survey of public liability verdicts suggests that at least 30% of public liability costs result from recreational activities. Legislative amendments currently under consideration could exclude nearly all such activities from cover, and thus reduce the need for local governments, schools, sporting associations, recreational facilities and tourism operators to take reasonable safety precautions.

Present proposals will however do very little to ensure that small businesses and community groups can obtain public liability cover at reasonable prices. The state and Commonwealth governments, and private insurers, seem unwilling to take any effective action. Several years of difficulty are likely before the insurance market returns to competitive health.

High prices or unavailability of some types of insurance

The Australian Financial Review of 9/7/02 quoted increases in professional indemnity premiums from submissions to the Senate Economics References Committee inquiry into the impact of public liability and professional indemnity insurance cost increases:

financial planners	up to 1000%
real estate agents	200-500%
property valuers	about 350%
accountants	100-200%

The Review noted that professional organizations have expressed concern that insurance companies were effectively "stringing them along" with the possibility of continued cover, only to have their cover denied at the eleventh hour.

Disturbing gaps have appeared suddenly in sectors of the public liability, professional indemnity and builders warranty insurance markets. Some businesses and community organizations have been unable to buy insurance at all, or only at very high prices.

Present shortage of insurance capital

It is unlikely that the sudden gaps in availability have resulted largely from growth in claim numbers and claims sizes, as these appear to have been growing steadily, with no particular change in the last couple of years. Current market gaps are largely the result of insurance capital shortage, stemming from

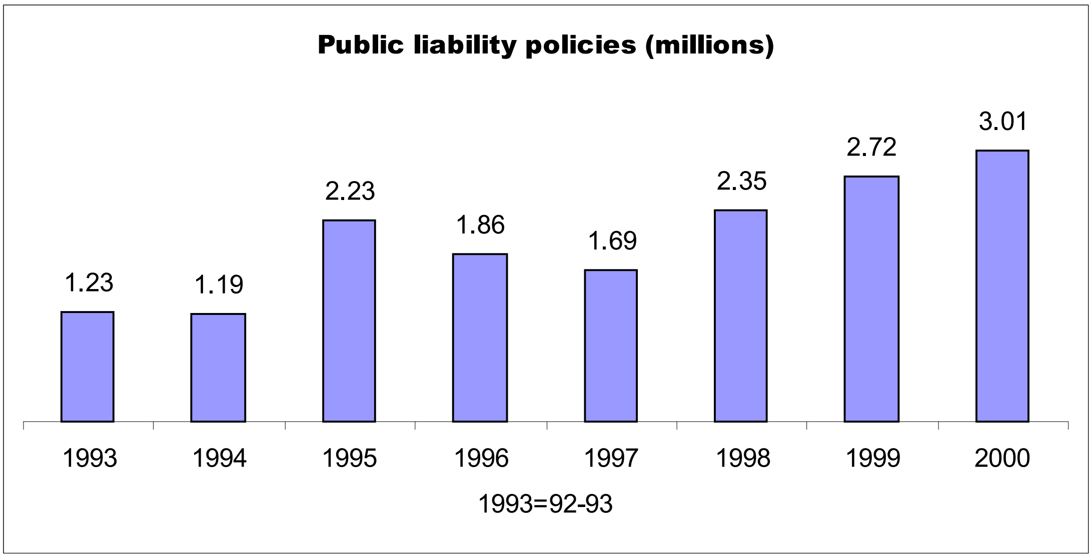
- inadequate supervision of the insurance industry in the 1990s, contributing to inadequate premiums and claim reserves
- the demise of HIH early in 2001 (HIH had large shares of the public liability and professional indemnity markets)
- the effects of the 11/9/01 tragedy (an 18/7/02 letter to the Australian Financial Review by APRA's Darryl Roberts estimates this took upwards of $US50 billion out of the world market)
- APRA's much increased capital requirements from 1/7/02
- share market falls.

Insurer responses to capital shortages

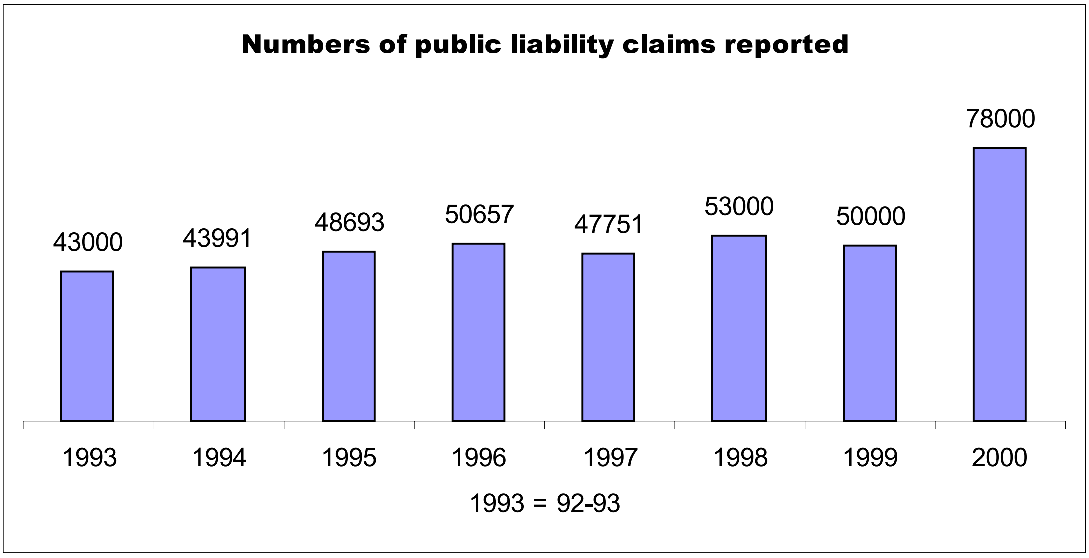
Insurers have responded by increasing premiums, and withdrawing from types of insurance requiring high capital. A submission of 23/10/02 to the ACCC by QBE Insurance (Australia), Allianz Australia Insurance and NRMA Insurance, seeking authorisation for a pool arrangement for not for profit organisations, said in part:

> “As a result of … the unavailability of capital and low returns, foreign and Australian insurers have had to become more selective about the risks they underwrite. Among the poorer prospects are long-tail liability classes since they have been unprofitable for many years and require significant reserves”
>
> “… there is a general reluctance to provide stand alone liability policies.”

Increases in public liability policy and claim numbers



From statistics published by the Insurance and Superannuation Commission and its successor the Australian Prudential Regulatory Authority, public liability policy numbers increased from 1.23 million in 92-93 to 3.01 million in 99-00, an increase of 145%.



By contrast, public liability claim numbers increased from about 43,000 in 92-93 to 78,000 in 00-01, an increase of about 81%. It should be noted that APRA have made substantial revisions to their recent numbers of policies and claims, and even the revised figures may not be reliable.

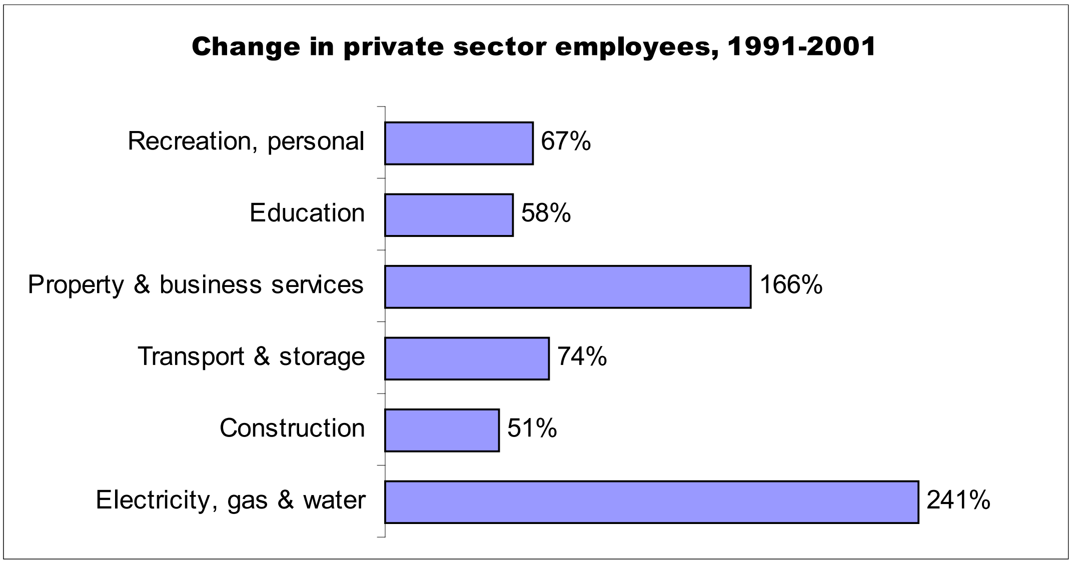
A substantial part of the growth in policy and claim numbers may reflect transfers to private public liability insurers of risks previously covered elsewhere:

- workers compensation insurance for subcontractors

- risks formerly covered by federal, state and local governments, but now being insured by private insurers as a result of asset sales or outsourcing

- risks formerly covered by state or local governments, but now being insured by venue hirers.

Transfer of risky activities to the private sector

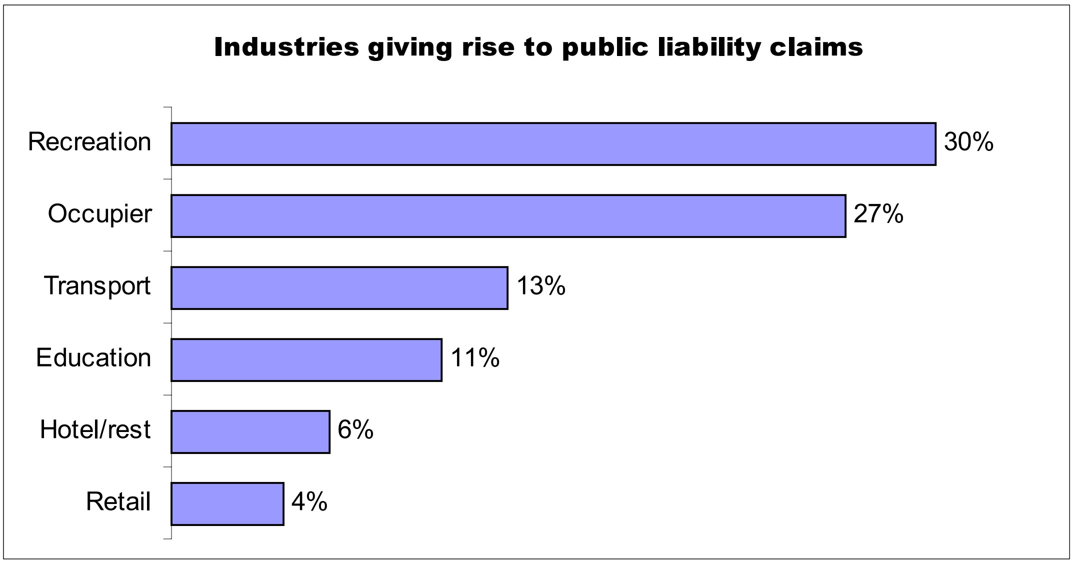


Overall, the number of private sector employees grew by about 46% from 1991 to 2001. Some of this growth was due to the transfer of risky activities from the public to the private sector. For example, the two largest public liability claims in Australia have probably come from electricity generation and distribution in Victoria – about $50m from a large spanner falling down a water turbine, and $200m from bushfires. Education is a surprisingly risky sector, where private sector employees have grown by about 58%. Allowing for the relative riskiness and growth rates of each major industry, private sector public liability claim numbers should have grown by at least 50%.

Survey of public liability verdicts

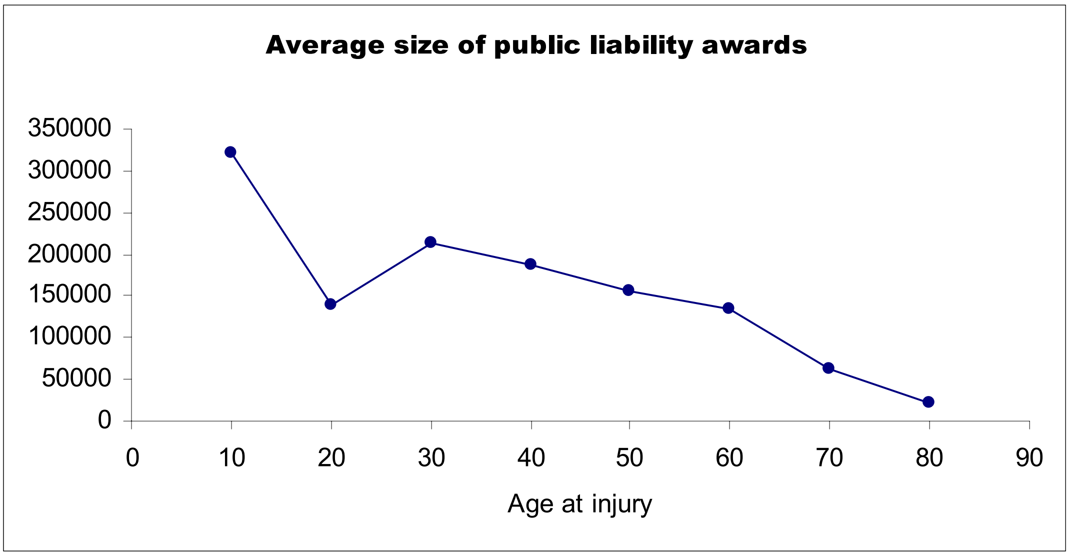
In their report of 27/3/02 titled "Public liability insurance", Trowbridge Consulting gave details of about 110 public liability verdicts taken from "Australian Tort Reports" 1988 to 2000 (CCH Australia Limited). For broadly these cases, and a few 2001 cases, I obtained details of sector, industry and age from the published details. The 112 cases surveyed consisted of 74% where the defendant was private, 8% local government, 17% state government and 1% Commonwealth. In some cases the industry was not clear, and I assumed them to arise from occupiers liability. In some cases the age of the plaintiff at injury was not stated, and was estimated from the cause of the injury and the occupation of the injured person.

Industries giving rise to public liability claims



Recreational accidents gave rise to 30% of the 112 verdicts, but accounted for 49% of the total amount of the awards. Recreational injuries tend to be more severe (often to the spinal cord), and involve younger plaintiffs.

Average size of awards by age



The above graph omits one claim under age 10, and one for $8.8m to a person injured at age 27 in a tobogganning accident (an award against the State of NSW in 2001). The remaining 110 cases show a clear trend for younger plaintiffs to receive higher awards.

Reduced recreational safety?

Recent legislative amendments, and those currently under consideration, could exclude nearly all recreational activities from cover. This would reduce the need for local governments, schools, sporting associations, recreational facilities and tourism operators to take reasonable safety precautions.

Continuing gaps in public liability cover

Present proposals will however do very little to ensure that small businesses and community groups can obtain public liability cover at reasonable prices. State governments could establish their own insurers, but this would reverse the privatisation of the state insurers in the 1990s. The Commonwealth could reduce the insurance capital requirements applying from 1/7/02, but does not accept that such a step would be reasonable or helpful. Insurers could extend their code of conduct to require reasonable insurance availability, but seem unwilling to do so. Several years of difficulty are likely before the insurance market returns to competitive health.