

Premiums, propaganda & the push

Everyone who has read a newspaper or watched TV in the last year knows that public liability and medical malpractice premiums have increased.

Insurers are blaming increases on increases in litigation. They attribute this to avaricious lawyers advertising, conditional fee agreements and a litigious society that places greater value on rights than it does on personal responsibility.

These claims are repeated so often that they become 'conventional wisdom'. The claims are false, but intelligence and education do not inoculate citizens against the effects of media hype. Truth and a critical mind are the only antidotes, but to the mass media truth is less important than spin.

Propaganda creates myths, myths fuel emotion, and emotions are the weeds that choke rational thought.

The result of this process is that ordinary citizens are now more afraid of being sued than they are of being injured. This is a dangerous position for society to be in. Under this delusion ordinary citizens can be convinced to surrender legal rights that society has taken centuries to acquire.

An old proverb says, "a lie will go round the world while truth is pulling its boots on". Mark Twain once famously wrote, "...one of the most striking differences between a cat and a lie is that a cat has only nine lives". In *Mein Kampf* Hitler wrote, "The broad mass of a nation will more easily fall victim to a big lie than to a small one".

Is there any truth to these claims that runaway premiums are due to runaway litigation?

Litigation rates vary from time to time according to economic factors and changes in government policy. Litigation trends are usually slow to take effect and are easily identifiable in advance. Insurers employ actuaries and economists to identify these trends and set premiums accordingly. The changes are slow and ought never to result in sudden changes in premiums.

The fact is that litigation rates have little (if anything) to do with the recent jumps in premiums that have occurred in Australia since early 2000. The jumps in premiums are due to a number of factors:

- Premiums for all risks in Australia declined in the latter half of the 1990s.
- Premiums were down because of fierce competition between insurers, a stable reinsurance market, stable risk environment, and healthy economic growth throughout the latter part of the 1990s. In

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retrospect insurance was too cheap for part of this period.

- Competition and lack of attention to the fundamentals of the insurance market resulted in depletion of reserves and a decline in insurance company profits.

Towards the end of 1999 premiums started to increase. In 2000 they had gone up by about 15-20%. The upward trend in premiums has continued in 2001, and is likely to continue into 2002. The main reasons for this are as follows:

I Lack of Regulation of the Insurance Marketplace

The relaxed regulatory environment permitted insurers in the HIH group to compete with very low premiums and inadequate prudential reserves. That competition forced other insurers to lower their own premiums to unsustainable levels and contributed to the magnitude of the eventual HIH collapse.

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2 Dramatic Recent Decline in Competition

The insurance market was aggressively competitive throughout the late 1990s. But since 2000 there has been a dramatic decline in the level of competition between insurers.

This decline has occurred because of mergers between major players and the collapse of HIH insurance in early 2001.

At the time HIH collapsed it was Australia's second largest general insurer. The group consisted of over 200 subsidiaries, including 7 Australian insurers and re-insurers, and others overseas.

3 Renewed Focus on Profitability

In a competitive marketplace, insurers reduce premiums in response to price competition. Most will incur significant losses to prevent erosion of market share. These losses have to be made up when competition declines.

The recent decline in competition has enabled the remaining players to become more focused on increased profitability.

4 Increased Reinsurance Costs since 11 September 2001

Local insurers reinsure on the global reinsurance market. The premiums charged by 'local' insurers reflect the cost of this reinsurance.

The events at the World Trade Centre have caused a major contraction

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in the reinsurance market. This has resulted in increased reinsurance costs.

5 Alteration in the International Risk Environment

The events on 11 September fundamentally changed the risk profile of the reinsurance market. Now, for the first time, insurers are worried about terrorism that causes enormous destruction of property and the loss of thousands of lives.

6 Alteration in Earnings Environment

The world economic outlook has worsened since 11 September. Interest rates are at their lowest levels for decades in Australia and the USA. Recent rate reductions in the USA, the world's largest insurance sector, have produced a 'real' interest return after inflation of zero percent! Declining return on insurer's investments increases pressure to increase premiums.

7 Insurer Panic at Terrorism Cover in Current Policies

Before 11 September public risk insurers included terrorism cover in their policies at no extra cost. They now remain exposed under policies that were written before 11 September.

This has caused many of them to panic, refusing to insure many events that were previously viewed as good risks and pushing up premiums on new policies to retrospectively cover the terrorism risk exposure under current policies.

The USA experienced a similar 'crisis' in premiums in the late 1970s and early 1980s. At that time USA insurers mounted a campaign for 'tort reform' that mirrors that which we are experiencing in Australia. This campaign is not home grown; it is a tried and tested strategy that worked in the USA.

Beginning in the mid 1980s many states in the USA reacted with legislation to suppress compensation awards to injury victims. These 'reforms' were intended to contain the increasing cost of insurance premiums.

Extensive research in the USA demonstrates that high levels of 'tort reform' have never produced lower premiums. The reason for this is simple. Increased premiums have nothing to do with litigation rates. **PL**

Rob Davis