QUEENSLAND COMPULSORY THIRD PARTY SCHEME REVIEW 2023

RACQ SUBMISSION

21 April 2023

TABLE OF CONTENTS

EXECUTIVE SUMMARY 3

INTRODUCTION 7

OPTION 1 IS NOT AN OPTION 8

RACQ'S UNSUSTAINABLE PORTFOLIO RISK 8

Market share growth and high-risk cohorts 9

Reported claim frequency 11

Brand recognition and switching trends 12

This is a scheme issue – not an RACQ issue 13

PRICE COMPETITION IN THE SCHEME 14

DISCUSSION QUESTIONS 15

OPTION 2: PREMIUM EQUALISATION – RACQ'S PREFERRED SOLUTION 16

HOW PREMIUM EQUALISATION COULD WORK 16

Actuarial model and risk attributes 18

Vehicle classes in scope 19

Evaluation period 19

Equalisation mechanism 19

Operationalising the model 20

BENEFITS AND IMPACTS OF PREMIUM EQUALISATION 21

COMPARISON TO INTERSTATE SCHEMES 22

Lessons 24

DISCUSSION QUESTIONS 24

OPTION 2: RANDOM ALLOCATION 25

DISCUSSION QUESTIONS 26

OPTION 2: OTHER APPROACHES 27

MULTIPLE LICENCES 27

ACTIVE DECISION MAKING BY MOTORIST 27

OPTION 3: PUBLIC UNDERWRITING MODEL 27

DISCUSSION QUESTIONS 29

CONCLUSION 30

REFERENCES 31

EXECUTIVE SUMMARY

The Royal Automobile Club of Queensland (RACQ) is proud of its participation in the CTP scheme and its long history helping Queenslanders on the roads. As a trusted mutual, we exist for the benefit of our nearly 1.8 million members. That is why we have engaged with the Motor Accident Insurance Commission (MAIC) and Queensland Government since 2016 to highlight the issues undermining the fairness, future stability and sustainability of the Queensland CTP scheme.

The scheme is designed so that, on average, insurers can achieve the target level of profitability (currently set at 7.75%). This opportunity for profitability should encourage insurers to innovate on claims management and lead to competition in price setting. However, the current design also relies on insurers' portfolios representing the average distribution of motorists across the Queensland population. It does not allow for imbalanced weighting of risk cohorts within portfolios, which has now emerged in the scheme.

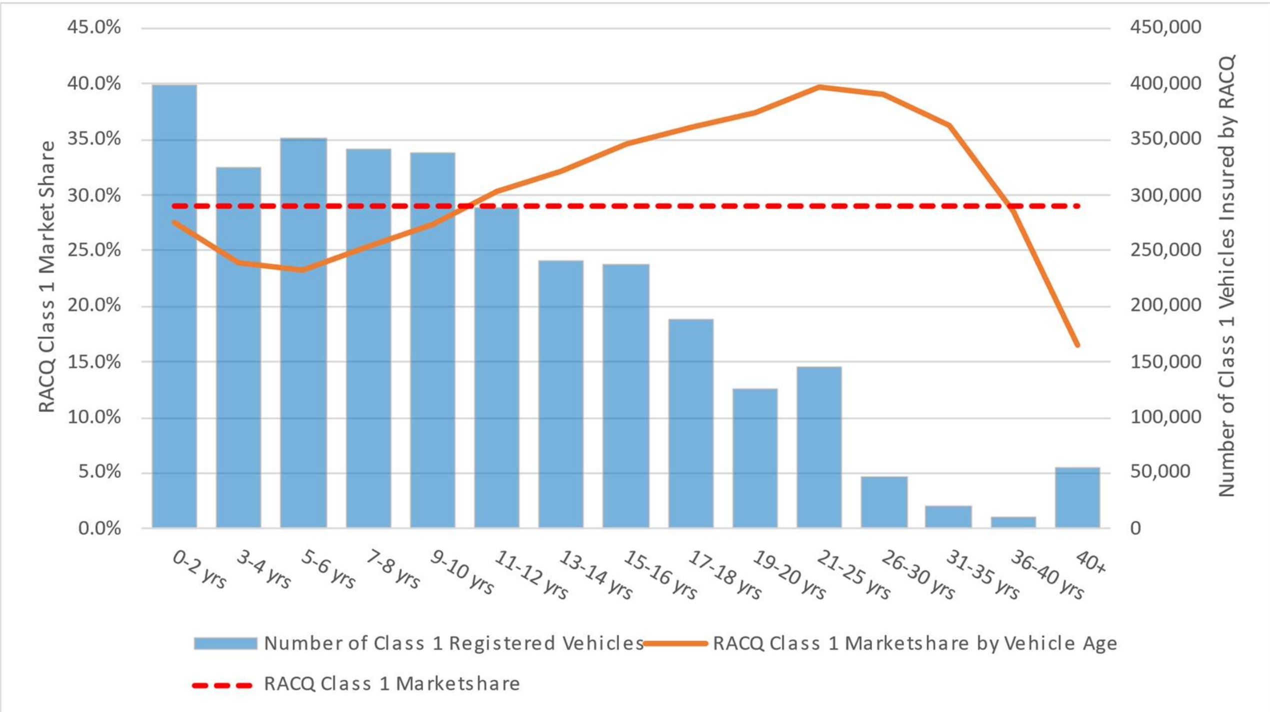
An insurer cannot choose what risks to underwrite and cannot refuse a motorist who selects them for their CTP. Everyone who drives the same class of vehicle pays the same CTP premium, regardless of their individual risk. There are limited measures within the insurer's control to improve their portfolio risk once it has deteriorated.

RACQ's portfolio is experiencing the impacts of these scheme dynamics that allow for a persistent imbalance of risk sharing between insurers. The scheme's own actuary Taylor Fry has calculated the risk index of RACQ's portfolio of Class 1 vehicles to be 13% riskier than the rest of industry (ROI). They also found that the distribution of vehicle age through the portfolio was the main contributor to its increased risk levels.

RACQ has a larger share of many riskier vehicle and motorist cohorts which have higher expected claims costs, like older vehicles, young or inexperienced drivers, shorter policy terms, and re-registered vehicles. Research indicates that strong recognition of the RACQ brand is driving this trend. RACQ also receives less than its fair share of the low-risk new vehicles, which help to offset riskier vehicles in the portfolio.

As a result of the higher risk index, RACQ's portfolio suffers a higher reported claim frequency. The latest valuation report shows that for accident years 2016 to 2022, the frequency relativity has ranged between 6% to 20% higher than the rest of industry (Finity Consulting, 2023). RACQ's growing market share, now at a record high 27%, is exacerbating the elevated risk and claim frequency. Put simply, the larger the market share for RACQ, the larger the problem, as we do not receive more of the premium.

The challenge is perhaps best encapsulated by the graph below. RACQ receives more than its share of vehicles aged over 10 years whose claim frequency is 13% above the average.



RACQ Class 1 Vehicle Market Share by Vehicle Age
Source: RACQ Internal analysis with industry data supplied, March 2023

Separate, independent analyses by MAIC, Taylor Fry, and Finity Consulting have shown that claims management performance is comparable across the four scheme insurers. RACQ's results are on par with, or exceeding, the rest of industry when it comes to claim settlement durations, return to work outcomes for injured motorists and average finalised claim cost.

There is little incentive for innovation in claims management for insurers with better than average risk, as they can still achieve acceptable profits without significant investment in claims initiatives. Efforts by insurers with riskier portfolios to innovate their way to profitability are insufficient to offset the costs related to the higher risk. While unintended, the dynamics of the scheme lead to persistent price setting at the ceiling and inequitable profitability outcomes.

If claims management performance across the scheme is fairly consistent, then it must be concluded that the way premium is distributed relative to risk is the source of the significant variability in insurer profitability observed in the Queensland scheme.

The underlying performance of RACQ's portfolio deteriorated significantly to the point of loss making in FY2020-21, buoyed only by reinsurance. This trend continued in FY2021-22 and the portfolio generated losses even after reinsurance was applied. These losses persist in FY2022-23 and RACQ's ongoing participation in the scheme is at risk. RACQ's important investments in community and road safety initiatives have already reduced due to CTP losses.

In a market with low public understanding of the product and very low levels of motorist switching between insurers, it has not been possible to return the portfolio to acceptable risk levels despite specific focus from management and the board over several years. Due to these dynamics, another insurer could find itself in the same position in the future. RACQ is merely showing the symptoms of a broader scheme problem that would hurt other insurers if it no longer participated.

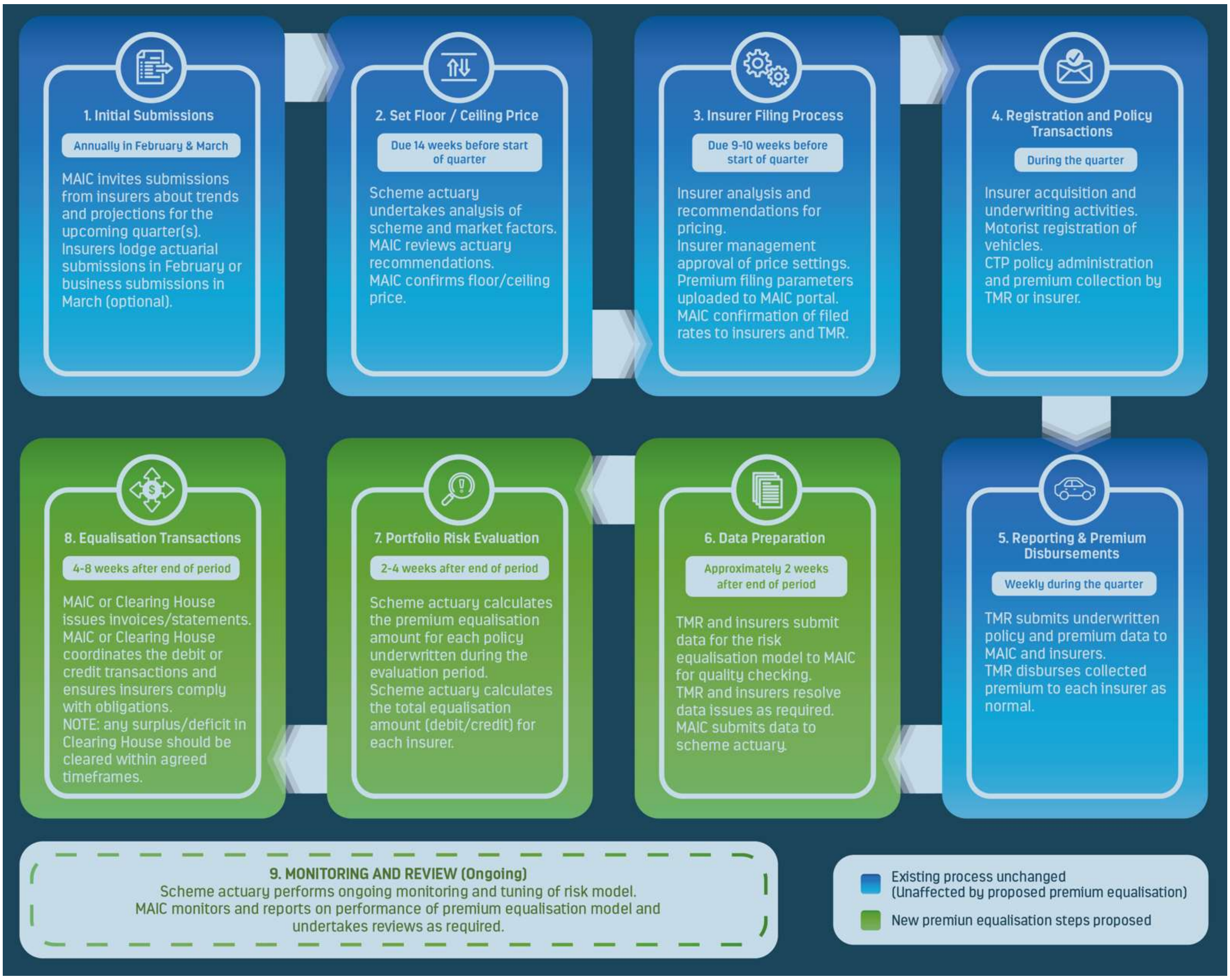
Option 1 is not an option. RACQ strongly opposes continuing with the status quo. Government intervention is urgently required to implement the changes necessary to restore fairness in the market and guarantee a level of stability, competition and sustainability for the future of the scheme.

RACQ recommends Option 2: Premium Equalisation, a system that is grounded in the principle of fairness and re-distributes premium based on the actual risk mix in an insurer's portfolio. This is the simplest to implement and causes the least disruption to the majority of organisations and industry groups currently operating within the scheme. It would not impact motorists or the annual premium they pay, and there would be no change to the care or benefits available to injured persons. This model would not impact any other associated professionals, including legal and health practitioners, and community-rated pricing would be retained. This is a fair solution.

An actuarially developed risk model would calculate an insurer's portfolio risk based on the selected risk attributes of vehicles underwritten during a defined evaluation period. Premium would be equalised by debiting insurers with a better-than-average risk mix and crediting insurers with a below-average risk mix. The risk attributes in the model should initially include vehicle age, licence level, driver age, policy term and re-registration indicator. Class 1 vehicles could be prioritised before expanding the model to other vehicle classes.

A table showing the premium equalisation amount for each combination of risk attribute sub-categories will reflect the difference between the community rating price, and the modelled risk price. The sum of all premium adjustments due to an insurer's over- or under-exposure within a defined cohort would determine the amount an insurer would need to pay to (in the case of below average risk) or receive from (in the case of above-average risk) a central fund at the end of each evaluation period.

A mechanism would be required to facilitate the premium equalisation transactions and should be budget-neutral at industry level over a set timeframe. It should operate independently of the Department of Transport and Main Roads (TMR) to avoid costly and complex system and process changes. MAIC or a clearing house could be engaged to administer. Monitoring and reporting over the model and related processes would be required and should be coordinated by MAIC.



Premium Equalisation model – indicative design.
Source: RACQ (2023)

The Risk Equalisation Mechanism (REM) in the New South Wales scheme has already realised material benefits since its inception, including reduced risk of anti-selection and increased price competition. While there are substantial differences to RACQ's preferred design, the New South Wales model indicates great potential for what is possible if Queensland adopted premium equalisation.

RACQ has previously considered the other variants of Option 2 presented in the discussion paper, but these are not recommended.

Random Allocation of new vehicles would help to increase RACQ's share of low-risk new vehicle registrations but would not address the concentrations of higher risk cohorts in its renewal book. This approach would not be sufficient to meaningfully dilute the risk in RACQ's portfolio within this decade. The allocation system would need to be automated via TMR software on a state-wide basis. The extent of change affecting customers, insurers, MAIC and TMR would be significant and costly.

The **Multiple Licences** approach is not expected to restore the risk in RACQ's portfolio or have any positive impact on the existing scheme dynamics that allow for risk sharing to become imbalanced between insurers.

Active Decision Making by Motorist would significantly increase the volume of switching between insurers. Motorists are already choosing RACQ more often than any other insurer when they are given an active choice. In the absence of other mechanisms to address imbalance in risk sharing, this approach would further increase the likelihood of RACQ attracting more riskier policies due to its strong brand in the market.

RACQ does not recommend **Option 3: Public Underwriting Model**. Not only would such an overhaul of the current scheme be a significantly complex and costly undertaking for Government, but it would have a major impact on scheme insurers, their staff and shareholders, and the experience of injured claimants. The lost opportunity to generate revenue and profits from CTP may result in job losses and diminished business value. Running off the claim portfolios would cause complications for capital requirements and reinsurance arrangements as they become more complex, costly and volatile.

RACQ's preference is that the CTP scheme remains privately underwritten by insurers, with recommended changes to restore its portfolio back to profitability within a reasonable timeframe. However, RACQ may tender for the provision of claims management services if the Government chose to outsource this.

Offering CTP is core to RACQ's strategy as the principal mobility body in Queensland and it remains a key priority of RACQ's management and board that we do everything we can to retain our participation. RACQ reiterates its commitment to ongoing collaboration on the changes needed to restore fairness and stability for the future of the scheme.

INTRODUCTION

The Royal Automobile Club of Queensland (RACQ) has played an integral role in the Compulsory Third Party (CTP) insurance scheme, proudly and passionately helping Queenslanders financially, physically and psychologically recover from road accidents since 1999.

RACQ is one of Queensland's most trusted brands and as a mutual we exist for the benefit of our nearly 1.8 million members who are our only shareholders. Over many years we've continued to be a popular choice for Queenslanders, providing CTP services for more than 20 years, comprehensive motor insurance for over 50 years and roadside assist services to motorists in trouble for 118 years.

We are well qualified to comment on all matters of road safety and mobility, and we bring a unique insight into how the laws, regulations and frameworks that are in place could be improved for the benefit of road users, Governments and the broader community. Accordingly, we make this submission to the Queensland CTP Scheme Review 2023, providing comments and recommendations we believe will help restore fairness and improve the stability of the scheme for many years to come.

In the past few years, RACQ has engaged with the Motor Accident Insurance Commission (MAIC) and Queensland Government to highlight the issues we believe are undermining the future sustainability and fairness of the scheme, as well as our proposed solution.

The dynamics of the scheme allow for an imbalance in risk sharing, which has manifested in perverse outcomes for RACQ. The intention is for motorists to access adequate cover at a universal price however the underlying risk is not universal at the policy level. For instance, a 15-year-old Class 1 vehicle is over 50% more likely to be the subject of a CTP claim than a one-year-old Class 1 vehicle, but the owners of these vehicles pay the same premium for their risk. The distribution of risk between insurers is persistently unequal, and RACQ's Class 1 portfolio has been independently assessed to be the riskiest in the scheme. The situation has become critical and RACQ's CTP portfolio is now loss making. The status quo has become untenable, and changes are urgently needed.

RACQ has previously proposed that a system of premium equalisation be implemented in the Queensland scheme. This would involve a behind-the-scenes redistribution of premium that matches the actual risk in an insurer's portfolio and would be targeted, simple and fair. It would be invisible to motorists and would not adversely impact any other sector associated with the scheme such as legal and healthcare. The risk of attracting higher risk policies due to an insurer's strong brand or lower prices offered would be mitigated, leading to increased competition and ultimately better outcomes for motorists.

RACQ would like to continue helping Queensland motorists injured on our roads, but changes are needed to level the playing field for all insurers. A profitable CTP business supports RACQ's investment in the important road safety education and mobility initiatives we are proud to deliver for Queensland. Tens of millions of dollars have already been invested over many years. Our CTP revenues also contribute to disaster recovery funding, resilience projects and other community initiatives, with more than $11 million distributed through the work of the RACQ Foundation since it was established 11 years ago. RACQ has sponsored LifeFlight for more than 30 years, and also sponsors RACQ CQ Rescue and RACQ Capricorn Rescue. The annual support is now over $7 million and covers 12 helicopters, the LifeFlight jets and critical care doctors. These programs and investments are very important to RACQ and its members, however decisions around ongoing investment must always be made in the context of the financial viability of its operations.

The portfolio generated a $35.6 million loss after reinsurance in FY2021-22 and the outlook for this year is also unfavourable. RACQ's market share continues to grow and has reached an all-time high while retaining the highest level of risk in the scheme. The situation is critical. Fairness in the market needs to be urgently restored to guarantee a level of stability, competition and sustainability. Premium equalisation is the best solution to achieve this.

RACQ trusts the comments and recommendations in this submission will assist MAIC and Government complete their review. We reiterate our commitment to ongoing collaboration for improvements to the CTP scheme that benefit all Queenslanders.

OPTION 1 IS NOT AN OPTION

RACQ strongly opposes Option 1, continuing with the status quo.

During the past two years, RACQ has discussed with the scheme regulator MAIC and the Queensland Government the acute challenges facing our CTP portfolio and the entire scheme. Due to the unfavourable “risk mix” in the portfolio, underlying performance has deteriorated significantly to the point of loss making in FY2020-21. This continued in FY2021-22 and FY2022-23 is on the same trajectory. The analysis and data available to RACQ leads to only one conclusion:

The scheme allows for an imbalance of risk sharing resulting in multinational insurers financially benefiting from being over-indexed with the lower risk new vehicles. RACQ, as a Queensland based member-owned organisation, is penalised from being over-indexed with the higher risk older vehicles, re-registered vehicles, and riskier motorist profiles.

RACQ does not believe this is right nor fair.

Nor do we believe this is what is intended by the scheme’s design. We believe the scheme was designed to provide a level playing field so that insurers could achieve the target level of profitability if they achieve average performance. However, this does not allow for imbalanced weighting of risk cohorts within insurers’ portfolios, which is apparent in the Queensland Scheme. An insurer cannot choose what risks to underwrite and cannot refuse a motorist who selects them for their CTP. There are limited measures within the insurer’s control to improve their portfolio risk once it has deteriorated.

RACQ has taken decisions within the CTP portfolio that have proven effective in avoiding further deterioration of the risk profile, but there has not been any reversal of the risk levels. RACQ has entered into quota share reinsurance arrangements that provide temporary relief while advocating for urgent scheme changes. However, the current situation is unsustainable and cannot be resolved without Queensland Government intervention. Keeping the status quo means not acting on a serious issue that threatens fairness, sustainability and stability in the scheme and so this option is unacceptable.

A key principle of the scheme is fair competition. Fairness has been eroded over the past several years at the expense of RACQ members and will only be restored through a Government policy direction that addresses these perverse market dynamics.

RACQ’S UNSUSTAINABLE PORTFOLIO RISK

The scheme’s own actuary, Taylor Fry, has calculated the risk index of RACQ’s portfolio of Class 1 vehicles to be 13% riskier than the rest of industry (ROI), being the three other scheme insurers. As seen in Figure 1, the risk index has increased six percentage points from about 107% in 2015. Class 1 vehicles are cars and station wagons. They comprise approximately 64% of the total industry vehicles and 72% of RACQ’s CTP policies, which total more than 1.2 million.

Figure 1

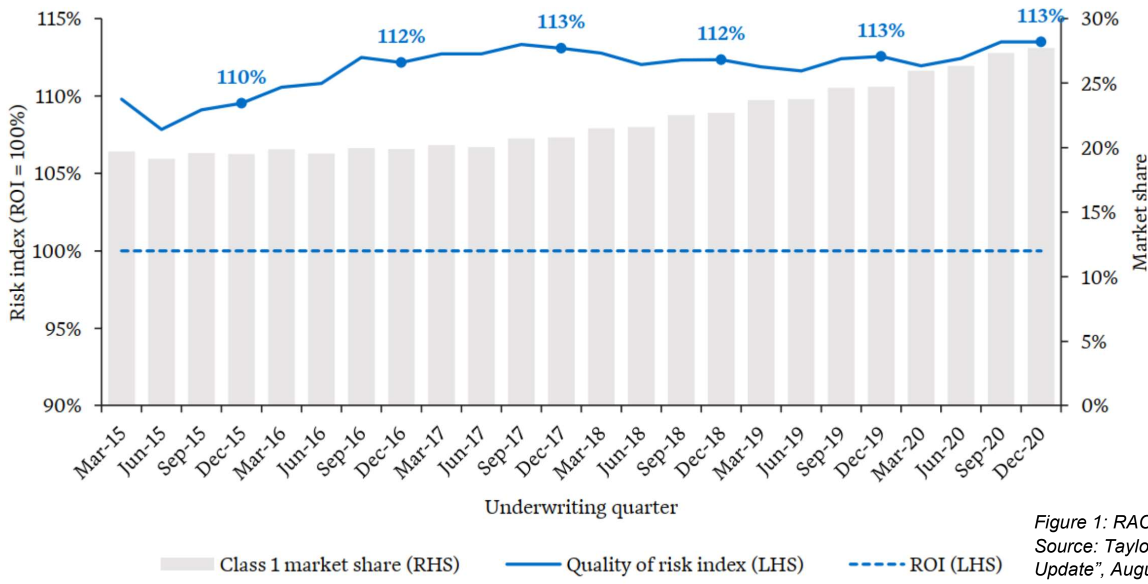


Figure 1: RACQ Class 1 risk profile trend
Source: Taylor Fry, “MAIC - RACQ Update”, August 2021, page 5.

There are three key factors exacerbating this elevated risk in RACQ's CTP portfolio:

1. RACQ's CTP portfolio has grown significantly over the past 8 years, with the relative proportion of higher-risk cohorts exceeding its overall market share of 27%.
2. RACQ's reported claim frequency (number of reported claims per policy) is higher than the rest of industry.
3. Despite very low levels of switching between insurers, those who do switch continue to choose RACQ more than any other insurer.

These three factors are further explored below.

Market share growth and high-risk cohorts

RACQ's market share for all vehicle classes, which until 2015 hovered around 16%, has steadily increased to now reach a record high 27%. When a growing market share is overlaid onto a very poor risk mix, one can conclude that the problem has become larger, inflicting even greater impact on the business. Put simply, the larger the market share for RACQ, the larger the problem, as we do not receive a greater share of the premium to cover the higher expected claim costs.

Figure 2

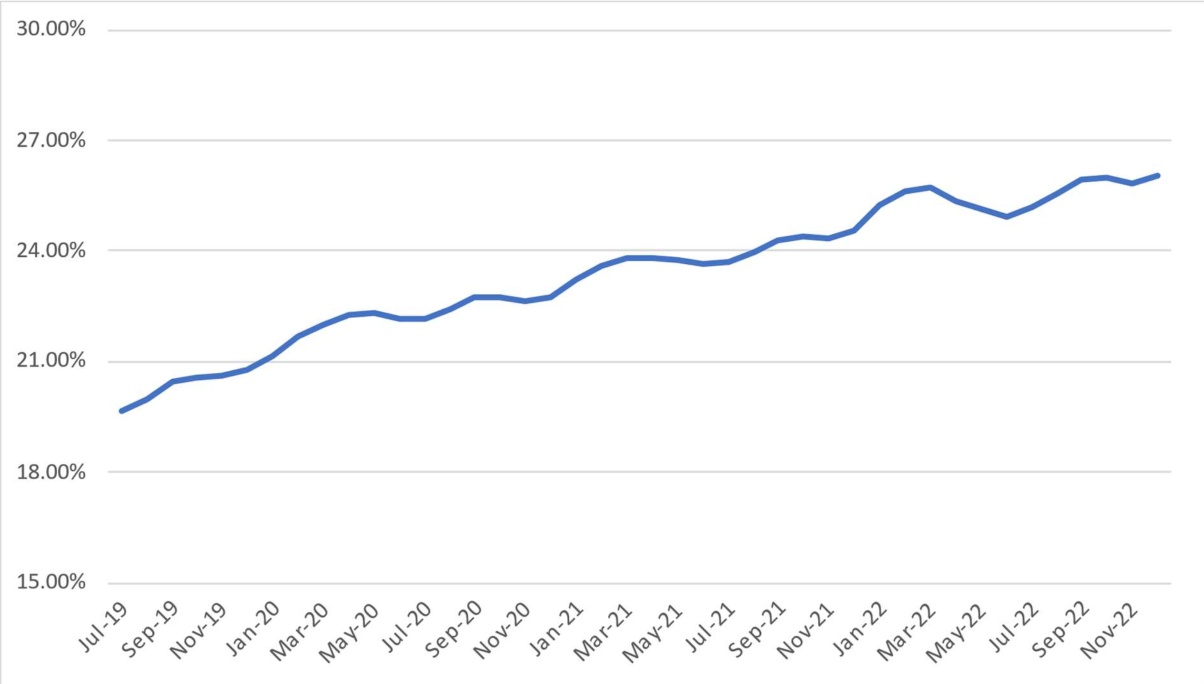


Figure 2: RACQ Total Market Share (all classes) three-month rolling averages as at 31 December 2022.
Source: MAIC Quarterly CTP Scheme Insights Oct-Dec 2022 (2023).

Taylor Fry data (2020)[1] finds the leading cause of RACQ's unfavourable risk mix to be the distribution of vehicle age through the portfolio. RACQ is also adversely represented in most other risk factors such as driver age and policy term[2].

As can be seen in Figure 3 below, RACQ is overweight in Class 1 vehicles (29.1%) compared to its overall market share for all vehicles (27%). There is also an under-representation in newer vehicles aged up to 8 years (4 percentage points below market share), which have lower expected claims cost. They have a cost per policy 11% below average. In contrast, RACQ is over-represented by 6.4% in older vehicles aged 9 years and above (6.4 percentage points above market share) which has a cost per policy 18% above average. The discrepancy is most pronounced in 21-25 year old vehicles where RACQ's share is over 10% above its overall market share.

[1] Taylor Fry. (2020). *Motor Accident Insurance Commission: RACQ update.*
[2] Taylor Fry. (2021). *Motor Accident Insurance Commission: RACQ update.*

Experience shows that many vehicles aged over 40 years are considered to be vintage and are generally well maintained by enthusiast owners. These vehicles tend to be driven less often which lowers their overall risk for CTP.

Figure 3

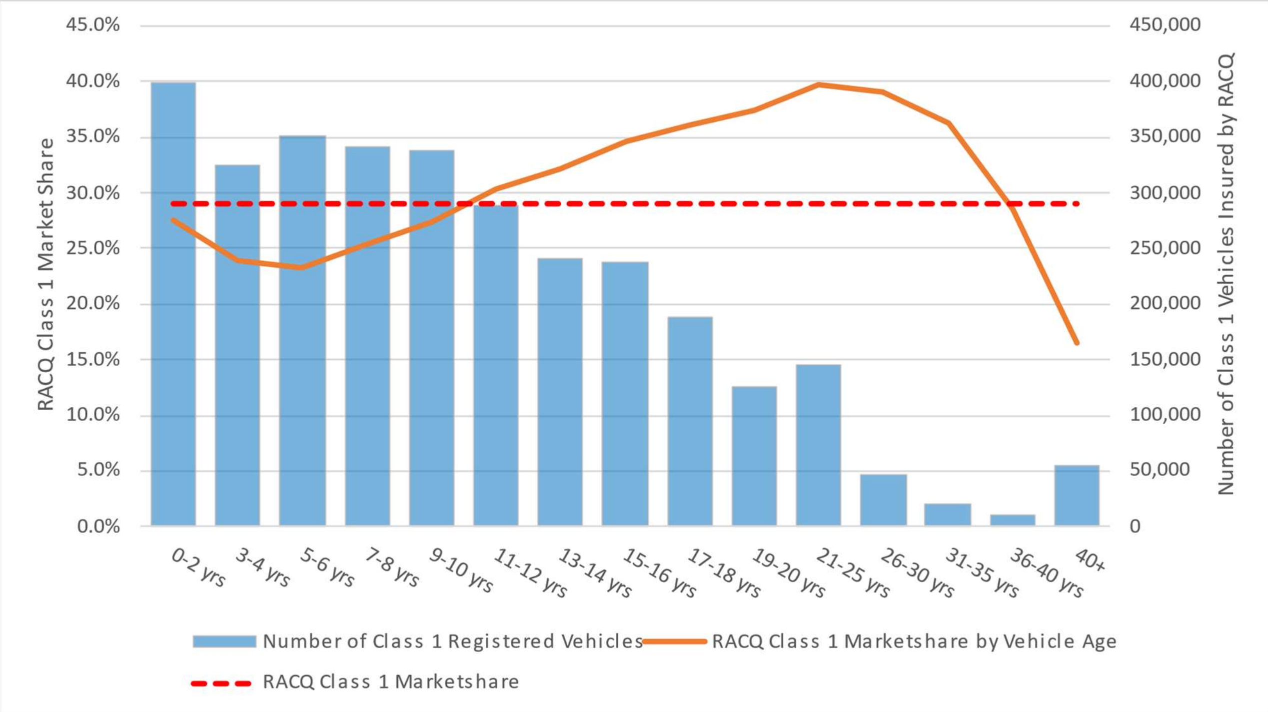


Figure 3: RACQ Class 1 Vehicle Market Share by Vehicle Age
Source: RACQ Internal analysis with industry data supplied, March 2023

Figure 4

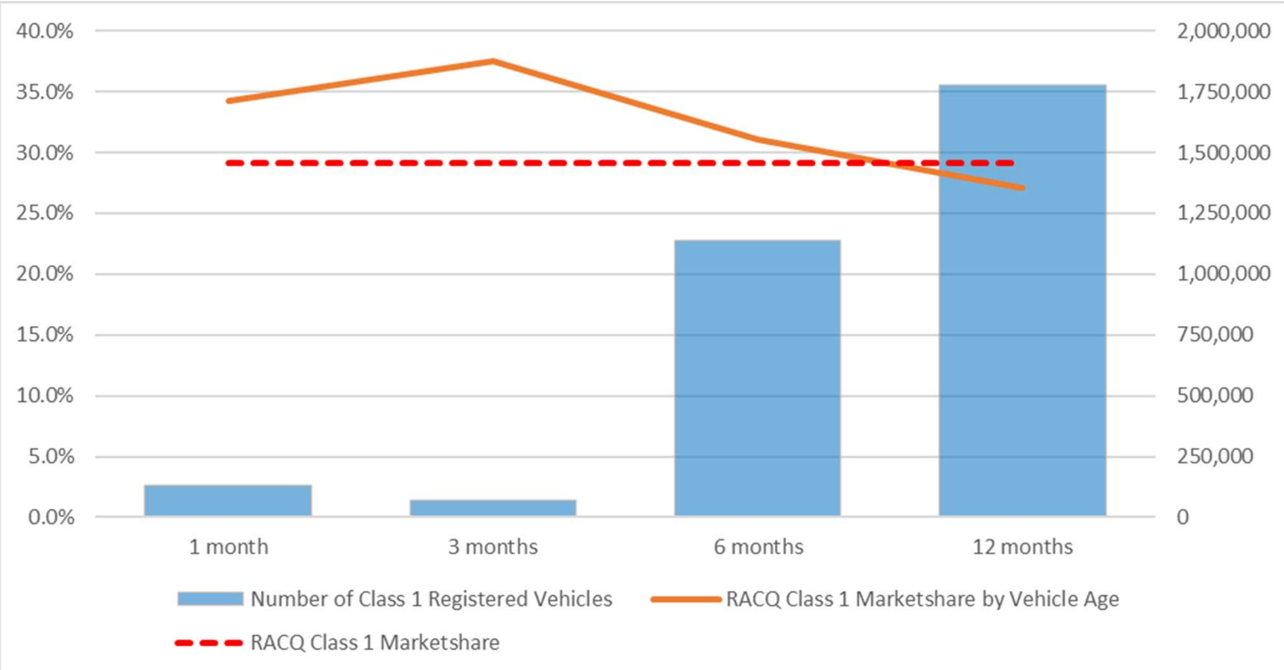


Figure 4: RACQ Class 1 Vehicle Market Share by Policy Term (aligned to vehicle registration term)
Source: RACQ Internal analysis with industry data supplied, March 2023

Analysis of RACQ's portfolio (Taylor Fry, 2021) identified an association between shorter policy terms and higher risk cost compared to the rest of industry. This risk factor was also evident in equivalent analysis conducted the prior year (Taylor Fry, 2020). As seen in Figure 4 above, RACQ has a larger share of 1, 3 and

6 month CTP policies compared to its market share, and fewer one year policies which carry lower risk for CTP.

Reported claim frequency

As a result of the higher risk index relative to other insurers in the scheme, RACQ's CTP portfolio also suffers from a higher reported claim frequency. The latest valuation report shows that for accident years 2016 to 2022, the frequency relativity has ranged between 6% to 20% higher than the rest of industry (Finity Consulting, 2023). RACQ's FY2021-22 Financial Condition Report (FCR) included commentary on this point, saying *"claim frequency that stubbornly sits at least 16% higher than the rest of the industry is the result of this risk mix issue"*. Taylor Fry has previously confirmed that RACQ's claim frequency was the primary driver of risk cost, rather than its average claims cost performance.

Figure 5

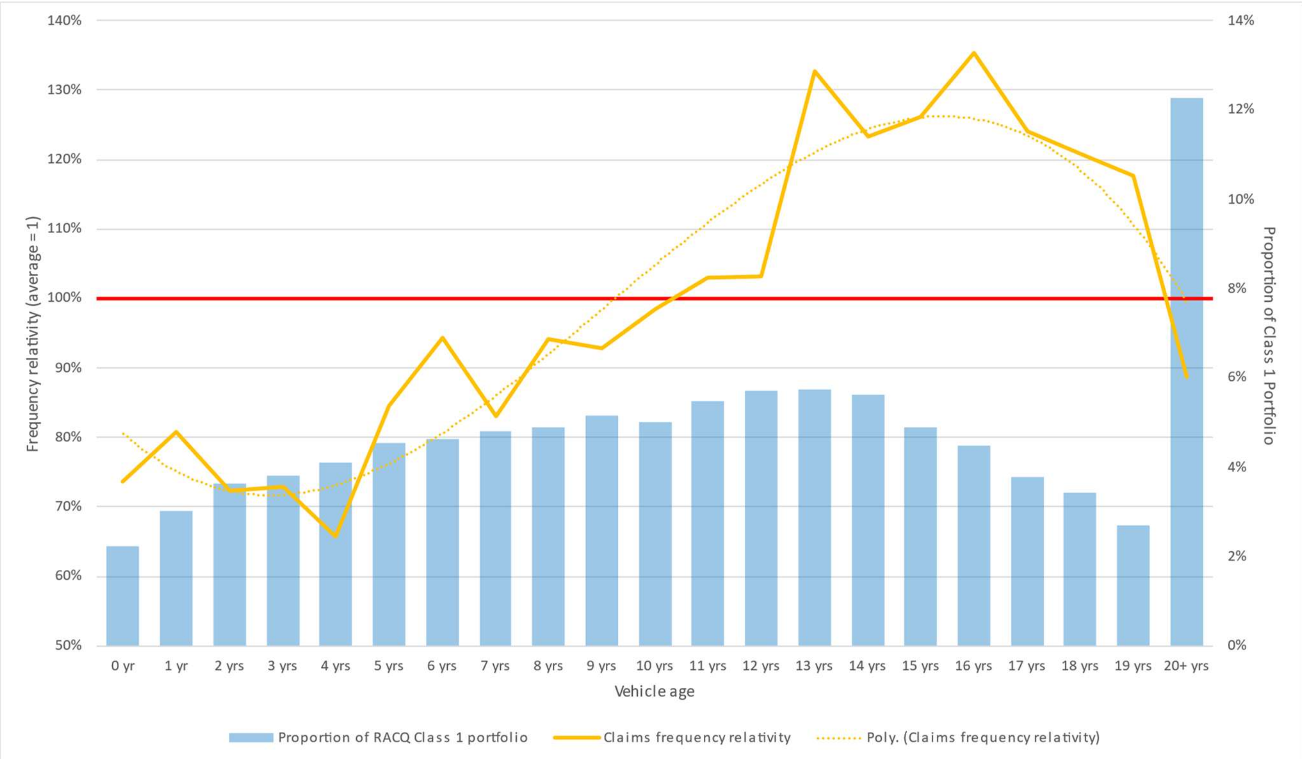


Figure 5: RACQ Reported Claim Frequency Relativity by Vehicle Age (Class 1 vehicles, Accident years 2017-2021). Source: RACQ Internal analysis, March 2023

The yellow line in Figure 5 above illustrates the reported claim frequency relativity of Class 1 vehicles in RACQ's portfolio, split by age of vehicle. When compared to the average claim frequency across all age groups (depicted by the red line) it is clear that older vehicles generate more claims than the average. Class 1 vehicles aged 10 years and older experience around 1.5 times the claim frequency of younger vehicles but make up more than 60% of RACQ's Class 1 portfolio.

To put this in dollar terms, a new Class 1 vehicle with a 25% lower claims cost would save the insurer approximately $50, and an older vehicle with a 25% higher claims cost would cost the insurer $50 more than the premium collected.

As RACQ's CTP portfolio skews towards the older vehicles with the higher frequency, the associated additional claims place pressure on claims management teams and portfolio profitability. RACQ's increasing market share exacerbates this problem, as outlined in the previous section.

RACQ analysis found that while the frequency relativity of three-month policies sits at around the average for the portfolio, the one-month and six-month policy frequencies are 30% higher than the portfolio overall, meaning they result in more claims for RACQ. The full year policies have a relative frequency that is only 72% of the portfolio average, meaning they carry lower risk of resulting in a claim, yet RACQ has proportionally fewer of these policies.

Brand recognition and switching trends

Behavioural economics suggests Queenslanders tend to remain with their insurer upon renewal (in the absence of significant price differential), due to the perceived level of effort to compare alternatives and complexity to switch. The Review's discussion paper supports this insight into consumer behaviour, confirming very low rates of switching between insurers at less than 1% per month[3].

Furthermore, RACQ conducted an online survey of 412 Queenslanders in February 2023 which confirmed very low public understanding of CTP. Less than 1% of respondents could accurately confirm what CTP insurance is, and what it does and does not cover. In a market where the typical customer does not understand the product or place much value in shopping around, improving risk levels through direct marketing and risk acquisition strategies alone is a slow undertaking yielding minimal results.

Since 2017, RACQ has invested in marketing offers to attract motorists and vehicles identified as being low risk. Since September 2019, almost 45,000 offers have been presented through the RACQ online self-service portal, and almost 100,000 email and SMS offers are sent out annually. While the overall conversion rates are quite good for a campaign of this nature (around 27% for online and 8% for email and SMS), the impact is only marginal considering RACQ's Class 1 portfolio of more than 916,000 vehicles.

When motorists do choose to switch, they select RACQ more than any other insurer. The latest quarterly scheme insights data (MAIC, 2023) illustrates the trend (refer Figure 6 below). RACQ continually receives a net increase in policyholders that is disproportionate to its market share. On average, RACQ's CTP portfolio has grown by around 5,400 policies each month since January 2020. In comparison, Suncorp has a net monthly increase of approximately 1,700 despite having the largest market share in the scheme, while Allianz has a net decrease of more than 6,000 policyholders per month.

Figure 6

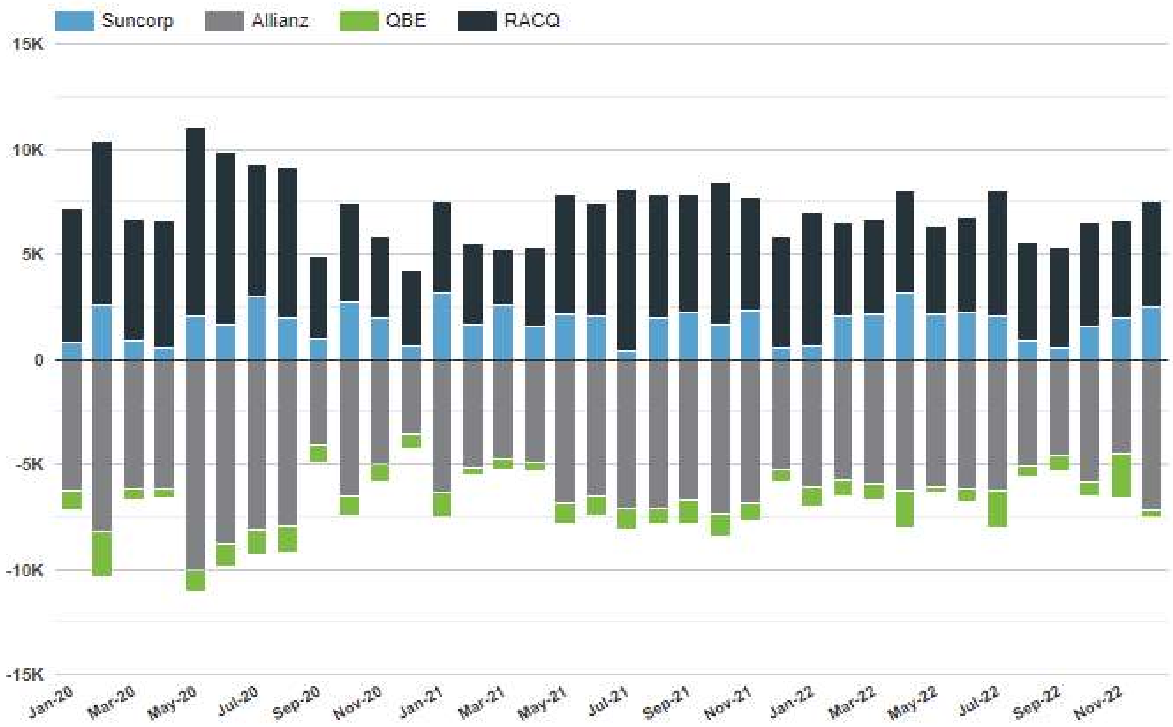


Figure 6: Net change in policyholders based on motorists switching between insurers, Data as at 31 Dec 2022.
Source: MAIC Quarterly Scheme Insights Oct-Dec2022, (2023)

Previous consumer research surveys conducted independently by both RACQ and MAIC validate our belief that our strong Queensland brand is contributing to this switching behaviour.

3 MAIC Discussion Paper March 2023

The MAIC-commissioned market research study[4] of 735 motorists who had recently registered a Class 1 or Class 6 vehicle revealed that 46% of all respondents ranked RACQ as their most preferred insurer for CTP. This percentage far exceeds RACQ's market share, indicating a likely connection to the strong brand recall of RACQ Club Membership and other products, rather than CTP brand association.

Of the 402 Queenslanders who responded to an unbranded 2018 survey commissioned by RACQ, 90% indicated that they would consider RACQ for their CTP provider, with 26% saying they would not consider any other brand. This indicator of brand loyalty increased significantly amongst younger drivers (18-24 years) who are generally a higher CTP risk, with 52% saying they would only consider RACQ.

But not all growth is good growth. The majority of RACQ's new business relates to re-registration of vehicles which are generally older cars and are associated with double the risk cost compared to other new business types (Taylor Fry, 2021). The nomination of CTP insurer at the time of re-registration is a deliberate choice by the owner of the vehicle and occurs online or in person at a Department of Transport and Main Roads (TMR) office (85% are new owners transferring registration to their name and 15% are the same owner who may have had a lapsed registration).

Figure 7 below shows a widening gap between RACQ's share of re-registrations (typically older vehicles) and its overall Class 1 market share. Specifically, the gap has widened from 9.4% difference in 2014 to 11.2% in 2020.

Figure 7

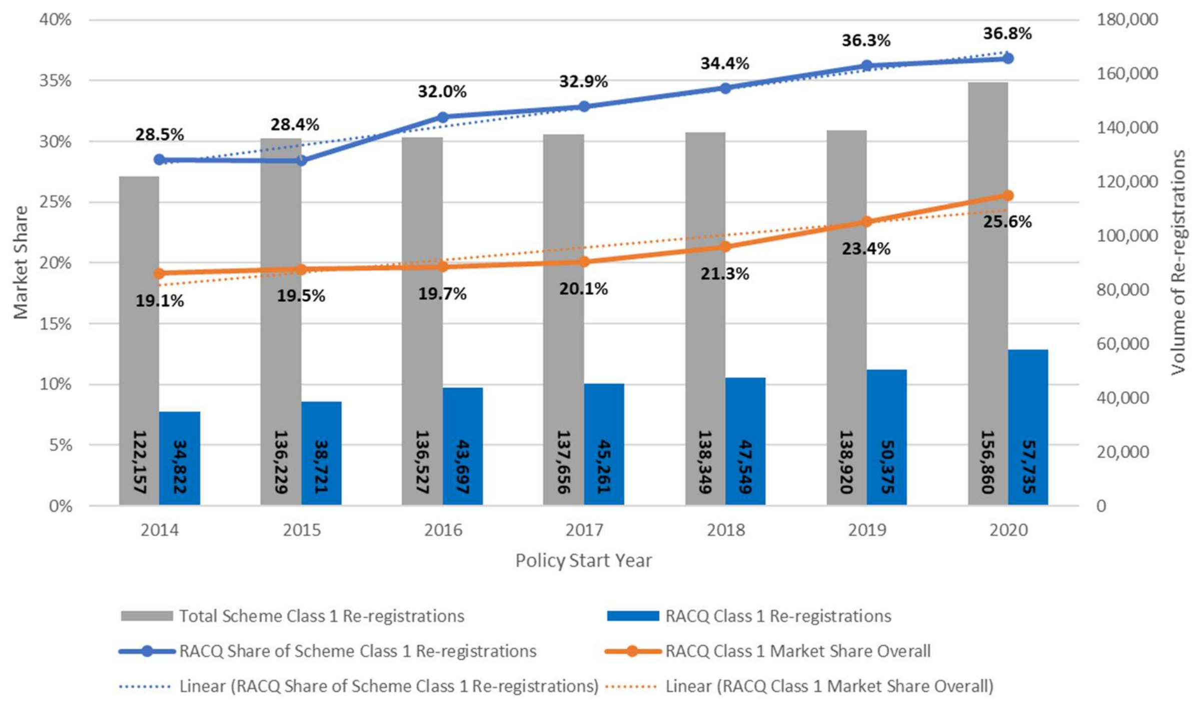


Figure 7: RACQ Market Share of Class 1 Re-registrations compared to RACQ Class 1 Market Share overall.
Source: RACQ Internal analysis, with re-registration data supplied by Taylor Fry via email, and market share data supplied by MAIC, November 2021.

This is a scheme issue – not an RACQ issue

RACQ's brand has attracted a larger proportion of young or inexperienced motorists, older vehicles, and people with riskier driving profiles. We have taken action to stem this tide to a point and focus on strategies to attract more favourable policyholders to dilute the risk that had accumulated in the portfolio. However, it has not been possible to return the portfolio to acceptable risk levels despite specific focus from management and the board over several years.

[4] Market & Communications Research. (2020). *MAIC General Motorist and New Car Buyer Research 2020.* Retrieved from https://maic.qld.gov.au/wp-content/uploads/2020/07/MAIC-Motorist-Research-Report-2020_Summary.pdf

RACQ's appointed actuary agrees, commenting on this point in the FY2021-22 FCR. "*RACQ Insurance has engaged in several marketing and sales activities to overcome this inequity of risk distribution. However, it has become evident through analysis that RACQ Insurance will not be able achieve a risk profile in line with the Scheme average in a reasonable timeframe without Scheme reforms*." (Finity Consulting, 2022)

It is important to highlight that while it is RACQ that has an imbalanced and risky portfolio, another insurer could find itself in the same position in the future. RACQ is merely showing the symptoms of a broader scheme problem that would hurt other insurers if it no longer participated.

Strong claims performance has always been important to RACQ and has been the subject of focussed management attention over many years.

Separate, independent analyses by MAIC, Taylor Fry, and Finity Consulting have shown that claims management performance is comparable across the four scheme insurers. RACQ is clearly leading the industry when considering key claims performance metrics like duration to settlement, claimant return to work outcomes and litigation rates. Our average claim cost performance is also closely aligned to the rest of industry. Recent Finity analysis explores RACQ versus rest of industry experience up to 31 December 2022. It indicates that since 2017, our average finalised cost (excluding large claims) is similar to, or better than, rest of industry. It also shows that for accident years up to 2021, the difference in RACQ's cost per policy versus rest of industry was due to frequency, not average claim size (Finity Consulting, April 2023). Taylor Fry has previously confirmed this same point.

If claims management performance across the scheme is fairly consistent, then it must be concluded that the way premium is distributed relative to risk is the source of the significant variability in insurer profitability observed in the Queensland scheme. All motorists need CTP insurance and even the riskiest of vehicles and drivers must have cover. That risk remains in, and belongs to the scheme, yet the dynamics of the scheme allows for imbalances between insurers that can lead to its own instability.

If an insurer departs the Queensland CTP scheme, their underwritten policies will likely be redistributed among the remaining insurers. In the event of RACQ's exit, our riskier portfolio would disrupt the risk mix balance of other insurers' portfolios. The redistribution of RACQ policies may be a destabilising force across the scheme generally, especially if another insurer does not wish to accept more market share, or a higher level of risk, than they currently have. Additionally, a reduction in the number of scheme insurers does not address any imbalances between relative risk mix and premium collected by an insurer.

This may also pose a risk to public confidence in the scheme, if it appears unable to support a trusted insurance brand, well-known for community and mobility advocacy work in Queensland.

PRICE COMPETITION IN THE SCHEME

RACQ agrees with MAIC and the Government in lamenting the lack of price competition in the scheme. We support a stable and competitive CTP Scheme for Queensland. However, the dynamics of the current scheme design do not foster an environment of competition around price. For instance, competition is clearly not evident for older vehicles which is detrimental to motorists and the overall scheme.

As a proudly Queensland based and member-owned mutual, RACQ would like nothing more than to be able to offer lower premiums to its CTP customers. However, efforts to innovate our way to profitability are insufficient to offset the costs related to our higher portfolio risk and reported claim frequency compared to the other scheme insurers. As a result, RACQ has been forced to price at the ceiling of the allowable premium range for many years.

RACQ has been concerned about the unfavourable trajectory of its portfolio for some time, raising these issues in performance meetings with the scheme regulator and also with Queensland Treasury since 2016. Over time, various RACQ policy benefits, like at-fault driver cover and CTP's contribution towards multi-policy discounts, have had to be withdrawn for the financial sustainability of the portfolio. The deteriorating risk profile in the portfolio has contributed to poor underwriting year profitability used to support our many road safety and community initiatives.

RACQ's concerns have now been realised with an Insurance Result of a $35.6 million loss (after reinsurance was applied) for the CTP portfolio in FY2021-22. It is simply not possible to set prices below the ceiling while RACQ member capital is already subsidising the scheme and the profits of multi-national insurers.

If the scheme is achieving its target profitability while RACQ is generating losses due to its riskier portfolio, then the only reasonable explanation is that other insurers are achieving higher than target profits despite carrying less risk. So why is it that no other insurer takes advantage of this competitive opportunity to increase its market share by lowering prices? Because there's a good reason not to.

Insurers with better than average risk can still achieve acceptable return on capital without the need for significant investments in claims initiatives. Additionally, there is very low likelihood for motorists to switch CTP provider. Experience shows that those who do take the time to switch are generally higher CTP risk. So, there is no incentive to price below the ceiling for insurers who can afford to, as this tends to attract the riskier customers at the detriment of their existing portfolio.

The low rate of switching represents another barrier to entry for new insurers considering joining the scheme. In addition, policies that switch insurers have higher expected claims cost than those that don't, so any new entrant is likely to experience anti-selection upon entry to the scheme. Insurers considering entry must ensure that they are compensated for the riskier policies they may attract due to their brand in the market or price setting. Premium redistribution would offset the impact of taking on riskier motorists and vehicles, enabling greater competition between insurers on other factors like claims management and policy benefits.

DISCUSSION QUESTIONS

How important is price competition to you or your organisation?

RACQ supports having a strong and competitive Queensland CTP scheme. Fewer insurers and reduced competition in the scheme will ultimately play out in claims service, with poorer outcomes for injured persons and the scheme itself.

As a proudly Queensland based member-owned mutual, and the peak motoring body in the state, RACQ would like nothing more than to be able to price competitively and offer lower premiums to its CTP customers. But in order to do that we need a level playing field – where CTP premium is fairly distributed between insurers to match the risk of their portfolio.

Should price competition remain an objective of the scheme?

Yes. The lack of price competition as outlined in the previous section creates a barrier to entry for new insurers considering joining the scheme, as there is no mechanism to address the higher risk policies they may attract due to their brand or lower premiums. Price competition should remain, but there needs to be a level playing field to enable all insurers to compete effectively and have the opportunity to earn appropriate return on capital.

Do you support retaining the existing scheme with no reforms? Why or why not?

No, RACQ strongly opposes continuing with the status quo. The current level of risk in RACQ's portfolio is unsustainable and the management actions permitted within the constraints of the existing scheme design and regulation are insufficient to restore risk to the level required or within a reasonable timeframe.

RACQ continues to evaluate the effects of prolonged detrimental risk mix and constraints on member capital. The persistent challenges, coupled with losses being realised (net of reinsurance) in FY2021-22, have further increased Board and Management's concerns that underwriting CTP insurance may not be a good use of RACQ member capital. Scheme change to addresses these perverse market dynamics is urgently required.

What, if any, impact would there be on you or your organisation (if applicable) if the CTP scheme remained as is?

As a mutual, our profits are reinvested back into Queensland through community programs, road safety education and disaster resilience initiatives. Last year alone, we reached almost 53,000 students with our education programs, supported the rescue of nearly 3,000 people with our longstanding sponsorship of air ambulance providers, and invested more than $11 million in Queensland through the RACQ Foundation, employee fundraising, community sponsorships and local giving programs.

There has already been a need to reduce this community investment due to the financial losses realised in the CTP portfolio. RACQ has sought short term relief through new reinsurance and capital management arrangements in order to remain in the scheme.

RACQ has a strong reputation for looking after people injured in road collisions and supporting their recovery. RACQ is proud of this record and wants to keep providing this important service for Queenslanders. Should there be a decision to retain the status quo under Option 1, RACQ would be forced to conclude its position on whether it could continue its participation in the scheme.

What material opportunities, risks or considerations, if any, do you believe need to be considered in the review of this scenario?

RACQ leads the industry with its Return to Work and Settlement Duration results. Should it become necessary to withdraw from the scheme, more injured motorists will receive the experience delivered by the other insurers, which may potentially be a poorer recovery or settlement outcome and longer duration until claim resolution.

OPTION 2: PREMIUM EQUALISATION – RACQ'S PREFERRED SOLUTION

RACQ has previously recommended that the Queensland CTP scheme should adopt a system that is grounded in the principle of fairness and re-distributes premium based on the actual risk mix in an insurer's portfolio. We reiterate our belief that such a system of remediation would address the most immediate issue in the scheme and help restore fairness and sustainability in the long term.

Of the options presented in the discussion paper, this is the simplest to implement and causes the least disruption to the majority of organisations and industry groups currently operating within the scheme. A premium equalisation system would not impact motorists or the annual premium they pay, and there would be no change to the care or benefits available to injured persons. This model would not impact any other associated professionals, including legal and health practitioners, and RACQ has already engaged peak bodies for these industries to explain this important point. Crucially, the scheme would retain community-rated pricing to ensure affordability for motorists. This is a fair solution.

Whilst we believe premium equalisation is the best way forward for the scheme, we acknowledge other insurers may disagree. Those that are currently enjoying greater profits despite carrying less risk than the scheme average will be vocal in their opposition, as it will require them to accept lower profitability than under the status quo. However, RACQ members are subsidising those extra profits of other insurers. If RACQ carries a disproportionate share of the higher risk motorists, then other insurers must be benefiting as a result. This is core to restoring fairness to the scheme. Each insurer should have an equal opportunity to achieve the scheme's target level of profitability, particularly when they have little control over which motorists select them as their CTP insurer, and limited methods to restore a portfolio's risk mix once it has deteriorated.

Independent analysis shows RACQ claims performance is on par with, or exceeding, the rest of industry. If claims management performance across the scheme is fairly consistent, then it must be concluded that the way premium is distributed relative to risk is the source of the significant variability in insurer profitability observed in the Queensland scheme. This is where the focus needs to be.

HOW PREMIUM EQUALISATION COULD WORK

Premium equalisation involves the evaluation of risk within an insurer's portfolio and a redistribution of collected premiums between insurers (where required) to 'correct' the differing risk levels. Specifically, premium is equalised by debiting insurers with a better-than-average risk mix and crediting insurers with a below-average risk mix. This reconciliation process would work entirely 'behind the scenes' to analyse insurer portfolios and coordinate the financial transactions that level the playing field.

Premium equalisation would address the impact of any imbalance associated with new car sales, re-registrations and other risk attributes as discussed in the previous section, restoring fairness within a reasonable timeframe and much sooner than other alternatives presented in Option 2 in the discussion paper.

This proposal will not impact the way insurers receive, assess or fulfill claims. The existing process will continue unaffected and can occur in parallel with the current underwriting process and proposed premium redistribution activities described below.

The objective is to reduce the risk of anti-selection, rather than eliminating it completely. Anti-selection emerges when a customer can acquire under-priced insurance relative to the risk, either where the insurer doesn't know the price is incorrect, or where it is obliged to accept the risk (such as the practice that exists in the CTP scheme). Avoiding anti-selection is critical for a successful insurance business.

An actuarially developed risk model would be required to calculate an insurer's portfolio risk based on the selected risk attributes of vehicles underwritten during the evaluation period. A mechanism would be required to facilitate transactions that equalise the premium collected. Monitoring and reporting over the process would also be required. These considerations are further explored in the sub-sections below.

Figure 8 below illustrates that the changes proposed by RACQ would involve three additional steps for each round of risk evaluation, that would occur independently of the existing cycle of premium setting and underwriting for the Queensland CTP scheme.

Figure 8

Figure 8: Premium Equalisation model – indicative design.

Source: RACQ (2023)

Actuarial model and risk attributes

To develop a premium equalisation solution, RACQ proposes that MAIC engage the scheme actuary, Taylor Fry. In consultation with insurers, an appropriate model should be developed that includes a broad range of risk rating criteria to enable a precise assessment of the risk of vehicles underwritten within a defined evaluation period.

Whilst there are limited risk factors in the current community rating model, there are additional data points available that would improve the sophistication of a premium equalisation model. Previous Taylor Fry analysis that determined RACQ’s Class 1 portfolio was 13% riskier than the rest of industry, incorporated a variety of risk attributes that were already available to Taylor Fry or that could be obtained from TMR. These attributes included vehicle age, customer type (private or commercial), age of driver, level of driving licence, licence status, geographic region, policy term, owner tenure (how long the vehicle has been owned by the registered owner) and driver infringement history. An indicator of whether the vehicle has been re-registered could also be included, given these policies carry double the risk cost of other vehicles.

A model comprising the above attributes will account for far more of the variability in risk compared to vehicle class alone. If it is not feasible to accommodate all of the above attributes in the model, RACQ would propose the following five attributes as a priority: Vehicle age, licence level, driver age, policy term and re-registration indicator.

Sub-categories would need to be defined for sensible groupings within each of these risk attributes. For example, modelling could identify a sub-category within the vehicle age attribute, splitting vehicles into simple “newer vehicle” vs “older vehicle” cohorts. Or the analysis may suggest additional groupings are needed, for example, “new”, “young”, “older”, and “vintage” vehicles. Further assessment would be required to ensure the right number of sub-categories are selected for each attribute to avoid overcomplicating the model, while also achieving a precise evaluation of the risk.

A premium equalisation amount would then need to be established for each combination of risk attribute sub-categories which reflect the difference between the community rating price, and the modelled price reflecting the actual risk. If the risk price is greater than the community rating price, then there would be a positive equalisation value amount and the insurer would receive a payment to account for the extra risk. Conversely, if the modelled risk is lower than the community rating price, then the insurer will pay the associated equalisation amount into the central fund. Figure 9 contains a hypothetical illustration of how this might work. If the community rating price of $220 reflects the scheme average, then the true price of a riskier motorist/vehicle combination will be much higher ($650). A less risky motorist/vehicle combination has a lower risk price ($190). The difference between risk price and the community rating price will become the premium equalisation amount for that combination of vehicle and motorist risk attributes.

Figure 9

Vehicle Age	License Level	Driver Age	One year Policy		1, 3 or 6 Months Policy	
			Re-registered = Yes	Re-registered = No	Re-registered = Yes	Re-registered = No
0-2yrs	P	<21				
		21-65		$100	-$250	
		65+				
	O	<21				
		21-65		$150		$120
		65+				
3-15yrs	P	<21	-$430			
		21-65				
		65+				$0
	O	<21				
		21-65		$0		$30
		65+				
15yrs+	P	<21				
		21-65				
		65+				
	O	<21				
		21-65			-$50	$0
		65+		-$50		

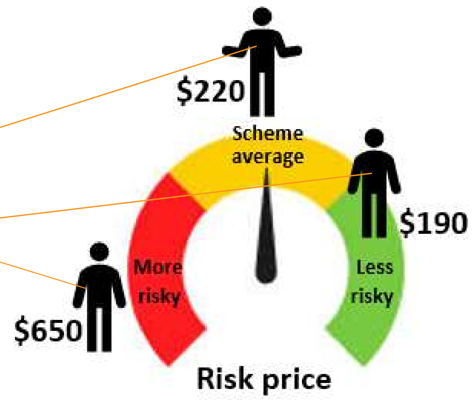


Figure 9: Illustration of a hypothetical Premium Equalisation Table.
Source: RACQ (2023)

The sum of all premium adjustments associated with an insurer's over- or under-exposure within a defined cohort would determine the amount an insurer would need to pay to (in the case of below average risk) or receive from (in the case of above-average risk) a central fund at the end of each evaluation period. The overall premium pool for each vehicle class should be unaffected and the community rating is preserved.

Importantly, these assessments would be invisible to motorists, with portfolio risk being calculated after they have purchased or renewed their policy under the existing community-rated pricing model.

Over time, it may become apparent that assumptions used in the model have diverged from the evolving population of registered vehicles in Queensland. For example, the demographic profile of Queensland motorists can alter due to significant interstate migration, and if road policing activity was to intensify, one might anticipate an increase in the proportion of the population who have recorded a recent traffic infringement. It will be important that the model itself is reviewed regularly to ensure it remains fit for purpose and reflective of the Queensland vehicle and motorist populations.

Vehicle classes in scope

The premium equalisation risk model should be applied to all underwritten business where there is material distribution inequality across the selected risk attributes and where sufficient data exists. A preliminary analysis across all insurer portfolios would be required to determine which vehicle classes and risk attributes would be viable to include in the model. A sufficient proportion of overall scheme cost should be covered by the classes in scope to ensure premium equalisation is meaningful an effective.

However, the design and implementation of a brand-new model to the Queensland scheme may bring unexpected complexities and challenges, so it may be prudent to start with Class 1 vehicles only which accounts for approximately 65% of all vehicles in the scheme. This approach allows for MAIC, Taylor Fry, insurers and any other impacted parties to test and refine the new approach, with opportunity to review the Class 1 implementation before expanding to other vehicle classes as appropriate. Rideshare vehicles (Class 26) are recommended as second priority.

Evaluation period

The duration of the evaluation period should be carefully considered and selected following consultation between MAIC, Taylor Fry and insurers. If premium equalisation is performed too often, there would be additional MAIC and Taylor Fry effort to conduct analysis and run the process, which may increase scheme operational costs. If it is too infrequent, the premium equalisation may be too slow to provide relief to an insurer suffering poor portfolio risk, and the debit/credit transactions will be larger and more impactful to each insurer's financial management processes.

RACQ suggests that a matured process would involve an evaluation period set at six months. This allows time for two quarterly price setting cycles to have an impact on the scheme between each premium equalisation assessment. The timing of the premium equalisation assessments does not need to be aligned to the middle and end of the financial year, which is already an extremely busy time generally, but especially so for financial services organisations. Scheduling the assessments to occur after the March and September quarters may be a suitable cadence. During initial stages of implementation, a quarterly frequency could be more appropriate, to promptly identify and rectify any issues with the actuarial model or the premium equalisation mechanism.

An alternate approach to evaluating risk could be explored, where an insurer's entire portfolio is analysed and adjusted, instead of only assessing risk of the underwriting activity that occurred during the evaluation period. While this approach may require more effort to complete each time, it could also allow premium equalisation to occur less often because the risk of the entire portfolio is being assessed. Further analysis of the options would be required to determine which approach best suited the Queensland scheme.

Equalisation mechanism

RACQ recommends a premium equalisation solution that does not impact TMR, given the expected prohibitive cost and complexity of making changes to systems and processes and training personnel. Designing a mechanism that operates independently of TMR should be possible, excepting provision of additional data that may be required by the actuarial model.

If an insurer's risk level was calculated to be lower than the scheme average, an invoice or statement would be issued with a debit commensurate to the lower rate of risk of the insurer's portfolio. This debit amount would be paid by the insurer into a central fund which could be managed by MAIC, or a clearing house. Similarly, if an insurer's risk level exceeded the scheme average, they would receive additional premium as a credit from this central fund, to offset the financial impact of the higher risk.

In the example below, Insurer 1 has the riskiest portfolio, and Insurer 2's portfolio is also slightly riskier than the scheme average. Insurers 3 and 4 have portfolios less risky than the average. Insurer 3 and 4 will be debited by the premium equalisation mechanism, and Insurers 1 and 2 would be credited.

Figure 10

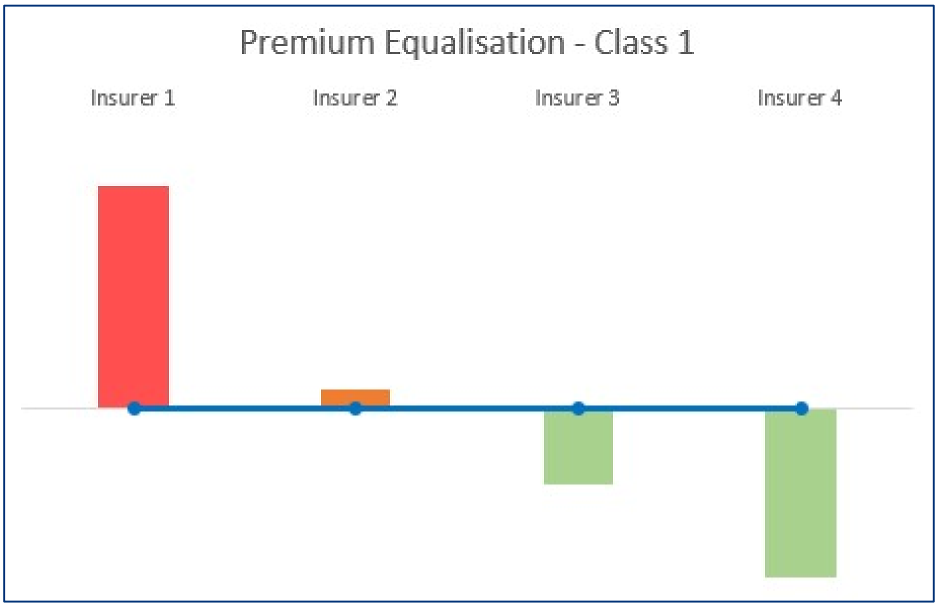


Figure 10: Premium equalisation should be budget neutral at industry level.
Source: RACQ (2023)

The premium adjustments should be neutral at the industry level. Consideration would need to be given to the potential scenario where equalisation transactions result in a surplus or deficit. This can occur when the assumptions of the model fall out of step with the proportions in the underlying population of vehicles and motorists. If equalisation credits exceed debits, the deficit amount could be carried over to be paid to the insurers with higher risk portfolios in future periods when a surplus exists. If the opposite occurs, the surplus could be held for an agreed period to support future deficits, or fairly distributed back to scheme insurers, based on their level of risk and previous amounts paid into the fund. Regular monitoring and tuning of the model will be important to ensure equalisation payments remain neutral.

A clearing house would provide independent management of the premium equalisation transactions (debits and credits) and monitor parties' compliance with their obligations. This would avoid additional administration by MAIC and changes to existing TMR processes for vehicle registration and distribution of premium to insurers. There is already a clearing house mechanism in place for CTP Claims which could be extended for this purpose. Otherwise, Taylor Fry could be engaged to perform this service as they do already for the New South Wales Risk Equalisation Mechanism (REM). As scheme actuary for Queensland, Taylor Fry already have established processes and access to data that may facilitate taking on this additional role.

Insurers could continue with their current acquisition and underwriting activities and there would be no change to the normal registration process for vehicle owners and TMR. The regular premium disbursements from TMR to scheme insurers can continue unaffected, with MAIC or the clearing house managing the premium exchange between insurers. This mechanism should be designed to work "behind the scenes", with no impact to Queensland motorists and little to no impact to TMR.

Operationalising the model

The Premium Equalisation Model should be completely transparent and shared with every insurer. Data that is available for the actuarial model should also be shared with insurers to help manage cash flows, optimise portfolio management, and support innovation. This would enable insurers to make internal calculations to

predict the appropriate premium (after equalisation) for the risks underwritten, for effective financial management. Trial results of the model using actual data from the past two years could be given to insurers to help them understand and prepare for the potential impact of premium equalisation on their businesses.

The actuarial risk assessments will depend on the timely and accurate provision of data to Taylor Fry. The number of risk attributes selected for the model will have a bearing on the effort to collate the required data. Where possible, automated or centrally sourced data (provided directly by TMR) should form part of the solution and cover all insurers' portfolios. If insurers are required to supply their own data, then MAIC should consult with industry to agree on data templates, definitions, and timelines. MAIC should monitor insurers' compliance with data quality and timeliness requirements, to ensure data provided to Taylor Fry is suitable for the risk assessments. This may be aligned with other existing monitoring responsibilities of the regulator.

To ensure the model is effective, RACQ suggests MAIC consider the issuance of Market Practice Guidelines in collaboration with TMR. Learnings from other jurisdictions can be leveraged to accelerate the development of such guidelines while also preventing inappropriate risk selection or risk avoidance activity that may have emerged elsewhere.

It will also be important that MAIC or the scheme actuary monitor and report on the premium equalisation solution and the actuarial model and seek feedback from insurers and other scheme participants as the process matures after implementation. This could be included in existing forums between MAIC and insurers to discuss scheme performance and trends. The model should be included in future reviews of the scheme.

BENEFITS AND IMPACTS OF PREMIUM EQUALISATION

There are a range of benefits from a premium equalisation model. It will specifically target the impact of imbalanced risk sharing between scheme insurers, while having little to no impact on injured motorists or other professionals working in the scheme. Reduced barriers to entry for new insurers and fairness being restored across the scheme should increase competition. Opportunities will also arise to compete and innovate on price, additional policy benefits, claims management and service.

The Risk Equalisation Mechanism (REM) in the New South Wales scheme has already realised material benefits since its inception. While there are substantial differences to RACQ's proposed model, the New South Wales model indicates great potential for what is possible if Queensland adopted premium equalisation. According to a report summarising key findings of a review conducted in 2019 by the scheme regulator (SIRA, 2019), the key benefits for the New South Wales scheme include:

- Insurers are generally accepting of the REM model and collaborating effectively on further refinements to the system. Overall, the CTP market is more competitive and attractive to new entrants, and direct pricing competition has re-emerged.
- Insurers no longer fear anti-selection and have reassessed their strategies, marketing and distribution activities. The higher risk and cost related to motorcycles, younger drivers and riskier geographies are now subsidised efficiently through the REM.
- The changes have successfully addressed the risk of receiving a disproportionate share of under-priced risks and moderated the extraordinary profits previously achieved by one insurer with a larger share of the favourable new vehicles.
- Vehicle owners observe no material difference in CTP arrangements as the equalisation mechanism works in the background. However, prices are more visible to the end consumer following the introduction of a premium calculator and the price sensitivity for motorists has increased as a result.

While there are significant benefits to be gained, RACQ acknowledges there will be additional effort and cost to implement and administer premium equalisation compared to the status quo. This, and other potential impacts, should be considered and optimised through the design and planning stages. Taylor Fry may be best placed to comment on the effort and cost to develop the actuarial model. Upfront effort to design the model may be higher than ongoing monitoring and model tuning, which should be less intensive.

MAIC may take on additional responsibilities in the regulation of this new model, but there are potentially other savings in current activities that could partially offset the additional effort. For example, there could be less focus on understanding trends in insurers' portfolio risk as this would be mitigated by the premium equalisation transactions, allowing more time to be spent on other areas of portfolio management. Furthermore, this solution would avoid the significant effort and cost required to navigate through a potential exit of RACQ, or another insurer if they were faced with a similar portfolio risk issue in future. This could be considered an investment in the future stability of the scheme. More benefits and impacts of a premium equalisation approach are summarised in Figure 11 below.

Figure 11

Parties Involved	Anticipated Impacts or Changes	Benefits
MAIC	• Monitor and report on effectiveness of equalisation model • Engage scheme actuary to establish the risk model and conduct risk evaluations • Coordinate quality checking of model data prior to risk evaluations • Coordinate for additional data to be provided to insurers as appropriate • Manage the central fund and premium equalisation transactions or liaise with the clearing house as required.	• Simple to design, implement and administer • Premium transfers will be neutral across the scheme • Reduce risk of anti-selection against high risk cohorts • Improve scheme competition and encourage new entrants • Reduce risk of disproportionate insurer profits • More precise calculation of individual and portfolio risk • Flexible framework that can respond to future changes in market dynamics • More comprehensive risk model and data may support public policy analysis and road safety initiatives.
Scheme Insurers	• Adjust premium filing assumptions for the new risk factors in the model • Make debit/credit transactions to/from the central fund as appropriate.	• Receive more equitable premium in line with actual portfolio risk • Minimal impact to quarterly premium filing process • Reduce cost and time invested in attracting favourable risks • More comprehensive risk model and data may support more effective pricing.
TMR	• Provide additional data to support risk evaluations as required.	• Processes or systems related to vehicle registration are unaffected.
QLD Government and Treasury	• Design and implement changes to legislation as required.	• A fairer and more sustainable scheme persists for Queensland motorists.
CTP Policy Holder	• No impact.	• Receive benefit of potential price competition.
Injured Claimant	• No impact.	• Processes, systems and claimant outcomes will be unaffected.
Legal Sector	• No impact.	• Processes, systems and claimant outcomes will be unaffected.
Healthcare Providers	• No impact.	• Processes, systems and claimant outcomes will be unaffected.

Figure 11: Benefits and Impacts of Premium Equalisation
Source: RACQ (2023)

COMPARISON TO INTERSTATE SCHEMES

The Premium Equalisation Model proposed by RACQ is not the New South Wales model. While there are some elements that share similarities with the Risk Equalisation Mechanism (REM) model adopted in that state in 2017, there are significant differences between the two models that are important to highlight.

The New South Wales scheme features of no-fault, defined benefits, and limited access to common law do not form any part of RACQ's recommendations for premium equalisation. We do not propose any changes to Queensland's community rating, the quarterly premium filing process or the way motorists register their vehicles. Only the few favourable features in NSW's scheme relating to portfolio risk evaluation and equalisation have been adopted in RACQ's proposed design. Refer to Figure 12 below for a comparison between the two models across key design features.

Figure 12

Scheme Feature	NSW Risk Equalisation Mechanism (REM)	RACQ's Proposed Premium Equalisation Model
Underwriting Model	Multiple private insurers.	
Customer Purchase & Distribution of Premium	Purchase CTP Green Slip policy directly from insurer, separately to vehicle registration. Insurer retains the premium paid.	CTP Insurance included when purchasing vehicle registration from TMR. TMR disburses the customer premium to scheme insurers weekly.
Premium Determination	Quarterly premium filing for each vehicle class within a floor-ceiling range set by the regulator, SIRA. Insurers may apply additional weighted rating factors to determine customer premium including: primary use of vehicle, insurance status, driving record, claims history.	Quarterly premium filing for each vehicle class within a floor-ceiling range set by the regulator, MAIC. Community rated within vehicle class. No additional rating factors applicable.
Equalisation: Risk Evaluation	Applies to Class 1 vehicles (excluding Government Vehicles) and motorbikes only. The Risk Equalisation Mechanism (REM) price is determined for each combination of: • vehicle class • vehicle age • owner age • location.	Actuarial Risk Model to be created. Proposed to apply to vehicle classes where distribution inequality exists and where the proposed risk assessment makes sense. Insurer's actual risk to be assessed on policies underwritten during the evaluation period based on the selected risk attributes in the model (to be confirmed).
Equalisation: Transactions	To enable cross-subsidies between vehicle cohorts, a clearing house manages quarterly debit/credit transactions to and from the REM pool, relative to the insurer's underwritten risk. Coordinated by Taylor Fry. Transactions to and from REM pool are intended to be neutral.	Bi-annual debit/credit transactions from Central Fund relative to actuarial risk assessment. Will be accounted for as additional income/expense at insurer portfolio level. Coordinated by MAIC or clearing house. Transactions to and from the central fund are intended to be neutral.
Equalisation: Ongoing Review	Annual review of assumptions and reset of prices as required.	
CTP Policy Term	6 or 12 months terms only.	1, 3, 6 & 12 month terms available.
Common Law Access	Yes.	
Liability	No fault.	Fault-based.
Scheme Benefits	Defined benefits based on injury severity. Plus claim for damages for more than minor injuries.	No defined benefits. Lump sum payments.

Figure 12: Benefits and Impacts of Premium Equalisation
Source: RACQ (2023)

Lessons

As Queensland considers changes to its CTP scheme, it has the benefit of leveraging the best elements of interstate scheme design and applying lessons from the successes and challenges of their implementation.

The New South Wales scheme regulator SIRA acknowledged that the introduction of the REM amount and Premium Determination Guidelines required investment in insurers' systems, administration and other business operations to incorporate the new mechanisms (SIRA, 2019). However, RACQ's proposed model does not require significant financial investment or disruption for the Queensland scheme insurers.

The level of complexity built into the NSW design has been questioned by insurers and reviewed by its regulator in 2019. However, from the very beginning of designing a model for the Queensland scheme, balance can be sought between model complexity and accuracy in risk modelling.

NSW also faced significant deficits in the REM pool and challenges with data quality and delays in equalisation transactions. Queensland can incorporate reviews of these elements soon after implementation, defining penalties and incentives where appropriate, to avoid any similar problems that may emerge.

Despite the potential challenges, a comprehensive premium equalisation solution can be designed for the Queensland CTP Scheme that delivers significant benefit and achieves:

- simplicity of design and administration;
- minimal impact to claimants, motorists, legal and health practitioners, and TMR;
- minimal investment into systems, processes and training; and importantly
- a fair and equitable opportunity for all insurers.

DISCUSSION QUESTIONS

Do you support adoption of an insurer premium equalisation mechanism in the scheme? Why or why not?

Yes. RACQ has previously recommended that the Queensland CTP scheme should adopt a system that re-distributes premium based on the actual risk mix in an insurer's portfolio. We believe this is the best solution to address the current issues in the scheme and guarantee fairness and sustainability in the long term.

Do you believe that the introduction of a premium equalisation mechanism would improve insurer price competition in the scheme?

Yes. Premium equalisation mitigates the risk of picking up unfavourable risk upon entry to the market or by setting lower prices. This reduces barriers to entry and should lead to increased competition and innovate on price, additional policy benefits, claims management and service.

If the government were to introduce a premium equalisation mechanism in the Queensland CTP scheme, what would this look like? In particular:

- **Which vehicle classes should the mechanism apply to?**

  The premium equalisation risk model should be applied to all underwritten business where material distribution inequality exists across the selected risk attributes and where sufficient data exists. Class 1 as the largest class should be prioritised, with learnings applied before rolling out to other classes.

- **What mechanisms would need to be established for funding deficits and returning surpluses?**

  Deficits can be addressed through refinement of amounts in the equalisation table, to be repaid to insurers with higher risk portfolios in future periods. Surpluses could be held for an agreed period to fund potential future deficits, before being redistributed to insurers based on their portfolio risk and previous payments into the central fund. MAIC should facilitate discussions to agree on the period, but 12 months may be suitable to begin with.

- **A potential model for passing the funds would be to use a clearing house. Do you agree with this model and if so, should it be revenue neutral?**

  Yes. The clearing house should aim to be revenue neutral, with deficits and surpluses cleared within the agreed time period.

- **Which available rating factors should the mechanism apply across?**

  As a minimum, rating factors should include: vehicle age, license level, driver age, policy term and re-registration indicator.

  Others that should be evaluated for inclusion: customer type (private/commercial), license status, geographic region, infringement history, and owner tenure.

- **What definitions of risk factors should be used?**

  Definitions should be standardised prior to commencement of the model, in consultation between MAIC, Taylor Fry, TMR and insurers. Industry standard definitions should be used wherever possible.

- **What rules should be implemented to govern the timing of data submissions and contributions/withdrawals from the clearing house?**

  These should be discussed and agreed through consultation with insurers, TMR, and operator of the central fund / clearing house. Sufficient time should be allowed for the collation and quality checking of data prior to actuarial risk assessments commencing.

- **What, if any, impact would there be on you or your organisation (if applicable) if the government were to introduce a premium equalisation mechanism?**

  This solution would stabilise the operating environment for RACQ, providing financial relief and certainty for reinsurers. It would enable RACQ to continue its participation in the scheme.

- **What measures could you or your organisation adopt to offset any negative impacts?**

  RACQ will fully participate in consultation and review activities, to help design the best possible premium equalisation model for Queensland's CTP scheme. RACQ will continue its targeted risk acquisition strategies and focus on claims management in the meantime.

- **Does this approach carry any broader implications for insurer competition and innovation?**

  RACQ believes this will be a positive step towards increased competition and innovation. Even with premium being equalised, there will be many opportunities to innovate on extra policy benefits, service delivery and claims management.

- **What material opportunities, risks or considerations, if any, do you believe need to be considered in the review of this scenario?**

  MAIC should prepare for potential entrants to the scheme with consideration for changes to market share.

  This option is likely to be unpopular with insurers who currently have lower risk portfolios. This could cause disruption to their CTP businesses which needs to be considered in light of overall scheme stability.

OPTION 2: RANDOM ALLOCATION

RACQ has previously considered how a model designed to provide a balanced but randomised allocation of new vehicles across insurers would assist in addressing its higher-than-average portfolio risk. While RACQ would welcome an allocation of the low-risk new vehicles more closely aligned to its market share, there are impacts and challenges associated with such an approach that should be considered.

A limitation of this option is that it only addresses part of the problem – the imbalance in new vehicle registrations. It would do nothing to address RACQ's persistently risky renewal book with concentrations in higher risk cohorts. Increasing the volume of new vehicles RACQ receives will not be sufficient to meaningfully dilute the risk in RACQ's portfolio within this decade. Our over-representation in the risky re-registered vehicles will continue to offset the good risk from new cars.

If random allocation was selected for the scheme, a set of criteria would need to be agreed to determine the share of allocation, as well as the degree of randomness to ensure no selection bias, whilst providing some allowances for consumer choice (e.g. where a family or business wishes to have all their vehicles with one insurer).

Of the options presented in the discussion paper, an allocation based on market share for the relevant vehicle class would be most viable for RACQ.

An equal allocation (25% for each of the four scheme insurers) would be unsuitable, as RACQ's current market share already exceeds this amount and is continually growing, particularly for Class 1 vehicles. This option seems particularly inequitable when considering the largest (~43%) and smallest (~7%) insurer market shares[5] versus a potential 25% share of new vehicles.

RACQ would also strongly oppose an option where a larger allocation was awarded to insurers who can set the lowest premiums. This would further entrench the risk in RACQ's portfolio. It is currently not possible to price below the ceiling due to the elevated portfolio risk, and under this option RACQ would never receive the volume of new cars appropriate for its market share or that is required to correct the risk.

RACQ already receives a larger volume of re-registrations, which carry double the risk cost of other new business types, compared to its market share. Including re-registered vehicles in a random allocation mechanism would only be suitable if RACQ received less than its existing market share for that vehicle class, to assist in lowering the risk level in the portfolio.

Regardless of the allocation criteria selected, the system would need to be automated via TMR software on a state-wide basis. The extent of change affecting customers, insurers, MAIC and TMR, as well as investment in technology required to automate the randomisation would be significant, making this option less favourable than a premium equalisation model, and is therefore not recommended by RACQ.

DISCUSSION QUESTIONS

Do you support mandating a random allocation of CTP insurer in the scheme? Why or why not?

This is not RACQ's preferred option. In the absence of other change, random allocation of new vehicles would have some positive impact on RACQ's portfolio. However, it is expected that the change would be too slow to address the already critically elevated risk that exists in the portfolio and would not offset the impact of re-registered vehicles.

Do you believe that the introduction of random allocation would improve insurer price competition in the scheme?

It is unlikely that this option would significantly impact on price competition, until portfolio risk is equalised across the scheme, which could take many years. Given the low price sensitivity of Queensland motorists, and the tendency for those who do switch for price to be of higher risk, there would be few incentives for insurers to set lower prices in the meantime.

What, if any, impact would there be on you or your organisation (if applicable) if the government were to introduce random allocation?

A slow improvement to RACQ's risk profile and financial performance may be observed, but it is expected this would take too long to avoid RACQ's exit from the scheme.

What measures could you or your organisation adopt to offset any negative impacts?

RACQ would continue with its targeted marketing to preferred risks and focus on effective claims management to supplement the random allocation of new vehicles. However due to reasons outlined in Section 1, the impact of these measures will be too slow to address the portfolio risk.

Does this scenario carry any broader implications for insurer competition and innovation?

A random allocation of the better risks (new vehicles) would not eliminate targeted marketing to these motorists enticing them to switch. Competition would then focus on lower-risk vehicle/motorist cohorts and innovation around claims management and service delivery.

The existing barriers to entry would not be lowered under this option, as there would still be no mechanism to mitigate a larger proportion of higher risk policies being attracted to a new insurer entering the scheme.

[5] MAIC. (2023). *Quarterly Scheme Insights Oct-Dec 2022.*

OPTION 2: OTHER APPROACHES

MULTIPLE LICENCES

RACQ does not support this option.

RACQ provides CTP insurance under only one brand, with no expectation of involving another brand to provide differentiated offerings in the Queensland CTP scheme.

This option would not restore the risk in RACQ's portfolio or have any positive impact on the existing scheme dynamics that allow for risk sharing to become imbalanced between scheme insurers.

ACTIVE DECISION MAKING BY MOTORIST

RACQ does not support this option unless it is accompanied by other changes to the scheme.

As outlined in previous sections, the higher concentrations of riskier motorist and vehicle cohorts in RACQ's portfolio is driven in part by RACQ's strong brand in Queensland.

Counterintuitively, RACQ's brand awareness in the market and its longstanding relationship with members work against it in CTP insurance. We attract more of the younger drivers, who may be selecting a CTP insurer for the first time and go with a brand they know. We receive a larger share of the riskier re-registrations too, when motorists make an on-the-spot decision while filling in the form at the TMR office.

When motorists need to make an active choice for CTP, they are choosing RACQ more often than any other insurer. Furthermore, it is unlikely this option would result in RACQ's higher-risk policies being distributed to other insurers to balance risk sharing across the scheme.

If this option was selected for the Queensland scheme without other mechanisms to address imbalance in risk sharing, the volume of active choices would increase significantly, further increasing the likelihood of RACQ attracting more of the riskier policies, pushing the level of risk in the portfolio even higher.

OPTION 3: PUBLIC UNDERWRITING MODEL

RACQ does not recommend this option.

Not only would such an overhaul of the current scheme be a significantly complex and costly undertaking for Government, but it would have a major impact on scheme insurers, their staff and shareholders, and the experience of injured claimants.

Losing the opportunity to generate revenue and profits from CTP would be a major impact for all insurers. There is a high likelihood of substantial job losses and diminished business value, which in the current economic environment would be particularly unpalatable.

There would also be complications for insurer's capital requirements and reinsurance arrangements as claims are run off over several years. As claims are run off, the portfolio of remaining claims becomes more complex, costly and volatile. Without the potential of ongoing business, CTP would become a less attractive proposition for reinsurers, further challenging insurer's ability to place appropriate cover. There may be some capital release because insurers would no longer be underwriting CTP policies, however this would be offset by the additional capital required in accordance with the increasing volatility in claims.

Public underwriting involves a potential financial and reputational risk for Government should any shortfall in CTP funds emerge that need to be met by tax revenue or increasing prices for future policy holders.

RACQ's advocacy efforts are first and foremost to ensure that fairness and affordability remain in the scheme. Offering CTP is core to RACQ's strategy as the principal mobility body in Queensland and it remains a key priority of RACQ management and board that we do everything we can to remain in the scheme. RACQ has a 118-year history of helping Queenslanders on the state's roads and is proud to have supported over 30,000 injured people or their families since joining the Queensland CTP scheme in 1999.

RACQ's preference is that the CTP scheme remains underwritten by private insurers, with the necessary changes to restore its portfolio back to profitability within a reasonable timeframe. This would allow RACQ to retain its highly experienced CTP personnel and continue offering the great claims outcomes we are known for. A level playing field would allow competition on price and policy benefits to re-emerge in the scheme.

Notwithstanding the comments above, RACQ would be interested to tender if the Government chose to outsource for the provision of claims management services. RACQ's industry leading performance on return-to-work outcomes and speed of settling claims is visible in Figures 13 and 14 below.

Figure 13

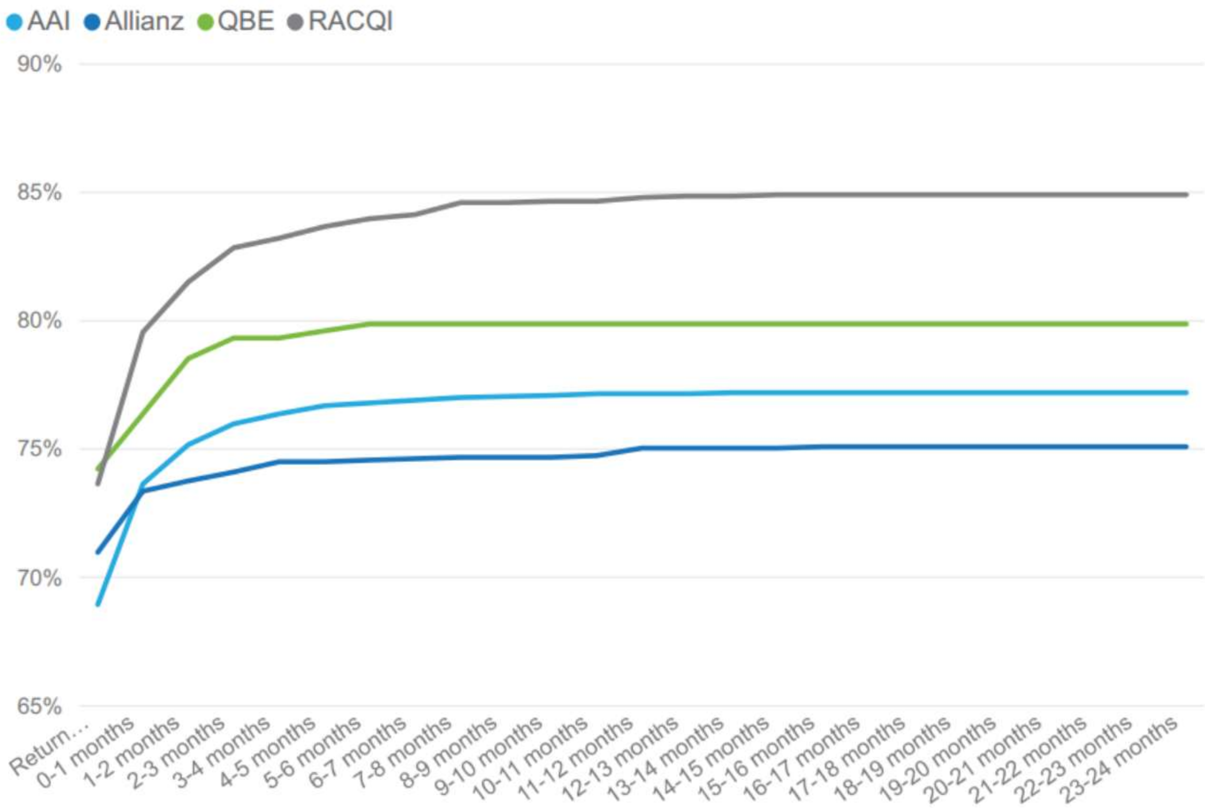


Figure 13: Return to Work (%) Results by Insurer (months from notification) – Sev1Y claims between 1 Jan 2021 and 31 Dec 2022. Source: MAIC Insurer Benchmarking Report for 31 December 2022 (RACQ), page 64.

Figure 14

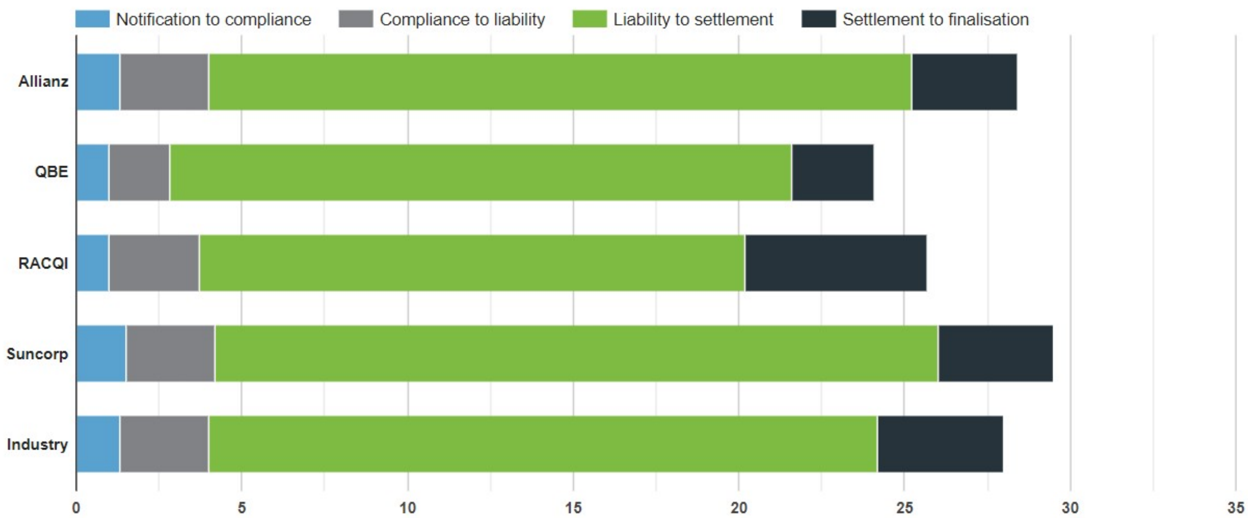


Figure 14: Average Claim Settlement Durations (months) by Insurer, legally represented claims finalised 1 July 2021 to 30 June 2022. Source: MAIC Quarterly Scheme Insights Oct-Dec2022, (2023).

While some may argue there is a risk that innovation and performance in claims administration could decline in the absence of competitive tension, this could be mitigated by well-designed key performance indicators, thorough monitoring processes and the establishment of appropriate service guidelines for claims management. MAIC already benchmarks insurer performance across a range of metrics and this could continue with a publicly underwritten scheme.

DISCUSSION QUESTIONS

Do you support a transition to public underwriting for the scheme? Why or why not?

RACQ prefers for the scheme to remain privately underwritten with changes that restore fairness and stability. Moving to a public underwriting model is not recommended due to the significant disruption it would cause for insurers, their personnel, motorists, TMR, and numerous other organisations and professionals operating within the scheme. It would also likely disrupt claim management and importantly, delay the resolution of claims to the detriment of injured claimants.

What, if any, impact would there be on you or your organisation (if applicable) if the scheme were to move to a public underwriting model?

Further deterioration of profitability on what would become a runoff portfolio. As the volume of business (claims) declines, the fixed and variable expense base required to support the operation will likely not scale down at the same rate.

Potential for inefficient and ineffective use of capital to support an increasingly volatile claims portfolio, although there may be some capital relief as underwriting ceases.

Loss of a revenue stream into the future. Loss of opportunity to provide a complete set of insurance products to the Queensland public.

Are there any significant economic, social or environmental impacts for you or your organisation in moving to a public underwriting scheme?

In addition to the points raised above, there could be wider implications and impacts for the community due to the potential for deterioration in the claims performance (claimant outcomes and financial results). This may occur due to a reduced focus on this line of business as it becomes a “non-core” product as the portfolio runs off. This can be managed through well-designed key performance indicators, effective oversight and performance monitoring by MAIC.

If the scheme were to move to a public underwriting model, do you consider that there would be any implementation issues or risks for you or your organisation that need to be considered in the review of this scenario?

Complications for capital requirements and future reinsurance placements would be expected.

Potential for high attrition as staff seek more stable employment opportunities, which could disrupt claim management and importantly, delay the resolution of claims to the detriment of injured claimants.

If the scheme were to move to a public underwriting model, to what extent do you believe there needs to be private sector service delivery?

RACQ believes it is imperative that service delivery sits with the private sector. Tapping into existing insurance operations cost efficiencies, leveraging existing insurance product and claims management knowledge and expertise, would ensure the scheme remains open, transparent, financially resilient and focussed on claimant outcomes.

There is a risk that poor or overly complex remuneration design structures could lead to suboptimal claimant outcomes and financial leakage. However, this can be managed through careful consideration of commercial arrangements, well-designed and transparent key performance indicators and effective monitoring of service delivery.

What are your views on the claims management functions for minor claims being performed by external claims management providers?

RACQ supports private sector delivery of claims management, including both minor and complex claims. Economies of scale could be achieved by both small and large claims being outsourced to the same third-party claims manager. Servicing both minor and complex claims also provides the opportunity for role progression for claims personnel, supporting engagement and retention.

What are your views on the claims management functions for complex claims being performed by external claims management providers?

As above

What opportunities are there in an external claims management arrangement to pursue positive incentives for good claims management outcomes?

This design would allow external claims managers to apply learnings from other product classes and jurisdictions they operate in, or are exposed to, through their industry associations. Well-designed performance criteria can inspire innovation in service delivery.

What compliance costs would be involved for your organisation?

Compliance costs are expected to be in line with those of a general insurer, plus additional requirements for contract management and monitoring against performance targets.

If the scheme does move to public underwriting with external claims management, would your organisation be interested in being a claims management service provider? Why or why not?

Yes. This would provide an additional non-underwritten risk revenue stream, with lower capital requirements than other insurance offerings, that is aligned with RACQ's strategy and values.

It would enable RACQ to retain its experienced CTP claims staff and minimise potential job losses.

It would partially replace the foregone profits due to no longer underwriting CTP, and support RACQ's ongoing commitment to road safety education, disaster recovery funding and assistance, and other valuable contributions to Queensland communities.

CONCLUSION

The dynamics of the Queensland CTP scheme allow for an imbalance in risk sharing between insurers, which has manifested in perverse outcomes for RACQ. The current situation is unsustainable and threatens RACQ's ongoing participation in the scheme. Government intervention is urgently needed to help restore fairness and sustainability.

RACQ strongly recommends a system of premium equalisation. We believe this is the most appropriate solution to address the consequences of imbalanced portfolio risk and would have minimal to no impact on motorists, TMR and other professionals involved in CTP.

RACQ has considered alternative models that include random allocation of new vehicles, deliberate choice by motorists on each renewal and public underwriting. These are not recommended as they would be more complex, costly and disruptive to implement than a premium equalisation system.

RACQ would welcome any further discussion on comments made in this submission and the recommended option of premium equalisation. RACQ reiterates its desire to continue providing CTP insurance for Queensland, and its commitment to ongoing collaboration on the changes needed to restore fairness and stability for the future of the scheme.

REFERENCES

Finity Consulting. (2022). *RACQ Financial Condition Report as at 30 June 2022.*

Finity Consulting. (2023). *Valuation of RACQ Insurance Liabilities for Queensland CTP as at 31 December 2022.*

Finity Consulting. (April 2023). *Queensland CTP Monitoring - RACQI vs Rest of Industry experience to 31 December 2022.*

MAIC. (2023). *Benchmarking Report - RACQ.*

MAIC. (2023, February). *Quarterly CTP Scheme Insights: Oct-Dec 2022.* Retrieved March 20, 2023, from Motor Accident Insurance Commission: https://maic.qld.gov.au/publications/quarterly-ctp-scheme-insights-oct-dec-2022/

MAIC. (2023, March). *Scheme Review 2023 Discussion Paper.* Retrieved March 6, 2023, from Motor Accident Insurance Commission: https://maic.qld.gov.au/scheme-knowledge-centre/2023-ctp-scheme-review/

MAIC. (n.d.). Monthly Market Share Data.

Market & Communications Research. (2020). *MAIC General Motorist and New Car Buyer Research 2020.* Retrieved from https://maic.qld.gov.au/wp-content/uploads/2020/07/MAIC-Motorist-Research-Report-2020_Summary.pdf

RACQ. (2018). *CTP Behaviour Online Survey Results.*

RACQ. (2023). *CTP Opinion Survey Results.*

SIRA. (2019). *NSW CTP Premium and Market Supervision: Review of the Risk Equalisation Mechanism (REM).* Retrieved from https://www.sira.nsw.gov.au/__data/assets/pdf_file/0010/604297/CTP-Premium-and-Market-Supervision-Review-of-the-Risk-Equalisation-Mechanism-REM.pdf

Taylor Fry. (2020). *MAIC - RACQ Update.*

Taylor Fry. (2021, August). *MAIC - RACQ Update.*