TAYLOR FRY

SA CTP Market briefing

Review of the risk premium for the 2020/21 underwriting year

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1 Risk premium

$134.90

▼ **$17.30**

The advised risk premium for the 2020/21 underwriting year,
excluding inflation and discounting

Taylor Fry estimates the components of the risk premium for the South Australian CTP scheme and advises the CTP Insurance Regulator on these components. The regulator integrates our advice with its own views to set a floor and ceiling for insurer CTP premiums. Our advice was prepared before the significance of COVID-19 was apparent and the impact of it is not addressed in our advice.

Table 1 shows the risk premium for the 2020/21 underwriting year as the product of the advised claim frequency and average claim size, based on data to 31 December 2019. We examine claim frequency and size in detail, separately, in Sections 2 and 3.

Table 1 – Advised risk premium for 2020/21 underwriting year

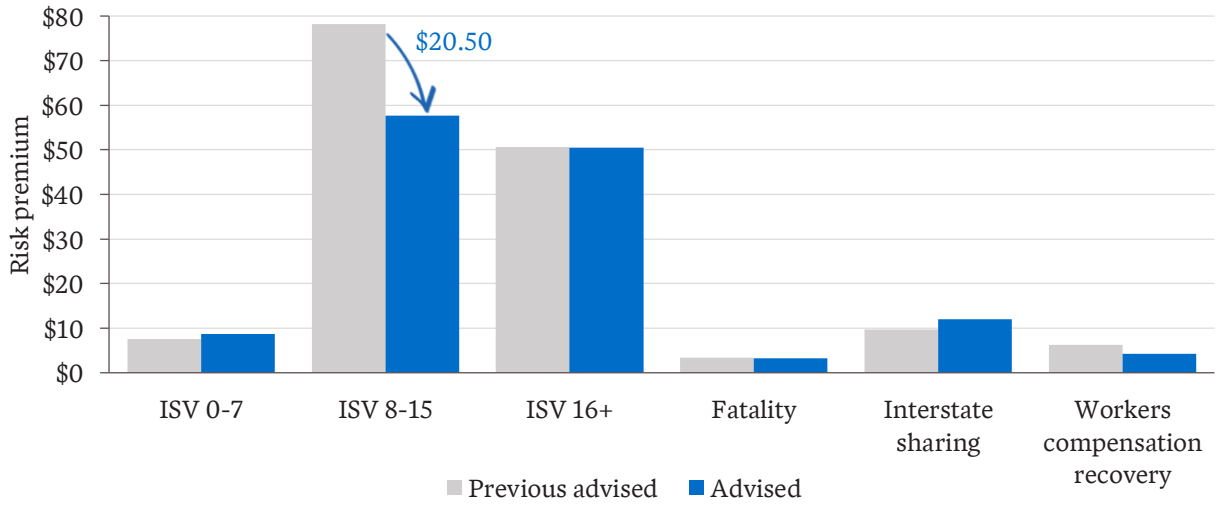
Claim frequency represents the number of reported claims per annual policy		0.167%
Average claim size represents the expected ultimate cost of a reported claim	×	$80,956
Risk premium is the expected future cost per policy of claims made to insurers		**$134.90**

Our advised risk premium is $17.30 lower than our advised risk premium at the previous annual review (based on data to 31 December 2018) because:

- ▲ $3.70 increase due to inflation over the year to 31 December 2019
- ▼ $21.00 due to updated assumptions for claim frequency and average claim size.

Figure 1 shows the revised assumptions in six segments based on claimants' Injury Scale Value (ISV), fatalities, interstate sharing claims and workers compensation recovery. The ISV 8-15 and ISV 16+ segments make up 80% the risk premium.

Figure 1 – Risk premium assumptions by segment



The $21 decrease in risk premium due to updated assumptions is concentrated in the ISV 8-15 segment.

2 Claim frequency by segment

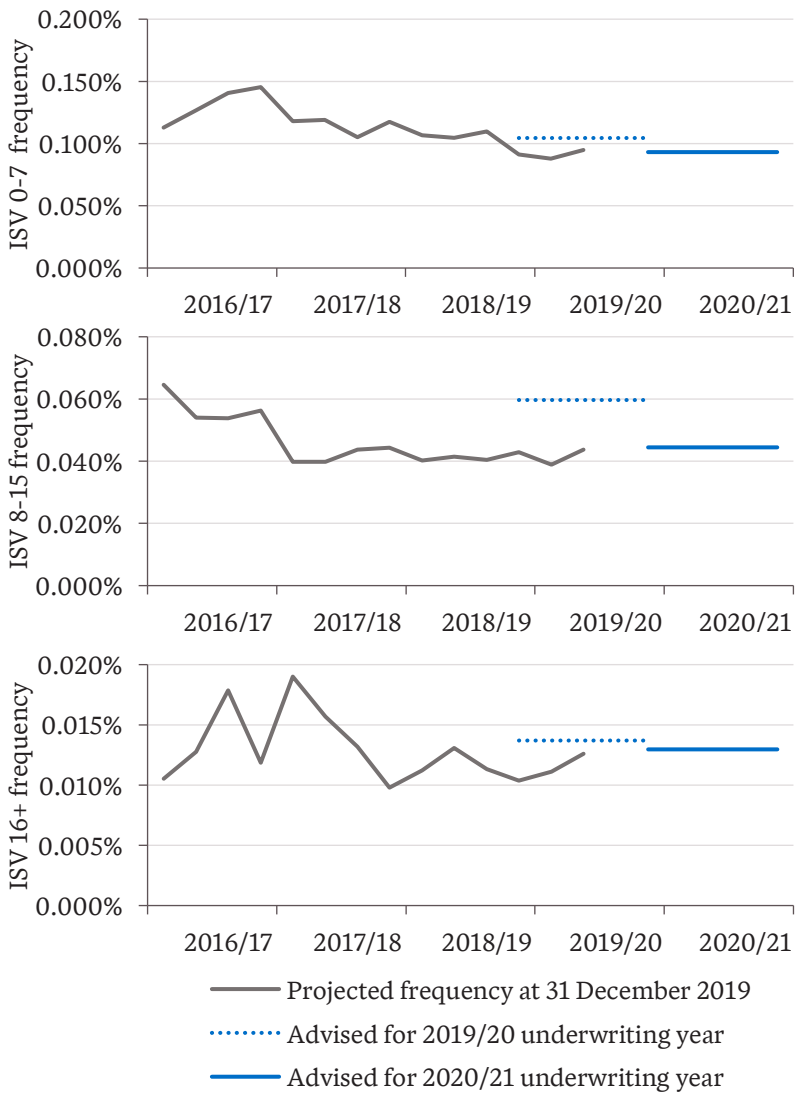
0.167%
▼16%

The advised claim frequency for the 2020/21 underwriting year
which represents the number of reported claims per annual policy

Taylor Fry reviews the claim frequency by segment at each annual review. Claim frequency is the rate of CTP claims per annual policy.

Figure 2 shows the claim frequency for the three most frequent claim segments - ISV 0-7, ISV 8-15 and ISV 16+. These segments constitute 90% of claims. We compare the advised frequency for the 2020/21 underwriting year to the advised frequency for the 2019/20 underwriting year (previous review) and the projected frequency for previous periods.

Figure 2 – Claim frequency for major segment



We advise an **ISV 0-7 claim frequency of 0.093%** down 11% compared to a frequency of 0.104% at the previous review.

ISV 8-15 frequency has been significantly lower than historical experience since the beginning of private underwriting in 2016/17. With another year of fewer claims than expected, we are more confident that there has been a reduction in frequency since private underwriting commenced. We advise an **ISV 8-15 claim frequency of 0.044%** down 26% compared to a frequency of 0.060% at the previous review.

We advise an **ISV 16+ claim frequency of 0.013%** down 6% compared to a frequency of 0.014% at the previous review.

The other segments – fatalities, interstate sharing and workers compensation recoveries – contribute 0.018% to the overall frequency (10% of claims).

3 Finalised average claim size

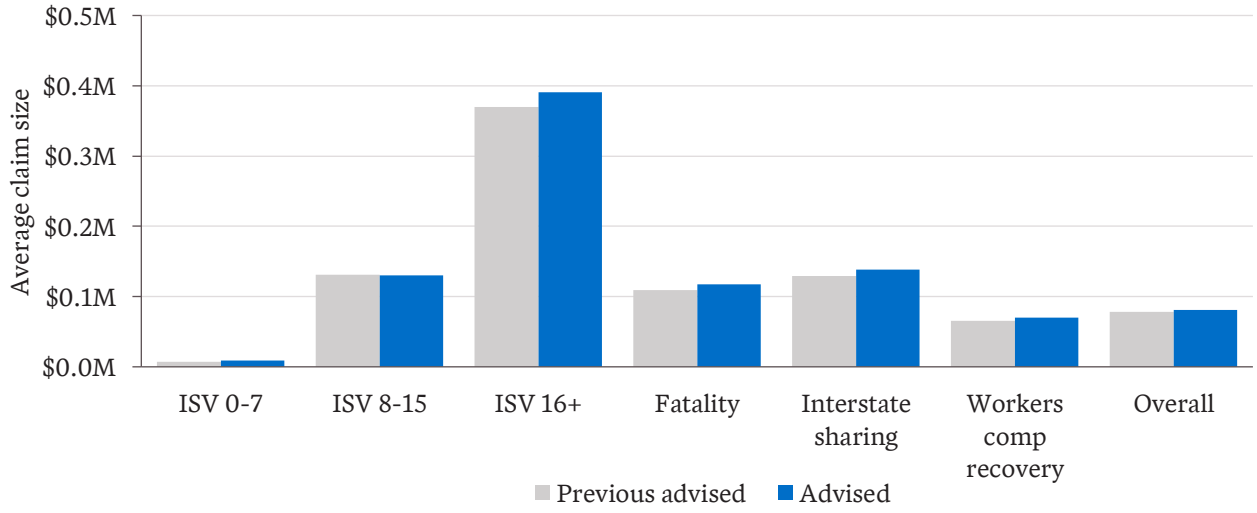
$80,956
▲ 3%

The advised average claim size for the 2020/21 underwriting year
which represents the expected ultimate cost of a reported claim

Taylor Fry reviews the average claim size by segment based on finalised claims at each annual review. Average claim size is the amount of compensation a claimant receives.

Figure 3 shows the revised assumptions in six segments. The previous advised has been adjusted to include inflation in the year to 31 December 2019. The size of compensation a claimant receives is highly dependent on the claim's ISV because access to future economic loss and benefits and general damages is dependent on ISV.

Figure 3 – Revised average claim size assumptions by segment and overall



Within each segment, we have kept the average claim size stable or increased it. The 3% increase in overall average claim size is mostly driven by the 6% increase in ISV 16+ average claim size.

4 Risk premium sensitivities

There is uncertainty in the assumptions underlying our risk premium estimate. There is a risk that the claim frequency and size that ultimately emerge for the 2020/21 underwriting year turn out to be different to our assumed values.

The privately underwritten environment has a short history and relatively few finalisations which leads to more uncertainty than for a mature scheme. The main source of uncertainty around the risk premium is high ISV claims (ISV 8+).

High ISV claims segments constitute most of the risk premium and we have limited experience since the 2013 tort reforms on which to base our estimates. Specifically, there is uncertainty around our estimation of:

- Frequency: Given the limited information it is difficult to estimate how many claims will finalise with a high ISV in the private post-reform environment.
- Average claim size: We have not observed any late finalisations post-reform from the high ISV segments. We rely on the extrapolation of observed claims experience to estimate the average claim size for late finalisations.

Table 2 illustrates the impact of uncertainty for high ISV claims.

Table 2 – Uncertainty scenarios for high ISV claims

Scenario	Risk premium impact
Transitions to ISV8+ segment occur at 20% more than assumed	+ $10
Late finalising ISV 8-15 claims are over- or under- estimated by 20%	± $5
Late finalising ISV 16+ claims are over- or under- estimated by 20%	± $7

We consider that our advised risk premium appropriately balances these uncertainties and is a reasonable central estimate of risk cost using experience up to 31 December 2019.

Our advice was prepared before the significance of COVID-19 was apparent and the impact of it is not specifically addressed in our advice.

5 Economic assumptions

-1.97%
▼1.24%

The economic gap for the 2020/21 underwriting year
The difference between the investment return and the projected inflation rate up to the time of claim payment

The risk premium from Section 1 is uninflated and undiscounted. To allow for claims inflation and investment returns, Taylor Fry reviews the timing of claim payments, risk-free investment returns and projected inflation.

Economic gap

The economic gap is the risk-free rate of return *minus* the SA Average Weekly Earnings (AWE) inflation rate. A higher economic gap translates to a lower CTP premium. Table 3 shows the projected risk-free rate of return and the projected AWE inflation rate to determine the economic gap.

Table 3 – Economic gap assumptions

Risk-free rate of return	**0.67%** (▼1.37%) p.a.
AWE inflation rate	**2.64%** (▼0.12%) p.a.
Economic gap	**-1.97%** (▼1.24%) p.a.

We have reduced the economic gap in line with the 1.37% p.a. reduction in the risk-free rate of return. The 0.12% p.a. reduction in inflation provides only a small offset.

Superimposed inflation

Superimposed inflation is claim inflation in excess of AWE. We assist the Regulator in adopting a superimposed inflation assumption.

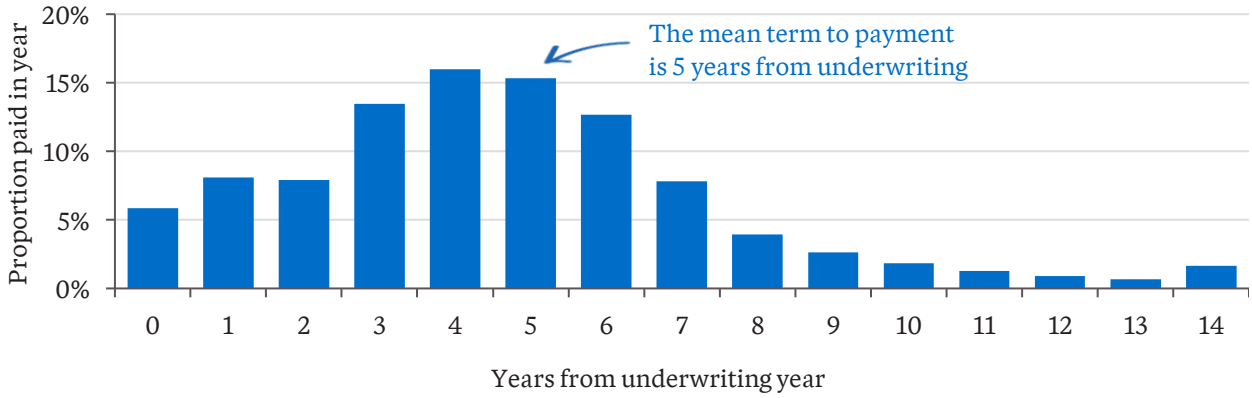
The 2013 tort reforms make it difficult to use South Australian CTP experience to assess superimposed inflation. Superimposed inflation experience has been benign in CTP schemes in New South Wales and Queensland, averaging 0%-1% p.a. over the last 10 years.

This suggests an appropriate **superimposed inflation rate of 0%-1% p.a.** over the medium term.

Timing of claim payments

The economic gap and superimposed inflation affect the risk premium more as the timing of claim payments extends further from underwriting. Figure 4 shows the timing of the claim payments following underwriting.

Figure 4 – Timing of claim payments



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