National Competitiveness and Productivity Council
Bulletin 21-1. Insurance Costs

- **Insurance markets are characterised by underwriting cycles – repeating, regular periods where insurance coverage is readily available at 'reasonable' prices (soft markets) and periods where prices are high, and coverage is limited or unavailable (hard markets). Available evidence suggests that liability insurance markets in Ireland are likely to have entered the 'hard market' phase as early as 2012.**
- **The Council believes that bringing award levels in line with other jurisdictions, ensuring consistency of award levels, and reducing settlement costs, are the key actions required to soften the Irish liability insurance market, and should lead to lower insurance costs and an increase the availability of insurance, and associated competitiveness.**
- **Key Actions in the Government's Action Plan for Insurance Reform, including the Personal Injuries Guidelines, should achieve this; if not – further actions, including Oireachtas Guidelines on award levels, need to be considered.**

THE NATIONAL COMPETITIVENESS AND PRODUCTIVITY COUNCIL

The National Competitiveness and Productivity Council (NCPC) mission is to promote sustainable economic growth and quality employment so that living standards and quality of life improve for all of society. To achieve sustainable economic growth, a wide range of factors need to be considered, including Ireland's **business environment** that, ultimately, needs to support Irish enterprise.

The business environment is determined by many factors, including the smooth functioning of key markets for business inputs. In any of these markets, lack of information or the presence of externalities may cause market failure, and these cases clearly must be addressed as a matter of priority. However, in other cases, markets may operate efficiently, but still may not deliver outcomes that support the competitiveness of the economy for structural reasons. Furthermore, there can be implicit (or explicit) policies designed to achieve particular Government objectives that can impact negatively on competitiveness. In these cases, recognizing that the Government is best placed to weigh up the different options, the Council's aim is simply to highlight these trade-offs.

The NCPC has examined insurance costs previously due to the compelling evidence that the high price of employers' liability (EL)[1] and public liability (PL)[2] insurance undermines the competitiveness of Irish businesses (especially Irish SMEs). As there is no single action that would address the high cost of insurance, the NCPC believes that a whole-of-government approach is needed to drive reform in the insurance market. In this regard, the NCPC acknowledges previous work done by the Cost of Insurance Working Group (CIWG) in this area and welcomes the decision by the Government to establish a Sub-Group on Insurance Reform chaired by the Tánaiste under the Cabinet Committee on Economic Recovery and Investment to drive the implementation of the Government's commitments in its *Programme for Government*. On foot of that, the Government published an *Action Plan on Insurance Reform*. In addition, the Council notes that the Competition and Consumer Protection Commission (CCPC) recently published its *Market Study on Public Liability Insurance* and the Central Bank of Ireland have published their interim report on differential pricing. The Council believes that it is timely to re-examine this issue, given these developments, and to re-emphasize the importance of competitive insurance costs.

Insurance Costs in Ireland

Liability insurance, which includes PL and EL insurance, is a key facilitator of activity in both the commercial and non-commercial sectors of the economy, as it allows organisations to transfer some of their risks to firms that specialize in absorbing risk. In doing so, organisations are able to undertake a broader range of activities and, in particular, a higher level of economic activity than they would otherwise have been able to do.

While there are no price indices (either in Ireland or internationally) that track the cost of PL and EL

[1] Protects businesses against liability for injury, illness, disease, or death of any employee under a contact of service with your business.

[2] Protects businesses if they are liable to a member of the public for bodily injury, damages, expenses etc. following an accident in connection with the business.

insurance, the findings of the CIWG, business organisation surveys, and the recent CCPC study, all indicate there has been a slow, but steady, rate of increase in public liability premiums over recent years. This is consistent with anecdotal evidence from the sectors most affected by the cost of insurance to suggest that pre-COVID-19, the price of insurance had been increasing and that it had become more difficult to secure for certain types of businesses [i ii iii].

The NCPC believes it is important that the innovative National Claims Information Database (NCID) becomes a vehicle for greater transparency and information on these markets, and this was echoed in the *Action Plan for Insurance Reform*. Indeed, later this year, the Central Bank of Ireland will publish its first report on EL and PL insurance as part of the extended NCID. This will be a valuable resource to evaluate the state of the Irish EL and PL market, and the impact of Government reforms to address high insurance premiums.

Why are insurance costs so high in Ireland?

Insurance markets are characterized by **underwriting cycles** – repeating, regular periods where insurance coverage is readily available at 'reasonable' prices (soft markets) and periods where prices are high, and coverage is limited or unavailable (hard markets)[iv].

Figure 1. The underwriting cycle

Source: CIWG

A key question for policymakers is where we are in this underwriting cycle for employers' and public liability insurance.

The underwriting losses sustained in the Irish EL and PL insurance market between 2012 and 2015 (see Figure 2) suggest that the market was coming to the end of the soft phase, and likely to enter a hard market phase. The Central Bank is unable to continue to collect and publish data in this format, due to the Solvency II regulatory framework commencing in 2016, and for this reason it is not possible to draw further conclusions on where the EL and PL markets now are in the underwriting cycle, though

Box A. Learning from Experience? The US Liability Crisis in the 1980s

During the mid-1980s, liability insurance markets in the United States experienced a major crisis – characterized by substantial price increases, reductions in coverage, and unavailability of coverage at any price for some segments of the market. Premiums rose, and losses diminished, so that overall insurer profitability increased. This profitability is reflected in the loss ratio (i.e. the ratio of losses to premiums), which changed dramatically over the 1985- 1988 period.

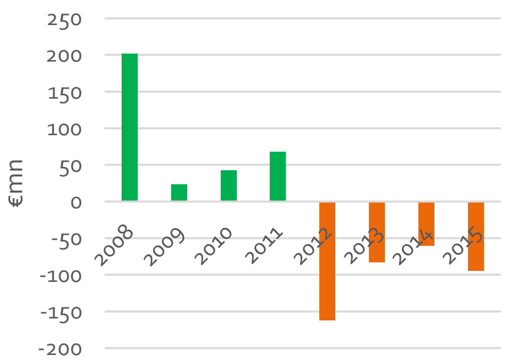
Affected firms responded to this increase in liability costs by pressuring state legislatures to pass liability reform laws[1] that would limit their insurance costs. The majority of States responded by enacting tort reform of some kind, though states differed significantly in the measures they implemented.

Research found that reforms had a strong significant effect in reducing general liability losses in the late 1980s, and that the reform efforts that had a significant effect in reducing losses were modifications of joint and several liability in 1986, and limits on non-economic damages.

There is evidence to suggest that US States that enacted tort reforms between 1985 and 1988 were able to restrain the growth of liability costs. A substantial negative effect on the level of losses was observed. Specific reform measures alone may not, however, account for all the significant drop in losses.

The results are consistent with the possibility that a State's undertaking of comprehensive effort to reform its liability laws may be more consequential than the specific component of the measures. The measures reduced costs and lowered the loss ratio, and ultimately, lowered premiums the high cost of insurance is consistent with the view that they remain in a hard market.

Figure 2. Liability Insurance - Underwriting Profit/ Loss



Source: Central Bank of Ireland

In a hard market, the underwriting cycle suggests that competition will decrease as incumbent operators consider reducing their exposures to the market, and there is less incentive for other insurance companies to enter the market. In theory, high prices typical of a hard market are expected to signal the market is profitable and attract new entrants, resulting in increased competition. It is also possible that the COVID-19 pandemic and the recent departure of the UK from the EU (as some smaller specialist UK insurance businesses may decide to no longer operate in the EU) will compound the issue.

However, regardless of what part of the underwriting cycle the insurance sector is in, it is possible for Governments to introduce measures that can impact that cost of insurance. While data limitations make hard markets difficult to identify, they are not unique to Ireland. One well documented example where lawmakers were compelled to act to address dramatic insurance price increases is the US in the 1980s (see Box A on the US Liability Insurance Crisis[v]). Measures designed to reduce settlement costs (i.e. the cost that insurers must pay to settle a claim against them) can have a significant impact on premiums. The NCID shows that the two major components of settlement costs for motor insurance companies (and presumably employer's liability and public liability insurance) are **compensation** (the award paid to the claimant to compensate them) and **legal costs**.

How are these issues currently being addressed?

One of the major Government initiatives to tackle the cost of insurance is based around reducing settlement costs.
Building on the work of the CIWG, the Government *Action Plan for Insurance Reform*[vi] (published in December 2020) continues a focus on reducing settlement costs and from a NCPC perspective makes recommendations in three key areas:

(i) Measures that will facilitate the swift adoption of new Personal Injuries Guidelines that will replace the Book of Quantum

Presently, the level of damages awarded in personal injury claims are determined with reference to the Book of Quantum (BoQ), a document that shows the prevailing range of payment for injuries based on research into real cases. The Personal Injuries Commission (PIC) demonstrated that, in some cases, the prevailing range of payment for certain injuries in the BoQ was significantly higher than the corresponding UK range. As a result, the Judicial Council was tasked with producing new Personal Injuries Guidelines, to replace the BoQ. It is hoped that these guidelines will bring settlement levels more closely in line with other common law jurisdictions, and importantly that they will bring both certainty and clarity to the settlement of personal injury actions in the courts. In addition, as both the Courts and Personal Injuries Assessment Board (PIAB) will be required to base assessments on these new guidelines, there will be less incentive for claimants to reject PIAB settlements and proceed to litigation.

If adopted by the Judicial Council, these PI Guidelines are due to be adopted before the end of July this year and are recognized in the Government's Action Plan. Based on the US experience of dealing with high insurance costs, this appears to be the best approach to tackling insurance costs. It is important that the impact of these Guidelines is monitored carefully over time. Data from the PIAB, the Courts, and the expanded NCID should enable policymakers to track the impact of these new Guidelines. If these Guidelines do not have the desired effect, the Government needs to consider legislating for a cap on award levels in line with the Law Reform Commission report, *Capping Damages in Personal Injury Actions*.

(ii) Measures to enhance and reform the role of the Personal Injuries Assessment Board

The NCID report shows that, for motor insurance, the legal costs of settling a case are much lower through the PIAB channel when compared with the legal costs of settling through the Courts. In addition, the process of finalising cases, from accident to resolution, through PIAB takes on average 2.5 years as against 4.5 years through the legal route. It is expected that a similar pattern will emerge regarding EL/PL claims when the NCID EL/PL report is published later this year.

However, the proportion of claims finalised through PIAB in recent years has decreased with higher share of claims settled through litigation resulting in higher legal costs and longer times to settle. There are several factors that may be influencing this decrease in the use of the PIAB including greater numbers of cases that fall outside its remit or are not appropriate for PIAB assessment, higher rejection rates of PIAB awards in anticipation of higher settlements post PIAB, and the potential for legal costs to be paid in settlements where claims are settled post PIAB. PIAB only awards legal costs in certain limited circumstances whereas claims settled in litigation usually result in the defendant paying legal costs. Accordingly, it is possible that claimants will reject a PIAB award in an attempt to secure a higher amount and potentially secure legal costs through initiating legal proceedings. The NCID report shows that while associated legal costs for cases settled through litigation are considerably higher than those settled through PIAB, the average award for litigated cases is only marginally higher than the average award for those cases settled through PIAB.

The Department of Enterprise, Trade and Employment is developing proposals for reform and enhancement of the PIAB, and under the *Action Plan for Insurance Reform* are due to commence a public consultation on these reforms shortly. This is a welcome development that will hopefully progress quickly.

(iii) Measures to promote competition in the insurance market

As mentioned previously, a reduction in competition is consistent with a hard market and is an issue that has been examined by the CCPC as part of its study of the public liability insurance market. In its report, the CCPC has highlighted several factors that may reduce competition in the Irish market (including certain barriers to entry, the switching behaviour of insurance purchasers, and cost inflation).

The *Action Plan for Insurance Reform* sets out a number of policies that should address these competition concerns, such as strengthening the enforcement powers of the CCPC and establishing a Central Bank databank for potential new entrants to the market. The CCPC has also recommended that open access for claims history information of all insurers and their agents is provided for and managed by an independent body. The Council particularly welcomes the recent establishment of an office within Government that is designed to encourage greater competition in the insurance market.

Conclusions

The Council views actions in the three areas highlighted as crucial to addressing the issue of high insurance costs, and should also help to ease concerns about availability of insurance. It is also important that the further actions set out in the Government's Action Plan that are designed to address other issues in the insurance market are also progressed. These include examining the duty of care (which requires individuals to adhere to a standard of reasonable care while performing an act that may harm others), monitoring whether personal injury award levels need to be capped, reducing insurance fraud, and examining differential pricing.

Ultimately, without greater consistency in award levels, and lower settlement costs, the cost of insurance will continue to weigh on the competitiveness of Irish businesses. The Council is hopeful that the adoption of the Personal Injuries Guidelines will fully address this issue – and insurance costs will gradually start to fall. Data from PIAB, the Courts, and the NCID will provide policy makers with the evidence to assess the impact of these Guidelines. If this intervention fails to bring about a reduction in insurance costs, further action such as Oireachtas Guidelines on award levels, needs to be considered to assure the competitiveness of enterprises operating in Ireland and especially SMEs.

Further Reading: The Council's annual flagship publication, *Ireland's Competitiveness Challenge 2020*, was published in September 2020 and makes 20 targeted and actionable recommendations to Government on how best to address the challenges facing the Irish economy. In November 2020, the Government published an official response to the Council's recommendations for the first time, signalling their commitment to continued dialogue with the NCPC on competitiveness and productivity matters. The *Challenge* report and Government response are available at: www.competitiveness.ie

This Bulletin has been issued by the Chair, Dr Frances Ruane, and prepared by Manus O Donnell in the NCPC Secretariat.

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[i] IBEC (2016) 'Time to reduce the burden of personal injury claims'
[ii] ISME (2020) Business Trends Report 2020 Q2
[iii] CCPC (2020) Public Liability Insurance Market Study
[iv] Weiss (2007) 'Underwriting Cycles: A Synthesis and Further Directions', Journal of Insurance Issues, Spring 2007, Vol. 30, No. 1 pp. 31- 45
[v] Berger, Cummins, and Tennyson (1992) 'Reinsurance and the Liability Insurance Crisis', Journal of Risk and Uncertainty, Vol. 5, No. 3, pp. 253- 272
[vi] Government of Ireland (December 2020) 'Action Plan for Insurance Reform'