Submission

By

BusinessNZ

The voice of business

to the

Ministry of Transport

on the

Compulsory Third Party Vehicle Insurance Discussion Paper

August 2008

PO Box 1925
Wellington
Ph: 04 496 6555
Fax: 04 496 6550

COMPULSORY THIRD PARTY VEHICLE INSURANCE
SUBMISSION BY BUSINESS NEW ZEALAND[1]

1.0 INTRODUCTION

1.1 Business New Zealand welcomes the opportunity to make a submission to the Ministry of Transport on the Compulsory Third Party Vehicle Insurance Discussion Paper – June 2008 ("the Discussion Paper").

1.2 While Business NZ appreciates that the Discussion Paper is well-intentioned (i.e. internalising the costs associated with driver behaviour by ensuring individuals pay for the costs associated with damage to vehicles and property to third parties), there are significant problems with the proposed approach which are outlined in this submission.

1.3 The vast bulk of vehicle owners insure against damage to their own vehicles and others, while a significant number of other vehicle owners (particularly those operating large fleets) decide to effectively self-insure. Making third party insurance compulsory is likely to impose significant costs on responsible drivers who for whatever reason decide to self-insure. On the other hand, there is no guarantee that making third party insurance compulsory will ensure the individuals the policy is intended to cover (high risk individuals with little or no capital to pay for damage to other vehicles or property) will necessarily get cover. In sum, the costs of enforcing compulsion are likely to outweigh any benefits achieved from the introduction of compulsory third party vehicle insurance.

1.4 Notwithstanding the above, the question needs to be asked as to why the focus on compulsory third party vehicle insurance when individuals are not required to obtain compulsory insurance for other activities which may impose significant costs on them personally, their families, and ultimately the general public (taxpayers)? While individuals can, and often do, insure for many such risks, it is purely of a voluntary nature.

1.5 Many people fail to obtain appropriate cover for a whole host of risks they may face (e.g. loss of income from employment, health difficulties, property damage as a result of storms etc). This may result in significant cost to them personally, their families, and often the Government via taxpayer-funded social welfare benefits and the provision of public health services. Taken to the extreme, one could argue that those who undertake risky activities e.g. are obese or undertake a sedentary lifestyle should be required to take out mandatory health insurance to minimise the costs on general taxpayers in case they need expensive health treatment later in life. While voluntary insurance is available in respect to both health-related risks and many other risks, generally it is not compulsory (apart from ACC levies covering

[1] Background information on Business New Zealand is attached as Appendix 1.

workplace accidents, accidents to earners outside the workplace and motor vehicle accidents, with the taxpayer picking up the bill for personal injuries to non-earners).[2]

1.6 While it is accepted that the nature of third party vehicle insurance is to ensure that (specified) "third parties" are adequately compensated for any damage to their vehicle and/or property, the above examples relate to costs imposed on "taxpayers" (a large but equally identifiable group). The only difference is that the costs are dispersed among all taxpayers rather than being sheeted home to particular motor vehicle owners. For a variety of good reasons, the government has not seen fit to require individuals or households to obtain insurance to cover all the real and perceived risk they may face.

1.7 Business NZ notes the Discussion Paper (p.4) states that in respect to the Regulatory Impact Statement (RIS) that *"Substantive RIS elements have been included in this discussion paper at a level that is reasonable given the stage of policy development. The Ministry of Transport has endeavored to adhere to the principles of the Code of Good Regulatory Practice."* While Business NZ accepts that at this stage in the policy development process, reasonable understanding of the costs and/or benefits of the proposal may be lacking, it is crucial that before proceeding to the next stage of policy development, reasonably accurate information is obtained, rather than simply proceeding based on a "perceived" problem with uninsured (or underinsured) motorists without examining the intended as well as possible unintended costs associated with the proposal. How such a proposal fits within the broader context of voluntary insurance in general would also be helpful.

1.8 Notwithstanding the above concerns with the proposals for compulsory third party vehicle insurance, Business NZ notes that in the Ministerial Foreword to the Discussion Document, the Minister for Transport Safety the Hon Harry Duynhoven states that:

> *"In most countries that already have compulsory vehicle insurance high-risk drivers (those with a poor driving history) have higher annual premiums. <u>Drivers can reduce their risk, and the size of their premiums, by adopting safer driving practices.</u> [emphasis added]. It may also act to dissuade novice drivers or high-risk motorists from driving high-risk or high performance vehicles"*

1.9 Business NZ essentially agrees with the Minister's endorsement of the experience-rating of premiums whereby responsible drivers are not required to subsidise irresponsible drivers, accepting that the nature of insurance is to pool risk within similar risk profiles.

[2] There may be cases where insurance is also required in respect to membership of some professional associations and in respect to some occupational regulation.

1.10 Business NZ notes that while private insurers already "experience-rate" to varying degrees, given the fact that ACC is effectively a monopoly service provider and insurer for all personal injuries suffered in motor vehicle accidents, "experience-rating" of premiums for personal injury should be investigated further. Currently, ACC premiums for motor vehicle accidents are effectively based on a flat levy structure irrespective of the size of car or person's previous claims history. This reduces the incentive to take appropriate care (on the margin), although accepting that very few, if any, people would deliberately go out to cause a road accident.

1.11 A number of road users, principally cyclists, pay nothing towards the cost of accidents involving motor vehicles (although it is accepted that if they have a car, they will contribute to ACC costs through both petrol taxes and relicensing fees). Meanwhile, motorcyclists are currently grossly subsidised by motor vehicle owners. Given the trend towards a greater use of motor cycles and/or bicycles (on road), it would be desirable to examine seriously whether ACC premiums should apply to those regularly using their cycles or motorcycles on-road, reflecting the true costs associated with accidents involving these forms of transport.

1.12 Business NZ notes that the PriceWaterhouseCoopers (PWC) Report on the ACC Scheme Review (March 2008) which was commissioned by ACC, noted in respect to experience-rating: "…*in our view, experience-rating which makes appropriate use of statistical credibility offers substantial fairness and economic resource allocation efficiencies, which if properly regulated, could outweigh the residual adverse incentive risk which may remain…" (p. xxxiii).*

2.0 Recommendations

Business New Zealand **recommends** that:

Compulsory third party vehicle insurance not proceed.

Without prejudice to the above recommendation:

Business New Zealand **recommends** that:

If a compulsory third party vehicle insurance (CTPVI) regime is introduced, then it be administered by the private sector as there is no justification for a state-administered scheme given that the government does not have to be a monopoly service provider to meet the social and economic objectives of an accident insurance scheme (which equally applies both in respect to property and vehicle damage as well as personal injury).

Business New Zealand **recommends** that:

Actions other than regulation be considered to help encourage individuals to obtain appropriate insurance cover, including education initiatives and website-based advice services. This should apply not only in respect to third party vehicle insurance but insurance in general.

Business New Zealand **recommends** that:

Consideration be given to the introduction of experience-rating in the ACC Motor Vehicle Account to ensure premiums paid by motor vehicle owners more accurately reflect the risk of motor vehicle accidents and the associated costs.

Business New Zealand **recommends** that:

Consideration be given to reducing the gross cross-subsidisation of motor cyclists and more particularly, cyclists, by on-road motor vehicle users in respect to the ACC Motor Vehicle Account.

3.0 General Discussion

3.1 Before coming to any decisions as to the merits or otherwise of the proposed regulations to introduce mandatory third party vehicle insurance, it is crucial that policymakers take a step back and ask some fundamental questions. These include – but are not limited to:

- Is there a problem *in New Zealand* with current vehicle insurance systems, including self-insurance options (i.e. are there significant issues of "market failure" which need to be addressed)?

- If there is a problem, is the problem significant?

- What are the costs and benefits (including unintended costs) of the proposals outlined in the Discussion Paper?

- Will the proposal to adopt compulsory third party vehicle insurance effectively address the alleged problem (and if so at what cost)?

- What are the potential options to improve outcomes which don't impose significant costs (e.g. by improving information to market participants)?

3.2 As a general principle, Business New Zealand considers that individuals and companies should bear the full costs associated with their behaviour (i.e. costs should be internalised) or individuals will over-consume resources if they can shift costs on to third parties. Motor vehicle insurance is no different in this respect. In order for individuals to make rational decisions in respect to vehicle insurance, they should ideally bear the costs (and benefits) associated with specific options/outcomes. On the other hand, if individuals and companies are forced to pay greater amounts than any costs those individuals and businesses impose (i.e. through the requirement to obtain third party vehicle insurance rather than self-insure), the outcome will be more cost impositions on those who willingly self-insure, which will ultimately be reflected in a higher price of vehicle insurance to consumers.

3.3 In order to justify government intervention, there must be a clear case of market failure and the problem of market failure must be significant. Moreover, there is a need to establish that any regulatory action will address the alleged problem in a cost effective manner.

3.4 Given that markets are generally faster at self-correcting than government intervention, the onus of proof must be on government to show beyond reasonable doubt that the benefits of intervention exceed the costs, including the unintended costs, associated with regulation (such as non-compliance).[3]

[3] It is noted on p.24 of the Discussion Paper that: *"In 2007, there were 83,487 infringement notices issued for using an unlicensed vehicle; 108,111 notices issued for failing to display valid evidence of inspection (WoF); and 947 notices issued for using an unregistered motor vehicle."*

3.5 There is an “optimal” amount of compliance, just as there is an optimal amount of resources that should be spent on crime prevention. Non-compliance cannot be completely eliminated, not at least without great cost (and even then probably not). It may be possible to reduce non-compliance, but beyond a certain point the marginal cost of taking action to minimize non-compliance becomes progressively higher, while the potential returns from taking action become less. In this respect it pays for companies and individuals to invest in risk minimisation strategies up to the point at which the marginal cost equals the marginal benefit of taking action. This equally applies in respect to making choices regarding vehicle insurance options, including self-insurance.

Problems with Compulsory Third Party Insurance

3.6 While Business NZ accepts that there may be some benefit associated with compulsory third party vehicle insurance, the costs are likely to outweigh any potential benefits.

3.7 Business NZ has outlined below a number of problems associated with compulsory third party vehicle insurance to back up its recommendation that compulsory third party vehicle insurance should not be introduced.

1. Is the problem significant?

3.8 Business NZ notes in the Ministerial Foreword to the Discussion Paper that: *“The insurance industry estimates that the cost of uninsured motorists is between $53.5 million and $85 million annually. At present those motorists who pay to have insurance pay this cost and subsidise the quarter of vehicles not currently insured in New Zealand.”*

3.9 There is no discussion as to whether this is large in the context of the vehicle insurance market nor whether insurers recoup some of this “cost” from uninsured vehicle owners either voluntarily or through the Courts. Presumably insurers will weigh up the costs and benefits of pursuing uninsured motor vehicle owners to seek payments either through voluntary contributions or through the Courts. Individuals are unique and will likely weigh up the consequences of obtaining full-insurance cover, third party insurance or self-insuring as the case may be. Given that a number of individuals take out only third party vehicle cover would suggest that they assume the potential risk of loss (i.e. their vehicle is written-off in the event of a crash) is worth taking compared to the annual premiums associated with full-insurance (given that most polices require the owner to carry a significant excess in the event of an accident causing damage to a vehicle). Moreover, a number of major vehicle fleets totally self-insure in the event of an accident causing damage to their own fleet and/or vehicles or property owned by third parties.

3.10 Compromises, such as only requiring certain (higher risk groups e.g. young people) to get compulsory third party insurance again would adversely impact on particular groups of people who would be caught by potentially high premiums simply because of their age, not necessarily their driving record and the activities they undertake.

3.11 It cuts right across consumer sovereignty to decide whether to fully insure, obtain third party cover, or simply self-insure based on unique circumstances. While insurance companies use of range of indicators in assessing risk (including experience-rating) to determine premiums charged, there will always be elements of cross-subsidisation given that the nature of insurance is to pool risks within similar risk bands. While some insurers will go to some lengths to try to accurately assess individual risk, the transaction costs of doing so makes it inevitable that some averaging takes place. In this respect, individuals often know more about their own risk profile than insurers, given that insurers cannot realistically take into account the uniqueness of every particular person seeking insurance cover. This is known in economics as "adverse selection", meaning that often premiums rise over time as "bad" risks come to light.

2. There is no reason to believe that making third party vehicle insurance compulsory will solve the alleged problem

3.12 Given a significant number of people fail to get their vehicles licensed, why would making third party vehicle insurance compulsory result in higher numbers of people obtaining (at least) third party insurance? The likely result is that "honest" people who would otherwise have chosen to self-insure, may obtain potentially costly third party vehicle insurance when they would have voluntarily paid out any costs imposed on third parties. This could have significant implications for fleet operators who choose to self-insure and/or young individuals in rural areas with low population density and/or risk of damage to third parties and/or elderly who do little driving and are well aware of their local environs. It would negatively impact on responsible transport companies with large fleets who often self-insure against damage to third parties vehicles and/or property.

3. Even if third party vehicle insurance could be enforced (notwithstanding the cost), there will still be a significant number of individuals who cause accidents on the road but will not be required to have insurance (e.g. cyclists).

3.13 A number of individuals who cause accidents on the road e.g. cyclists, presumably will not be required to license their cycles and/or obtain third party vehicle insurance, so arguably a significant number of accidents resulting in damage to vehicles and/or property will not be covered by the proposal (assuming for a moment that most of those required to obtain third party vehicle insurance actually obtain it – which is highly debatable).

4. The cost of enforcement is likely to be prohibitive

3.14 Unless very costly capital equipment and/or random checking by enforcement officers take place, it will be impossible to ensure high levels of compliance. The costs of such enforcement need to be borne in mind, compared to any potential benefits of compulsory insurance. It is noted that the Discussion Paper states (p.24) that in 2007 there were 83,487 infringement notices issued for using an unlicensed vehicle. Presumably the number of infringement notices issued does not necessarily cover even a majority of vehicles which are travelling on the road but are unlicensed, so the number of vehicles unlicensed is likely to be significantly more than issued infringement notices, although quite possibly some vehicle owners will be issued multiple infringement notices over the period of a year.

3.15 Unless New Zealand moves down the path towards “smart cards” or a similar mechanism that can determine whether a car is licensed and/or contains details of insurance policies (which would likely to result in significant capital costs and issues surrounding potential commercial confidentiality for insurance companies (see below)), the process of random checking (which currently occurs) still leaves significant non-compliance in respect to licensing so it is difficult to understand why this would necessarily change in respect to requiring compulsory third party vehicle insurance.

5. Potential for commercial confidentially issues to arise

3.16 There is potential for enforcement to require greater coordination (data sharing) between vehicle licensing authorities and insurance companies. This might or might not raise transaction costs and/or issues of commercial confidentiality for individuals and insurers which ultimately would be reflected in higher overall premiums to consumers, or subgroups of consumers.

3.17 Given all of the above issues, Business NZ considers that compulsory third party vehicle insurance should not proceed at this time. This conclusion notwithstanding, Business NZ considers there may be merit in providing greater information to individuals and businesses as to the risks they face in respect to both vehicle and property damage and the need to ensure adequate coverage, taking account of unique circumstances. This information campaign should not necessarily apply only to motor vehicle insurance but to insurance in general, given that many people appear not to be fully informed as to the benefits and costs associated with obtaining insurance in respect to property, health, or other risks faced by individuals and businesses on a daily basis.

3.18 While it could be argued that individuals bear the costs and benefits associated with sub-optimal decisions and therefore there should be no role for government (possibly contracted to the private sector to undertake), potentially the costs associated with such a campaign would be significantly lower than any provision to make third party vehicle insurance compulsory and would arguably have a better outcome than blanket compulsion. It is noted in this respect that "Financial Literacy" is now being given much more prominence in schools which is an excellent initiative towards ensuring young individuals are more aware of the risks and trade-offs involved in making various financial decisions. Presumably management of risk through appropriate insurance cover will be part of this education campaign - something Business NZ would support.

Business New Zealand **recommends** that:

Compulsory third party vehicle insurance not proceed.

Without prejudice to the above recommendation:

Business New Zealand **recommends** that:

If a compulsory third party vehicle insurance (CTPVI) regime is introduced, then it be administered by the private sector as there is no justification for a state-administered scheme given that the government does not have to be a monopoly service provider to meet the social and economic objectives of an accident insurance scheme (which equally applies both in respect to property and vehicle damage as well as personal injury).

Business New Zealand **recommends** that:

Actions other than regulation be considered to help encourage individuals to obtain appropriate insurance cover, including education initiatives and website-based advice services. This should apply not only in respect to third party vehicle insurance but insurance in general.

Business New Zealand **recommends** that:

Consideration be given to the introduction of experience-rating in the ACC Motor Vehicle Account to ensure premiums paid by motor vehicle owners more accurately reflect the risk of motor vehicle accidents and the associated costs.

Business New Zealand **recommends** that:

Consideration be given to reducing the gross cross-subsidisation of motor cyclists and more particularly, cyclists, by on-road motor vehicle users in respect to the ACC Motor Vehicle Account.

APPENDIX 1

BACKGROUND INFORMATION ON BUSINESS NEW ZEALAND

Business New Zealand is New Zealand's largest business advocacy organisation.

Through its four founding member organisations – EMA Northern, EMA Central, Canterbury Employers' Chamber of Commerce and the Otago-Southland Employers' Association – and 70 affiliated trade and industry associations, Business NZ represents the views of over 76,000 employers and businesses, ranging from the smallest to the largest and reflecting the make-up of the New Zealand economy.

In addition to advocacy on behalf of enterprise, Business NZ contributes to Governmental and tripartite working parties and international bodies including the International Labour Organisation, the International Organisation of Employers and the Business and Industry Advisory Council to the Organisation for Economic Cooperation and Development.