

FEATURE

THE MAGIC PUDDING - UK MOTOR INSURANCE

Motor insurance in the UK has been very controversial in recent years particularly with regards to bodily injury claims. In this article, Geoff Atkins and Jamie Reid summarise the developments and trends in the UK motor market, causes of these trends and UK government responses. It examines the lessons learned in the UK and whether they are relevant for Australian jurisdictions.





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We first look at the large industry of businesses that help innocent victims of UK car accidents get the compensation due to them. The system involves claims management companies, personal injury lawyers, after the event insurance, and credit hire companies, all of which concurrently provide their services at absolutely no cost to the claimant.

CLAIM MANAGEMENT COMPANIES (CMCs)

People involved in a motor accident in the UK can engage a CMC to help them claim compensation from an insurance company. The CMCs will do all the work in running the claim, organising a solicitor and repairer as well as dealing with the insurance company and the court. There are more than 3,000 CMCs in the UK.

Advertisements for these companies are a common sight in the UK media. CMCs use a range of techniques to generate their business, from TV ads through to upfront cash payments to clients.

CMCs have sometimes generated controversy, with a government minister recently publicising examples of “misleading marketing, high pressure selling, unfair contracts, poor customer service, outright scams and fraud”.

In 2007, the UK government established the Claims Management Regulator to oversee CMCs. Some marketing techniques such as cold calling are now illegal, although there are a number of examples of this continuing.

PERSONAL INJURY SOLICITORS

In addition to obtaining referrals from CMCs, some solicitors advertise directly to people who have been involved in motor accidents.

Promotional material typically states that no costs are payable if the claimant doesn't receive compensation. If the claimant is successful they are promised one hundred per cent of the amount awarded, with all the solicitor's fees recovered from the other party.

Solicitors refer to these arrangements as Conditional Fee Agreements (CFAs). The CFA includes a success fee payable to the solicitor if the claim succeeds. This success fee is also currently recovered from the losing party.

Since publically funded legal aid is not available for UK personal injury claims, CFAs protect injured parties from the cost uncertainty of legal action. However, CFAs are also often used when liability is admitted and an injury is clear. The solicitor is therefore able to claim a success fee, even though there was (almost) no possibility of losing the case.

AFTER THE EVENT (ATE) INSURANCE

CMCs or personal injury solicitors can arrange insurance to cover the cost of legal action. The name “after the event” (ATE) refers to the fact the insurance is purchased after the injury has occurred.

The insurance covers the claimant's legal expenses if the legal action is unsuccessful. If the claimant is successful, they will get to recover legal costs (including the insurance premium) from the other party. The premium is typically not payable until the legal action is completed, and may not be payable at all if the legal action is unsuccessful.

FOR THOSE UNDER THE AGE OF 50

The Magic Pudding: The Adventures of Bunyip Bluegum is a classic Australian children's book by Norman Lindsay. It tells of a magic pudding which, no matter how often it is eaten, always re-forms in order to be eaten again. The pudding is owned by three friends who must protect it against Pudding Thieves.

THE “SUPER-CLAIMANT”

A recent UK government report described how plaintiff law firms use ATE insurance as part of a package of measures to create a “super-claimant”.

Clients of the law firm are offered a package comprising a CFA (on a no win, no fee basis, but with a success fee of one hundred per cent of costs), ATE insurance (premium ranging between 20–65 per cent of costs) and third party funding of the above.

However, this package means that the other side will face a significant cost burden if the legal action is lost, which would include the costs of both sides (as usual), plus the ATE premium and the success fee (together up to 165 per cent of costs).

The super-claimant therefore has minimal exposure to costs liability, whereas the opponent has a very substantial exposure to costs risk. This would incentivise the opponent to settle early, while the ATE insurance premium and success fee remain at a low level.

CREDIT HIRE

Other services provided by CMCs include arranging replacement vehicles and co-ordinating any repair works. The costs of these services are recovered from the at-fault driver's insurer.

If you are not at fault, British law entitles you to a replacement vehicle while the damaged car is being repaired. Credit hire businesses are able to attract customers (and create cost pressures for insurers) by offering a "like-for-like" replacement vehicle at no cost, whether this is a Mini or a Mercedes. There have been examples of very large claims against insurers for the use of prestige vehicles for long periods of time.

Insurers have observed that repair periods are longer when credit hire vehicles are provided. Customers may not be in a hurry to get their cars back if the replacement vehicle is just as good.

REFERRAL NETWORK

An extensive referral network has developed to facilitate insurance claims. For example, CMCs pay referral fees to tow truck drivers, medical receptionists, repair shops, insurance brokers, and emergency workers. The CMC will then earn a referral fee from the personal injury solicitor and credit hire company if their services are required.

The cost of referral fees are inevitably paid by the at-fault vehicle's insurer because they end up as part of the costs that are compensated in the legal fees, car hire, and after the event insurance premiums.

Perhaps surprisingly, motor insurers sometimes participate in the referral network, earning a fee for referring their own customers to personal injury solicitors following a not-at-fault accident.

FRAUD

UK motorists who are not injured are increasingly helping themselves to a slice of the pudding through exaggerated and fraudulent claims.

Whiplash is a term used to describe injuries to the neck or spine following a sudden strain, for example, in a rear-end motor collision. According to the Association of British Insurers (ABI), one in every 140 people in the UK claimed for whiplash

"Despite the statistics I doubt that the UK has some of the weakest necks in Europe. Often difficult to diagnose, easy to fake and exaggerate, whiplash is a fraudsters dream."

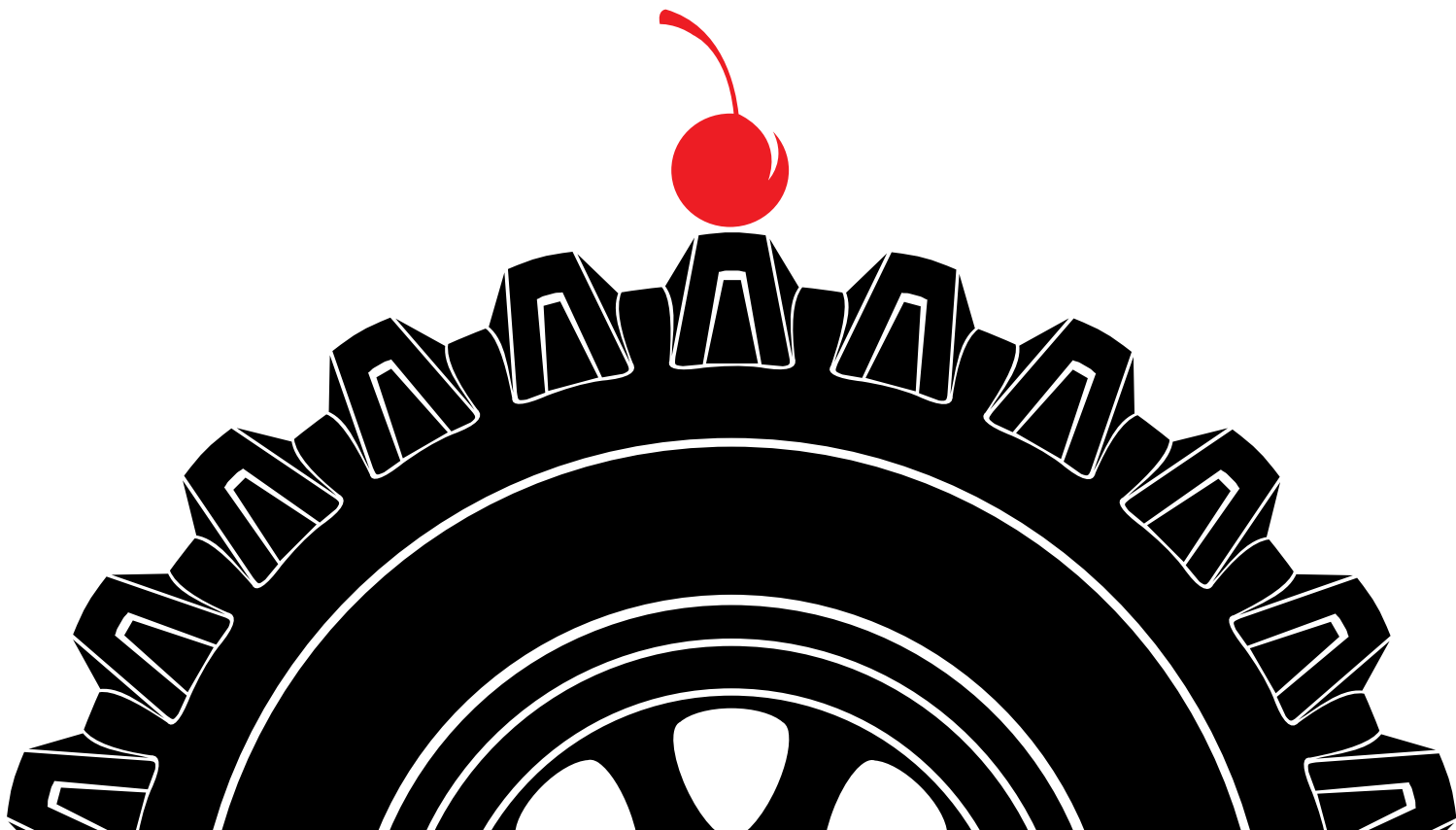
— Assistant Director of Motor and Liability, Association of British Insurers (ABI)

last year. Three quarters of UK personal injury claims are for whiplash, with a total cost to insurers of around £2 billion per year (compared to premium income of around £10 billion). Other common scams identified by the ABI include;

Phantom passengers – following a minor crash, the driver exaggerates the number of people in the car so that his friends can also submit whiplash claims.

Crash for Cash – a car causes a collision with another vehicle, for example, by braking sharply on a roundabout, possibly with brake lights non-operational. The fraudster will then make a claim for personal injury (usually whiplash), possibly with phantom passengers.

The ABI estimated the total cost of fraudulent motor insurance claims at £360 million per year.



PREMIUMS

The number of UK motor accidents has reduced in recent years, due to improved vehicle safety and other initiatives. However, the total cost of bodily injury claims has been increasing at around thirty per cent p.a. Cost pressures include both increasing claim size (for example, due to legal expenses) and increasing claim frequency (for example, from whiplash).

The UK motor insurance industry has not been profitable for the last 16 years. Motor insurers made an underwriting loss of almost £2 billion in 2010, equivalent to around 17 per cent of premium.

Insurance premiums have risen significantly as insurers move to reduce losses. At October 2011 average premiums were double the level of four years earlier. Average premiums increased by forty per cent in the year to March 2011.

While motor insurance is compulsory in the UK, one consequence of high premiums is that many drivers choose not to insure. Since the cost of certain claims from uninsured drivers is met by a levy on all insurers, this further increases pressure on premiums. It has been estimated that approximately one out of every twenty motorists drives without cover, and that this adds about £30 a year to the average motor premium.

GOVERNMENT RESPONSE

The increases in premiums over the last couple of years may trigger a meaningful response from the UK government. Lord Justice Jackson was commissioned to review the costs of civil litigation, and published his final report in December 2009. The recommendations of the review included:

- banning referral fees
- fixing the amount of legal costs that can be recovered for smaller claims (up to £25,000)
- stopping successful claimants recovering success fees and ATE premiums from the losing party
- encouraging people to purchase "Before the Event" legal expenses insurance.

In September 2011, the UK government announced it would introduce legislation to ban referral fees, and require success fees to be paid by claimants rather than the defendant. Announcing these proposals, Justice Minister Jonathan Djanogly said, "Honest motorists are seeing their premiums hiked up as insurance companies cover the increasing costs of more and more compensation claims. Many of the claims are spurious and only happen because the current system allows too many people to profit from minor accidents and incidents. (The changes) will make claimants think harder about whether to sue".

Stopping the recovery of success fees should give claimants more interest in the cost of litigation, encouraging people to "shop around" for the solicitor offering the best value.

LESSONS FOR AUSTRALIA

Many personal injury schemes in Australia have been through "out of control" periods, when the cost of claims increased rapidly through the behaviour of accident victims and various service providers taking advantage of "the magic pudding" of other people's insurance premiums.

A crucial difference between Australia and this recent UK experience is that, at least for our motor accident (CTP) and workers' compensation schemes, there is a state regulator of some kind with a degree of responsibility for balancing the interests of premium payers and injured persons.

In the case of UK motor this scheme regulator was (and still is) completely absent. The 2007 attempt by the Department of Justice to regulate the Claims Management Companies by registration and monitoring seems to have been spectacularly unsuccessful in dealing with the underlying issues.

It comes as quite a surprise that the country of origin of our legal system and traditions could encounter this problem so recently, and be so slow to react. Having always regarded the legal system in the UK as relatively conservative and sensible, the idea that this litigation system could spawn such a large and robust industry of businesses and people taking advantage of the magic pudding of unregulated insurance premiums was difficult to accept.

The lessons to be learned include:

- making it too easy to claim will incur an inevitable cost
- an industry supporting claimants at the insurers' expense is very difficult to control and can grow unnoticed
- full restoration (including all costs of restoration, advice and protection) will not be affordable without direct cost constraints such as scheduled fees
- general damages for minor injuries is a difficult area of compensation
- sadly, human nature must be regarded from a cynical perspective in insurance scheme design. ■

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