Injury Schemes Seminar

Road to Recovery

8-10 November 2015
Hilton • Adelaide

Actuaries Institute

The Role of the Regulator in Statutory Schemes: The Guardians of Sustainability

Prepared by Geoff Atkins and Andrew McInerney

Presented to the Actuaries Institute
Injury Schemes Seminar
8 – 10 November 2015
Adelaide

Institute of Actuaries of Australia
ABN 69 000 423 656
Level 2, 50 Carrington Street, Sydney NSW Australia 2000
t +61 (0) 2 9239 6100 **f** +61 (0) 2 9239 6170
e actuaries@actuaries.asn.au **w** www.actuaries.asn.au

Scheme Regulator - The Guardian of Sustainability

Abstract

The purpose of this paper is to examine the role of the regulator in a compensation scheme and identify how the design and operation of the regulator impacts on scheme outcomes.

The regulator should be thought of as ***'The Guardian of Sustainability'*** for the scheme. The regulatory role is critical in maintaining the effectiveness and efficient operation of a compensation scheme.

This paper considers the various functions a regulator has and identifies what best practice looks like in a modern and well-functioning scheme.

Keywords: role of the regulator; guardian of sustainability; dispute resolution; scheme culture.

1 Introduction

Financial and social sustainability is a fundamental goal for a successful compensation scheme – compensation schemes are part of our social fabric, and they need to avoid wild swings in design and/or cost to maintain their credibility.

What influence then, can the Regulator have on managing both elements of this sustainability? The subtitle of this paper, 'The Guardian of Sustainability' is what we believe this role should be. Political considerations mean this role cannot be left to the government of the day, and nor can it be performed by the insurers.

There is some factual background on the major schemes and regulatory arrangements for Motor Accidents (MA) and Workers Compensation (WC). Most of the paper is devoted to various functions of the regulator, with a final section on scheme culture. We have avoided comparisons or evaluations of existing arrangements in order to focus thinking on the future.

The opinions put are those of the authors, not of their employer or any of their clients. The opinions are meant to be challenging in order to stimulate serious thinking about what works, what doesn't and what might be ideal in a particular scheme situation.

1.1 Who or what is a scheme regulator?

A regulator is a person or body that supervises a particular activity, usually with the intent of ensuring it works effectively and fairly. In looking at different definitions of what a regulator is, the definition of a 'mechanical' regulator (i.e. a device that is used to regulate parts of a mechanical system) also had some appeal: "a subsystem or independent device that determines and maintains the operating parameters of a system, usually within certain prescribed or preset limits." Indeed keeping a compensation system operating within preset financial and social limits seems to nicely fit our suggested approach to what represents sustainability!

For those involved in the private sector it may help to consider this in the context with which they are familiar. In the financial services sector, including insurance, there are three main regulatory bodies:

- APRA – prudential
- ASIC – market conduct
- ACCC – competition.

1.1.1 Prudential regulation

APRA prudentially regulates private insurers writing MA or WC insurance, although it does not regulate government insurers or self-insurers. Some of the scheme regulators operating in competitive markets also try to undertake some form of prudential regulation. This is a waste of time and money. Scheme regulators should leave this job to APRA, while using a Memorandum of Understanding to ensure information sharing with APRA and licencing rules to ensure timely disclosure from insurers.

For a monopoly scheme prudential regulation is the responsibility of the state government. It should be undertaken by the Treasury & Finance department as the manager of government finances. There are always various laws that public sector entities must comply with and these should be supplemented with 'prudential insurance standards'.

Self-insurer prudential regulation is the responsibility of the scheme regulator and involves minimising the chance that a self-insurer will default on its liabilities to claimants.

1.1.2 Market conduct regulation

The scheme regulator is directly responsible for market conduct – the products and services, the way insurance and claims are handled and how market participants and service providers interact. In financial services this is the role of ASIC. By way of example ASIC is responsible for the Insurance Contracts Act, the Agents & Brokers Act and the Financial Ombudsman.

It may not be intuitive, but the scheme regulator is much more like ASIC than APRA.

1.1.3 Competition regulation

For a MA or WC scheme there is no separate place for competition regulation alongside market practice. Whether it is price competition among insurers or competition in the various service provider markets, this is an integral part of the market conduct regulation.

In insurance and other financial services, ASIC actually takes direct responsibility for most competition matters, with the ACCC being involved in a responsive mode only.

1.2 Monopoly and competitive underwriting

There are clearly differences in roles and functions for scheme regulators between:

- Monopoly (state underwritten) schemes, whether or not external claim agents are used
- Competitive (privately underwritten) schemes, which have a distinct state regulator.

Through the report we discuss these differences in the relevant sections.

2 Regulator Structure and Funding

2.1 Competitive markets

In a competitively underwritten scheme it seems clear enough that the regulator must be a government entity separate from the insurance function. The regulator is focused on scheme oversight and management of stakeholders. Insurers are focused on premiums, management of claims, customer interactions and, of course, shareholder value (the polite term for profits).

The regulator will be established by the scheme legislation. It should have its own legal identity, staff and branding. There will be a responsible government department and Minister, although a primary aim should be to maintain political independence in how the regulator performs its role.

2.2 Monopoly markets

In a monopoly scheme it is not essential that the regulator be a separate legal entity from the insurer. In Queensland and NSW WC it is separate (very recently so in NSW), while in Victoria and South Australia WC it is part of the insurer. The monopoly MA insurers do not have separate regulators other than in very limited roles such as premium approval.

The critical feature for these schemes must be that the regulatory division is, and is seen to be, able to make decisions independently of the insurer. Distinct branding is advantageous and the regulatory division should have a direct reporting line to the Board. Either way, it can put the scheme regulator in a difficult position if the insurer CEO is running a different view based on how they want things to run for the insurance side of the business.

This structural decision in a monopoly scheme is important and has different implications for different roles, which we return to later in the paper.

2.3 Regulator governance

A regulator separate from insurers is best structured with its own Board of Directors – a relatively small board chosen for relevant commercial expertise and not for stakeholder representation. The Board is for oversight only – in general it is not a decision making body.

For a regulatory division inside a monopoly insurer it can assist if one or a small committee of Board Directors is designated to have special responsibility for oversight of the regulatory functions.

2.4 Funding the regulator

The regulator should be funded by a small levy on premiums. Funding independent of government budgets increases the distance of the regulator from political decisions. It also gives the ability for the regulator to invest either more or less in certain areas for the benefit of the scheme.

2.5 Staffing the regulator

Suitable staffing is important – effective management requires a specialist skill set with domain knowledge of insurance markets, and it would be dangerous to assume that a broad based management or bureaucratic skill set can necessarily meet these requirements.

A state agency will be subject to public sector employment rules which can sometimes be disadvantageous in terms of pay limitations, keeping specialist skills and career progression. Nonetheless there are very fine government agencies that operate in this environment and there is no reason to not accept this challenge. Some of the monopoly insurers have different employment rules that give them greater flexibility, which may be one reason to consider the combined structure.

3 Dispute Resolution

The dispute resolution system is one of the critical elements in a sustainable scheme. It needs to be fast, inexpensive and consistent.

3.1 The regulator should be the dispute resolver

In our view the optimum structure is for the regulator to be the entity responsible for the resolution of most disputes. Dispute resolution in the context of compensation schemes should be viewed as an operational function, not a policy function, and to that extent has different considerations.

An independent dispute function such as the courts or some tribunal has no line of sight, or any mandate to care about, scheme sustainability. Each case is considered individually in an adversarial system. It is not unknown for trends within the dispute system, outside the influence of the regulator, to take a scheme off the pathway of sustainability.

The nature of accident compensation schemes lends them to an **administrative resolution process** rather than a judicial one (with the support of independent medical experts when required on specific questions). Great progress has been made in Australia in designing administrative tribunals that are more inquisitorial than adversarial. Decisions can be made in one place by people with extensive subject matter expertise and within a framework of objectivity and procedural fairness.

With few exceptions a MA or WC claim is not so complex or unusual that it needs a court hearing to decide it. The law is well established, the types of evidence that may be relevant are clearly defined, and a hearing conducted on an adversarial basis is not necessary to achieve justice.

The dispute tribunal, then, is a part of one function of the scheme regulator.

3.2 Organising the dispute resolution function

3.2.1 Internal review

The first stage of dispute resolution is an 'as of right' internal review by the insurer. Processes for these reviews are now well established. The regulator will have an interest in, and oversight of, the internal review operations of insurers.

3.2.2 External review

A large number of disputes are medical in nature, while others involve factual decisions on causation, earnings and the like and/or interpretation of the laws. The dispute resolution system will accordingly have two streams – a medical stream and a factual/legal stream.

The medical and legal parts of the tribunal should be operated under a single registry system, with active management by an Intake Officer to get all parties and documents in order as quickly as possible. If the only issue in dispute is a medical one, then an Independent Medical Assessor will be used.

As soon as information is exchanged there will be a compulsory mediation.

If the mediation is unsuccessful then a case is listed for hearing almost immediately (within about two weeks) and the arbitrator makes a decision.

3.2.3 Appeal

Natural justice requires a level of appeal from a tribunal decision at first instance. For medical issues, the appeal should involve a Medical Panel. Other issues will be dealt with on appeal by senior members of the tribunal.

3.2.4 Escalation to Court

There are two different issues regarding escalation to the court. Firstly, there are sometimes important or novel issues to resolve and the tribunal may refer such cases directly to the court. The regulator should not hesitate to sponsor and fund relevant test cases in the court.

Secondly, there is likely to be some process of judicial review, which we understand is part of administrative law and is available only on 'points of law'. In NSW (for example) the number of judicial reviews has been increasing in recent years, and in many of these cases it is a stretch to consider that the grounds really are points of law. This trend is a sign that the dispute system is not working and should lead to a systemic response by the regulator. If necessary a 'leave to appeal' system may be needed.

3.3 A monopoly scheme regulator within an insurer

If the regulator is a division of the monopoly insurer, then it cannot be the forum for dispute resolution. In this case there will need to be another independent body, whether a specialist tribunal just for the scheme or a general 'administrative appeals tribunal'.

In our view either of these structures is less desirable than the regulator being the dispute resolution system. Within the regulator there can be true dedication to the sustainability of the scheme without having any bias on individual decisions. External tribunals (specialist or generalist) are unlikely to be concerned with sustainability and can tend to 'pursue justice' beyond the economic and social significance of the cases.

If the tribunal is a separate entity from the regulator then there needs to be an open and constructive relationship about 'how the system is working' (not about individual cases).

3.4 Measurement and accountability

Each aspect of the dispute resolution system needs to be routinely assessed – volumes, timeframes, costs and resolution rates. Making this assessment does not require examining who wins or loses.

The scheme regulator has this role, whether the dispute resolution system is part of its own organisation or external. The regulator needs to maintain active oversight, to make various players in the dispute system accountable for their performance (including itself) and to be ready to make adjustments when needed.

4 Stakeholders and service providers

We have a basic view that the true stakeholders in a compensation scheme are insureds (employers and motorists) and claimants. We think of everyone else living off the system as a service provider. The insurer does have a different character from other service providers because it is taking the underwriting risk for the scheme, not just earning its fee revenue.

4.1 WC – Regulator relationship with individual employers

It is up to the insurer to run the insurance relationship with the employer – registration, information collection (such as wages and industry class), issue of documentation, setting and collecting premiums and responding to claims.

The regulator will, in a competitive market, have a lot to do with setting, auditing and reviewing the standards for these activities.

Are there any direct regulator to employer interactions? Not normally. The interactions are likely to be:

- Providing basic information and query responses
- Response to complaints
- Dealing with disputes about premiums or industry classification
- Enforcement of non-compliance.

The regulator may disseminate information to employers, but will generally find that this is better done through insurers.

We do wonder if enforcement functions for non-compliance could be done by the WHS regulator, although the skills needed differ (accounting rather than safety) and we are not convinced. We take a look at the WHS regulation issue a little later.

4.2 MA – Regulator relationship with individual motorists

Essentially none. In most schemes all dealings with motorists are done through the vehicle registration system and authorities, and enforcement is the responsibility of the police.

In a competitive insurance system there will be some role for basic navigation information for motorists. If the premium rating system is complex there might be a complaints mechanism run by the regulator.

4.3 Regulator relationship with individual claimants

It is the insurer's job to deal with claimants and, apart from the structured dispute resolution, involvement by the regulator will not help. In our view the role of the regulator should be limited to the passive provision of information (website) and navigation assistance. Taking on individual complaints is not a productive use of resources and does not contribute to sustainability; that said, where systemic issues are identified with the behaviour of an insurer through the complaint procedures, then it is

entirely appropriate for the regulator to engage with the insurer to ensure their behaviour meets the requisite standards.

4.4 Regulation of Service Providers

Firstly, the service providers that we want to consider here are:

- Acute care providers – ambulance, hospitals, emergency departments, clinics
- Primary and secondary care providers – GPs and specialists including psychologists and psychiatrists
- Rehabilitation providers (both medical and occupational)
- Ancillary healthcare providers (physio, pharmacy, occupational therapy, etc)
- Lawyers
- Investigators
- Medico-legal experts (doctors whose role is to prepare reports but not to provide treatment).

That is already a long list. Before moving into it, we want to suggest a 'significance test':

(a) If work for the compensation scheme is a minor part of the business of the service provider (individually or as a group) then the scheme regulator does not need to pay any special attention. It may communicate from time to time with a professional or peak body but generally only in response to an identified issue. The regulator will want to be concerned that the scheme is not being taken advantage of by unrealistically high fees, but this can be tackled on an exception basis.

(b) If work for the compensation scheme is a major part of the business of the service provider (individually or as a group) then the scheme regulator needs to take a greater interest and continuously consider how the system is operating and whether intervention is needed.

4.4.1 The regulatory tool kit

In managing, influencing and intervening with service providers the regulator potentially has quite a large tool kit, including:

- Training
- Accreditation
- Practice guidelines
- Fee regulation
- Practice-level monitoring
- Outlier responses

- Peer practice reviews
- Regulator review
- Enforcement – professional and legal.

For example, the TAC is a small part of the work of trauma and acute providers – that is, ambulances and hospitals – but is a big part of the work of rehabilitation hospitals. It does not actively manage trauma provider performance (only on exception basis) but needs to have a more active role with the rehabilitation hospitals.

For a monopoly insurer, the insurer should take responsibility for understanding provider performance, with the regulator responsible for establishing standards and escalating enforcement.

In a competitive market the regulator may (depending on the priority) need to do its own provider performance monitoring and intervention. The regulator will need to be selective in determining priorities as per the significance test above.

Any regulatory intervention will cost money, and sometimes can have unintended consequences. The judgements about whether, when and how to intervene are not easy.

One lesson learned with the medical and allied health providers is that peer practice reviews work well. The scheme regulator works with the professional body or college and ensures that it is a respected member of the professional body that undertakes the practice review. The medical colleges and most of the allied health professional bodies want good quality from their practitioners and have an incentive to support the regulator.

Lawyers and medico-legal experts fall into a different category from the treating professionals. The subject is a fascinating and important one, but is a question of scheme design more so than regulator role and is not addressed further in this paper.

4.5 Managing insurers

In a competitive market a key role of the regulator is oversight of insurers. Insurers will need to apply for the opportunity to write business, and the regulator needs to assess any application. Of course in a stable market this happens rarely.

So what is the regulator's function for an existing pool of insurers? By and large there are a broad range of rules and standards for insurers in each jurisdiction, but very little in the way of effective sanctions. Mostly the only sanction available is a threat to take the license away.

Keeping insurers on the straight and narrow tends to be done rather more by cajoling, and most regulators feel it is important to maintain good relationships with the insurers. Sometimes, though, we think the regulator will need to take a tougher line. A more graduated set of sanctions would help, likely to involve administrative fines and/or name and shame.

4.6 Self-insurers (in WC)

Authorising and supervising self-insurance is a significant role in WC schemes. In a monopoly scheme this is easier to structure and execute when the regulator is a separate entity. There will always be a perception (and sometimes a reality) that the monopoly insurer is in competition with, and does not like, self-insurers. In our view this is a bad outcome.

The system for self-insurance is outside the scope of this paper. Suffice to say that in our view the regulation in each of our jurisdictions is more than adequate.

4.7 Managing agents

A few of our schemes have outsourcing contracts with claims management agents (sometimes policy management as well). Responsibility for managing the agents rests squarely with the monopoly insurer, not the regulator. If the regulator is dissatisfied with something, it needs to make sure the insurer gets its agents to fix it – an agency relationship allows outsourcing of the operational activity, but it does not diminish the responsibility for those actions.

5 Other regulator roles

In addition to the dispute resolution and stakeholder and service provider management functions discussed above, the regulator also has a number of other specific functions as described below.

5.1 Relations with Government

An accident compensation scheme is not an arm of government. The insurance is compulsory, but it is insurance, with premium payers and claimants.

One feature of sustainable schemes is that they are able to avoid becoming politicised and subject to short-term politically based decisions.

How can the regulator be a guardian of sustainability in this situation? Continuous attention will be needed to manage relations with government, with the challenge of being cordial without giving the impression of any desire to please government. Ministers, ministerial staff and departmental staff are likely to change more often than the regulatory staff, hence the need for continuous attention and clarity on 'how things work here'; a pre-prepared education process may be worthwhile.

This goal is far easier to achieve for a MA scheme than for WC. With WC it seems inevitable that the regulator will need to have its own relationship with employer and worker advocacy groups. It is another challenge to make this work effectively and maintain stability.

This is a very short section of the paper, but that is not to say that it is not important. It is easier said than done and when it is working well you don't notice.

5.2 Making and interpreting rules

The regulator is a key adviser to government on rule making – both legislation and regulation. In our view it should also have a role in making subsidiary rules itself, helping to keep the system functioning and avoiding the difficulty of getting Parliaments to change legislation or Ministers to make regulations.

As a guardian of sustainability the regulator may also play a role in interpreting rules – advising on what the regulator believes is an optimal interpretation and, if necessary, supporting steps to achieve legal certainty whether through government or courts.

5.3 Regulating premiums

In a competitive scheme the regulator will have some role in approval or oversight of premium rates. Having worked through the evolution of different schemes and proposals, we have formed the view that 'less is more' in this regard. Tighter and tighter regulation of premiums seems to be a pathway to continuing problems as the system (read insurers) adapts and find other ways to pursue their commercial objectives.

The WC schemes in Western Australia and Tasmania seem to us to have a pretty good balance. They know what insurers charge (see the later section on data), they publish scheme wide data and 'suggested' rates, both of which contribute strongly to an

orderly market. There is a backstop protective mechanism for employers, but it is administered in a way that very few employers actually benefit from it.

5.4 Regulating prevention

Reducing accidents is an important social and economic goal, and potentially also a financial one if the prevention activities come at a sensible price. What part does the scheme regulator have?

In WC, this starts with the question about whether the WC regulator is joined with or part of the WHS regulator. We tend to favour them being in separate organisations, the primary reason being focus.

Within a single entity, the WC regulation and WHS regulation will be in separate divisions or branches, but it seems that the competition for resources and attention often outweighs any synergy benefits. Active co-operation can sometimes be more effective between separate entities if it is structured well.

For MA the corresponding activity is road safety. Our view is that the MA scheme is, if anything, a contributor to funding and little more. Road safety is the purview of road builders, rule makers and enforcers; vehicle safety is the purview of manufacturers; and road user education is reaching the point of diminishing returns. There is a vast amount of technical knowledge and research on road safety which does not reside in a MA scheme regulator.

If the scheme is contributing funds there comes with it some responsibility to influence the effective use of those funds. Most important, as the guardian of sustainability, is to prevent the MA scheme becoming the 'magic pudding' of funding in an area where resources are always scarce.

5.5 The Uninsured back-up arrangements

All of our schemes have provision to meet claims when the employer or motorist did not buy insurance or cannot be identified. The regulator is responsible for this back-up arrangement, variously referred to as a nominal defendant or uninsured employer scheme.

We do not favour the regulator running its own claims operation for this arrangement. There are various ways of organising for the insurer(s) to run the claims, with the financial liability being met by the regulator and absorbed into premiums and levies.

The regulator may also have 'legacy' liabilities from previous schemes and similar comments apply. Less frequent but more disruptive is the insolvency of an insurer. Most competitive schemes experienced a major disruption with the collapse of HIH/FAI and fortunately there has been nothing since. Nonetheless there needs to be a contingency plan both for funding and for claims management.

5.6 Central statistical data

Management and influence of a scheme is so much easier when it is evidence-based. While not the only source of evidence, a key component is the collection and analysis of a considerable amount of data.

With rapid improvements in technology, collecting large volumes of data does not require the same cost and burden as it once did.

The scheme regulator (or insurer in a monopoly scheme) should own and operate a central statistical system which records data at a granular level (but which is not driving functions or workflow). In order to be successful:

- The data requirements need to be clear, streamlined and consistent over time, and
- Insurers need to contribute data in a timely manner.

Uses of the data, both regular and ad hoc, include:

- Monitoring performance of insurers, industries or segments
- Tracking performance of the scheme, especially for emerging pressure points
- Identifying outlier providers for intervention
- Fraud detection.

6 Scheme culture

Scheme culture is an intangible but vital outcome that arises over time from the outworkings of various elements of the scheme's design and operation.

It can be described as 'the way we do things around here' or 'the norms of beliefs, values and behaviours shared by participants in the system'. By its very nature, culture is subtle and intangible; efforts to overly define it are unhelpful.

6.1 You can't legislate for culture

It is not possible to legislate for culture. Regulations, rules, handbooks and the like do not create or change a culture. The best they can achieve is to give some guideposts to the types of behaviour that are desirable, or otherwise, in the interests of scheme objectives.

6.2 How can culture be influenced?

Some of the available mechanisms are:

- Starting at the top with the messages and behaviours of the leadership
- Maintaining a focus on system level outcomes, and accepting responsibility for all that underlies these outcomes
- Setting clear and realistic expectations for the scheme, stakeholders and service providers
- Genuine independence of decision makers
- Breaking down adversarial features such as 'duelling doctors'
- Minimising the need for service provider involvement in the scheme (while a base level of services will always be needed, high levels of unnecessary involvement encourage rent seeking behaviours)
- Making extensive use of behavioural science (e.g. the 'nudge' theory).

6.3 Can or should culture be measured?

Our short answer is yes. Continually assessing and guiding the scheme culture is a high-value activity for a guardian of sustainability, although one will not find it in the legislation (see 6.1 above). The Board of the regulator can take ownership of this task, by:

- Being willing always to listen to views of stakeholders outside the regulator itself
- Emphasising the importance of culture inside the regulator
- Undertaking one-off reviews if a potentially significant issue with culture has been identified
- A substantial review of scheme performance and culture (say) every five years.