



The Challenges and Benefits of Risk-Based Regulation in Achieving Scheme Outcomes

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Introduction

The regulatory model for Compulsory Third Party (CTP) insurance in NSW has been transforming over the past three years to a more risk-based approach. Risk-based approaches to regulation are now becoming the norm for governments around Australia and the world, as governments attempt to deal with their accountability for public outcomes that are being delivered by the private or not-for-profit sectors.

The risk-based approach calls for the regulator to focus on harm prevention and the promotion of outcomes, and to choose the appropriate instruments to achieve performance. This paper will argue that the traditional rule-based orientation of personal injury schemes (especially common law schemes) creates challenges for a regulator trying to be more risk-based, but the risk-based approach offers the promise of better outcomes for the community. Using the case study of CTP in NSW, this paper sets out some key insights about these challenges.

The craft of regulation: achieving public value through others

The traditional notion of regulation is the exertion of public authority through a system of rules and laws in which the regulator ensures technical compliance by the regulated. Such approaches are seen as reactive and focussed on enforcement, and may miss critical emerging risks because they are seen as being outside of jurisdiction, with regulators often being slow in their response.

A more modern approach to regulation, however, has emerged in recent years that focuses on the delivery of outcomes and public value, in which the regulator seeks to partner with the regulated in the proactive prevention of harms. This is often described as a 'risk-based' approach to regulation.

A risk-based approach to regulation will focus on those risks that hamper the delivery of public value rather than expending resources on ensuring compliance to laws where no real harm is being done – sometimes pejoratively described as 'tick-a-box' regulation.

Malcolm Sparrow, the Harvard academic, has described this as a shift from a focus on illegality into a more agile approach aimed at minimising harms (Sparrow, 2011). Sparrow makes the point that not everything that is illegal is harmful, and many things that are legal can cause harm (Sparrow, 2008).

The risk-based approach calls for a regulator that is not solely focussed on technical compliance and enforcement, but rather a more purpose-driven and agile approach in which the regulator exercises choices about the issues to focus on and employs a range of instruments to address harms that impede the achievement of outcomes, and thus influence or ensure the delivery of public value. Sparrow calls this the 'craft of regulation' (Sparrow, 2011).

Of course, this shift can be contentious, because at the other extreme from nit-picking, mindless bureaucracy is the accusation of over-reach, a regulator acting beyond their power. This is set out in the following schematic:

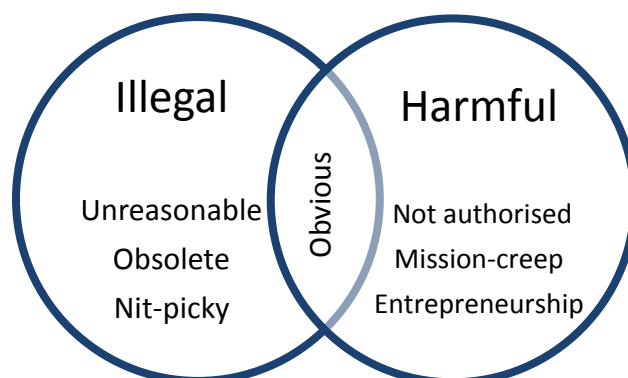


Figure 1: An illustration of Sparrow’s harm vs illegality framework

Regulators need to take a balanced approach between these extremes and therefore must tread a careful path when selecting the appropriate instruments when using a risk-based approach. As intimated in the figure above, it is clear that the priority will be in those areas that are both harmful and illegal. It is also helpful for a regulator to be able to relate back their activities to the overall objectives of their legislative mandate rather than ensuring technical compliance for its own sake. It is particularly important for the regulator to clearly communicate overall objectives and expectations, to encourage the regulated to understand and accept accountability for their delivery.

The regulator can choose from a range of activities that are both more traditional (so-called ‘hard’ regulation) and more modern (so-called ‘soft’ regulation). Hard regulation is usually more prescriptive and reactive to events, while soft regulation will tend towards the proactive and preventive (Sparrow, 2011). Some examples of different approaches are set out in the next figure.

Examples of “hard” regulation	Examples of “soft” regulation
<ul style="list-style-type: none"> • investigations and enforcement (penalties) • auditing • licencing • monitoring/reporting/name and shame • approvals/authorisation 	<ul style="list-style-type: none"> • education programs • consumer information • industry advisory and guidance • standards • funding and contracting • industry research and development • Collaborative problem solving/ • conversations

Figure 2: Different instrumental choices for regulators

Crafting the right regulatory response

Regulatory burden should never be an end in itself. Hence the adoption of risk-based approaches often goes hand-in-hand with a pull-back from unnecessary red-tape, which helps explain why often risk-based regulation is (sometimes wrongly) associated with light-touch regulation. In fact, risk-based regulation is about finding the right level of touch to deal with the most important risks.

At the outset, therefore, we should not see risk-based regulation as being the antithesis of using rules or prescription. In fact, the best response to some risks is through appropriate and proportionate levels of control or oversight, supported by systems of rules and compliance, with appropriate sanctions. Public safety programs are an example where high levels of prescription are often required having regard to the consequences of system failure.

The difference between the traditional rules-based approach and risk-based regulation is that in risk-based regulation, the use of 'hard' regulation is a strategic choice, not an end in itself. Put another way, risk based regulation involves a 'top down' viewpoint where solutions to problems are explored, whereas the traditional approach takes a 'bottom up' approach in which the possibilities are bounded by what the rules allow. This approach allows the regulator to make choices based on priority, risk and urgency, and allows a regulator to choose where it does and does not put its effort, rather than ensuring compliance across the board.

A risk-based approach can thus be seen as a tool for prioritisation and the allocation of a regulator's scarce resources and will be influenced to a large degree by the purpose of the regulator's role (e.g. customer protection versus public safety).

From this perspective, and as set out in Figure 3, risk-based regulation calls for the regulator to:

- articulate the outcomes to be achieved to deliver public value;
- develop rich and variable sources of data, metrics and evidence;
- take a proactive and evidence-based approach to assessing the consequence and likelihood of the risks of achieving the outcomes (the harms);
- choose the appropriate and proportionate instrument for managing the risk. which, depending on the risks:
 - may be light- or heavy-handed; and
 - may vary between hard or soft regulation or a combination of both;
- monitor and evaluate the effectiveness of regulatory instruments over time; and
- be agile in continually reviewing objectives and risks, and make changes in instrumental choices as necessary – as and when risks or objectives change.

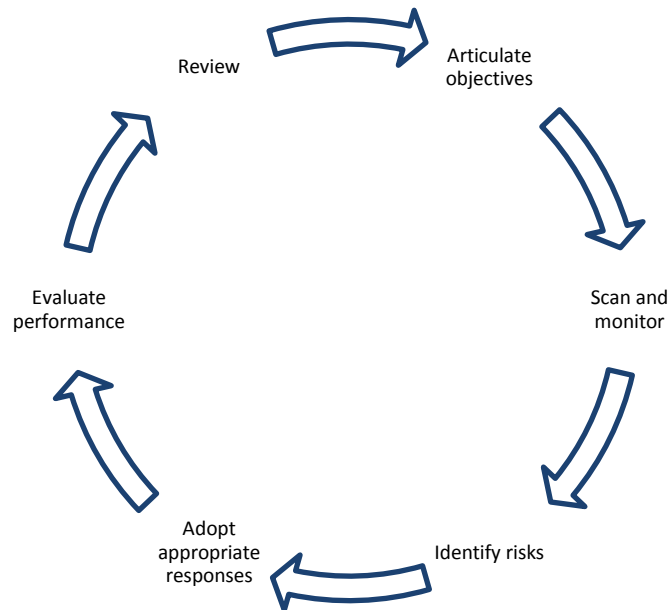


Figure 3: Cycle of risk-based regulation

In a risk-based regulatory framework, there is greater transparency about the objectives to be achieved, and greater accountability placed on both the regulator and the regulated to work proactively to ensure delivery of the outcome.

Sparrow identifies that lack of agility is a key risk which can lead to regulatory failure. It is frankly easier for everyone – both the regulator and the regulated – to simply comply with a set of rules. Many systems of regulation will often eventually gravitate towards the inertia of tick-a-box compliance even if they start out with a risk-based approach. Such systems will often fail to adequately deal with new threats or emerging issues. Therefore agility is central to successful risk-based regulation, but it is harder work.

The risk-based regulator, by focussing on outcomes, is constantly monitoring performance, and detecting and assessing risks, and must be prepared to change priorities or instrumental choices as needs arise. The regulatory framework is not fixed, and will change over time. In this sense, the regulatory environment can be seen as more organic rather than static.

This approach makes it hard for the regulated to learn the rules of the game and work out ways to exploit them – the constant vigilance of the regulator, and its preparedness to change response as necessary, means that there is less point in gaming the system and more incentive to partner with the regulator towards outcomes. Hence risk-based regulation presents a new approach for both the regulated as well as the regulator.

The rise and rise of risk-based approaches to regulation

Despite the fact that services might be outsourced, or some activities occur in the private or not-for-profit sectors, governments are nonetheless still held to account by the community for the delivery of effective outcomes. Governments are under

pressure to find better regulatory approaches to achieve outcomes, and as our economies become increasingly complex across the public, private and not-for-profit sectors, the pressures on Governments are growing.

Mark Moore, another Harvard academic, has written extensively on the challenges of delivering public value (Moore, 1995). In Moore's model, the delivery of services aligned to public value is the central challenge of the public sector. In what is called Moore's Strategic Triangle, the assessment of the delivery of public value is determined ultimately by the electors, who hold Governments to account, and Governments in turn give authority and resources to public sector agencies to deliver the services. Public managers must therefore be more creative to engage with the community that benefit from the system (in the case of CTP, for example, this would be road users, the injured and the insured) to understand value, and develop delivery strategies aligned to expectation. This will include a mix of delivery models beyond traditional bureaucracy, and include co-production opportunities.

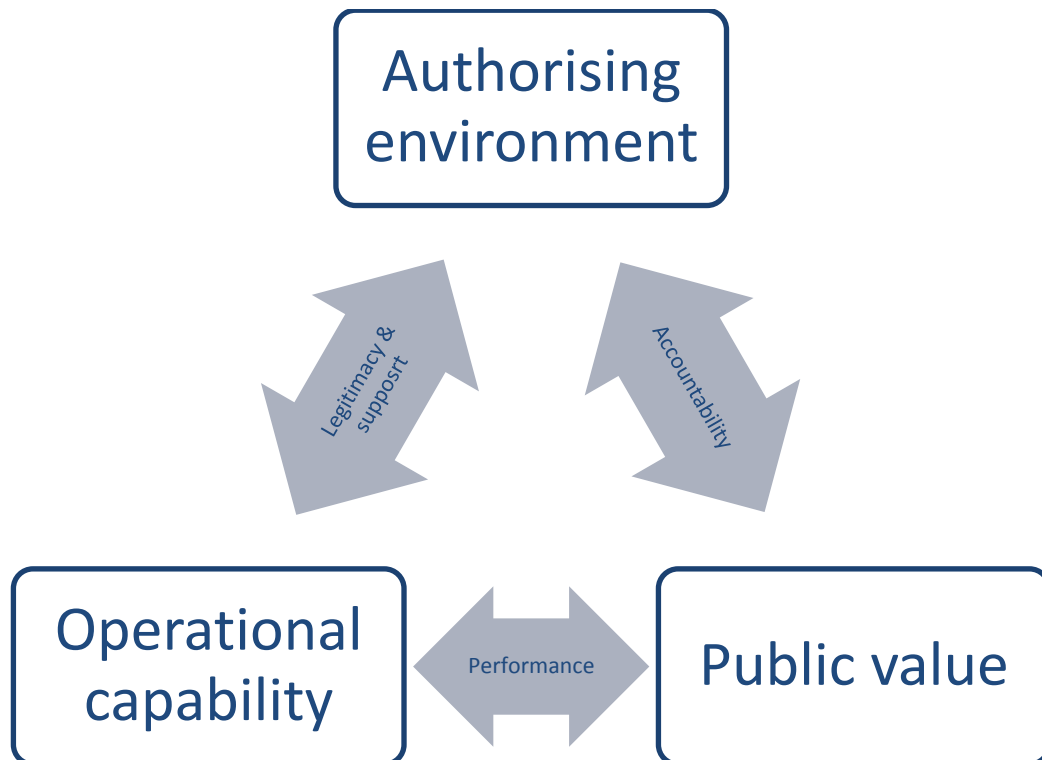


Figure 4: An illustration of Moore's Strategic Triangle

Hence the concept of risk-based regulation is emerging as a key theme in public administration as a way of achieving this nexus between the accountability of Governments for public outcomes and the ability for Governments, through the authority and operation of public sector regulators, to influence the delivery of services by external parties towards the community's expressed value proposition.

Against this backdrop, it is apparent why Governments around the world are recoiling from the failure of traditional regulatory models to proactively address the pressures of accountability and the delivery of public value, for instance:

- their failure to cope with innovation and the emergence of the shared economy; and/or
- perceptions of red-tape and unnecessary waste and bureaucracy, adding a drag to economic performance.

Many Governments now openly promote risk-based regulation as official policy. The NSW Government, for example, issued a document entitled *Guidance for regulators to implement outcomes and risk based regulation* in July 2014 (NSW Government, 2015) but there are many other examples in most jurisdictions.

This document sees several key benefits from a risk-based approach as follows:

- “Clear focus contributing to regulatory outcomes (i.e. the impact) and the resources and activities used to achieve these outcomes (i.e. the impact’s efficiency);
- Greater flexibility to adapt to changing circumstances;
- Increased transparency through clear outcomes and accountability;
- A more informed basis for effective organisational improvement;
- More informed and meaningful interactions with regulated entities; and
- More effective customer engagement, reducing unnecessary regulatory burden.” (NSW Government, 2015).

A challenge for regulators in the insurance sector is translating these risk-based objectives into a meaningful regulatory program. I want to talk about the journey that the NSW CTP regulator (formerly Motor Accidents Authority (MAA))¹ has been on, but first I will come to some initial observations.

Risk-based approaches and the regulation of private insurance

The insurance sector, in my opinion, has some natural advantages when it comes to risk-based regulation.

The insurance sector has historically been delivered by the private sector, though with some notable public examples, and insurance regulators have been grappling with these challenges for longer than some other sectors. Trowbridge (2010), for example, has written about the experience of APRA in developing a more supervisory regulatory approach, in response to the challenges arising from the failure of HIH.

A particular advantage for an insurance regulator is being able to more readily partner with the insurers in achieving outcomes. This arises in two ways:

First, compared with many other industries where there may be perhaps thousands or even hundreds of thousands of businesses or individuals to be regulated, the insurance industry is more concentrated and definable, and it is possible for an insurance regulator to engage more directly with the leadership of each insurance

¹ On 1 September 2015, the MAA was abolished and merged into the new NSW State Insurance Regulatory Authority (SIRA). For ease of reference, this paper will refer to the MAA.

company, both on objectives and any performance concerns. By way of example, in the case of CTP in NSW, there are just 5 insurance companies (with seven licences) to be regulated, enabling the MAA to very easily have direct contact with each.

Second, the regulator has a head start because it is usually dealing with professional, larger organisations. While there are risks of ‘contagion’ as Trowbridge (2010) describes it, for the most part these companies will be concerned about reputational and customer impacts of any failure in their services, and the consequential impact on their finances and shareholders.

These advantages naturally give the regulator a starting point to leverage insurers towards public interest; but in the personal injury lines, as we will see, there are also powerful forces working against the achievement of public outcomes.

Personal injury schemes and the difficult task of risk based approaches to regulation

The regulators of personal injury schemes face some difficult challenges.

The *first challenge* is the culture and nature of adversarial personal injury system. Personal injury schemes are arguably more adversarial than other forms of insurance, particularly common law type systems or systems with a long tail and high levels of uncertainty.

Statutory personal injury schemes are complex and largely dependent on rules. Such systems are heavy on

- laws
- regulations
- guidelines; and
- procedures

Disputes emerge over the application of the rules. Over time, parties on all sides develop gaming strategies, and test the boundaries of the rules.

By way of example, claims practices in other insurance lines appear to have advanced considerably in recent years – easier, customer-friendly claims systems, less officious assessment processes and the like. Yet the approach in personal injury remains (generally) rule-based, adversarial, and less innovative. Consider, for example, this exclusion from the new Insurance Code of Conduct (Insurance Council of Australia, 2015) as follows:

This **Code** covers all general insurance products except **Workers Compensation, Marine Insurance, Medical Indemnity Insurance, and Motor Vehicle Injury Insurance.**

Although this exclusion of personal injury schemes is in part because these are regulated markets with legislated requirements and dispute processes, the mere exclusion of them nonetheless fails to reinforce the need for good customer relationships and instead promotes a litigation-oriented and rule-based approach to

dealing with claims. That is, they spend more time building their case than resolving it.

The risk for the regulator is getting caught up in this adversarial culture and, by adopting a technical-based approach, can in fact contribute to a legal rather than beneficial approach to claims. This was a particular problem in the former regulatory model at the MAA, for a couple of reasons.

The MAA maintained very operational, rule-based guidelines and did not adequately set out the expectations of good performance, nor did it effectively monitor performance as opposed to process. There were not standards of service, or customer charters. The MAA's compliance activities operated in a quasi-judicial fashion – deciding on complaints on the basis of whether the rules were followed correctly, rather than the outcome. For the most part, the MAA would leave most of the disputes and issues in the scheme to be sorted out by insurers and formal processes. Overall this approach worked reasonably well early on, but eventually was surpassed by the increasing sophistication (and gaming) of the players in the system, because the rule-based approach did not lend itself to respond quickly to emerging risks. Sparrow (2011) identifies that it is easy for regulator to become dominated by the process and fail to evolve.

This former approach by the MAA also influenced and reinforced the behaviour of the insurers being regulated. An insurer would defend their position by pointing to their compliance and any attempt to influence their position would be met with a view that they are doing the 'right' thing in terms of what the laws or guidelines require. The MAA's approach made it hard for it to take the moral leadership of the scheme, and so this technical rule-based approach is self-perpetuating if left to its own devices. The cycle needs to be purposefully broken.

The *second challenge* is driving public outcomes from the actions of private insurers who may have incentives to put competitive and commercial interest ahead of public interest.

Inherently, and provided the regulator is careful to avoid regulatory capture, there is some level of conflict between

- the regulator's objectives to deliver public value; and
- the insurer's commercial objectives to avoid poor risks in the acquisition of policies, or to defend claims by the injured.

This can be a positive tension if harnessed appropriately, since private insurers will theoretically have a greater incentive to resist paying out unworthy claims, and will presumably seek to ensure an underwriting model that is sustainable. But an insurer may:

- seek to push the boundaries of what is allowable, such as using rules to justify poor treatment of an otherwise legitimate claim, or
- try to test the mettle of the regulator, or

- just perform poorly in the areas of supposed strength (such as tardy claims management or bad underwriting strategies).

This inherent tension can lead to poor outcomes which may threaten the delivery of public value. In the author's opinion, this has been a central issue in CTP in NSW, and I will come back to this.

Optimistically, however, a successful risk-based approach to insurance regulation is about trying to achieve the right balance to permit insurers to pursue commercial objectives to the overall benefit of public outcomes. This means that there is some pressure on an insurance regulator to be clear about expectations with insurers understanding that they will be held to account for performance and not just compliance with the law.

The *third challenge* is that the regulator is faced by a complex system over which it may have only some influence but which impacts on overall performance of the scheme (e.g. the activities of legal or medical professionals, or the prevailing culture in the wider community towards personal injury). In personal injury, it is the performance (and culture) of the *entire system* that will help determine success.

What often gets lost in an adversarial personal injury scheme, is that the system is actually meant to be delivering a public service to people who are injured on the roads or at work, and, like the famous 'prisoner's dilemma', gaming strategies which may make sense on individual claims basis can have an overall deleterious impact on the system as a whole. This is a particular experience in the CTP system in NSW in recent years, which is leading to excessive costs in the system.

The regulator of personal injury schemes therefore has an important leadership role of driving performance and setting the tone – and influencing the culture – of the system as a whole in order to avoid systemic failure.

In part, this is because, in line with Moore's theories on public value, the regulator will be held to account by its political masters and ultimately the community at large for the performance of the entire system. Therefore the regulator of personal injury lines, in taking a risk-based approach, necessarily needs to look at the entire 'value chain' to enable regulatory responses that are appropriate and targeted.

This obviously includes the main protagonists (insurers, lawyers and medical professionals) but includes a broader church of actors from across the value chain – road safety agencies, peak transport bodies, emergency response and public health agencies, federal prudential bodies, other compensation schemes, peak medical professional bodies, care agencies and carer bodies, legal and medical regulators, and the like. In fact, few of these key actors have a line-of-sight over the whole system, and their actions can in some cases result in outcomes that are impactful or detrimental to scheme performance.



Figure 5: Value chain in Motor Accidents Personal Injury

In this sense, the task of an insurance regulator like the MAA is somewhat different to some other types of regulation. This is why Trowbridge (2010) prefers the term 'supervision', or why Geoff Atkins (2015) talks about the role of management and culture ("how a scheme is run") as being as equally important as scheme design and dispute systems.

This can be a difficult concept to grasp for outsiders to personal injury, because many regulators in other spheres do not have this line of sight over the entirety of a system as a whole. But a failure in any part of the value chain can cause a cumulative impact on scheme performance and cost, leading to a failure to meet objectives or deliver public value.

For example, cost drivers or inefficiency can occur if, for example:

- too many people get injured (frequency of claims rises);
- the propensity to claim goes up;
- insurers spend too much on acquisition of business;
- legal representation increases putting pressure on average claims size;
- insurers become lax with expenses;
- there is over-servicing by doctors; or
- there are too many disputes.

In all these examples, the regulator will ultimately be held accountable by Government (which in turn is held accountable by electors) for the inefficiency and rising costs, but yet there are clearly many points of potential failure.

Historically, the MAA had less influence on the system as a whole. Like the traditional regulators described by Sparrow, the MAA compartmentalised its role to that over which it had clear powers using technical rule-based approaches. Internally, teams operated in silos and no one 'joined the dots' to see the bigger picture of scheme performance. Road safety was largely seen as a problem for a different portfolio, and likewise health services. And the regulation of insurers was driven by assumptions about the inherent efficiency of market delivery and allowing insurers to exercise the main decisions in the day-to-day operation of the scheme.

For most of the decade after the 1999 reforms, this regulatory approach, however, may have been appropriate. Using a risk-based lens, for the most part, the scheme was performing well. Claims frequency and costs were falling, prices were falling in real terms, and the competitive underwriting model was working to its strengths. A light-touch, rule based approach was sufficient. However this regulatory approach needed to change when these scheme metrics began to turn in the wrong direction.

Moving to a risk-based approach: the experience of the MAA

After nearly a decade of successful operation in which prices fell in real terms, in 2008 the scheme turned. The Global Financial crisis hit first, pushing yield rates to record lows, which have continued ever since, and which impacted on insurer's financial performance. But perhaps more insidiously, claims frequency started to rise, along with average claims costs. Responding to these challenges has been a central theme for the MAA over the past few years.

The combined effect on pricing over the subsequent years caused affordability to deteriorate fairly rapidly. Against this backdrop, criticisms of insurance profit margins were mounting and in 2011, shortly after the election of a new Liberal-National Government in NSW, the issues spilled over into newspaper headlines. By 2012, NSW became the least affordable state in Australia for CTP. The perceptions of regulatory failure meant that the need to take a new approach became urgent.

Although the NSW Government at that time identified scheme reform as a priority, internally the MAA began questioning the somewhat rule-based and laissez-faire approach to regulation. As noted earlier in this paper, Atkins (2015) has identified that both design and the way a scheme is run is essential to sustainability. Arguably in NSW, both the 15-year-old scheme design and its particular regulatory model had run its course.

One of the first shots came in late 2011 when the regulator rejected insurer premiums. This was a shock to the insurers who were used to a different way of operating. Then when the Government's proposed reforms to the scheme (to establish a no-fault, defined benefits system to replace the current modified common law system) didn't proceed in 2013, it was clearly up to the MAA to find a way forward, through better management of the scheme as a regulator.

A piece of work that the MAA carried out early, was what was called the 'friction points' review. This has been an essential part of the development of a risk-based approach to regulation by the MAA. In a risk based model, these friction points are the areas where the highest risks of failure or excessive cost will manifest when looking at the end-to-end view of scheme performance. The task of identifying risk has in turn been embedded sustainably by the establishment internally of a risk committee, whose job is to monitor the friction points and emerging metrics in each area, using improved data sources as set out below, to enable a more agile response to risks as they emerge in the future.

The identification of friction points led to a significant program of work with more than 50 separate identifiable projects. There was a lot of catching up to do! The most visible projects involved rewrites of regulatory instruments, to take an outcomes- and principles-based approach, linked much more firmly to the key objectives of the Act².

² Extract from *Motor Accidents Compensation Act 1999*

(1) The objects of this Act are as follows:

(a) to encourage early and appropriate treatment and rehabilitation to achieve optimum recovery from injuries sustained in motor accidents, and to provide appropriately for the future needs of those with ongoing disabilities,

(b) to provide compensation for compensable injuries sustained in motor accidents, and to encourage the early resolution of compensation claims,

Taking a risk-based approach has involved the MAA assessing these legislative objectives and making strategic choices about how to translate these objectives into appropriate regulatory responses. Such an approach would have been impossible by taking a technical compliance approach alone.

The MAA sought to mimic successful approaches of other regulators as well as using the NSW Government guidelines for risk based regulation, while unashamedly augmenting its capabilities and capacity with core insurance expertise – senior actuaries, former insurers and key thought leaders. Within this approach, the regulator made very clear what its objectives are in each regulatory instrument across premiums, market practice, and claims management including treatment, rehabilitation and care practices. In line with the legislative objects, the instrumental choices are directed towards ensuring outcomes for the customer (vehicle owners and claimants), with their rights and benefits as the focus.

These objectives form part of new regulatory instruments, requiring insurers to not only apply the letter of guidelines, but the principles, and allowing the regulator to more easily address non-compliance with principles inside the regulatory framework (rather than have the regulator being challenged by an insurer for interference or acting out of power).

In true risk-based fashion, some guidelines remain more prescriptive than others, simply because the risk assessment process identifies that, in some cases, current poor behaviour needs to be carefully managed for the time being. For example:

- insurers have less wriggle room to play with assumptions in price filings, which is a deliberate response the historic gaming of pricing proposals, but the new approach encourages an active dialogue about pricing strategy rather than gaming of numbers;
- insurers have more latitude in marketing and acquisition strategies within a principles-based framework; and
- new claims handling guidelines, well advanced in the pipeline at the time of writing, have a mix of both principles and prescription, again based on risk.

Importantly by taking a risk based approach in this way, the MAA has been establishing itself as *being in charge of the scheme* and not *just another player in the game*.

These efforts have been supported by other actions. A big focus has been on building the data sources (on top of those that were already there) to enable the

(c) to promote competition in the setting of premiums for third-party policies, and to provide the Authority with a prudential role to ensure against market failure,

(d) to keep premiums affordable, recognising that third-party bodily insurance is compulsory for all owners of motor vehicles registered in New South Wales,

(e) to keep premiums affordable, in particular, by limiting the amount of compensation payable for non-economic loss in cases of relatively minor injuries, while preserving principles of full compensation for those with severe injuries involving ongoing impairment and disabilities,

(f) to ensure that insurers charge premiums that fully fund their anticipated liability,

(g) to deter fraud in connection with compulsory third-party insurance.

MAA to see where outcomes are succeeding or failing and building the regulator's business intelligence capacity and insight to allow for better end-to-end regulation of the scheme in its entirety. Some examples:

- New costs regulations have been imposed on lawyers, which has brought a requirement for disclosure to the regulator of all their costs (not just regulated costs), while the system at the same time gives the opportunity for lawyers to give feedback to the MAA in return.
- The MAA has established new database of policy data, sourced from insurers, to enable it to better manage the operation of the market and premiums, and to better understand cross-subsidies.
- The MAA, working with other government agencies, has established a data linkage project with Health, Police and CrashLink data, now enabling a greater influence in the setting of evidence-based strategies in road safety under a new Memorandum of Understanding (MOU) with the NSW Centre for Road Safety.
- The MAA has forged a new partnership and MOU with APRA, to enable sharing of data and early warning of emerging issues.
- The MAA has commenced the first of what will be regular focus groups and mass surveys of injured people and vehicle owners – forming a not too flattering picture of the perceptions of the current scheme.

The MAA has also identified opportunities to more actively intervene in the process to improve customer outcomes – looking at non-traditional approaches such as customer support, education, and research. The MAA had historically operated a very successful pricing calculator, but missed a big opportunity to help proactively in the claims process, since most injured people contact the MAA before the outset of a claim.

The MAA invested in measures to improve the customer experience for both vehicle owners and injured people, for example:

Vehicle owners

- The establishment of e-Green Slips.
- A new Green Slip calculator platform allowing usage across devices.
- A project that will progressively integrate the purchase of the Green Slip with the registration process.

Claimants

- A new streamlined claims form reducing red tape.
- An improved process of proactively assisting new claimants reach their insurer
- A pilot of addressing complaints directly over the phone (instead of formally in writing)
- A customer charter in the disputes resolution area

These claimant-oriented initiatives in particular have been met with high degrees of satisfaction from injured people.

In the background, the MAA has also shifted to a proactive system of funding and grants to promote better practice, by

- establishing the John Walsh Centre for Rehabilitation Research, and
- positive grant rounds in areas that are directly targeted at addressing the performance of the scheme.

Using this greater access to business intelligence, the MAA has become better at looking at overarching trends that insurers and others cannot see acting alone, and the MAA has now emerged playing a leadership role where for privacy and competitive reasons it is not possible for the individual players to get together and act. A good example is a recent project looking at current claims trends, which has involved partnership with insurers and the legal services regulator. These issues may have fallen between the cracks under the previous technical compliance model in which insurers were meant to go it alone.

Altogether, the MAA's capacity to analyse performance, assess risks and adjust headings is now much more complete. This business intelligence allows the MAA to use key metrics and consumer perspectives to support arguments for a change in approach and not rely merely on the use of internal expertise which insurers could largely run rings around because of superior market wisdom and insurance knowledge.

With smarter analytics, better knowledge and a greater use of expert insurance advisers, the MAA is now better positioned to show clear scheme leadership and be shrewder when dealing with insurers, lawyers, and medical professionals on a day-to-day basis. But it hasn't been all clear sailing, and the biggest challenge has been resistance from internal and external stakeholders used to another operating model.

Will the new risk-based approach stick?

The new risk-based approach had strong support at a Government and Board level, but the hardest part of this process has been the resistance of key players – mainly insurers and internal MAA staff – who have needed some convincing that change is required. There has been scepticism that a move to a risk-based approach is positively the right direction.

A key question in the planning process was whether it is the regulator's job to uphold the letter of the law, or the spirit of the law? Put another way, is the greatest current risk the non-compliance with the law, or the failure to achieve the objectives of the legislation? I will venture that it is actually a bit of both. From a risk perspective, there are many harms in the current system that are also non-compliant, while also many outcomes that are clearly not meeting an objective for just and expeditious resolution of claims despite the insurer following each step of the rules. This has meant a balanced approach to both prescription and description in regulatory instruments.

Yet merely changing the guidelines and getting better data without any resultant change in *behaviour* by both the regulator and the regulated will leave this new risk-

based approach unfulfilled. This creates a requirement for change in approach, systems and capabilities in both the regulated and the regulator, a significant change exercise.

An important feature of the change in regulatory approach has been a shift from passive to proactive engagement such as:

- meetings at very senior levels of the insurance companies at the outset and ongoing;
- substantive processes of proactive engagement with stakeholders (lawyers, insurers, medical professionals) in specific projects; and
- staff involvement in the development and execution of plans including establishing an outcomes-based business plan and assigning key team leaders with the job of representing specific customer outcomes, outside normal business silos, leading to greater collaboration.

From the perspective of insurers, a difficult aspect has been accepting that the regulator will not in all circumstances be prescriptive and that it is not possible to come up with a check-list to ensure they will avoid the wrath of the regulator. In a risk-based model, the onus is on insurers to implement their activities in compliance with the objectives and to successfully demonstrate to the regulator that they are delivering in line with outcomes.

For insurers, it has been hard for them to tell if this is a continuation of “the game”, or the start of a new process of partnership and engagement. With this uncertainty, some insurers have been cautious about over-sharing and hesitant about releasing commercially confidential information. This puts pressure on the MAA to deliver on the promise of a new way of operating, to allay these concerns, and internal staff in turn have been worried about the capacity and capabilities of the existing resources to take the new approach forward.

In the new approach to regulation, insurers will be held to account for the delivery of outcomes against their own business plans, aligned to principles, as well as meeting guarantees of customer service embedded in rules, rather than ticking the regulator’s boxes for procedural compliance. The compliance and enforcement program has now been aligned to focus on those ‘friction points’ that are the most important or impactful on scheme performance from a customer perspective (e.g. liability decisions), with insurers being largely left to their own devices in the areas perceived to be lower risk or already being well managed.

This is a demonstrable change in approach, where in the past poor performance in critical areas might have been mitigated by perceptions of good performance in less critical areas, when looking at their compliance with the rules overall.

The risk based approach also means that the MAA may take a different approach with different insurers depending on their individual performance, noting that each insurer has their own immediate performance issues and culture. This has led to suspicions that the regulator is playing favourites or unfairly targeting some and not others.

Moreover, some insurers have been struggling with the uncertainty about whether their actions will or will not be acceptable, as the MAA now has a clearer hand to address any activities that it regards as unacceptable. This in turn has led some insurers feeling uncomfortable that this is an over-reach by the regulator, an interference in the adversarial game that is common law, and an attempt to sit above the law and take a pro-claimant viewpoint in the resolution of disputes.

While for its part, the MAA's approach is to promote customer-centricity and not pro-claimant behaviours, nonetheless the adversarial and technically complex scheme design is working hard against a risk-based regulatory approach and represents an ongoing challenge. Similarly, the need to drive public outcomes in areas such as premium affordability and fair market practices, works against the usual market and pricing strategies of insurers, creating friction points where insurers will naturally want to press the edges of the scheme.

The conundrum for the MAA is that it both wants insurers, with their commercial interests, to keep costs in check, but to stop gaming strategies that affect customer experience in both acquisition and claims management.

The aim of the risk-based approach, however, is to achieve the right balance, and try and break the cycle of gaming altogether – to lift the regulatory engagement with insurers to be a strategic discussion about scheme performance and delivery against objectives.

A benefit of the new approach however is that the MAA aims to play to its strengths in setting objectives and monitoring performance, while leaving the market to play to its strengths in underwriting, acquisition and claims management.

In this model, the MAA doesn't need to replicate the insurer's skills to achieve successful regulation, since insurers will be held to account for outcomes more so than process, thus enabling the MAA to better target the use of its scarce resources.

This new approach offers greater flexibility for the MAA to reduce red tape where there are areas of lower risk, or where the market is working successfully with no need for regulation, rather than having to prescriptively regulate every step of the way. This is offset with a greater strategic dialogue with insurers on the areas that matter in terms of performance, which is the start of a long journey in changing the culture of the scheme away from a focus only on technical compliance.

The MAA is only just starting on this journey. There is more yet to be achieved and there are other areas on the to-do list. The biggest challenge is shifting the culture inside both the insurers and the MAA, and the relevant commitment to change. It requires a positive commitment to embrace the defined outcomes and to shift efforts, capabilities and capacity towards focussed, sustainable performance. This will take time and so for now the most important thing for the MAA is to remain on course with the risk-based regulatory approach to avoid retreat to a technical compliance model.

Conclusion

Being a risk-based regulator is more demanding and presents greater strategic challenges in getting the balance right, but the rewards are greater. The repositioning of the regulatory model for CTP insurance in New South Wales remains a work in progress. I have described the Motor Accidents Authority's shift towards a focus on outcomes and a move away from technical compliance and enforcement oriented regulatory frameworks. This has involved a comprehensive review of regulatory instruments, high levels of engagement with the insurance sector and other sectors, and the implementation of new requirements. The pay-off will come as the regulator plays a stronger role in driving performance towards public value, and influencing the culture of the scheme. It will take time, as behaviour and cultural change do not happen quickly. The new model positions the MAA to emerge as a more modern regulator of personal insurance, but fulfilment will be challenging under the current adversarial scheme design.

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