MOTOR ACCIDENTS INSURANCE BOARD

Proudly Promoting Road Safety in Tasmania

DIRECT LINE: (03) 6336 4831
E-MAIL:
OUR REF: DC:KP
YOUR REF:

23 May 2013

Mr Glenn Appleyard
Chairman
Tasmanian Economic Regulator
Level 5, 111 Macquarie Street
HOBART TAS 7000

Dear Mr Appleyard

Re: 2013 Investigation into the Pricing Policies of the Motor Accidents Insurance Board

The MAIB operates a competitively priced, adequately funded, appropriately designed and well managed CTP scheme built upon the foundation of a robust balance sheet. It is highly valued by the Tasmanian community, well regarded internationally and the envy of some other Australian States and Territories.

The MAIB Board is strongly of the view that the scheme and its robust foundations should be carefully protected for the long term benefit of the Tasmanian community. Further, the MAIB Board has a duty to act commercially to ensure the long-term viability of the scheme. This duty arises from the Board's obligations under the MAIB's Portfolio Act, the *Government Business Enterprises Act 1995*, the MAIB's Ministerial Charter, the Statement of Corporate Intent and Performance Agreement with the Portfolio Minister and the Treasurer.

It is in this context that the attached response to the 2013 Investigation's Draft Report is provided and I respectfully request that it be afforded full consideration.

I look forward to receiving a copy of the Final Report in due course.

Yours sincerely

D W Challen AM
CHAIRMAN

Enc

Level 1, 33 George Street, Launceston PO Box 590, Launceston 7250 DX 70112, Launceston
Telephone: (03) 6336 4800 Toll Free: 1800 006 224 Facsimile: (03) 6336 4848 www.maib.tas.gov.au

The Motor Accidents Insurance Board's

Response to the

Office of the Tasmanian Regulator's

Draft Report of the

2013 Investigation

The following sections provide detailed comments on key elements of the Draft Report, and the consequences of several factual errors in the Draft Report's conclusions.

Target Solvency Range

In its Capital Adequacy Policy, the MAIB retains a target solvency range of 20% - 25%. This is sometimes referred to as a funding ratio of 120% to 125%. For the purposes of calculating solvency, capital is defined as net assets less net deferred tax assets less deferred dividends payable to the Department of Treasury and Finance.

In Section 4.2.1 of the draft Report, the recent performance against target and the history of those targets has been correctly recorded. It should be noted, however, that the increase in the target to 20% - 25% in 2007 was as a result of the MAIB increasing its allocation to growth assets in its investment portfolio.

The MAIB regularly reviews its solvency target range which is negotiated annually with the Shareholding Ministers in the corporate planning approval process. A Performance Agreement incorporating financial and non-financial targets is then signed off by the Shareholding Ministers and the MAIB Board. The MAIB considers this process most adequate and regards the Finity suggestion that further work in relation to risk tolerance to be unnecessary and an additional financial burden on Tasmanian motorists.

In the Draft Report, it is stated that *'the level of solvency adopted by the MAIB is at the upper end of the range typically adopted by government owned CTP schemes'*. That assertion is incorrect. Finity, who provided this information to the Regulator, has reissued its report and removed this incorrect statement.

Mercer Consulting recently published an analysis of Solvency Targets of Accident Compensation Schemes and has generously allowed the MAIB to use their report. For Australian CTP schemes, Mercer reports the following:

Jurisdiction	Target Funding Ratio	Target Solvency Range Conversion
Insurance Commission of Western Australia (ICWA) *	>125%	>25%
Motor Accidents Insurance Board (Tas)	120% - 125%	20% - 25%
Motor Accident Commission South Australia (MAC)	>115%	>15%
Territory Insurance Office (NT)	>135%	>35%
Transport Accident Commission (Victoria)	80% - 120%	-20% - +20%

* - *ICWA advise that their target funding ratio is* ***'not less than 125%'***.

It is evident from the table above, that the MAIB approach to target solvency is totally consistent with all other Australian centrally managed CTP funds except the Transport Accident Commission. Significantly, the cluster of the non-Victorian schemes has claim liabilities which are comparable to that of the MAIB.

The MAIB finds both the Finity and Regulator's reports most ambiguous. On the one hand, it is said that the MAIB's current solvency range is "not unreasonable" but that for pricing purposes, the Regulator has accepted the Finity view that the MAIB solvency range should have a lower bound of 0%. Of even greater concern, the Regulator appears to be of the view that no remedial action is required if circumstances change providing solvency is not less than 0%. The consequences of this view are considered further in the section dealing with premium stability.

The Draft Report indicates that the MAIB can operate at a lower level than that mandated by the Australian Prudential Regulatory Authority (APRA). This is consistent with the MAIB's capital policy. However, the MAIB rejects the arguments put forward in the Draft Report for a target solvency range with a lower bound of 0%. Some of these reasons are discussed below.

- The Draft Report indicates that benefits available under the MAIB scheme are defined by legislation and the Government could amend entitlements if the viability of the scheme were in question.
  - A decision to seek legislative amendments to restrict benefits to people injured in motor accidents would be a poor public policy response to the imprudent and unnecessary running down of scheme net assets to zero or less. Further, legislative change, except in exceptional circumstances, is prospective and will not provide a remedy for Court or tribunal decisions that have retrospective application. The February 2012 Fair Work Australia Gender Equity pay decision which was noted in the MAIB submission is such an example.

- The other remedy, the imposition of a levy on motorists, conflicts with the MAIB approach to premium stability and is covered in that section.

- The history of personal accident schemes in Australasia suggests that it is unwise to allow a scheme to fall near or to an unfunded situation. The Accident Compensation Commission in New Zealand in its 2010 Financial Condition Report reported a net funding position of -$10.3 billion at 30 June 2010. At 30 June 2012, the net funding position had been improved but was still at an extremely poor level of -$7.2 billion.

The Draft Report indicates that the government insurer can continue to operate while technically insolvent. The MAIB Board is of the firm view that it is required to operate commercially under the *Government Business Enterprises Act 1995*, its Ministerial Charter and the Statement of Corporate Intent and Performance Agreement approved annually by the Shareholding Ministers and, unless directed by the Shareholding Ministers, would not operate in the manner suggested. Further, the MAIB's financial position ultimately forms part of the State's Balance Sheet and it would be reckless to embrace a policy which seeks to drive down net assets to a dangerously low or negative level with its concomitant whole of State implications.

At section 4.2.4 of the Draft Report, the Regulator notes that the actual solvency level of the MAIB only fell to 15.5% at 30 June 2009 despite lower forecasts. Improved investment returns in the last quarter of 2008/09 and the reversion of economic assumptions used in the valuation of outstanding claims liabilities at 30 June 2009 were the reasons for the better outcome. The strong solvency level held by the MAIB at the commencement of the global financial crisis held it in good stead during that critical period and it is puzzling indeed as to why the Regulator is considering recommending a diminution of that strength.

In the same section, the Regulator noted that the global financial crisis may be considered an extraordinary event unlikely to be repeated any time in the near future. The MAIB suggests that this statement has no basis and serves no purpose. Capital is maintained (with solvency being the measure of the adequacy of that capital) to buffer the scheme against unanticipated and unusual events. No-one can predict such events and to suggest otherwise is extraordinary.

As required by its Ministerial Charter, the MAIB will be undertaking its next review of its target solvency level in mid 2013. Based on previous actuarial advice, it is possible that target solvency will be increased, conceivably to a new range of 20% – 30%. Any adjustment will form part of the 2014 corporate planning approval process with the Shareholding Ministers following detailed consultation with Treasury. In the absence of a directive from the Shareholding Ministers, the MAIB will not be adopting a solvency margin with a lower bound of 0% as suggested in the Draft Report. To do so would be to abrogate the MAIB Board's duty.

Currently, the MAIB does not consider it necessary to nominate a trigger point above the upper end of the target solvency range at which action needs to be taken. Modelling suggests that the tax equivalence and dividend payment regime under which the MAIB operates in the more profitable years is a moderating influence on increasing solvency. It is therefore highly unlikely that solvency would drift upwards to unacceptable levels.

Risk Margin

The Draft Report found that the MAIB's approach to the valuation of its claims liability is appropriate. It recommended that the risk margins used by the MAIB in its claims liability valuation should be reviewed prior to the next investigation.

The MAIB's Consulting Actuary notes in the annual outstanding claims valuation report that, while the MAIB is not required to comply with the APRA mandated risk margin of 75% probability of sufficiency, the current prudential margin of 20% is likely to exceed that benchmark. The comparison with other schemes shows that the risk margin adopted by the MAIB is higher than comparable interstate schemes and the MAIB has not felt that there is sufficient benefit in further actuarial analysis to warrant the cost of that analysis.

The MAIB believes that the retention of a strong solvency position is of far greater importance than a regular analysis of probability of sufficiency (which has a large element of subjectivity) particularly where the consulting actuary believes the current prudential margin exceeds the APRA benchmark.

Hospital Cost Increases

The Draft Report stated that the Department of Health and Human Services (DHHS) indicated that the review of the MAIB charges had been delayed and is unlikely to occur for several years. The DHHS disputes this version of events and has advised the MAIB in writing that a review is likely to take place in the next 12 to 18 months. Taking the mid-point of this range (15 months) from March 2013 indicates a possible review from 1 July 2014 – close to the middle of the current premium year. In other words, it is highly likely that increased hospital costs will need to be reflected in premiums from 1 December 2014. The increases in premiums due to hospital cost increase will be material – the consequences are considered under "Premium Stability" below.

With the Regulator's Draft Report dismissing the case for recognition of premium increases to fund hospital rate increases during the four period ending 30 November 2017, the MAIB wishes to point out that the fee increases, when implemented, will have a significant element of retrospectivity. This relates to people whose injury occurred before the implementation date but the hospitalisation continues beyond the implementation date, sometimes for extended periods.

The issue of hospital fee increases is discussed further under "Premium Stability".

Premium Stability

As discussed above, the view that no remedial action is required if circumstances change, providing solvency is not less than 0%, violates a number of MAIB's capital policies. It also has serious implications for premium stability and this section discusses those implications.

The MAIB has always practiced the importance of premium affordability and stability. In the past ten years, the MAIB has increased premiums on only two occasions – and in each of those two cases, the increases did not exceed wage inflation. Tasmanian premiums are among the most affordable of all schemes in Australia, and the MAIB's benefits are among the most generous.

The Draft Report recommends a premium reduction from 1 December 2013 including a premium reduction for vehicle classifications targeted for premium increases above wage inflation from 1 December 2014. In practice, this could mean a premium reduction of 7.4% in year one, followed by a premium increase of a similar percentage in year two for some classifications. It is the experience of the MAIB that motorists appreciate premium stability without wondering what shocks are going to appear in their next renewal. It is difficult to conclude how the proposed premium volatility is in the interests of the MAIB or the motorists.

As indicated above, there is a very strong likelihood that premiums will need to be increased annually to offset the proposed year one premium decrease. The reasons for this are as follows:

- Over the past ten years, claim frequency improvements have largely offset inflation, allowing the MAIB to keep premium levels largely unchanged;

- As the MAIB's submission showed, there are two sources of additional costs that are almost certain to affect MAIB premiums in the period until the next TER review:

    1. Hospital costs will increase in the next 12 to 18 months; and

    2. While the timing is uncertain and quantification is not possible, there are likely to be cost implications in relation to NIIS;

- The MAIB's best estimate of the effect of hospital cost increases is that premiums would increase by a similar percentage to the reduction recommended in the Draft Report. This represents a material increase. The effect of NIIS is still uncertain, but early estimates indicate that the additional costs to the MAIB may well be material and would therefore, require premium increases;

- Claim frequency improvements may well continue, but they are highly unlikely to offset inflation, hospital cost increases and any costs arising from the introduction of NIIS;

- Thus a reduction of 7.4% from 1 December 2013 is highly likely to be followed by annual increases from 1 December 2014;

- The Draft Report does not address the trade-off between a one-year reduction in premiums and continuation of the premium stability that the MAIB has achieved over the past decade.

The MAIB proposes an alternative approach for the setting of maximum premiums which avoids a reduction followed by AWOTE increases each year. This is consistent with the principle of premium stability while achieving the Regulator's objective of ensuring that premiums are not excessive.

Our specific proposal is that maximum premiums (aside from those for Classes 4, 5 and 20, 6, 18 and 16 which are considered below) be held at their present nominal levels for the premium years commencing 1 December 2013, 2014 and 2015 and adjusted by the increase in AWOTE for the premium year commencing 1 December 2016.

Premium Relativity Adjustments

The Draft Report recommends a small number of increases to maximum premiums for the motorcycle and taxi classifications from 1 December 2014. This is consistent with the recommendations in the MAIB submission.

However, Table 1 of the Draft Report recommends that the maximum premiums for these classifications be decreased from 1 December 2013.

It seems incongruous that, on the one hand, the Regulator is recommending an increase in maximum premiums and, on the other, premiums are being decreased in the first instance. It is respectfully suggested that this approach will cause unnecessary confusion and should be abandoned.

In relation to Class 18, the Executive Summary of the Draft Report recommends increasing the maximum premium over four years to 0.75 (of a Class 1 vehicle). This reflects the detailed assessment contained in Section 6 of the Draft Report. In the Summary of Proposals at the end of the Executive Summary, this is incorrectly expressed as increasing the maximum premium over the next four years until it is equal to a Class 1 premium.

Consistent with the MAIB's views on premium stability noted early, we recommend the Regulator set an alternative path for premiums for Classes 4, 5 and 20, 6, 18 and 16 to avoid a premium reduction followed by a period of increases at a faster rate than AWOTE.

For example, the current maximum premium for a Class 4 motorcycle could be inflated by 3.5% (or a similar percentage) from 1 December 2013, 1 December 2014, and 1 December 2015 to achieve the desired relativity. This approach would avoid the significant premium rate increases from 1 December 2014 and the following two years as proposed in the Draft Report.

Conditions for Re-Opening the Pricing Order

In the Draft Report, conditions for the re-opening of the Pricing Order are detailed.

The MAIB finds the inclusion of this section to be unusual as it does not appear to be within the Investigation's Terms of Reference. Further, the Regulator appears to be pre-empting the outcome of any approach to Government by the MAIB over the next four years should increased claim costs not expected by the Regulator emerge.

The Draft Report indicates that the Regulator will be relying on advice from Finity that a premium adjustment should only be considered if solvency falls below zero. This advice has been shown above to have been based on incorrect methodology and an erroneous assertion in the Finity report.

The MAIB's consulting actuary advises that the general view among actuaries is that it can be dangerous for accident compensation schemes to subsidise premiums by running down surpluses. This view is the result of the unfortunate experience of some schemes where premiums were set below the cost of claims plus expenses (break-even premium) plus profit margin and surpluses reduced. It then proved difficult to increase premiums once the surplus had run down to its target level. The solvency of several of those schemes dipped to alarmingly low levels and took many years to regain their target solvency level and some have still not done so.

The MAIB's view is that, if there is to be a recommendation on conditions for re-opening the pricing order, it should not be based on solvency. Solvency is largely an irrelevant consideration in setting premiums, except in circumstances where solvency has dropped to an unacceptable level. As noted in the MAIB submission and the Regulator's Draft Report, premiums should be set by adding to the break-even premium an appropriate profit margin. Consequently, our view is that a re-opening should be related to the materiality of any change which would impact on the break-even premium.

The two main factors which it would appear will not be reflected in the Regulator's recommended premium are DHHS bed-day costs and the cost impact of the NIIS scheme. The MAIB proposes that the re-opener for these cost items be a material change in the break-even premium (say at least 5%) after the break-even premium has been re-calculated by the MAIB's consulting actuary to ensure that the judgement about materiality is made with reference to current conditions. This approach would provide a mechanism for appropriate reconsideration of the premium in the light of material changes in cost factors not reflected in the Regulator's recommendations, while ensuring that account can be taken of any offsetting reductions in costs that may occur between the time of the Regulator's recommendations being made and the new cost impact being known.

Governance

At the conclusion of Section 4 - MAIB's Financial Circumstances, the Draft Report seeks comment from stakeholders in relation to a range of issues such as the MAIB's target solvency level, claims liability valuations, investment policy etc.

The Board takes expert advice on all these matters to assist in fulfilling its responsibilities to the Shareholding Ministers as detailed in Section 12 of the *Government Business Enterprises Act 1995*.

Other Issues

The following issues have been identified in the Draft Report:

Executive Summary and Section 6.10.1

Summary of Proposals/Proposed Maximum Premiums

- The Executive Summary uses the Wage Price Index as the annual escalator whereas Section 6.10.1 uses AWOTE. The MAIB suggests that AWOTE continues to be used and in the manner prescribed in the 2009 Premiums Order.
- Ambiguity should be removed from the Class 16 Medium passenger escalator.
- In Table 1, it is suggested that:
  - Duty be removed to avoid confusion;
  - "Impact of relativity changes" be clarified; and
  - Current pensioner discount premium is $275 (Premiums for pensioner discount are calculated as per the formula in the current Premiums Order).

Section 3.4.1.3.1 Projected Claim Frequency

The paragraph above Figure 3.6 mentions economies of scale as an explanation for the observed frequency differences between jurisdictions. The MAIB's consulting actuary advises that this is, at the very best, a second or third order effect. The primary explanatory variable is scheme characteristics and, in particular, the differences between no-fault and common law schemes. The Draft Report should clearly identify this in the first paragraph as the primary differentiator.

The last paragraph of Section 3.4.1.3.1 suggests detailed investigation of the influences of the MAIB's claims frequency for the next investigation. There is a multitude of influencing factors and any investigation will find it difficult to disentangle the effects of each factor. The Draft Report indicates that such investigation may inform the "pattern of claim frequency into the future and when it may stabilise". The last objective, while admirable, should perhaps be expressed less definitively, as the results of any investigation (if undertaken) are likely to be highly speculative. Given all the circumstances including investigation costs, it is unlikely that the MAIB would act on the suggested detailed investigation as proposed in the Draft Report. In the MAIB's view, the costs of such an investigation will far outweigh any benefits and the MAIB respectfully suggests this be deleted from the Regulations Final Report.

(23 May 2013)