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Medical Indemnity (Prudential Supervision and Product Standards) Bill 2002

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Medical Indemnity (Prudential Supervision and Product Standards) Bill 2002

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Medical Indemnity (Prudential Supervision and Product Standards) Bill 2002

Date Introduced: 12 December 2002

House: House of Representatives

Portfolio: Treasury

Commencement: 1 July 2003

Purpose

The purpose of this Bill is to create a regime for the regulation of providers of medical indemnity insurance.

Background

This Bill forms part of the Government's package of reforms, announced by the Prime Minister in October 2002, to address the problems being experienced by providers of medical indemnity insurance in Australia.[1]

The current medical indemnity insurance crisis is characterised by an inability to provide affordable medical indemnity cover to insureds at a level that is financially sustainable to insurance companies. Clear evidence of the effects of this crisis have been large premium increases for insureds[2], and the appointment of a provisional liquidator to the country's largest medical defence organisation (MDO), UMP Insurance, in May 2002.

The medical indemnity crisis forms part of the broader insurance crisis in Australia. Several reports have been commissioned which document and inquire into the sources of the crisis.[3] These reports have identified a number of cost elements as having driven up the price of indemnity insurance in Australia (for example, increases in the costs of claims and the downturn in the international investment market). The Government's package of medical indemnity bills passed by Parliament in December 2002 in part addresses some of the cost pressures that have led to the insurance crisis through the provision of premium subsidies and Government funding for large claims notified after 1 January 2003. A discussion of these bills is contained within Bills Digest No *71* Medical Indemnity Bill 2002[4].

Also included in the list of factors contributing to the medical indemnity crisis has been the weakness in the regulatory supervision of MDO's.

The Trowbridge Consulting report of November 2001 noted that:

> As MDO's are not insurers, they have not been subject to the same accounting and reporting requirements as insurers. MDO's need to comply with the usual company accounting standards but do not need to comply with AASB1023 or AAS26 which apply to general insurers. This has led to a variety of accounting practices in relation to:
>
> - The reporting of Incurred But Not Reported (IBNR) claims…..
> - Full insurance disclosures of known claims liabilities
>
> Liabilities for known, reported claims have always been reported in MDO's balance sheets. However, there has been inconsistency in reporting of IBNR's between MDO's, with some including the IBNR on their balance sheet, others disclosing it in a note to the accounts, and others not disclosing the extent of the IBNR.[5]

The report to the Australian Health Ministers Advisory Council (AHMAC) stated that:

> One of the reasons that the MDO industry has experienced financial difficulties is that it has not been subject to same prudential scrutiny as insurers. The difficulties faced by UMP were of a kind which may well have been identified and acted on earlier if there were a regulatory regime in place. Some of the key problems of competitive underpricing of products and a failure to adequately reserve for potential liabilities are likely to have had to be addressed at an earlier stage.[6]

Many MDO's are currently not required to comply with the insurance specific regulatory requirements in the *Insurance Act 1973*. The requirements within the *Insurance Act 1973* apply to all other providers of general insurance (including other forms of professional indemnity insurance).

The *Insurance Act 1973*, which was substantially amended in 2001, contains a rigorous prudential regulatory regime in relation to general insurers. It requires that insurers comply with the following regulatory requirements;

- APRA authorisation to a body corporate for carrying on an insurance business in Australia.[7]
- Standards of conduct, including fit and proper person requirements for directors, senior managers and other representatives of general insurers and their authorised non operating holding companies (NOHC's).[8]
- Prudential supervision of general insurers, including APRA determination of prudential standards.[9]

- All general insurers to have an APRA approved actuary and auditor.[10]
- Standards of conduct, including fit and proper person requirements for actuaries and auditors.[11]
- Minimum asset requirements placed on general insurers.[12]

The legislation and standards made pursuant to it, focus on governance and the insurers financial ability to meet claims.

Medical Indemnity (Prudential Supervision) Bill

In essence, this Bill draws providers of medical indemnity cover under the regulatory arrangements contained within the *Insurance Act 1973*. The bill will also states that insurance contracts will need to meet minimum standards to ensure that health practitioners receive cover for all claims that may be made against them.

Position of significant interest groups/press commentary

The *Australian Financial Review* in an article dated 18 February 2003[13], reported that three MDO's, the Medical Protection Society of Tasmania, Queensland Doctors Mutual and the Medical Indemnity Protection Society had expressed opposition to the bill.

Whilst the article does not set out in detail the concerns held by each body, the article does raise two key issues of concern for MDO's, namely that;

- indemnities will now need to be provided on a contractual rather than a discretionary basis (see discussion at page 5).
- the MDO's may be unable to meet their obligations in relation to minimum capital requirements (see discussion at page 6).

Main Provisions

Glossary of terms

Claims made cover: insurance cover for claims reported to the insurer during the term of the insurance policy.

Normally claims made cover only insures against incidents that occurred during the term of the insurance policy. Events that took place prior to the commencement of the insurance policy but which were notified during the operation of the insurance policy will be covered if the insured holds retroactive cover.

An insured who holds 'claims made cover', 'retroactive cover' and 'run off' cover will essentially have the same coverage as claims incurred policy.

Claims incurred cover: otherwise known as 'incident occurring' or 'occurrence based' cover is insurance cover for any claim arising out of an incident that took place during the term of the insurance policy, regardless of when the claim was notified.

Retroactive cover: insurance cover for claims arising out of incidents that took place before the commencement of the current insurance policy.

Retroactive cover is often provided in conjunction with 'claims made' cover. Where retroactive cover is provided in conjunction with 'claims made' cover, it insures against claims arising out of incidents that occurred before the commencement of the current 'claims made' policy, but which are notified during the term of the current 'claims made' policy. Without retroactive cover, these claims would be uninsured.

'Run off' cover: or 'extended reporting benefit cover' is cover for claims that are made after a 'claims made' insurance policy expires for incidents that occurred during the term of the policy.

Incurred but not reported claims: are claims where there is a time lag between when the incident producing the claim occurs and when the insurer is notified of the claim. 'Claims incurred' cover creates a vast number of 'incurred but not reported' claims.

Part 1 - Introductory

Part 1 Division 1 of the Bill sets out the objects of the Act, namely to ensure that health care professionals have access to medical indemnity cover that is provided by properly regulated insurers and to specify minimum standards to be provided to health care professionals.

Key definitions including 'claim', 'providing medical indemnity cover', 'claims made based cover' and 'incident occurring based cover', are contained within **clauses 4 – 6** of the Bill. **Clause 7** of the bill sets out the period when arrangements for death, disablement and retirement cover are taken to be entered into for the purposes of having to meet the requirements of the Act.

The Bill excludes certain groups from the application of the Act including State Government and Commonwealth Government provided insurance (**clause 8**) and extends the application of the Bill to the external territories (**clause 9**).

Prudential requirements

As discussed above, many providers of medical indemnity cover are not captured by the prudential regulatory requirements that apply to other general insurers in Australia.[14] MDO's provide protection to their members on a discretionary basis. Discretionary cover entitles a member to seek indemnification from an MDO. However, a member has no legal

right to be indemnified, and the MDO can exercise its discretion not to indemnify the member.

While this discretionary medical indemnity cover appears in substance to be an insurance product, it does not fall within the terms of the definition of 'insurance business' for the purposes of the *Insurance Act 1973*. Since providers of this cover are not conducting an insurance business, they are not required to become an authorised insurance company in order to provide the cover. As a result, APRA does not have the power to regulate these MDO's nor are they subject to the prudential requirements contained within the *Insurance Act 1973*.

Clause 10 of the Bill amends the law to ensure that providers of medical indemnity cover become subject to the same regulatory requirements that apply to other providers of general insurance.

Clause 10 of the Bill contains two key requirements. It states that a person that offers, invites an offer, enters into or renews medical indemnity cover must be a 'general insurer' (therefore authorised under *the Insurance Act 1973* to carry on insurance in Australia). In addition, the clause provides that the insurance must be provided through a 'contract of insurance', thereby ensuring that provision of the cover is regarded as 'insurance business'.

In effect, these amendments will mean that MDO's will be unable to provide discretionary cover and as stated above, they will be required to comply with the requirements of the *Insurance Act 1973.*

Contravention of this provision is a criminal offence with a maximum penalty of 12 months imprisonment.

The Bill also limits the conduct of insurance intermediaries (for example insurance brokers) in regard to the provision of medical indemnity cover. **Clause 11** provides that an insurance intermediary can only arrange, offer to arrange, renew or recommend that someone enter into or renew medical indemnity cover if the cover provider is a general insurer and the arrangement is effected by way of a 'contract of insurance'.

Contravention of this provision is a criminal offence with a maximum penalty of 12 months imprisonment.

As a result of **clause 10** of the Bill, providers of medical indemnity insurance will need to become authorised[15] and hence will be required to operate in compliance with the prudential standards[16] that have been developed by APRA. APRA will be responsible for enforcing compliance with these prudential standards **(clause 28)**.

The legislation contains transitional provisions that give providers of medical indemnity insurance time to comply with the prudential standards relating to minimum capital requirements. Prudential Standard GPS 110 sets out minimum capital requirements for insurers. This prudential standard requires that insurers hold a minimum of $5 million

capital at the point of start up. Some MDO's may not be in a position to comply immediately with these obligations and the Bill contains transitional provisions to give MDO's until 1 July 2008 to acquire the $5 million in capital.

In order to take advantage of these arrangements, MDO's may apply to APRA for an exemption from the capital requirements (**clause 13-14**). An MDO's application will need to be accompanied with a 'funding plan' which sets out the detail of how the insurer intends to bring their capital requirements up to the minimum level set down in the prudential standards.

APRA will be required to grant the exemption from the capital requirements provided:

- The body corporate is not a general insurer at the time of the application,
- The body corporate is not able to meet the capital requirements when the legislation commences operation,
- The body corporate lodges a funding plan which is,
  - in the prescribed form,
  - certified by an independent auditor and actuary, and
  - complies with the guidelines issued by APRA.

APRA's decision to exempt an MDO from the capital requirements is subject to review by the Administrative Appeals Tribunal (**clause 14**).

Standards for minimum cover and offers for retroactive and run-off cover

Minimum cover

Part 3 sets out requirements that medical indemnity insurance contracts must meet.

The insurance contract must satisfy the following minimum claim requirements, namely, that

- the minimum cover for a single claim must be $5 million (**clause 17**), and
- the minimum cover for all claims in any given year of $5 million (**clause 18)**.

It is an offence for an insurer to provide cover of less than this amount. A contravention of this requirement incurs a maximum penalty of 12 months imprisonment (**clause 17**).

Retroactive and run-off cover

The Bill also states that providers of 'claims made' medical indemnity cover will be required to offer to the insured 'retroactive cover' (**clause 21 and 22**) and 'run off' cover

(**clause 23**) to ensure that the insureds are comprehensively covered for all claims that may be made against them.

Until 1997, all MDO's provided protection on a 'claims incurred' basis. Currently some MDO's only offer 'claims made' policies.[17] The Trowbridge Report stated that the main reason for this shift has been;

> The greater level of predicability of the costs of claims made protection rather than claims occurring protection, owing to the long reporting delays that can occur with medical indemnity. From a pricing perspective, it was very difficult to 'get it right'; when protection is issued on a claims occurring basis [because of the large number of incurred but not reported claims][18]

There are however gaps in the coverage of 'claims made' policies and this Bill seeks to remove these gaps by imposing the requirement to supply additional cover.

Under the Bill, 'retroactive cover' must be offered at the time that the insurer offers 'claims made' cover. 'Retroactive cover', will ensure that incidents that took place before the commencement of the 'claims made' policy that give rise to claims notified during the term of the 'claims made' policy, are covered by indemnity insurance. If the insured does not hold 'retroactive cover', these claims will be uninsured as 'claims made' cover only applies to incidents that occur and are notified during the term of the policy.

In addition, an insurer that provides 'claims made' cover to an insured must offer 'run off' cover to the insured if the insured dies, becomes disabled, retires, terminates their insurance policy, does not renew their insurance contract, or during the term of the policy, specifically makes a request for 'run off' cover. A 'claims made' policy ceases when one of these events (other than making a request for run off cover) occurs. A claim that arises from an incident that occurred whilst the 'claims made' policy was active and that was notified after the policy terminates will be uninsured. Run-off cover provides indemnity insurance for these claims.

Failure to provide retroactive or run-off cover is an offence with a maximum penalty of 12 months imprisonment **(clauses 22 and 23)**.

Offers for run-off cover and retroactive cover must comply with the requirements set out in **clause 24**, including the requirement that the offer must take the form an insurance contract, and the premium to be paid on the policy is reasonable.

APRA may issue guidelines to determine if the premium that is payable is reasonable (**clause 25**).

The Australian Securities and Investments Commission is responsible for the ensuring that these minimum standards are met (**clause 30**). If an insurer fails to comply with the requirements to provide retroactive and run-off cover, the Federal Court may grant an injunction ordering the insurer to offer the cover.

Insurance intermediaries are also required to ensure that the policies that they offer comply with the minimum cover requirements in **clauses 16-20** or the retroactive cover requirements in **clause 22**. Interestingly, an insurance intermediary is not required to ensure that the policies that they offer comply with the requirement to offer run-off cover.

Part 5 of the Act contains anti-avoidance provisions. Under these provisions, where arrangements for medical indemnity cover were entered into before 1 July 2003 and the sole or dominant purpose of entering into these arrangements was to avoid having provisions of the Bill apply to them, the arrangement will be one that is treated as being entered into after 1 July 2003 and hence subject to all the requirements within the Bill.

Concluding Comments

This Bill puts in place key regulatory requirements to ensure that providers of medical indemnity insurance meet the prudential regulatory requirements that are imposed on all other providers of general insurance in Australia.

In addition to this, the Bill states that medical indemnity insurance contracts must have certain key attributes so that health care professionals have access to insurance policies that give then complete coverage.

The Bill forms part of the Government's package of legislative measures to respond to the insurance crisis and are designed to address underlying deficiencies in the current arrangements for the regulation of MDO's in Australia.

Endnotes

1 A New Medical Indemnity Insurance Framework, *Media Release*, Mr John Howard, Prime Minister, 22 October 2002: http://www.pm.gov.au/news/media_releases/2002/media_release1937.htm, (25 February 2003).

2 The AHMAC Legal Process Reform Group, *Responding to the Medical Indemnity Crisis: An Integrated Reform Package*, 2002 stated that in 2001, UMP premiums rose by an average of 50% (page 4): [http://www.health.act.gov.au/publications/medicalindemnity/index.html], (25 February 2003).

3 Gillian Harrex et al, Medical Indemnity in Australia, Presented to the Institute of Actuaries in Australia XIII General Insurance Seminar, Trowbridge Consulting, November 2001: [http://www.trowbridge.com.au/4A2568A90009B04D/0/B5C44D7ADCDC789DCA256BDC0001B3F3/$FILE/Med_Indem_Aust_Apr02.pdf?OpenElement], (25 February 2003) AHMAC Legal Process Reform Group, *Responding to the Medical Indemnity Crisis: An Integrated Reform Package*, 2002:

[http://www.health.act.gov.au/publications/medicalindemnity/index.html], (25 February 2033) Australian Competition and Consumer Commission, *Second Insurance Industry Market Pricing Review (2002)*, September 2002.

4 Susan Dudley. 'Medical Indemnity Bill 2002', Bills Digest No 71, 2002–2003, Department of the Parliamentary Library: http://www.aph.gov.au/library/pubs/bd/2002-03/03bd071.htm

5 Gillian Harrex op. cit, p. 19.

6 The AHMAC Legal Process Reform Group op. cit, p. 95.

7 *Insurance Act 1973*, sections 9–17.

8 *Insurance Act 1973*, section 24–27.

9 *Insurance Act 1973*, section 32–35. APRA has released a number of prudential standards; Capital Adequacy for General Insurers, Assets In Australia for General Insurers, Liability Valuation for General Insurers, Risk Management for General Insurers, Reinsurance Arrangements for General Insurers, Transfer and Amalgamation of Insurance Business for General Insurers, Early Approvals of Auditors and Actuaries. A copy of these prudential standards is located at: [http://www.apra.gov.au/General/loader.cfm?url=/commonspot/security/getfile.cfm&PageID=4206], (25 February 2003).

10 *Insurance Act 1973*, section 39–40.

11 *Insurance Act 1973*, section 44.

12 *Insurance Act 1973*, section 28.

13 'Doctors insurance plan in trouble', *The Australian Financial Review*, 18 February 2003.

14 It is not entirely accurate to say that MDO's are never subject to the Insurance Act or APRA regulation. For example Australian Medical Insurance Limited (AMIL) provide insurance policies to doctors.

15 Section 12 *Insurance Act 1973.*

16 Section 32 *Insurance Act 1973.*

17 Gillian Harrex op. cit p. 12.

18 Gillian Harrex, op. cit p. 13.