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APRA Member

30 June 2004

[To all medical defence organisations]

REPORTING REQUIREMENTS FOR MEDICAL DEFENCE ORGANISATIONS

As you know, APRA recently undertook consultation in respect of a proposed reporting framework for Medical Defence Organisations (MDOs). APRA has now made reporting standards under the *Financial Sector (Collection of Data) Act 2001* to implement this reporting framework. These reporting standards commence today.

Outlined below is a summary of the main issues raised by respondents in respect of the proposed reporting framework and the actions APRA has taken in response to this feedback. The forms and instructions have been redrafted to reduce overlap and to more clearly tailor the forms to the business of MDOs. Some of the forms originally proposed have been deleted.

It has been pleasing to note that the majority of respondents have confirmed that in principle they support the proposed collection of data in respect of MDOs by APRA. APRA acknowledges, however, that some MDOs may initially face some difficulties in preparing the data required. We are willing to work through these issues with the MDOs and envisage that the timeframe within which MDOs will be required to provide the first set of data will be sufficient to enable such issues to be resolved.

Objectives of the data collection

Some respondents noted concerns in respect of the costs versus the benefits of the proposed new reporting requirements for MDOs. As highlighted in our initial consultation letter, APRA is concerned about the health of the medical indemnity insurance industry as a whole. This includes the potential impact that the financial position of an MDO may have on its subsidiary medical indemnity insurers (MIIs) that are prudentially regulated by APRA. Since MDOs provided medical indemnity coverage prior to the 1st July 2003, MDOs retain legacy liabilities from business written prior to this date and these liabilities can, and do, have an impact on the health of the overall industry.

The reporting standards will therefore require MDOs to submit a range of financial information to APRA. APRA will use this information to assist in the prudential regulation of MIIs, taking into account the circumstances of the medical indemnity 'group' as a whole. The data collection is also intended to assist the Government in its implementation of a number of medical indemnity reforms and in monitoring whether those reforms continue to meet their stated objectives. The data collection will also better position APRA to forewarn the Government of any deterioration in the financial viability of an MDO.

Submissions and APRA response

Consolidated reporting

Respondents sought clarification on whether APRA proposed to collect consolidated data in addition to data in respect of the MDO. After consideration of this issue we have decided that we will not require consolidated reporting. MDOs will therefore only be required to report to APRA on a stand alone basis. This reporting will include details of large asset exposures (refer MRF 150.0 Asset Exposures).

APRA also collects data from the MIIs on a quarterly basis, and five of the MIIs are subsidiaries of MDOs. The information provided by the MIIs, in addition to that proposed for MDOs, should be sufficient to enable APRA to assess the financial position of the MIIs and their related MDOs and also identify any emerging issues in relation to the medical indemnity industry.

In addition, MIIs currently provide APRA with a Financial Condition Report (FCR) that includes details in respect of intra-group relationships and the financial position of the group overall. Since APRA will not be requiring consolidated reporting, APRA proposes to strengthen this FCR by requiring the actuary to consider the impact of intercompany and intra-group transactions on the MII. Further, when providing their report on the valuation of MDO outstanding claims liabilities, the actuary for the MDO will need to include commentary on relevant intercompany and intra-group reinsurance transactions.

Capital requirements

Some respondents also questioned the applicability of the proposed Minimum Capital Requirement (MCR) form. As we have decided not to pursue consolidated reporting as outlined above, we will not require the completion of the MCR form. Also, where the proposed reporting forms and instructions made reference to "risk charges", these references will be deleted. There will be no MCR imposed on an MDO. However, the financial information provided by the MDO will enable APRA to review the financial position of MDOs and emerging issues as indicated above.

Maximum Event Retention (MER)

Several respondents raised concerns in respect of the applicability of a MER for MDOs who are effectively in run-off. APRA would expect that, as part of the determination of IBNR liabilities, there should be allowance made for unexpected large losses arising from past claims or from a series of claims arising from the one dependent cause. Accordingly, allowance for such unexpected large losses should be considered in the context of determining outstanding claims liabilities and we would expect to see this issue being addressed in the actuary's report in respect of the calculation of MDO liabilities. Because this information will be received in this fashion, APRA has decided to not impose a separate reporting requirement and has deleted form MRF 170 Maximum Event Retention.

Claims development

Respondents also expressed concerns with the proposed claims development tables for prior years. A number of difficulties were noted particularly in instances where the basis of coverage had changed from a claims incurred basis to a claims made basis. There were also issues noted in respect of reporting underwriting years or accident years and the different bases of cover provided in prior years which may not allow for consistency in reporting.

In light of these considerations we have decided to delete proposed MRF 440.0. However, the actuary will need to include commentary in their report on the valuation of MDO liabilities in respect of claims development, particularly in relation to the differing bases of cover previously provided.

Premiums and reinsurance expense

Some respondents argued that the reporting of premium revenue and reinsurance expense was obsolete since covers had ceased and no further inwards premiums would be received and no further reinsurance expense would be incurred. APRA recognises this will be the case for the majority of MDOs. The intention, however, was to recognise premium adjustments (inwards and outwards) and reinsurance premium adjustments based on results of the various underwriting and/or accident years. Following the comments received and on the understanding that there would be minimal exposures to these by all MDOs, we have decided to delete MRF 310.1.

Accordingly, MRF 310.0 has been amended to more clearly reflect the revenue received by MDOs (that is, contribution income received from MDOs' membership). Line items will still be included for premiums revenue and reinsurance expense to accommodate the reporting of any adjustments where necessary (as noted above).

Confirmation was also requested in respect of the reporting of contribution income. This should be accounted for on a prospective basis, that is, recognised 100 percent at the date of payment to the MDO. This has been detailed in the instructions to MRF 310.0 Statement of Financial Performance.

Calculation of MDO liabilities

Submissions noted that MDOs are not subject to tax on income so there should be no tax effect on excess margins. APRA has incorporated this change. Similarly, the discount rate in paragraph 20 of the 'Calculation of MDO Liabilities' stated that this should be the discount rate net of tax and this has also been amended.

There was a suggestion made that paragraph 3 in the 'Calculation of MDO Liabilities', was not clear in respect of the nature of the liabilities, particularly where there had been changes to bases of coverage in years leading up to 1st July 2003. APRA has not specifically made reference to this in the instructions as the actuary should be able to assess the liabilities of the differing types of coverage to ensure that due allowance is made for extended reporting benefits or triggered death, disablement and retirement benefits.

The instructions for 'Calculation of MDO Liabilities' have now been incorporated into MRF 210.0 Outstanding Claims Liabilities.

Reporting requirements

As a result of the foregoing amendments to incorporate comments received, we have reduced the number of reporting standards to the following 17:

- MRS 120.0 Capital Base
- MRS 130.0 Off Balance Sheet Business - Credit Substitutes Provided
- MRS 130.1 Off Balance Sheet Business - Liquidity Support Facilities Obtained
- MRS 130.2 Off Balance Sheet Business - Charges Granted
- MRS 130.3 Off Balance Sheet Business - Credit Support Received
- MRS 140.0 Investments - Direct Interest Rate Holdings
- MRS 140.1 Investments - Direct Equity Holdings
- MRS 140.2 Investments - Direct Property Holdings
- MRS 140.3 Investments - Loans and Advances
- MRS 140.4 Investments - Assets Indirectly Held
- MRS 150.0 Asset Exposures
- MRS 160.0 Derivative Activity
- MRS 210.0 Outstanding Claims Liabilities
- MRS 300.0 Statement of Financial Position
- MRS 310.0 Statement of Financial Performance

- MRS 310.2 Claims Expense and Reinsurance Recoveries
- MRS 310.3 Investment and Operating Income and Expenses

The reporting standards will specify the overall requirements for the provision of the data to APRA. The reporting standards will also comprise the relevant forms and instructions. As previously advised, each of these reporting standards will specify the basis upon which the data contained in the forms must be calculated. Specifically, assets other than land and building and other assets that are not normally relied on to meet outstanding claims liabilities or not generally of significance in assessing the performance of a MDO should be reported at market value and liabilities will be required to be valued in accordance with the principles stated in the instructions to MRF 210.0 Outstanding Claims Liabilities (that is, at a 75% level of sufficiency).

Reporting frequency and timeframes

Several comments were received indicating that the proposed timeframes were onerous however there appeared to have been some misunderstanding as to the proposed reporting timeframes. The requirements are clarified below.

Initial reporting

The first set of reporting forms (i.e. as at 30 June 2004) will be required to be submitted to APRA by 31 October 2004.

For MDOs with a balance date of 30 June, this set of reporting forms must be in respect of the 12 months to 30 June 2004. These then represent the MDO's 'annual' reporting forms and must comply with the audit and actuarial requirements.

For MDOs with a balance date of 31 December, this set of reporting forms must be in respect of the 6 months to 30 June 2004. This set of reporting forms will not be considered the 'annual' reporting forms of the MDO.

Any potential difficulties in meeting this reporting timeframe should be discussed with APRA.

Ongoing reporting

There are two reporting periods at 6 monthly intervals, i.e. half yearly and annual reporting. The same forms are to be used for both types of reporting.

For annual reporting, MDOs will have 4 months from their balance date to submit the reporting forms to APRA (that is, an MDO with a balance date of 30 June will be required to submit annual forms to APRA by 31 October, and an MDO with a balance date of 31 December will be required to submit annual forms to APRA by 30 April).

The half yearly (unaudited but audit checked) reporting forms are to be submitted to APRA within 20 business days of the end of the half year. APRA does not require a full actuarial valuation nor a fully audited version of the reporting forms for these half yearly reporting forms.

Audit and actuarial requirements

These requirements were outlined in our initial letter and no comments were received in respect of these proposed requirements. Accordingly, no changes will be made to these proposals other than the additional requirements to be included in the report of the actuary on the calculation of MDO liabilities as noted above.

Commencement

As noted above, APRA has determined the reporting standards and these become effective today (30 June 2004). MDOs are therefore required to submit their first set of reporting forms to APRA by 31 October 2004.

Copies of the Reporting Standards (including the forms and instructions) are available on the APRA website at <http://www.apra.gov.au/General/Medical-Defence-Organisations.cfm>. MDOs will also be provided with electronic copies of the forms to facilitate submission to APRA.

If you have any queries in relation to the new reporting requirements please contact Nigel Boik (phone 02 9210 3388, or email nigel.boik@apra.gov.au).

Yours sincerely

A handwritten signature in black ink, appearing to read 'Nigel Boik', with a long horizontal flourish extending to the right.