

General Purpose Standing Committee No. 1

# **NSW Workers Compensation Scheme**

## **Second Interim Report**

Ordered to be printed according to the Resolution of the  
House

New South Wales Parliamentary Library cataloguing-in-publication data:

**New South Wales. Parliament. Legislative Council. General Purpose Standing Committee No. 1**

NSW Workers Compensation Scheme: Second Interim Report / General Purpose Standing Committee No. 1. [Sydney, NSW]: The Committee, 2002. - 295 p.; 30 cm. (Parliamentary paper, no. 1102)

Chair: The Revd the Hon Fred Nile MLC  
"Ordered to be printed 17 January 2002".

**ISBN 0-7347-6474-X**

1. Workers compensation—New South Wales.
- I. Title
- II. Nile, Fred.
- III. Series: Parliamentary paper (New South Wales. Parliament); 1102

368.41 (DDC21)

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## Terms of reference

- 1) That General Purpose Standing Committee No. 1, have the following functions:
  - a) to monitor the financial position of the workers compensation scheme under the Workers Compensation Act 1987 and the Workplace Injury Management and Workers Compensation Act 1998, and
  - b) to monitor and review the implementation and operation of the Workers Compensation Legislation Amendment Bill 2001 (No. 2) and the Workers Compensation Legislation Further Amendment Bill 2001, as finally passed by the Parliament,
  - c) to investigate and report on the efficiency of the operation of the workers compensation system and the administration of the WorkCover Authority,
  - d) to monitor the impact on premiums of the Bill.
- 2) That the Committee be authorised to engage the services of:
  - a) an actuary, who is a member of the Institute of Actuaries of Australia, and
  - b) an accountant, who is a member of the Institute of Chartered Accountants in Australia or the Australian Society of Certified Practising Accountants,
  - c) for the purpose of advising and assisting the Committee, as the Committee thinks fit, in relation to the Committee's functions.
- 3) That the Committee:
  - a) provide interim reports to the House each 3 months, and
  - b) finally report to the House by 30 June 2002.
- 4) Nothing in this resolution authorises the Committee to investigate a particular compensation claim—put and passed.

*(Minutes of Proceedings No. 111, 28 June 2001, Item No. 21 and Minutes of Proceedings No. 134, 29 November 2001, Item No. 23)*

These terms of reference were referred to the Committee by the House.

## Committee membership

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**The Revd the Hon Fred Nile MLC** Christian Democratic Party (Chairman)

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**The Hon Tony Kelly MLC** Australian Labor Party (Deputy Chairman)

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**The Hon Michael Gallacher MLC** Liberal Party<sup>1,2</sup>

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**The Hon Greg Pearce MLC** Liberal party<sup>3</sup>

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**The Hon Janelle Saffin MLC** Australian Labor Party<sup>4</sup>

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**The Hon Henry Tsang MLC** Australian Labor Party

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**The Hon Dr Peter Wong MLC** Unity

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<sup>1</sup> Correspondence received 6 July 2001, the Hon Richard Colless MLC will replace the Hon Patricia Forsythe MLC for the duration of this inquiry.

<sup>2</sup> Correspondence received 29 October 2001, the Hon Mike Gallacher MLC will replace the Hon Richard Colless MLC for the duration of this inquiry.

<sup>3</sup> Correspondence received 6 July 2001, the Hon Greg Pearce MLC will place the Hon Don Harwin MLC for the duration of this inquiry.

<sup>4</sup> Correspondence received 8 Aug 2001, the Hon Janelle Saffin MLC will replace the Hon Peter Primrose MLC for the duration of this inquiry.

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## Chairman's Foreword

This is the second of four reports from the Committee's inquiry into the NSW Workers Compensation Scheme. The report focuses primarily on Scheme design whilst continuing to investigate the financial situation being experienced by the Scheme, including the financial impact of 2001 legislative reforms and possible mechanisms for reducing the deficit. In this report the Committee draws conclusions regarding the information received during the inquiry to date. It is envisaged that the Committee will make its recommendations in the fourth and final report to be tabled by 28 June 2002.

Evidence reviewed by the Committee identified a lack of stakeholder ownership over the Scheme as being a primary problem inherent in the NSW Scheme's design. It is believed that this lack of ownership and control by stakeholders is impacting adversely on most aspects of the scheme including claims management, compliance and return to work rates.

Various methods for increasing stakeholder ownership were examined by the Committee, and workers compensation schemes in other jurisdictions were considered for guidance. A number of options were identified as worthy of further investigation. While valuable lessons can be learned from other jurisdictions, it is important to take care when applying aspects of other schemes in the New South Wales context. The Committee is aware that what works in one jurisdiction will not necessarily be appropriate for New South Wales due to the structural, historical, environmental and cultural differences that exist.

This lack of ownership also extends to the scheme's finances for which no direct accountability or responsibility is defined under the current legislation. No stakeholder, including WorkCover has legal ownership of the deficit. The Committee has concluded that there is an urgent need to rectify this situation by establishing clear accounting and legislative responsibility for the Scheme's finances.

During the course of the inquiry the Committee has received conflicting evidence about the extent to which the proposed 2001 legislative reforms would reduce Scheme expenditure and thus improve its financial position. Evidence presented to the Committee in public hearings by WorkCover's Scheme actuaries, Tillinghast Towers Perrin, stated that the 2001 legislative reforms would have only a minor impact on the Scheme's deficit and that further measures, such as increasing premiums or reducing benefits, were necessary.

Consequently, the Committee developed four scenarios for resolving the Scheme's deficit and sought actuarial review from WorkCover's actuaries Tillinghast-Towers Perrin. In response the Committee received figures showing significantly greater savings based on an alternate actuarial approach. The report (dated January 7 2002) concluded that the savings from the 2001 reforms would be sufficient to stabilise the Scheme in 23 years based on a 'high implementation scenario'. In considering a low implementation scenario, the 2001 reforms would still be insufficient to bring the Scheme back to a fully funded position. Irrespective of the impact of the 2001 legislative reforms, the current average premium collected by WorkCover remains insufficient to meet the current costs of the Scheme.

At the time of reporting, the Committee has had insufficient time to properly review the actuarial advice given to the Committee by Tillinghast-Towers Perrin on 7 January 2002 and further advice received by the Committee on 14 January 2002. As part of its ongoing inquiries, in preparation for the Committee's third interim report the Committee intends to review the advice and conclusions received

The Committee recognises the assistance of the Hon John Della Bosca MLC, Special Minister of State and Minister for Industrial Relations and the office of WorkCover and Tillinghast Towers-Perrin for their continued assistance and consideration in working to achieve successful workers compensation outcomes for New South Wales.

Finally, I take this opportunity to thank my fellow Committee Members and the Committee secretariat for their tireless work on this demanding inquiry. In particular, Committee Director, Mr Steven Carr, for overseeing the Inquiry and to Senior Project Officer Ms Rachel Simpson and Project Officer Ms Emma Lawson who shared in the drafting of this comprehensive and balanced report. I am also very appreciative of the work undertaken by the Committee Officers Ms Ashley Nguyen and Ms Natasha O Connor in formatting the report, assisting in the administration of all aspects of the inquiry and in particular for facilitating the delivery of information from representatives in Victoria, Western Australia via tele-conferencing and videoconferencing. Video conferencing proved to be an innovative, effective and cost efficient means for the Committee to discuss issues of interest. Acknowledgment must also be given to the assistance and general counsel of Mr David Blunt, Acting Clerk Assistance, Committees and Mr Peter McCarthy and Mr Warrick Gard from Ernst and Young for their actuarial advice and guidance.

The Revd the Hon Fred Nile MLC

**Chairman**

## Summary of committee conclusions

### **Conclusion 1** *Page 8*

The level of deficit as at 30 June 2001 of \$2.76billion is a serious concern. The deficit will continue to grow by an increasing amount each year unless measures are put in place to halt its growth and stabilise the Scheme.

Only once the Scheme is stabilised, can measures be put in place to reduce the level of deficit

### **Conclusion 2** *Page 9*

The main factors that have contributed to the Scheme's current level of deficit include:

- increased use of common law;
- inappropriate commutation payments;
- inadequate premium collection, and
- reduced return on investments.

### **Conclusion 3** *Page 14*

Due to the apparent disunity amongst psychiatrists and psychologists, and uncertainty about the level of claims and awards that will be made for psychological impairment, the Committee will continue to monitor WorkCover's adoption and application of PIRS as a means of assessing permanent psychological impairment for the purpose of receiving section 66 and section 67 payments.

### **Conclusion 4** *Page 15*

The compensation of workers with a psychological impairment is a positive development in workers compensation. However, it is possible that claims for permanent psychological impairment will increase considerably once the legislation becomes operational. Historical data on claims for psychological impairment may not be an accurate indicator of future claims experience.

There is evidence to suggest that past legislative and regulatory reforms have resulted in unexpected changes in the nature of benefits claimed, for example in relation to commutations.

### **Conclusion 5** *Page 16*

As part of its monitoring of the implementation of the 2001 Act and the Further 2001 Act, under Terms of Reference 1 (b), the Committee will monitor the completion of the projects identified by WorkCover against the key dates specified in their Implementation Plan up to and including June 2002.

### **Conclusion 6** *Page 23*

If the January 2002 figures are correct it is possible that WorkCover, the Government and other stakeholders were not properly informed of the potential higher level of savings to be realised from the December 2001 reforms during the passage of the Bill.

The final costing by the Scheme's actuary dated 14 January 2002 indicated that the successful implementation of the recent reforms will have one-off savings on the deficit of up to \$1.33 billion and ongoing savings of up to \$400 million per annum.

**Conclusion 7** *Page 32*

During the second reading speech, , repealing the measures for private underwriting and in the Minister's letter to the Chairman dated 8 January 2002, the Government indicated that further consideration of underwriting options would occur at a later date. The Committee endorses any efforts in this regard. It may be appropriate to reconsider underwriting options once the Scheme's deficit has stabilised.

The Committee recognises that the Government's ten point plan for reforming the scheme encapsulates principles of scheme design, and that if the Government's reform program is successfully implemented, that the NSW scheme will satisfy these principles.

**Conclusion 8** *Page 36*

The establishment of the Advisory Council was a mechanism to instil a sense of control over scheme ownership by stakeholders. This purpose remains valid.

Four years after the Grellman report and over a year after the merger of the Advisory Council and the Occupational Health and Safety Council, there remains a lack of scheme ownership among stakeholders. This lack of ownership continues to adversely impact on claims management, compliance, and return to work rates. This situation, combined with a lack of clarity regarding responsibility for the financial management of the scheme is culminating in ongoing problems with the deficit.

The Government's proposed review of scheme design and the successful implementation of the Government's ten-point plan for the reform of the Scheme may improve stakeholder ownership in the Scheme.

**Conclusion 9** *Page 38*

The Committee believes that there is an urgent need to:

- improve stakeholder ownership of all aspects of the Scheme and;
- establish clear accounting and legislative responsibility for the Scheme's finances

The Government's proposed review of scheme design and the successful implementation of the Government's ten-point plan for the reform of the Scheme may improve stakeholder ownership and clarify accounting and legislative responsibility for the Scheme's finances

**Conclusion 10** *Page 42*

The Committee will continue to monitor the implementation of the new insurer remuneration arrangements during the course of its inquiry.

**Conclusion 11** *Page 48*

Common law costs have contributed significantly to the Scheme deficit. It is likely that the recent legislative changes will reduce these common law costs however the exact level of savings that will be made to the Scheme are uncertain at this stage.

**Conclusion 12** *Page 50*

Commutation costs have contributed significantly to the Scheme deficit. It is likely that the recent legislative changes will reduce these commutations costs however the exact level of savings that will be made to the Scheme are uncertain at this stage.

**Conclusion 13** *Page 54*

There is a need for further analysis of benefits being received by the seriously injured to ensure that they are adequately compensated, and that those with less severe injuries are not being relatively over compensated.

**Conclusion 14** *Page 58*

The current average premium of 2.76% is insufficient to cover the current costs of the Scheme. The average premiums have been insufficient since 1991-92.

The final 'high', 'optimistic' actuarial projections on the 2001 reforms indicate that the effective implementation of the reforms will reduce costs below premiums and commence a significant downward trend in the deficit (however, these costings have not been tested by the Committee).

**Conclusion 15** *Page 65*

Certain aspects of the group improvement rebate schemes seem to provide mechanisms for not only aiding scheme ownership by employers but also encouraging improvements to be made to OH&S and injury management. To this end, the Committee notes that the NSW Government has implemented a Premium Discount Scheme and Small Business Strategy, and the Committee considers that the implementation of these programs should be monitored more closely before further consideration is given to other programs, such as the proposed Victorian Group Improvement Rebate program, which has not been implemented or tested to date.

**Conclusion 16** *Page 66*

Self insurance has expanded and seems to be operating efficiently and economically. The implications for the Scheme of the recent changes have yet to be determined. Future examination of the benefits of the self insurers model would be beneficial to the financial viability of the Scheme.

**Conclusion 17** *Page 69*

Advisory councils, such as in Western Australia and Queensland, which are representative but not cumbersome, can be an effective means of increasing stakeholder ownership of workers compensation schemes.

The Committee notes the Minister's letter to the Chairman dated 8 January 2002 indicating that the Government is committed to improving Scheme design, and that the Minister has indicated that as part of the final stage of the Government's reform agenda, the Government is proposing a review of scheme design to identify their preferred options for underwriting the Scheme, and for achieving better Scheme options.

**Conclusion 18** *Page 71*

The Queensland model of separating conflicting functions provides an interesting comparison for New South Wales, however the extent of its usefulness depends largely on what roles WorkCover New South Wales is considered to perform. In Queensland, WorkCover has a very clear role as the sole public insurer, both managing and underwriting the scheme, whereas insurer roles and functions of WorkCover New South Wales need to be more clearly defined.

The Committee notes the Minister's letter to the Chairman dated 8 January 2002 indicating that the Government is committed to improving Scheme design, and that the Minister has indicated that as part of the final stage of the Government's reform agenda, the Government is

proposing a review of scheme design to identify their preferred options for underwriting the Scheme, and for achieving better Scheme outcomes.

**Conclusion 19** *Page 73*

It is noted that under the current arrangements the Board is responsible for providing the Government with independent advice about premium rates, and that this role may be reconsidered during the Government's review of Scheme design.

**Recommendation 20** *Page 87*

Although the option of reinsurance is a radical one it should be investigated further as one of a number of options to reduce the deficit, after the recent reforms have been successfully implemented and the Scheme is showing significant positive trends.

**Conclusion 21** *Page 88*

The Committee notes the Government has a multifaceted strategy to reduce the deficit, and if the recent reforms and other strategies are effectively implemented, they should reduce the underlying costs of the Scheme and have a tangible impact on the Scheme's deficit.

# Glossary & abbreviations

## Glossary

The following definitions of key terms and concepts are based on those provided to the Committee by the Committee's consultant actuaries, Ernst & Young ABC.

<b>Actuarial report</b>	Is simply a report by an actuary. The scope of the actuarial report can cover many aspects. WorkCover obtain actuarial reports on a regular basis for the actuarial estimate of the outstanding claims liabilities and the estimated premium rate to fund the cost of claims and related expenses in a year. Less regular reports are obtained on such matters as costings of changes to the scheme (e.g. common law), remuneration for insurers, review of the premium rating system and industry premium rate relativities.
<b>Claims management</b>	The effective co-ordination of all tasks (e.g. medical management, legal management, rehabilitation management, payment of entitlements, claim strategy, co-ordination of claim management with the employer, injury management, etc) associated with the just and economic resolution of a claimant's rights pursuant to the <i>Workers Compensation Act</i> .
<b>Commutations</b>	The workers compensation scheme pays ongoing weekly, medical and related benefits. Under the Act an insurer, with the consent of the worker and approval of the court, can commute all future weekly and other regular payments and receive the lump sum equivalent. After the commutation all ongoing payments cease. In theory the worker still retains the right to sue at common law but normally when negotiating the level of the commutation the worker signs a common law deed of release and gives up the right to common law action. The S66/67 lump sums are usually settled at the same time as the commutation. In many ways commutations could be viewed as an out of court settlement of a common law action.
<b>Deficit</b>	The deficit of the scheme is the difference between the value of its assets and liabilities. If the value of assets exceeds the value of liabilities the scheme is in surplus and if the value of liabilities exceed the value of assets the scheme is in deficit. The funding ratio is the value of assets divided by the value of liabilities for the NSW workers compensation Scheme. The largest asset are investments including cash and the next largest item are unpaid premiums. The largest liability item is the estimate of the value of outstanding claims liabilities as estimated by the actuary including the value of the claims handling expenses.
<b>Injury management</b>	Restoration of workers pre-injury physical condition, or alternatively to provide assistance to attain optimal recovery (i.e. return to work). Also to

co-ordinate and support workers' attempts to mitigate secondary economic loss through effective rehabilitation.

**Premium leakage**

Is a subset of **system leakage**

**Recoveries**

Under workers compensation in New South Wales an insurer is entitled to seek recovery from another party where the other party contributed to the injury of the worker. Examples include: recoveries from a CTP insurer where the worker was involved in a car accident while working; recoveries from a product liability insurance policy where a product used by the worker was faulty and caused an injury to the worker (a good example is asbestos), and recoveries off other workers compensation insurers which insured the employer over different periods over which the injury occurred (a good example is deafness which may have arisen over a period of 30 years from 1971 to 2001 and the employer was insured by 5 different insurers over that period).

**Redemptions**

Under the *Workers Compensation Act 1926 (NSW)*, commutations were known as redemptions. Redemptions became known as commutations under the 1987 Act.

**Risk free rate of return**

In the actuarial valuation of the scheme's outstanding claims liabilities the future liability cash flow (i.e. future claims payments) are discounted using an appropriate interest rate. The interest rate normally used is the risk free rate of return being the market interest rate on Government bonds for the length of the liability cash flows. APRA (Australian Prudential Regulation Authority) in the amendments recently incorporated into the *Insurance Act* require the use of the risk free rate of return for discounting all insurers claims liabilities (note APRA does not apply to the NSW workers compensation scheme liabilities under the managed fund).

**Section 66 benefit**

Is compensation for permanent injury (e.g. loss of an eye, loss of an ear) and is sometimes referred to as a 'Table of Maims'. The benefit paid is calculated as a percent of a maximum amount with the percent depending on the nature and extent of the injury. [The Committee notes that the method for calculating permanent impairment was changed under the 2001 Act].

**Section 67 benefit**

Is compensation for pain and suffering and is equivalent to the non-economic loss benefits paid under common law. Like section 66 the loss is based on a table and is a percent of the maximum amount of \$50,000 with the percent depending on the extent of the pain and suffering. Claimants can only gain access to section 67 compensation if they pass a threshold, being the ability to receive compensation of at least 15% of the maximum amount under Section 66.

*Section 66 and Section 67 benefits are referred to as Statutory lump sum payments.*

**System leakage**

Leakage can refer to a variety of different matters and have different interpretations. In its simplest form it can refer to employees receiving compensation that they strictly should not have received and to employers that strictly have under paid premiums. Both situations adversely impact on the financial status of the scheme and there are numerous examples. Leakage may occur from the actions of many stakeholders in the scheme including employers, employees, WorkCover, insurers, doctors, lawyers, and all others. Leakage can refer to direct fraud or to avoidance or to malingering and other views. Employer and employee fraud is one form of leakage. Examples of direct fraud include a worker claiming compensation for an injury that did not occur and an employer under declaring wages or not insuring for workers compensation or an employer deliberating using the wrong industry classification for premium calculation. Other examples of leakage include: workers staying on compensation when they are strictly well enough to return to work by using doctors' medical certificates to substantiate the injury; employer splitting the company into smaller legal entities to reduce premiums paid; putting pressure on insurers to reduce case estimates to reduce the employers premium, incorrect classification of employer industry classification by insurers.

Insurer's poor management including poor claims management, not undertaking wage audits of employers, not following WorkCover guidelines on case estimating may cause leakage. WorkCover's poor management of insurers and stakeholders is also a form of leakage. Such an example is not taking action to improve insurer management of claims.

## Abbreviations

<b>1987 Act</b>	<i>Workers Compensation Act 1987</i>
<b>1998 Act</b>	<i>Workplace Injury Management and Workers Compensation Act 1998</i>
<b>2001 Act</b>	<i>Workers Compensation Amendment Act 2001</i>
<b>APRA</b>	Australian Prudential Regulation Authority
<b>Common Law Report</b>	PwC, <i>Analysis of trends in NSW Workers' Compensation common law claims</i> , June 2001
<b>Commutations Report</b>	PwC, <i>Analysis of Trends in NSW Workers' Compensation Commuted Claims</i> , October 2001
<b>Ernst &amp; Young</b>	Ernst & Young ABC, the Committee's consultant actuaries
<b>Further 2001 Act</b>	<i>Workers Compensation Legislation Further Amendment Act 2001</i>
<b>Grellman Report</b>	Report of the Inquiry into Workers' Compensation System in NSW 1997
<b>IRG</b>	Industry Reference Group
<b>OH&amp;S</b>	Occupational health and safety
<b>PAC Report</b>	Parliament of NSW, Public Accounts Committee, <i>Financial Disclosure of the workers compensation Scheme Statutory Funds</i> , July 2000
<b>PwC</b>	PricewaterhouseCoopers
<b>Remuneration Report</b>	PwC, <i>Review of WorkCover NSW MGA Remuneration Arrangements</i>
<b>Scheme</b>	NSW Statutory Workers Compensation Scheme
<b>Sheahan Inquiry</b>	Commission of Inquiry into Workers Compensation Common Law Matters, August 2001
<b>Sheahan Report</b>	Report of the Commission of Inquiry into Workers Compensation Common Law Matters, August 2001
<b>SNEL</b>	Statutory non-economic loss
<b>Tillinghast</b>	Tillinghast-Towers Perrin (Scheme actuaries)
<b>WCRS</b>	Worker Compensation Resolution Service
<b>WorkCover</b>	WorkCover Authority of NSW
<b>wpi</b>	Whole person impairment

# Chapter 1 Introduction

## Referral of inquiry

**1.1** On 28 June 2001 during debate in the Legislative Council on the Workers Compensation Legislation Amendment Bill 2001 (No 2), the House passed a resolution referring the following terms of reference to General Purpose Standing Committee No 1:

1. *That General Purpose Standing Committee No. 1, have the following functions:*
  - (a) *to monitor the financial position of the workers compensation scheme under the Workers Compensation Act 1987 and the Workplace Injury Management and Workers Compensation Act 1998, and*
  - (b) *to monitor and review the implementation and operation of the Worker's Compensation Legislation Amendment Bill 2001 (No. 2), as finally passed by the Parliament,*
  - (c) *to investigate and report on the efficiency of the operation of the workers compensation system and the administration of the WorkCover Authority,*
  - (d) *to monitor the impact on premiums of the Bill.*
2. *That the Committee be authorised to engage the services of:*
  - (a) *an actuary, who is a member of the Institute of Actuaries of Australia, and*
  - (b) *an accountant, who is a member of the Institute of Chartered Accountants in Australia or the Australian Society of Certified Practising Accountants,*

*for the purpose of advising and assisting the Committee, as the Committee thinks fit, in relation to the Committee's functions.*
3. *That the Committee:*
  - (a) *provide interim reports to the House each 3 months, and*
  - (b) *finally report to the House by 30 June 2002.*
4. *Nothing in this resolution authorises the Committee to investigate a particular compensation claim<sup>5</sup>*

**1.2** On 29 November 2001, the terms of reference were amended to include the Workers Compensation Further Amendment Bill 2001 as finally passed by Parliament. Term of Reference 1(b) was affected. The amended term of reference reads:

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<sup>5</sup> *Minutes of the Proceedings of the Legislative Council*, No 111, 28 June 2001, Item No 21. and No 134, 29 November 2001, Item No 23. Resolution passed by the Legislative Council based original motion of Mr Gallacher MLC as amended by the motion of Rev Nile MLC, further amended on the motion of Rev Nile MLC.

- b) *to monitor and review the implementation and operation of the Worker's Compensation Legislation Amendment Bill 2001 (No. 2), and the Workers Compensation Further Amendment Bill 2001 as finally passed by the Parliament,*

## Conduct of this inquiry

**1.3** Reporting requirements stipulated in the Committee's terms of reference require provision of interim reports every three months (three in total) and a final report by 30 June 2002.

**1.4** The Committee identified the date of assent by the Governor of New South Wales to the Workers Compensation Amendment Legislation Bill 2001 (No 2) as the date at which the Committee commenced its review and monitoring functions with respect to this legislation and other parts of the terms of reference.<sup>6</sup> The Committee has agreed to the following timetable for completion of its interim and final reports based on the original assent date of 17 July 2001.

**Table 1.1 Inquiry reporting timetable**

Report	To be completed on or before
First interim report	17 October 2001
Second interim report	17 January 2002
Third interim report	17 April 2002
Final report	28 June 2002 (as 30 June 2002 is a Sunday)

**1.5** The Committee's first interim report was tabled on October 17, 2001 in accordance with the Inquiry's reporting timetable. That report included an overview of the workers compensation system in New South Wales and identified key issues and priority areas that the Committee intended to examine in subsequent interim reports and the final report. The report is available by telephoning the Committee Secretariat on (02) 9230 3544 or via the Internet at [www.parliament.nsw.gov.au/Committees](http://www.parliament.nsw.gov.au/Committees), following the links to General Purpose Standing Committee No 1.

### Additional submissions

**1.6** The Committee received 5 additional submissions to the inquiry since the release of its first interim report. A list of submissions is presented as Appendix 8.

### Public hearings, public briefings and questions on notice

**1.7** The Committee conducted public hearings and one public briefing in preparation for its second interim report. Hearings were conducted on 21-22 November 2001 and included representatives from the Scheme's actuaries, Tillinghast-Towers Perrin ("Tillinghast") and other actuarial, accounting and insurance industry representatives as well as officers of WorkCover. A list of witnesses appears as Appendix 9.

<sup>6</sup> Minutes of the Proceedings of General Purpose Standing Committee No 1, No 57, 6 July 2001, Item No 4.

- 1.8** A public briefing was conducted on 22 November 2001 at which the Committee focussed on interstate workers compensation systems and to this end was addressed by the chief executives of Queensland, Victorian and Western Australian WorkCover authorities. Possible limitations on the powers of the Committee to receive evidence from another jurisdiction required briefings to be conducted. Transcribed proceedings of the briefings have subsequently been identified as submissions to the Committee at the request of the participants.
- 1.9** A list of documents tabled by witnesses during the public hearings appears as Appendix 10.
- 1.10** Witnesses at the Committee's hearings agreed to take a number of questions on notice providing further information to the Committee than what was possible at the time of their appearance. The Committee found this process useful in obtaining additional and more technical information that may not normally be presentable orally.
- 1.11** Questions on notice arising out of the public hearings on 21 and 22 November, and responses received to date, are presented as Appendix 7.

### **Minutes of the proceedings of the Committee**

- 1.12** The Committee considered the Chairman's draft second interim report at its meeting on 9 January 2001. The Minutes of the Proceedings of the Committee since the first interim report was tabled on 17 October 2001, presented as Appendix 11, detail relevant resolutions and activities of the Committee over the course of preparing its second interim report.

### **Further reports**

- 1.13** The Committee's inquiry process for the third interim report will be similar to that of its first and second, involving research, assessment of stakeholder views, inviting witnesses to appear at public hearings and Committee analysis. Evidence and witnesses with particular areas of expertise will be invited to assist the Committee in its inquiry.

### **Structure of this report**

- 1.14** The second and third interim reports are intended to continue the strategy outlined in its initial interim report. While it is intended that each interim report examines discrete issues and thus stands alone, they rely on previous reports for background and context. Readers might find it particularly useful to refer to the report of the Committee's consultant actuaries, Ernst & Young ABC in Appendix 4 of the first interim report and Tillinghast's 30 June 2001 Scheme Evaluation in Appendix 8 when reading this second interim report.
- 1.15** As with many industry fields, there are a number of key terms and concepts within workers compensation that have specific meaning and relevance. A Glossary of some such terms provided to the Committee by its consulting actuaries, Ernst & Young ABC ("Ernst & Young") are presented at the front of this report at page xv to assist readers.

- 1.16** The body of this report consists of six chapters. Chapter 2 updates and further explains the financial position of the Scheme, drawing on evidence received by the Committee from the Scheme's actuaries, Tillinghast. Chapter 2 also outlines reforms contained in the *Workers Compensation Legislation Further Amendment Act 2001* ("the Further 2001 Act"), which was proclaimed on 19 December in Special Gazette No 195A and commenced on 1 January 2002.
- 1.17** Chapter 3 provides an outline of the model options available for workers compensation schemes. It looks at private and public schemes, and hybrid schemes such as the New South Wales scheme. Chapter 3 also identifies some important features of good scheme design.
- 1.18** Chapter 4 identifies problems inherent in the design of the New South Wales Scheme. The primary problem considered in this chapter is the lack of ownership of the New South Wales scheme, and the affects of a lack of ownership of the Scheme are highlighted. Other problems explored in Chapter 4 include:
- insurer remuneration;
  - benefit design;
  - premium design/setting;
  - OH & S injury and prevention;
  - funds management, and
  - non-compliance and fraud.
- 1.19** Chapter 5 considers options within the current New South Wales Scheme framework to increase ownership of the Scheme. Interstate models are examined in relation to the role of WorkCover within the Scheme and also the manner in which premium rates are set.
- 1.20** Chapter 6 focuses on options for reducing the Scheme's deficit. These include:
- increased premiums;
  - decreased benefit payments;
  - operational efficiencies, and
  - reinsurance.
- 1.21** Chapters 5 and 6 identify some options for improving the New South Wales Workers Compensation Scheme. These, and others identified in the Committee's third interim report, will be evaluated in the fourth and final report, which will also include the Committee's recommendations.

- 1.22** Appendix 3 contains “what if” scenarios for the management of the deficit. These will be examined in detail in the third interim report when submissions will be sought from all interested parties.
- 1.23** No Recommendations are made in this report. The Committee draws Conclusions at the end of each section where relevant and appropriate. Recommendations will be made in the fourth and final interim report.
- 1.24** The Committee welcomes comments by stakeholders in relation to the options identified in chapters 5 and 6. Comments may be forwarded to the Committee using the contact details listed on page iii of this report.



## Chapter 2      **Current state of NSW Workers Compensation Scheme**

### **Financial position of the Scheme**

**2.1**      The Committee's first interim report noted that the financial position of the Scheme had been reported to be \$2.76 billion at 30 June 2001.<sup>7</sup> In that report, the Committee stated its intention to investigate the size of the deficit and actuarial methodologies employed by WorkCover's Scheme actuaries in calculating their projections.<sup>8</sup> To this end, the Committee heard evidence from representatives from WorkCover's scheme actuary Tillinghast Towers-Perrin, Mr David Finnis and Mr Andrew Cohen and other actuarial and accounting experts during its first day of public hearings on 21 November 2001.<sup>9</sup>

**2.2**      Mr Andrew Cohen, Manager, Tillinghast, estimated the size of the deficit to be:

... \$3.1 billion by December this year [2001] and growing to \$5.5 billion by the end of June 2006, assuming no changes to the scheme's structure at all.<sup>10</sup>

**2.3**      Mr David Finnis, Principal, Tillinghast described the financial position of the Scheme to the Committee in the following manner:

The scheme is, as you pointed out, in a deficit position. That would be a concern to the scheme but not necessarily an ultimate concern, if you like, because the assets of the scheme are still sufficient to cover payments for between two and three years of an ongoing basis. Having said that though, of course, ... for the last two years we have been estimating an increasing deficit. Indeed we are forecasting at the moment that if nothing changes in terms of premium contributions, then that deficit will continue to increase over the forthcoming years.<sup>11</sup>

**2.4**      Mr Richard Grellman, author of the 1997 *Report of the Inquiry into Workers' Compensation system in New South Wales* ("The Grellman Report"), was asked whether he anticipated such a substantial increase of the Scheme's deficit as has been experienced to date. Mr Grellman responded:

Looking at the actuarial data at the time [1997], the trend lines were all looking a bit unhappy. In the absence of some strong action being taken, it was going to end up looking like a nasty number. I note in your first interim report a prediction that it will be about \$3.2 billion by June next year. That is a very unhappy number. Did I think it was going to be that high? I think, when I was working on my report, I

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<sup>7</sup> At para 2.30.

<sup>8</sup> At para 2.30.

<sup>9</sup> On 21 November 2001, the Committee also heard evidence from Mr John Walsh, Mr Daniel Tess and Mr Michael Playford from PriceWaterhouseCoopers who have prepared a number of specialised actuarial and accounting reports for WorkCover focussing on areas of proposed reform including commutations and insurer remuneration.

<sup>10</sup> Evidence of Mr Andrew Cohen, Manager, Tillinghast-Towers Perrin, 21 November 2001, p 33.

<sup>11</sup> Evidence of Mr David Finnis, Principal, Tillinghast-Towers Perrin, 21 November 2001, p 32.

would have been surprised if you had told me then it was going to be \$3.2 billion by June 2002. We knew it was jumping up, but that is probably higher than I might have anticipated.<sup>12</sup>

**2.5** Mr Finnis identified two key trends detrimental to the Scheme's financial position:

Certainly over the period of our tenure over the past 18 months, there has been increasing activity in the use of common law as a means to achieve or obtain benefits. Directly, common law areas, on average, are a more expensive way of achieving benefits than the alternative statutory benefit route, so purely by that increased activity there is a detrimental effect in financial terms. The other adverse trends which I think to this stage have not been finally confirmed are the possible changes in the use of commutations. By that I mean that certainly in the early stages of the use of commutations, following the 1998 legislative changes, there was significant evidence that the use of commutations worked to create financial savings for the scheme. Indications now are that that trend is moving towards a position where commutations will actually cost the scheme money. ... in our opinion at the moment, it is very close to a balanced position. In other words, any commutation will effectively have a neutral effect on the scheme's financial position within the next two months, but if that trend continues then commutations will start to have a detrimental effect on the scheme.

**2.6** A positive trend in the Scheme was also identified by Mr Finnis:

... the main [positive trend] is the reducing number of claims that we have seen. That is now an established trend that has been going on over the time that we have been looking at the scheme and it appears to be continuing over the last quarter that we have examined. Even allowing for the fact that there have been movements in the membership of the scheme, for instance, there are now more self-insurers than they were 18 months ago. Even allowing for that, the number of claims is going down.

**2.7** Following the evidence of Mr Finnis and Mr Cohen the Committee requested its consultant actuaries Ernst & Young prepare a paper explaining insurance concepts and the Scheme deficit. The paper in its entirety is included in Ernst & Young's second report to the Committee which is appended at Appendix 1.

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**Conclusion 1**

The level of deficit as at 30 June 2001 of \$2.76billion is a serious concern. The deficit will continue to grow by an increasing amount each year unless measures are put in place to halt its growth and stabilise the Scheme.

Only once the Scheme is stabilised, can measures be put in place to reduce the level of deficit

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<sup>12</sup> Evidence of Mr Richard Grellman, 21 November 2001, p 3.

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## Conclusion 2

The main factors that have contributed to the Scheme's current level of deficit include:

- increased use of common law;
  - inappropriate commutation payments;
  - inadequate premium collection, and
  - reduced return on investments.
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**2.8** Options for reducing the deficit are canvassed in Chapter 6 of this report.

## Recent legislative reforms

**2.9** The Committee outlined reforms contained in the *Workers Compensation Legislation Amendment Act 2001* ("the 2001 Act") in its first interim report.<sup>13</sup> In November 2001, the *Workers Compensation Further Amendment Act 2001* ("the Further 2001 Act") was passed. The primary objective of the reforms contained in the Further 2001 Act was to give effect to key recommendations of the Commission of Inquiry into Workers Compensation Common Law Matters ("the Sheahan Inquiry"), completed in August 2001. All the provisions contained in the Act were proclaimed on 19 December 2001, to commence on 1 January 2002.

**2.10** Ms Kate McKenzie, General Manager WorkCover, outlined the aims of the recent legislative reforms in evidence before the Committee:

What we are aiming to do is reduce the reliance on lump sums in the scheme and try to increase the concentration on better injury management and return to work. We think the only way we will shift significantly in that direction is by reducing the reliance on lump sums that are represented by common law and commutations.<sup>14</sup>

**2.11** Ms McKenzie had noted previously that the reforms were:

... part of an overall strategy. I do not think you can look at any of these individual bits of the Scheme in isolation. What we are trying to do is come up with an overall Scheme design that balances fairness and affordability, and this is just one part of that overall plan.<sup>15</sup>

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<sup>13</sup> At para 2.34.

<sup>14</sup> Evidence of Ms Kate McKenzie, General Manager, WorkCover NSW, 21 November 2001, p 58.

<sup>15</sup> Evidence of Ms Kate McKenzie, General Manager, WorkCover NSW, 21 November 2001, p 50.

**2.12** The initial bill as circulated for public comment in November 2001 contained a number of provisions which provoked public outcry.<sup>16</sup> Two of the most controversial provisions concerned the threshold for access to common law and the complete removal of commutations. Other significant reforms relate to private underwriting of the Scheme and the payment of damages for workplace psychological and psychiatric injury.

### **Common law**

**2.13** The Sheahan Report recommended that only one threshold for access to common law damages be prescribed – and that the threshold be set at 20% wpi (whole person impairment).<sup>17</sup> In reaching this conclusion, Justice Sheahan considered the purpose of setting a common law threshold, to ensure that the benefit available is targeted to the most appropriate group of employment injury victims.<sup>18</sup> In response to a submission from WorkCover arguing for a single threshold of 25% wpi, Justice Sheahan concluded

The Inquiry is satisfied that a 25% threshold, even with the anticipated improvements to be effected in the WorkCover “guides”, would allow the common law damages remedy to only the most “serious and permanent injury” and/or the most “seriously injured workers”, ...and the Inquiry is of the view that a broader class of very seriously injured workers should have access to the common law remedy.... I recommend that there be only one threshold necessary to recover damages at common law (aside from establishing liability) and that it be set at 20% of wpi.<sup>19</sup>

**2.14** The draft bill circulated for comment prior to its introduction into Parliament prescribed a single threshold for common law damages of 20% wpi. Following negotiations with the Labor Council, the threshold was lowered to 15%. Unions had argued that the threshold should be 10% wpi.<sup>20</sup>

**2.15** Other provisions introduced to give effect to the Sheahan Inquiry’s recommendations and reduce the level of common law damages include:

- Common law damages are only payable for economic loss. Damages for non-economic loss (such as pain and suffering) are abolished. Such damages are still recoverable via the statutory compensation system.

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<sup>16</sup> Newspaper articles focussing on the Further Amendment Bill include: K Bissett, ‘Union victory in WorkCover’ *The Daily Telegraph*, 14 November 2001, p 11; S Long, ‘Unions defiant on workers’ legal rights’, *The Australian Financial Review*, 14 November 2001, p 9; ‘Strike warnings over WorkCover reforms’, *The Daily Telegraph*, 16 November 2001, p 9; G Jacobsen, ‘Workers offered 15% solution over compo reform’, *The Sydney Morning Herald*, 27 November 2001, p 2; L Allen, ‘Reforms to aid injured workers’, *The Australian Financial Review*, 27 November 2001, p 7; M Waldren, ‘Reforms add dash of insult to invisible injuries’, *The Australian*, 28 November 2001, p 11; ‘Unionists warn of campaign against compensation bill’, *The Newcastle Herald*, 28 November 2001, p 7; ‘Workers to maintain compo rage’, *Illawarra Mercury*, 28 November 2001, p 2. Copies of relevant newspaper clippings are maintained by the Committee Secretariat.

<sup>17</sup> *Commission of Inquiry into Workers Compensation Common Law Matters Report*, (“Sheahan Report”), August 200, p 41.

<sup>18</sup> Sheahan Report, p 38.

<sup>19</sup> Sheahan Report, p 41.

<sup>20</sup> ‘Workers offered 15% solution over compo reform’, *The Sydney Morning Herald*, 27 November 2001, p 2.

- The calculation of future economic loss will be limited to damages up to age 65.
- New pre-litigation procedures and processes for common law work injury claims, aimed at reducing legal system costs.
- Injured workers who fail in their bid for common law damages can pursue statutory lump sum payments (as a result of removing the requirement to make an irrevocable election between common law and statutory damages).

**2.16** To compensate for restricted common law damages payments, the Further 2001 Act increases benefits payable under sections 66 and 67 of the 1987 Act. Following the amendments, the maximum amount of compensation payable under section 66 has been increased from \$121,000 to \$200,000 (section 67 payments continue to be capped at \$50,000). Additional benefits are also payable, for example compensation for domestic assistance which is payable under the new section 60AA.

**2.17** The Further 2001 Act contains a new method for distributing non-economic loss benefits under section 66. A new formula has been devised under which benefits are apportioned according to a 'whole person impairment' rating attributed to an injury by medical practitioners following WorkCover Impairment Guidelines.<sup>21</sup> The purpose of the new formula is to provide the most severely injured workers with significantly greater compensation than is currently payable to them.

**2.18** The 2001 Act changed the way in which permanent impairment was assessed – from using a Table of Injuries contained in part 3 Division 4 of the 1987 Act to using the WorkCover Impairment Guidelines. Tillinghast explained the effect of moving from the Table of Injuries to the WorkCover Guidelines in their financial evaluation of the 2001 Act and Further Amendment Act, dated 14 January 2002. The relevant section is quoted below while a copy of the Evaluation is appended in full as Appendix 3.

### **6.1 Use of AMA Guides to support injury impairment definition**

The current Table provides compensation payable for permanent injuries in 48 types of defined injury.<sup>1</sup> This compensation is represented as the percentage of the maximum dollars available for an injury type assessed as 100% impaired. If the injury is medically determined to be less than 100% impaired, the claimant is entitled to their assessed impairment percentage of the maximum amount available for that injury type.

The amendments propose the use of the WorkCover Guides to assess permanent impairment injury levels rather than by reference to the Current Table. The WorkCover Guides evaluate all permanent injury impairments as a Whole of Person Permanent Impairment (WPI) % which generally provide permanent impairment injuries with reduced impairment percentages when compared to the Current Table. Different injuries would end up with different relative reductions,

<sup>21</sup> The formula is contained in section 66(2) of the 1987 Act.

depending on how they were classified and evaluated under the Current Table versus the WorkCover Guides.<sup>22</sup>

<sup>1</sup> Workers compensation Act 1987, pages 65,551 –65,552.

## **Commutations**

**2.19** The Government had intended to remove access to commutations completely.<sup>23</sup> However, after consultation following the release of the draft bill, the Government agreed to retain commutations, although with restricted access.

**2.20** The role of commutations was discussed during the Committee's public hearings. Mr Grellman stated that:

I would not want to see commutations, if I was writing a scheme like this, terminated but I would like to see some fairly clear guidelines around when a commutation might be given effect so that it is just not something that can be used to extract greater benefits or in some way step around the intent and thrust of the legislation.<sup>24</sup>

**2.21** Mr Pearce, Chief General Manager, Commercial Insurance and Financial Services, NRMA Insurance, highlighted the importance of commutations in certain circumstances:

I should say, too, with regard to commutations, that although we agree that commutations, as they are currently enacted, are not performing as I think intended, the complete removal of them we do not see as the answer. They do work in some instances, and the complete removal of those takes quite a powerful method of closing claims and reducing the claims costs in the scheme.<sup>25</sup>

**2.22** The Hon Richard Amery MP, Minister for Agriculture and Corrective Services (on behalf of the Minister for Industrial Relations the Hon John Della Bosca MLC), acknowledged the level to which commutations have contributed to the Scheme's financial position when he introduced the Workers Compensation Legislation Further Amendment Bill 2001 into the Legislative Assembly on 27 November 2001:

...the current commutation arrangements have completely failed to reduce the number of open claims, and in fact have generated a demand for lump sum commutations from workers with no ongoing entitlement to further benefits. In view of the financial position of the scheme, the Government has no alternative but to follow the prudent course of action and to restrict commutation to those with a permanent impairment of 15 per cent. The worker must also have a current entitlement to weekly benefits and all return-to-work options must be exhausted. As with common law claims, the current extreme escalation of commutations and

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<sup>22</sup> Dave Finnis & Sally Wijesundera, Tillinghast-Towers Perrin, *Financial Evaluation of the 2001 NSW Workers Compensation Systems Reforms for the WorkCover Scheme*, 14 January 2002, pp 20-21.

<sup>23</sup> Schedule 8 draft Bill.

<sup>24</sup> Evidence of Mr Richard Grellman, 21 November 2001, p 7.

<sup>25</sup> Evidence of Mr Douglas Pearce, Chief General Manager, Commercial Insurance and Financial Services, NRMA, 21 November 2001, p 42

the financial position of the scheme indicate that an immediate restriction of commutations is warranted.<sup>26</sup>

**2.23** The Further 2001 Act reduces the extent to which commutations can be utilised. Under the amended legislation, commutations will only be available in cases where WorkCover is satisfied that the following conditions are met:

- the injury has resulted in a degree of permanent impairment of at least 15%, and
- lump sum compensation for permanent impairment and pain and suffering has already been paid, and
- 2 years has elapsed since the worker's first claim for weekly payments, and
- all opportunities for injury management and return to work for the injured worker have been fully exhausted, and
- the worker has an existing and continuing entitlement to weekly payments, and
- the worker has received weekly payments regularly and periodically for the previous 6 months, and
- the worker has not had weekly payments of compensation discontinued or reduced.<sup>27</sup>

**2.24** The impact on the Scheme of commutation payments is discussed in Chapter 4 of this Report.

### **Workplace psychological and psychiatric injury**

**2.25** An important addition to benefits payable under the 1987 Act was introduced in the Further 2001 Act. Prior to its commencement, no damages were payable for work related psychiatric or psychological injury. The Further 2001 Act enables section 66 and section 67 payments to be made for permanent impairment of at least 15% wpi resulting from a primary psychological injury.

**2.26** The method for assessing the degree of permanent impairment resulting from a primary psychological injury is not specified in the Act. However, WorkCover has adopted the Psychiatric Impairment Rating Scale (PIRS). The Committee questioned Ms McKenzie on WorkCover's choice of means of assessing permanent psychological injury during the public hearing on 21 November 2001.

**2.27** Ms McKenzie informed the Committee that PIRS is currently being used by the Motor Accidents Authority and is likely to be adopted by ComCare in Tasmania.<sup>28</sup> She further

<sup>26</sup> NSWPD, 27 November 2001, p 18895.

<sup>27</sup> Workers Compensation Further Amendment Bill 2001, Explanatory Note, p 6.

<sup>28</sup> Evidence of Ms Kate McKenzie, General Manager, WorkCover NSW, 21 November 2001, p 57.

stated in relation to the Committee's suggestion of dissent amongst psychologists and psychiatrists over the proposed use of PIRS:

I am certainly aware that there has been very robust debate about the merits of various ways of measuring psychiatric illness. I acknowledge that it is a very difficult area. But we have gone through a very thorough process. Sadly, we were not able to get universal agreement to one scale rather than another. In the end the PIRS scale was recommended based on the advice of the forensic psychiatrists. Because we have adopted the AMA 5 approach to impairment guidelines we have to have a psychiatric scale that fits in with that whole regime. PIRS is the only one available that fits in with that regime. If we are to have a consistent way of assessing lump sums for those sorts of injuries PIRS is the only scale available that we believe can reliably deliver that.<sup>29</sup>

**2.28** The types of workers who will benefit from the introduction of compensation for psychological impairment were outlined by Ms McKenzie in response to a question from the Committee about claimant profiles:

We are anticipating that it will be people such as bank staff who suffer from robberies and ambulance officers who end up with some kind of permanent impairment as a result of something that happens in the workplace. If post traumatic stress disorder is permanent and serious it would be eligible for compensation under these provisions. We do not anticipate huge numbers because there are not huge numbers now.<sup>30</sup>

**2.29** In their Evaluation of the 2001 legislative reforms, Tillinghast identified that an estimated 773 additional claimants may qualify for section 66 payments based on a permanent psychological injury of at least 15% wpi.

**2.30** Some of the potential problems with allowing damages for psychological impairment were noted by Ernst & Young in their second report to the Committee:

With recent legislation [NSW] is allowing for the first time compensation for psychological injuries. These are very difficult injuries to objectively assess with many differing views on how and who are qualified to conduct an assessment. Most longer term claims develop psychological overlay on top of the original and primary injury and that makes it very difficult to assess if the compensation should be paid for the primary injury.<sup>31</sup>

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### **Conclusion 3**

Due to the apparent disunity amongst psychiatrists and psychologists, and uncertainty about the level of claims and awards that will be made for psychological impairment, the Committee will continue to monitor WorkCover's adoption and application of PIRS as a means of assessing permanent psychological impairment for the purpose of receiving section 66 and section 67 payments.

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<sup>29</sup> Evidence of Ms Kate McKenzie, General Manager, WorkCover NSW, 21 November 2001, p 56.

<sup>30</sup> Evidence of Ms Kate McKenzie, General Manager, WorkCover NSW, 21 November 2001, p 58.

<sup>31</sup> Peter McCarthy, Ernst & Young ABC, *The Legislative Council Nsw Workers' Compensation Review Second Report & Young Second Report*) 28 December 2001, pp 5-6.

### **Conclusion 4**

The compensation of workers with a psychological impairment is a positive development in workers compensation. However, it is possible that claims for permanent psychological impairment will increase considerably once the legislation becomes operational. Historical data on claims for psychological impairment may not be an accurate indicator of future claims experience.

There is evidence to suggest that past legislative and regulatory reforms have resulted in unexpected changes in the nature of benefits claimed, for example in relation to commutations.

### **Private underwriting**

**2.31** The Further 2001 Act provides for the repeal of the provisions enabling private underwriting of the Scheme, originally due to commence on 1 October 1999. The Minister for Agriculture and Corrective Services, The Hon Mr Amery MP, stated in his second reading speech to the Further 2001 Act that:

The commencement of these provisions has been deferred twice, primarily on the basis of unaffordability. A further review will be conducted to identify the preferred option for underwriting the scheme. Accordingly, it is appropriate that the current provisions should be repealed.<sup>32</sup>

**2.32** The Minister's letter to the Chairman dated 8 January 2002 indicated that the Government is committed to improving Scheme design, and that the Minister has indicated that as part of the final stage of the Government's reform agenda, the Government is proposing a review of scheme design to identify their preferred options for underwriting the Scheme, and for achieving better Scheme outcomes. The Minister's letter is appended as Appendix 2.

### **Implementation of legislative reform**

**2.33** In response to a question on notice from the Committee, WorkCover has prepared a legislative and policy implementation plan for 2001-2002. The plan provides details of 16 discreet projects that WorkCover will undertake during 2001-2002 to implement the 2001 workers compensation legislative reform program. These projects include:

- Workers Compensation Commission
- Claims Assistance Service
- Insurer Remuneration
- Provisional Liability
- Communication & Education Program
- WorkCover Assistance Project
- Legislative & Regulatory Development
- Common Law

<sup>32</sup> NSWPD, 27 November 2001, p 18895.

- Self Insurers
- Impairment Guidelines
- Injury Management Pilots
- Performance Monitoring Dispute Resolution
- Compliance
- Premium Discount Scheme (PDS)
- Medical Management
- Legislative Council General Purpose Committee

**2.34** The plan identifies a number of key dates for completion of the 16 implementation projects. Relevant dates are:

<b>January 2002</b>	Establishment of Workers Compensation Commission
<b>January 2002</b>	Claims Assistance Service fully operational
<b>January 2002</b>	Agreements entered into for WorkCover Assist (including milestones and reporting requirements)
<b>February 2002</b>	Provisional Liability performance monitoring system operational
<b>March 2002</b>	Report and recommendations on outcome of Injury Management Pilots to Minister
<b>April 2002</b>	Proposed performance based investment package implemented
<b>June 2002</b>	Complete implementation of Cabinet approved recommendations arising out of Sheahan Inquiry

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### **Conclusion 5**

As part of its monitoring of the implementation of the 2001 Act and the Further 2001 Act, under Terms of Reference 1 (b), the Committee will monitor the completion of the projects identified by WorkCover against the key dates specified in their Implementation Plan up to and including June 2002.

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**2.35** WorkCover's Legislative Reform Implementation Plan is reproduced in its entirety at Appendix 4.

### **Financial impact of reforms**

**2.36** The level of Scheme savings to be achieved by the Government's recent legislative reforms was discussed in the public hearing with the Scheme's actuary, Mr David Finnis. Following the public hearings, Tillinghast provided the Committee three additional documents further examining the impact of the reforms on the Scheme deficit.

**2.37** In relation to savings to be achieved by the 2001 Act, passed in July 2001, Mr Finnis estimated the saving was between \$200 million and \$210 million, dependent on reasonable

implementation. In relation to the Further 2001 Act, passed in November 2001, Mr Finnis gave the Committee an estimate ranging from zero to \$214 million.<sup>33</sup>

**2.38** The Committee received a draft report on the financial evaluation of the 2001 reforms dated 26 November 2001 which estimated annual savings to be between \$88m and \$210m .

**2.39** However, on 14 January 2002 correspondence was received by the Committee from WorkCover and Tillinghast requesting that the 26 November draft report be withdrawn as it had been superseded:

Tillinghast-Towers Perrin has indicated that there have been significant changes from the 26 November 2001 draft evaluation report, which should be withdrawn forthwith.<sup>34</sup>

and

There has been significant changes from our 26 November 2001 draft report. After the Further Amendment Act was passed (in December 2001), a number of regulations and guidelines were developed, finalised and issued. These include provisional liability guidelines, the rules and start dates for the Workers Compensation Commission and the legal cost regulations.

The legal fee basis for dispute resolution was also negotiated and finalised after 26 November 2001. This has altered our costings. After discussions with WorkCover and the Motor Accidents Authority, we have also allowed for a marginal improvement in claims costs due to better return to work outcomes. The final report also includes analysis by accident year and an assessment of the impact on the Scheme deficit.

These issues have been more clearly resolved since our draft report of 26 November 2001 and the draft report should be withdrawn forthwith. This report also supersedes any previous advice to the Parliamentary Standing Committee. Also note, our 7 January 2002 letter in regards to actuarial projections of funding scenarios for the Scheme refers to our 26 November 2001 draft report; this should now be considered to refer to this report.<sup>35</sup>

**2.40** The final costing by the Scheme's actuary dated 14 January 2002 indicated that the successful implementation of the recent reforms will have one-off savings on the deficit of up to \$1.33 billion and ongoing savings of up to \$400 million per annum.

**2.41** None of the above figures have been tested by the Committee and the Committee will be conducting hearings into the findings of the 14 January document in preparation for the Committee's third interim report.

**2.42** Tillinghast's Financial Evaluation of the 2001 reforms contained a number of tables estimating annual savings from the 2001 reforms. The first was based on a 'settlement year' approach:

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<sup>33</sup> Evidence of Mr David Finnis, Principal, Tillinghast-Towers Perrin, 21 November 2001, p 41.

<sup>34</sup> Correspondence from Ms Kate McKenzie, General Manager, WorkCover, 14 January 2002.

<sup>35</sup> Correspondence from Mr David Finnis, Tillinghast-Towers Perrin, 14 January 2002.

**Table 2.1 Estimated Annual Scheme Savings from Reforms (recent stable settlement year)**

Initiative	Estimated Annual Scheme Savings from Reforms (recent stable settlement year)	
	Estimated Scheme Savings (\$m)	
	Targets Mainly Achieved	Moderate Position
• Restructure the dispute resolution system*	250	165
• Restructure common law claims processing*	40	35
• Section 66, 67 common law benefits <sup>1</sup>		
- Incorporates use of the WCA Guides; and		
- Changes in access to common law (Sheahan)	(70)	(90)
• Restrict Commutations <sup>2</sup>	100	80
<b>TOTAL</b>	<b>320</b>	<b>190</b>

\* Includes the effects of legal cost regulations finalised subsequent to the 26 November 2001 draft issue of this report.

1. We have not performed an independent analysis of the effect of restricting commutations. These figures are based on the PriceWaterhouse Coopers report "Analysis of trends in NSW Workers Compensation Commuted Claims", dated 8 October 2001 and their additional analysis (e-mail dated 23 November 2001).
2. To allow for potential leakage we have applied an approximately \$20million reduction to the savings figure for the Moderate scenario.

Source: Dave Finnis & Sally Wijesundera, Tillinghast-Towers Perrin, *Financial Evaluation of the 2001 NSW Workers Compensation Systems Reforms for the WorkCover Scheme*, 14 January, Table 1.1, p 5.

## 2.43

The same costings were also done on the basis of an 'accident year' approach:

**Table 2.2 Components of Projected Savings from Scheme Reforms 2002 Accident Year Basis Example (\$M)**

Initiative	Moderate / Low
• Restructure the dispute resolution system <sup>1</sup>	120
• Restructure common law claims processing <sup>1</sup>	60
• Section 66, 67 common law benefits	
- Incorporates use of the WCA Guides; and	
- Changes in access to common law (Sheahan)	(50)*
• Restrict Commutations	60
• Allowance for better return to work outcomes. <sup>2</sup>	40
<b>TOTAL</b>	<b>230</b>

1. Includes the effects of the Workers Compensation (General) Amendment (Costs) Regulation 2001- Final (gazetted December 2001).

2. Not evaluated in the settlement year estimates.

- \* (50m) comprises:  
 \$60M S66 Statutory  
 (\$10) S67 Statutory  
 (\$25) Common Law  
 35M Psychiatric

Source: Dave Finnis & Sally Wijesundera, Tillinghast-Towers Perrin, *Financial Evaluation of the 2001 NSW Workers Compensation Systems Reforms for the WorkCover Scheme*, 14 January, Table 7.1, p 41.

**2.44** Tillinghast also included a table illustrating projected savings from scheme reforms, based on an accident year approach:

**Table 2.3 Projected Savings from Scheme Reforms – Accident Year Basis (\$M)**

<b>Accident Period</b>	<b>Targets Mainly Achieved / High</b>	<b>Moderate /Low</b>
<b>Retrospective</b>		
Accident periods prior to 01/01/2002	1,330	810
<b>Prospective</b>		
Accident year 2002	400	230
Accident year 2003	400	230
Accident year 2004	410	230
Accident year 2005	420	230

\* Includes a small allowance for better return to work outcomes has been added in both retrospective and prospective savings that was not included in the settlement year estimates.

*Source: Dave Finnis & Sally Wijesundera, Tillinghast-Towers Perrin, Financial Evaluation of the 2001 NSW Workers Compensation Systems Reforms for the WorkCover Scheme, 14 January, Table 1.2, p 5.*

**2.45** The Evaluation explained the use of two scenarios, ‘Targets Mainly Achieved’ and

Since the financial outcome is largely dependent on the manner and degree by which reforms are implemented, the uncertainty in our evaluation is further increased. In providing our estimates we examined a range of possible implementation scenarios ranging from one in which all the WorkCover reform targets and objectives are fully met to a scenario where the reforms are highly compromised, result in unintended consequences and are poorly implemented. In the body of our report we have focussed on the two scenarios which are the most appropriate assuming the reforms operate (largely) as intended and are effectively implemented.

The two scenarios are:

- **Targets mainly achieved:** Assumes the reforms operate as intended and are effectively implemented so that the targets and objectives from the reform process \*(as established by WorkCover) are mostly met. This scenario is a compromise between the ‘Targets Fully Achieved’ scenario and the ‘Moderate’ scenario. The assumptions underlying this scenario will form the basis of performance targets for implementation and monitoring of the reforms (ie. in implementing the reforms WorkCover will be aiming to equal or better these targets)
- **Moderate position:** This moderate case reflects an expectation for all of the critical initiatives reducing legal and investigation costs to be implemented with a ‘moderate’ level of effectiveness, in conjunction with no erosion in the crucial ‘building blocks’ of the system (eg rigorous monitoring and correction for any slippage found). In broad terms this position is consistent with the

actuarial valuation basis, and hence may be described as the actuarial best estimate.<sup>36</sup>

**2.46** Tillinghast explained the difference between using a settlement year approach and an accident year approach:

The primary approach used was to model the existing and proposed arrangements on a years worth of claims recently settled or finalised. The advantage of this approach is that it is relatively straight forward to establish and forms a firm basis for modelling alternative scenarios (ie. the numbers of claims settled, their type, nature, duration etc. and amounts paid are known). This approach will provide the expected financial impact on claim payments in current dollar terms assuming the reforms apply to all relevant processes and payments on claims settled in a recent year.

This approach is not necessarily applicable to providing the impact on the Scheme deficit or on further accident years. For example, as the number of common law claims have been increasing, current common law settlements will under-estimate the numbers of common law claims projected for future years. Therefore the settlement year basis will underestimate the savings for future accident years.

The results on a settlement year basis have subsequently been converted to accident year results to provide estimates of the financial impact on the Scheme deficit and on future accident years (please note this analysis was only recently completed and not included in earlier draft versions of this report). We have provided a commentary on the techniques and methods used to convert the savings from settlement year to accident year in preparation for the 31 December 2001 valuation (see section 7). These estimates will be revised and further dealt with in our 31 December 2001 valuation report and in further valuations.<sup>37</sup>

**2.47** The difficulties faced by Tillinghast in quantifying financial impacts were made evident to the Committee during the public hearing. To a large extent the final estimate depends on the implementation of the legislation. The difficulties faced were explained by Mr Finnis:

... the chances of all targets being fully achieved would be fairly small. It would be at the extreme end of the range. We had a series of estimates ranging from what we described as a pessimistic scenario, where the new reforms would have actually complicated the process, increased dispute and cost the scheme an additional amount, to a reform compromise position where we felt that interpretation of the reforms may differ from what WorkCover expected.<sup>38</sup>

**2.48** These difficulties were further explained by Tillinghast in their Evaluation of the 2001 reforms:

Due to limitations largely caused by the lack of data and relevant Scheme experience for changes underlying the reform amendments, together with the

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<sup>36</sup> Dave Finnis & Sally Wijesundera, Tillinghast-Towers Perrin, Financial Evaluation of the 2001 NSW Workers Compensation Systems Reforms for the WorkCover Scheme, 14 January, pp 3-4.

<sup>37</sup> Dave Finnis & Sally Wijesundera, Tillinghast-Towers Perrin, Financial Evaluation of the 2001 NSW Workers Compensation Systems Reforms for the WorkCover Scheme, 14 January, p 9.

<sup>38</sup> Evidence of Mr David Finnis, Principal, Tillinghast-Towers Perrin, 21 November 2001, p 40.

difficulty of assessing the impact of changes on claimant behaviour, substantial uncertainty surrounds our findings.<sup>39</sup>

**2.49** The Committee notes the difficulties faced by Tillinghast when costing proposed legislative changes and determining definitively the level of savings to the Scheme. To assist the Committee in coming to an understanding of the level of savings to be achieved by the reforms, Tillinghast were asked to undertake a costing of a number of scenarios:

- **Scenario 1.** Calculate how much the current Scheme premium rate of 2.76% will need to increase on average (as a percentage of Scheme wages) if the deficit is to be funded over alternative periods from increased premium rates. The current cost of the Scheme is assumed to stay constant at 3.13% for this scenario.(Note: excludes the effects of the 2001 legislated Scheme reforms).
- **Scenario 2.** Calculate how much the ongoing cost of the Scheme will need to reduce from the current cost of the Scheme of 3.13% of wages if the deficit is to be funded over alternative periods from a lower cost of the Scheme. The premium rates for prospective exposures are assumed to stay constant at 2.76% for this scenario. (Note: excludes the effects of the 2001 legislated Scheme reforms).
- **Scenario 3.** Perform the same calculations as Scenario 1 except taking into account the effects of the proposed Scheme reforms. This scenario includes both a high and low estimate in order to take account of the range of possible savings in relation to the Scheme reforms.
- **Scenario 4.** Perform the same calculations as Scenario 2 except taking into account the effects of the proposed Scheme reforms. This scenario includes both a high and low estimate in order to take account of the range of possible savings in relation to the Scheme reforms.

**2.50** The Committee received Tillinghast's projections on 7 January 2002. As with their November 2001 Evaluation of the 2001 legislative reforms, Tillinghast provided two scenarios to illustrate possible savings, a 'high' scenario and a 'low' scenario. The difference between these two scenarios was explained in the projections:

**Low** – This scenario assumes all of the critical reform initiatives being implemented effectively, with no erosion to the crucial 'building blocks' of the system (eg with rigorous monitoring and mitigation of any potential slippage). In broad terms, this position is consistent with a potential actuarial valuation basis which might be adopted immediately after the introduction of the Scheme reforms. As more information is received in relation to the impact of the reforms this position will be subject to revision. However, we expect the emergence of objective evidence with which to assess the success of the reforms to be slow. This may limit the extent to which the valuation basis, at least in the short term, can react to the emerging experience.

**High** – This scenario is based upon the outcome if the targets that WorkCover expect are fully achieved. In this scenario it is assumed that WorkCover meets the

<sup>39</sup> Dave Finnis & Sally Wijesundera, Financial Evaluation of the 2001 NSW Workers' Compensation System Reforms for the WorkCover Scheme, 14 January 2002, p 5.

targets set on a broad range of measures, not just those relating to the crucial 'building blocks'.<sup>40</sup>

- 2.51** Following the passage of the Further 2001 Act, the Committee is interested in measuring the savings that will be achieved by these reforms. The Committee asked Tillinghast to consider the reforms in scenarios 3 and 4. Their results are outlined in the following table:

**Table 2.4 Projected savings from Scheme reforms**

<b>Accident period</b>	<b>Low (\$M)</b>	<b>High (\$M)</b>
<b>Retrospective</b>		
Accident periods prior to 01/01/2002	809	1,330
<b>Prospective</b>		
Accident year 2002	232	396
Accident year 2003	228	400
Accident year 2004	228	409
Accident year 2005	229	419

Source: Dave Finnis & Sally Wijesundera, Tillinghast-Towers Perrin, *Actuarial Projections of Funding Scenarios for the NSW Workers Compensation Scheme*, 7 January 2002, p 8.

- 2.52** The impact of the savings on premium and benefit levels is discussed more fully in Chapter 6 of this Report.

- 2.53** Tillinghast came to the following conclusions based on their projections of savings from the four scenarios:

The impact from the Scheme reforms under the low savings scenario is not substantial enough in itself to reduce the deficit without the aid of further premium rate increases or reductions in the breakeven cost of the Scheme. For the high savings scenario, the Scheme is estimated to reach a fully funded position after 15 years provided that the Government's target Scheme premium rate of 2.8% can be achieved and maintained [it is currently 2.76%].<sup>41</sup>

- 2.54** The Committee notes that the conclusions based on a low savings scenario are consistent with previous advice given to the Committee by Tillinghast, that they are insufficient to reduce the deficit without the aid of either premium increases or a reduction in the cost of the Scheme. These options are explored more fully in Chapter 6 (paras 6.15 and 6.28).

- 2.55** Ernst & Young provided the Committee with comments in relation to the actuarial costings of potential savings from the 2001 reforms, and have provide the Committee with options for the Committee's future consideration.

<sup>40</sup> Dave Finnis & Sally Wijesundera, Tillinghast-Towers Perrin, *Actuarial Projections of Funding Scenarios for the NSW Workers Compensation Scheme*, 7 January 2002, pp 7-8.

<sup>41</sup> Dave Finnis & Sally Wijesundera, Tillinghast-Towers Perrin, *Actuarial Projections of Funding Scenarios for the NSW Workers Compensation Scheme*, 7 January 2002, p 13.

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**Conclusion 6**

If the January 2002 figures are correct it is possible that WorkCover, the Government and other stakeholders were not properly informed of the potential higher level of savings to be realised from the December 2001 reforms during the passage of the Bill.

The final costing by the Scheme's actuary dated 14 January 2002 indicated that the successful implementation of the recent reforms will have one-off savings on the deficit of up to \$1.33 billion and ongoing savings of up to \$400 million per annum.

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## Chapter 3 Scheme design features

This Chapter examines relevant features of scheme design that may impact on the efficiency of the Scheme. While useful lessons can be learned from examining other schemes, and valuable ideas for reform can be applied in the New South Wales context, the Committee notes the caution with which this must be done.

- 3.1** The main reason necessitating this caution was explained in the paper presented by Win-Li Toh and Daniel Tess of PwC to the Eighth Institute of Actuaries Accident Compensation Seminar in November 2000:

Each scheme operates in a specific social, legal and economic environment. A scheme design which might be appropriate in one jurisdiction may not be appropriate in another jurisdiction. Often, policymakers have fallen into the trap of oversimplification of an issue when attempting to apply a successful feature from another jurisdiction with a different history and culture to their own schemes, only to be surprised when it does not deliver the desired outcomes in their own environments. Issues such as cultural differences, belief in the use of the judiciary as the course to achieve natural justice, the interaction with the wider social security structure, form a significant part of the reason why certain features work in some jurisdictions and not in others.<sup>42</sup>

### Scheme design options

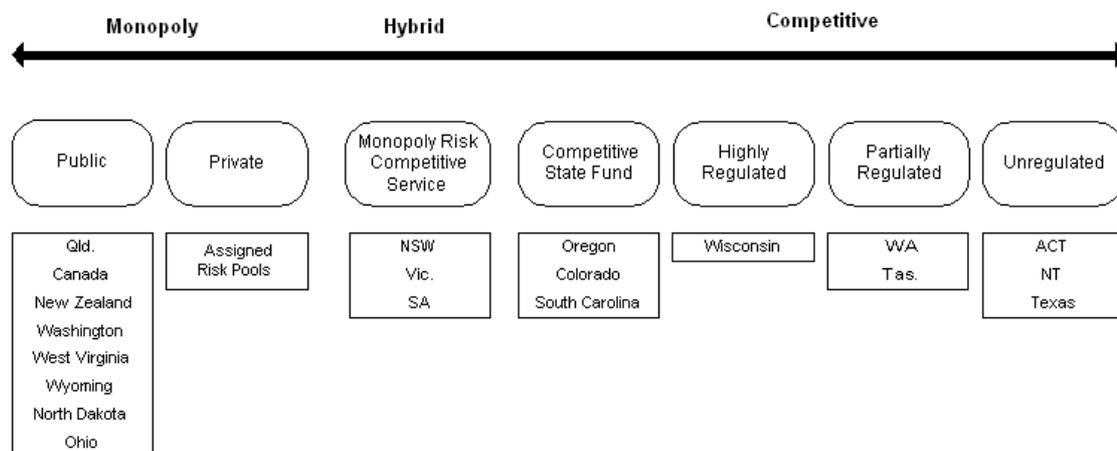
- 3.2** PricewaterhouseCoopers (PwC) have depicted a continuum of workers compensation scheme designs, from a monopoly to a competitive scheme. This continuum is illustrated in the diagram on the following page.<sup>43</sup>
- 3.3** In monopolistic systems the workers compensation authority acts as both regulator and service provider in the areas of premium setting, claims management, compensation payments and rehabilitation services.<sup>44</sup> In Australia the only fully monopolistic system operates in Queensland.
- 3.4** Competitive schemes are also called 'private' schemes. They are characterised by private insurers providing workers compensation insurance and services. The level of regulation may vary between schemes, from those that are highly regulated, to those which have minimal regulation, particularly with respect to pricing.<sup>45</sup> This is the dominant model in the United States. Western Australia is the only competitive scheme in Australia.

<sup>42</sup> Institute of Actuaries of Australia Eighth Accident Compensation Seminar, Hamilton Island, November 2001, p 196.

<sup>43</sup> This table is taken from a paper presented by Win-Li Toh and Daniel Tess of Pricewaterhouse Coopers Services, to the Institute of Actuaries of Australia Eighth Accident Compensation Seminar, Hamilton Island, November 2000, p 178.

<sup>44</sup> Eighth Accident Compensation Seminar, November 2000, p 180.

<sup>45</sup> Eighth Accident Compensation Seminar, November 2000, p 179.

**Figure 3.1 Continuum of Workers Compensation Scheme Designs**

Source: Win-Li Toh and Daniel Tess, PwC, Institute of Actuaries of Australia Eighth Accident Compensation Seminar, November 2000, p 178.

**3.5** The New South Wales Scheme is an example of a 'hybrid' model, which appears to be a scheme type unique to Australia. Hybrid schemes combine monopolistic pricing with varying degrees of competitive service provision. In New South Wales, most services are provided in a competitive environment while WorkCover maintains control of premium setting and regulation. Other hybrid schemes in Australia include Victoria and South Australia. South Australia operates at the opposite end of the spectrum from New South Wales in that it only contracts out claims management services.<sup>46</sup>

**3.6** The fundamental difference between a public/hybrid scheme such as New South Wales and a private scheme such as Western Australia was explained by the NRMA in their submission to the Inquiry:

The fundamental difference between NSW and WA is the commercial discipline provided by private underwriting to the task of scheme regulation and administration. Insurers have a high degree of flexibility in pricing. Premium changes in response to scheme deterioration created an urgent and widespread demand for reform. Unlike NSW, the losses incurred when the scheme deteriorated in the late 1990s were borne by insurers and not the wider community.<sup>47</sup>

**3.7** Mr Garry Moore, General Manager, Commercial, NRMA Insurance (Western Australia), highlighted some of the benefits of a privately underwritten scheme such as that operating in Western Australia, as perceived by NRMA:

In Western Australia, which has a very open and privately underwritten scheme, there is great flexibility in the way in which premium rates are set on the bigger, rather than the small, end of the market; that is, the medium to large employers. Their premiums are determined very much by their own claims experience. So

<sup>46</sup> Eighth Accident Compensation Seminar, November 2000, p 180.

<sup>47</sup> Submission 19, Mr Doug Pearce, Chief General Manager, Commercial Insurance and Financial Services, NRMA, 16 November 2001, p 6.

they are judged by their performance. That puts a great discipline on employers in the way in which they manage their workers compensation exposure. The benefit then flows back to the employer through the appropriate premium rating mechanism and the premium discounting rebate ~~a~~ mechanism that gives rewards, or imposes penalties, for good or bad performance.<sup>48</sup>

**3.8** Mr Moore later added:

That highlights the point we are making in terms of this discipline and the way in which you fund a scheme. When the Western Australian scheme went into deficit, that deficit was picked up in the claims reserves carried by the insurers. What forces the change and what forced the correction to the Western Australian scheme was the response to the scheme going into deterioration, and that was premiums increasing substantially. That is where we come back to discipline. That forced the stakeholders to acknowledge that there had to be fundamental changes to the scheme. The employers could not afford to pay the premiums and the unions reluctantly agreed that there needed to be ~~not~~ that they supported all the changes ~~e~~changes. Effectively, a change was brokered in Parliament to achieve a stable outcome to that scheme.

So, it forced the outcome that was necessary to bring the scheme back under control. Here, because you do not seem to have that pressure, because employers are not being charged the right premium to cover the current liabilities in the system, they do not have an incentive to do anything, and the converse applies to the worker. So, where is the pressure coming from for the change? Probably just from the Government because of the \$3 billion deficit, and something needs to happen.<sup>49</sup>

**3.9** In his submission to the Inquiry, Mr Anthony Hawkins, Chief Executive Officer of WorkCover Queensland, outlined the key features of a monopolistic public scheme such as that operating in Queensland:

We do all our own underwriting, premium setting, claims management and case management in-house, within WorkCover.<sup>50</sup>

**Private v public scheme design options**

**3.10** The Grellman Report recommended that New South Wales become a privately underwritten scheme.<sup>51</sup> The Further 2001 Act repealed provisions enabling the private underwriting of the New South Wales workers compensation scheme.<sup>52</sup> The Committee discussed the advantages and disadvantages of a privately underwritten scheme with witnesses during its public hearings held in preparation of this Report.

<sup>48</sup> Evidence of Mr Garry Moore, General Manager, Commercial, NRMA Insurance Ltd, 21 November 2001, p 47.

<sup>49</sup> Evidence of Mr Garry Moore, General Manager, Commercial, NRMA Insurance Ltd, 21 November 2001, p 52.

<sup>50</sup> Submission No 22, Mr Anthony Hawkins, Chief Executive Officer, WorkCover Queensland, p 14.

<sup>51</sup> Grellman Report, para 1.5.

<sup>52</sup> In Schedule 6.

**3.11** Mr Grellman reiterated his belief that private underwriting is ultimately appropriate for New South Wales in evidence before the Committee:

In my report I recommended transfer of the risk to the underwriting community. I actually still believe that that is the appropriate place for the risk-carrying responsibility to reside.<sup>53</sup>

**3.12** However, Mr Grellman also told the Committee that the timing is not right for such a move:

I am not sure that just at this point of time is the right time to transfer that across. There are two reasons that I say that. Firstly, there is the HIH royal commission, which will doubtless have something to say about the whole arena of general insurance, the way it is regulated, and the prudential environment within which general insurers should operate, and I think it would be worthwhile awaiting to see what implications that might have. Secondly, the Australian Prudential Regulatory Authority [APRA] is in the process of introducing additional responsibilities and obligations on insurers which I think will have an impact. Others will be more qualified than I to speak about this, but as the new APRA guidelines on insolvency and capital adequacy impact the industry I would not be surprised if there is a bit more rationalisation. It would be good to see both of those moving arenas settled before private underwriting is revisited.<sup>54</sup>

**3.13** Mr Grellman went on to caution those who believe a move to private underwriting will be a 'cure-all' for the problems facing the New South Wales Scheme:

...it would be inappropriate and I think facile just to suggest that private underwriting is going to fix everything. It is just one part of a range of initiatives that need to come together to make a system like this functional.<sup>55</sup>

**3.14** Mr Grellman went on to add:

It would be wrong to regard private underwriting as a cure-all. I also think that it would probably be inappropriate to do it now...I'd see it as an important part of the jigsaw but probably no more important than are the other issues like benefit design, dispute resolution, et cetera.<sup>56</sup>

**3.15** Mr Grellman outlined a number of aspects of the Scheme that would need to be reviewed in order to avoid a resultant significant increase in premium level to cover the risk assumed by insurers under private underwriting:

Well, you would certainly need to guard against that before you privatised the risk by ensuring that the whole infrastructure and balance of the scheme was as right as you could make it, and that goes to the whole gamut of areas that need addressing. You have to ensure that the benefit regime is appropriate and that the costs that are likely to be incurred when the employee is injured are identifiable and predictable. That is only going to occur if there is a regime that everyone

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<sup>53</sup> Evidence of Mr Richard Grellman, 21 November 2001, p 4.

<sup>54</sup> Evidence of Mr Richard Grellman, 21 November 2001, p 4.

<sup>55</sup> Evidence of Mr Richard Grellman, 21 November 2001, p 9.

<sup>56</sup> Evidence of Mr Richard Grellman, 21 November 2001, p 10.

understands, that is equitable but not overly generous. Certainly there would be a concern, in the event of privatising the risk, that the underwriters would just continue to lever up the premiums to ensure that they do not lose money.

...it requires careful scheme design, benefit design, et cetera, dispute resolution — everything that needs to come together in a package before you could let the underwriters come in on a product like this.<sup>57</sup>

**3.16** In response to a question from the Committee regarding the potential for a privately underwritten workers compensation scheme in New South Wales, Mr Finnis replied:

There is no simple answer. The answer is dependent on the motivation implied by underwriting the scheme. An insurer will certainly manage their claims and premium collection differently if they have full underwriting control. That is not necessarily all good news. We are aware of certain insurance failures over the past few months. The good news should be that that will basically focus the insurer on more efficient management of the claims. If that effect happens, then that will, in my view, improve the financial position of the scheme. If the insurer, despite the best intent, does not have that effect on claims, and that has happened in the past, then by definition there will be a negative effect on the scheme.<sup>58</sup>

**3.17** In their second report to the Committee, Ernst & Young made the following comments in relation to the private/public debate:

#### **Private and Public Schemes**

- 3.4 Views on whether privately underwritten or publicly managed workers compensation schemes are better usually come down to philosophical differences. Each system has advantages and disadvantages. There are examples of public schemes that perform well and those that perform poorly as there are for privately underwritten schemes. Criteria for assessing the performance of schemes again depends on philosophical views. For example a low cost scheme may be an advantage from one perspective and be seen to be unfair to claimants by others.
- 3.5 Most aspects of a scheme's design can remain unchanged whether it is privately or publicly managed including benefit design, compensation levels, benefit delivery, role of service providers (excluding insurers), insurance system, premium system and the type and extent of regulation.
- 3.6 The major difference between the two systems is financial accountability. In a privately underwritten system insurers are financially accountable for the financial status of the scheme. If premium rates are inadequate then insurers fund any shortfall, not employers as in publicly managed scheme. In other words insurers bear the risk for the financial performance of the scheme whether it is good or bad.
- 3.7 Different financial accountability changes the financial incentives on insurers to manage claims and other aspects of their responsibilities. For example

<sup>57</sup> Evidence of Mr Richard Grellman, 21 November 2001, p 9.

<sup>58</sup> Evidence of Mr David Finnis, Principal, Tillinghast-Towers Perrin, 21 November 2001, p 36.

private underwriting creates greater incentives on answers to reduce the cost of claims than in a public system.

- 3.8 The other major difference is the regulation and management of insurers or agents by WorkCover. Typically in a privately underwritten system there is substantially less management of insurers than under a public system. In both systems the regulator must ensure insurers comply with the legislation. In a private system the regulator must ensure insurers remain solvent whereas in a publicly managed system there is no equivalent requirement. In Australia workers compensation regulators largely rely on the Australian Prudential Regulation Authority (APRA) to ensure insurers remain solvent.<sup>59</sup>

### **Principles of good scheme design**

**3.18** Principles of good scheme design were outlined by NRMA in their submission to the Inquiry. A 'good' scheme would have the following features::

- Fully funded, with stable and predictable performance
- Premiums which are affordable by all sections of the business community
- Full or close to full indemnity for economic loss for persons who have suffered significant injury
- Limiting the damages for less serious injuries and ensuring that the benefits are applied to the intended purpose
- Individual assessment within an objective framework with minimal need for the external intervention by Courts or Tribunals
- Minimising the drain by service providers on funds available to claimants
- A framework which ensures only those who are properly entitled receive benefits.
- In applying those principles, the scheme design should seek to align the financial incentives for participants with the desired behaviour. The scheme should:
- Provide a guarantee of quality care and support for seriously and permanently injured workers
- Send unambiguous signals to less seriously injured workers that it is in their best interests to achieve optimal health outcomes and regain financial independence
- Encourage providers to actively pursue optimal health outcomes through application of best practice evidence-based medicine while discouraging unproductive treatment

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<sup>59</sup> Ernst & Young Second Report, p 7.

- Maximise certainty of outcomes and minimise the scope for disputes, with financial disincentives to marginal or speculative testing
- Clearly align the interests of policy and decision makers with the scheme's principles and objectives, rather than balancing the competing interests of participants
- Provide a reasonable return on any capital committed to support the scheme.<sup>60</sup>

**3.19** The NRMA concluded in their submission that:

There is already a substantial body of evidence before this inquiry, as well as many other forums, to demonstrate that the NSW workers compensation scheme design has been fundamentally flawed when tested against these principles.<sup>61</sup>

**3.20** Following a question from the Chairman to explain his submission to the Committee that the Scheme design is fundamentally flawed, Mr Pearce went on to say that:

Before I answer that, the reforms put forward earlier this year and the current round of reforms are headed in the right direction for fixing the flaws.<sup>62</sup>

**3.21** To give a scheme the best possible opportunity to achieve its objectives, Ernst & Young argue that the interests of all participants should be aligned to the objectives of the scheme. This can be achieved by carefully structuring the financial incentives within the scheme.<sup>63</sup> Ernst & Young noted that

There is little variance between desirable characteristics whether the schemes are private or publicly managed.<sup>64</sup>

and

It is a common mistake to believe that the incentives will be different if the scheme is publicly or privately underwritten. It may be that the incentives are achieved by different mechanisms.<sup>65</sup>

**3.22** Ernst & Young's second report to the Committee identified a number of desirable financial characteristics of a workers compensation scheme.<sup>66</sup> These include:

- fully funded premium rates;

<sup>60</sup> Submission 19, Mr Doug Pearce, Chief General Manager, Commercial Insurance and Financial Services, NRMA, 16 November 2001, pp 3-4.

<sup>61</sup> Submission 19, Mr Doug Pearce, Chief General Manager, Commercial Insurance and Financial Services, NRMA, 16 November 2001, pp 3-4.

<sup>62</sup> Evidence of Mr Doug Pearce, Chief General Manager, Commercial Insurance and Financial Services, NRMA, 21 November 2001, p 40.

<sup>63</sup> Ernst & Young Second Report, p 8.

<sup>64</sup> Ernst & Young Second Report, p 8.

<sup>65</sup> Ernst & Young Second Report, p 8.

<sup>66</sup> Ernst & Young Second Report, pp 8 - 11.

- financial solvency;
- clear financial accountability;
- stable scheme costs and premium rates;
- financial incentives on service providers are aligned to scheme objectives;
- transparency of the premium setting process;
- transparency of the financial status of the scheme;
- premium rates for individual employers and groups of employers (eg by industry) that reflect their claims cost contribution to the scheme, and
- provide financial incentives for claimants to return to work.

**3.23** The Minister's ten-point plan, as set out in the Committee's first interim report (pages 14-20) encapsulates the principles of scheme design.

**3.24** If the Government's reform program is given time to be successfully implemented, it is expected that that NSW Scheme will meet these principles.

**3.25** The Minister's letter to the Chairman dated 8 January 2002 indicated that the Government is committed to improving Scheme design, and that the Minister has indicated that as part of the final stage of the Government's reform agenda, the Government is proposing a review of scheme design to identify their preferred options for underwriting the Scheme, and for achieving better Scheme outcomes.

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### **Conclusion 7**

During the second reading speech, , repealing the measures for private underwriting and in the Minister's letter to the Chairman dated 8 January 2002, the Government indicated that further consideration of underwriting options would occur at a later date. The Committee endorses any efforts in this regard. It may be appropriate to reconsider underwriting options once the Scheme's deficit has stabilised.

The Committee recognises that the Government's ten point plan for reforming the scheme encapsulates principles of scheme design, and that if the Government's reform program is successfully implemented, that the NSW scheme will satisfy these principles.

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## **Chapter 4 Problems inherent in the NSW Scheme's design**

A number of problems inherent in the New South Wales Scheme's design have become apparent during the Committee's inquiry. These problems have been instrumental in creating the Scheme's current financial position and include:

- Ownership
- Insurer Remuneration
- Scheme structure
- Benefit design
- Premium design / setting
- OH&S injury and prevention
- Funds management
- Non compliance and fraud

## Ownership

**4.1** During the inquiry the term "ownership" has been used in different contexts. These include:

- direct ownership and responsibility for the Scheme's deficit, and
- ownership by stakeholders of the Scheme generally.

**4.2** The two terms the Committee will use to describe these concepts are "deficit ownership"

**4.3** The Grellman Inquiry identified structural weaknesses in the system which had reduced the focus on injury management and return to work. The inquiry found that the most important of these structural weaknesses was associated with a lack of stakeholder ownership by the main Scheme participants including employees, employers, WorkCover and insurers:

...(there is a) lack of stakeholder ownership in most aspects of the system, including injury management processes, regulation, premium and benefit structures and formulation of legislation.<sup>67</sup>

**4.4** Mr Grellman reiterated his inquiry's conclusions in evidence before the Committee:

I think the most outstanding problem that I encountered four years ago was what I called lack of stakeholder ownership and the fact that the two stakeholders –

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<sup>67</sup> Grellman Report, 15 September 1997, p 4.

employers and employees- were both suffering from a sense of lack of ownership.<sup>68</sup>

- 4.5** The Grellman Inquiry found that this lack of ownership also extended to the Scheme's statutory funds:

The lack of stakeholder ownership extends to the Scheme's statutory funds. The inquiry has found that no sector of the workers compensation system is legally and financially responsible for the statutory funds.<sup>69</sup>

- 4.6** The result of this lack of ownership and a lack of responsibility was resulting in non-compliance, inefficient claims management and lower than average return to work rates culminating in an ever-increasing deficit.<sup>70</sup>

### **Advisory council**

- 4.7** To address the lack of stakeholder ownership being experienced by the Scheme, the Grellman Report recommended that an Advisory Council made up of employer, employee and insurer representatives be established.<sup>71</sup>

- 4.8** Accordingly, an Advisory Council and a network of Industry Reference Groups were established in 1998. The Advisory Council's intended role was outlined by the Minister for Industrial Relations, the Hon Jeff Shaw MLC, during the second reading of the Workers Compensation Legislation Amendment Bill 1998. He stated-

One of the main proposals is to promote stakeholder control and accountability by establishing a permanent Workers Compensation Advisory Council. The council will have a key advisory role in relation to the ongoing policy direction and review of the scheme, and further recommendations for change. All legislative amendment proposals, including regulation-making proposals, will be formulated by the advisory council and recommended to the Government. This will replace in part the role and functions previously carried out by the board of the WorkCover Authority. The council, however, will not be distracted by the day-to-day management of the WorkCover Authority, which will have the role of a genuinely independent scheme regulator managed as it currently is by a board of directors appointed by the Minister.<sup>72</sup>

- 4.9** However, after less than two years of operation the Advisory Council was abolished and some of its functions/objectives merged with the Occupational Health and Safety Council. The reasons for this were explained by the Hon John Della Bosca MLC, Special Minister for State and Minister for Industrial Relations in his second reading speech for the Workers Compensation Legislation Amendment Bill 2000:

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<sup>68</sup> Evidence of Mr Richard Grellman, 21 November 2001, p 2.

<sup>69</sup> Grellman Report, p 37.

<sup>70</sup> Grellman Report p 35.

<sup>71</sup> NSWPD, 26 June 1998, p 6708.

<sup>72</sup> NSWPD, 14 November 2000, p 9889.

The Grellman report recommended a need for further reform in key areas such as dispute resolution, improved medical management, simplified legislation and the introduction of private underwriting. Almost three years after the Grellman report and two years after the establishment of the Advisory Council, the council has been unable to agree as to how to best progress reforms in these areas. The only area where significant progress has been made is in relation to improved injury management. ... It is now apparent that consensus will never be reached on further reform.<sup>73</sup>

and

The intention of the proposed merger between the two bodies (Occupational Health and Safety Council and the Advisory Council) is to give greater priority to occupational health and safety issues.<sup>74</sup>

- 4.10** The Committee received evidence about reasons why the Advisory Council failed to meet the Government's objectives. Mr Grellman suggested that one of the reasons was that the Advisory Council had too many members:

The Advisory Council was established in accordance with my recommendations, save for one point and that was that it ended up a little bigger than I was recommending. ... From memory, I suggested four employer and four employee representatives and I think that there were five or six of each. I think in simple terms that reduced the amount of dialog around the table, making reaching a conclusion that more challenging."<sup>75</sup>

- 4.11** Mrs Mary Yaager, OH&S and Workers Compensation Co-ordinator, Labor Council of NSW, also indicated that one of the problems with the Council was its size:

I do not believe the current advisory council works. It is too big.<sup>76</sup>

- 4.12** Another explanation put to the Committee by Mr Walsh, Partner, PwC, was that the timing for the establishment of the Council was not right.

Ultimately I think, it may have been just a bit too late. I think the financial position of the scheme was so difficult that the decisions that had to be taken by the Advisory Council led to, I suppose, not a full sharing of responsibility in terms of walking away totally from the constituencies. My personal view - is that that was ultimately the difficulty with the NSW Advisory Council.<sup>77</sup>

- 4.13** The Committee notes that:

- the Minister, in his letter to the Chairman dated 8 January 2002, indicated that as part of the final stage of the Government's reform agenda, the Government is

<sup>73</sup> NSWPD, 14 November 2000, p 9889.

<sup>74</sup> NSWPD, 14 November 2000, p 9889.

<sup>75</sup> Evidence of Mr Richard Grellman, 21 November 2001, p 4.

<sup>76</sup> Evidence of Mary Yaager, OH&S and Workers Compensation Co-ordinator, Labor Council of NSW, 10 October, p 4.

<sup>77</sup> Evidence of John Walsh, Partner, PwC, 21 November p 19.

proposing a review of scheme design to identify their preferred options for underwriting the Scheme, and for achieving better outcomes;

- the Government has a multifaceted strategy for improving stakeholder ownership in the Scheme, including the new insurer remuneration arrangements, injury management pilots, medical management pilots, the premium discount scheme and small business strategy, general premium reform and compliance initiatives, and
  - if the Government's multifaceted reform program is successfully implemented, that stakeholder ownership in the Scheme should be greatly improved.
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### **Conclusion 8**

The establishment of the Advisory Council was a mechanism to instil a sense of control over scheme ownership by stakeholders. This purpose remains valid.

Four years after the Grellman report and over a year after the merger of the Advisory Council and the Occupational Health and Safety Council, there remains a lack of scheme ownership among stakeholders. This lack of ownership continues to adversely impact on claims management, compliance, and return to work rates. This situation, combined with a lack of clarity regarding responsibility for the financial management of the scheme is culminating in ongoing problems with the deficit.

The Government's proposed review of scheme design and the successful implementation of the Government's ten-point plan for the reform of the Scheme may improve stakeholder ownership in the Scheme.

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### **Deficit ownership**

**4.14** Ms McKenzie, General Manager, WorkCover NSW, advised the Committee that the workers compensation Scheme debt

is owned by a statutory trust. It is a creature of the statute. It is not owned by Government. It is run for the benefit of employers and... it is a legislative construct.<sup>78</sup>

**4.15** Ramifications of this Scheme structure were raised by Mr Grellman. In evidence to the Committee he stated:

The fact remains that this deficiency, which as we said earlier is getting to be quite a large number is not recorded by anyone in their balance sheet as an obligation. WorkCover records it as a note. ...The Solicitor General says that it is not workers compensations' responsibility so a note is appropriate. Employers have paid their premiums and they think they have discharged their obligations with regard to their financial contribution to the scheme. There is a remaining question mark about who owns it and how it is going to be paid for. I think that is

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<sup>78</sup> Evidence of Ms Kate McKenzie, General Manager, WorkCover NSW, 21 November, p 59.

something that has to be addressed sooner or later, and preferably sooner, because as the number gets bigger it will be that much more difficult to deal with. You can find plenty of people who will say that in a practical sense employers will have to pay for this one way or another. Employers do not like that thought very much. Is it a government liability? I do not think it is a strict liability of the State.<sup>79</sup>

**4.16** Mr Grellman's view was supported by Mr Pearce, Chief General Manager, Commercial Insurance and Financial Services, NRMA, who stated in evidence before the Committee:

It goes back to some of the earlier questions as to who owns the deficit and that financial discipline, or lack of it, we see as the big problem. Our understanding is that it is not the Government who owns the liability, it is not the insurers, definitely and it is not WorkCover. It seems that the scheme we have is some sort of trust and the deficit is collectively owned by the employers of NSW, but even that is not clear. If it ever actually came to it there would be a very interesting litigation over the matter.<sup>80</sup>

**4.17** The Institute of Chartered Accountants argued that it was the State Government that has true ownership of the debt, in their submission to the Public Accounts Committee (PAC) inquiry into the financial disclosure of the WorkCover Scheme Statutory Fund:

The State Government has true control of the Scheme Statutory Funds because:

- the debt arising from the scheme is subject to NSW legislation;
- the debt is administered by the WorkCover Authority in accordance with the legislation and at the direction of the Minister; and
- the extent of debt is directly influenced by the control and administration of the legislation by the Government<sup>81</sup>

**4.18** The NSW Assistant Auditor-General, Mr Lee White, stated in evidence before the PAC that there was a need for the liability to be recorded somewhere:

... the net liability exists in the scheme. It has to sit somewhere with someone. If it does not, then one of the sectors, whether it is the private sector, the public sector or both, are running a type of risk that they are trying to achieve objectives and operating in a way that perhaps they would not if they were aware that they had a \$1.6 billion liability there, a net liability that needs to be recorded.<sup>82</sup>

**4.19** The impact of the lack of ownership on the Scheme's deficit was also raised by the NRMA in their submission to this Committee:

<sup>79</sup> Evidence of Mr Richard Grellman, 21 November 2001, p 4.

<sup>80</sup> Evidence of Mr Douglas Pearce, Chief General Manager, Commercial Insurance and Financial Services, NRMA, 21 November 2001, p 47.

<sup>81</sup> Public Accounts Committee, *Financial Disclosure of the WorkCover Scheme Statutory Funds*, July 2000 ("the PAC Report"), p 16.

<sup>82</sup> PAC Inquiry into the financial disclosure of the NSW Workers Compensation Scheme Statutory Funds, 4 May 2000, p 66.

There can be no doubt that NSW is facing a financial crisis in workers compensation with long-term implications for the health of the whole economy. It has arisen at least partly because the scheme was originally structured in such a way that no one has direct financial responsibility, it operates as a trust, administered by the Government on behalf of the employees of NSW.<sup>83</sup>

**4.20** In their Report, the PAC states that:

Evidence provided to the Committee confirmed that employers do not disclose in their accounts any liabilities related to the unfunded deficit of the Scheme- either off balance sheet as a contingent liability or on balance sheet as accounts payable<sup>84</sup>

**4.21** The PAC concluded that ownership of the Scheme cannot be determined under current legislation<sup>85</sup> and that:

The Government must exercise more effective direction over the existing Scheme's liability risks, including the very significant unfunded liability. One of the necessary measures is to establish ownership of the accumulated deficit.<sup>86</sup>

**4.22** The PAC also added that a result of determining ownership is that it focuses people's minds on addressing the liability:

The lack of ownership gives rise to concerns about its management – the representatives drew parallels with the earlier situation of the State Government's unfunded superannuation liabilities- once ownership and control was clear it focused minds on addressing the liability.<sup>87</sup>

**4.23** Community awareness and sensitivity to debt and debt ownership was considerably heightened in 2001 with the collapse of corporations such as HIH, Ansett and One-Tel. This has made the need to establish ownership and responsibility for the Workers Compensation Scheme in NSW both important and timely.

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## Conclusion 9

The Committee believes that there is an urgent need to:

- improve stakeholder ownership of all aspects of the Scheme and;
- establish clear accounting and legislative responsibility for the Scheme's finances

The Government's proposed review of scheme design and the successful implementation of the Government's ten-point plan for the reform of the Scheme may improve stakeholder ownership and clarify accounting and legislative responsibility for the Scheme's finances

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<sup>83</sup> Submission 19, Mr Douglas Pearce, Chief General Manager, NRMA, p 5.

<sup>84</sup> PAC Report, p 7.

<sup>85</sup> PAC Report, p 3.

<sup>86</sup> PAC Report, p 16.

<sup>87</sup> PAC Report, p 15.

- 4.24** Various options for improving scheme ownership based on experiences in other jurisdictions are presented in Chapter 5.

### **Insurer remuneration**

- 4.25** WorkCover (in consultation with insurers) is currently reviewing insurer remuneration arrangements for 2001-2002. As a result of the very recent nature of these reforms the Committee has been unable to review the impact of the changes on insurer behaviour to date. This section therefore explores the problems experienced under the 2000-2001 insurer remuneration arrangements as identified by witnesses who appeared before the Committee and the measures taken by WorkCover to rectify these problems through the new remuneration arrangements.

- 4.26** The Committee has identified two key issues with respect to insurer remuneration under the 2000-01 incentive entitlements:

- remuneration level, and
- performance measures.

#### **Remuneration level**

- 4.27** Mr Richard Gilley, Managing Consultant, RiskNet Group, raised the issue of the level of remuneration received by insurers for their management of the workers compensation scheme. He said:

You do not cut down insurers fees, because all you are doing is taking away their ability to properly manage the claims. The more you screw them down in the amount that you pay them, the less able they are to provide the services that you need. ...Insurers are not being paid enough to manage the system properly.<sup>88</sup>

- 4.28** In addition, Mr Daniel Tess, Director, PwC indicated to the Committee that the returns received by insurers in Australia are much lower than those received by insurers of workers compensation schemes in the United States. While insurers in the United States receive 15-20% of the cost of claims, insurers in New South Wales only receive close to 5-6%.<sup>89</sup>

#### **Performance measures**

- 4.29** The Committee received evidence indicating that the weighting of different remuneration measures was not aligned with the Scheme's main objectives. Remuneration arrangements have a direct impact on the way in which the Scheme is managed. This point was made by Mr Doug Pearce, Chief General Manager, Commercial Insurance and Financial Services, NRMA:

<sup>88</sup> Evidence of Mr Richard Gilley, Managing Consultant, Risknet Group, 22 November 2001, p 7.

<sup>89</sup> Evidence of Mr Daniel Tess, Director, PwC, 21 November 2001, p 18.

...most of the measures around those managing the claims, that is the insurers, have traditionally been process rather than outcome. We see this as a fundamental reason for insurers to go the way that they do<sup>90</sup>

and

I think that the insurers who operate in NSW are all very, very commercial operations. However, we do what we are asked to do and in the end business is in business to make money, and we are driven by the incentive schemes. The remuneration method is, in the end, primarily what we are asked to do. Do we act commercially? Absolutely - we act to maximise the amount of money we make out of the scheme. As I see the issue, is that the remuneration method it is not alive to the minimisation of liability or the reduction of the deficit in the State of NSW. That is the problem.<sup>91</sup>

**4.30** The lack of incentives for insurers to manage the Scheme in a way that is consistent with its objectives was raised in the Sheahan Report:

The insurers appear to have no interest or incentive in securing, by humane means an early return to work on an individual case by case basis, nor in taking a timely approach to questions of settlement.<sup>92</sup>

**4.31** Similarly, Mr Tess said that research that he had been part of had found that changes to the remuneration system would improve insurers performance:

I think it is fair to say that as far as the remuneration committee was concerned, there was general agreement that there was under performance, before we did this qualitative and quantitative research and that (the research) only strengthened everyone's belief that, in fact, there was under performance and that new remuneration arrangements were likely to help....<sup>93</sup>

**4.32** The remuneration reforms being developed by WorkCover in close consultation with insurers draw strongly on recommendations made by PwC in their report *Review of WorkCover NSW MGA Remuneration Arrangements* ("the Remuneration Report"). In their November 2001 briefing to the Committee, WorkCover states:

Following the PriceWaterhouse Coopers Review of MGA Remuneration Arrangements, a new insurers' remuneration package has been introduced for the 2001-2002 period. The key element of the new package is to provide insurers with an even stronger incentive for improved injury management performance.<sup>94</sup>

**4.33** Key elements of these reforms include:

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<sup>90</sup> Evidence of Mr Douglas Pearce, Chief General Manager, Commercial Insurance and Financial Services, NRMA, 21 November 2001, p 40

<sup>91</sup> Evidence of Mr Douglas Pearce, Chief General Manager, Commercial Insurance and Financial Services, NRMA, 21 November 2001, p 44

<sup>92</sup> Sheahan Report, p 47.

<sup>93</sup> Evidence of Mr Daniel Tess, Director, PwC, 21 November 2001, p 12.

<sup>94</sup> WorkCover NSW, *Outline of the Operation of the NSW Workers Compensation Scheme*, November 2001, p 45.

- Increased value of remuneration.
- The total funding amount available has been increased for the 2001-2002 from a maximum of \$158.5 million (00/01) to \$205 million. The entire \$46.5 million extra is available to insurers who perform well on both short term and long term performance measures. Some of these performance criteria include:
  - Return to work;
  - Setting correct premiums and ANZIC's classification of employers;
  - Dispute prevention, and
  - Pro-active injury management
- Base fees
  - Base fees have not increased under the new insurer remuneration arrangements.<sup>95</sup>
- There is also a potential open ended remuneration amount for tail management. This funding is not capped.

**4.34** Mr Tess told the Committee that the new remuneration arrangements were designed so that both the insurers and WorkCover would be adversely affected if the Scheme returned poor financial results:

What this remuneration package is designed to do is produce increased expenditure and investment in claims administration service, so if more money is spent on more expertise, more staff to do a better job on the claims and claims costs deteriorate anyway, there is a sharing of that extra cost between the scheme and insurers. It will go well for neither party but it would not be fair to say that the new remuneration arrangements in any way shield WorkCover from any deterioration. That is not true.<sup>96</sup>

**4.35** Although the Committee has been unable to assess the extent to which these reforms will be successful in creating a better incentive system for insurers because of their recent introduction, the Committee has received positive responses to the changes proposed to date. Mr Pearce told the Committee that:

...the reforms put forward earlier this year and the current round of reforms are headed in the right direction for fixing the flaws.

and

Overall we support the new remuneration system. We have gone from basically a 70% flat fee and a 30% performance fee to a 55 base and 45 performance. Performance criteria are harder. However, overall there is more money out of it. At the same time those performance fees have a very much stronger outcome orientation about getting people back to work. We believe that if they work, they will go some way toward reducing the deficit and controlling claim costs. The big issue is whether they will work, but they are definitely a step in the right direction.

<sup>95</sup> Base fees will increase only with the level of CPI.

<sup>96</sup> Evidence of Mr Daniel, Director, PwC, 21 November 2001, p 25.

There are some issues that are not finalised though.... Legal fees for instance, are not finalised at this stage and particularly for minor claims. That will be a key driver of adversarial behaviour within the system.<sup>97</sup>

**4.36** Ms McKenzie told the Committee that WorkCover was already beginning to see signs of the improvements being made by insurers:

We are beginning to see some encouraging early signs in the sense that we know that insurers are beginning to recruit more injury management experts and are investing in their system, particularly their information technology systems, to try to improve their management of claims.<sup>98</sup>

**4.37** However, evidence presented to the Committee by Mr Tess indicated that the changes to the remuneration arrangements were not certain to achieve the desired outcomes. Mr Tess told the Committee that there is a 75% chance that the changes made by WorkCover to insurer remuneration would produce scheme savings of between 3.4% and 17%. Conversely, there is a 25% chance that the new arrangements will either produce no savings at all to the scheme or could in fact increase costs.<sup>99</sup>

**4.38** The Committee notes that the new remuneration arrangements were due to commence on 1 July 2001, but that as at December 2001 the exact nature of the arrangements had yet to be finalised and provided to the insurers for implementation. The Committee trusts that this situation is taken into consideration by WorkCover when remunerating the insurers for their performance in the 2001-2002 financial year.

**4.39** In recognition of this, the Minister, in his letter to the Chairman dated 8 January 2002, indicated that as part of the final stage of the Government's reform agenda, the Government is proposing a review of scheme design to identify their preferred options for underwriting the Scheme, and for achieving better Scheme outcomes.

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### **Conclusion 10**

The Committee will continue to monitor the implementation of the new insurer remuneration arrangements during the course of its inquiry.

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## **Scheme structure**

### **The roles of WorkCover**

**4.40** In its *2000/01 Annual Report*, WorkCover's core functions are broadly defined as being:

- Regulator – regulating workers compensation and occupational health and safety,

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<sup>97</sup> Evidence of Mr Doug Pearce, Chief General Manager, Commercial Insurance and Financial Services, NRMA, 21 November 2001, p 47.

<sup>98</sup> Evidence of Ms Kate McKenzie, General Manager, WorkCover NSW, 21 November 2001, p 55.

<sup>99</sup> Evidence of Mr Daniel Tess, Director, PwC, 21 November 2001, p 16.

- Administrator of the workers compensation system, and
- Educator and promoter – educating employers and employees about injury prevention (OH&S), injury management and their responsibilities with regards to workers compensation.<sup>100</sup>

**4.41** WorkCover has traditionally identified itself as the regulator and no explicit insurance role is defined for the Authority in the 1998 Act. However, the Committee has received evidence from Mr Greg McCarthy, Executive Director, Workplace Injury Management Services, that WorkCover needs to behave as the insurer of workers compensation:

There needs to be an acknowledgment within the New South Wales system that there is one insurer. I hear people talking about insurers but the reality is that there is only one insurer, called WorkCover. From what I have seen in recent times WorkCover is starting to see itself needing to monitor the scheme the way an insurer would, because it is the insurer. Organisations referred to as insurers are agents that have a monopoly on being agents in New South Wales. They are not insurers in this scheme.

There is no doubt that it sees itself as a regulator and not as an insurer. Having had discussions with a recently appointed senior executive, I know that there is a very strong view by that individual that that needs to change and that there needs to be a stronger focus on the broader issues as well. But over the years –this has led us to where we are today– here has been a strong focus on administrative process and regulation and not enough on the underwriting result. The agents, if I can call them that, are not underwriters. So someone has to be. Over the fullness of time that is what has been missing, going back through the whole 10 years of the scheme.<sup>101</sup>

### **Conflicting roles**

**4.42** In addition to the lack of clarity surrounding the role of WorkCover in relation to insurance, the Committee heard evidence about perceived inherent conflicts between the multiple roles undertaken by the Authority.

**4.43** Evidence received by the Committee indicated that separation of the conflicting functions between different agencies/departments within WorkCover would ultimately allow the functions to be performed better. Mr McCarthy explained:

I would see it (WorkCover) being less focused on what I would call the inspectorate style of issues.... The policing should be left to a separate body, because the policing can often intimidate an employer when you should be risk managing rather than policing. There is a role for both but they do not go hand in hand well together.<sup>102</sup>

<sup>100</sup> WorkCover Authority of New South Wales Annual Report 2000/2001, p 3.

<sup>101</sup> Evidence of Mr Gregory McCarthy, Executive Director, Workplace Injury Management Services, 10 October 2001, pp 38-39.

<sup>102</sup> Evidence of Mr Gregory McCarthy, Executive Director, Workplace Injury Management Services, 10 October 2001, p 37.

**4.44** The Grellman Inquiry found that some aspects of WorkCover's role did not sit well together in the one organisation:

A cause of the lack of cooperation and consultation may be the dual role of WorkCover. WorkCover acts as "watchdog" for ensuring that OH&S regulation are being carried out, premiums are paid and benefits are not being abused. ...However, WorkCover is also expected to act in an advisory capacity to employers and workers to assist in injury prevention and the delivery of rehabilitation and compensation. This inherent conflict may well frustrate WorkCover from carrying out either role effectively. The system may benefit from a review of WorkCover's roles, which should be limited to educator and regulator. The advisory role is more appropriately placed with a separate body.<sup>103</sup>

**4.45** Many Australian WorkCover agencies have not seen the need to separate the various functions involved in managing the workers compensation scheme, for example Victoria. However, in Queensland the various roles surrounding the management of the scheme have been separated and are now managed by three different agencies.

**4.46** Chapter 5 explores other jurisdictions and the appropriateness of utilising their scheme design as a template in making changes to the New South Wales model as well as other possible divisions between the roles of WorkCover.

## Claims management

**4.47** The adequacy of the current claims management processes and procedures as implemented by WorkCover and their agents was raised in the public hearings as an issue for further investigation. Although the management of the Scheme is not the subject of this report and indeed will be the focus of the Committee's third interim report, some of the concerns raised by participants are outlined here.

**4.48** Mr Tess indicated to the Committee that the management of claims in Australia and in New South Wales in particular, was in qualitative terms not as efficient as in the United States:

Almost 60% of claims in the United States receive a benefit payment within two weeks of an insurer being notified. In New South Wales the figure is around 30%. So again there is a real qualitative difference in the way the processing happens in this State.<sup>104</sup>

**4.49** Mr Walsh stated that:

Clearly the whole issue of early management is one that is not done well. Reporting delays need to be improved.<sup>105</sup>

**4.50** The importance of getting employees back to work as soon as possible through efficient claims management was reiterated by Mr Pearce:

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<sup>103</sup> Grellman Report, p 41.

<sup>104</sup> Evidence of Mr Daniel Tess, Director, PwC, 21 November 2001, p 14.

<sup>105</sup> Evidence of Mr John Walsh, Partner, PwC, 21 November p 21.

The sooner you can get them back to work and fixed, the less adversarial the whole issue is because you are not then fighting about ongoing injuries and measurement of impairment.<sup>106</sup>

**4.51** Mr Walsh also discussed the adverse impact of claims management processes on employee and employer relationships:

The whole ownership of workplace injury does not seem to be well managed in the Australian context, and NSW certainly is an example of that. There seems to be almost an adversarial approach to a claim between the injured worker and the employer pretty much immediately, except in cases where the employer is a large employer and has a specific commitment to better management of injured workers, such as with self insurers or large employers that have taken a decision to do this.<sup>107</sup>

**4.52** The number of injured workers still receiving benefits at 26 or 52 weeks is an indication of the adequacy of injury management. At a conference in November 2000 Mr McInnes, Assistance General Manager, Insurance Division, WorkCover, told those present that although the number of injured workers receiving benefits for at least 26 and 52 weeks in New South Wales had been increasing until 1996, it had since stabilised, reflecting perhaps an improvement in WorkCover's claims management processes:

...until about June 1996 there was a steady increase in workers receiving benefits for at least 26 and 52 weeks. This occurs across all classes of claim regardless of severity. It is a symptom of poor injury management and return to work initiatives and reflects a focus on lump sums and litigation. Since June 1996 there has been a levelling out of the proportion of workers still receiving benefits for at least 26 weeks.<sup>108</sup>

**4.53** The Committee notes the Government's initiatives to improve insurer claims management performance, including the review of insurer remuneration arrangements, the requirement for insurers to accept provisional liability, injury management pilots, and the establishment of the Workers Compensation Commission and Claims Assistance Service.

**4.54** The successful implementation of these initiatives may significantly improve insurer claims management performance and make a considerable impact on the overall performance of the Scheme.

## Benefit design

### Common law

**4.55** In 1990 common law remedies were reinstated, after being abolished in 1987. The new laws prevented minor claims from receiving common law remedies and limited the non-

<sup>106</sup> Evidence of Mr Doug Pearce, Chief General Manager, Commercial Insurance and Financial Services, NRMA, 21 November p 48.

<sup>107</sup> Evidence of Mr John Walsh, Partner, PwC, 21 November p 21.

<sup>108</sup> Mr Rod McInnes, Eighth Accident Compensation Seminar, November 2000, p 257.

economic loss payable. A common law claim could be brought, but only where the non-economic loss suffered by the injured worker was greater than \$36,000 (indexed). Where the injured worker met the threshold, the level of damages awarded was a proportion of the maximum amount payable. This proportion was based on the severity of the injury.

**4.56** Damages for economic loss could only be awarded if the worker received a serious injury, or had died as a result of the injury. A worker was also required to elect whether they wished to claim common law damages or make a claim for permanent loss compensation under the 1987 Act.

**4.57** Despite the restrictions on access to economic and non-economic common law remedies, the Sheahan Inquiry found that

The common law claimants component of the scheme as a whole accounts for a total of approximately \$600m out of the \$2.1B annual claims costs<sup>109</sup>

**4.58** The Committee also received evidence indicating that the costs of common law have contributed significantly to overall Scheme costs. In June 2001, WorkCover requested PwC to undertake an analysis of common law experience since the commencement of the workers compensation Scheme in 1987. In relation to the report of that work, the *Analysis of trends in NSW workers' compensation common law claims* (the "Common Law Report"), dated August 2001, Mr Walsh told the Committee that:

...we estimated that the additional cost of common law as a benefit type per se was in the range of \$100million to \$300million<sup>110</sup>, with our best guess being towards the lower end of that - \$100million to \$170million.<sup>111</sup>

**4.59** Mr Playford, Director, PwC, further explained that the Common Law Report indicated that the number of common law settlements would increase in 2001-2002, further adding to the costs of the Scheme:

Part of the problem with common law is that the number of claims accessing common law continues to increase. The figures we came up with are based on the scenario or the picture, for the 2000-2001 year where there were about 1,300 common law settlements. Based on what we understand is happening, the number of common law settlements for next year, in the absence of any changes, would be considerably higher than that. Hence, the additional cost of the scheme is likely to be higher as well.<sup>112</sup>

**4.60** The following graph from the Common Law Report supports the evidence presented to the Committee highlighting the increasing cost of common law.<sup>113</sup>

**Figure 4.1 Lump sum benefits as a % of total payments**

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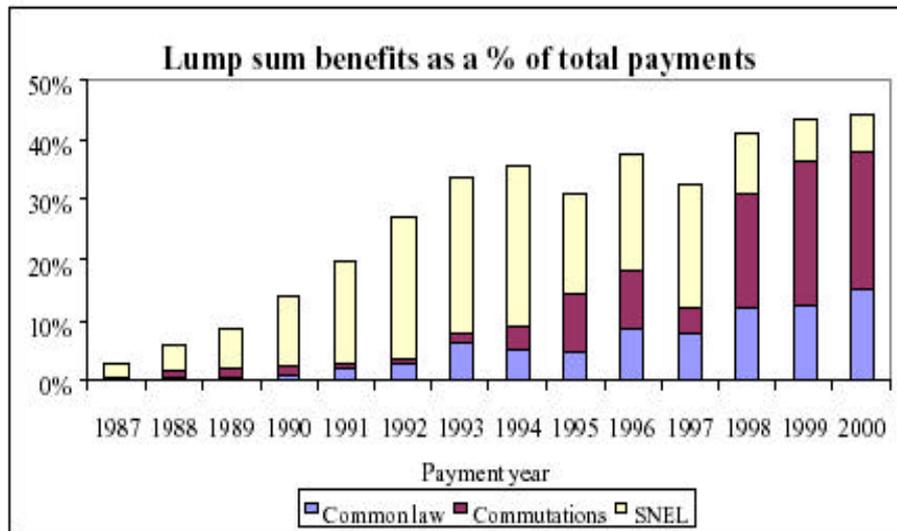
<sup>109</sup> Sheahan Report, p 22.

<sup>110</sup> This estimate takes into account that some of the costs currently incurred through common law would be transferred to other areas of the workers compensation scheme should access to common law be removed completely.

<sup>111</sup> Evidence from Mr John Walsh, Partner, PwC, 21 November 2001, p 15.

<sup>112</sup> Evidence from Mr Michael Playford, Director, PwC, 21 November 2001, p 18.

<sup>113</sup> Commutations Report, p 10.



Source: *Commutations Report*, p 10.

**4.61** Although it can be seen that the percentage of common law benefits has been increasing the graph indicates that common law benefits are proportionately not as large as for commutations. However, PwC state that in this way the graph is misleading and that the reader is left with an incorrect impression. They give the following reasons for this:

- The recent surge in commutation activity contains a ‘blip’ resulting from the buy-out of a significant tail of long term weekly benefits. This activity will stabilise over the next few years;
- The graph is expressed as a percentage of total payments. In fact the annual net payments on about 1,300 common law claims now exceeds \$300m, which is higher than the highest annual amount paid on up to 25,000 SNEL claims per annum in the Scheme’s history; and
- The real danger of common law is not only the payments to date, but rather the emergence of an increasing number of new common law claims which have entered the system and can be expected to receive settlements in the future.<sup>114</sup>

**4.62** Tillinghast also told the Committee that increasing activity in the use of common law as a means to obtain benefits was a key-contributing factor in the adverse trends being experienced by the Scheme’s liability.<sup>115</sup>

**4.63** In the Common Law Report PwC sought to explain why these costs were occurring. Some of the report’s main conclusions include:

- That there has been a weakening of thresholds evidenced by the fact that there was a dramatic increase in the number of common law claims being assessed at low levels of severity.

<sup>114</sup> Common Law Report, p 34.

<sup>115</sup> Evidence from David Finnis, Principal, Tillinghast-Towers Perrin, 21 November 2001 p 28.

- Those less severely injured workers have been receiving higher bands of damages for comparable levels of injury.
- That the use of the “election” option as a deterrent to the utilisation of common law may not have been as efficient as first hoped.<sup>116</sup>

**4.64** Reforms introduced as a consequence of the Sheahan Inquiry are considered in Chapter 2 of this Report.

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### **Conclusion 11**

Common law costs have contributed significantly to the Scheme deficit. It is likely that the recent legislative changes will reduce these common law costs however the exact level of savings that will be made to the Scheme are uncertain at this stage.

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### **Commutations**

**4.65** The primary form of benefit payable under the 1987 Act is a weekly payment during the period that an injured worker is incapacitated for work. Injured workers and their employers can agree to settle a compensation claim for weekly payments on a once and for all basis, by the payment of a lump sum. This lump sum (commutation) payment terminates the employer’s liability to the injured worker.

**4.66** Prior to 1996 it was WorkCover’s policy that commutations would be approved in cases where ‘need’ was demonstrated. By 1996, the interpretation of ‘need’ had been diluted and commutation activity had started to increase. In 1998 a strategy was embarked upon by the Advisory Council to encourage insurers to commute claims as a way to finalise the ‘tail’.<sup>117</sup>

**4.67** The Committee received evidence that the process of commuting as a means of finalising claims has contributed to the Scheme’s financial situation. In evidence to the Committee Ms McKenzie highlighted the increasing cost of commutations by stating:

...during the last few years, particularly in the last year or so, we have seen a very dramatic increase in the number of commutations. Partly this is a result of a deliberate policy that was introduced back in 1998 to liberalise the way in which people could get commutations. The theory was that it was better to commute the claims and for people to leave the scheme and get on with their lives rather than have them stay on weekly benefits, but I think that the latest actuarial valuations tell us that rather than being a benefit to the scheme, the number of commutations is beginning to be of increasing concern.

and

The difficulty is designing a regime that ensures that commutations are only used in appropriate circumstances and not in inappropriate circumstances. ... it appears

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<sup>116</sup> Common Law Report, pp 32-55.

<sup>117</sup> Commutations Report p 5.

that commutations are being offered in far too broad a category of cases and far too often and with no capacity to constrain that in any sustainable way.<sup>118</sup>

**4.68** WorkCover requested PwC to undertake an analysis of commutation experience since the commencement of the 1987 Scheme, with particular emphasis on experience since 1998. The result of that analysis was the report *Analysis of trends in NSW Workers' Compensation Commuted Claims* ("the Commutations Report"), dated October 2001. Mr Walsh discussed the results of this work with the Committee:

at the highest level our finding was that the commutations strategy of the last three years has not been well enough targeted to apply commutation to the claims that were most suitable for commutation; and that claims that had not had a long experience of benefits for incapacity were receiving commutations which, arguably, were inappropriate to that type of claim.

and

Those findings were that the extent to which commutations are available to what we term inactive claims in that report has a negative cost impact on the scheme. Any commutation strategy needs to be more restricted and more targeted than has been the case in New South Wales over the last three years. I believe that finding is legitimate and stand by it.<sup>119</sup>

**4.69** The report concluded that under the present commutations strategy:

There is a net cost to the scheme of having commutations<sup>120</sup>

**4.70** In correspondence to the Committee on 18 December 2001, Mr Michael Playford indicated that 70% of commutations in 2000-01 were awarded to injured workers with a 15% whole of body injury or less, making up just over 60% of the total amount spent on commutations in that financial year. The impact of the 15% wpi threshold for commutations introduced in the Further 2001 Act is potentially quite large – only 30% of the commutation claims paid in 200-01 (40% of total dollar value) would have been paid. Of the total commuted dollars only 26% were awarded to those with a greater than 20% wpi severity.<sup>121</sup> This is depicted in the following graph:

<sup>118</sup> Evidence from Ms Kate McKenzie, General Manager, WorkCover NSW, November 21 2001, p 54.

<sup>119</sup> Evidence from Mr John Walsh, Partner, PwC, 21 November 2001, p 16.

<sup>120</sup> Commutations Report, p 4.

<sup>121</sup> Correspondence to the Committee from Mr Michael Playford, Director, PwC, 18 December 2001.

**Figure 4.2 Commutation number, size and cost 1999-00 to 2000-01**

	Severity										Total
	0%	5%	10%	15%	20%	25%	30%	30%-40%	40%-60%	60%-100%	
<b>Number of commutations</b>											
1999/00	1,698	1,740	1,849	1,819	1,165	624	507	442	281	133	10,258
2000/01	1,825	1,661	2,133	1,959	1,267	787	575	521	312	122	11,162
<b>% of commutations by number</b>											
1999/00	17%	17%	18%	18%	11%	6%	5%	4%	3%	1%	100%
2000/01	16%	15%	19%	18%	11%	7%	5%	5%	3%	1%	100%
<b>Average commutation size</b>											
1999/00	31,739	41,198	46,951	53,573	57,585	59,177	63,882	63,839	68,599	88,980	49,285
2000/01	31,022	42,329	44,313	51,584	53,642	57,215	59,319	61,097	66,605	103,017	47,910
<b>Total commutation cost</b>											
1999/00	53,892,822	71,684,520	86,812,399	97,449,287	67,086,525	36,926,448	32,388,174	28,216,838	19,276,319	11,834,340	505,567,672
2000/01	56,615,150	70,308,469	94,519,629	101,053,056	67,964,414	45,028,205	34,108,425	31,831,537	20,780,760	12,568,074	534,777,719
<b>% of commutations by commuted dollars</b>											
1999/00	11%	14%	17%	19%	13%	7%	6%	6%	4%	2%	100%
2000/01	11%	13%	18%	19%	13%	8%	6%	6%	4%	2%	100%

Source: Correspondence received by the Committee, Mr Michael Playford, PriceWaterhouse Coopers, 18 December 2001.

**4.71** The Further 2001 Act contains provisions aimed at reducing the cost to the Scheme of common law damages and commutations. These are outlined in Chapter 2 of this report.

### Conclusion 12

Commutation costs have contributed significantly to the Scheme deficit. It is likely that the recent legislative changes will reduce these commutations costs however the exact level of savings that will be made to the Scheme are uncertain at this stage.

### Distribution of benefit payments

**4.72** The Committee received evidence that the distribution of benefit payments tends to be skewed away from those with more severe injuries.

**4.73** Mr Pearce indicated to the Committee that the intended purpose of the Scheme is to ensure that the most seriously injured receive the majority of the benefits:

...damages are not limited for the less serious injuries. If they were, that would ensure that the major benefits of the scheme go for the intended purpose, that is those most seriously injured.<sup>122</sup>

**4.74** PwC make reference to the level of commutations received by the severely injured a number of times in their Commutations Report. They conclude that:

From a financial perspective commuting the less severely injured claims does not appear to be a sensible policy for the scheme. For the more severely injured the

<sup>122</sup> Evidence from Mr Doug Pearce, Chief General Manager, Commercial Insurance and Financial Services, NRMA, November 21 2001, p 22.

scheme does save money –but it could be argued that by commuting at a discount the scheme is failing its responsibility.<sup>123</sup>

And also:

One must question whether “discounted lump sums” at this high level of severity are in the best interests of the claimant<sup>124</sup>

**4.75** In evidence to the Committee Ms McKenzie recognised that whilst injured persons need to be appropriately compensated for their injury it is difficult to develop a system which ensures that this will occur. She stated:

...you could also make the argument that people at the higher end are being under compensated, because we are saving money on the real value of their claims, whereas the evidence suggests that at the lower end we are overcompensating them. For both of those reasons, I do not think that is healthy at either end of the scale. ... the difficulty is putting in place a regime that delivers a fair result in every case.<sup>125</sup>

**4.76** Evidence received by the Committee is supported by comparative research undertaken by the Federal Department of Employment, Workplace Relations and Small Business.<sup>126</sup> Two scenarios are outlined, one of a worker who has a relatively minor injury and is able to return to work (“Example 6”), and the other of a worker who is permanently incapacitated with no real prospect of being able to return to work (“Example 7”). The benefits payable to the injured workers in these two different scenarios are then compared across the different jurisdictions.

**4.77** As can be seen by the graphs for these examples, the levels of benefits for the injured worker who is permanently impaired but has been able to return to work are considerably higher in New South Wales than for any other jurisdiction. The state with the next highest level of benefits is Victoria. When the example of the worker who is permanently incapacitated is considered the benefits available to the injured worker in New South Wales are considerably less than most other states except for Tasmania.

<sup>123</sup> Commutations Report, p 22.

<sup>124</sup> Commutations Report, p 3.

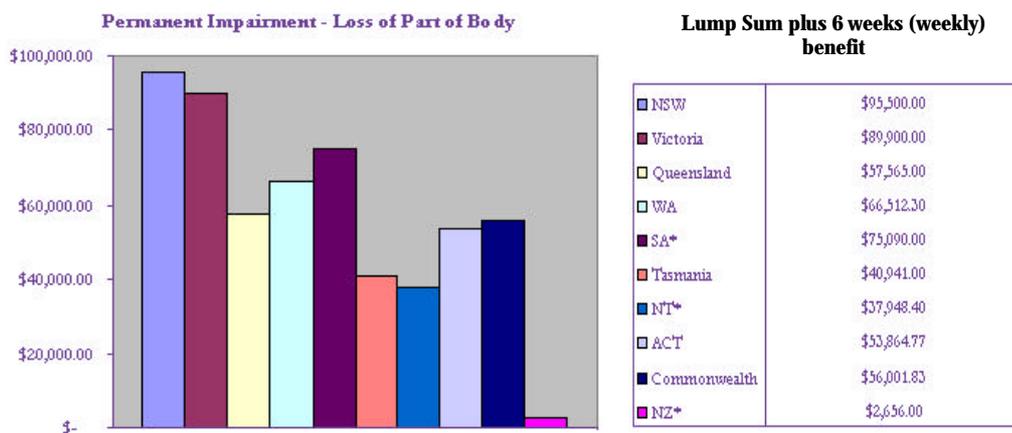
<sup>125</sup> Evidence from Ms Kate McKenzie, General Manager, WorkCover NSW, November 21 2001, p 64.

<sup>126</sup> Workplace Relations Ministers’ Council, *Comparative Performance Monitoring- Third Report*, August 2001 pp 68-70.

**EXAMPLE NO 6: PERMANENT IMPAIRMENT - LOSS OF PART OF BODY**

Example six examines the differing level and type of payments following a degree of permanent incapacity.

In this instance, the injured employee received an award wage of \$500 per week and performs no regular overtime. The employee has a dependent spouse but the couple is childless. The injury sustained concerns the severance of 2 digits, the thumb and forefinger, on the right hand. While there is no partial return-to-work, the employee returned to full time duties after 6 weeks.



\*No access to common law

In example six the difference are explained by the maxima placed upon lumps um payments, which provide the figure for which injuries are paid a proportion thereof. The methodology used to arrive at a percentage of these maxima is also an issue. Different schemes use different methodology to assess the degree of permanent impairment and this can lead to a divergence in outcomes across jurisdictions.

Also included in the figure presented is a total of six week’s compensation provided as weekly income replacement. The right to, or lack of, common law redress is likely to impact upon the pecuniary benefits received by the employees.

**Example no 7: Permanent incapacity**

Example seven examines the types and level of compensation payable following a workplace accident that resulted in severe injuries and incapacity for self-care.

The twenty-eight year old male worker was working a 38-hour week with no overtime when he sustained injury. There was no element of contribution in the circumstances of the accident. The worker’s injury was diagnosed as complete tetraplegia below the 6th cervical neurological segment. This resulted in paralysis of his hands, impaired upper body movement and paralysis of the trunk and lower limbs. He lost all lower body function and was wheelchair-bound. Incapacity was total and permanent. At the time he sustained injury, he was in receipt of the award wage, which was \$500 net per week. He had been taxed at a rate of \$93.50 per week. He had expected to work to 65 years of age. He contributed to a superannuation fund.

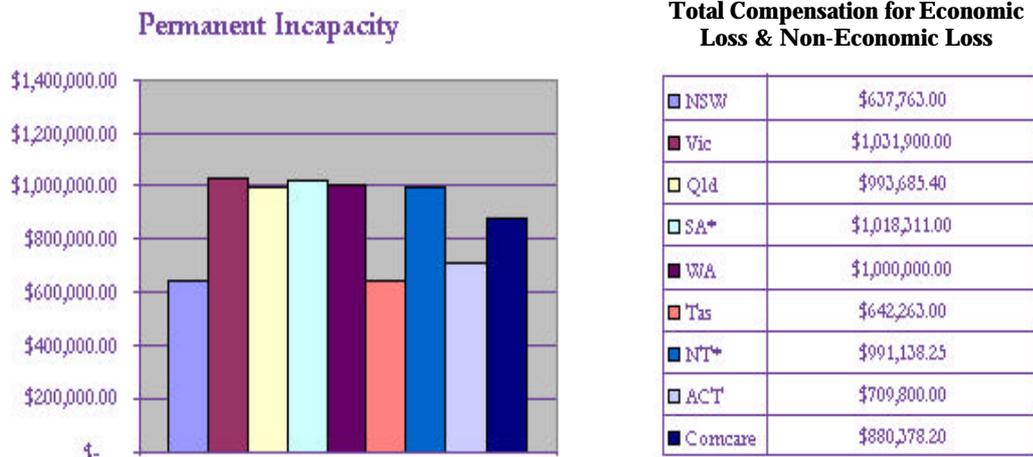
There was no real prospect of him being able to return to employment. The worker had no dependents at the date of injury but had intended to marry and have children.

The following chart details the benefits payable to the injured employee and includes:

- the weekly benefits that would be payable for the remainder of the individual’s working life (or 40 years, which ever is the sooner). It must be noted that these figures have not been calculated in NPV as in previous years.

- all lump sum payments for permanent incapacity; and estimates of common law settlements, where applicable (excluding medical and like services as attendant care).

Please note that qualifiers following graph must be read when analysing the reported outcomes.



Calculations are as at May 2001.

In addition to payments for economic and non-economic loss there are also a range of other benefits to which the employee may be entitled. These include but are not limited to: fertility treatment; hospital and other medical; carer costs; pharmaceutical; aids and equipment; housing purchase, construction or modification of housing; housing upkeep; vehicle purchase, vehicle modification; and the provision of swimming facilities and physiotherapy services. Although the provision of these benefits is not uniform between the schemes, there is a high degree of commonality in the funding of these services with a 'reasonable cost' or cost/benefit approach adopted by the majority of schemes for the majority of services.

Considerable caution should be exercised when considering this example, as there are a number of factors, both jurisdictional and cultural, which inevitably give rise to anomalies when comparing the possible outcomes. Jurisdictional influences include:

**Common law access**

Some jurisdictions, which have no right of access to common law, may have generous benefits payable under their statutory compensation schemes. The calculations from these jurisdictions (shown above) will therefore be enhanced by the inclusion of components, which are excluded in the case of schemes with access to common law redress.

Conversely, the benefits listed on the preceding page are excluded from the economic and non-economic loss chart. In jurisdictions which provide a right to common law access, payments may be higher than stated to account for issues such as future medical costs. In States where common law access is available, in particular Qld, NSW, WA and ACT, it should be noted that compensation benefits are also provided until a common law claim is settled. Once settled, the employee must repay any statutory compensation benefits paid by the scheme back to the scheme. The corresponding amounts for these states are therefore only common law claim estimates and do not include compensation benefits the employee would be entitled to if no common law redress was sought.

Vic has reintroduced access to common law and therefore the person has the option of accessing common law because of whole person impairment of 80 per cent; the figure for Vic in the above graph does not include an estimate of common law.

WA also has access to common law; there is no cap on the amount of damages awarded to workers whose degree of disability is agreed or determined to be 30 per cent or more (as in this case) and statutory benefits continue until the claim is settled the maximum amount awarded for a person with

significant disability is \$256,490. In the case of workers whose degree of disability is 30% or more (as in this case), there is no cap amount and statutory benefits continue. The figure for WA in the above graph only includes compensation benefits paid.

For these reasons there is no direct parity between schemes which have common law access and schemes which do not.

#### **Contributory negligence**

In this example it is explicit that there is no contributory negligence. However, for similar cases contributory negligence may be applied differently across jurisdictions. In practice this process reduces settlement levels in some jurisdictions much more than in jurisdictions where contributory negligence is rarely applied.

#### **Thresholds**

Some jurisdictions with common law access impose a threshold before an action can be brought. Because of these limitations, which in some jurisdictions preclude recovery of damages for minor injuries, fund monies can be more generously applied to serious injuries.

#### **Superannuation**

In some jurisdictions superannuation entitlements may reduce the level of compensation paid.

#### **Cultural influences**

Cultural influences can affect both the incidence of injury and consequential costs. For example:

- industry makeup and geographic factors affect the prevalence of serious injury;
- geographic and urban/rural lifestyle issues affect the costs of transport and other services;
- climatic conditions affect the provision of swimming facilities; and
- issues such as geography, climate, and custom also affect the type of housing modification, and therefore costs.

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### **Conclusion 13**

There is a need for further analysis of benefits being received by the seriously injured to ensure that they are adequately compensated, and that those with less severe injuries are not being relatively over compensated.

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## **Premium level**

**4.78** Evidence presented to the Committee raised the issue of the average premium level in New South Wales, how it compares with other states and the problems associated with increasing the rate.

**4.79** Currently in New South Wales the average target premium rate for employers is set at 2.8%. The actual average premium rate charged is 2.76%. The following table, from Tillinghast's 30 June 2001 valuation of the workers compensation Scheme illustrates the fact that since 1991-92 the collected premium rate (as a percentage of wagheroll) has fallen short of the breakeven premium rate (as a percentage of wagheroll):<sup>127</sup>

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<sup>127</sup> This table shows the average premium rate by financial year. The Committee is aware that premium rates vary considerably between industry types (note section 2.27 of the First Interim Report). The Committee is

**Table 4.1 Comparison of estimated breakeven and collected premium rates, 1987-88 to 2000-01, NSW workers compensation scheme**

<b>Comparison of Estimated Breakeven and Collected Premium Rates (excluding NTS/GST – related effects)</b>		
<b>Policy Renewal Year</b>	<b>Breakeven Rate (% of wageroll)</b>	<b>Collected Rate (% of wageroll)</b>
1987/88	1.75	2.47
1988/89	1.76	2.45
1898/90	1.76	2.24
1990/91	1.9	1.92
1991/92	2.14	1.71
1992/93	2.62	1.73
1993/94	3.01	1.83
1994/95	3.22	1.95
1995/96	3.25	2.43
1996/97	3.15	2.66
1997/98	3.16	2.76
1998/99	3.23	2.85
1999/00	3.21	2.75
2000/01	3.06	2.70 <sup>1</sup>

<sup>1</sup> 2.76% rate including effects of NTS/GST

Source: *Actuarial Review of the Outstanding Liabilities of the workers compensation Scheme Statutory Funds as at 30 June 2001*, p 13.

**4.80**

In evidence presented to the Committee Mr Gary Moore, General Manager, Commercial Insurance (WA), NRMA, suggested that the premium rates needed to be reviewed in light of the costs of the Scheme, and that debates about changes to the Scheme should start with the premium levy. He said:

I think 3.1% or 3.2% are some of the numbers I have heard are currently required. I think that is where the whole debate about the scheme should actually start, what is the appropriate rate for the states scheme's benchmark, if you like. If you say it is 2.5% or 2.7% whatever it is, you then work backwards to see what are the costs that are going to drive a 2.5% rate. At the moment the theory is that it should be 2.7% but the costs are at 3.1% or 3.2%, so the gaps have to be addressed.<sup>128</sup>

**4.81**

Mr Katsogiannis, private citizen (NSW Workers Compensation Manager, QBE Insurance) also told the Committee that the premium rates were too low to cover costs:

...the scheme at the moment, has an average rate far too low for the cost of claims. The average tariff/premium rate which is 2.8% is too low to meet the claims costs.<sup>129</sup>

acknowledges that in some circumstances premium rates for certain industries have changed markedly over the last few years. This issue will be explored in the Third Interim Report.

<sup>128</sup> Evidence from Mr Garry Moore, General Manager, Commercial Insurance (WA), NRMA, November 21, p 44.

<sup>129</sup> Evidence from Mr George Katsogiannis, private citizen (NSW Workers Compensation Manager, QBE Insurance), 10 October, p 27.

**4.82** The following table shows the average level of premium paid in selected Australian States by financial year.

**Table 4.2 – Average workers compensation scheme premiums – Cross jurisdictional comparison**

	1997/98	1998/99	1999/00	2000/01
<b>NSW</b>	2.8%	2.8%	2.8%	2.8%
<b>Victoria</b>	1.8%	1.9%	1.9%	2.22%
<b>Queensland</b>	2.15%	2.15%	1.75%	1.55%
<b>Western Australia</b>	2.4%	2.73%	3.09%	2.97%
<b>South Australia</b>	2.86%	2.86%	2.86%	2.86%

*Source: Head of Workers Compensation Authorities, Comparison of Workers Compensation Arrangements in Australian Jurisdictions, July 2000.*

Notes on graph:

- Large increase in premium rates in 00/01 for Victoria was a result of changes to benefits provided to injured workers – ie common law was reintroduced and statutory benefits increased.
- Increases in Western Australia from 1998-2000 were as a result of previous discounting by insurers. Premiums collected were not covering costs, this situation was rectified by 2000/01.
- Victoria has the closest business climate to that in New South Wales. Western Australia has a much larger proportion of high-risk industries than NSW.

**4.83** It can be seen from the above table that only Western Australia has a demonstrably higher premium rate than New South Wales. Average premium rates are considerably lower in Victoria and Queensland.

**4.84** Concerns were raised in evidence that if the average premium in New South Wales was to be increased there would be an adverse impact on the State's competitiveness. It might also compel businesses to move interstate with resulting in possible increases in unemployment in New South Wales.

**4.85** In evidence to the Committee Mr Grellman discussed the impacts of increasing premium rates in New South Wales:

It is a very complicated issue because New South Wales is already at the high end of the spectrum relative to other States in Australia in terms of the cost of workers compensation premiums... All I can say is that I would hate to have to be making the decision because if I was going to be financially responsible, if it was up to me and I was sitting in Government, I know that I would be charging higher premiums. That would result in several unpleasant outcomes. One is that New South Wales would, on this expense area, become that much more uncompetitive, and it would obviously send a shock into the community, which would be difficult to deal with. So it is a most difficult situation to have to deal with. Is it inappropriate or irresponsible? I do not know whether I can say. All I can say is that I would not want to have to make that decision myself.<sup>130</sup>

**4.86** Reflecting this concern, Ms McKenzie indicated to the Committee that WorkCover is unsure what pressure increased premiums would place on employers:

<sup>130</sup> Evidence from Mr Richard Grellman, 21 November, p 8.

We are at the high end of average premium rates when compared to Queensland and Victoria. There is a question mark about how much tolerance there would be for an increase in premiums.<sup>131</sup>

**4.87** Ms McKenzie's concerns are reiterated in the Sheahan Report. The Sheahan Inquiry received evidence indicating that increased premiums would result in job losses in New South Wales. The report states:

It is frequently argued that the level of workers compensation insurance premiums is a proven disincentive to employment in NSW. Access Economics estimates that a 0.5% rise in premiums translates into a loss of 3,800 full-time equivalent jobs. The NSW Treasury submission, however, estimates the loss of 9,000 jobs for every 0.5% rise in premiums.<sup>132</sup>

**4.88** In evidence to the Committee Ms McKenzie said that the WorkCover Board had not made a recommendation to increase premiums since the last increase, which was in 1997.

There is a recommendation every year, but I think the last recommendation for an increase was in 1997.<sup>133</sup>

**4.89** Rather than increase premiums, Mr McInnes told the Committee that WorkCover was trying to reduce the cost of the Scheme. He said-

As you are aware, for some time the premiums that have been collected have fallen short of costs, which is why, in part, the deficit has been growing. Obviously, we have to bring down costs to below current premium levels in order to eat into that deficit. That is the approach, to work to bring down costs by making the reforms we are talking about.<sup>134</sup>

**4.90** The Minister's letter to the Chairman dated 8 January 2002 notes that Tillinghast's actuarial projections confirm that with effective implementation of the recent reforms, the Scheme should for the first time in ten years, collect more than it will spend.

**4.91** Tillinghast's final costings dated 14 January 2002 indicate that the successful implementation of the recent reforms will have one-off savings on the deficit of up to \$1.33 billion and ongoing savings of up to \$400 million per annum.<sup>135</sup>

<sup>131</sup> Evidence from Ms Kate McKenzie, General Manager, WorkCover NSW, 21 November p 62.

<sup>132</sup> Sheahan Report, p 19.

<sup>133</sup> Evidence from Ms Kate McKenzie, General Manager, WorkCover NSW, 21 November p 63.

<sup>134</sup> Evidence from Mr Rod McInnes, Assistant General Manager, Insurance Division, WorkCover, 21 November, p 54.

<sup>135</sup> Dave Finnis & Sally Wijesundera, Tillinghast-Towers Perrin, Financial Evaluation of the 2001 NSW Workers Compensation Systems Reforms for the WorkCover Scheme, 14 January, pp 37-38.

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**Conclusion 14**

The current average premium of 2.76% is insufficient to cover the current costs of the Scheme. The average premiums have been insufficient since 1991-92.

The final 'high', 'optimistic' actuarial projections on the 2001 reforms indicate that the effective implementation of the reforms will reduce costs below premiums and commence a significant downward trend in the deficit (however, these costings have not been tested by the Committee).

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- 4.92** Means by which the deficit can be reduced, including increasing premiums, are outlined in Chapter 6 of this Report.

**Premium setting**

- 4.93** In 1997 the Grellman Report recommended the formation of the New South Wales Workers' Compensation Bureau, which would be responsible for developing both the industry premium rates and the experience rating system. Because the Bureau would exist within Grellman's overall plan of a privatised system, membership of the Bureau would consist of one representative from each licensed insurer.

- 4.94** Following the findings of Grellman, the Premium Rating Bureau was established in the 1998 Act. The Premiums Rating Bureau's core functions were to determine and submit to WorkCover a proposed methodology for calculating premium risk, to provide advice, statistical and actuarial information on scheme performance and costings and provide costing estimates in relation to any proposals for change. The Bureau was also to provide advice in the development of workers compensation insurance industry standards. The Bureau would be subject to the control of the Minister.

- 4.95** Currently the WorkCover Board makes recommendations to the Minister regarding what the average premium rate should be.

- 4.96** In the Hon Minister Della Bosca's second reading speech for the Workers Compensation Further Amendment Bill 2000, he indicated that the Premium Rating Bureau's role was to be reviewed because of the deferral of private underwriting:

The Rating Bureau was established under the 1998 Act for the purpose of determining premiums under the privately underwritten scheme. With the deferral of private underwriting it is unnecessary for the bureau to continue to carry out the functions of monitoring scheme performance and preparing costings on legislative proposals. This will produce unnecessary expenditure. These functions are already carried out by the WorkCover Authority through its actuaries. The Auditor-General provides an independent review of scheme valuations. The appropriate role of the Rating Bureau can be reviewed after a decision is made in relation to private underwriting.<sup>136</sup>

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<sup>136</sup> NSWPD, 14 November 2000, p 9889.

**4.97** The Further 2001 Act repealed the private insurance arrangements. The provisions relating to the Ratings Bureau were also removed by this amendment.

**4.98** The Committee's consultant actuary has expressed concerns about the transparency of the premium setting process. In their second report to the Committee Ernst & Young state:

The desirable level of transparency in setting scheme premium rates in a publicly managed scheme is probably debatable. In the current NSW scheme there is limited transparency being a function in part of the lack of financial accountability of the scheme.<sup>137</sup>

**4.99** Mr Grellman also indicated to the Committee the importance of broader stakeholder involvement in premium setting. He said:

It must be almost a whole-of-government issue as to how this State remains competitive because this is one of the big expenses for employers. Under the current model, the Government has always had an interest in the premium levels. I think, from memory, WorkCover makes a recommendation and then that is the premium level adopted.<sup>138</sup>

**4.100** Options to improve the transparency of premium setting are discussed in Chapter 5.

## **OH&S / injury prevention, funds management and compliance fraud**

**4.101** During the course of the Committees' inquiries for this report issues relating to injury prevention, funds management and compliance/fraud have been brought to the Committee's attention. These areas are considered to be management issues and will be addressed in the Committee's third interim report.

<sup>137</sup> Ernst & Young, Second Report, p 10.

<sup>138</sup> Evidence from Mr Richard Grellman, 21 November, p 9.



## Chapter 5 Options for future scheme design

The Committee understands that it is not always possible to take aspects from another jurisdictions scheme and apply them unchanged in the New South Wales context. However, there is scope for practitioners of the New South Wales workers compensation scheme to learn from the experiences of other jurisdictions and adapt measures from elsewhere to suit the New South Wales environment.

**5.1** In evidence presented to the Committee Mr Bill Mountford, Chief Executive Officer, Victorian WorkCover Authority, reiterated the need to analyse a particular aspect of a schemes design in the specific context of the local environment:

Ontario in Canada has a program, which has been running for a couple of years. The Ohio State scheme runs this as well in the US. Washington State has a program and New York State fund, which is the government fund –and they also have private funds –already has a retrospective rebate program. They are all a bit different and so we are not looking to implement any one of them holus-bolus, but they have some of these common features which we think we might be able to learn from, distil and put into our system.<sup>139</sup>

**5.2** During the inquiry the Committee received evidence from other jurisdictions about different scheme designs. This chapter explores a number of meritorious scheme design options with regards to the following areas identified in Chapter 4:

- Ownership;
- Roles of WorkCover, and
- Premium setting

### Ownership

**5.3** Various methods are used to try and improve ownership by key stakeholders, both interstate and overseas. A few methods brought to the Committee’s attention include:

- group improvement rebates;
- self insurance;
- partnership plans, and
- reference groups and advisory groups.

**5.4** In their paper presented to the Eighth Accident Compensation Seminar in Queensland, Daniel Tess and Win-Li Loh from PwC emphasised the importance of stakeholder ownership in workers compensation schemes:

<sup>139</sup> Submission 23, Mr Bill Mountford, Chief Executive Officer, WorkCover Victoria, 22 November 2001, p 28.

Many jurisdictions in the US and Canada have recognised the importance of participation in scheme design and have established governance structures which enable management and labour to participate at the policy level. The aim is to ensure that the scheme remains accountable to the major stakeholders, provides an opportunity for transparency as well as a consensus approach to scheme design and management.<sup>140</sup>

### **Group involvement rebates / Premium discount scheme**

- 5.5** Group improvement rebate programs have been used by some North American jurisdictions as a method to improve workplace occupational health and safety, and engage small business employers to pro-actively help each other to achieve superior occupational health and safety standards.
- 5.6** The concept of a group improvement rebate program has been examined by the NSW Government, which has looked at similar programs in North American and other Australian jurisdictions, including South Australia. The NSW Government has introduced the Premium Discount Scheme (PDS), which has different features of a group improvement rebate program. This has been available to NSW employers since 30 June 2001.
- 5.7** The PDS provides incentives to employers to implement programs to improve workplace safety and return-to-work strategies for injured workers. The incentive scheme provides a discount on the employer's workers compensation premium.
- 5.8** WorkCover Victoria has also recently been examining the concept of adopting a group improvement rebate program but has not implemented the program to date.
- 5.9** Although the exact nature of the programs varies between jurisdictions, essentially they all have very similar aims. In essence, the core aims of the programs are to:
- improve OH&S, return to work rates and injury management through employer collaboration;
  - give small employers an opportunity to reduce their premium rates, and
  - involve in a pro-active way small employers in the Scheme.
- 5.10** Another benefit of the group improvement rebate program is that it improves ownership of the scheme by the employers involved by giving them more control over the premiums charged and promoting active participation in aspects of the scheme's management. Mr Mountford identified the likely improvements to scheme ownership by employers as one of the attractions of the program for WorkCover Victoria:

What we have been doing, certainly in the last 18 months, is seeking to get more ownership of the scheme by the employers and the unions. We have done that through stakeholder forums, where we regularly meet with them and discuss what

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<sup>140</sup> Eighth Accident Compensation Seminar, p 181.

we are doing, and through programs, such as the group improvement program, where we seek to get them more actively involved.<sup>141</sup>

#### **5.11** Features of a typical group improvement rebate scheme include:

- Groups of small employers.
  - A number of small employers in the same or similar industries form a group, which is often sponsored by a trade association or chamber of commerce. The groups tend to form in high risk industries, with consequent higher premium rates. The group then acts as one large business for the purposes of workers compensation premiums.
- Collaboration in improving experience.
  - The groups establish business plans that aim to improve the experience of the entire group, aiding the likelihood of rebates at the end of the year.
- Rewards for performance.
  - Higher than average performance is rewarded with a rebate on the premium paid by the group at the beginning of the year. This design aims to provide more financial incentive by treating what would be small firms as if they are big firms for insurance purposes under the experience-rating scheme. Conversely, in some schemes where a group performs badly they may have their premiums increased.
- Group ownership of the rebates.
  - Where a rebate is awarded the group determines how the money is to be distributed between the members, the expectation being that the money will be reinvested to further improve the group's OH&S, return to work rates and injury management.
- Encouragement to meet performance targets
  - The scheme is designed such that there is an incentive for all employers to encourage and aid others in their group to make improvements to their OH&S and return to work standards. Mr Mountford summarised this incentive as follows;

#### **5.12** Mr Mountford summarised the benefits attainable by groups under such a scheme:

Under these schemes, essentially the extent to which their group will get a rebate or a discount on their insurance is governed by their overall performance. If they have got a couple of people letting them down, then you can be sure that the rest of the group will be hammering those people to improve their performance...<sup>142</sup>

<sup>141</sup> Submission 23, Mr Bill Mountford, Chief Executive Officer, WorkCover Victoria, 22 November 2001, p 29.

<sup>142</sup> Submission 23, Mr Bill Mountford, Chief Executive Officer, WorkCover Victoria, 22 November 2001, p 29.

**5.13** Mr Mountford theorised how a group rebate program may work in Victoria:

You might have the Victorian meat works association, or whatever the employer body is here. Basically you might form a group which would consist of a number of meat works in Victoria. It might be 20, 30 or 40, depending on how big they are. They would form a group. They would come together and basically they would sign the charter which would say that they are going to work together and develop a business plan which is about how they are going to improve their performance in both prevention and return to work. Then what would happen is that we would just send them an invoice for their premium as usual each year. But at the end of each year, we would group them all together and say, "Right, did they do better than the industry?", for example. The industry incident rate or costs rate might be X and this group did better than that, then you rebate them or give them a discount in retrospect for having done better than the industry rates.<sup>143</sup>

**5.14** The group involvement scheme engages small employers in actively trying to minimise risk in the workplace as well as in aiding employees return to the workplace. In this way all employers have a direct role. This role is further reinforced by the fact that by participating in a group they are being further encouraged to improve their standards and meet the groups overall objectives. In this way the group involvement rebate scheme gives small employers more interest in the scheme as a whole.

**5.15** The costs of implementing and managing a group rebate program are not known and would need to be explored in some depth in relation to the New South Wales system. Mr Mountford summarised WorkCover Victoria's understanding of the programs costs, concluding that the ultimate benefit of the scheme would be derived from reducing injury and improving employer performance:

In terms of the costs of the group improvement premium, were we to introduce it, there would be, or there could be, some initial costs. We have not actually got to the bottom of that yet but ultimately in any of these schemes, in the final analysis, the sustainable way that the group improvement program would improve the scheme and would reduce premium costs is by improving performance and reducing injury.<sup>144</sup>

**5.16** In response to a question on notice Mr Mountford updated the Committee on the Victorian WorkCover Authority's position with regards to the implementation of the program:

... Whilst the feasibility study and stakeholder consultation process concluded it is a meritorious concept, which WorkCover remains keen to introduce, it is not viable for introduction within the current premium system. This is due primarily to the complexities associated with the cross subsidies within the current premium system. .... WorkCover will further consider the introduction of a group rebate program concept in the context of the third stage of the Premium Review process.

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<sup>143</sup> Submission 23, Mr Bill Mountford, Chief Executive Officer, WorkCover Victoria, 22 November 2001, p 27.

<sup>144</sup> Submission 23, Mr Bill Mountford, Chief Executive Officer, WorkCover Victoria, 22 November 2001, p 27.

<sup>145</sup> Correspondence received from Mr Bill Mountford, Chief Executive Officer, WorkCover Victoria, 10 December 2001.

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## Conclusion 15

Certain aspects of the group improvement rebate schemes seem to provide mechanisms for not only aiding scheme ownership by employers but also encouraging improvements to be made to OH&S and injury management. To this end, the Committee notes that the NSW Government has implemented a Premium Discount Scheme and Small Business Strategy, and the Committee considers that the implementation of these programs should be monitored more closely before further consideration is given to other programs, such as the proposed Victorian Group Improvement Rebate program, which has not been implemented or tested to date.

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### Self insurance

- 5.17** Self insurance relieves an employer or corporate group of employers from obtaining a workers compensation policy of insurances and allows such employers to carry their own underwriting risk. Self-insurers are responsible for the payment of their claim liabilities and for the management of those claims ie all costs of any individual employee becoming injured in the work place are borne by the employer directly. Self insurers by law are required to provide the same benefits to an employee as would be supplied by an employer covered by the New South Wales workers compensation scheme. Under the New South Wales workers compensation scheme WorkCover has a responsibility to ensure that workers outstanding claims are adequately protected and will be met.<sup>146</sup>
- 5.18** In 1997 the Grellman Report recommended the extension of the self-insurance system. Key alterations recommended included:
- Reduce the minimum size for an employer to be categorised as a 'self insurer' from 1,000 to 750 full time New South Wales workers.
  - Consideration be given to endorsing as self insurers large national companies who self insure in other Australian states and meet New South Wales licensing requirements except for the number of workers.
  - Permit the outsourcing of claims management by self insurers to a New South Wales licensed insurer within the system.
- 5.19** After the Grellman Report a number of changes were made to the restrictions on self-insurers by the WorkCover Board. The current licensing policy of WorkCover for self-insurers and group self-insurers outlines the requirements for self insurance. Two of the most important aspects of this policy, which relate to the changes suggested in the Grellman Report, are:
- a minimum required employer size of 500 employees (reduced from 1000), and

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<sup>146</sup> WorkCover NSW, *Outline of the Operation of the NSW Workers Compensation Scheme*, November 2001, pp 41-42

- permission for self insurers to outsource claims management and injury management to a suitably qualified third party with the approval of WorkCover. WorkCover must be satisfied that such an arrangement will not lead to a decrease in established service standards to injured workers. WorkCover must also be satisfied that its powers will not be impaired as a result of any proposed outsourcing.

**5.20** Some of the advantages and disadvantages of self-insurance in terms of improving scheme ownership were outlined to the Committee during its Inquiry. In his submission to the Committee, Mr Harry Neesham, Chief Executive Officer, WorkCover WA, stated:

... they (self insurers)... manage their own risk, they manage their own claims and basically they pay the claims and generally they tend, by virtue of that, to be far more interested in injury management and in dealing with their injured workers. Their performance is generally better than the system as a whole but then within that system as a whole, clearly you have other issues where an employer -say, a small employer with five people who has somebody injured with a sore back or strain to their arm or shoulder -finds it very difficult, by virtue of its size, to place that worker back into an appropriate job. As such, for them to remain in business, they would prefer to have that employee on compensation rather than try to manage that person back into the workplace. That is clearly one of the issues.<sup>147</sup>

**5.21** Mr Walsh also highlighted to the Committee the advantages of differences in the management of claims between employers under the Scheme and self-insurers.

There seems to be almost an adversarial approach to a claim between the injured worker and the employer pretty much immediately, except in cases where the employer is a large employer and has a specific commitment to better management of injured workers, such as with self-insurers or large employers that have taken a decision to do this.<sup>148</sup>

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### **Conclusion 16**

Self insurance has expanded and seems to be operating efficiently and economically. The implications for the Scheme of the recent changes have yet to be determined. Future examination of the benefits of the self insurers model would be beneficial to the financial viability of the Scheme.

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### **Reference groups and advisory groups**

**5.22** Many jurisdictions utilise reference groups, stakeholder forums and/or advisory groups with have broad stakeholder representation as a means to give policy control and scheme ownership. These groups and their exact roles vary considerably between the different jurisdictions. Some examples from Victoria, Queensland and Western Australia are outlined here:

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<sup>147</sup> Submission 21, Mr Harry Neesham, Chief Executive Officer, WorkCover Western Australia, p 35.

<sup>148</sup> Evidence from Mr John Walsh, Partner, PricewaterhouseCoopers, 21 November 2001, p 22.

### **Victoria**

**5.23** WorkCover Victoria has established a number of forums to aid the involvement of stakeholders in various aspects of the workers compensation scheme. The Minister appoints the Victorian WorkCover Advisory Committee (WAC). Comprising representatives from key stakeholder groups, the WAC advises the WorkCover Board in relation to its objectives, which are to:

- promote a healthy and safe work environment;
- ensure that appropriate compensation is paid to injured workers in the most socially and economically appropriate manner and is expeditiously as possible, and
- promote occupational rehabilitation and early return to work of injured workers.

**5.24** In this way the WAC seems to share similarities with the Occupational Health and Safety Council which operates in the New South Wales scheme.

**5.25** Supporting the role of the WAC are the Rehabilitation and Compensation Working Group, the Health and Safety Working Group and the Major Hazards Advisory Committee. All of these groups comprise of representatives from unions, employer groups, self-insurers, service providers and agents.

**5.26** In relation to the success of these groups, and in response to a question on notice, Mr Mountford replied:

These groups have been instrumental in opening the channels of communication and have contributed to initiatives such as the Premium Review, the Claims Management Review, the Safety Development Fund and the renewed focus on prevention.<sup>149</sup>

### **Queensland**

**5.27** WorkCover Queensland involves employees and employers in the management of the scheme through the WorkCover Review Council. The Council's functions are to monitor the performance and outcomes of the review process and of the medical assessment tribunals; and to make recommendations to WorkCover's board on these issues.

**5.28** Under the WorkCover Queensland Act 1996 the Review Council is required to have two employees and two employer representatives. The Board receives quarterly reports from the Council and accepted and implemented the majority of their recommendations during the 2000/01 financial year.<sup>150</sup>

<sup>149</sup> Correspondence received from Mr Bill Mountford, Chief Executive Officer, Victorian WorkCover Authority, 11 December 2001.

<sup>150</sup> Working Relationships – WorkCover Queensland Annual Report 2000-2001, p 11.

**Western Australia**

**5.29** In Western Australia stakeholders are involved in managing and overseeing the workers compensation scheme through the Premium Rates Committee. This Committee has power under the *Workers Compensation and Rehabilitation Act 1981* to recommend premium rates for different industry categories, report on the reasons for the rate, and receive appeals from employers on classifications determined by the Committee.<sup>151</sup>

**5.30** The Committee consists of the following members:

- the Auditor General as member and Chairperson;
- the managing director of the State Government Insurance Commission;
- a person experienced in management affairs in commerce or industry;
- a person experienced in trade union affairs, and
- a person experienced in insurance business.

**5.31** In response to a question from the Committee regarding how well the Premium Rates Committee has worked given that the members represent the interests of different groups, Mr Neesham replied:

To some extent we have been extremely fortunate up to the present time that we have been able to get consensus on almost all of the things that have come up — and there have been some fairly tough ones over those 20 years, but basically they act in their roles, in effect, as directors. They come with the knowledge and benefit of their backgrounds and they apply themselves to the benefit of the system. ... The positions are put quite forcefully, I am sure you would appreciate, but at the end of the day they have to look at the system and that is what they are charged with administering and whether by good luck, good selection or good judgment, the people who have been nominated and who have operated in those roles have conducted themselves in a very appropriate manner in the interests of our system.<sup>152</sup>

**5.32** The Premium Ratings Committee in Western Australia will be considered further in an analysis of premium setting.

**5.33** WorkCover's governing body is the Workers Compensation and Rehabilitation Commission. Much like the Premium Ratings Committee, this body is made up of representatives from the various stakeholder groups. Each of these representatives heads up one of a number of advisory committees. These advisory committees include:

- Accreditation and Monitoring Advisory Committee

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<sup>151</sup> Workers Compensation and Rehabilitation Act 1981 (WA) section 150.

<sup>152</sup> Submission 21, Mr Harry Neesham, Executive Director, WorkCover Western Australia, p 37.

- Audit and Budget Advisory Committee
- Grants Advisory Committee
- Insurer and Self Insurer Committee
- Legislative Review Advisory Committee
- Medical and Allied Services Advisory Committee

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### **Conclusion 17**

Advisory councils, such as in Western Australia and Queensland, which are representative but not cumbersome, can be an effective means of increasing stakeholder ownership of workers compensation schemes.

The Committee notes the Minister's letter to the Chairman dated 8 January 2002 indicating that the Government is committed to improving Scheme design, and that the Minister has indicated that as part of the final stage of the Government's reform agenda, the Government is proposing a review of scheme design to identify their preferred options for underwriting the Scheme, and for achieving better Scheme options.

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## **Roles of WorkCover**

**5.34** Chapter 4 explored concerns that have been raised about the multiple roles performed by WorkCover and possible conflicts which may exist between a number of these roles.

**5.35** Ernst & Young have summarised WorkCover's roles as follows:

- Occupational Health and Safety
  - information and advice
  - enforcement of OH&S legislation
  - regulation (policy implementation and review)
- Workers Compensation
  - advice to stakeholders
- Management of agents/insurers/other service providers
  - monitoring,
  - penalising,
  - setting policy.
- Premium Rating System
  - setting premiums
  - designing premiums

- monitoring scheme performance.
- Workers Compensation Regulation
- General human resource functions.<sup>153</sup>

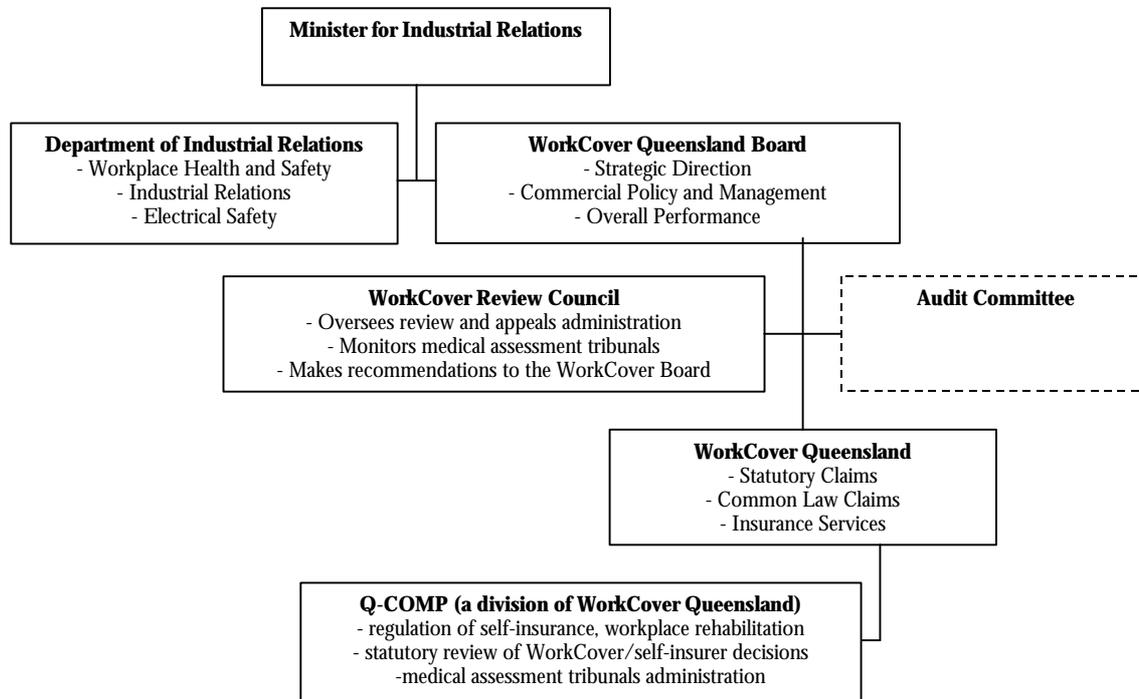
**5.36** The Minister has indicated that as part of the final stage of the Government’s reform agenda, the Government is proposing a review of scheme design to identify their preferred options for underwriting the Scheme, and for achieving better Scheme outcomes.

**5.37** Should the Government decide to separate the functions/roles of WorkCover, there are numerous possible models that may be considered. Ernst and Young ABC have provided the Committee with six possible options for consideration. These options are outlined in table form in Appendix 5.

**Queensland**

**5.38** Queensland provides an example of a model where the multiple functions of a workers compensation scheme have been separated between two different agencies - WorkCover Qld and Q-Comp. The separation of workers compensation management functions in Queensland are summarised in the following diagram:

**Figure 5.1 Workers compensation management roles and responsibilities in Queensland**



<sup>153</sup> Advice received from Ernst & Young, 14 December 2001.

**5.43** However, the *Annual Report* also noted that

Although we have worked administratively to reinforce the independent identity of Q-Comp, a legislative separation will address some stakeholder perceptions regarding the regulator's impartiality.<sup>157</sup>

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**Conclusion 18**

The Queensland model of separating conflicting functions provides an interesting comparison for New South Wales, however the extent of its usefulness depends largely on what roles WorkCover New South Wales is considered to perform. In Queensland, WorkCover has a very clear role as the sole public insurer, both managing and underwriting the scheme, whereas insurer roles and functions of WorkCover New South Wales need to be more clearly defined.

The Committee notes the Minister's letter to the Chairman dated 8 January 2002 indicating that the Government is committed to improving Scheme design, and that the Minister has indicated that as part of the final stage of the Government's reform agenda, the Government is proposing a review of scheme design to identify their preferred options for underwriting the Scheme, and for achieving better Scheme outcomes.

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<sup>154</sup> Submission 22, Mr Tony Hawkins, Chief Executive Officer, WorkCover Queensland, p 13.

<sup>155</sup> Submission 22, Mr Tony Hawkins, Chief Executive Officer, WorkCover Queensland, p 35.

<sup>156</sup> *Working Relationships – WorkCover Queensland Annual Report 2000-2001*, p 4.

<sup>157</sup> *Working Relationships – WorkCover Queensland Annual Report 2000-2001*, p 4.

## Premium Setting

**5.44** As identified in Chapter 4 the Committee has some concerns regarding the transparency of premium setting in the current workers compensation scheme.

**5.45** The Committee's consultant actuary summarised some options to improve transparency in premium setting. These options include:

- Creating an independent premiums rating committee internal or external to WorkCover, that recommends to the Minister premium system design and rates to apply. The Premiums Committee report including their actuary's report is publicly available. The Minister can then publicly adopt or reject the recommendations.
- Creating an independent premium rating committee external to WorkCover that sets premium rates without reference to the Minister. The Premium Committee's report including their actuary's report is publicly available.
- Using established independent pricing regulatory mechanisms used in setting prices for Government Services (e.g. rail and bus tickets).<sup>158</sup>

**5.46** In relation to a premium ratings committee Ernst & Young provided the following advice to the Committee:

The role of any independent premium rating body would need careful consideration and may involve monitoring the scheme's financial progress and reporting on it and recommending considerations of scheme design changes. ... The setting up of such a body would also improve financial accountability of the scheme.

**5.47** The premium setting scheme design in Western Australia is similar to some extent to the second option outlined above. As summarised in the section on "Ownership" the Western Australian Workers Compensation Scheme has an independent premium setting committee, made up of representatives from various stakeholders. The Committee's role is to:

- set the recommended premium rates by industry;
- fix additional industrial disease premiums, and
- Provide reports on the recommended premium rate to any person upon request - stating the actuarial basis for the premium rate and the comparative claims of the different businesses or groups concerned.<sup>159</sup>

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<sup>158</sup> Ernst & Young, Second Report, p 10.

<sup>159</sup> Workers Compensation and rehabilitation Act 1981 (WA), section 147.

**5.48** Mr Neesham, Executive Director, WorkCover Western Australia, summarised the role of the Premium Rates Committee in evidence presented to the Committee, as follows:

While the private system is intended to provide a capacity for negotiation, the reality is that the Premium Rates Committee sets a recommended rate. This rate is generally accepted as the base rate for that bulk of small employers. It reflects the true cost of the system. Obviously, within that there is scope for the insurers to load premiums, depending upon the performance of the employer, or to discount them. Generally the discounts in those areas are about five per cent to 10 per cent.<sup>160</sup>

**5.49** One of the benefits of the premiums being determined through this structure is that it was less open to being utilised for political purposes. Mr Neesham stated:

... the fact that the system is, in effect, audited in terms of the premiums, independently of government means that nobody can come back and point their finger and say ...<sup>161</sup>

and

The reality is that the government of the day cannot impact upon what is the correct pricing structure for our system. I think as a final comment, legislators have a very short time horizon. In workers compensation it is critical to understand that it has a long horizon.<sup>162</sup>

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### **Conclusion 19**

It is noted that under the current arrangements the Board is responsible for providing the Government with independent advice about premium rates, and that this role may be reconsidered during the Government's review of Scheme design.

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<sup>160</sup> Submission 21, Mr Harry Neesham, Executive Director, WorkCover WA, p 33.

<sup>161</sup> Submission 21, Mr Harry Neesham, Executive Director, WorkCover WA, p 35.

<sup>162</sup> Submission 21, Mr Harry Neesham, Chief Executive Officer, WorkCover WA, p 35.



## Chapter 6 Options to reduce the Scheme's deficit

**6.1** The Scheme's deficit was estimated by Tillinghast to be \$2.76 billion at 30 June 2001. This deficit has been forecast to increase to \$3.1 billion by December 2001 and continue to increase at a rate of approximately \$500 million per year over the next five years if current conditions remain unchanged.<sup>163</sup> The result, according to the Committee's consultant actuary, Ernst & Young, is

the deficit will grow to \$5.6 billion by June 2006. This is more than double the deficit as at June 2001, in a period of 5 years.<sup>164</sup>

**6.2** While this deficit does not need to be repaid immediately, nevertheless it is a real debt that must be paid at some stage in the future. This point was made by Mr David Finnis, Principal, Tillinghast, in evidence to the Committee:

There is no immediacy of the debt, if that is what you are trying to say. But at some stage someone is going to have to pay for it, because this is an amount that will not go away. As you say, cash flow, if you like, will deal with it on a rolling basis for a number of years, but if things continue to deteriorate at some stage you will be hit with a bigger whack than the apparent \$2.75 million you have now.<sup>165</sup>

**6.3** The Government's ten point plan for the reforms of the Scheme pursues a multifaceted strategy designed to reduce the underlying costs of the Scheme and for targeting the deficit. The Committee notes that:

- Tillinghast's final actuarial projections confirm that successful implementation of the recent reforms will have one-off savings on the deficit of up to \$1.33 billion and ongoing savings of up to \$400 million per annum, and that these savings will have a real impact on the deficit;<sup>166</sup>
- the recent Scheme reforms only for part of the Government's overall strategy to reduce the underlying costs of the Scheme.

**6.4** These strategies (including the incentives provided under the new insurer remuneration arrangements, the injury management pilots, medical management pilots, the Premium Discount Scheme, Small Business Strategy and premium reform) are expected to generate further savings and/or improvements, that will further contribute to reducing the underlying costs of the Scheme and reducing the deficit.

**6.5** The Committee notes that if these strategies are not successful, that the Government will need to consider 'additional steps' to reduce the existing deficit.

<sup>163</sup> Evidence of Mr Andrew Cohen, Manager, Tillinghast-Towers Perrin, 21 November 2001, p 43.

<sup>164</sup> Ernst & Young Second Report, Appendix p 9.

<sup>165</sup> Evidence of Mr David Finnis, Principal, Tillinghast-Towers Perrin, 21 November 2001, p 38.

<sup>166</sup> Dave Finnis & Sally Wijesundera, Tillinghast-Towers Perrin, *Actuarial Projections of Funding Scenarios for the NSW Workers Compensation Scheme*, 7 January 2002, pp 37-38.

**6.6** According to Ernst & Young's advice, there are four means by which the deficit may be reduced. These are:

- Increase premium level;
- Reduce benefit payments;
- Increase operational efficiencies, or
- Reinsurance.

**6.7** The Committee has not endorsed any of these approaches.

**6.8** The Minister for Industrial Relations, the Hon Della Bosca MLC, wrote in a letter to *The Daily Telegraph* on 19 November 2001 made the following comments in response to that paper's editorial of 16 November 2001 which claimed the Government's proposed changes to workers compensation were too generous:

The new legislation is expected to save \$215 million a year. The savings come from the process, not from the benefits.

The alternative path is to increase premiums for business or cut benefits to workers. This Government has rejected those options.<sup>167</sup>

**6.9** Evidence presented to the Committee in submissions and public hearings suggest that the Government's preferred path of finding savings within the process of the workers compensation Scheme, not benefits or premiums, will not yield sufficient savings to reduce the deficit.<sup>168</sup> This Report will, therefore outline a wider variety options for reducing the deficit.

**6.10** The Committee will evaluate deficit reduction options and make recommendations in its fourth and final report, due to be tabled on 28 June 2002.

## **Increase premium levels**

**6.11** There are a number of options which will result in increased funds entering the Scheme. Some of these options have been discussed in previous chapters of this Report. The options include:

- Increase level of premium generally
- Introduce a special debt reduction levy
- Ensure premiums truly reflect OH & S experience

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<sup>167</sup> Hon John Della Bosca MLC, Special Minister of State and Minister for Industrial Relations, Letter to *The Daily Telegraph*, 19 November 2001, p 23.

<sup>168</sup> Evidence of Mr David Finnis, Principal, Tillinghast-Towers Perrin, 21 November 2001, p 37.

- Minimise premium avoidance

**6.12** Mr Gary Moore, General Manager, Commercial Insurance (WA), NRMA stated in evidence before the Committee that premium levels was the place where efforts to reform the New South Wales Scheme should start.<sup>169</sup> Mrs Yaager, OH&S and Workers Compensation Co-ordinator, Labor Council of NSW, also indicated to the Committee that she felt employers should be made to pay the true rate to cover the costs of the Scheme:

Premiums have been capped at an unrealistic rate of 2.8% and the unions are now of the view that pressure on the scheme should not just be applied to benefits; that the Government needs to consider making employers pay the true rate.<sup>170</sup>

**6.13** Mr Grellman highlighted to the Committee the difficulty facing those who must make a decision about premium levels. He also informed the Committee that if he was 'sitting in Government' he would be charging higher premiums, despite the unpleasant outcomes a decision of this kind would have:

... New South Wales is already at the high end of the spectrum relative to other States in Australia in terms of the cost of workers compensation premiums. It must be almost a whole-of-government issue as to how this State remains competitive because this is one of the big expenses for employers.... All I can say is that I would hate to have to be making the decision because if I was going to be financially responsible, if it was up to me and I was sitting in Government, I know that I would be charging higher premiums. That would result in two unpleasant outcomes. One is that New South Wales would, on this expense area, become that much more uncompetitive, and it would obviously send a shock into the community, which would be difficult to deal with. So it is a most difficult situation to have to deal with. Is it inappropriate or irresponsible, I do not know whether I can say. All I can say is that I would not want to have to make that decision myself.<sup>171</sup>

**6.14** The option of increasing premiums – so that they are set at an 'appropriate' level – was the approach adopted by WorkCover Queensland to reduce their unfunded liability of \$326 million in January 1998:

In terms of turning it [the unfunded liability] around, we set the premium at an appropriate level.<sup>172</sup>

**6.15** Prior to the Further 2001 Act, the 1998 Act contained provisions allowing a deficit reduction contribution to be levied where WorkCover is satisfied (from the results of an actuarial investigation or from other information) that there is an overall deficit among the statutory funds of insurers under the 1987 Act or a deficiency in particular statutory funds.<sup>173</sup>

<sup>169</sup> Evidence of Mr Garry Moore, General Manager, Commercial Insurance (WA), NRMA Insurance Ltd, 21 November 2001, p 52.

<sup>170</sup> Evidence of Mrs Mary Yaager, OH&S and Workers Compensation Co-ordinator, Labor Council of NSW, 10 October, p 2.

<sup>171</sup> Evidence of Mr Richard Grellman, 21 November 2001, p 8.

<sup>172</sup> Submission 22, Mr Anthony Hawkins, Chief Executive Officer, WorkCover Queensland, p 15.

<sup>173</sup> 1998 Act, section 174(1) – repealed by the Further 2001 Amendment Act.

**6.16** The deficit reduction levy had been put in place as a part of the move to private underwriting of the Scheme. It, along with all other provisions related to private underwriting, were repealed by the Further 2001 Act. In response to a question from the Committee, whether or not WorkCover indented to levy every worker or employer as a means of reducing the deficit, Ms McKenzie stated:

Certainly not at this stage.<sup>174</sup>

**6.17** In order to ascertain the positive impacts of increased premiums on Scheme finances, the Committee requested that Tillinghast cost a scenario (Scenario 1) in which the only measure used to reduce the deficit was higher premiums.

**6.18** This scenario required Tillinghast to calculate how much the current Scheme premium rate of 2.76% will need to increase on average (as a percentage of Scheme wages) if the deficit is to be funded over alternative periods from increased premium rates. The current cost of the Scheme is assumed to stay constant at 3.13% for this scenario and the 2001 legislated Scheme reforms are excluded.

**6.19** Tillinghast's results indicated that if this scenario were to be followed it would be necessary to increase the current premium rate by at least 15% to remove the current deficit over the next 50 years, all other things being equal.<sup>175</sup> This is demonstrated by the following table-

**Table 6.1 Scenario 1: Deficit Funding Using Premium Increases (Excluding Scheme Reform Impacts)**

<b>Funding Period (yrs)</b>	<b>5</b>	<b>10</b>	<b>15</b>	<b>20</b>	<b>25</b>	<b>50</b>
Premium Rate Required	3.90%	3.50%	3.37%	3.30%	3.26%	3.18%
Change to Current Premium rate (2.76%)	1.14%	0.74%	0.61%	0.54%	0.50%	0.42%
% change to current premium rate (2.76%)	41%	27%	22%	20%	18%	15%

Note: All rates are quoted net of GST

Source: Tillinghast Towers Perrin, "Actuarial projections of funding scenarios for the NSW Workers Compensation Scheme", January 7 2002, p6.

**6.20** Scenario 3 performs the same calculations as scenario 1 except that it takes into consideration the effects of the 2001 legislative reforms. Under the low savings scenario, Tillinghast concluded:

It is evident that to achieve full funding under the low savings scenario within a reasonable period of time, increases in the current premium are required despite the beneficial impact of the Scheme reforms.<sup>176</sup>

<sup>174</sup> Evidence of Ms Kate McKenzie, General Manager, WorkCover NSW, 21 November 2001, p 54.

<sup>175</sup> Tillinghast Towers Perrin, *Actuarial projections of funding scenarios for the NSW Workers Compensation Scheme*, January 7 2002, p 6.

<sup>176</sup> Tillinghast Towers Perrin, *Actuarial projections of funding scenarios for the NSW Workers Compensation Scheme*, January 7 2002, p 9.

**6.21** Under the high savings scenario, Tillinghast concluded:

Given the inclusion of additional estimated savings under the high savings scenario, the Scheme is projected to reach a fully funded position in 23 years time without any increase to the current premium rate of 2.76%. If the Government's target Scheme premium rate of 2.8% is achieved and maintained then the Scheme is projected to reach a fully funded position in 15 years time. In order to remove the deficit over a much shorter period of time, such as 5 years, a premium rate increase of 12% of the current premium rate is required.<sup>177</sup>

**6.22** The results of the projections are summarised in the table below:**Table 6.3 Scenario 3 required scheme premium rates to fund deficit – low and high savings**

<b>Funding Period (Yrs)</b>	<b>5</b>	<b>10</b>	<b>15</b>	<b>20</b>	<b>25</b>	<b>50</b>
<b>Premium rate required</b>						
Low savings	3.44%	3.15%	3.06%	3.01%	2.98%	2.92%
High savings	3.08%	2.87%	2.80%	2.77%	2.75%	2.71%
<b>Change to current premium rate (2.76%)</b>						
Low savings	0.68%	0.39%	0.30%	0.25%	0.22%	0.16%
High savings	0.32%	0.11%	0.04%	0.01%	-0.01%	-0.05%
<b>% change to current premium rate (2.76%)</b>						
Low savings	25%	14%	11%	9%	8%	6%
High savings	12%	4%	2%	0%	0%	-2%

*Source: Tillinghast Towers Perrin, Actuarial projections of funding scenarios for the NSW Workers Compensation Scheme, January 7 2002, p 9*

**Reduce benefit payments****6.23** There are a number of ways by which benefit payments can be reduced. Some of these options have been discussed in previous chapters of this Report. The options include:

- Restrict access to benefits;
- Reduce amount of benefit paid;
- Shorten length of time benefits are paid;
- Increase employers' "excess";
- Improve claims management, and
- Reduce commutations.

<sup>177</sup> Tillinghast Towers Perrin, Actuarial projections of funding scenarios for the NSW Workers Compensation Scheme, January 7 2002, pp 9-10.

**6.24** Mr David Finnis, Principal, Tillinghast, said in response to a question from the Committee that in his opinion a reduction in benefit levels is the preferred means of reducing the deficit.

The standard answer that you will get from an actuary –and I will give it because I am an actuary –is reduced benefit levels, because if you reduce benefit levels it is a clear change in the amount being paid to workers. It is also a clear sign that the scheme culture is changing. From experience, what appears to happen is that you get less propensity to claim and therefore you get a saving that is greater than the one you would cost without taking into account those other issues: not only benefit levels but I guess access to benefits as well –a combination of those two elements. That would be the no-brainer actuarial answer. That does not take into account the non-financial aspects of managing our scheme, of course. I am not so naive as to assume that the actuarial answer will win the political argument. At this stage it is difficult to perceive an alternative solution. Another solution is an increase of the inputs to the scheme, which is premium rates above the current levels.<sup>178</sup>

**6.25** Reforms contained in the Further 2001 Act are aimed at restricting access to common law (see para 2.12 of this Report for details). This will have some impact on the deficit, although the level of impact is unknown. Western Australia also reduced access to common law in 1999, as was explained by Mr Harry Neesham, Executive Director, WorkCover Western Australia, in his submission to the Inquiry. Access was not limited in respect of those workers with permanent impairment of 30% or greater. It was only restricted for those with an impairment in the 16% to 29% range:

In 1999 the 30 per cent was not changed but there was a limitation placed on those who were in the range of 16 per cent to 29 per cent whole body impairment. That is based on a disability; it is not based on the American Medical assessment tables. We have a review at the present time looking at that issue. At six months workers in that lower group are required to elect whether they stay in the statutory system or go to common law. The impact of that clearly has been quite dramatic, because their common law claim cannot be resurrected. Once they get to six months, those people who are below the threshold cannot reinstate their common law position, unless they can establish a 30 per cent disability. That was the major thrust of the change. It was to clearly address the issue of the second gateway.<sup>179</sup>

**6.26** Another means of reducing benefit payments is to cap weekly benefits. This approach is adopted in Western Australia:

The maximum a worker can get under our system for weekly benefits is \$126,000. There is a capacity to extend that by a further \$50,000, but that is in exceptional circumstances. In 20 years I think there has been one extension beyond that amount. Separate to that, workers have a medical entitlement, which is 30 per cent of the prescribed amount. That is in excess of \$30,000. There is an ability to extend that by a further \$50,000 for more seriously injured workers, and that is often accessed and is fairly automatic. There is a separate entitlement to vocational

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<sup>178</sup> Evidence of Mr David Finnis, Principal, Tillinghast-Towers Perrin, 21 November 2001, p 37.

<sup>179</sup> Submission No 21, Mr Harry Neesham, Executive Director, WorkCover Western Australia, p 35.

rehabilitation. That is 7 per cent and is about \$8000, which is available for use for the benefit of the worker.<sup>180</sup>

- 6.27** Western Australia also caps common law payments for the lower group – 16 to 29% injured, at \$250,000 maximum worst case.

Common law is capped for the lower group, 16 per cent to 29 per cent, at \$250,000 maximum worst case. In other words, if you have 29 per cent disability, then you are at the top end of the scale. If you are down to 16 per cent, you are at the lower end.<sup>181</sup>

- 6.28** The author of the *Western Australian Report on the Implementation of the Labor Party Direction Statement in Relation to Workers' Compensation*, Robert Guthrie was critical of previous governments' method of restricting payments to injured workers as a means of containing costs. This report was presented to the Workers' Compensation and Rehabilitation Commission in July 2001 and contained a number of major findings including No 11:

The approach to workers' compensation needs to be more holistic. In the past Government has struggled with the issues of rising costs and has often attacked worker benefits as a means of containing the problem. This leads to enormous tensions between the parties to the system. The common interest of all parties is the return to work of disabled workers, and mechanisms to facilitate this process should be given priority. Therefore better practice in Injury Management is a key. The reduction of the use of rehabilitation as a claims management tool and greater focus on the maintenance and creation of meaningful work for disabled workers is important.<sup>182</sup>

- 6.29** In comparison to Western Australia, the cumulative amount of weekly benefits payable to injured workers are not capped in New South Wales, although there is a maximum amount payable for weekly benefits of \$1,259.20 per week. The 1987 Act also allows for discontinuation of payments for partially incapacitated workers who have already received benefits for at least 104 weeks and who are either not seeking suitable employment, have unreasonably rejected suitable employment, or have been unable to find suitable employment primarily because of the state of the labour market.<sup>183</sup> Common law damages payments, although not capped, are restricted under the Further 2001 Act to damages for lost past and future economic loss due to loss of earnings.

- 6.30** Queensland is another state which caps statutory compensation payable to injured workers. Statutory benefits cease after five years, and there is a \$150,000 maximum benefit payable during that time. There are lump sums available for seriously injured workers, and common law payments are not restricted, although like New South Wales, common law payments are based on future economic loss.<sup>184</sup>

<sup>180</sup> Submission 21, Mr Harry Neesham, Executive Director, WorkCover Western Australia, p 36.

<sup>181</sup> Submission 21, Mr Harry Neesham, Executive Director, WorkCover Western Australia, p 36.

<sup>182</sup> Robert Guthrie, *Report on the Implementation of the Labor Party Direction Statement in Relation to Workers Compensation*, 31 July 2001, p 7.

<sup>183</sup> WorkCover NSW, *Outline of the Operation of the NSW Workers Compensation Scheme*, November 2001, p 21.

<sup>184</sup> Submission No 22, Mr Anthony Hawkins, Chief Executive Officer, WorkCover Queensland, pp 16-20.

**6.31** Victorian WorkCover Authority had an unfunded liability (deficit) of \$1 billion in December 2000. This was reduced to \$683 million at June 2001. When asked by the Committee what steps Victoria took to reduce their deficit, Mr Bill Mountford, Chief Executive Officer, Victorian WorkCover Authority answered that there was two components to Victorian WorkCover's strategy. The first was reducing common law liabilities, and the second arose as a result of an increase in assets from their investment strategy.<sup>185</sup>

**6.32** Mr Mountford explained to the Committee that there had been no change in the law in Victoria. Rather, the Victorian WorkCover Authority focussed more on ensuring only those people most intended to receive common law benefits gained access to common law:

We have not changed the law but managed the common law so that the people who get through the system are the people it was designed and meant for. We are not looking to deny common law rights to anybody for whom there is an entitlement. We are simply ensuring that it is going to the people who are entitled to it and not those who it is not meant for, and this is what happened in the past because the authority had not managed the defence of common law effectively.<sup>186</sup>

**6.33** At the request of the Committee Tillinghast Towers Perrin also completed some costings of what Scheme cost reductions would necessary to reduce and eliminate the deficit in New South Wales.

**6.34** The Committee requested that Tillinghast calculate how much the ongoing cost of the Scheme will need to reduce from the current cost of the Scheme of 3.13% of wages if the deficit is to be funded over alternative periods from a lower cost of the Scheme. The premium rates for prospective exposures are assumed to stay constant at 2.76% for this scenario and the 2001 legislated Scheme reforms are excluded.

**6.35** The following table shows the results of this work.

**Table 6.2 Scenario 2: Deficit Funding Using Cost Reduction (Excluding Scheme Reform Impacts)**

<b>Funding Period (yrs)</b>	<b>5</b>	<b>10</b>	<b>15</b>	<b>20</b>	<b>25</b>	<b>50</b>
Required Cost of Scheme	2.08%	2.41%	2.53%	2.59%	2.63%	2.71%
Change to Current Cost of Scheme (3.13%)	-1.05%	-0.72%	-0.60%	-0.54%	-0.50%	-0.42%
% Change to Current cost of Scheme (3.13%)	-34%	-23%	-19%	-17%	-16%	-14%

Source: Tillinghast Towers Perrin, "Actuarial projections of funding scenarios for the NSW Workers Compensation Scheme", January 7 2002, p7.

<sup>185</sup> Submission 23, Mr Bill Mountford, Chief Executive Officer, Victorian WorkCover Authority, 22 November 2001, p 22.

<sup>186</sup> Evidence of Mr Bill Mountford, Chief Executive Officer, Victorian WorkCover Authority, 22 November 2001, p 23.

**6.36** Summarising this scenario, Tillinghast state that:

... by holding the future premium rates level at 2.76% of wageroll, the cost of the Scheme would need to reduce from its current level of 3.13% to at least 2.71% to return the Scheme to a fully funded position over the next 50 years.<sup>187</sup>

and

This implies that the cost of the Scheme would need to reduce to at least the current premium rate of 2.76% to ensure prospective exposures do not add to the current deficit. In addition to this reduction a further reduction is required to fund the current deficit resulting from prior accident periods.<sup>188</sup>

**6.37** Scenario 4 performs the same calculations as scenario 2 except that it takes into consideration the effects of the 2001 legislative reforms.**6.38** The results of the projections are summarised in the table below:**Table 6.4 Scenario 4 required reduction in the cost of the Scheme – low and high savings**

<b>Funding Period (Yrs)</b>	<b>5</b>	<b>10</b>	<b>15</b>	<b>20</b>	<b>25</b>	<b>50</b>
<b>Required cost of Scheme</b>						
Low savings	2.26%	2.51%	2.60%	2.64%	2.67%	2.72%
High savings	2.39%	2.58%	2.67%	2.68%	2.70%	2.74%
<b>Change to current cost of Scheme (3.13%)</b>						
Low savings	-0.87%	-0.62%	-0.53%	-0.49%	-0.46%	-0.41%
High savings	-0.74%	-0.55%	-0.49%	-0.45%	-0.43%	-0.39%
<b>% change to current cost of Scheme (3.13%)</b>						
Low savings	-28%	-20%	-17%	-16%	-15%	-13%
High savings	-24%	-18%	-16%	-14%	-14%	-12%
<b>Change to post reform cost of Scheme (2.89%)</b>						
Low savings	-0.63%	-0.38%	-0.29%	-0.24%	-0.22%	-0.16%
High savings	-0.30%	-0.11%	-0.04%	-0.01%	0.01%	0.05%
<b>% Change to post reform cost of Scheme (2.89%)</b>						
Low savings	-22%	-13%	-10%	-9%	-8%	-6%
High savings	-11%	-4%	-2%	-1%	0%	2%

Source: Tillinghast Towers Perrin, Actuarial projections of funding scenarios for the NSW Workers Compensation Scheme, January 7 2002, pp 10-11.

<sup>187</sup> Tillinghast Towers Perrin, Actuarial projections of funding scenarios for the NSW Workers Compensation Scheme, January 7 2002, p 7.

<sup>188</sup> Tillinghast Towers Perrin, Actuarial projections of funding scenarios for the NSW Workers Compensation Scheme, January 7 2002, p 7.

**6.39** A further means by which the benefits paid by the Scheme are reduced is to increase employers' "excess" payable on each claim. Currently in New South Wales the following excess applies:

- Employers with annual premiums >\$3,000 (Category A employers) – first \$500 of weekly payments for each claim
- Employers with annual premiums <\$3,000 (Category B employers) – first \$500 **or** payment of excess surcharge of premiums of 3%.<sup>189</sup>

**6.40** Other states' excesses vary. There is no employer excess in Western Australia or the ACT, whereas South Australian employers are required to pay the first two weeks of incapacity per worker per calendar year and Victorian employers are required to pay the first 10 days of incapacity. Queensland and Tasmania operate under similar conditions to New South Wales where the employer is required to pay for the first five days of incapacity. Unlike some jurisdictions, New South Wales employers are not required to pay an excess on medical expenses. Victorian employers, for example, are required to pay the first \$440 of medical costs.<sup>190</sup>

**6.41** It was suggested by Mr Richard Gilley, Managing Consultant, the Risknet Group, in evidence to the Committee that New South Wales employers' excess be increased to the level in Victoria:

Should we increase the deductible in the same way that Victoria did so that instead of just paying for the first five days of costs we would be paying for the first 10 days?<sup>191</sup>

**6.42** This suggestion is further supported in Tillinghast's 30 June 2001 Scheme valuation, where it is stated that:

A constant dollar claims excess of the first \$500 of the first weekly benefit has declined in value in real terms over the Scheme's history.<sup>192</sup>

## **Increase operational efficiencies**

**6.43** This is the Government's preferred approach, as outlined in paragraph 6.5 above. Mr McInnes reiterated the Government's position in evidence before the Committee:

As you are aware, for some time the premiums that have been collected have fallen short of costs, which is why, in part, the deficit has been growing. Obviously, we have to bring down costs to below current premium levels in order

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<sup>189</sup> Heads of Workers' Compensation Authorities, Comparison of Workers' Compensation Arrangements in Australian Jurisdictions, July 2000, p 6.

<sup>190</sup> Heads of Workers' Compensation Authorities, Comparison of Workers' Compensation Arrangements in Australian Jurisdictions, July 2000, pp 6-7.

<sup>191</sup> Evidence of Mr Richard Gilley, Managing Consultant, the Risknet Group, 22 November 2001, p 5.

<sup>192</sup> WorkCover Authority of NSW, Actuarial Review of the Outstanding Liabilities of the WorkCover Scheme Statutory Funds as at 30 June 2001, 26 September 2001, p 16.

to eat into that deficit. That is the approach, to work to bring down costs by making the reforms we are talking about.<sup>193</sup>

**6.44** Ms McKenzie did not rule out altogether the possibility of premium or benefit adjustment when she said in evidence before the Committee:

Our theory has been to get the scheme under control and operating more efficiently before we look to any of those options.<sup>194</sup>

**6.45** Ernst & Young identified some areas where operational performance may be improved in their second report to the Committee:

#### **Operational Performance**

4.5 Significant inroads can be made into the deficit by improving the operational performance of the Scheme. We have defined operational aspects to include matters outside the nature, level and eligibility of compensation. The operational aspects that can be improved include:

- The operational performance of WorkCover including their management of service providers (eg insurers), monitoring of the Scheme, identifying leakage or inefficiencies in the Scheme, proactive management, expertise, etc
- The effectiveness and performance of functions performed by insurers (ie agents) particularly claims management
- The efficiency of the premium system by reducing premium leakage, reducing cross subsidies, improve incentives on employers to reduce claims and their cost
- The detection of fraud and reducing its level
- Employers ability to better manage injuries and providing return to work options
- Performance in occupational, health and safety to reduce the number of claims through education and assistance of employers, investigations of incidents and inspections
- Performance of other service providers including lawyers, doctors, injury management specialists etc.

4.6 It can be difficult extracting significant efficiencies from operational performance improvements as many of the matters are complex and involve large numbers of professionals and staff. In some cases it may be necessary to amend legislation (eg premium system, fees to service providers, etc).

<sup>193</sup> Evidence of Mr Rod McInnes, Assistant General Manager, Insurance Division, WorkCover NSW, 21 November 2001, p 62.

<sup>194</sup> Evidence of Ms Kate McKenzie, General Manager, WorkCover NSW, 21 November 2001, p 62.

- 4.7 Many of the possible changes can take years to fully flow through and are difficult if not impossible for actuaries to estimate their cost impact.<sup>195</sup>

**6.46** Operational efficiencies and other Scheme management issues will be discussed further in the Committee's third interim report.

## **Reinsurance**

**6.47** Ernst & Young raised the option of reinsurance as a means by which the Scheme's deficit might be reduced:

### **Reinsurance Options**

4.11 Reinsurance options can be complex and the details of the arrangements vary according to the objectives and parameters set by the buyer and purchaser. In order for reinsurance to be viable deficit reducing option the basic concept is for WorkCover to pay a reinsurer a sum of money say \$A, to take a higher amount of claims liabilities off the balance sheet of the workers compensation system say \$A + \$B. WorkCover benefits by \$B, the difference. Reinsurers hope to achieve a profit by transferring the assets and liabilities overseas to take advantage of more favourable tax rates and investment earning than available in Australia. It is also possible for reinsurers to benefit financially by taking over claims management to improve operational performance.

4.12 We are currently not confident about the feasibility of overseas reinsurers being interested in putting forward options. The conditions to make it attractive to reinsurers are not attractive for the reasons noted below. Current reinsurance market conditions are poor world wide with most reinsurers suffering from very poor profits and a shortage of capital. The World Trade Centre terrorist attacks and general poor profitability are expected to result in a significant number of reinsurance insolvencies worldwide. In addition the WorkCover scheme's claims experience has been volatile and generally deteriorating over the past few years. There have been significant untested changes to the Scheme and the Scheme is not seen to be stable.

4.13 It is also very unlikely that a reinsurance option could be used to significantly reduce the deficit. Such an option is likely to only have a relatively small benefit.<sup>196</sup>

**6.48** Mr Grellman also discussed the reinsurance option:

When I was working on my report I became the best friend of every reinsurance broker in town. Reinsurance thought they would be able to fix this one way or the other. A few of them talked to me about what they would do and frankly I never understood it because I thought it was a little like smoke and mirrors. A debt is a debt and it just does not go away by waiving strange pieces of paper over an annual report. I think there has been some dialogue with reinsurers. I think about

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<sup>195</sup> Ernst & Young Second Report pp 12-13.

<sup>196</sup> Ernst & Young Second Report pp 14-15.

a year or so ago WorkCover talked to a few reinsurers. Probably what the reinsurers would come up with was some way to manage the funding of the tail, to make it a more manageable cash flow exercise rather than leaving whoever is paying for it exposed to a lumpy outflow. So, that would be one benefit that a reinsurer might be able to bring.<sup>197</sup>

- 6.49** The Committee notes that the Government has recently conducted an expressions of interest process in order to consider options including reinsurance options, for reducing the deficit.

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### **Recommendation 20**

Although the option of reinsurance is a radical one it should be investigated further as one of a number of options to reduce the deficit, after the recent reforms have been successfully implemented and the Scheme is showing significant positive trends.

- 6.50** The Committee believes that no single strategy will have sufficient impact on the Scheme's deficit. In briefing the Committee on the steps undertaken by Queensland WorkCover to reduce their deficit, Mr Hawkins explained that it was by a combination of increasing employers' excess, improving claims management, increasing premium rates and imposing a surcharge and changing statutory weekly benefits that the deficit was reduced:

The Hon Greg Pearce asked me to outline what steps were taken to reverse the deficit including the principal legislative changes that took place. My initial response was to outline one of the changes at the time to the definition of worker and injury. However, there were also other key changes including:

- **in 1995/96:**
  - an election provision for common law whereby those with less than 20% work related impairment had to choose between statutory lump sums and common law access than pay their own legal costs if they chose to proceed to common law
  - an employer excess of four days compensation
  - increased premium rates and a surcharge
  - statutory weekly benefit changes (initially 85% NEW and stepdown at 26 weeks)
  - a comprehensive table of injuries linked with the AMA impairment guides
- **1996/97**, significant legislative reform including introduction of self-insurance, experience based rating, a pre-proceedings process for common law with removal of some of the court's discretion (e.g. contributory

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<sup>197</sup> Evidence of Mr Richard Grellman, 21 November 2001, p 5.

negligence), mandatory rehabilitation requirements and right of non-adversarial review of insurer decisions.<sup>198</sup>

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### **Conclusion 21**

The Committee notes the Government has a multifaceted strategy to reduce the deficit, and if the recent reforms and other strategies are effectively implemented, they should reduce the underlying costs of the Scheme and have a tangible impact on the Scheme's deficit.

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<sup>198</sup> Correspondence received from Mr Anthony Hawkins, Chief Executive Officer, WorkCover Queensland, 4 December 2001.