

**Submission
No 236**

INQUIRY INTO NSW WORKERS COMPENSATION SCHEME

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Joint Select Committee
NSW Workers Compensation Scheme
Parliament House
Macquarie Street
SYDNEY NSW 2000

17th May 2012

Dear Sir / Madam,

NSW Workers Compensation Scheme Inquiry

At the beginning of May 2012, an inquiry into the workers compensation system was announced. A very short period is provided for interested parties to make their submissions. The Government may need to consider the possibilities of changing the system, presumably after costings have been provided by Pricewaterhouse Coopers ("PwC") as the actuary to WorkCover, then write and pass the legislation, have premiums for 2012/13 calculated by PwC & published in the Government Gazette and all before 30th June 2012. This will be hard to do.

Some broad comments may be useful to set the context. Workers compensation is a very complex system with many interactions that can change over time.

It is much more than just the two apparently opposing interests of the employer and an injured employee. Whilst there are some employers and employees who push the system, I suggest the majority try to be fair and reasonable. Of course, an injured employee wishes to be looked after by way of medical treatment, compensated for loss of earnings and facilitated to get back to an income-earning capacity. The employer wishes to keep their costs to a minimum, but generally recognise that providing proper support and assistance to the injured employee may be an effective way to do so.

It is easy to get very one-eyed about workers compensation depending on one's point of view. I suggest remembering the old adage "there but for the grace of God, go I". If I or a family member should be injured, I would like that person to receive the best medical attention, quality legal advice to protect their interests and the fullest financial support appropriate to their circumstances.

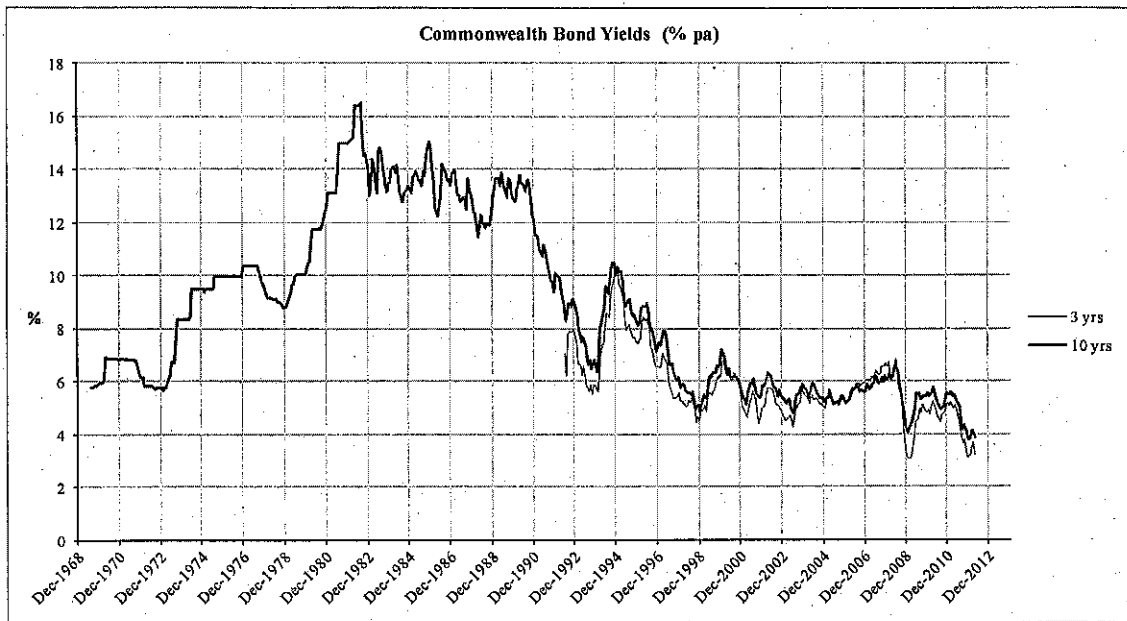
However desirable, we can recognise that a gold-plated workers compensation system may be very high cost. If the costs are high, then there may be consequences such as adverse impacts on general employment levels and conditions, competitiveness of industry etc.

Who bears the cost of a workers' compensation system? Under the existing systems in Australia, the employer is deemed responsible in the first instance but to varying degrees. Under common law, the employer is deemed fully responsible as it must financially indemnify the injured employee and put them in a position as close as possible to pre-injury. Common law requires the injured employee prove negligence on behalf of the employer which is its weakness and why statutory compensation was provided to those who were injured during work but without being able to prove negligence. In practice, an injured employee may not get to a position of full restitution from an employer. So support may also come via social security and Medicare. And finally the injured employee (with possible support from family etc) has recourse to their own resources if any.

As mentioned before, there are various parties to the process beyond the employer and the employee. We also have doctors and the health industry as an essential component. We have the legal profession looking after the interests of the employer and employee. The employer can be wide-ranging and include private enterprise, charities, religious entities etc and of course the public sector (ie local councils and State government). The employer may be operating in a variety of industries. We have administrators and managers of the workers compensation process who act as intermediaries between the employer and employee, coordinating the process with the various interested parties. We have WorkCover as regulator and controller of the operation of the workers compensation system. We have State government who make policy decisions about the structure and framework of the system, subject to their particular set of political values. We have actuaries who try to measure and predict the financial outcome of the adopted workers compensation system. Arguably, whilst each party wishes to have an effective workers compensation system, there is no perfect way of doing that and pleasing everyone. There are valid differences of opinion. Each party may also be protective of their own interests in the operation of any particular workers compensation system.

The benefit structure of the workers compensation system varies one State to another. This results in different costs to employers, with NSW having a higher average premium rate than for Qld and Victoria. Whilst the difference in average premium rates does not appear large, there may be significant differences in some industries and especially for small business. Outside the resource sector, economic conditions in Australia over the last few years have been flat at best, especially after allowing for the impact of the high A\$ on some industries. This economic scenario seems unlikely to change by much for the foreseeable future.

The following graph shows the yields on 3-year and 10-year Commonwealth bonds (source Reserve Bank website):



Given the likely future cashflows of the NSW workers compensation scheme as currently defined, then discount rates approximating to the 10-year bond yield look appropriate. The Reserve Bank recently reduced the cash rate to 3.75% pa. It seems likely bond yields will stay low for a while and possibly less than those used in the most recent PwC actuarial valuation as at 31.12.2011. If so, this would further increase the outstanding claims liability as at 30.06.2012 and beyond.

Some may argue the design of the workers compensation should not be affected by the various up or down changes in external economic factors such as bond yields. To some extent this is valid, but if there appears to be a structural downward shift in bond yields then this may require greater premiums for a period into the future.

There has been recent re-structuring of some employers with a downsizing of employee numbers. This may affect the costs of the workers compensation system.

Some argue the employer should pay 100% of the costs relating to injured employees. Others may say the employer operates within a community (eg. NSW and more broadly Australia) and, whilst the employer should be responsible for a proportion of the costs, the rest should be met by the community. As an example, the employer may meet the cost of all small / moderate claims but the few very serious claims become the responsibility of the community (eg. LTCS via special levy).

An important effect of the various State workers compensation systems is the amount of fallback by the injured employee on social security and Medicare. This is a source of subsidy from the Commonwealth budget (provided by taxes raised across Australia) to persons within the State. Arguably NSW is getting less subsidy than Qld and Victoria (even though NSW may be paying more tax to the Commonwealth). Perhaps this should be no more than a consideration by the NSW government at this stage.

The cost of the workers compensation system depends on a number of often interactive factors. The benefit structure / design is the starting point. It then becomes subject to actual claims experience in the real world when employees in different industries etc become injured. OH&S is very important to minimise the risk of injury. Claims management and health professionals then become key. (Employers in the fully-insured WorkCover scheme sometimes feel marginal to the process, although self-insurers obviously have greater control of the claims management process). The legal profession generally gets involved when particular payments are requested such as deafness claims, s66 claim etc and otherwise when there are disputes.

The same workers compensation legislation affects to all entities in NSW, but the focus may differ between them. The WorkCover scheme acts as the full-insurer for the bulk of the employers/ employees in NSW. It is in deficit so employers will be concerned about the premium cost implications and employees will be concerned about possible reductions to entitlements. We also have the Government's TMF for a variety of State employees, specialised insurers and self-insurers. Whilst all are subject to the same rules with regard to benefits to injured employees etc, self-insurers for example have no real concern over the premiums to the WorkCover scheme.

I have read the PwC actuarial report as at 31.12.2011. I do not have access to the appendices which may contain more details on the modelling processes adopted by PwC. I also do not have access to the underlying raw claims data as extracted from the WorkCover database. However, I have done some simple calculations to estimate some suggestions that may arise. These are approximate estimates, hopefully of the correct order, and PwC would be able to provide more accurate figures. (Perhaps PwC has already provided figures to the Inquiry / Government).

PwC estimate the total net outstanding liability was \$16,100M as at 31.12.2011. 2012/13 premium is \$2,957M. (Including expenses etc).

Given the deficit in the WorkCover Scheme is \$4B as at 31.12.2011, the Inquiry is considering what may be done to remedy the situation. This deficit may not improve in the short term, and may deteriorate further, so possible reductions in compensation entitlements to injured employees (rather than increase premiums) are considered below.

In the comments below on some items that seem to have arisen, I do not make any judgement call about what is reasonable or acceptable. I treat the situation professionally and purely on a financial basis to indicate the likely impact. It is for the NSW government to decide on policy. The comments below are isolated estimates: doing several together may not change costs equal to the sum of those estimates as they may interact. The figures below include expenses etc.

1. The outstanding claims liability of \$16,100M as at 31.12.2011 includes claim handling expenses and a 12% risk margin. The 12% risk margin is some \$1,725M. It is best to estimate the true ultimate cost of claims for any one accident year, so there is no cross-subsidy from one accident year to another. In practice, this is not easy and this is a reason for using a risk margin to cover the possibility of underestimation. If the ultimate claim cost was exactly estimated, then the risk margin is redundant. Perhaps we should question the use of the risk margin.

2. Suppose s67 pain & suffering is merged into s66 lump sum permanent impairment for all future reported events. There may be a small reduction in costs of some \$80M from the outstanding claims liability and some \$20M off the 2012/13 premium.

3. Suppose s67 pain & suffering is cancelled completely for all future reported events. There may be a reduction in costs of some \$320M from the outstanding claims liability and some \$80M off the 2012/13 premium.

4. Suppose s66 lump sum permanent impairment has only one payment and no top-ups in respect of all future reported events. There may be a reduction in costs of some \$240M from the outstanding claims liability and some \$60M off the 2012/13 premium.

5. Suppose journey / recess are cancelled completely (for future reported events, but existing such claims remain in-force). There may be a reduction in associated costs of some \$350M or possibly more from the outstanding claims liability and some \$170M off the 2012/13 premium.

6. Suppose all entitlements cease completely after say 5 years from date of injury for all future reported claims. Suppose also all existing claims have a maximum of a 5 year continuation from 2012. Common law / WID remain in place. [Somewhat like the QLD system]. There may be a reduction in associated costs of some \$3,700M or possibly more from the outstanding claims liability and some \$550M off the 2012/13 premium. (Note, with a fixed period of entitlements there is less need for commutations to limit any growth in "tail" liabilities).

7. Suppose Common law / WID are cancelled completely (for future reported events). Such claims would be ongoing moderate / serious claims, but legal costs would be reduced. Probably a reduction in costs of some \$400M from the outstanding claims liability and some \$70M off the 2012/13 premium. [Increasing the threshold to say 25% of some other level would be some intermediate figure].

8. Suppose commutations are permitted. This is a contentious subject as WorkCover and PwC appear to be opposed to commutations or any lump sum process such as common law. They seem to argue that a "lump sum mentality" would take hold and overall costs will go up. However, self-insurers are extremely keen on having this facility as they believe the opposite. Commutations may also directly assist in trying to limit the size of the "tail" liability. A possible reduction in costs of some \$700M from the outstanding claims liability and some \$100M off the 2012/13 premium, possibly more depending on how it is managed.

[The question of whether or not to allow commutations is a very important one. In particular, commutations may be critical to improving the "tail" liability as there are no other options available to manage these claims. The processing of medium / long term compensation also has many indirect costs for all involved parties for every year into the future. There is no choice in the process which becomes inflexible and "locked-in". A commutation cannot occur without the mutual agreement of the injured employee and the employer (eg. self-insured employer directly or WorkCover in respect of fully-insured employers). If agreement cannot be made, then the default status is the continuation of the ongoing compensation: so the injured employee has choice where they have none under the existing system. The injured employee must have competent legal advice to ensure they are properly represented (no different to any settlement process in areas of law other than workers compensation). It is possible WorkCover and its agents may not have handled the commutation process very well in the past some 12 years ago, but this may have been a reflection of their claims management function at the time and presumably can be changed now. In contrast, self-insurers believe they can manage the commutation process. Perhaps PwC could provide some analysis on their opinion. The "lump sum" effects of common law and commutations may be different].

9. Changing the weekly benefit formula. For example, changing the step down periods from 26 weeks to something different. Or changing the whole formula away from specified dollar amounts to some % of weekly earnings. I do not have enough information to produce cost estimates of these changes.

10. Changing the entitlements to have less serious claims limited after 130 weeks (2.5 years) etc somewhat like the Victorian scheme. I do not have enough information to produce cost estimates of such a change, but the reduction in costs may be significant.

Whilst much of the Inquiry's focus is on compensation entitlements, it may be worthwhile to consider the many other aspects of the entire workers compensation system. For example: whether the standard premium formula should change; how thorough is the monitoring of the effectiveness of OH&S and claims management processes of fully-insured employers / agents in the WorkCover scheme (self-insured employers are already closely monitored and have been for many years); and so on.

I would be happy to discuss.

Yours sincerely,

David Zaman

PwC Actuarial Estimates as at 31.12.2011

	(\$M's)
	<u>O/S Liability</u>
Commutations	290.5
Weekly	5,912.2
Common Law	1,770.9
Legal	433.3
s66	590.0
s67	237.2
Medical	3,339.4
Investigation	382.8
Rehab	236.5
Death	81.1
Other	143.1
Pre WC	1.1
Asbestos	154.8
ULIS gross	106.0
Gross	13,678.9
Excess Recoveries	-2.6
Tax recoveries	-77.8
Other Recoveries	-341.5
ULIS Recoveries	-10.6
Net Cost (exclude expenses €	13,246.4
CHE	1,131.8
Risk	1,725.4
Net cost	16,103.6

PwC Actuarial Estimates as at 31.12.2011

	(\$M's)
	<u>2012/13 Premium</u>
Commutations	23.9
Weekly	995.9
Common Law	289.2
Legal	93.7
s66	167.5
s67	60.7
Medical	658.7
Investigation	85.7
Rehab	105.7
Death	47.1
Other	37.6
Pre WC	
Asbestos	
ULIS gross	
Gross	2,565.7
Excess Recoveries	-7.2
Tax recoveries	-22.7
Other Recoveries	-85.1
Net Cost (exclude expenses €	2,450.7
Leveies etc	506.4
Net cost	2,957.1