Submission No 3

INQUIRY INTO STATUTORY REVIEW OF THE STATE INSURANCE AND CARE GOVERNANCE ACT 2015

Name: Mr Ryan Shaw

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Hon Shayne Mallard MLC
Chairman
Standing Committee on Law and Justice
Parliament House
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Dear Sir

STATUTORY REVIEW OF STATE INSURANCE AND CARE GOVERNANCE ACT 2015

I refer to the above enquiry and make the following submission.

SUMMARY

Since January 2016 I have been in correspondence with the State Insurance Regulatory Agency ('SIRA') in relation to their role as regulator of the NSW Workers Compensation system as set out under the State Insurance and Care Governance Act 2015 (the 'Act').

Although I am aware that the scope of this statutory enquiry does not extend to the actual operation of the workers compensation system, the response of SIRA to the enquiries has indicated that:

1. SIRA is failing in its responsibilities under the Act, specifically its responsibility under s23(f) which requires that SIRA "*promote compliance with the workers compensation ... legislation.*"
2. The evidence suggests that SIRA is not acting in a manner independent of icare, the main body it is tasked with regulating.
3. The evidence suggests that SIRA and/or the Department of Finance, Skills and Innovation ('DFSI') are in breach of s20(4) of the Act, in that SIRA are not acting independently of Government and Ministerial control (absent a valid Ministerial direction under the Act).

Overall, the structure of SIRA under the Act and their behaviour to date demonstrates the clear conflicts of interest that are inherent in this structure, in that:

1. SIRA, being an agency of the DFSI, are not capable of acting in an independent manner and needs to be made fully independent.

2. The decision to staff SIRA primarily with former Workcover employees has created an inherent conflict of interest and loss of objectivity which the SIRA Board, backed by the DFSI, have failed to address.

From the correspondence and enquiries that I have made, it appears that there is a strong likelihood that the workers compensation system is operating in direct violation of its primary legislation and that many of the actions of Workcover and now icare would be ultra vires. SIRA and DFSI have been unable and unwilling, after almost two years, to provide any substantive and legally robust response to these points. As a result, very significant legal liabilities may be accruing to the NSW Government.

LEGALITY OF THE WORKERS COMPENSATION SYSTEM

In January 2016 I wrote to SIRA and specified that the workers compensation system appeared to be operating in violation of its primary legislation in four main areas.

I will not go into the details as they are not strictly relevant to this Review, although they are certainly relevant to the Committee in its general role. Should you wish to receive my submissions, which are quite voluminous, I would be happy to provide them.

In making these submissions, I argued to SIRA that:

1. Their role under s23(f) of the Act required SIRA to determine whether the scheme is operating in compliance with its legislation.
2. SIRA had both an apparent and actual conflict of interest in providing a response, because:
    a. A finding that the scheme may not be operating in compliance with its legislation would have the effect of opening the Government to significant damages. As an agency of the DFSI it would be clearly questioned whether SIRA would be free to make such a finding; and
    b. Almost all SIRA staff at foundation were formerly employed by Workcover. Therefore, they may well have been involved in setting the policies on which they were being asked to now rule.
3. As a result, I requested that SIRA obtain and publish independent legal advice on whether the scheme was in compliance with legislation as this was the only way in which SIRA could properly discharge its new obligations under the Act.

SIRA refused to obtain independent legal advice. Eventually and after almost six months of considerable pressure from myself, SIRA finally issued a reply dated 14 June 2016. The reply is a textbook example of cynical avoidance. The five page letter contained numerous explanations of the structure and role of SIRA and the Workers Compensation system, none of which was remotely relevant. None of the four key items raised in the submission were even mentioned in the reply, with the exception of the single statement that "*I acknowledge your*

interpretation of the legislation and Guidelines as it applies to the various issues you have raised, however, SIRA is unable to give you legal advice on the accuracy, or otherwise, of the assertions and statements that you have made in your correspondence."

In my view, this stance was inconsistent with SIRA's stated responsibilities under the Act. The whole point of a Regulator *is* to determine whether the actions of the bodies which it is charged with regulating are legal. I would also argue that this function needs to be carried out with full transparency, otherwise the system set out in the Act will be no better than the system that it replaced.

After further pressure including Ministerial intervention, SIRA agreed to perform a second review of the submission. I was originally advised that this would include a detailed reply to the legal issues raised. However, when the review commenced SIRA declined to meet with me to discuss the issues and refused to obtain independent legal advice. Instead, they procured advice from the Crown Solicitors Office which they then refused to release claiming privilege. In response to over 100 pages of detailed evidence, SIRA provided a short (two page) reply in which SIRA advised that *"SIRA's position is that the statutory premium making powers were not and are not constrained by any particular ... system objective set out in Section 3 of the 1998 Act"*. Instead, they are apparently permitted to interpret the legislation 'holistically' – in this case to ignore specific system objectives in the legislation because in the view of SIRA (which is coincidently exactly the same as the view of the former Workcover) the system has other objectives to meet which are not in fact set out in the legislation. In relation to the other matters, no proper legal reasoning was provided at all.

Obviously, this legal position is highly contentious. I am sure that Legislators will be interested to find that specific objectives set out in legislation can be ignored because the Government can choose to interpret them 'holistically'. Since SIRA refused to release either the briefing to the Crown Solicitors Office or the advice in response to a GIPA Application, claiming and then refusing to waive privilege, it is impossible to be sure of the strength of the advice or whether in fact the CSO were correctly briefed by SIRA.

More importantly, SIRA has demonstrated that it simply cannot operate as an independent regulator. Throughout all my enquiries SIRA has simply behaved as a Government Agency, doing nothing but defending their position, and the position of the Workcover (now icare) and the NSW Government and trying to limit any legal exposure. However, as a regulator they are charged with ensuring and promoting compliance with the legislation. The decision of a supposedly independent regulator to refuse to take independent legal advice, and then to refuse to publish any detailed reasoning as to why the scheme is or is not operating in compliance with legislation despite their statutory role lays bare the conflict of interest which is inherent in the structures set out under the Act.

GOVERNMENT INTERFERENCE

In my view, these comments indicated a clear breach of s20(4) of the Act and a complaint was made to the NSW Ombudsman. Unfortunately, so far the Ombudsman has not taken any action. Nonetheless, these comments are clearly indicative that SIRA are failing to perform their statutory role which should be totally independent of such considerations.

LACK OF INDEPENDENCE FROM iCARE

Prior to the establishment of SIRA, workers compensation premiums were set by an Insurance Premium Order issued by the Minister after submission by Workcover. In effect, Workcover was acting as its own regulator and the Act was designed to ensure separate regulation of, amongst other matters, the setting of premiums.

The IPO process was replaced by one in which SIRA set guidelines (known as the Market Practices and Premium Guidelines, or 'MMPG's) with which insurers, now almost exclusively icare, are required to comply.

In theory, the MMPGs are required to comply with and promote compliance with the primary legislation, although as we have seen SIRA have a somewhat unique view as to what this entails. However, what should be uncontroversial is that the MMPGs needed to be developed by SIRA independently from icare and independently from what had been previous practice, when Workcover was effectively unregulated.

In fact, SIRA produced the first set of MMPGs in 2015 which contrived to exactly replicate the existing premium structure. In order to achieve this, SIRA drafted contradictory and totally contrived principles to attempt to 'retrofit' the existing premiums structure into some sort of statement of new principles. As a result, the MMPGs are completely at odds with the primary legislation and are internally inconsistent and contradictory.

At a high level, the primary legislation requires the workers compensation scheme to sell 'insurance' (as defined by its common meaning) and '*to ensure contributions by employers are commensurate with the risks faced, taking into account strategies and performance in injury prevention, injury management, and return to work.*'

In fact, the scheme does no such thing. For 'small' employers, premiums have almost no connection to performance in injury prevention to return to work, whilst for 'medium' and 'large' insurers premiums are not based on risk, but on a recovery of a multiple of actual costs incurred (the exact antithesis of insurance). Therefore, in the MMPGs, SIRA were forced to state and then completely negate the principles set out in the legislation and magic into existence a dual scheme of 'insurance principles' and 'user pays' (i.e. not insurance) depending primarily on SIRA's view of the employers ability to pay, a concept that has no legal basis whatsoever in the legislation.

I would invite Committee Members to read the 'premium principles' set out the in MMPGs. They are attached at the end of this submission.

Irrespective of the legalities, the question relevant for this Review is whether these principles could be reasonably be seen to have been developed independently by SIRA as the regulator. I would submit that quite clearly this is not the case. The basis of these principles is simply to provide retrospective approval to the existing Workcover premium structure which has always been inconsistent with the legislation.

In 2016 I was invited to participate in the first 'review' of these MMPGs by SIRA who stated that this would be the most effective way of addressing my legal concerns. I made a detailed submission which examined the legalities and inconsistencies of the 'principles' as well as demonstrated that despite the best efforts of SIRA, the premium filings by icare were still inconsistent with the new principles in any event.

After going through a full public consultation process, SIRA released a summary of submissions that was deliberately and unacceptably vague and, of course, which failed to record any of the points that I had raised. Shortly thereafter, SIRA re-issued the MMPGs in almost exactly the same format as before. When I asked Carmel Donnelly about this, she replied that this consultation was never intended to produce significant changes.

To get to the bottom of this matter, I made a GIPA application to determine how the premium principles were originally drafted and by whom. SIRA and the DFSI failed to deal with this request in the statutory timeframe and they were subject to a finding by the Information and Privacy Commissioner that they were in 'deemed refusal' to comply with the GIPA Act. I bought the case to the NSW Civil and Administrative Tribunal, who ordered SIRA and DFSI to produce the documents by 4 October 2017, by this stage over three months late. The DFSI and SIRA have, at the date of this letter, failed to comply with the order of the Tribunal.

I submit that this history proves that SIRA is simply regulating in line with the requirements of icare and to preserve the status quo as preferred by the DFSI. They are not demonstrating any ability or interest to properly regulate the dominant workers compensation insurer.

I note that all this information has been provided to the 'independent' board of SIRA, who have refused to discuss this in person or take any action. Given that the Board were appointed by the DFSI, this is possibly no surprise.

RECOMMENDATIONS

The introduction of an independent regulator for the workers compensation was an essential and welcome step in providing effective oversight of the workers compensation system. However, the Act was flawed in that it tried to create a hybrid system instead of a proper system of regulation. SIRA was created as regulator but with obvious constraints and conflicts of interest. The result is that SIRA has been totally ineffective at best, and at worst has consciously refused to carry out its statutory functions and the quality of the workers compensation system for both employer and employees has continued to decline.

Therefore I make the following recommendations to the Committee:

1. That the Committee instructs an independent legal expert, in likelihood senior counsel, to review whether the workers compensation scheme is in fact compliant with its primary legislation, and to commit to publish the legal advice.
2. That the Act be amended to ensure that SIRA is genuinely independent of the executive, subject only to specific Ministerial Directions under the Act, and that it as status as an agency of the DFSI is revoked.
3. That the Board of SIRA be appointed or approved by the State Legislature and should report to the Legislature.
4. That SIRA be required to take steps to demonstrate its operational independence from icare and the DFSI, which will involve the replacement of the existing Board and executive team with people who do not have a pre-existing apparent or real conflict of interest.
5. That the Committee set up a separate review to determine whether the workers compensation scheme is in fact achieving its stated objectives with a view to making recommendations to a reformed SIRA.

If you have any questions please contact me at
I would be happy to provide all the submissions and correspondence that are referred to in this submission.

Yours sincerely

Ryan Shaw

MARKET PRACTICES AND PREMIUM GUIDELINES
PREMIUM PRINCIPLES
ISSUES BY SIRA - EXTRACT

Principle 1: Premiums fair and reflective of risk

Employer premiums should be fair and reflective of risk as indicated by the employer's industry, the employer's size and the employer's previous claims experience and risk management.

In general, fairness can be assessed relative to other similar cohorts of employers.

The intention is that all employers engaged in the same or similar industry or business activities should have premium rates that are the same or similar unless influenced by the individual employer's previous claims experience and its risk management and return to work practices. Insurers should not deliberately introduce cross subsidies between cohorts of employers.

Where an employer's previous claims experience is taken into account, the fairness of its premium will be assessed under Principles 2 and 3.

The insurer will need to provide justification that its proposed target average premium rate for a particular cohort fairly reflects the claims costs, expenses and suitable profit margin for that cohort.

Principle 2: Balance between 'user pays' and 'insurance principles'

Employer premiums should strike a reasonable balance between 'user pays' (through experience rating) and 'insurance principles' (through the pooling of the experience of all employers).

Large employers generally have more influence over their claims experience through risk management and return to work management than small employers. While they need a level of insurance protection through their workers compensation cover, especially for very large claims, they can generally operate according to premiums that are based on their claims experience, such as premiums largely determined on a 'user pays' basis.

For small employers, their primary requirement is an insurance cover, which provides certainty of protection against the costs of workers compensation claims for a fixed premium. Insurers therefore need to pool the premiums for smaller employers so as to spread their claims costs across the premium pool. That is the meaning of 'insurance principles' for the purpose of Principle 2.

Insurers are therefore required to apply to small employers industry-based rates in accordance with Principle 1 and very limited premium adjustments for claims experience and risk management. As employer size increases, however, they can increasingly take into account the employer's own claims experience and risk

management practices according to the employer's size, whereby the largest employers can be rated almost totally on their claims experience, return to work management and risk management practices.

Principle 3: Premiums should not be unreasonably volatile or excessive

This principle builds particularly on the objective that the workers compensation system be fair, affordable, and financially viable.

At a system level, employer premiums should not be excessive and in general should be reasonably stable from year to year while fairly reflecting individual employer risk, but at the same time not endangering the financial viability of the system.

Affordability in this context relates to the premium burden on employers in general and the subsequent impact on the NSW economy.

Protecting employers from excessive and unreasonably volatile premiums is particularly important for small employers. The claims experience of a small employer can be very volatile from period to period and can be unduly affected by one large claim. A small employer's individual claims experience should not have an unreasonable impact on their premium. From this perspective, stability of small employer premiums is consistent with the affordability objective in the legislation and the insurance principles articulated in Principle 2.

Large employers have a greater capacity to pay premiums and to influence their own claims experience. The fairness of the system is more clearly served if the premiums of larger employers are more directly reflective of their claims experience.

To the extent that financial viability is not unduly impacted (see principle 5), premium stability includes consideration of staged implementation of changes to claims experience, premium loadings, discounts and investment earning rates. This will enable employers to make financial plans to prepare for premium changes and to adjust injury risk management and return to work practices to mitigate against expected future premium expenses where there is an opportunity for projected premium changes to incentivise safe and healthy workplaces.

Principle 4: Incentives for risk management and good claims outcomes

Individual employer premiums should provide incentives for employers to undertake effective risk management aimed at improving health and safety in the workplace and work opportunities for injured employees.

Employers can have their premiums discounted or loaded on the basis of their previous claims experience and the effectiveness of their return to work and risk management practices. Such discounts and loadings, which must also conform with Principles 1, 2 and 3, should be designed as far as possible to generate

incentives for the employer in the form of premium rebates or reducing future premiums for good performance or improving performance.

At the same time, perverse incentives or incentives that might compromise the objectives of the scheme in relation to the effective treatment and rehabilitation of injured workers must be avoided.

Principle 5: The premium basis needs to be consistent with the insurer's capital requirements

Insurers are required to have a capital management plan that recognises the substantial financial and insurance risks inherent in workers compensation portfolios. An insurer's premium basis needs to be consistent with the insurer's capital position and the management of that capital position.

For the Nominal Insurer, the premium rates as a whole are to be set so as to achieve, as far as can be estimated, an overall target premium pool for the year. The target premium pool is to be linked to the Nominal Insurer's funding plan, which will take account of the Nominal Insurer's overall capital management plan, its current capital position and its target capital position at the end of the next year.

For each specialised insurer, the premium rates as a whole are to be subject to an annual total premium revenue plan that accords with the insurer's capital management plan. For those insurers authorised by APRA, the insurer's capital management plan is to be presented to the Authority and is required to be consistent with capital management plans that the insurer has submitted to APRA.

For all licensed insurers, the ling will be required to justify the difference between:
- the target premium rate
- the breakeven premium rate (including cost of claims, expected investment earnings and expenses).

The filing must also show how this difference impacts on the insurer's projected capital position.