

**STATUTORY REVIEW OF THE STATE INSURANCE AND
CARE GOVERNANCE ACT 2015**

Organisation: RiskNet Pty Ltd
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Partially
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30 October 2017

The Hon. Shayne Mallard
Chair
Legislative Council Standing Committee on Law and Justice
Parliament of NSW

Dear Mr Mallard,

Re: RiskNet Group Submission to the Statutory Review of the State Insurance and Care Governance Act 2015

This submission makes no comments about the functions or operations of SafeWork NSW and will only comment on issues which relate to workers compensation.

If the Committee permits submissions to conglomerate the objectives of the SICGA with the functions of the Agencies it has created, then a meaningful and comprehensive review is possible. Otherwise, a review of SICGA objectives alone will first require that the objectives are fully identified, a task we are not qualified to undertake.

Terms of Reference

That a committee of the Legislative Council be designated by resolution of the Legislative Council to review the State Insurance and Care Governance Act 2015 (including the amendments made by this Act) to determine whether the policy objectives of the Act or those amendments remain valid and whether the terms of the Act (or of the Acts so amended) remain appropriate for securing those objectives.

Policy Objectives

According to the then Minister for Finance, Services and Property, Dominic Perrottet (the Minister) in his second reading speech, the reforms introduced through the provisions of the State Insurance and Care Governance Act (SICGA) were an overhaul of the governance of State Insurance and Care schemes and the way in which those schemes are serviced.

The SICGA creates three new organisations which operate the State's insurance schemes, regulate insurance schemes and regulate workplace safety.

A number of stakeholders (and this Committee) had previously identified a conflict of interest with one organisation fulfilling the three roles. The three organisations created are Insurance and Care NSW (ICNSW), the State Insurance Regulatory Authority (SIRA) and SafeWork NSW.

The creation of the three new Agencies, whilst seemingly removing an identified conflict of interest, has created another conflict which is much more insidious than the original. This conflict is in the Agencies' reporting structure which makes SIRA junior to ICNSW and has permitted ICNSW to create a monopolistic system which is now beyond the Regulator's grasp.

Now that all scheme underwriting functions have been absorbed by ICNSW and Agents have ceased to perform any policy management tasks, and that from 1 January 2018, all new claims will be lodged with a single Agent, (EML) SIRA has no power to effectively regulate ICNSW.

ICNSW/NI is not licensed by SIRA but authorised to operate by statute and most of the regulatory levers available to SIRA are not able to be applied to ICNSW/NI. As a result, ICNSW/NI is operating as a monopoly largely unfettered by regulatory controls.

SIRA should immediately call for submissions from interested parties to submit applications for licences to underwrite workers compensation in NSW. This will have the effect of reintroducing competition in the market and minimise the risks inherent in a bureaucratic monopoly¹.

SICGA must be appropriately amended so that SIRA is able to effectively regulate ICNSW's operations and management.

ICNSW should continue to report to the Minister for Finance, Services and Property, however SIRA should be carved out of the Department of Finance, Services and Innovation and moved to Premier and Cabinet thereby removing any potential bias in its functions when they relate to ICNSW.

¹ Since monopolies are the only provider, they can set any price they choose. That's known as price-fixing. Not only can monopolies raise prices, they can also supply inferior products. Monopolies lose any incentive to innovate. They have no need to provide "new and improved" products. Monopolies create inflation. Since they can set any price they want, they will raise costs to consumers. It's called cost-push inflation.

ICNSW

The SICGA provides for the establishment of the Government Agency ICNSW which has a Board of Directors with these functions:

- to give the Minister any information relating to the activities of ICNSW that the Minister requests,
- to keep the Minister informed of the general conduct of ICNSW's activities and of any significant development in ICNSW's activities,
- to determine general policies for ICNSW and to give directions to the chief executive of ICNSW in relation to the ICNSW's activities,
- such other functions as are conferred or imposed on it by or under this or any other Act or law.

Interestingly, none of the Board members (according to their profiles) have any general insurance experience let alone experience managing a very large statutory workers compensation insurer and the claims that are generated; also there are no employer representatives on the Board although there is one member who has a long association with Unions NSW.

The ICNSW Board should properly represent all of its stakeholders, an employer member and a member with relevant insurance experience must be appointed.

Unlike its sister Agency SIRA, ICNSW Board does not publish Minutes of its Board's Meetings nor does it publish any information in relation to its interactions with the Minister. SICORP and the Nominal Insurer (NI) who fund 94% of the costs of ICNSW² are in turn funded by employers' premiums or taxpayers. Both of these key stakeholders are kept completely in the dark over the machinations of the ICNSW Board.

In this respect the ICNSW Board has failed to honour the commitments made to Parliament by the Minister, who said in his Second Reading Speech: "The new structure will be far more transparent and accountable and more importantly lead to better outcomes for injured workers".

The chief executive of ICNSW is also required by the provisions of the SICGA to enter into a performance agreement with the ICNSW Board. If a Performance Agreement has been entered into, no details have been made available to stakeholders/employers/public as to the performance standards or their measurement.

² ICNSW Annual Report 2015/16 Notes to Financial Statements; 2. Revenue

The lack of transparency by the ICNSW Board is an issue which must be addressed. The Board has conduct of the management of the NI's activities which involves spending employer's premiums. Currently there is no way for employers to determine whether their money is being spent wisely and in accordance with the workers compensation legislation.

The Board should be compelled to publish summary minutes of its meetings and an appropriately redacted copy of the CEO's performance agreement and its implementation results.

The provisions of the SICGA require ICNSW's Board "to determine general policies for ICNSW and to give directions to the chief executive of ICNSW in relation to the ICNSW's activities".

ICNSW has established a "Foundation" which uses funds drawn from employers' premiums to sponsor a range of activities. According to ICNSW's web site as at 28 October 2017, four organisations have been granted assistance in total of \$2,329,500.

³ Refer: <https://wirc1.wordpress.com/2014/06/21/craigs-table/>

It is difficult to see where the authorisation for the Board of ICNSW to apply monies from the Insurance Fund to a Foundation lies. Section 154E may contain the required authority, if it does so it is very difficult to identify.

The matter should be referred to the Auditor General for investigation into whether the establishment of the Foundation and its funding is allowed for by the workers compensation legislation, unless it can be easily established that the funding came from SICORP.

ICNSW has the following functions:

- to act for the NI in accordance with section 154C of the Workers Compensation Act 1987,
- to provide services (including staff and facilities) for any relevant authority, or for any other person or body, in relation to any insurance or compensation scheme administered or provided by the relevant authority or that other person or body,
- to enter into agreements or arrangements with any person or body for the purposes of providing services of any kind or for the purposes of exercising the functions of the NI,
- to monitor the performance of the insurance or compensation schemes in respect of which it provides services,
- such other functions as are conferred or imposed on it by or under this or any other Act.

In acting for the NI ICNSW takes on its functions which are as follows:

- The NI is taken to be a licensed insurer as if it were the holder of a licence in force under Division 3 of Part 7 and as if that licence were not subject to any conditions.
- The NI has such functions as may be necessary or convenient for enabling the NI to function and operate to the fullest extent as a licensed insurer.
- Without limiting subsection (2), the NI may issue directions to any employer with respect to the insurance arrangements of the employer.
- The NI has such other functions as may be conferred or imposed on the NI by or under this or any other Act or law or by the regulations.
- The liabilities of the NI as insurer under a policy of insurance can only be satisfied from the Insurance Fund and are not liabilities of the State, ICNSW or any authority of the State.

We understand (anecdotal market intelligence) that in the third week of July 2015, ICNSW's predecessor (Safety, Return to Work and Support Board) put out a tender for the Provision, Implementation and Support of an Insurance Platform for all ICNSW's Relevant Authority claims. Responses closed at the end of the first week in August 2015, some two week later.

We understand that a decision on the successful tenderer was made two week later and the start date was set for mid-September 2015.

We further understand that the tender value was between \$110,000,000 and \$140,000,000.

The roll out of the platform was supposed to commence 12 months after the start date i.e. September 2016 and the whole project was to have been completed by September 2017.

As far as we are aware, the roll out phase for claims management has yet to commence and the project is at least another year away from completion.

If the Committee determines that the sequence of events set out here is in the main correct, it needs to also then determine if the time frames for the tender were realistic and whether, if in the Committee's mind, some skulduggery was involved in the process.

Regardless, it seems to be an extreme business practice to let a tender with a value of more than \$100 million in two weeks. The matter should be referred to ICAC to determine if the process complied with PBD-2017-02-Procurement Board Direction – Use of Procure IT for procurement of ICT goods and services.

The Committee must determine what the revised deployment date is and how much of an overrun in costs has been incurred. This investigation may lead to other complementary investigatory actions.

ICNSW is required to prepare a statement of business intent and submit the statement to the Minister and the Treasurer not later than three months after the commencement of each financial year. The statement of business intent is to set out the business plan of ICNSW over the financial year to which the statement relates and is to include the following:

- the objectives of ICNSW and its main undertakings,
- the nature and scope of the activities to be undertaken,
- the accounting policies to be applied in the financial reports of ICNSW,
- the performance targets and other measures by which the performance of ICNSW may be judged in relation to its stated objectives,
- any other matter required by the Minister.

In another example of non-transparency, employers who in the main fund ICNSW, have no idea what the objectives of ICNSW have been for the past two years thereby limiting any accountability by ICNSW for its performance against those objectives. The ICNSW Business Statement must be published.

ICNSW has taken on the responsibility (conferred by Statute) of the NI to set workers compensation premiums for all employers in the NI scheme. The NSW Auditor General's Financial Performance and Reporting Report analyses the results of the financial statement audits of the Finance, Services and Innovation cluster entities for the year ended 30 June 2016. The Auditor General found that ICNSW was developing its risk management framework and strategy including capital management policies to protect its capital⁴.

It is important that this process is completed as a matter of urgency given that the Auditor also found that ICNSW was not collecting the target breakeven premiums⁵ and recommended that premium rates should be reviewed annually to ensure long term financial viability of the schemes.

It has recently emerged that this premium under collection is already jeopardising the Insurance Fund's viability. As a result of the passing of the 2012 Amendment Bill, scheme liabilities nosedived and as at 30 June 2015, the scheme was in surplus to the tune of \$4 billion (\$3,911,697,000 to be precise) i.e. a turnaround of \$8 billion over three years.

⁴ Volume 5 2016 Finance, Services and Innovation | 5. Governance

⁵ Volume 5 2016 Finance, Services and Innovation | 3 Financial Performance and Reporting

Fast forward to 30 June 2016 and the deterioration has well and truly begun to set in. The NI Liability Valuation as at 30 June 2016 shows that the \$4 billion surplus has already shrunk to \$3.363 billion, a deterioration of \$0.637 billion. The really bad news is that the deterioration is accelerating.

The NI Liability Valuation as at 30 June 2017 shows that a further deterioration of \$0.998 billion had occurred in a scant 12 months. If this deterioration rate is sustained, then the surplus as at t 31 October 2017 will have reduced to \$2.033 billion. At this rate of deterioration, the scheme will be back in deficit by June 2019. This will no doubt be unpleasant news for some employer advocates who wholeheartedly supported the Government's/ICNSW's management initiatives⁶.

If this is the case then it may be too late to close the barn door, the horse has already bolted, the scheme's viability and capital is very much at risk.

The NI Liability Valuation as at 31 December 2016 shows that the funding ratio (using an 80% probability of adequacy) had fallen to 112% which is below the target operating range. This has triggered a management action plan to reverse the trend and return the funding ratio to the target of between 120% and 140%. Gross outstanding claims liabilities were \$13.38 billion.

The NI Liability Valuation as at 30 June 2017 shows that the funding ratio (using a 75%⁷ probability of adequacy) is now at 119% a 1% short of the minimum target range. Interestingly this latest valuation notes a funding ratio of 115% using an 80% probability of adequacy. Gross outstanding claims liabilities had grown \$0.947 billion to \$14.327 billion. Whereas in the same time period (June 2016 through June 2017), assets had shrunk by \$0.212 billion.

As noted by Mr Greg McCarthy (former CEO of RTWSA) in his LinkedIn article "Improving a Work Injury Insurer's Funding Ratio⁸", there are only four ways that can improve an insurer's capital funding ratio:

1. Improve investment performance - easier said than done.
2. Increase premiums and/or reduce benefits - often politically difficult.
3. Improve risk, underwriting and claims management – critical, though this can take 3-5 years or more and is also easier said than done (3-5 years could be too long if you are a private underwriter and have APRA looking over your shoulder).
4. The owners/shareholders can inject more capital (money) - usually last resort and a stop gap measure - points 2 and/or 3 are the only permanent fix.

⁶ "As a long-term advocate for workers' compensation reform, the NSW Business Chamber strongly supports the Government's recent efforts to implement a compensation regime that is fair and balanced, while also being financially viable in the long term," said NSW Business Chamber Chief Executive, Stephen Cartwright, 11.11.2015.

⁷ The 75% of adequacy is the minimum standard allowed by APRA. Most insurers would be using 80% - 90%.

⁸ <https://www.linkedin.com/pulse/improving-work-injury-insurers-funding-ratio-greg-mccarthy/>

Clearly ICNSW's capital management strategies are failing to meet its stated objectives, no doubt contributed to by its excessive spending on the development of technology platforms and spurious initiatives like

In the interests of transparency ICNSW must be required to publish its capital management plan and be held accountable for delivering on its capital objectives.

We believe that the costs of running ICNSW have skyrocketed. We will need the ICNSW Annual Report for 2016/2017 to further comment in relation to this issue.

SIRA

The principal objectives of SIRA in exercising its functions are as follows:

- to promote the efficiency and viability of the insurance and compensation schemes established under the workers compensation and motor accidents legislation and the other Acts under which SIRA exercises functions,
- to minimise the cost to the community of workplace injuries and injuries arising from motor accidents and to minimise the risks associated with such injuries,
- to promote workplace injury prevention, effective injury management and return to work measures and programs,
- to ensure that persons injured in the workplace or in motor accidents have access to treatment that will assist with their recovery,
- to provide for the effective supervision of claims handling and disputes under the workers compensation and motor accidents legislation,
- to promote compliance with the workers compensation and motor accidents legislation.

SIRA has the following functions:

- such functions as are conferred or imposed on it by or under this or any other Act (including under the workers compensation and motor accidents legislation).
- to collect and analyse information on prudential matters in relation to insurers under the workers compensation and motor accidents legislation,
- to encourage and promote the carrying out of sound prudential practices by insurers under that legislation,
- to evaluate the effectiveness and carrying out of those practices.

As noted earlier, SIRA's ability to effectively regulate ICNSW has been largely removed by the manner in which ICNSW has been created by Statute putting itself outside of the authority of SIRA.

SIRA has approved two premium filings by insurers (including ICNSW). In both cases SIRA was or ought to have been aware that the NSW workers compensation insurance market does not operate as a level playing field. The Department of Finance Services and Innovation (DFSI) Strategic Plan for 2016 – 2019 has as one of its principle outcomes, a regulatory framework which fosters a competitive, fair and secure marketplace⁹.

It is more than faintly ridiculous that a NSW not for profit, Government Agency is able to compete unfairly with private underwriters (specialised insurers) jeopardising their viability and hundreds of NSW jobs.

The NI has been established by Statute to operate outside of the NSW Government – it does not form part of the NSW Government accounts for example – yet is not subject to requirements of Federal insurance prudential regulatory framework as administered by the Australian Prudential Regulatory Authority (APRA). ICNSW have selectively chosen to apply aspects of the APRA prudential framework but there is no consequence for failing to meet those standards that they have selectively applied. Neither APRA nor SIRA regulate ICNSW/NI from a capital or prudential perspective.

As a result, the NI is free from the regulatory controls established and monitored by APRA, including:

- Internal Capital Adequacy Assessment Process – a process for ensuring an insurer has robust processes in place for monitoring its capital adequacy.
- Prescribed Capital Requirement – a requirement to set aside additional capital to set against the range of potential risks a particular insurer may face.

The current APRA prudential framework is one of the most robust internationally and contributed to Australia's successful weathering of the financial crisis. Application of this regulatory regime to the NI would have precluded ICNSW from setting premiums at below cost as highlighted by the Auditor General in his report on the June 2016 Financial Statements and from adopting a high growth and high risk investment strategy. The weak prudential oversight of ICNSW and its predecessors has contributed to the boom bust workers compensation cycles that had occurred over many years in NSW.

⁹ https://www.finance.nsw.gov.au/sites/default/files/DP0009_0.pdf | Page 4

Specialised insurers that operate in competition with ICNSW/NI, on the other hand, are required to be licensed by APRA and to comply with the APRA prudential framework. In addition, Specialised insurers must be licensed by SIRA and meet SIRA regulatory requirements. If a Specialised Insurer should fail to meet either APRA or SIRA requirements, it would face regulatory intervention and ultimately could have its licence to underwrite removed.

As a result Specialised Insurers are required to set aside additional capital to meet Prescribed Capital Requirements; establish premiums that exceed costs and invest in products with low risk but also low yield.

In this regard the current legislative framework has failed to meet its principal objective to promote the viability of the insurance and compensation schemes established under the workers compensation legislation.

ICNSW/NI must be subject to the same regulatory framework as the Specialised Insurers it competes against and further, to the same degree of regulatory oversight by institutions with the capability and the authority to ensure ICNSW/NI adheres to the framework.

SIRA must be compelled to publish its own break-even premium rates for all industries, in this way employers and other stakeholders will be able to see just how effective and competitive the rate that they are paying really is.

There has long been a very well-founded belief that specialised and self-insurers perform better in all of the key indicators of efficiency and effectiveness in managing workers compensation claims than ICNSW and its predecessor, the WorkCover Authority.

Another of SIRA's principal objectives is to promote the efficiency of the insurance and compensation schemes established under the workers compensation legislation.

SIRA must be compelled to publish comparative key performance indicators of all insurers' (specialised insurers, self-insurers and the NI) claims management activities.

ICNSW has over the past few years introduced claims and policy management protocols which have increased the costs of the scheme and will continue to do. SIRA has permitted these to be implemented.

One of the most contentious policy change was to alter the premium algorithm such that limited claims costs are now used in calculating an employer's premium. One of the costs to be excluded is rehabilitation. As noted in the 31 December 2016 NI Liability Valuation, "Increased average

rehabilitation payment assumptions and higher experience led to an increase in the liability estimates of \$40 million”.

It would surely be obvious to the most inexperienced observer that if you remove the oversight of the provision of a service, then it is likely that the use of the service will increase and since no one is checking, the standard of service provision will suffer.

Another practice by ICNSW which has increased the delays in injured workers receiving the medical care that they need is the decree issued to Agents by ICNSW that all IME referrals must allow the claimant a choice of three examiners. This has led to a three to six week delay (anecdotal) in an injured worker being seen by an IME, which of course in many cases, delays reasonable and necessary treatment.

This has no doubt contributed to the increase in average time to settlement per claim.

ICNSW has issued a decree to its Agents that forbids them to arrange surveillance on a claimant without prior approval from ICNSW. This approval can take several days. Surveillance is a critical tool in managing the risk of fraudulent claims going undetected, particularly fraud by exaggeration. Previous inquiries have taken evidence that fraudulent workers compensation claims cost between 10% and 20% of all claims costs. If this is accurate (there is no means of knowing that it is not) then fraud is costing over \$200 million each year in NSW.

By permitting ICNSW to manage NI and SICORP workers compensation claims by decree is costing NSW employers many millions of extra dollars in premiums and workers jobs. SIRA must enforce its own Guidelines on making workers compensation claims which make no allowance for insurers to vary the workers compensation laws.

We respectfully request that the Committee confirm the weaknesses we have identified in our submission in the current framework in their final report and that the Committee recommend to government changes to address these gaps, specifically:

- Requiring ICNSW to provide greater transparency on its financial and operational objectives and its performance against those objectives
- Providing SIRA with the powers and authority to effectively regulate ICNSW/NI
- Requiring SIRA to allow insurers (who meet relevant licensing criteria) to underwrite workers compensation in NSW to eliminate the emerging monopoly that is ICNSW.

We thank you for the opportunity to make this submission and are available if needed, to answer any questions the Committee may have in relation to issues raised or other relevant matters.

Richard Gilley
Director
RiskNet Pty Ltd