CORRECTED

REPORT OF PROCEEDINGS BEFORE

GENERAL PURPOSE STANDING COMMITTEE No. 1

INQUIRY INTO REVIEW AND MONITORING OF THE NEW SOUTH WALES WORKERS COMPENSATION SCHEME

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At Sydney on Wednesday 21 November 2001

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The Committee met at 8.45 a.m.

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PRESENT

Reverend the Hon. Fred Nile (Chair)

The Hon. Michael Gallacher
The Hon. Tony Kelly
The Hon. Greg Pearce
The Hon. Janelle Saffin
The Hon. Henry Tsang
The Hon. Dr Peter Wong

RICHARD JOHN GRELLMAN, Chairman, Motor Accidents Authority, Level 22, 530 George Street, Sydney, sworn and examined:

CHAIR: I welcome the media and members of the public to this hearing of General Purpose Standing Committee No. 1 inquiry into the review and monitoring of the New South Wales workers compensation scheme. I advise that, under Standing Order 252 of the Legislative Council, evidence given before the Committee and any documents presented to the Committee that have not yet been tabled in Parliament "may not, except with the permission of the Committee, be disclosed or published by any member of such Committee or by any other person". Copies of guidelines covering the broadcast of proceedings are available.

Mr Grellman, what is your occupation?

Mr GRELLMAN: Company director.

CHAIR: In what capacity are you appearing before the Committee?

Mr GRELLMAN: I think my capacity is as the author of the report into workers compensation back in 1997.

CHAIR: Are you conversant with the terms of reference for this inquiry?

Mr GRELLMAN: I am.

CHAIR: For your benefit, Mr Grellman, if you should consider at any stage during your evidence that, in the public interest, certain evidence or documents you may wish to present should be heard or seen only by the Committee, the Committee will be willing to accede to your request and take that evidence in camera. Do you wish to make an opening statement?

Mr GRELLMAN: A very short one, Mr Chairman, simply to plead the indulgence of the Committee from the perspective that I really have not had a lot of involvement with workers compensation over the last four years. I wrote my report a little over four years ago and submitted it to the then Attorney General. I had a little involvement with the Interim Advisory Council in late 1997 and early 1998. Since that time my involvement with workers compensation has been effectively zero. So I would need to pre-qualify any answers that I might give with that in mind.

CHAIR: You are Chairman of the Motor Accidents Authority. The Committee would be interested to know what workers compensation lessons can be learned from the experience of undertaking reform of the compulsory third party [CTP] insurance scheme, which seems, from our perspective, to be working satisfactorily.

Mr GRELLMAN: The CTP scheme under the new Act is now two years old, and we are about to commence a review of that scheme for submission to the Minister. That report probably would be handed across by about the middle of next year. At the moment, one could say that the CTP scheme is operating fairly stably, and that it is affordable and efficient. I am not sure that it would be wise to draw too many conclusions from the CTP experience when thinking about workers compensation in terms of scheme reform. Certainly, they are both statutory, compulsory State schemes, but the workers compensation arena, to my mind, is somewhat more complex than is CTP. I think that the reform of workers compensation, as I think has been experienced, is a somewhat more tortuous process.

The CTP reform of 2½ years ago was achieved relatively quickly. It is a new piece of legislation. It was achieved with a high level of consultation with the service providers and stakeholders, and it was done within a very compressed timeframe. But a decision would have to be taken effectively to start again if we are to draw any conclusions on comparisons with what was experienced with CTP and what might happen with workers compensation. I do not know whether that is in anyone's mind at this point.

CHAIR: In your report you listed a number of weaknesses in the WorkCover system. Can you identify the major weaknesses, the reasons you believe they are major, and what options there are for dealing with them?

Mr GRELLMAN: Do you mind if I flick through my report as I attempt to answer this question?

CHAIR: No.

Mr GRELLMAN: 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—employers and employees—were both suffering from a sense of lack of ownership. Therefore a lot of the dynamic in the scheme at that time was being driven by service providers or political processes. From the people who were paying for the scheme—being the employers—and those who were potentially benefiting from it—being the employees—I was hearing a lot of frustration at that time. I think that was the primary weakness that I encountered. I noted about 10 in total, but I think I would put that one down as the outstanding issue five years ago. I could go through the lesser weaknesses, but that may result in my repeating what is more carefully articulated in my report. I am happy to do that, if you would like me to.

CHAIR: Four years ago seems to be an important date, in a way. Did you anticipate it would blow out so dramatically from that point on?

Mr GRELLMAN: Looking at the actuarial data at the time, 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 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.

CHAIR: If there had been, say, a more rapid response to your recommendations, would that have headed off that growing deficit?

Mr GRELLMAN: That is probably speculative. I would like to think it would have, but authors of reports always have a certain sense of pride in their work. I was hopeful that my recommendations would have arrested the growing deficiency. But, of course, not all of this report was implemented. So, whether or not it would have worked is, I guess, speculation.

The Hon. GREG PEARCE: Nothing has been done to address the central issue that you spoke of earlier, the lack of scheme ownership.

Mr GRELLMAN: I have to say I am not overly familiar with the amendments and the various initiatives that have been taken over the last, let us say, two or three years. So, if that central issue has not been addressed, I think it remains as a concern, because what we were able to do with the CTP—and it perhaps come back to the Chair's first question—was segregate the interests and contributions of the stakeholders and service providers. They both have a valuable contribution to make, but I think when the contributions blurs and overlap it can be a bit untidy.

The Hon. MICHAEL GALLACHER: On that issue of the ownership of the scheme: the legislation that we are currently awaiting the arrival of actually has abolition of a privately-underwritten scheme as a key fundamental plank in the next stage of reform. Do you still believe there is opportunity in the scheme for it to be privately underwritten? You made the point earlier that you have not been actively involved in workers compensation for the last four years, but the fundamental problems of lack of ownership that existed four years ago, in the main, are still here now. What opportunities do you believe present for the future regarding a privately-underwritten scheme?

Mr GRELLMAN: 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. 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.

The Hon. MICHAEL GALLACHER: One issue that most certainly is of concern to the Opposition, but which the Government seems to be mute on, relates to the comments recently made by international reinsurers about the coverage of acts of terrorism in the workplace. Have you got a view in relation to that? Is that likely to have a significant impact here in Australia, and particularly on New South Wales and on our scheme?

Mr GRELLMAN: I have heard that the international reinsurers are going to withdraw from providing terrorist cover as from 1 January 2002. Certainly we are looking at that in the CTP context and what that might mean in terms of the underwriters—who of course in that case are the private insurance underwriters—being left not reinsured for any acts of terrorism. I can only presume that the same concern would have to flow across into workers compensation. I mean, if an act of terrorism takes out a city building, and thousands of employees at their workplace are injured or even killed, I presume that would give rise to a claim. If that claim is not reinsured, then there will be a financial impact. At this point, it will impact the deficiency negatively, I would imagine.

The Hon. MICHAEL GALLACHER: It also raises the question of what is the definition of terrorism as well. Many things can be pushed across to that if you do not have a suspect. Surely that must be a real concern, especially in compulsory third party?

Mr GRELLMAN: Yes. There is quite a lot more dialogue and work to be done on this. It is a new issue. It is a week or two old and a number of people are grappling with its implications in operational terms and financial terms.

The Hon. JANELLE SAFFIN: I think it is unfair to say that the Government is mute on it. It is a Federal-State issue. It was only 11 September and the events thereafter in which this has arisen. We could hardly be expected, either Federal State, to come out with a fully-fledged policy on it. But I understand discussions are going on at Federal and State levels and with the Insurance Council of Australia.

The Hon. MICHAEL GALLACHER: When it was first raised a couple of weeks ago, nothing was said by the Government that it is not going to stand for this, or whatever.

The Hon. JANELLE SAFFIN: It is hard to say that we are not going to stand for it.

CHAIR: Let us return to the inquiry. Probably "mute" was not the best word to use. Mr Grellman, you made the point that you recognise there was a lack of ownership and then you recommended that there be the establishment of an advisory council. Was that supposed to give ownership? If so, where has it failed or was it not introduced in the way that you anticipated?

Mr GRELLMAN: No, 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.

CHAIR: That is the point I was going to make. I gather it tends to be deadlocked. It is difficult to reconcile the views within council, so it has not been as effective as it should have been. Would you have seen it as a smaller council with only employer and employee representatives?

Mr GRELLMAN: No. The basic model that was adopted was consistent with my recommendations. It is just that, from memory, I suggested four employer and four employee representatives, and I think there were five or possibly six of each. I think in simple terms that reduced the amount of dialogue around the table, making the reaching of a conclusion that much more challenging. Whether that was a fundamental flaw or not is arguable, but I doubt it was a fundamental flaw in the way that the advisory council operated. It just made its task that much harder, I think.

CHAIR: Some people have said it is a white elephant. Do you think that is a bit extreme?

Mr GRELLMAN: I have never seen a white elephant. I do not know.

CHAIR: Ineffective.

The Hon. JANELLE SAFFIN: They are lucky.

The Hon. TONY KELLY: I think somebody claimed that the Opera House and the Entertainment Centre were both going to be white elephants. Maybe it is successful.

Mr GRELLMAN: It was a fairly brave experiment, there is no doubt about that. My report left about 19 quite controversial issues to be resolved. The main reason I did that was to leave on the table a number of issues for the stakeholders to grapple with and reach consensus on, or trade-off with, so that when the scheme was ultimately built they all felt that something had been created that they had made some contribution towards. In the final analysis, for a variety of reasons, it did not work as well as it might have, and I was not close enough to know why it failed to achieve its maximum potential. It certainly seems like the group found difficulty in dealing with entrenched differences in a way that was going to be productive.

CHAIR: In your 1997 report it is stated, and this gets back to the stakeholder ownership issue:

> 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. The Auditor-General holds the view that the statutory funds are controlled by WorkCover and the New South Wales Government within the terms of the Australian accounting standards and ought to be consolidated into the financial statements of WorkCover and the whole of government. This view is not shared by WorkCover, the Government or the Solicitor General. Currently no sector is required to record the statutory funds in its balance sheet. Financial results of the statutory funds merely appear as a note to the accounts of WorkCover. Regardless of which is the correct view, the current situation needs to be rectified to ensure that one sector is financially and legally accountable.

Do you still hold to that view? If so, can you suggest any changes to ensure financial accountability within the current environment?

Mr GRELLMAN: I know I am skating on thin ice when I start commenting on issues that the Solicitor General and the Auditor-General have commented on. But 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. I think the Auditor-General is probably still qualifying the workers compensation accounts as a result. The Solicitor General says that it is not workers compensation's 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. I think that is 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. It is just a very untidy situation. I was not sure, Chairman, whether it was embodied in your question, but it is one of the benefits that would flow from transferring the risk to the underwriting community. It will not affect the accumulated deficit issue, that will have to be dealt with in some other way, but from the point in time when the risk-carrying responsibility transfers, if there is a deficiency it is borne by the underwriters. That is all the more reason for them to try to price their product appropriately, to ensure they do not incur deficiencies. If they do, it is a loss they incur.

CHAIR: As you say, if that new system came into place, who takes care of the deficit, the $3.2 billion?

Mr GRELLMAN: Yes. As the number becomes bigger that is a more difficult question to answer.

CHAIR: Are you implying that there may have to be a levy on employers?

Mr GRELLMAN: No. I am just saying there is a view around that the employers are feeling like they will be the last chequebook in town.

The Hon. MICHAEL GALLACHER: Legislation is already in place to allow the reduction levy to happen.

The Hon. GREG PEARCE: If you look at WorkCover's last annual report, in the notes you refer to it says:

> The workplace injury management and workers compensation legislation provides for the funding of any overall deficit that may arise in the WorkCover scheme by the payment of a contribution by employers as part of future premiums.

So, the Government has already put in place a levy.

The Hon. MICHAEL GALLACHER: Have you given any thought, other than the straightforward introduction of the debt reduction levy, which would just be devastating, to other alternative measures that can be put in place? It would have still been an issue when you were conducted your inquiry?

Mr GRELLMAN: Yes, it was.

The Hon. MICHAEL GALLACHER: Now it is manifestly more important that we get some resolution of this sooner rather than later.

Mr GRELLMAN: When I was working on my report I became the best friend of every reinsurance broker in town. Reinsurers 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 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. But there are people sitting in the corner there who are much more qualified than I am to speak about that sort of exercise. They will probably tell me later that I have just made some terrible mistakes.

CHAIR: The other matter is whether the way WorkCover is set up is a fundamental problem. That is, that it has two roles in relation to the insurance system, one being regulation and the other being managers of insurers. Does that create some conflict or tension within WorkCover itself?

Mr GRELLMAN: In my report, the conflict issue I raised was WorkCover's obligation, on the one hand, to prosecute breaches of safety practice and, on the other hand, be like a big brother, an advisory group, to help employers get their processes right. So, as the policeman and the big brother, I think there is a tension. I do not think it is impossible for WorkCover to be a regulator and also to watch over the insurers, who are essentially the service providers. I do not think that is a profound flaw or difficulty. I am not sure how well it is doing that, because I have not been close to it, but I imagine it is manageable.

CHAIR: The other matter you raised in your report concerned commutation. You said that is another key cost driver. You said:

> The commutation provisions are largely inconsistent with the objectives of the system yet there is a place for commutation of weekly benefits on a more objective basis.

What is your view on that now?

Mr GRELLMAN: I think it is appropriate to have a facility to commute. In a number of circumstances that can work well for the recipient or the entity paying the money to bring closure and finality to a situation that might otherwise be debilitating, and not necessarily to achieve financial benefits for one party or the other but just keep claimants moving through the system and have the system finish with them and let them get on with their lives.

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 computation 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.

The Hon. MICHAEL GALLACHER: Are you talking about a suggestion, for example, that for an actual loss injury—if someone loses an eye or a limb or has a specific actual loss injury—then they should qualify or could qualify for a computation whereas, for example, if someone has a non-specific loss injury, such as a reduction in mobility through a back injury or stress, or something like that, they would not necessary qualify for a commutation. Is that the sort of thing?

Mr GRELLMAN: That is the sort of thing. I think for someone who has an injury which, with rehab and treatment over six or 12 months may well recover, I would not be commuting them because they will get back into the workforce, hopefully sooner rather than later, but someone who has lost an eye is going to have to get on with their life, difficult though that might be. They are the sort of people for whom there should be some mechanism whereby you say, "All right, this is very unfortunate. You have to change what you are doing in the workplace, but the obligation of the employer can be quantified as this amount of money. There it is, off you go, and good luck."

The Hon. MICHAEL GALLACHER: I will always remember a discussion I had with a barrister on the Central Coast a few years ago about a fellow who had a back injury and who received a substantial commutation. When a barrister asked his client what he was going to do with the money, he said, "The first thing I am doing is

booking an airfare to Lourdes and there I am going to be cured." Sure enough, the fellow came back and it was a miracle. Is it not a fact that for many employers, that is a real bane for them, the fact that they are having to pay out when they hear through the grapevine or they see for themselves that six to 12 months later there has been a miraculous recovery, and there is no vehicle by which that matter can be brought back for further investigation.

Mr GRELLMAN: Yes, I think it is a matter of great frustration for employers. For any employer who operates a facility where physical labour is involved, I would be surprised if there were very many who did not experience that once or twice at least and, of course, they see the implications of claims of that nature coming straight through into their premium load. If they suspect that a claim was not a real claim or if it was overstated, then they feel unreasonably punished.

The Hon. MICHAEL GALLACHER: That point then takes us back to the very opening issue that you raised as far as ownership is concerned because the employers see or hear that this miraculous event has occurred. They ring the insurer and say, "What are you going to do about it?", and the insurer says, "Nothing." It is not their problem and the employer knows that it is simply a matter of writing out the cheques. Why? Because there was no ownership of the scheme by the insurer's to get involved at a very early stage and they simply, for want of a better term, manage funds.

Mr GRELLMAN: That is right. If you like, they are spending someone else's money and with the best will in the world and with all of the protocols and monitoring, if someone or an entity is spending someone else's money, you do not have quite the same interest in where it goes as if it is your own. It is just human nature, really. It is not that they are being naughty or inefficient. It is just very hard to keep an organisation focused when it is not their own capital that is going out the door.

The Hon. MICHAEL GALLACHER: Through you, Mr Chairman: while we are on this issue of concerns of employers, in your report did you consider the issue or have any sort of inquiry into the issue of fraud or exaggeration of claim?

Mr GRELLMAN: Certainly it was discussed a number of times, and what I have actually found quite refreshing, and it is worth, I guess, recording here, is that the employees were more concerned about it than were the employers—

The Hon. MICHAEL GALLACHER: That is exactly right.

Mr GRELLMAN: —which surprised me.

The Hon. MICHAEL GALLACHER: You are spot on.

Mr GRELLMAN: The unions and the employees see it as very antisocial behaviour.

The Hon. MICHAEL GALLACHER: They have to carry the load.

Mr GRELLMAN: That is right, yes, and they were very concerned to try to find ways to deal with it, to make it unpopular and unacceptable in the workplace. Again, it is one of the benefits if you can get the employees back into a sense of ownership. It gives them more opportunity to ensure that everyone is playing the game properly.

CHAIR: In your report at 4.9, Mr Grellman, you list the overall system weaknesses and you mention as one of the points a lack of incentives for licensed insurers to research and implement best practice injury management processes. That was one of the weaknesses. Do you have a view on how that could be overcome—for example, what incentives could there be?

Mr GRELLMAN: I think that was probably taken from the section where I was talking about privatising the risk. If you look at the experience of insurers in jurisdictions where the risk is carried by the insurance community—there are some states in the US where this is worth having a look at—there really are some world's best practice processes and procedures to rehabilitate people who are injured. They are doing that because it is their own capital at risk and they want people to get back into the workforce sooner rather than later so that that will reduce the cost to them of remuneration of those employees for their incapacity, or of supporting them during their incapacity. At the moment, under the current system, I do not think that there are is much incentive for the insurers, given the role that they are playing, to reach for best practice rehab activities.

I am really not familiar enough with the way WorkCover requires them to operate and how they are incentivised so I may be out of line here but, as I said earlier, if they have not got their own capital at risk, they will do what they have to do in order to comply with the contractual obligations and they probably will not do much more than that. But there are some very interesting models overseas and some big US non-life insurers have quite advanced activities and principles to help people to get back on their feet quickly. They are quite interventionist and I do not think anyone really complains about that. I think, generally speaking, an injured worker would be happier back on the workforce than just getting a cheque every week or fortnight.

CHAIR: Could you just mention what those other states are? They would be at a state level—Wisconsin?

Mr GRELLMAN: Yes. I cannot remember beyond Wisconsin but certainly the whole concept of managed care of early intervention involves relationships they have with medical providers whereby they put the injured worker into a managed rehab program. The underwriter and the rehab provider and the employee and, I guess, by definition the employer form a three or four way contract. The person's injury is assessed and they provide a program of recovery which is actively monitored by all parties. So everyone has an interest in the scheme, that is, the stakeholders as well as the key service providers. They are almost locked up in a contract to get this person back into the workforce. In the absence of something like that, something that occurs often, is that they go to a particular service provider who does the best they can and there is dialogue between the underwriters and the employers with the service provider, but it is not quite as focused on outcomes as I suspect occurs in some other places.

CHAIR: The point you are making is that unless the insurance companies' capital is being used, it is hard to get them to focus their mind on it.

Mr GRELLMAN: I just think it is harder. I do think it is harder. As I said earlier, 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.

CHAIR: Because I suppose the theory is that if you did have it privatised, the insurance companies, to cover the risk, would then set huge premiums which would then affect the employers.

Mr GRELLMAN: 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 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.

Again, sir, coming back to your very first question, having stuck with private underwriting and compulsory third party [CTP] and sought to achieve the $100 reduction in premium, it does not happen because the insurers are being generous to the community: it happens because the cost expectation is measurable and the outgoings on the back of a motor incident are reasonably well contained but, I do not believe, harshly and inequitably for the claimant. So it requires careful scheme design, benefit design, dispute resolution—everything that needs to come together in a package before you could let the underwriters come in on a product like this.

CHAIR: That gets back to one of the controversial matters of the use of common law which makes it unpredictable, from the point of view of not knowing what the awards will do.

Mr GRELLMAN: Yes, indeed.

CHAIR: Do you have any views on that?

Mr GRELLMAN: I have to say I have not read carefully enough through Mr Sheahan's report. I understand the broad thrust of it. Certainly, when I wrote my report, I was able to remain comfortable with common law access but I was suggesting that it really should be available in extreme cases for the seriously injured and not as a broader avenue or opportunity. Frankly I am just not too sure where that all is now but at the nasty end of the spectrum I think that common law is an entitlement that people should have.

The Hon. MICHAEL GALLACHER: Mr Grellman, we are coming close to the end of this first session but I just want to be fairly clear in my mind that the burning issue still, as far as you are concerned, is the private underwriting of the scheme. Is it the great piece of the jigsaw that still needs to be put in place?

Mr GRELLMAN: No, I do not think so. I think it is one of 250 pieces that all have to lock together. I think 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, for the reasons I mentioned earlier. I do 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.

The Hon. MICHAEL GALLACHER: There is one last question from me before I hand you over to the Hon. Greg Pearce. When you look at the scheme, there is workers compensation that relates to the private sector and there is also the Treasury Managed Fund [TMF] which looks after the public sector, even though the rules by which both are operated, so far as injured workers are concerned, are basically the same. Did you look at that Treasury Managed Fund in terms of its unfunded liability? The reason I make that point is because if, at the end of the day, the state is the owner of the scheme—if we eventually agree that the state is the owner of the scheme—we have an unfunded liability in the workers compensation scheme and the private sector, but we also have an unfunded liability that exists in the public sector as well.

Mr GRELLMAN: I can remember brushing past the TMF at the time and I may have made a sentence or two comment about it, but I do not recall ever looking at whether it was unfunded. I am sorry, I just do not think I did.

The Hon. GREG PEARCE: One of the issues you were concerned about was that the premium rate was inadequate to meet the underlying true cost of running the scheme. Would it surprise you that that is still the case?

Mr GRELLMAN: No. I assume it still is the case because of the increasing deficiency.

The Hon. GREG PEARCE: It definitely is still the case. It is the way the Government is choosing to manage the fund. At the moment, from looking at the accounts, it seems to me that the annual deficit is effectively being funded by the earnings of the investment of the assets; the Government is taking the earnings to cover the annual expenses of operating the scheme and thereby pushing out an increasing deficit. Do you think that is a good practice?

Mr GRELLMAN: 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. 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. 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.

The Hon. GREG PEARCE: My untutored understanding of these figures is in effect, as I said earlier, that the Government is taking the earnings on the accumulated assets and using that on an annual basis to fund the annual shortfall, thereby increasing the overall deficit, and doing that very deliberately, and not addressing the sort of competitive issues you have just raised. Do you agree with that as, essentially, the interpretation of the way this is being operated?

Mr GRELLMAN: I am not trying to be difficult but I am just not familiar enough with the way the WorkCover regime is undertaking its affairs these days.

The Hon. GREG PEARCE: Since you have reported and at the time you reported the premium rate, according to your report, was less than the annual cost of running the scheme.

Mr GRELLMAN: Yes.

The Hon. GREG PEARCE: Since then each year the premium rate adopted by the Government has been less than the cost—and I can give you the figures if you would like to see them. So each year that problem has been perpetuated by the Government. As you say, the cost of workers compensation is already very high in New South Wales. Notwithstanding four or so packages of legislation, there does not seem to have been anything done to address the cost issues and the other issues of the scheme so the deficit has continued to increase. It seems that that whole failure was well and truly identified in your report and should have been addressed by now if there was any serious concern or attempt to do something about it.

Mr GRELLMAN: It is a very unhappy situation. The deficit will be $3.2 billion in seven months time.

The Hon. GREG PEARCE: I think it is more than unhappy.

Mr GRELLMAN: I am not sure what I can say in answer to your question. Certainly, the growing deficit would support the fact that not enough is being charged to cover the cost of the scheme. I am aware that there is a range of initiatives that have recently come into place and more that are coming into place. I am not familiar with very much of that and whether or not they will have the desired effect of reining in the cost so that the premiums that are currently being charged will, in the ultimate effect, be adequate. If they are, and the premium stabilises around the $3 billion mark, then attention can be turned to dealing with that deficiency.

The Hon. GREG PEARCE: The deficit?

Mr GRELLMAN: The unfunded deficit, yes. What makes that whole issue difficult is when the unfunded deficit continues to climb, because it makes it a bit of a moving target and it is hard to know how to deal with it. Once it stops moving in a material sense, it is something that clever minds can worry about in terms of how to extinguish it.

The Hon. GREG PEARCE: But it will continue to climb as long as the Government's policy is to undercharge premiums and if it does not address the cost issues?

Mr GRELLMAN: As I said, the initiatives that I gather are being worked on may address the cost issues. I am just not familiar with them so I cannot really comment.

The Hon. GREG PEARCE: I return to the issue of stakeholder ownership that you identified as the principal concern you found. It gets used in a couple of different senses. One sense is management of the scheme, and I think that was partly addressed by the advisory council. Is that the case in terms of potentially bringing together a more co-operative approach to how the scheme is managed?

Mr GRELLMAN: Yes, in the event that changes might need to be made and you have people at the table.

The Hon. GREG PEARCE: That advisory council met until late last year when basically it was emasculated. I do not know the reason for that, but one thing it did was to engage an independent actuary. That actuary did his own assessment of the scheme deficit and came out with a very different figure. As at 30 June 2000 Trowbridge had the deficit at $2.038 billion, and the advisory council's actuary came in at $909 million. The advisory council's report was given to WorkCover and I do not know what happened to it, but I am told that the advisory council no longer has an independent actuary. You probably cannot comment on much of that, but does it surprise you, particularly with your accounting background, that two actuaries would come up with such diverse figures?

Mr GRELLMAN: That is a very common question and I would like to deal with it. Actuaries are curious creatures. They are actually quite intelligent so most people cannot understand what they are talking about. However, depending on the assumptions and the various discount rates, you could come up with a report that would throw up a materially different result. You would need to compare the Trowbridge report with the other reports to see what underlying assumptions drove their calculations. The difficulty is that a report on a scheme like this is probably about two inches thick and it is not user friendly in my experience. You have to try to understand what methodologies they have used to come up with a number, and you will probably fail if you try to do that. I tried once and could not do it but I am not very enumerate. You will get different views from different actuaries.

The Hon. GREG PEARCE: On the other side of the ownership issue, I think in some of the discussion, is a question of who ultimately pays the deficit if it is incurred. That was resolved by the Government in its 1998 so-called reforms where it introduced this provision that allows for a contribution by employers as part of future premiums. I wonder what you think in terms of fairness to employers if down the track, in 10 or 20 years or so,

there is an attempt to recover this deficit. First of all, I would be surprised if the same employers were around, except in limited circumstances. Do you think there is a fair way to deal with it, particularly given that, as you said, employers have paid their premiums and think that is the end of it?

Mr GRELLMAN: That is a concern. I think the generational issues that attach to a problem like this are very real. As you say, the employers that "incurred" that deficit by not paying a high enough premium may well not be there or they may have changed in size or structure and therefore the employers who will be paying the levy will be profoundly different to the people who incurred it, if you like. The issue has to be: Who else will pay for it? It can only come from the one of four sources. One is that somehow or other you get future employees to pay for it from the benefits. In any event, that is grossly inequitable. Secondly, you say to the underwriting community, "We have got a great deal for you. You will underwrite the scheme but you just have to take care of this small problem." The third option would be for the Government to pay but that is getting to be a pretty big number and it is difficult for any State government to find that sort of money. The fourth option is the employers. I do not think there are any other chequebooks so you probably end up with the conclusion that the employers will have to pay it because they are the last ones standing. Is it equitable? Probably not. I am an employer. I do not want to pay it but I probably will have to.

The Hon. GREG PEARCE: Do you think the business community is aware that this is looming for it?

Mr GRELLMAN: At some levels businesses would be aware of it, but they have so many other problems of the day to worry about at the moment that this is probably something that they are happy to allow to consume them next year, not this year.

CHAIR: Obviously there is a reluctance to increase the premium levels because of the comparison with other States. Is there another way of doing it where you can arrive at a higher level in companies where accidents occur in the workplace and their premiums dramatically increase so to speak?

Mr GRELLMAN: In substance that is happening now and there is a differentiation of premium load depending on the actual experience and the perceived risk of

the sector that the employers operating in. You will find there is quite a load being carried by high-risk or poor-performing employers already. The last time I looked at it—and I am quite out of date on this—there was quite a lot of cross-subsidisation taking place and some employers were being artificially held down and part of their load was being carried by other sectors where the premium load was slightly higher. I do not know whether that sort of thing is still happening but I believe the Australian and New Zealand Standard Industries Classification [ANZSIC] codes are now being used to help with assessing premium allocation and risk assessment so there is probably currently a more scientific approach to letting the load sit where it ought to sit.

The Hon. MICHAEL GALLACHER: I wonder whether Mr Grellman would be agreeable to answering questions on notice.

Mr GRELLMAN: Certainly. Yes, I will help if I can.

(The witness withdrew)

MICHAEL JAMES PLAYFORD, Actuary and Director of PricewaterhouseCoopers, 5 Ford Street, Balmain, sworn and examined:

JOHN ERNEST WALSH, Actuary, PricewaterhouseCoopers Partner, 6 Taleeban Road, Riverview, sworn and examined:

DANIEL ALLEN TESS, Actuary and Director of PricewaterhouseCoopers, 26 Cross Street, Bronte, affirmed and examined:

CHAIR: Mr Playford, in what capacity are you appearing before the Committee?

Mr PLAYFORD: As an actuary who has had involvement with workers compensation in New South Wales.

CHAIR: Mr Walsh, in what capacity are you appearing before the Committee?

Mr WALSH: As an actuary with experience in the workers compensation system in New South Wales.

CHAIR: Mr Tess, in what capacity are you appearing before the Committee?

Mr TESS: As an actuary with experience in the workers compensation scheme in New South Wales.
CHAIR: Are each of you conversant with the terms of reference of this inquiry?

Mr PLAYFORD: Yes.

Mr WALSH: Yes.

Mr TESS: I am.

CHAIR: If at any stage any of you want to give evidence or make a statement in camera, the Committee will be happy to accede to your request. In that event we will clear the room of members of the public. Do any of you wish to make an opening statement?

Mr WALSH: The Committee clerk invited us to make a five- to 10-minute presentation to open the discussion. I thought it would be worthwhile doing that, just to give an overview of our experience with the scheme in recent years. I will go through the presentation briefly and talk to it. However, different sections of it are relevant to Michael or Dan. In overview, I will talk about our general experience in the scheme and the development of the five main pieces of involvement that we have had over the last 12 months or so.

In general, we have been involved in the scheme for a long time. PricewaterhouseCoopers—or, as it was then, Coopers and Lybrand—was the scheme actuary from 1992 to 1995 and, in that role, had general responsibility for all of the actuarial work of the WorkCover system.

When the Grellman report was tabled in early 1997, a number of bodies were formed and initiatives taken, including the establishment of a rating bureau for a move towards private insurer underwriting of the scheme. We were actuary to that rating bureau. In that role our responsibility was overall advice on scheme trends, participation in the meetings of the advisory council, actuarial costing of the implications of the 1998 Act, development of a premium structure that would be suitable to a competitive environment, and the development of various monitoring systems to allow the advisory council and the rating bureau to follow claims cost trends in the scheme.

Just to give an overview of some of those, our ongoing role is to provide monthly monitoring reports to New South Wales WorkCover and to the new council, with high-level indicators of scheme performance through key performance indicators [KPIs] which, after discussion with WorkCover and other stakeholders, were deemed to be reasonable indicators of trends in scheme performance. Recently, due to questions regarding that high-level monitoring, we have been asked to extend that experience to more detailed monitoring, specifically in terms of trends by industry, employer size and bodily location of injury. That is expected to be six-monthly monitoring.

We have also recently collaborated with an insurer in the system, Employers Mutual Indemnity (Workers Compensation) Ltd, to implement, monitor and evaluate one of the injury management pilots pertaining in the scheme at the moment.

And this major piece of work that we were asked to do this year was to review the remuneration arrangements for insurers in the scheme. Daniel did most of the work. I will not go through that in detail, but this slide provides an overview of the main findings of the review. I suppose at the highest level what we found was that there is not enough incentive in the system at the moment to reward insurers for good performance—or to penalise them, for that matter, for bad performance. At the same time there is not enough strength in the tools available to WorkCover to ensure that insurers make that commitment.

We have also this year done a review of the experience of common law within the system. Michael was the actuary most involved in that. We found that, over time, the scheme has come to rely more on lump sums rather than on periodic benefits. The number of common rule claims has been escalating, due to a number of factors, including weakening of thresholds and general increases in utilisation. We have also more recently produced a report on the commutation experience of the scheme. Again, I will not go through the detail of it, but I suppose 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.

I believe that is all I want to say by way of introduction. We are happy to respond to questions on these matters, any other matters that the committee deems appropriate.

Report tabled.

CHAIR: In your report to WorkCover on agent remuneration you stated:

> There is general stakeholder agreement in the New South Wales workers compensation scheme that various operational aspects of the system perform poorly and that performance ought to be better. Examples include claim reporting delays, injury and medical management, rates of return to work for injured workers and dispute prevention and management.

Will you will please explain in more detail what you were referring to and, where possible give examples and reasons for your statement? What stakeholders agree and disagree? Who are the stakeholders you are referring to? How long has performance been poor? Why do you believe these issues have not been addressed by WorkCover?

Mr TESS: I will attempt to answer that. The job that we did to assist in designing the new remuneration arrangements was done reporting to a committee for remuneration that was composed half of executives of WorkCover and half of agents in the scheme. The general agreement that we refer to is the unanimous agreement of that committee during the time that we developed the new remuneration arrangements. The statement is not intended to be a historical reference to longstanding agreement, of which there has been none. As part of that job, I spent two weeks in the United States of America researching workers compensation schemes in that country. I looked at six different schemes and actually travelled to those States and spoke with various stakeholders or managers of those schemes.

One of the standard ways that schemes are benchmarked and measured against each other is through an organisation called the Workers Compensation Research Institute [WCRI] that is based in Boston, Massachusetts. They have a standard approach towards benchmarking and measuring schemes that covers four main areas: How quickly claims are reported; how much average claims cost; the level and cost of disputes in a system; and how quickly people go back to work. We simply took New South Wales schemewide data, modified it so that it was more or less comparable to the data in the Workers Compensation Research Institute reports, and stacked it up against performance in the United States of America.

Some of these indicators are difficult to make fair comparisons for. However, by and large, New South Wales seems to underperform a good number of those indicators. I think it is fair to say that, as far as the remuneration committee was concerned, there was general agreement that there was underperformance before we did this qualitative and quantitative research and that only strengthened everyone's belief that, in fact, there was underperformance and that new remuneration arrangements were likely to help that performance.

CHAIR: You mentioned visiting the United States of America. Would you name the States you visited?

Mr TESS: California, Ohio, Massachusetts, Florida and Rhode Island. Those are the ones I can remember off the top of my head.

CHAIR: The Committee keeps hearing reports from Wisconsin.

Mr TESS: We did not visit Wisconsin as part of that trip, although the Wisconsin scheme has been very well documented and researched by the Workers Compensation Research Institute. We certainly discussed the Wisconsin scheme with the institute while we were there, but we did not physically visit the State of Wisconsin.

CHAIR: Was that because there was so much material available to you?

Mr TESS: Yes.

CHAIR: It was not because you were not interested in that particular scheme? From what the Committee has been told it has apparently been successful.

Mr TESS: That is right. Our lack of visiting there had more to do with the fact that it was a remote location relative to the other locations and it was not convenient. It was not because we were not interested in its performance.

CHAIR: It may be difficult to give a definitive answer to this question, but you said that New South Wales has underperformed. If any way of measuring that underperformance?

Mr TESS: There is. In the reports that we issued on agent remuneration there is an appendix that addresses this issue, Appendix I. It is located five pages from the end of the report. It summarises the four main areas of measurement in the WCRI benchmarking reports. The first area is how quickly claims are notified. You will see from the first measure that, on the average in the United States of America, for the business that is reported through these reports—I should mention that this report covers about 40 per cent of the workers compensation claims in United States of America; it is not a comprehensive set of all workers compensation claims, due to the fragmented nature of the market in the United States of America. However, we do think that the results are representative of the United States of America as a whole.

CHAIR: There is no requirement in the United States of America for all States or companies to report to the Workers Compensation Research Institute. Is that so?

Mr TESS: There is no such requirement.

CHAIR: The Institute is a private organisation.

Mr TESS: That is correct.

CHAIR: There is no Federal regulation.

Mr TESS: There is no Federal regulation of workers compensation in any way in United States of America. It is purely regulated by the States. There is largely a requirement for private insurance results to be reported to a national institute—the National Council of Compensation Insurers [NCCI]. However that is a different organisation. This is a voluntary reporting organisation.

CHAIR: So it is possible that the most efficient ones report and the ones that are really inefficient do not report?

Mr TESS: It is possible. However, the WCRI has addressed this issue through various survey and sampling-type techniques and it is the opinion of the WCRI that its reports are largely representative of the national whole, although I suppose you could not ever rule out the other possibilities. Getting back to your earlier question about the actual quantitative performance, on the first measure, the time close to notification of claims and the first payment of claims, you will see that the first measure listed is the percentage of all claims which receive a payment—that is a payment for weekly benefits—within 21 days of injury. In the United States more than half of claims receive a weekly benefit payment within three weeks of the injury. The New South Wales figure is about 14 per cent. That is not only a quantitative difference but a qualitatively different level of speed with which people receive benefits in this system.

Another way to think about speed of benefit payment is not to measure from the date of injury but to measure from the date of insurer notice because an insurer cannot begin to process a claim and make a payment until there is notification of a claim. Once again, almost 60 per cent 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 per cent. So, again, there is a real qualitative difference in the way the processing happens to work in this State.

The next area that is benchmarked is the average cost of claims. There are various indicators. You have to be judicious when you look at these indicators. There are different schemes and they provide different levels of benefit. So you have to be selective and question these statistics more. One statistic that I think is an interesting and valid comparison refers to the average medical payment per claim. The figure in the United States on an adjusted basis to Australian dollars using appropriate exchange rates at the time these payments were made is almost $A9,000. In the New South Wales scheme it is less than $A4,000. We are not aware of any distortion or data issue that is driving this result. The result seems to show a valid difference between the jurisdictions, and it does not seem to be a distinction that is in favour of New South Wales.

It is difficult with the other benefit types to make direct comparisons because the average duration of claim is very different in New South Wales from what it is in United States. Most of the United States jurisdictions have aggregate caps of benefits which limit the durations of payments. So the amount outstanding per claim is a different amount from in New South Wales. It is difficult to look at how much has been paid at an early stage in the average claim's lifetime. That is probably not true for medical payments, which are largely paid quickly. If there are no questions I will move on to the next category.

The Hon. GREG PEARCE: Could you take us through the savings to the scheme that would eventuate if your recommendations were adopted?

Mr TESS: The recommendations for the new remuneration arrangements?

The Hon. GREG PEARCE: Do it when you are ready but I would like you to take us through that. I have gone through the various scenarios in whatever chapter it is but I would like some sort of quantification of it.

Mr WALSH: That is a good question. The overwhelming opinion that we drew from this was that the New South Wales scheme, and probably Australian schemes in general, are far slower to deal with claims from injured workers in terms of both reporting delays and medical attention. Although it is anecdotal, the evidence seems to be that early attention leads to good outcomes.

The Hon. GREG PEARCE: Can you put a figure on that?

Mr WALSH: I would rather not.

The Hon. GREG PEARCE: A range?

Mr WALSH: No. I think it is impossible without analysing data for specific schemes.

The Hon. GREG PEARCE: And you have not done that?

Mr WALSH: Not in this report.

The Hon. GREG PEARCE: Have you done it in some other report?

Mr WALSH: We do it pretty much every time we conduct an actuarial valuation. There is an assumption about the relationship between short-term benefits and long-term benefits and that assumption emanates from the experience that scheme has developed over a number of years. Without looking at an individual scheme and that relationship I do not think it is possible. It would be irresponsible to give an off the top of my head number of the relationship.

The Hon. MICHAEL GALLACHER: When we were given what I call workers comp mark one we were given a figure of approximately $350 million worth of savings on the scheme. When mark two came in no figure was given, and no figure has ever been given. Even when you very graciously came in one night to discuss it with us there was no discussion—and there has never been a discussion—about what sort of savings we can expect to see in the short term or the long term. It is very much a leap of faith. What we have been pushing for we do not believe is unrealistic or unfair. If there was a preparedness to give us the figure in relation to mark one, why can we not have a figure in relation to mark two? I would like to hear your views on that.

Mr WALSH: I was wondering whether it was a question. We are not the actuaries to the scheme and we have not made any attempt—nor have we been asked to—to develop an estimated cost of either mark one or mark two.

The Hon. MICHAEL GALLACHER: But is it a fact that on 25 July you prepared an actuarial analysis for WorkCover on common law and on 8 October a similar report was done on commutations?

Mr WALSH: Yes.

The Hon. MICHAEL GALLACHER: What is the impact of those two reports on the scheme?

Mr WALSH: Those reports were not costings of any change; those reports were commentary on the experience of two types of benefits and an overall opinion on the economic value of those types of benefits. In both cases I think we found that savings would emanate to the scheme by changing the status quo in the way in which has been initiated by the latest bill before Parliament. For the common law report we estimated that the additional cost of common law as a benefit type per se was in the range of $100 million to $300 million, with our best guess being towards the lower end of that—$100 million to $170 million. For the commutation report we did not attempt to do that exercise at all.

The Hon. MICHAEL GALLACHER: Am I right in assuming—please forgive my lack of your expertise—that putting them together the estimated savings from the common law of the commutation changes will have very little impact on the deficit?

Mr WALSH: I would not be prepared to say that. I would not be prepared without having done the work, without making an estimate of the impact it would have on the deficit.

The Hon. MICHAEL GALLACHER: What do you say about David Zaman's criticisms of the methodology in his 24 October report? First, have you read it, are you aware of it, and what comments do you have of his criticisms of the methodology that PWC used?

Mr WALSH: We are aware of it. We have not been given a copy of it. I am aware of what was said in the report. I suppose all I can say is that there are lots of different ways that actuaries could approach this problem. We did the work in the way that we thought was most appropriate. It was done in a limited timeframe. If we had our time again we might think about things that we could do in addition but I think what we did was an excellent job. We have done further investigations since the report was done. This is on the commutation report we are talking about. That work has pretty much confirmed the evidence we found in that report. 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.

CHAIR: Mr Tess said earlier that the scheme here falls behind in comparison with some of the American schemes. Mr Walsh said that the situation applies across Australia. Is the problem within the WorkCover administration or within the insurers? Are they both slow? It is our job to recommend an improvement. Should we be targeting the administration within WorkCover or is the problem with the insurers. Is the problem with the delays shared equally?

Mr WALSH: My view is that all stakeholders, probably including actuaries, have a responsibility for the way in which the New South Wales scheme has gone—probably including government. The state of the New South Wales workers compensation scheme is a result of the political environment in which it operates, the advice that has been given by all professional advisers to the scheme, the stakeholders, including employers and injured workers, and service providers, including medical, legal, rehabilitation and investigators, and insurers, of course. I think that to say that the fault, if you like, is that of any one person is the wrong way to attack the problem. I do not think it is a constructive way to look at it. To answer the question directly, both insurers and WorkCover have a current role in the present state of the scheme. I do not think it is possible to attribute that responsibility either way.

CHAIR: So we should be focusing our attention on both areas, not simply on WorkCover?

Mr WALSH: I would think so.

CHAIR: How do you rate the performance of insurers? In what areas are they performing poorly?

Mr WALSH: It is probably a general statement of commitment to the New South Wales scheme in terms of being managers rather than owners. The fact that they have had that role means that the attention and commitment to the scheme are less than they would be were they more directly involved with the outcome of performance of the scheme. That results in less attention in the early management of the scheme than would be the case, leading to delays and possibly poor outcomes as a result of the delay.

The ongoing claims management is not as well organised as it might be in terms of the relationship between injury management and claims finalisation. I think it is a range of those sorts of comments. I would like to clarify an earlier comment, I said that we had not been given a copy of David Zaman's letter. I remember now that Michael told me that we did receive a copy, but not officially.

The Hon. GREG PEARCE: Following on from the Chair's question about performance of insurers, which relates to your report on remuneration arrangements, in your report you suggest effectively doubling the payments to insurers to try to improve their performance. What sort of savings would you expect to achieve by adopting those measures?

Mr TESS: It may help to direct your attention to appendix H at the back of the report.

The Hon. GREG PEARCE: I see it, but I do not follow it.

Mr TESS: I do not blame you.

The Hon. GREG PEARCE: Would you just explain the headlines?

Mr TESS: I recommend you skip the first page of appendix H for the moment. The second page is labelled "Sensitivity Analysis Scenario 7". This scenario is a model of the entire remuneration arrangements that were ultimately adopted. This is, in general, the level of each of the components that are being taken forward.

The Hon. GREG PEARCE: Has it been adopted by WorkCover?

Mr TESS: It has, and approved by WorkCover's board. What you can get out of this is the fact that although this scenario is what has been taken forward, the results under this scenario are uncertain. There is a range of possible outcomes. This exhibit is intended to show what will happen in terms of agent profitability and scheme impact under various levels of scheme performance under this scenario. In the preparation of this report we generated different scenarios to show why each of the other scenarios that we considered was not really viable, for one reason or another. We feel that this scenario is balanced and viable.

In the first box, one uncertain thing going forward is how the level of loss costs is going to change in the scheme. If there were no change to how insurers were remunerated, or how they managed claims, our projection was that loss costs would deteriorate in the scheme by 1.5 or 2 per cent next year, given recent trends.

The Hon. GREG PEARCE: What are loss costs?

Mr TESS: The cost of claims as opposed to management expenses and other costs in the scheme. Perhaps "claims costs" would be a better term. Under the new remuneration arrangements what we have put forward as a model, and what has been accepted by the remuneration committee as a scenario, is that there may be a 20 per cent chance that there would be no change to the level of claims costs in the scheme. That is the third column of the first box. There might be a 75 per cent chance of improvement in claims costs and there may be a 5 per cent chance that claims would deteriorate, despite the fact that we have new remuneration arrangements. The level of claims costs is not entirely related to how well you manage the claims; other factors are involved, such as the scheme design.

Since that report was created there have been some rather dramatic changes to scheme designed, so it is difficult to say how those that will filter in. This report was made before any legislative changes to the scheme occurred over the past 12 months. You can see that under different levels of claims costs change how that will translate into profitability for agents in the scheme. In the report we use the letters "MGA" to refer to the insurers that manage claims. You can see the impact that would accrue to the WorkCover scheme in terms of financial value of the particular year's worth of claims. As a percentage, these net scheme impacts are not the impacts to the entire liability of the scheme, but to only one year's worth of policies.

The Hon. GREG PEARCE: The range in savings you expect to one year is between 3.4 and 17 per cent. Is that correct?

Mr TESS: That is correct.

The Hon. GREG PEARCE: Basically you are saying that you are predicting a 75 per cent chance that there will be a 3.4 to 17 per cent saving?

Mr TESS: That is correct, and a 25 per cent chance that there will be either no saving to the scheme or an additional cost to the scheme during the first year, or any particular year, that this was to run.

The Hon. MICHAEL GALLACHER: Will that figure shift?

Mr TESS: Yes.

The Hon. MICHAEL GALLACHER: When you do your monthly reports, do you look at this to see whether it is shifting?

Mr TESS: The monthly reports are much more detailed. This overall level of scheme impact would not be visible for some years, perhaps as many as five years after the year that is modelled here. This is the ultimate level of savings, once it is clear in an actuarial sense what the overall value of this policy year would be. That would not be visible month to month. The monthly monitoring reports are focused on leading indicators of scheme performance that do not necessarily guarantee final actuarial claim values.

The Hon. GREG PEARCE: What was GWP?

Mr TESS: The premiums.

The Hon. GREG PEARCE: The gross premiums, $2.1 billion or so?

Mr TESS: Indeed.

The Hon. GREG PEARCE: You are saying that on the changed remuneration system that has been adopted, there is a 75 per cent chance that there will be a 3.4 to 17 per cent saving on that $2.1 billion in premiums. We are talking big numbers.

Mr TESS: Significant numbers.

The Hon. GREG PEARCE: On my calculation 17 per cent of $2.1 billion is $350 million, potentially.

Mr TESS: Yes, but 17 per cent would be the bigger end of the range.

The Hon. GREG PEARCE: I understand that. When were you instructed by WorkCover to look at this?

Mr TESS: December 2000.

The Hon. MICHAEL GALLACHER: That is following the passage of the first trenche of reforms.

CHAIR: WorkCover has accepted your recommendations. However, does the ratio of 75:25 rely on a perfect interpretation by the insurers of what they have to do? Do they understand what you have proposed in your scenario? How do they know that? Do you meet with them or do they read this chart and, hopefully, come to the right conclusion?

Mr TESS: This project was developed more collaboratively than that. The role we filled was not so much as academic consultants developing a report and delivering it to the committee, but rather it was developed in partnership with the committee.

CHAIR: With the insurers?

Mr TESS: With the insurers and with WorkCover. These numbers are not knowable; there is no actuarial analysis that you could ever do that would generate these numbers with great confidence in an academic sense. Rather, the numbers represent a balance point, a point of agreement between the regulators and the agents in the scheme about a scenario that seems fair. It is not an analytic result.

CHAIR: The insurers are saying that if they get increased remuneration they will do certain things more efficiently or appoint staff.

Mr TESS: That is right. It is really about the cost of administering claims closer to the standard that is seen in the United States of America's schemes. There is a chart in this report that shows that as a percentage of claims costs, on average organisations that administer claims in the United States pay, as expense, 15 to 20 per cent of the cost of the claims, whereas in New South Wales that figure would be closer to 5 or 6 cent. The level of cost of investment in operations to get that kind of performance is a different qualitative level than we have in New South Wales.

In this modelling we have shown that under current remuneration arrangements, if insurers were to make that investment they could never recoup it. Their remuneration could never reach that level. A major achievement of the report was to get both sides involved; to recognise that if you have a world-class level of investment and expenditure on claims costs there needs to be a way to recoup that investment. It needs to be run as a business. Likewise, they need to be penalised if they do not achieve the results, and that is also a problem with current remuneration.

CHAIR: That means that in some ways the profitable parts of a company are actually subsidising their WorkCover business?

Mr TESS: That is right.

The Hon. MICHAEL GALLACHER: Earlier I mentioned the two reports on common law and commutations. A figure of $100 million to $300 million in savings was mentioned, but tended towards the $170 million mark. Is it correct that no actuarial calculation was conducted on the savings for common law?

Mr WALSH: Not that we have done. I am aware that the scheme actuary has done a costing. From memory that was a range, but I am not sure of the exact number.

The Hon. MICHAEL GALLACHER: Is the scheme actuary applying the same methodology as you are in commutations in common law?

Mr PLAYFORD: They have rung me a few times in the past two weeks to ask me details of our reports. I understand that they are incorporating some features of those reports in their analysis and calculations. Their methodology and how they are incorporating the results from our reports, I do not know. You have to ask them that question.

The Hon. GREG PEARCE: Is that $100 million to $170 million savings achieved by completely abolishing common law?

Mr PLAYFORD: In the absence of common law, the statutory benefits that claims that have received common law are likely to receive would be, in aggregate, that much lower.

The Hon. GREG PEARCE: So it completely abolishes common law?

Mr PLAYFORD: That is correct.

The Hon. MICHAEL GALLACHER: It is a significant amount, but when compared with the $2 billion-plus context it is not the biggest piece of the pie.

Mr PLAYFORD: 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.

The Hon. MICHAEL GALLACHER: Did you happen to do any actuarial calculations on the difference between what the Government is proposing on impairment levels and the total abolition of common law?

Mr PLAYFORD: No, we have not.

Mr WALSH: I should comment on that. I was a member of the advisory group of the Sheahan enquiry. I was asked to do a back-of-the-envelope estimate. I do not remember, to be honest, what that number was.

The Hon. MICHAEL GALLACHER: Could you do one for us now? I have an envelope in my pocket!

Mr WALSH: It wasn't that back-of-the-envelope! The scheme actuary was asked the same question and came up with a number. Michael was not involved in this.

The Hon. MICHAEL GALLACHER: You are always last to find out, aren't you?

Mr WALSH: It was in my capacity as a member of the advisory group to the Sheahan enquiry. My view was consistent with what Michael came up with. That number was higher than the scheme actuary saw as the potential savings.

The Hon. MICHAEL GALLACHER: On common law?

Mr WALSH: On common law.

The Hon. MICHAEL GALLACHER: So we can expect to hear a figure much less than the $100 million to $170 million that you came up with?

Mr WALSH: I would expect so, but I have not seen it.

The Hon. MICHAEL GALLACHER: On the issue of the Advisory Council—and perhaps it is appropriate to ask this question of John—do you have any observations regarding the effectiveness of the Advisory Council, and what factors impacted on the effectiveness of the Advisory Council?

Mr WALSH: The Advisory Council or the advisory group to the Sheahan inquiry?

The Hon. MICHAEL GALLACHER: The Advisory Council. I note your participation in the Advisory Council is spelt out in this document.

Mr WALSH: I think the concept of the Advisory Council is excellent. We actually wrote a paper that was used, to some extent, by Richard Grellman in forming that governance model. I think the Advisory Council was effective in its first, probably, 12 months of operation, and I thought that the initiatives that went into the 1998 Act were positive and constructive. 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—although I have never said this to any of the Advisory Council members—is that that ultimately was the difficulty with the New South Wales Advisory Council. I do not think that commentary says that it was not a good idea.

The Hon. MICHAEL GALLACHER: Do you have any observations on the new model, as opposed to the old one?

Mr WALSH: I think the new model was probably a necessary result of that outcome. It seemed to me that the financial position of the scheme was deteriorating at a rate that needed some hard decisions to be made. It did not seem that the Advisory Council was able to get consensus to make those hard decisions. The individuals on the Advisory Council have an enormous amount to offer to the scheme, so I think it is a legitimate and positive step to keep them involved and keep their contributions going.

The Hon. MICHAEL GALLACHER: On a separate issue, but still talking about commutation, what were the financial impacts of the 1998 reforms on the scheme?

Mr WALSH: I think it is too early to tell, to be honest. The short-term financial impacts were positive. Our monthly monitoring showed that there were real reductions in the number of claims. The number of new claims being reported has been falling steadily over probably a decade. Insurers were committed to and were showing a real interest in getting better outcomes. So, for the period from probably the end of 1998 to mid-2000 I think there were signs of good operating performance in the scheme. Our monthly report and also the qualitative report from scheme stakeholders is that that initiative and momentum probably have fallen away over the last 12 to 18 months.

The Hon. MICHAEL GALLACHER: What was the reason for that?

Mr WALSH: Probably a combination of insurers losing commitment because of the withdrawal of the attraction of private underwriting; for the other stakeholders, the inability to get consensus on the decisions that needed to be made; and from the Government's point view, probably frustration that things were not happening as quickly as would have been liked.

The Hon. MICHAEL GALLACHER: Did commutation have a positive or negative impact? You say the 1998 reports were positive. Was commutation positive or negative on the scheme?

Mr WALSH: Again, we have not done a clear study on this. The initial analysis done by the scheme actuaries showed that there were scheme savings in the first year at least, and maybe the second year.

The Hon. MICHAEL GALLACHER: So it has only been negative in the last 12 months?

Mr WALSH: Yes. I think the impact of the commutation strategy also needs to be seen in terms of the way in which it was implemented and targeted. I think that was done poorly.

The Hon. MICHAEL GALLACHER: If we have had two years of good results, and 12 months of other factors that have seen a deterioration, is commutation something that should be thrown out or should it be modified to effect an improvement?

Mr WALSH: We have not really been involved in the discussion regarding total abolition. Our report said the eligibility needed to be targeted, and thereby restricted. The difficulty arises as to how to do that. Another thing that our report found was that to the extent that we could match payments with claimant characteristics—and Michael can talk more about this—the matching of claims characteristics was not a good predictor of the commutation amount. So we would have found it difficult to say, "This is the sort of claim if you target commutations," because the outcomes of that were variable.

The Hon. MICHAEL GALLACHER: One of the things I raised earlier with Richard Grellman was the possibility, in so far as commutations were concerned, of adopting a distinction between actual loss injuries versus say a non-specific or more-difficult-to-define loss, such as back strain or stress or something along those lines. Would that be a possible path by which you could target commutations more specifically and still maintain for people who do receive an actual loss injury the chance to go on to a new career with the financial backing to do so?

Mr WALSH: Possibly. It is a lot more complicated than that. There are lots more things that surround commutation.

Mr PLAYFORD: And the range of outcomes for people with stress injuries and so on are still variable. You could not predict that. For someone with a back injury, what they receive as a commutation and the range of outcomes is so large that it is very difficult to identify which back injury is producing bad outcomes, whether they are commuting or not.

CHAIR: If I could clarify that point. If common law and commutations are restricted, is it possible that the cost of other areas of the scheme may show substantial increases, such as weekly benefits?

Mr PLAYFORD: I am sure that is the case. The rationalisation of commutations in 1998 was more to do with the continuance problem that the scheme had. The elimination of commutations now will not get rid of that underlying problem of the continuance problem in the scheme.

CHAIR: The other general question is: What strategies do you believe WorkCover needs to develop to reduce scheme claim costs if both common law and commutations are restricted? What should WorkCover do in other areas?

Mr WALSH: Clearly, the whole issue of early management is one that is not done well. Reporting delays need to be improved. Michael and Daniel might want to comment as well. The whole ownership of workplace injury does not seem to be well managed in the Australian context, and New South Wales 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.

Somehow, WorkCover, insurers and claim managers need to help facilitate that to happen. What makes it difficult in the Australian environment is that the medical management of employees is at arm's length from the employer. We have talked a lot about why there are big differences between the United States system and the Australian system. There is no great magic in the United States system, but in the United States the history of care delivery has involved the employer, regardless of the workers compensation situation. So employers are involved in the health management of their workforce in any case. So the fact that there is a workers compensation claim is, to some extent, irrelevant because the idea of the employers is to get the injured workers, sick employees or absent employers back to work as soon as possible because that will save them money, either in health insurance or workers compensation insurance or in productivity. The great challenge to Australian schemes is in replicating that sort of commitment by employers.

CHAIR: Does that mean that in the United States the employers have staff responsible for this area, when we do not have that in our Australian companies?

Mr TESS: It might be helpful to observe that there is no nationalised health system in the United States of America. Healthcare is provided through private insurance in the United States. That has been the case certainly throughout the twentieth century. Private insurance for individuals is difficult to obtain. So, generally, where people are covered by private insurance they are covered through their employers, through group health plans that are marketed to entire employers and are mostly subsidised by the employers as an employee benefit.

If you get sick or hurt in the United States, you cannot just go to a doctor in the expectation that the doctor will take care of you. You do not have an entitlement to the taking of care. First, you have to demonstrate that you are covered for care by some sort of insurance plan. There are two ways in which to demonstrate that. The first is to show that you are insured through private health insurance. The second way to demonstrate that is to show that you are injured or sick due to something that has occurred at work, so that you are covered through the workers compensation system, which is also privately provided. Hardly anyone in the United States is covered by workers compensation by State-provided workers compensation; that is a rarity in the United States.

That simply means that, over time, employers have a financial stake in the total health and wellbeing of their employees, regardless of whether the health condition is something that has occurred at work or something that has occurred at home. To a large extent, they bear the financial consequences of employee health, regardless of whether it is a workers compensation claim or a more general health claim. That has allowed the evolution of a system that is simply more efficient in dealing with claims being reported. Employers in the United States do not have much of a stake in trying to keep claims out of the workers compensation system,, because if they do employees will simply go into the private health system, for which the employers have to pay as well. There is not such an obvious financial reward, as has accrued in Australia due to the national health care system, for non-workers compensation claims. I thought that background might be helpful.

It is also fair to point out that that situation can help to explain why some of these performance indicators seem good in the United States. However, the lack of that situation does not fully explain why some of these performance indicators are poor in Australia. Despite the fact that there is a national health care system in Australia, one would think that claim reports and determinations of liability could be done within reasonable or statutory time frames more than they are done here. So, despite the fact that we cannot have a health-care system that is aligned with the United States, there is still significant scope for improvement in performance.

Mr WALSH: I believe the injury management pilots that have been initiated by WorkCover are a positive step in answering that question. Hopefully, evaluation of those pilots will shed more light on the dynamics of what happens between the workplace injury and either a return to work or an unsatisfactory outcome of a claim. So, I believe it is not that WorkCover or insurers or other stakeholders do not know the problems, it is all of the interests and stakeholder conflicts that prevent a positive solution being achieved.

The Hon. MICHAEL GALLACHER: Go back to the savings issue. The fact that we are going to see something in the vicinity of $100 million savings with common law, and we all except that the running costs of the scheme are simply outstripping the revenue of the scheme, where are we going to get the $1.9 billion savings with what we have now? It seems that the reforms we have had and what is going to be coming in scheme design will see us back here in about two years time saying that we will have to start from scratch. It seems to me like we are doing this in a piecemeal process. I just cannot see $1.9 billion worth of savings in what we have had and what we have been promised so far that will somehow stop this debt spiralling out and bring us back here in a couple of years of time. What are your views on that?

Mr WALSH: The scheme is in a very difficult financial situation. I believe that the reforms in the two bills of this year are significant changes to the scheme. A lot of the success of those reforms will depend on how well the new commission works, how well the objective assessment of impairment works and is successful in restricting damages to injured workers who are not arguably the most seriously injured, and how well the early management of claims and early reporting of claims is able to be improved. I think it is that last one that is probably the one that is not addressed yet. The major problem with the New South Wales scheme over the past few years has been in disputes. I think there is potential for the new commission to assist in disputes, given that it also has the instrument of an objective assessment mechanism to provide clear arbitration of those disputes.

What I think is unclear is how early claim reporting, early injury management and employer and injured worker buy-in will fix the short end of the claim process. I suppose my response to your direct question is that I do not know. We will have to wait and see how it goes. I should say that in the best case scenario, where the assessment mechanism works and the dispute resolution process is improved through the commission, there is potential for significant savings.

The Hon. MICHAEL GALLACHER: Significant amounts are still yet to be achieved at $1.9 billion, though.

Mr WALSH: That is right.

The Hon. MICHAEL GALLACHER: It is a considerable amount of money. The last figure that we were given that showed a $500 million deterioration in the scheme, in the deficit, cited about $140 million or $150 million worth of poor return on investment. Is that just a recent trend or, when you were doing the actuarial work in the past, were you confronted with that?

Mr WALSH: I am not aware of that detail, to be honest. I have not studied the report in that amount of detail. No, the history of investment return on the WorkCover managed fund up until the end of 1995 was positive. It was double-digit average.

The Hon. MICHAEL GALLACHER: In your term as the actuary did you have complete and open access to all the investment decisions made by the trustees?

Mr WALSH: No.

The Hon. MICHAEL GALLACHER: Who does?

Mr WALSH: My understanding—I do not know whether Dan or Michael know more about this than I do—is that the investments are outsourced to fund managers and that those fund managers are given guidelines within which they must make the investments. For example there may be a range of 30 per cent equities, 20 per cent fixed interests etc. I do not know what the guidelines are. Provided that the fund managers operate within those guidelines, they are able to invest pretty much independently. They are required to provide returns to WorkCover at least monthly on the performance of those investments.

The Hon. MICHAEL GALLACHER: I am concerned about the fact that with a click of the fingers another $150 million goes onto the unfunded liability, which is simply pushed over onto the employer's side of the ledger. We do not know how long this trend has been going, who knows what that figure is, and why should employers be paying for decisions made by governments about their investments? If the Government has made a bad call on investments, why should a mum and dad business have to pay for it?

Mr WALSH: I suppose it is no different from any other statutory fund which needs to make investments. If the investments were made on a purely risk-free basis since the start of the scheme, then the expectation—I think, I

have not done these numbers—would be that the financial position would be worse than it is at the moment. I am fairly confident that the investments over the past 13 or 14 years would show a return above risk-free. When you depart from risk-free you then run the risk of having some bad years. The net effect of that is the employers and citizens of New South Wales have benefited from departing from a risk-free strategy.

CHAIR: Just for the record, you were the actuaries before. You do not question the deficit figure as announced, the potential figure by June?

Mr WALSH: We have not done a full actuarial liability of the scheme for a couple of years now, but I am not surprised by the number at all.

CHAIR: What, the $3.2 billion as an accurate estimate?

Mr WALSH: As a reasonable estimate.

The Hon. MICHAEL GALLACHER: When was the last monthly report concluded?

Mr WALSH: I think the last monthly report was in respect of the September month, and that was presented to the council last week or the week before. It is recent.

The Hon. MICHAEL GALLACHER: It has not been publicly made available at this stage, though, has it?

Mr WALSH: I am not aware. We provide it to WorkCover and it is provided to the council. I am not sure how more publicly it is made available.

CHAIR: I would like your opinion, too, on the premium discount scheme. Do you support that or recommend that?

Mr WALSH: I supported it. I thought it was a good idea. I should disclose that we are approved premium discount advisers. We have a practice within PricewaterhouseCoopers that provides occupational health and safety advice. We are a premium discount adviser. The take-up rate by employers has been disappointing. I do not really understand why. Dan or Michael might want to talk about the Massachusetts experience, which is the scheme on which the premium discount scheme was based. The results of that scheme were positive.

Mr PLAYFORD: They were very positive but two points need to be made about the Massachusetts scheme. In the first year of the Massachusetts scheme the take-up rate there was also quite poor. It took a while before employers were convinced that they really wanted to get involved in it. In the second and third years more employers got involved, and maybe that will happen in New South Wales, maybe it will not. The other important distinguishing feature between Massachusetts and New South Wales is that the Massachusetts premium discount scheme was only in respect of poor employers who were part of the uninsured pool, whereas New South Wales is trying to roll it out for all employers. To that extent the positive outcomes from Massachusetts will probably have to be moderated to some extent when you consider it is being rolled out over all employers in New South Wales. But you would still expect there to be good outcomes.

The Hon. GREG PEARCE: Is the Massachusetts scheme privately underwritten?

Mr PLAYFORD: Yes, it is.

The Hon. GREG PEARCE: And they have the assigned risk pool. So if your were to go down that path, you have to look closer at the Massachusetts experience as opposed to New South Wales if we were going to re-examine the privately underwritten scheme here?

Mr WALSH: Yes. What to do with basically uninsurable risks is a difficult question in a privately underwritten scheme. The difficulty is unassigned risk pools have tended to snowball. Even though in the Massachusetts scheme it was only the assigned risk pool, that was a pretty big part of the scheme, approaching 50 per cent I think.

Mr TESS: Eighty per cent at the time of the premium discount scheme. At that time, which was years ago, it is arguable whether that was a privately underwritten scheme.

The Hon. MICHAEL GALLACHER: What is the size of it now?

Mr TESS: It is minuscule.

The Hon. MICHAEL GALLACHER: So it actually worked?

Mr TESS: Yes. The whole Massachusetts scheme has turned around due to a wide range of factors including significant legislative benefit changes.

The Hon. MICHAEL GALLACHER: So there is international experience that displays clearly how poor performance can be lifted out of that assigned risk pool into a competitive privately underwritten scheme? That is one of the biggest concerns that some people have, what to do with poor performance.

Mr TESS: In Massachusetts it was less a factor of the performance being turned around and more due to the newer scheme being a more viable business as a whole. Poor performance is a relative concept. There are still some poor performers. The whole scheme is a tolerable business proposition now, whereas it was not in the early 1990s due to a wide range of factors.

CHAIR: John, you mentioned that report in September. I wonder whether our Committee could have a copy of that or whether you would have to get WorkCover to give approval?

Mr WALSH: The monthly monitoring report? That is the one that we tabled just last week at the council?

CHAIR: Yes, that is the one.

Mr WALSH: I do not see any reason why not. They are pretty innocuous reports, to be honest. I am not sure that they will help the Committee a lot.

CHAIR: There is no problem with you making it available to our Committee?

Mr WALSH: I am not aware. If you do not mind, I would appreciate my asking WorkCover, but I do not think there will be a problem.

The Hon. GREG PEARCE: On the commutations in your report, your report does not conclude that all commutations are bad. If you go to the table you use for calculations for severities from 15 per cent up to 100 per cent, there are potentially very significant savings to the scheme, up to 35 per cent on your calculations. Your comment was that commutations should be better targeted.

Mr PLAYFORD: That is correct, but you cannot just say severity is the be-all and end-all of how you decide which claims should be commuted.

The Hon. GREG PEARCE: I am just going on the table you used to come to your conclusion that overall there was a 7 per cent cost to the scheme. If you take out the lower range you get very significant savings.

Mr PLAYFORD: Correct. Another argument should be put with those very severely injured claimants, that maybe commutations are not the best way to serve their underlying needs.

CHAIR: Just to clarify that, you are saying it may be of benefit to the severely injured worker that it is not commuted, but ongoing care?

The Hon. GREG PEARCE: The injured worker has to ask for commutation.

Mr PLAYFORD: That is correct, and you would expect that they have had good advice that it is a good outcome for them to take the commutation.

The Hon. GREG PEARCE: Mr Tess, your adoption of newer remuneration arrangements for the insurers, that has been done purely as a management and administrative exercise, it does not require any legislative change, any additional powers for WorkCover?

Mr TESS: That is correct.

CHAIR: I suppose if it does not increase its efficiency it could increase the deficit, the extra remuneration?

Mr WALSH: We do not think so. We think it is constructed in such a way that, if efficiency is not improved, insurers actually will not get any benefit.

CHAIR: They will not benefit?

Mr WALSH: That is right.

CHAIR: Therefore, it will not affect the deficit—or it will not increase the deficit, but it could reduce the deficit.

The Hon. GREG PEARCE: It could significantly reduce it.

Mr TESS: I think to be precise, though, you would have to say that the model is about a sharing of financial performance between WorkCover and their agents. If, under the new remuneration arrangements, agents perform worse than they are performing now, that is going to have a negative impact on the scheme. The scheme may even end up paying more in remuneration itself than it currently does.

CHAIR: That is the point I was trying to make.

Mr TESS: Yes. However, the insurers will perform much, much worse in that scenario and will make significant losses under that scenario. There is no way round it. What this remuneration package was designed to produce is 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.

CHAIR: Do those insurers have to report to WorkCover that they have done all those things you just mentioned, such as increase staff and all those things? Do they actually have to prove that they have done that?

Mr TESS: Yes. As a part of the new package, WorkCover's board insisted that the introduction of the new arrangements be accompanied by independent external audits, both of the insurer's business plans and of performance against those plans in terms of detailed expenditures on the claims service infrastructure for each one of the MGAs.

The Hon. GREG PEARCE: Why did not WorkCover do that five years ago?

Mr TESS: I do not know the answer to that question.

The Hon. MICHAEL GALLACHER: Has your organisation done any actuarial work on the savings so far as compliance by employers is concerned?

Mr WALSH: In terms of premium declaration?

The Hon. MICHAEL GALLACHER: Yes.

Mr WALSH: No, we have not.

The Hon. MICHAEL GALLACHER: Would you be happy, Mr Walsh, to accept some questions on notice if they were forthcoming as a result of this hearing?

Mr WALSH: We would.

CHAIR: Thank you very much for appearing before the Committee and for giving us your valuable time. In the back of my mind I am thinking about what it all adds up to, and we have three experts people here to hear the evidence.

(The witnesses withdrew)

(Short adjournment)

DAVID JOHN FINNIS, Principal, Tillinghast-Towers Perrin, Level 17, MLC Centre, 17-29 Martin Place, Sydney, 2000, and

ANDREW MYLES COHEN, Manager, Tillinghast-Towers Perrin, Level 17, MLC Centre, 17-29 Martin Place, Sydney, 2000, sworn and examined:

CHAIR: In what capacity are you appearing before this Committee?

Mr FINNIS: As actuary to WorkCover.

Mr COHEN: As actuary to WorkCover.

CHAIR: Are you conversant with the terms of reference of this inquiry?

Mr FINNIS: Yes.

Mr COHEN: Yes.

CHAIR: Mr Finnis and Mr Cohen, if at any stage during the giving of your evidence, you consider that, in the public interest, certain evidence or documents you may wish to present should be heard or seen only by the Committee, the Committee will be willing to accede to your request. Proceedings will be heard in camera at that stage. Do have an opening statement that you wish to make?

Mr FINNIS: I have a brief one, if I may, just to help me to help the Committee confirm our role in terms of our support to WorkCover. We are employed as the actuaries to the WorkCover scheme. We have been employed on that basis since 1 July 2000. In a nutshell, the job, as I see it, is to provide actuarial advice hence viewed as objective a support as possible to the scheme's financial deliberations, the key point being that the valuations would assume liabilities but it does extend to other areas of financial management of the scheme. Hopefully that is of help. That is really all I need to say.

CHAIR: Are you present at all board meetings?

Mr FINNIS: Not all the board meetings, but certainly those where there is a financial impact, if you like. Over the last year I believe we have been to more than 50 per cent. Certainly for each quarterly monitoring statement we produce, we attend the board meeting and also for each of the two valuations that we have done for the whole scheme, we have attended a separate board meeting for each of those. I would not know exactly, but it adds up to something like just over 50 per cent of the meetings.

CHAIR: So who would ask you to attend the meetings, the WorkCover manager?

Mr FINNIS: Effectively, the general manager of WorkCover, yes.

CHAIR: I have some general questions relating to the deficit. The reported deficit was $2.76 billion which was projected by you in September 2001. How would you describe the financial state of the scheme?

Mr FINNIS: 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 on an ongoing basis[1]. Having said that though, of course, if you look at our reports, as I am sure you have, 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.

CHAIR: You have actually put a figure, have you not, of $3.2 billion?

Mr FINNIS: By December, I believe.

Mr COHEN: Yes, it will be $3.1 billion by December this year and growing to $5.5 billion by the end of

[1] This assumes no further contributions in the form of premiums or investment returns with which to augment current assets in addressing the likely claim payment on outturn ~ *Dave Finnis, 30 November 2001.*

June 2006, assuming no changes to the scheme's structure at all.

CHAIR: What are the key adverse trends in the scheme that are causing that?

Mr FINNIS: 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. I guess 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.

CHAIR: Just a final question in that area: what are the main favourable areas of the scheme's main trends? You have seen the negative ones. What are the positive ones?

Mr FINNIS: There is a positive one and the main one 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. Other favourable trends? Nothing immediately comes to mind, I am afraid.

CHAIR: So in fact you are reviewing the claims experience of the WorkCover scheme since June 2001?

Mr FINNIS: Yes.

Mr COHEN: No, since June 2000.

Mr FINNIS: Yes, the last 18 months.

Mr COHEN: We have done three valuations.

CHAIR: Have you done that since the last report?

Mr FINNIS: Since our last valuation report of 30 June 2001, we have produced no additional complete valuations. We are in the process at the moment of completing a quarterly monitoring report which looks at the trends to 30 September 2001, and that is nearly finished. It is in a draft form at the moment. I believe it is going to be looked at by the board at next Monday's meeting.

CHAIR: Does that work that you are doing reflect what you just said a moment ago about those trends? Are there any changes that you are picking up?

Mr FINNIS: No. In fact it is coming in very close to our valuation projections in overall terms. There are some differences. For instance, the actual common law payments are in fact slightly lower than we projected for that quarter. It is a very volatile situation so I would not necessarily read too much into that. That is actually being offset anyway by increases in other payments, so overall it is pretty close to expectations.

Mr COHEN: I think that total payments in the last quarter were within one per cent of our expectations, so our June model is tracking reasonably well against that.

Mr FINNIS: Purely by luck, I might add. We were not going to claim credit for that one.

CHAIR: Your deficit projections, though, are not affected by the work that you have been doing?

Mr FINNIS: It is difficult to say. As I say, we are not doing a full valuation review at the moment. We will do one at 31 December and at that stage we will assess whether that extra six months information we got will affect

our assessment of the liabilities. I think that all I could say at this stage is that there is nothing screaming out at me that will change our assumptions in a major way at this stage.

CHAIR: So if it was $2.76 billion projected by you in September 2001, you would not like to make an estimate of what it might be in December?

Mr FINNIS: At this stage, we would stick with what we said in June, which is $3.1 billion. I think that is fair enough. Andrew, you would not want to add anything?

Mr COHEN: Except to say that interest rates have come down so just allowing for that would probably increase the deficit. The effect of that on the way we value our liabilities would on its own change the deficit figure but it is hard to say by how much because of the effect on the assets.

Mr FINNIS: That is right. We would have to assume that that would be the position at 31 December, effectively, and obviously that is difficult to tell at this stage.

CHAIR: Because you cannot anticipate the impact on investments and interest rates?

Mr COHEN: The only approach is to do that when you know what the position is at 31 December. It would be speculative to second-guess the market right now.

The Hon. MICHAEL GALLACHER: You took over as the scheme's actuaries on 1 July 2000.

Mr FINNIS: Correct.

The Hon. MICHAEL GALLACHER: When you walked into the office and collected the books what was the considered unfunded liability by your predecessor prior to taking over?

Mr COHEN: It is a guess because I do not know the number off the top of my head, but I think it was around $1.8 billion, $1.9 billion.

The Hon. MICHAEL GALLACHER: When you assessed it using your methodology what did you assess it to be?

Mr FINNIS: We brought it down to $1.6 billion at 30 June 2000. At the time we were careful to say to the board, despite the fact we were coming in lower than Trowbridge, if we had done it at 31 December, previous to that date we would have shown a deterioration over that period.

The Hon. MICHAEL GALLACHER: Since July 2000 have you continued to use the same actuarial methodology in determining the unfunded liability, or have you changed in any way how you make that determination?

Mr FINNIS: I am not sure how you define "actuarial methodology". Perhaps if I can give a bit of background, we are using the same actuarial approach and the methods within that approach have changed in a small way. But I would regard them as normal dynamic changes that are necessary as you pick up more information. Certainly there is no major difference in the approach, if that answers the question.

The Hon. MICHAEL GALLACHER: We have heard today of quite distinct differences in the way in which information is interpreted to come to certain figures, and I was keen to see whether there was a consistent level in terms of what you used to apply to make that determination or whether there was a change. Mr Finnis, earlier you said that nothing will happen—we are talking about the unfunded liability—to premium contributions, whereas Mr Cohen said "scheme structure". Are we talking about the same thing when you refer to "scheme structure" and "premium contributions", or are we talking about two different things?

Mr FINNIS: I think we are talking about the same thing. To me, the financial structure would incorporate the inflows and the outflows, so we are talking about premium coming in, investment returns coming in, claims going out.

The Hon. MICHAEL GALLACHER: If we read it tomorrow in *Hansard* and one says premium contributions in black and white that it looks like simply a matter of income, whereas, Mr Cohen, is talking about scheme design and structure. In writing it looks like two totally different situations.

Mr COHEN: I was thinking, I guess, of the totality of the scheme affecting the inflows and the outflows; it could be anything on the asset side or the liability side.

Mr FINNIS: Perhaps we should clarify that we tend to think in terms of the financial structure of the scheme, so maybe there is an implication there that we will interpret things differently[2].

The Hon. MICHAEL GALLACHER: One area of concern to the Opposition with the passage of the second tranche of reforms, if you can recall, earlier this year we received what we call mark one of the second tranche of reforms. Then they disappeared and were replaced by mark two. Mark one, we were told savings of about $350 million as a result of that mark one package. Mark two, we have never been given a figure. We have never been told what savings can be anticipated as a result of the second tranche of reforms. Equally, the new draft legislation that has been circulated with respect to commutation at common law and the abolition of any proposal to move towards a privately underwritten scheme, at this stage there has been no financial figure given with regard to that. As you are the actuaries—and I suspect you would have done a significant examination of the second tranche of reforms—can you tell the Committee the expected savings on the scheme from the second tranche of reforms as well as the draft legislation that we are in the process of looking at now?

Mr FINNIS: We are working on a process that has been carrying on since the first tranche of reforms. We are working on what I would call a living report in respect of the total reform process. At this stage my preference would be to confirm that those reforms or the proposed reforms have not changed since our last iteration of the savings. However, if we were to be asked, based on your understanding of the current reform package, what is the potential savings we could get an answer to that.

The Hon. MICHAEL GALLACHER: Consider that question asked.

Mr FINNIS: Unfortunately because it has come a bit out of the blue I cannot answer it on the spot, but I could certainly take it away and give you an answer within the day.

CHAIR: Have you advised WorkCover what you think the savings are?

Mr FINNIS: Yes. They have a draft of our latest iteration of the report.

CHAIR: So the information is available but you simply do not have it with you.

Mr FINNIS: I do not want to give misinformation. I know these reforms are fairly dynamic. I know changes are being considered this week, for instance. I am not in the inner circle in terms of what the current position is. Certainly, if I could explain a little more about what I would regard as the first tranche as opposed to the second tranche, certainly the first tranche was very much focused on the dispute resolution process and the legal and investigation costs involved in that. Part of the second tranche inherent in the legislative amendment Act that was passed in July deals with those same dispute resolution effects. My view of the reform process is that there are additional things connected with that legislative amendment Act that are going through at the moment and that effectively impinge on any savings that you might expect from that Act. If I was to give you a figure of what you think the effect the Act will have, it will be dependent on my view of what the current reform process is coming up with.

The Hon. MICHAEL GALLACHER: Bearing in mind that the Government has got absolutely everything it wanted through in that, in the July debate no changes were made to the bottom line so far as the legislation. So if one were to assume that the common law were to go through on a similar basis it should be a lot easier for you to work out the potential savings that can be made.

Mr FINNIS: Yes. As you know, the Sheahan Committee made recommendations. As I understand it, the final reforms will differ from those recommendations. There have been several iterations along the way and the costs are changing almost on a daily basis.

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[2] I suggest that this response be clarified to indicate that this interpretation of financial structure is an actuarial one. It may be interpreted differently by other interested parties ~ *Dave Finnis, 30 November 2001.*

The Hon. MICHAEL GALLACHER: What is the view of Tillinghast so far as the potential for a privately underwritten scheme and the benefits that might have on the future of the scheme?

Mr FINNIS: The view of Tillinghast as employed actuaries of WorkCover is that that is a decision for WorkCover. If you are going further and saying that you would like the views of Tillinghast, an actuarial firm, I am happy to do that. In the normal circumstances I would defer to my employers and say it is their decision. There is no simple answer of course. Can I just confirm that you would like to go further? It probably does not need saying.

The Hon. MICHAEL GALLACHER: Yes.

Mr FINNIS: 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.

The Hon. MICHAEL GALLACHER: So there is still potential for a privately underwritten scheme. The package of these reforms and what has gone past does not close the door on it, I take it?

Mr FINNIS: Not from an actuarial perspective.

The Hon. MICHAEL GALLACHER: Surely from the policy perspective.

Mr FINNIS: I do not think I am in a position to answer that.

CHAIR: By way of clarification, does WorkCover work out reforms in the hope that they will bring about savings, or does WorkCover ask you, "How can we do this in order to make savings?

Mr FINNIS: It is a balance. It is both. They normally will come to us with the high-level ideas and they will ask us, "What are the encumbrances? What are the things that may stop this from working? What are the key elements within this that we need to ensure will go through to improve the prospective savings? "We had an input on that basis although, as I say, the initial draft reforms, if you like, to come from WorkCover.

CHAIR: As an actuary, you work out what the saving might be, because WorkCover would not be clear about that, what it?

Mr FINNIS: No. I mean, if you ask the question, "What is a saving on this?" You usually have a list of questions, firstly, "How is this going to be implemented? Can you define this a little better for me? Can you provide me with the data to support that?" It is an intrinsic process, even before we can answer that apparently simple first question.

The Hon. GREG PEARCE: I want to explore a little the deficit itself. There is a little confusion and, shall we say, panic out there about it. If my understanding is correct, if you look at the fund you have assets according to your last report of $6.4 billion. It is fair to say that that is real; that is mostly investments plus some outstanding premiums and cash and various bits and pieces. Those assets of the fund have increased virtually every year—for example, in 1994 it was $3.75 billion, and it has increased yearly from then on. Then you work out the liabilities. Again, that has what is called a current part, which include the actual claims that are in the area and the actual debts—which, again, at the date of your last report was about $2.5 billion.; and the balance is the non-current liabilities, which is your actuarial assessment of the potential liabilities of the fund. Is that correct?

Mr FINNIS: The difference between current and non-current—from an accounting standards standpoint, if you like, current means liabilities in respect of claims that are less than a year old. Non-current means liabilities in respect of claims that are more than a year old.

Mr COHEN: Sorry—that will be paid within the next year. Current is claims paid within the next year.

The Hon. GREG PEARCE: You actually work out your estimate for each of the subsequent years as to how much is going to have to be paid out?

Mr COHEN: Subsequent payment years, yes.

Mr FINNIS: Sorry, can we just clarify that. Andy is right; I was wrong. Current means pay into over the next 12 months, and non-current means paid—

The Hon. GREG PEARCE: No wonder I am confused.

Mr FINNIS: Yes. The accountants confuse us, as well.

The Hon. GREG PEARCE: I was amused reading your report your description old how complex your calculations are; that some of them go out for 40 years. I read about a mythical worker who might lose part of his foot. You worked out what his weekly payments would be in 40 years time—

Mr FINNIS: It may not be a mythical worker. If he is aged less than 20 he could actually have those claims. However, we have not got a definite worker there, no.

The Hon. GREG PEARCE: You talk about the inherent uncertainty of it all, and the fact that it is likely to deviate, perhaps materially. I thought the best part was where you said,

> The overall estimate is the central estimate in a sense that there is, in our view, a probability of around 50 per cent that an amount equal to the estimate will prove to be at least sufficient to meet the liability.

It seems to me that the odds are of you being right are about the same as the odds are of me winning the game of two-up on Anzac Day next year. Is that about the right odds?

Mr FINNIS: That is a very even way of looking at it. If I could expand—

The Hon. GREG PEARCE: I do not mean to be jestful about it, but I am looking at the last two reports that you have done. Each six months they have a varied by half a billion dollars. The deficit is not just a hypothetical, is it? It is more than that.

Mr FINNIS: It is a solid, But it is flexible, if you like—which may be the best way to think about it.

The Hon. GREG PEARCE: It is not, though, a debt, is it?

Mr FINNIS: If you were talking to an insurance company, they would say it is a debt, because their balance sheet would have to allow for appropriate assets and liabilities relating to business on the books. That would basically say to that insurance company, "We're insolvent."

The Hon. GREG PEARCE: But, it would be wrong to say something like, "There is a debt there, and every man, woman and child in New South Wales owes $338 or something like that

Mr FINNIS: 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.

The Hon. GREG PEARCE: I guess what I am getting at is—just to try to understand, in terms of what you are saying—that there is no real crisis at the moment. You are shaking your head, so you are agreeing with me?

Mr FINNIS: I am agreeing with you that there is no crisis, if you mean that the scheme will deteriorate.

The Hon. GREG PEARCE: I think you said in some of your reports the situation is manageable, complicated and so on.

The Hon. MICHAEL GALLACHER: Could not just ask what question in relation to my understanding of that. When you work out the figures to come up with that figure of $2.1 billion or $2.2 billion, you maximise the potential in terms of all of the pay-outs, too, do you not?

Mr FINNIS: No.

The Hon. MICHAEL GALLACHER: You do not?

Mr COHEN: Are you referring to the assumption, perhaps, that every worker will keep getting benefits until they are 65 years old?

The Hon. MICHAEL GALLACHER: No. What do you used to work out percentages that will be successful and those that will not?

Mr FINNIS: Basically, past experience would show us that. Coming back to this 50 per cent figure, as you say, the chance of it being exactly right is very small, but the idea of the 50 per cent figure is that we are really talking about a range of possible outcomes. We are doing our best to come in the middle of that range. That is the point. In other words, we are using past experience to come up with the best estimate of what the outcome would be.

CHAIR: When you say you are in the middle, it could actually be worse?

Mr FINNIS: Yes. In our opinion, yes.

Mr COHEN: There is a 50 per cent chance it could be worse and a 50 per cent chance it could be better.

CHAIR: The 50 you have quoted is not the extreme figure; it is a central figure.

Mr FINNIS: Yes, a central estimate.

The Hon. GREG PEARCE: In your current report you did not repeat the table 4.4 that you had in the December report, which was a breakdown of the increase in the deficit. It had a number of things—premium inadequacy, negative fund return, investment-related effects and premium undercollection effects. I wonder why you did not repeat that chart, which was quite interesting? I wonder if you could just explain what "negative fund return" means.

Mr FINNIS: Hopefully, the answer to the first question is relatively simple. The June review was certainly, initially anyway, an upgrade to the December review. Therefore, we do not do the same full-scope, if you like, as we do for December. In turns of the negative fund return, this comes back to the, if you like, problems that the accountants give us. That is very unfair. No, it comes back to the accounting standard and the need to assume, in a notional way, that you have sufficient assets to back your full liabilities when you apply the discount rate. In other words, when I am valuing liabilities I use a rate of interest that assumes that I have 100 per cent funding for those liabilities, even though I know we have not. The negative fund return is, if you like, the unwinding of that effect over a six-month period—the fact that we only have 75 per cent or less of funding.

The Hon. GREG PEARCE: Do not end up with double counting it in the liabilities, the deficit?

Mr FINNIS: No.

Mr COHEN: There is another way to think about that. You have assets on one side of the balance sheet and liabilities on the other. Let us say that assets are growing at 6 per cent, which is the discount rate, and liabilities are also, because you are discounting them back to June 2001,

The Hon. GREG PEARCE: Five and a half—I think you talking down to 5 million—you took it up to five and a half.

Mr COHEN: Now we are discounting back to June 2001. If you discount those liabilities only back to June 2002, they will, by definition, have grown by 6 per cent or 5½ per cent. So you have your assets going up by a particular rate and your liabilities going up by the same rate, but because the bucket of assets is smaller you are widening the gap[3].

[3] There appears to be some confusion in the transcript relating to the discount rates adopted in the valuation. To clarify this issue, please note that the annual discount rates were 6% at June 2000, 5.5% at December 2000 and 6% at June 2001 ~ *Andrew Cohen, 30 November 2001.*

CHAIR: Just to clarify a comment you made earlier about this 50 per cent probability of sufficiency. You selected the 50 per cent? Did you select that or did WorkCover select that? Where did it come from? Apparently Australian Prudential Regulation Authority [APRA] has said it should be 75 per cent.

Mr FINNIS: Yes, for the Insurance Act requirements, that is correct. I think that relates to the point I was mentioning before, that the solvency of an insurer is partly dependant on adequacy of reserves. Whereas he could argue that WorkCover is not as dependent on its solvent position, for want of a better term. It does not have to comply with the Insurance Act 1973. In direct answer to your question, it was provided to us by WorkCover to give them a central estimate of the liabilities. That is what they use in their accounts, basically. That is what they have agreed with our auditors is the appropriate figure to use in their accounts.

CHAIR: Are you aware whether that has changed since the previous actuaries? Has that been a consistent figure?

Mr FINNIS: I am pretty sure it has not changed. We were incumbent in the early 1990s and it was the same position in those days. I am pretty sure it has stayed the same over the interim period.

The Hon. GREG PEARCE: You also dropped out a paragraph that you had in the earlier report, paragraph 4.5, headed "Action points". One of those dot points stated, "Increased focus on the use of the commutation option. This will enable savings from the use of this option to continue." I think you explained earlier on in your evidence that you consider that the commutations should not be used indiscriminately. Of more concern to me is the fact that this report included two main purposes —the first was to estimate the outstanding liabilities, and the second was to estimate the break-even average premium rate. That has been dropped from your latest report. Was that because—

Mr FINNIS: Yes, same explanation as the first answer. The review at 31 December effectively is the one that is used to set the premium rate for the renewals from 1 July for the subsequent year. Of course, we do not have that requirement for at 30 June. There is in section 10 some—

The Hon. GREG PEARCE: Yes. If I could just go back to the question my colleague asked about savings. Do you recall a letter dated 28 August 2000, a submission you made to Justice Sheahan, which referred to a summary of estimated annual savings and the reforms?

Mr FINNIS: I recall writing it.

The Hon. GREG PEARCE: I will show it to you.

Mr FINNIS: Thanks.

The Hon. GREG PEARCE: What was the scenario for bill one and for bill two, the bill that has been passed?

Mr FINNIS: Okay. Again, no easy answer, I am afraid. Maybe I can give a bit of background. Again, we are referring to our costing of the effect of the reforms bill one and bill two, and the current reforms I guess. What we did was set up a model that basically enabled certain inputs to be put in there, which enabled WorkCover to understand the effects of certain changes to initially the dispute resolution system. In other words, if bill one effects had been implemented very well, or less well, or perhaps not well at all, what effect would each of those scenarios have on the financial position of the scheme. We actually set out a table that showed that for bill one, if the targets that were set were fully achieved, they might expect $335 million annual savings from the implementation of bill one

The Hon. GREG PEARCE: If I might interupt, that was probably the sort of figure referred to in all the newspaper reports, the $300 million to $350 million in savings.

Mr FINNIS: Quite likely, I would have thought. In our view, that would have been a fair amount less than practical answer because 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 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. There the savings would have been around $120 million. Probably because we wanted to put more figures in there, we put a central estimate as well.

The Hon. GREG PEARCE: So what was your reasoned estimate?

Mr FINNIS: Again, that is a difficult one because it depends on specifics, on implementation. But if you are talking about a range of outcomes, certainly there was one in the middle[4] there that was just over $200 million, $210 million. So that might be interpreted as the answer to your question. The estimates changed, firstly, because we did a new valuation at 31 December. We got the results of that valuation and because the valuation showed a deterioration on 30 June our expected savings from the reforms actually went up as well. For instance, that $335 million figure went up to $369 million at that stage. Then, as you know, there was negotiation. A new bill was put there as alternative. Including the deferral of the common law activity, which effectively was delegated to the Sheehan committee, that reduced our targets for the achieved estimates, if we are comparing like with like again, down to $279 million and reduced our central estimate to something like $65 million. But we were also told at that time that there were likely to be benefit augmentations included in the original dispute resolution scenario. Based on what we had been told about those likely benefit augmentations, we reduced the estimate, because obviously benefit augmentations would have had that affect. At the time, the targets for the achieved option then came down to $214 million and our central estimate came down to zero.

The Hon. GREG PEARCE: So your best guess figure again on that is, what, the $214 million?

Mr FINNIS: No, the $214 million is the end of the extreme range—the targets fully achieved, if everything works perfectly. The zero is the middle of the range—I think I would prefer, rather than the central estimate because it is not the central estimate in strict actuarial terms.

CHAIR: When you are making these assumptions does WorkCover give you the bill or the list of objectives it has to achieve in the bill? What are you working off, a sheet of paper that lists a number of propositions?

Mr FINNIS: During the process in building up the bill we do not get the bill itself; we get what WorkCover thinks will be important issues in the bill and we are asked to cost those individual issues. As soon as the bill is finalised we are asked to look at the bill to see whether it agrees with the way we have costed WorkCover's interpretation of it. If there are changes we let WorkCover know as soon as we can.

The Hon. GREG PEARCE: To be clear, you are saying that the savings from the first bill, if it had been implemented, reasonably would have been $200 million to $210 million? That is what was to be expected?

Mr FINNIS: One expectation, yes.

The Hon. GREG PEARCE: For the second bill your best ability to say anything is from zero to where?

Mr FINNIS: Zero to around $114 million, depending on how much—this is going back to my original answer to—

The Hon. MICHAEL GALLACHER: I was just going to ask: Why is it that you can now answer this and you could not answer it earlier?

Mr FINNIS: I still cannot. That is my point. This is still an unfinished feature. Sheehan asked the same question as you did. He said, "What can you tell me now?" I did the same thing with him. I said, "I will give you this table but I need to explain it to you." Once we had been through that, hopefully it was understood what the current position was.

The Hon. GREG PEARCE: But is not your real opinion that there are not any savings at all in it? You estimate out for weekly payments to a worker who has lost his big toe in 40 years time. You can work that out but you do not put a single dollar in your report for these savings, not one dollar notwithstanding you are projecting out years and years and years? You tell us that in June 2006 you expect the total liabilities of $13.176 billion. You have got that poor worker in there with his lost toe 40 years out but you do not have a single dollar in there for savings.

Mr FINNIS: You are talking about the 30 June valuation report?

The Hon. GREG PEARCE: Yes.

[4] refers to the "Targets Mainly Achieved" option - ie the option proposed by WorkCover ~ *Dave Finnis, 30 November 2001.*

Mr FINNIS: The Amendment had not been passed. Therefore we did not allow for that in our valuation report, because we were not sure what the Act was going to—

The Hon. GREG PEARCE: So we will see it in the next report?

Mr FINNIS: Yes, providing things are finalised in other respects.

The Hon. MICHAEL GALLACHER: On the common law aspect—I would hope that the common law aspect would be the most fresh in your mind in terms of current reforms that have been proposed, and I will draw a distinction between common law and the commutation aspect—on that aspect alone, if it were to go through as the Government's draft legislation unamended, what sort of savings can we look at on the scheme?

Mr FINNIS: The Government's current draft legislation?

The Hon. MICHAEL GALLACHER: Yes.

Mr FINNIS: So you are talking about the bill as drafted at the moment?

The Hon. MICHAEL GALLACHER: Yes, if it goes through unamended.

Mr FINNIS: So we are talking about a restriction of common law to—

The Hon. MICHAEL GALLACHER: Bring it down to 20 per cent of gross impairment.

Mr FINNIS: Twenty per cent impairment but it has been restricted to economic loss only. The alternative gateway to common law is being closed.

The Hon. MICHAEL GALLACHER: Yes.

Mr FINNIS: I think that agrees with my understanding of the current position. Again, I would prefer to confirm with WorkCover that there have been no changes from the draft I have seen recently.

The Hon. MICHAEL GALLACHER: There do not appear to have been.

CHAIR: It is better for you to base your answer on what you believe those changes are and for you to state what you think the changes are just in case there is a difference in the actual bill.

Mr FINNIS: Yes. You mentioned the 20 per cent whole of person impairment threshold. The election provision will be repealed, as I understand it. Economic loss only we have mentioned. Everything else does not relate to common law specifically. Okay, we have put a costing on that. Again, it is not easy to strip all that out of the other changes but at a broad estimate at this stage I know we are saying something to WorkCover, if I can find the right sheet of paper just to confirm that. Yes, we are basically saying that the effect of those changes will be approximately a saving of between $100 and $125 million per annum on a cash-low basis. The way we have costed it at the moment is going forward on a settlement year.

The Hon. MICHAEL GALLACHER: And currently the scheme is losing a billion dollars a year as we calculated before lunch, on $3 million a day. If we look at $100 million to $130 million there, with what you have before you in terms of the legislative framework that has been passed and what has been proposed with commutations, can the Government's reform strip back that other $900 to at least bring it back to a level of stability? I simply cannot see where the Government can pull another $900 million out of the reforms that have gone through on top of that $100 million for common law to at least stop the flow into the unfunded liability. Your views please, Mr Finnis?

Mr FINNIS: Based on our estimate at the moment, it would be difficult to see. Focusing on those changes alone, it would be difficult to see how they could have a significant effect on the deficit within a short period of time.

The Hon. MICHAEL GALLACHER: The next question follows on: What then do we have to do to the scheme to fix it and get it right so that we can stop that $3 billion deficit getting bigger?

Mr FINNIS: It is a reasonable question. 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.

The Hon. MICHAEL GALLACHER: Have you looked at fraud in the scheme?

Mr FINNIS: Not specifically, no.

CHAIR: It seems that the aim is to stop the deficit increasing. We cannot get rid of the deficit and it may not even stop the total deficit increasing. Adding all the figures you have given, it would be $500 million over a 12 month period?

Mr COHEN: Between June and December it is about $250 million but it is about $500 million per year average over the next five years.

CHAIR: That is the increase in the deficit?

Mr FINNIS: The increase in the deficit per year is $500 million.

CHAIR: Is the aim to try to get the savings to $500 million? Are we getting close to it?

Mr FINNIS: Not from what I have seen at the moment.

The Hon. MICHAEL GALLACHER: We are not getting close?

Mr FINNIS: No.

CHAIR: So the total with the new bill would be $300 million? What figure would you put on it?

The Hon. GREG PEARCE: It is zero to $100 million.

CHAIR: I am asking about all the savings.

Mr FINNIS: I think that the question I was asked before was what was my best estimate. As I mentioned before, there is this range of potential outcomes. If you do achieve all the targets then obviously the savings will be greater. There certainly is a potential for savings to be greater than the $200 million per annum that we have costed based on the description I based my answer on earlier.

CHAIR: On the earlier bills and on the new proposed bill?

Mr FINNIS: Correct. The combination of all the reforms as we understand it.

The Hon. GREG PEARCE: Can you explain the $290 million for claims handling expenses to 31 December?

Mr FINNIS: It is the cost of paying the insurers to manage the claims.

The Hon. GREG PEARCE: Do they not get that out of the premiums?

Mr FINNIS: That is the way it is collected but in terms of the balance sheet, if you like, you have to allow for the future cost of settling claims. The accounting standard is to do that with the claim liabilities.

The Hon. GREG PEARCE: But you did not include future premiums.

Mr FINNIS: Again, the balance sheet allows for the unearned premiums, if that is what you are talking about.

The Hon. GREG PEARCE: Yes.

Mr FINNIS: That is the premium that is in there to account for the risk over the remainder of the year of cover. That is in the balance sheet. As I said, it is a balance between assets and liabilities—an appropriate balance.

The Hon. GREG PEARCE: Could you explain the impact on these calculations and your report that the 1998 legislation has and the intention to move to private underwriting? I notice in the notes to WorkCover's last annual report it says that it is assumed that there will be a move to private underwriting. It has been deferred, but once that happens the scheme will go into rundown mode, and there is provision for a levy on employers if at the end of the day there is a deficit.

Mr FINNIS: I am not sure that our report refers to that levy.

The Hon. GREG PEARCE: No, your report does not, it was in the WorkCover report. What impact, if any, does that have on your calculations and your report?

Mr FINNIS: Firstly, during our valuation the report basically makes no such allowance. We are now assuming, effectively, that there will be no move to private underwriting.

The Hon. GREG PEARCE: When you did your June valuation, you were assuming that there would be private underwriting?

Mr FINNIS: That is correct. In the December valuation we were basically trying to make allowance for some stage in the future when there would be an outstanding liability that would not be covered by the current fee system. Effectively, the way that the claim handling liability is worked out is by looking at what insurers are being paid at the moment under the current agreement. In the future, if that agreement effectively stops, which it would do if there were a move to private underwriting, you would need to make some allowance. That is what the adjustment was for, but there is no attempt to add to or change the liability as a result of a move to private underwriting.

The Hon. GREG PEARCE: Referring to the annual cash flow, you report that the break-even premium rate is much higher than what has been charged by the Government. You reported 3.13 per cent of the break-even premium rate, while premiums have been set at 2.8. I think they are collected at about 2.75 per cent. How does the scheme manage to increase assets every year when it is not charging enough to cover costs?

Mr FINNIS: That is related to the delay in the process. Basically an employer will pay a premium; while WorkCover is managing that premium, using insurers as its agents, there will be a return on the premium. The claim payments may not occur until many years down the track. Of course, you can extrapolate that into growing the liability year on year.

The Hon. GREG PEARCE: Which is what we have here?

Mr FINNIS: That is right.

The Hon. GREG PEARCE: What happens to the investment income?

Mr FINNIS: The investment income, per se, stays in the fund. When the fund is needed to pay claims there will be a reduction to the fund as a result of that payment. Because you are effectively growing your exposure over a period, those assets will still keep growing despite the fact that your year-on-year premiums are inadequate. It is difficult to explain.

Mr COHEN: You have $6 billion of assets.

The Hon. GREG PEARCE: $6.4 billion.

Mr COHEN: $6.4 billion, growing at a certain percentage.

The Hon. GREG PEARCE: $523 million a year.

Mr COHEN: Okay, and you have claims going out and premiums coming in. If the gap is less than $523 million, very simplistically you can still have your asset base growing while claims costs for the current policy exceeded the premiums coming in.

Mr FINNIS: The reason that that is happening is that the claims are in respect of premiums that were paid a couple of years ago. Premiums are coming in, you are not really comparing like would like.

The Hon. GREG PEARCE: Effectively the income being earned on the investments of the fund is being used to subsidise the underpayment of premiums.

Mr FINNIS: Yes.

The Hon. GREG PEARCE: And that is why in this situation of no crisis, WorkCover has been able to sit around and not deal with those issues.

Mr FINNIS: No immediate crisis.

CHAIR: Regarding the premium discount scheme, have you undertaken any costings of the impact of the premium discount scheme?

Mr FINNIS: We did, yes.

CHAIR: What cost savings did you estimate?

Mr FINNIS: We did those costings earlier this year, I cannot recall.

CHAIR: I ask you to take that question on notice and send a report to the Committee on the cost savings and reductions in the premium pool that you estimated, and on what basis did you make that estimation.

Mr FINNIS: Certainly. I suggest that the report we produced for WorkCover might be useful to the Committee. It basically answers your questions.

CHAIR: You undertake to send a copy of that report to the Committee?

Mr FINNIS: Yes.

The Hon. MICHAEL GALLACHER: Would the director be happy for the Committee to send any outstanding questions on notice?

Mr FINNIS: Certainly. It has been refreshing to have an active analysis of our report.

CHAIR: I ask all Committee members to furnish any additional questions to supply them to the secretariat by 5.00 p.m. tomorrow.

(The witnesses withdrew)

GARRY JOHN MOORE, General Manager, Commercial, NRMA Insurance Ltd, 170 St Georges Terrace, Perth, and

DOUGLAS ROY ANTHONY PEARCE, Chief General Manager, Commercial Insurance and Financial Services, NRMA Insurance Ltd, 388 George Street, Sydney, sworn and examined:

CHAIR: In what capacity do you each appear before the Committee?

Mr MOORE: As an officer of NRMA Insurance.

Mr PEARCE: As an officer of NRMA Insurance.

CHAIR: Are you conversant with the terms of reference of this inquiry?

Mr PEARCE: Yes, I am.

Mr MOORE: Yes, I am.

CHAIR: If either of you should at any stage consider your evidence that in the public interest certain evidence or documents you may wish to present should be heard or seen only by the Committee, the Committee would be willing to accede to your request. Do either of you wish to make an opening statement?

Mr PEARCE: We have provided a submission to the Committee, which makes it clear that a key position of NRMA Insurance in the statutory scheme has been one of proper financial management and to achieve the results of proper social outcome for the beneficiaries of the scheme. That is our primary position; a balance between those two tends to be competing objectives.

CHAIR: In your submission you stated that the current scheme design is fundamentally flawed. Could you explain that?

Mr PEARCE: 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. The flaws that we have seen are several. Firstly, the scheme is not fully funded. The premiums do not need liabilities as they occur on an ongoing basis. We see that as one of the major financial weaknesses of the scheme, giving rise to the deficit. The result of that is that the scheme lacks the financial discipline that it requires to keep it under control. Secondly, damages are not limited for the less serious injuries. If they were, that would ensure that the major benefits of the schemes go for the intended purpose, that is those most seriously injured.

Thirdly, 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. Fourthly—and this has been corrected—is that in the past there has been no objective framework for measurement of impairment and injury. Fifthly, there has been a drain by service providers with incomplete regulation, and that is still the case.

CHAIR: Other than the changes that the Government has made and plans made to common law and commutations, what other changes do you suggest be made to the scheme to rectify the flaws? For the record, you might state the percentage of WorkCover that you insure through NRMA.

Mr PEARCE: Through the acquisition of the HIH workers compensation business in March this year, we are responsible for about 13 per cent of premiums for New South Wales, which represents about 7 per cent of policies. Primarily we insure large employers. In the past that has been significantly higher, historically around 25 per cent. We are the largest workers compensation insurer nationally, particularly when the risk stakes are considered. We have by far the largest stake in the Western Australian scheme.

Our major recommendations are outlined fairly well in the document, on the third page, that is the issues that we see as poorly defining the principles of good scheme design.. The scheme could be fully funded with stable, predictable performance. Premiums which are affordable, full or close to full indemnity for economic loss; persons who suffer significant injury; limiting of damages for serious injuries; ensuring the benefits are applied for the purpose of individual assessment within the objective framework with minimal need for external intervention by

courts for tribunals; minimising the drain on service providers on the funds available for payments; and a framework which ensures only those who are properly entitled to receive benefits to receive them.

They are basically the outcomes. 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.

CHAIR: So you would like to keep that option open to insurers?

Mr PEARCE: In a more refined way. I think a study needs to be done into it to determine how they work best. We do appreciate the argument that they are being overused, but in certain instances we think they are a good method of finalising a claim.

CHAIR: If they are being overused, where is that being driven from?

Mr PEARCE: It is being driven, I would say, from the behaviour of insurers, that is, ourselves. Our behaviour—and many of the other questions come back to this answer—is driven by the incentive scheme that is currently in place. Incentive schemes, in commercial arrangement, are primarily for defining the basis of the performance of the people who receive those incentives. At the moment, the incentive scheme is so structured that it encourages insurers to commute and finalise claims.

CHAIR: So that increases your financial return?

Mr PEARCE: Yes. In fact it reduces costs.

The Hon. MICHAEL GALLACHER: Mr Pearce, I am interested to know why, in light of the fact that the State Government on two previous occasions has put on hold plans to privately underwrite the scheme, the NRMA has continued to push quite strongly to get into the market. Obviously, you feel there is still an opportunity there. I recognise the very strong case you have put in your paper for a privately underwritten scheme. If you are aware, for how many years was the NRMA desirous of getting into the workers compensation market, and what was the stumbling block to the NRMA getting into that market?

Mr PEARCE: Traditionally, NRMA Insurance has been a personal lines insurer. We sell car insurance, home insurance and CTP insurance. It has only been through the acquisition of the SGIO and SGIC group that we became involved in workers compensation.

The Hon. MICHAEL GALLACHER: When was that?

Mr PEARCE: In December 1998. The SGIO had been the leading workers compensation insurer in Western Australia and a major commercial insurer. It was a strategic decision to move into commercial business, to diversify our portfolios. We commenced writing commercial business in New South Wales, and it was a natural complement to be writing workers compensation. So we applied for a licence in our own right. Since then, through the acquisition of the HIH workers compensation business, we have gone to be the leading workers compensation insurer in the country.

The Hon. MICHAEL GALLACHER: What would a privately underwritten scheme mean for NRMA business insurance holders? What sort of benefits could you give them in a privately underwritten scheme?

Mr PEARCE: As NRMA policyholders?

The Hon. MICHAEL GALLACHER: Yes, as policyholders.

Mr PEARCE: Policyholders being employers, we would give them all of the benefits and experience that we have in compensation insurance.

The Hon. MICHAEL GALLACHER: What about no-claim bonuses and all those types of benefits?

Mr PEARCE: Specific policy benefits depend entirely on what we are able to do under the privately underwritten scheme itself. Garry may like to comment about Western Australia.

Mr MOORE: Indeed. 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 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.

Mr PEARCE: Technically, those policies are known as burning cost policies. The costs, on a year-by-year basis, are factored into their ongoing premiums, and they are contractually bound.

The Hon. MICHAEL GALLACHER: Some of the concerns of many who are opposed to a privately underwritten scheme relate to insurance companies refusing to take on bad risks or poor performers, with those people floating around until a point in time when they cannot get insurance. I am keen to know what the NRMA's view would be on addressing that issue, in light of what happens in Western Australia. Also, what other proposition would the NRMA be prepared to consider to provide the safeguard necessary to ensure that both workers and employers under a privately underwritten scheme would not be thrown to the wolves but would have some protection, such that employers have some right of redress and, equally, employees who want assistance from the scheme will not find themselves up against the wall all the time?

Mr MOORE: It is probably worth using the Western Australian system as an example here. Under the legislation an insurer cannot refuse to write a workers compensation policy. So all employers are guaranteed cover. But then it is a question of determining the premium bearing in mind the risk.

The Hon. MICHAEL GALLACHER: You could determine the risk to be absolutely anything.

Mr MOORE: Recommended rates are set, and they have a profit margin built into them. So you can control the overall size of the premium pool and, in the long term, the amount of profitability to be gained by insurers if the scheme operates in accordance with the expected claims costs. In looking at an individual employer, insurers are able to load those recommended rates by up to 100 per cent to take into account the experience of the individual employer. Therefore a very poor employer may have a premium loading that can be up to double the recommended rate.

An insurer who wishes to charge more than that would need to apply to WorkCover Western Australia to get permission to charge more. There is a protection provided for employers whose premiums are outside the 100 per cent loading to have an appeal process to make sure that the premium is not unfairly applied in that employer's particular circumstances. That provides, firstly, protection for the employer, who is guaranteed cover, and, secondly, an overall appeal process in regard to the amount of the premium that is levied in a particular case.

Mr PEARCE: Importantly, a rate much closer to the true risk rate is charged to the employer. So that employers who perform particularly badly in safety and back-to-work injury management pay the financial penalties that go with that sort of behaviour. Traditionally, the SGIO has operated in the mining segment, which people say presents a terrible risk. That is not our experience at all. Many employers, particularly in the mining industry, have really taken up occupational health and safety as a major issue. When it is done properly, no matter what the industry is, the risk can be reduced significantly. But it is the cost of workers compensation that has driven them to that.

The Hon. MICHAEL GALLACHER: Has the NRMA considered the issue of fraud or exaggeration of claims? We hear a lot from the Government about compliance by employers but we do not hear a great deal about compliance by employees. If we are to effect a cultural change in workers compensation, there needs to be compliance by all parties within the scheme. Does the NRMA have a view in relation to fraud?

Mr MOORE: I must admit that I do not think there is a great fraud issue involved in workers' claims.

The Hon. MICHAEL GALLACHER: Are you drawing a distinction between fraud and exaggeration?

Mr MOORE: I am. And even exaggeration is almost a behavioural aspect that has developed in the scheme. In the behaviour of looking to gain access to a lump sum, or trying to achieve a certain threshold test, or whatever., a certain behaviour is developed by workers within the scheme. In some cases there may be a deliberate attempt. But

in the majority of cases, in our experience, the same issues apply under the Western Australian scheme which are fundamental to what I am talking about. It is just the way in which the whole aspect of the scheme encourages or allows development of the behaviour that creates the exaggeration.

Mr PEARCE: I might add to that. The experience is very similar in the CTP scheme. As has been explained to me by a few doctors and so on, it is specifically known as the abnormal illness syndrome. As I understand it, if you are told often enough and loud enough that you are ill, strangely enough you begin to believe it and behave accordingly. My belief is that that is the direct outcome of the very adversarial approach that can, and it is, taken with this type of insurance.

The Hon. MICHAEL GALLACHER: Would the NRMA have a view in relation to the seven-day provision under the second tranche of reform legislation that went through?

Mr MOORE: We are a very strong supporter of as early as, if not earlier than, seven days. Same-day notification is the ideal. As an example of that, under a different compensation system again, as we understand it—and we analyse all schemes around the country—one of the great strengths of the Victorian TAC scheme is in fact the notification process, or discovery process, for injuries that they have in place whereby they have very strong links with the hospitals and are able to track people as they arrive at hospital as a result of motor accidents—on the same day. That is hugely successful.

The Hon. MICHAEL GALLACHER: Some employers have raised concerns that the seven-day notification period may lead to employees expanding the period they have off work to the full duration of that seven days. There is concern that a significant number of people would take the full complement of seven days. I note that you just mentioned 24-hour notification, so obviously it is the view of the NRMA may that it should be a 24-hour period.

Mr PEARCE: For many reasons, but particularly for soft-tissue injury, the earlier the notification the better.

The Hon. MICHAEL GALLACHER: Am I right in assuming therefore that you would like to see the seven-day period cut down to 24 hours?

Mr PEARCE: Absolutely. But seven days is a vast improvement on what it is now. A think your question is whether having the seven-day provision will encourage people who would normally be off work for two or three days to stay off work for the full seven days.

Mr MOORE: I think it has that potential. If you think about what behavioural effect that might have, you will see it has that potential.

CHAIR: Mr Moore, you spoke about premiums in Western Australia. What is the average premium? What is the range of premiums?

Mr MOORE: The average premium is currently around about 2.7 per cent in Western Australia.

The Hon. MICHAEL GALLACHER: What are the benefits like in comparison with those available in New South Wales?

Mr MOORE: The statutory benefits are lower.

The Hon. MICHAEL GALLACHER: Significantly lower?

Mr MOORE: There is a prescribed amount available for loss of earnings and table of maims coverage. That, currently, is around about $126,000. After that there is greater access to common law—and this is where you get back to the balance—in that if you have a whole-of-body disability greater than 16 for cent you can access common law. There is an election process involved there. In accessing common law you come out of the statutory system and you are subject to a $250,000 cap in regard to the common law aspect. If your disability is 30 per cent or greater than whole-of-body disability, then you have unlimited access to common law. There is no cap.

The Hon. MICHAEL GALLACHER: What is the financial status of the scheme in Western Australia?

Mr MOORE: The financial status is that it is stable currently and fully funded.

CHAIR: Mr Pearce, in your submission—and this question probably relates to Mr Moore too—you stated:

> The fundamental difference between New South Wales and Western Australia is the commercial discipline provided by private underwriting to the task of scheme regulation and administration.

That implies that New South Wales insurers do not apply commercial discipline, or certainly not as effectively as Western Australia. Is that a correct interpretation?

Mr PEARCE: I think the insurers who operate in New South Wales 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, with the remuneration method it is not alive to the minimisation of liability or the reduction of the deficit in the State of New South Wales. It is that problem.

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 New South Wales, but even that is not clear. If it ever actually came to it there would be very interesting litigation over the matter.

CHAIR: In your submission you stated that Western Australia did have problems in the late 1990s and there were losses, and they were borne by the insurer, I suppose because it is private underwriting?

Mr MOORE: 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—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.

Mr PEARCE: With that deficit, there is not a financial impact on the Government or the State in that the deficit does not sit on the Government's balance sheet, so there is no impact on the State's credit rating. If this is the way it is, it will come to a head and it will come to a head the day a large employer in New South Wales is forced by its auditor to bring to account the liability on to its balance sheet. When that happens, it will happen with one company and within a month it will happen right across New South Wales.

CHAIR: You speak about the premiums as if Western Australia has worked out a perfect system. New South Wales has roughly the same level of premium. So, are you suggesting even though yours is 2.7 per cent, that New South Wales should be three?

Mr MOORE: I think 3.1 per cent or 3.2 per cent 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 State scheme's benchmark, if you like. If you say it is 2.5 per cent or 2.7 per cent, whatever it is, you then work backwards to see what are the costs that are going to drive a 2.5 per cent or 2.7 per cent rate. At the moment the theory is that it should be 2.7 per cent but the costs are at 3.1 per cent or 3.2 per cent, so the gap has to be addressed.

Mr PEARCE: I should add that the profile of Western Australian employers is much different to New South Wales. There is a much heavier skew towards the mining industry and industrial.

Mr MOORE: That is a valid comment, remembering the different benefit scale, too, within the two systems. When you have a heavier industry, the potential across the whole industry classifications influences the rate and you also have lower statutory costs. So all that causes the comparison that you like demonstrating.

The Hon. MICHAEL GALLACHER: The election of the Australian and New Zealand Standard Industries Classification[ANZSIC] scales—

Mr PEARCE: Yes, a good move.

The Hon. MICHAEL GALLACHER: You say it is a good move but it still has not arrested this issue of the distinction between inputs and outputs in relation to the scheme. Income is still not keeping pace, even though you have fluctuations—50 per cent have gone down and 50 per cent have gone up, approximately.

Mr MOORE: You would hope that it would address cost subsidisation between the industries by moving to ANZSIC.

Mr PEARCE: ANZSIC is aimed at the cross-subsidisation issue. It has not addressed the mean price, the average price, and the total amount of premium paid. In the end, something has to give. Either premiums have to go up or the amount of money paid out of the scheme has to go down.

The Hon. MICHAEL GALLACHER: I would not like to be the brave broker who has to ring some of the people who have brought to our attention these massive escalations in the premiums as a result of ANZSIC, who are sitting there nearly dying opening these envelopes, to tell them that they still have not gone far enough, that they have to go further.

Mr MOORE: You do need a transition. It took Western Australia about two or three years.

The Hon. Dr PETER WONG: Are you suggesting then that the Government has a duty to assign who owns that deficit as from now? Is it not the Government's duty to accept what it is at the moment?

Mr PEARCE: I am not sure if the only pragmatic answer to that is to put the deficit onto the State's balance sheet. I am not sure that that is immediately in the State's interest.

The Hon. Dr PETER WONG: I am not saying it is the employers, the State Government or the insurance companies perhaps?

Mr PEARCE: What, some form of tax?

The Hon. Dr PETER WONG: Who owns the liability at the moment? You are suggesting nobody.

Mr PEARCE: As I understand it, it is collectively owned by the employers of New South Wales. When it is recognised you almost have an intergenerational transfer as this deficit is inherited by whoever happens to be standing.

The Hon. Dr PETER WONG: Are you suggesting also that without some kind of reform within the WorkCover Authority and its non-monitoring system, there is no solution to New South Wales' problem?

Mr PEARCE: Absolutely. WorkCover, as I understand it, does what the legislation asks it to do. Employers do what they are asked to do by the remuneration system. The problem is no-one has accountability or responsibility for the financial management of the scheme. Having recently tried to look into and understand how this scheme came about, and our own role, I understand it to be that basically we had an underwritten scheme that was then changed to one where the Government did not become the underwriter, insurers were no longer underwriters but acted and were regulated as if they were. So, you took away all of these financial imperatives and all the financial accountability on the one hand but it was not replaced with any regulation or contractual arrangement between it and WorkCover or the owner of the scheme.

The Hon. Dr PETER WONG: Who do you suggest should be the manager of this scheme?

Mr PEARCE: In its current form I suggest it should be WorkCover. I do not see who else it could be.

CHAIR: What more should WorkCover do, then? We agree with you that it should be responsible. What should it do?

Mr PEARCE: It is more than what it should do. It should be given clear financial accountability for it. It is no good just saying go off and do that, unless it is charged with doing something. That means changing the Act so it has an objective that is clear to do everything in its power to financially control this scheme.

CHAIR: So, it almost becomes the de facto insurer, WorkCover?

Mr PEARCE: Well, manager. As an example, the Motor Accidents Authority has specific objectives about the financial management of the compulsory third party scheme. That is a privately underwritten scheme. It has duties to ensure it is fully funded and that the premiums collected are in balance with the costs and, if not, to be making recommendations to Parliament to fix it.

CHAIR: Say we did make it responsible, what should WorkCover do? What more responsibility should it have? It would then be controlling you, the insurer, would it not?

Mr PEARCE: Yes, and that is the relationship they have.

CHAIR: In other words, you are suggesting that WorkCover should be wearing this scheme as a business, applying commercial disciplines in its endeavours. What should it do to ensure that?

Mr PEARCE: It should be monitoring of the financial performance of the scheme, the guidelines and minimum performance, the requirements of the insurers and, for that matter, all of the stakeholders in the scheme and monitoring that performance.

The Hon. Dr PETER WONG: Obviously increasing premiums is totally unpalatable for any government. Would it be better as one alternative for the WorkCover authority to be a WorkCover commission, for argument's sake, to be independent and therefore can manage and impose a rising premium, and therefore is away from politics?

Mr PEARCE: If that separation could be achieved, yes, it would be easier in the end if it is a State-run scheme. I cannot see how you can establish a commission that is that independent. If that commission then had financial accountability, you are actively setting up a government-sponsored monopoly, I would think, into the scheme.

Mr MOORE: Which is insolvent.

Mr PEARCE: If you establish an independent commission, clearly the Government has control over it, if only through the legislative process. So, in the end it has power to appoint, if only indirectly.

CHAIR: The commissioners.

Mr PEARCE: You are sort of re-establishing a government insurer.

Mr MOORE: That is what you would be doing.

Mr PEARCE: That is effectively where you would end up, because if it had financial responsibility and accountability, given the direct link, you have brought the deficit onto the balance sheet.

The Hon. Dr PETER WONG: Alternatively, are you saying that the whole thing should be privatised? Is that what you are suggesting?

Mr PEARCE: That is our position. We are very clear on that. We believe that should be the case right across Australia.

Mr MOORE: That reduces the liability going forward. It does not address the deficit.

The Hon. MICHAEL GALLACHER: Mr Pearce, I am an employer and I have a concern, and I am raising an issue I have raised on a number of occasions. I ring the NRMA because I believe I am having a fraudulent

claim committed upon me so far as workers compensation is concerned. What does the NRMA do once one of its customers reports a fraud? Do you investigate it?

Mr PEARCE: Absolutely. Under the current scheme fraud is the responsibility of WorkCover. We have just struck an agreement with WorkCover that our statutory classes fraud investigation unit can work as an investigation agent for WorkCover and we can use it to do that kind of investigation. In Western Australia we would use our investigators to investigate that fraud.

Mr MOORE: Fraud allegations.

Mr PEARCE: It is very much our approach and policy that if we were able to build a case we will hand it over to the police.

The Hon. MICHAEL GALLACHER: Do you think it is a fair observation that successive governments have not been really serious about fraud in the scheme in New South Wales?

Mr PEARCE: Again, my involvement has not been long enough to give a fair assessment.

The Hon. MICHAEL GALLACHER: What about this government?

Mr PEARCE: Again, our involvement in New South Wales until March this year has been very, very small.

Mr MOORE: It is behavioural fraud, though, in my opinion. I did not know the ins and outs of the whole system but just knowing how statutory systems work, it is behavioural fraud as distinct from other types of fraud. Yes, I am sure there are examples where it is blatant fraud where a person has not been injured, or whatever it might be.

The Hon. MICHAEL GALLACHER: One of the biggest issues facing employers who are paying their premiums is the feeling that nothing gets done to investigate the fraud issue properly and very, very rarely do we ever hear of any criminal convictions being brought forward. If we are going to bring about cultural changes, I think we have to be serious about looking at both sides of the ledger. I would like to think that if we are going to privately underwrite the scheme, that would be examined. It is something that has been raised with me. If you go down the path of a privately underwritten scheme, insurers will say, "Look, it is going to cost us X dollars to investigate this. It affects the bottom line and it is much cheaper to try to resolve it more quickly rather than actually pouring money into an investigation."

Mr PEARCE: That is an argument that is put forward but that is definitely not our experience. I can draw on CTP which is not so different. We actively pursue those matters. It is very difficult to get convictions but we get a couple a year. In the past we have been a victim of organised crime in this area, particularly in the ACT scheme in the mid-1980s. We were fighting, as were the GIO down there, or going up against the Trimbolis and other people involved in the Griffith drug scene. That was a major fight and we were very successful in that. We have exactly the same issues in our comprehensive motor vehicle portfolio with car insurance fraud and we actively pursue it. It is the stated policy of our company that you have got to deter it and you have got to pursue it. You cannot be complicit about fraud. If we are complicit about fraud, we are actually part of the problem.

CHAIR: We are running out of time, but I wonder whether you could give us some comments on the new agent remuneration scheme. What impact you believe that will have on the function of the scheme and even the deficit? Do you believe the insurers will receive sufficient remuneration? We gather that you were part of the discussions in agreeing to it. There were some joint meetings.

Mr PEARCE: Overall, we support the new remuneration system. We have gone from basically a 70 per cent flat fee to a 30 per cent performance fee to a 55 base and 45 performance. Performance criteria are harder. However, overall, there is more money on the table so we are striving to achieve at least a 90 per cent performance, so we expect to make 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 claims cost. The big issue is whether they will work, but they are definitely a step in the right direction. There are some issues that are not finalised, though. The whole adversarial nature of those schemes is key. 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 scheme.

CHAIR: So you would favour, then, this new system of reconciliation?

Mr PEARCE: Yes, absolutely.

CHAIR: And trying to avoid being in court?

Mr PEARCE: Absolutely—a key advocate of that.

The Hon. GREG PEARCE: Have you seen the draft bill that the Hon. John Della Bosca proposes to introduce on 27 November?

Mr PEARCE: No, we have not.

The Hon. GREG PEARCE: Are you aware that in it he proposes to abolish the option of private underwriting?

Mr PEARCE: Yes.

The Hon. GREG PEARCE: What would you say to that? If you would like a copy, I am sure you should just ring the Labor Council and they will send it.

Mr PEARCE: We think that is, I suppose, a retrograde step. However, the provision that allowed private underwriting has been totally ineffective and, as I see it, it will be just as easy to put it back as it is easy to take it out.

The Hon. GREG PEARCE: You have not dealt with the crossbenchers. What company actually holds your licence?

Mr PEARCE: It is NRMA workers compensation No. 2—No. 1 and No. 2. The reason we have two is that we have a licence in our own right as NRMA which we applied for about three years ago and when we bought HIH workers comp, we bought its workers comp company and the name of the company is workers comp No. 2. I think we are trying to get rid of workers compensation No. 1 but until you get rid of all the claims, you cannot get rid of it.

The Hon. MICHAEL GALLACHER: Through you, Mr Chairman: would Mr Pearce be agreeable to any further questions being put on notice and forwarded through the Chairman to him?

Mr PEARCE: Absolutely.

The Hon. JANELLE SAFFIN: I have a question to do with the adversarial issue. Do you have any comments to make about what you are doing as insurers to try to reduce or change the adversarial situation? It is not just legislation alone that makes an adversarial situation—I am sure you know that—and there would be some policy things that you could do, instead of just waiting for legislative changes to make a less adversarial system. Are you doing anything in regard to that?

Mr PEARCE: We are. I suppose that part of it has been in preparation for the new remuneration but part of it is also when we saw how workers comp worked compared with our own CTP claims operation. I should say up-front that we manage the two as a single unit because there is 70 per cent to 80 per cent in common and we focus on the commonality rather than on the difference. The old HIH claims operation did not have much of a focus on rehabilitation. We have corrected that. They had about two permanent staff whereas for our CTP business, which is around about the same number of claims handlers, we have about 12. We have increased that to 12 and the reason for that is a little bit indirect but it goes right to the heart. It is all about early intervention. We have been running a strategy of early intervention into claims management, getting rehab people in there and basically trying to get people fixed up and back to work. That approach goes right to that.

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. That is really what the fight is all about. It is actually then a negotiated settlement or finalising of the matter. Yes, we actively in all our other lines of business and particularly in CTP conference with the plaintiffs' solicitors and avoid as much as we can going to courts unless, of course, it is I suppose a sort of a test case type of issue or it is a real issue at law that needs to be decided by a court.

The Hon. JANELLE SAFFIN: But there would not be a lot of that. There are very few cases that fit into that category.

Mr PEARCE: Like one in 2,000.

The Hon. JANELLE SAFFIN: I still see a lot of it, particularly country lawyers who come down here and just before they go into court they settle, and insurance companies settle. I just see that it is not just you alone but a real problem and I do not see that changing a great deal. Maybe we need to see some statistics.

Mr PEARCE: It is one of our absolute strategies in all our statutory classes to settle claims as quickly as possible. Where we are underwriting, there are key financial drivers to do that. I do not know whether the actuaries have spoken to you about superimposed inflation but the rate of inflation or the way in which these claims grow in size outstrips average weekly earnings by usually over double, so the sooner you can settle them, the sooner you reduce that effect. Conferencing and going out and actively trying to finalise them is the best way we can do it and it has been very, very successful where we are a risk carrier.

(The witnesses withdrew)

(Short adjournment)

KATHERINE MARY McKENZIE, General Manager, WorkCover Authority, 400 Kent Street, Sydney, and

RODNEY STUART McINNES, Assistant General Manager, Insurance Division of WorkCover Authority, 400 Kent Street, Sydney, on former oath:

CHAIR: Do you wish to make an opening statement?

Ms McKENZIE: No, not particularly. We made an opening statement last time and probably continue to rely on that for the general context from our point of view.

CHAIR: As you know, there are proposals for restricting common law and commutations. Is it possible that the cost of other areas of the scheme, for example weekly benefits, may show substantial increases if common law and commutations are restricted? How and to what extent has this been taken into account in your costings?

Ms McKENZIE: It has been taken into account in our costings. I think we acknowledge that there may be some increase in weekly benefits if common law and commutations are restricted. 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.

CHAIR: In its 8 October report on commutations, PWC stated that the removal of access to commutations on its own will not rid the scheme of its continuance problem, particularly for the tail of long-term claims. Why restrict common law and commutations if that will not reduce the cost of the scheme to a sustainable level?

Ms McKENZIE: We believe it will reduce the cost of the scheme. Going back to what we said last time we appeared before the Committee, this is 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.

CHAIR: We have been hearing today even from insurers that sometimes commutations can have benefits for WorkCover from an economic point.

Ms McKENZIE: Yes, I think that is true.

CHAIR: Would you agree with that?

Ms McKENZIE: Yes. The difficulty is designing a regime that ensures that commutations are only used in appropriate circumstances and not in inappropriate circumstances. Certainly, from the research work that PWC did, which I think the Committee has available to it, it appears 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. Once again, linked to the overall philosophy of trying to return the focus to return to work and better injury management, we feel that abolition of commutations is the best available option at the moment.

CHAIR: Would it not be better just to have restrictions on that, rather than abolition?

Ms McKENZIE: The difficulty with restrictions is coming up with a simple, clear way of restricting commutations that is self-enforcing to the maximum extent possible. In preparing for this, we looked at a whole range of options in relation to different schemes, saying you can only get commutations in these circumstances or those circumstances but in the end all of them were found to be flawed because of the difficulty of trying to ensure that in the scheme generally commutations are restricted to circumstances where they may be justified. People do have other options. The whole theory of commutations is that you have an entitlement to weekly benefits that you want to take as a one-off payment rather than continue to take it as a weekly benefit. If you have a permanent impairment you still have access to lump-sum payments under sections 66 and 67. I think a lot of the evidence that suggests that the free availability of commutations is interfering with a focus on return to work and injury management because it contributes to a lump-sum culture.

The Hon. MICHAEL GALLACHER: You said you have looked at the various models that can be put in place as far as commutations are concerned and the difficulties there. Can the Committee get a look at the document that looked at that issue?

Ms McKENZIE: I am not sure whether it is written down in any nice neat way anywhere. I mean, a lot of this has been through a process of discussion with various people. We do not have something called "options paper: Commutations" here you go. I am not sure I have anything that would serve the Committee's purposes all that well in that regard.

The Hon. MICHAEL GALLACHER: That is a shame.

CHAIR: If you are making those decisions—and you support them—about common law and commutations, what are the strategies you believe WorkCover needs to develop to reduce scheme claims costs?

Ms McKENZIE: Once again I go back to the fact that we have a longer-term overall scheme overhaul that we are engaged in at the moment, and that includes a whole range of things like an increased focus on injury prevention and management and our injury management pilots that we are running, moving towards more evidence-based medicine. At the moment we are running a pilot about back injuries and trying to get the doctors to do the right thing in terms of best practice treatment. One aim of the insurer remuneration package is to try to focus the insurers on early return to work and better management of claims. We are hoping that with that range of strategies in place and reduced availability of lump sums, restricting them only to the more seriously injured, we should have an impact.

CHAIR: When do you think you will see some of that impact?

Ms McKENZIE: I guess there is a debate to be had in the Parliament on the next raft of reforms. I would not want to pre-empt that and the outcome of that. It depends on what comes out of that process.

CHAIR: So it takes six months before you begin to see some impact.

Ms McKENZIE: I think it will be at least six months before you would start to see impacts.

CHAIR: Particularly that remuneration one with the insurance companies?

Ms McKENZIE: 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 systems, particularly their information technology systems, to try to improve their management of claims. So hopefully in about that kind of timeframe we will start to be able to measure the impact of some of that.

Mr McINNES: I think the other issue there is that you are looking at long-tail liabilities that are run off over 10, 20, 30, 40 years. It is the number of long-term claims that determines your ultimate costs so it is not something you can determine after six months or even 12 months. It is something that you need to look at in the longer term. To know what the real effect is in terms of total scheme costs and sustainable scheme cost changes, we need to look at it over quite a long period.

CHAIR: If it was possible—maybe it is not—to somehow deal with some of those long-period claims retrospectively, somehow to reconsider them—

Mr McINNES: The problem is that once you get claimants on benefits beyond about 12 months they become very intractable and there are very restricted options as to what you can do with those injured workers to get them back to full employment. I suppose there are other more draconian options you can look at but certainly in terms of getting them back to work, which is your primary objective, once they have been off work for 12 months, two years, it becomes extremely difficult to get them back into the workplace.

The Hon. MICHAEL GALLACHER: The Committee was given information earlier today that the unfunded liability is growing at a rate of approximately $3 million a day, which equates to about $1 billion a year. Is that a correct figure?

Mr McINNES: I think the actuaries have projected that it will grow by something in the order of $500 million over the next 12 months. Certainly it did grow by that over the past 12 months but there is factored into that

some deterioration in claims experience and growth in common law. So for the future, assuming that nothing deteriorates further, or improves, for that matter, they are projecting $500 million.

Ms McKENZIE: We have to be wary about taking those raw numbers because the dynamics of this scheme change over time and that is why we do regular valuations to keep track of what is happening.

CHAIR: Is that $500 million with the projected changes?

Mr McINNES: No.

CHAIR: If there are no changes it would be $500 million. Hopefully, it will be what?

Mr McINNES: Significantly less than that, I guess, assuming all the reforms go through.

Ms McKENZIE: It is a bit speculative until we see what happens with the next package of reforms.

The Hon. MICHAEL GALLACHER: Ms McKenzie, you made the comment earlier that if the reform goes through it will have an impact.

Ms McKENZIE: Yes.

The Hon. MICHAEL GALLACHER: Are you confident that the reform package that has gone through to date and the next phase of the common law reforms, if it goes through unamended, together with your scheme design proposals for next year, will in fact arrest the deterioration in the scheme it to the point where it either stabilises or reverses? Are you confident that that is in fact the case?

Ms McKENZIE: Yes.

The Hon. MICHAEL GALLACHER: What did you think about the comments of your scheme actuary earlier this afternoon when he said that he did not believe that it was necessarily going to have that level of impact?

Ms McKENZIE: I have not seen the detail of what he said. I guess I would just have to say again in this context that you have to be very careful about the figures because actuaries cost on a certain basis according to their own models. They don't always take account of the things we have in mind, like culture and that kind of thing.

The Hon. MICHAEL GALLACHER: Who do you rely on to gauge the impact, in so far as the bottom line of the scheme is concerned? Is it correct to say you relay on the actuary?

Ms McKENZIE: Yes.

The Hon. MICHAEL GALLACHER: The actuary has said today he does not believe the reforms will have a significant impact on the scheme.

Mr McINNES: I do not think he said that. I think he said in his view—getting back to the point, I think he has not factored in cultural change, injury management or initiatives of the remuneration package, and the effect that might have. In practice, actuaries, by nature I suppose, are looking backwards at what has happened and projecting that forward. I think the changes actually occur—this is where there is a dilemma in this process—you need to work effectively and efficiently and, clearly, the current system needs reform.

Ms McKENZIE: It is going to be a ongoing process. There are no magic answers here. We have to fix it now.

CHAIR: I think the point we have to clarify is that there are legislative change which you can probably quantify, and then there are these internal management changes which you cannot fix until they occur.

Mr McINNES: That is right.

The Hon. MICHAEL GALLACHER: Do you accept, therefore, that if what the actuary is saying is correct, in effect you may not achieve the results that you believe could be achieved? Obviously, you are looking at

the best case scenario, trying to promote some changes. Do you agree there is a possibility of less than the best case scenario, as was put forward by the actuary?

Ms McKENZIE: Of course, there is always that possibility. The best we can do is give it our best effort as effectively as we can. I think the next year will need to be spent concentrating our efforts consolidating some of the gains we make. The better we do that, the better the outcome will be.

The Hon. MICHAEL GALLACHER: I have a question in relation to the 1 January kick-off date for the reforms. Can you tell us where we are at in relation to that? Is it guaranteed that we will be starting on 1 January?

Ms McKENZIE: That is very difficult. It depends on the parliamentary debate on the next bill. It is dependent on that. I am pretty confident we will make it.

The Hon. MICHAEL GALLACHER: Is it not the fact that your are still advertising for arbitrators until 27 November?

Ms McKENZIE: Yes.

The Hon. MICHAEL GALLACHER: You will have that finalised by 1 January.

Ms McKENZIE: You have to remember that this will be a staged implementation. We are not expecting absolute total operation on 1 January but will have a sufficient bank of people to make delivery.

CHAIR: It is a continuing process and you will employ more of these assessors.

Ms McKENZIE: Yes, as the workload increases over a period of time.

The Hon. MICHAEL GALLACHER: There seems to be a degree of uncertainty involved. I believe the Minister used the word "hopefully".

Ms McKENZIE: Once again, the biggest risk to the 1 January starting date is the passage of the legislation. If that goes smoothly, we are pretty confident that 1 January date will be delivered.

The Hon. MICHAEL GALLACHER: The Minister could have introduced it last week and it could already have started.

Ms McKENZIE: He is very keen to ensure there has been adequate consultation with all the parties.

The Hon. GREG PEARCE: Can you explain to me—we have not seen the WorkCover Annual Report for 2000-01. I do not believe it has been tabled as yet. Just looking at the 1999-2000 report, the WorkCover scheme's accounts, the following comments:

> The Government has deferred commencement … underwritten to a date to be determined … date.

It talks about a long period of time to run for the claims. It says that the legislation provides for the funding of any overall deficit by the payment of a contribution by employers as a part of future premiums. Can you explain to me how that would work? What in fact would happen to cover that sort of deficit?

Mr McINNES: There is provision in the privately underwritten pieces of the statute that allows a levy to be applied to the privately underwritten premium to fund the deficit in the run-off of the WorkCover scheme.

Ms McKENZIE: That was included in the 1998 package.

Mr McINNES: That is part of the privately underwritten provisions, basically to allow any shortfall in the statutory scheme to be paid for at some stage in the future. Again, it is all contingent on private underwriting proceeding, which it looks decidedly unlikely, at least in the short term.

The Hon. GREG PEARCE: That is what the Premier said on 20 June 2001, that all employers—large, medium and small—would pay a share of it.

Ms McKENZIE: I do not know. You would have to ask the Premier what he meant by that.

The Hon. GREG PEARCE: It is quite clear, is it not? He said, "The day will come … share of it." It is quite clear. That is what is in the notes to your—

Ms McKENZIE: It is a bit different. It was accurate at that point.

The Hon. GREG PEARCE: What does it say now?

Ms McKENZIE: The draft bill that is currently out there proposes abolishing it.

The Hon. GREG PEARCE: What will happen to the deficit?

Mr McINNES: The existing scheme will continue to operate.

Ms McKENZIE: We will continue systematically working through scheme reform, including next year looking at the scheme and working out ultimately what is the best set of arrangements. It is a staged thing.

The Hon. GREG PEARCE: Just to be clear on that. If private underwriting does not proceed, the scheme will continue to run. You will collect premiums and fund the deficit .by collecting those premiums.

Mr McINNES: 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.

The Hon. GREG PEARCE: What you are saying is that there is not actually a crisis; it is manageable; you will be able to work through it. What I am getting to, though, is that there have been suggestions that the deficit is in some way owed by employers or by the people of the State. You say that that is not the case; that you are going to have to ride it out and that you will not levy every worker or employer or anything else. Is that so?

Ms McKENZIE: Certainly not at this stage.

The Hon. Dr PETER WONG: I agree with the Hon. Greg Pearce's question. Somehow or other there is a deficit. Who owns the deficit?

Ms McKENZIE: It is owned by a statutory trust. It is a creature of the statute. It is not owned by the Government. It is run for the benefit of employers and, you know, it is a legislative construct.

The Hon. Dr PETER WONG: If, at the end of the day, there is a debt of, say, $2.73 million, who are the debtors who own this debt, as of today?

Ms McKENZIE: Of course, in practice, there is a whole range of answers to that. The size of the deficit can go up and down over time.

The Hon. Dr PETER WONG: As of today? Who owns the debt?

Ms McKENZIE: It is not a crystallised debt. There is a range of options for what you could do if down the track the same reforms do not deliver.

The Hon. Dr PETER WONG: In the case of a company debt, the company owns it. Obviously, whether you like it or not, there is a debt. You cannot just say to the Committee, "We are not even sure who owns the debt. It belongs to nobody."

Ms McKENZIE: It is a statute debt. That is the way the scheme is defined. That is the way it has been set up.

The Hon. GREG PEARCE: As the Premier said, one day, if WorkCover is unsupportable or insolvent, really the employers own the debt.

Mr McINNES: The only source of income is from premiums, but that does not mean employers should have to pay. It just simply means the source of funding for the scheme is premiums which are paid by employers.

CHAIR: At the moment, because of WorkCover's assets, it is not likely to become insolvent.

Ms McKENZIE: Yes, that is right.

The Hon. GREG PEARCE: It would be wrong to say that each person in New South Wales owed $338, or something like that?

Ms McKENZIE: I do not know if it is wrong. I suggest it is not the proper way of looking at it.

The Hon. GREG PEARCE: Well, is it or is it not? Do the people of New South Wales owe $338 each, or do they not?

Mr McINNES: There is a legal perspective, but the short answer is no, they do not.

Ms McKENZIE: Over time the scheme has to be managed in such a way that it is kept at a manageable level.

The Hon. GREG PEARCE: It would be wrong to say that to the people of New South Wales, "Each one of you owes $338 to this scheme".

Ms McKENZIE: I do not know. It is based on premiums. It is all based on risk and expertise and that kind of thing. I cannot answer a simple proposition like that with a simple answer.

The Hon. GREG PEARCE: The Premier does not think that. On 21 June 2001 that is exactly what he said.

The Hon. TONY KELLY: He did not say it was owed by them. It should be taken in context.

The Hon. GREG PEARCE: Can you give me a short outline of the experience of the WorkCover directors in relation to insurance.

Ms McKENZIE: I do not really understand the question.

The Hon. GREG PEARCE: I would like you to outline for me the experience of WorkCover directors.

Ms McKENZIE: The members of the board?

The Hon. GREG PEARCE: yes. Their experience in insurance, other than being directors of WorkCover.

Ms McKENZIE: Look, I do not know the details about everyone. You probably know the members of the board. The details of their background and experience is public knowledge. The board is chaired by Joe Riordan.

The Hon. GREG PEARCE: A former politician.

Ms McKENZIE: He has had long experience of running a department and being an industrial relations commissioner. He has had a lot of life experience. We also have Eddie Price, Doug Wright, who formerly came from one of the employer organisations. He also has a long history, background and involvement in this kind of scheme. We have the head of the Labor Council, John Robertson, Greg Keating, and we have recently appointed a new member called Donna Staunton.

The Hon. GREG PEARCE: So there is no-one on there with any real experience of the insurance industry, or funds management for that matter? I know that you did have a director who was with HIH.

Ms McKENZIE: Yes.

The Hon. MICHAEL GALLACHER: Mr McInnes, there has been a lot of talk recently about rehabilitation. We constantly hear from the Government about getting employees back to work as soon as possible.

Could you outline to the Committee the rationale behind WorkCover's decision not to accept the decision in *Harbison v Harbison*? I do not know whether you are aware of it, but I am told that it was a significant case in which the insurer, QBE, and the respondent agreed with regard to the fellow returning to work but it was refused by WorkCover.

Mr McINNES: I do not have full details of that case at my hand but if you like I will get back to you.

The Hon. MICHAEL GALLACHER: I am told that it is a significant case.

Mr McINNES: I am aware of the case but, as I said, I am on the hop, so to speak. I do not have the details in front of me. So I would prefer not to comment now and will give you a fuller response later.

The Hon. MICHAEL GALLACHER: Ms McKenzie, are you aware of the growing dissension amongst the ranks of psychologists and psychiatrists over the proposed implementation of what are commonly in referred to as the PIRS in respect of the medical guidelines? I am told that the Medical Services Committee, together with the Royal Australian and New Zealand College of Psychiatrists and the Australian Psychological Society are talking strongly about refusing to work within the confines of the recommended PIRS—and the need to re-examine how the degree of injury is determined by psychiatrists and psychologists. I have in writing that they are prepared to walk away from it. If that is the case, what sort of impact will that have?

Ms McKENZIE: It is certainly not my information that people are walking away from it. We got a letter from the College of Forensic Psychiatrists supporting the PIRS scale. 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.

The Hon. MICHAEL GALLACHER: Can you tell us what you believe is wrong in the APS guidelines as opposed to the PIRS?

Ms McKENZIE: They do not gel. The APS guidelines are based on a thing called the global assessment of functioning. The only place that we have been able to discover that actually in place is in the US, where it is used in a managed-care environment to determine whether someone receives in-patient or outpatient services. The difficulty is converting a scale that, as far as we are aware, is used only for that purpose into something that can give you a consistent percentage measurement of somebody's permanent impairment consistent with the rest of the AMA 5 regime that has been adopted and gone through quite thoroughly by a series of working parties with expert doctors on it to ensure that we come up with the best available methodology for doing this.

The Hon. MICHAEL GALLACHER: Can you tell me your knowledge of the position of the Medical Services Committee in terms of the decision?

Ms McKENZIE: I do not want to put anything wrong on the record. As I understand it, there is a lot of dissension and argument amongst different branches of the profession. I am aware that the psychologists do not like this scale. But basically we are talking about medical assessment of impairment across the board. So it is about doctors. And doctors will be doing all these impairment assessments. I guess there are less charitable interpretations that you can put on the opposition of the psychologists to this. In the end, we felt we had to recommend what looks like the fairest best fit with the whole regime that we are introducing in impairment guidelines. We are confident that PIRS represents that. I do not think that anyone would pretend that any of these guidelines are absolutely perfect. Indeed, looking around at the other jurisdictions, to the extent that they allow permanent impairment lump sum payment for psychological injury—and not everybody does—everybody has got their own different variation of this, which is a problem. Via the heads of workers comp we have approached the other jurisdictions to see if we can get joint research done on what is the best scale, what adjustments need to be made over time, and we have had quite a favourable response.

CHAIR: There should be a national scale.

Ms McKENZIE: Yes. At the moment there are all sorts of variations of ways that people can determine this. Some is more consistent than others. A number of jurisdictions have acknowledged that they have problems with their current method for doing it. So we need to get some national work going to come up with something that everyone can agree is reasonable. But I suspect that that will take years. And it is a very difficult area in which to come up with an objective and fair way of judging this. We have had to pick what we think is the best available.

CHAIR: Will you fund the research through WorkCover or do you have some way of getting the other States to contribute?

Ms McKENZIE: That is what we would be aiming to do, to share the expense of it and do it as a national exercise.

CHAIR: The Federal Government could have some involvement.

Ms McKENZIE: Both Comcare and the Tasmanian scheme are looking to adopt the PIRS scale at the moment. Early indications are that they are inclined to get involved with us in some research. We just need to tidy that up.

CHAIR: So PIRS could be the temporary national scale.

Ms McKENZIE: It could be. South Australia does not have any lump sums for psychological injuries so it probably will be less interested in participating. But hopefully we will be able to get it as close as we can to a national approach to this.

CHAIR: What do the other States have?

Ms McKENZIE: I am not an expert. They all have variations on a theme, different ways of converting different types of scales. There is a big variety of methodologies that can be used and they all have slightly different things. Beyond that I think you would have to ask the individual jurisdictions for details on exactly how they do it.

The Hon. MICHAEL GALLACHER: I have a series of detailed questions. In fairness to you, you could not answer them without substantial backup. Would you be happy if I got them to you so that you could answer them on notice?

Ms McKENZIE: Sure, more than happy. We have relied a lot on medical expertise in this area so I would want expert input.

CHAIR: Has the AMA made a statement of support?

Ms McKENZIE: I am not sure that we have asked the AMA for a statement of support. A co-ordinating committee has been overseeing the pulling together of all the different body systems, if you like. But the way they have been developed is by specific working parties with expertise in that particular field. The psychiatrists have looked at the psychiatric scale; neurologists the nervous system and so on with orthopaedic surgeons. The individual groups were full of people who were there for their expertise in that field. We have not asked anybody to give overall endorsement to them at this stage.

CHAIR: Did that task force come to a unanimous decision to use PIRS?

Ms McKENZIE: No, I cannot claim that. I acknowledge that there was a lot of very robust debate and people with absolutely diametrically opposed views about what should or should not happen. That certainly was more difficult than any of the other areas to get consensus on. In the end we just had to come to a decision about what was the most fair and reasonable thing. It is the scale that the Motor Accidents Authority uses. It looks like it will be adopted by Comcare in Tasmania. So it is sort of gaining recognition as the most reliable scale. On that basis and the fact that it fits in with the overall framework of AMA 5 it seemed to us the only option. It appeared to us that none of the other options could be made to work from a practical point of view.

CHAIR: Why did you have to change? What is wrong with what has been happening?

Ms McKENZIE: We do not have any lump sums for psychological injury at the moment. This is part of what is coming up with this next package of reform connected to the last package of reform. It is a new kind of lump sum, for psychological impairment. So we have to have a scale to measure it.

CHAIR: Did that recommendation for lump sums come from WorkCover?

Ms McKENZIE: That is really a government decision that is part of the whole raft of negotiations about this set of reforms.

CHAIR: But there must have been payments previously for psychological—

Mr McINNES: Not lump sums.

CHAIR: What did they get before, just periodic payments?

Ms McKENZIE: Yes, treatment and weekly benefits. There was no lump sum. This scale is to measure how much lump sum they get, basically. If you use the scale, apply the formula, that gives you a dollar amount.

CHAIR: There has been criticism of commutation so it seems strange to be introducing a lump sum benefit at this point. So WorkCover is not driving this move for lump sums?

Ms McKENZIE: No. I think it came out of a series of negotiations. Various players, particularly some of the unions, argued strongly that lump sums should be available for this kind of illness. In the context of introducing a new system of measuring impairment that moves away from the old table of maims under which if you did not have a condition that was listed in the table you did not get a lump sum for it, this is trying to look at whole-of-person impairment. I think there is an argument from that point of view that psychiatric injury is a legitimate form of impairment that should be included in the same way as any other kind of impairment.

CHAIR: Especially if it is an ongoing or permanent—

Mr McINNES: It has to be permanent.

CHAIR: Is that because there have been more hold-ups in credit unions and banks with the staff affected?

Ms McKENZIE: I think is more an argument that there has been a gap in the scheme historically. You could not get a lump sum for some of these kinds of impairment. So regardless of the frequency or anything else, if you are going for a system where all injuries are compensated then psychiatric injury has a place in the scheme.

CHAIR: Where do you think most claims will come from? Has there been any estimate of what the possible costs might be?

Ms McKENZIE: 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.

The Hon. MICHAEL GALLACHER: I am not interested in the political reasons but where there practical reasons for the decision to move away from binding medical panels in mark one and mark two—the difference between the two? Were you not looking at binding medical panels earlier this year?

Ms McKENZIE: Yes, and we still have that concept.

The Hon. MICHAEL GALLACHER: Are there distinct changes between the two?

Ms McKENZIE: No.

The Hon. MICHAEL GALLACHER: My understanding was that there were.

Mr McINNES: There were some changes. There is still a binding medical determination in relation to the degree of permanent impairment and all aspects related to that. What is not binding and what was binding in the original bill, for example, was whether the condition is work related. That is now for the arbitrator to determine.

Ms McKENZIE: But that was all part of the last bill.

The Hon. MICHAEL GALLACHER: Have the self-insurers raised with you concerns that the abolition of commutation might see premiums rise for them by up to 20 per cent? Is that correct?

Ms McKENZIE: No. We had correspondence from the self-insurers indicating concerns about the abolition of commutation but I have not seen any correspondence or any complaints from anybody saying it would increase their premiums.

The Hon. MICHAEL GALLACHER: I was shocked when I saw it. I will find out and come back to you.

Ms McKENZIE: Okay.

CHAIR: You probably saw the advertisements in yesterday's *Daily Telegraph* about PIRS, that it would pose an untested method for assessing psychological or psychiatric injuries. Is untested an accurate description?

Ms McKENZIE: No, I do not think so. For a start it has already been used by the Motor Accidents Authority. From all the information gathered so far it seems to be working reasonably well.

CHAIR: So it has been tested?

Ms McKENZIE: Yes. I do not know what " untested" means in that context. You could say that about any of the guidelines.

CHAIR: In a small number of cases would that affect WorkCover or its planning for the future if that section of the bill were delayed or stood over for further review?

Ms McKENZIE: It would be difficult to disentangle it from the entire new regime. We would face accusations of unfairness, because it would basically mean that there would be no lump sum for psychiatric impairment in the meantime.

The Hon. TONY KELLY: Teachers and police would probably look forward to it.

Ms McKENZIE: Possibly.

Mr McINNES: In part. It creates a benefit that does not now exist.

CHAIR: It would be better to finetune it in the future.

Ms McKENZIE: I guess that is right. We should put it in, have a go at it and engage in research. We should work overtime and have another look in two years to see what it has delivered and how it has worked. We should then make a decision about what further tinkering or changes need to be made. We would have the same issue whatever scale we adopted. Through this process it has become apparent that there is no one scale that everyone, universally, agrees is perfect. Probably there never will be, that is the reality.

The Hon. GREG PEARCE: In the actuarial report to 30 June 2001, page, 6, clause 4, summary of results, the headline states that the blow-out in the deficit is $340 million claims related and $200 million asset related. Could you expand on what action you have taken to deal with the $200 million in asset-related deterioration of the fund?.

Mr McINNES: Clause 4.3 breaks it up a little, and states that $120 million of that is related to greater than expected claims payments during the six-month period. The actuaries had projected that they would pay out a certain amount, in practice they paid out $120 million more.

The Hon. GREG PEARCE: Is that a one-off?

Mr McINNES: Yes, to the extent that they have corrected that in their latest liability protection. Earlier today Dave Finnis explained that the September quarter results are pretty close to their projection. At least for the September quarter that differential is no longer there. The $80 million in premium income is $80 million less than the actuaries predicted would be collected in premium income. That is due to a number of factors, one of which was wage projection that was higher than transpired. They were projecting wage growth at a higher rate than transpired. To some extent that is related to the state of the economy. They were also projecting that the average premium rate would be at a level above what was collected. The premium rate that is being collected is, from memory, 2.76, which is slightly below the projected level, and that contributed to the $80 million.

The Hon. GREG PEARCE: On page 70 the fund projections are summarised. It states that the increase is driven by two factors: the negative return on the negative net assets of the fund and the addition to the deficit due to setting premiums, which were lower than the costs of claims and expenses. Will you explain what is meant by negative return on net assets?

Mr McINNES: I will do the best that I can. If you think of it in terms of the way that liabilities are assessed, it assumes that liabilities are fully funded and, therefore, will be offset by growth in the assets due to investment return. To the extent that currently you have a $2.7 billion shortfall, they are assuming that the $2.7 billion that is not there would earn about 6 per cent in investment return. So, 6 per cent of $2.7 billion is about $180 million. That is the shortfall, that $180 million goes straight to the bottom line for next year.

The Hon. GREG PEARCE: So the deficit is compounding?

Mr McINNES: Yes, in effect it is just the deficit compounding with inflation. Although it is not really an inflation, it is actually the 6 per cent investment return. The other half of that is because premiums are lower than the actual cost.

The Hon. GREG PEARCE: I looked at the board papers that you were kind enough to send to the Committee. I looked at the period October to December and I was surprised that I did not see any discussion of premiums being set lower than claims and expenses. Is the board not concerned about that?

Mr McINNES: Yes, it is. Maybe Kate should answer the question, because I am not a member of the board. Questions on premiums are dealt with in the first half of the year, because premiums are set in the period leading up to 30 June when rates are applied for the financial year. Obviously, there is considerable discussion and consideration of it at that time.

The Hon. GREG PEARCE: It does not find its way into the minutes?

Mr McINNES: I think you have looked at the second half of the year, clearly it would not be in the minutes that you have.

The Hon. GREG PEARCE: There does not seem to be any sense of urgency by the board about this problem. Everyone who has had anything to say about the scheme brings up this matter.

Ms McKENZIE: There is certainly plenty of discussion about it within the board.

CHAIR: The Committee has received a lot of complaints about the dramatic increase in premiums by WorkCover from employers.

Mr McINNES: On an overall basis?

CHAIR: You say that the average is 2.7?

Ms McKENZIE: It is still 2.8.

CHAIR: Has something happened within WorkCover, are you reassessing the risks?

Mr McINNES: We have introduced a new premium rating scale which is based on ANZSIC. As a result, a number of employers changed classification and the way that they have been rated. Certainly some employers have had significant increases. The numbers of those compared to the total numbers that are insured appear to be very small.

Ms McKENZIE: ANZSIC is a more refined classification system, it is meant to match the premium rate more closely to the risk rate. Previously we had an antiquated system that had only about 100 classifications. People had to be shoved into whatever classification most closely fitted them.

The Hon. TONY KELLY: In the cross-subsidisation?

Ms McKENZIE: That is right. It led to a whole lot of cross-subsidisation and people paying the wrong premium rate, according to their level of risk.

CHAIR: Have some employers had a reduction?

Ms McKENZIE: Yes, certainly. People tend to complain only when they get an increase, not when they get a reduction.

CHAIR: I am concerned that the premium level has been put up under this new method.

Ms McKENZIE: No. Some people would have gone up and some would have come down.

CHAIR: The rate would be the same. Do they have a right of appeal?

Ms McKENZIE: Yes.

CHAIR: It is alleged that some went up thousands of dollars.

Ms McKENZIE: Without looking at specific cases it is hard to know what contributed to that. Some of it might be an ANZSIC effect, some of it might be that they employed more people or actually had a claim that increased their premium.

CHAIR: Do you have an appeal mechanism?

Ms McKENZIE: Yes.

CHAIR: Do you know how many appeals you have had?

Mr McINNES: We have had some, I do not know the number.

CHAIR: Would you advise employers, when there has been an increase, that they can appeal?

Ms McKENZIE: By all means, they can give us a call.

Mr McINNES: If we get queries or complaints, we tend to put them onto the process of lodging an appeal. Traditionally we get less than 1,000 appeals a year in relation to premiums. That compares to 350,000-plus employers insured under the scheme. We are talking about a relatively small percentage of employers that have complaints in relation to premiums. I cannot quote the exact numbers since ANZSIC came in, but the numbers have not increased dramatically. It appears to be in the same magnitude that we traditionally have had in relation to complaints about premiums.

CHAIR: Do you agree that the premium level is really a Government decision?

Ms McKENZIE: It is ultimately a Government decision.

CHAIR: Even if you discussed it, you could only make a recommendation to the Minister?

Ms McKENZIE: That is correct. The Minister decides the rate and the Governor signs off.

CHAIR: In a sense, it is locked in.

Mr McINNES: Yes, it is.

The Hon. GREG PEARCE: The result of that is that if the Government had been continually running at a deficit on the premiums, the Government, notionally at least, or perhaps morally, would accept responsibility for the deficit because of the premium price.

CHAIR: I suppose the outcry over some of the increases gives an idea of the outcry that would occur if premiums were increased across the board?

Ms McKENZIE: Yes, and there are issues about competitiveness between the States as well. 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.

CHAIR: You could shift some industries out of New South Wales?

Ms McKENZIE: Our theory has been to get the scheme under control and operating more effectively before we look to any of those options.

CHAIR: Earlier Mr Grellman appeared before the Committee. He made a lot of recommendations, perhaps four years ago, and some have not been taken up. Did you look at them and reject them?

Ms McKENZIE: Yes, one of his main recommendations was the introduction of private underwriting. Clearly, that has not happened. He recommended the introduction of the ANZSIC classification system, and we have done that. He recommended the development of a central database, and we are beginning work on introducing that.

The Hon. MICHAEL GALLACHER: The creation of the Advisory Council?

Mr McINNES: It was created.

Ms McKENZIE: He recommended loosening up the restrictions on who could become a self-insurer. We have implemented that. He also recommended the new injury management process, which was implemented in the 1998 Act.

The Hon. GREG PEARCE: He recommended that you deal with the deficit premium costing?

Ms McKENZIE: Yes. Half of his recommendations have not been implemented.

CHAIR: Are you progressively examining those?

Ms McKENZIE: Certainly the dispute resolution. Probably what we are doing is not 100 per cent consistent with everything he said, but it is based on his recommendations about what we should do with the dispute resolution system. A lot of the other recommendations relate to the introduction of private underwriting, like having a rating bureau and who will do those things if we do not have private underwriting.

CHAIR: Has WorkCover ever made a recommendation to the Minister that premiums should be increased?

Ms McKENZIE: Certainly not in my time.

CHAIR: Has management made a recommendation, or would your recommendation go through the WorkCover board?

Ms McKENZIE: That's right.

Mr McINNES: It is a matter for the board to make a recommendation to the Minister. Certainly, premiums have been increased in the past, and the board at times has recommended those increases.

CHAIR: Recently?

Ms McKENZIE: Not recently.

Mr McINNES: There has not been a recent recommendation to increase premiums.

CHAIR: Has there been such a recommendation in the last five years or two years?

Mr McINNES: It is not five years ago, because I think premiums were increased to 2.8 per cent in 1996.

CHAIR: That was the last increase?

Mr McINNES: That was the last increase.

CHAIR: Was it the last recommendation?

Ms McKENZIE: There is a recommendation every year, but I think the last recommendation for an increase was in 1997.

Mr McINNES: I would have to double check that.

CHAIR: You say there is a recommendation every year. What do you mean?

Mr McINNES: Recommendations on premiums are made every year. There is the headline average rate, but then there are all the individual industry rates and so on.

CHAIR: Recommendations to maintain the current average?

Ms McKENZIE: Yes.

Mr McINNES: That is right.

The Hon. GREG PEARCE: So the board has been pretty warm, fuzzy and comfortable about not dealing with this issue of premium rates.

Ms McKENZIE: You are entitled to form a conclusion, I suppose. I am not sure that I would agree with it.

The Hon. GREG PEARCE: To what extent do you think rorting is contributing to the deficit?

Ms McKENZIE: I think that is a very difficult question to answer.

The Hon. GREG PEARCE: Have a go.

Ms McKENZIE: A lot of the assertions that are made about rorting are very much anecdotally based. Certainly, if you look at the number of prosecutions in which we have been successful and the number of sustained complaints of that kind that come to our attention, they are very, very small numbers. They do lead to the conclusion that there are a lot of exaggerated claims about fraud in the system. I guess it depends what your definition of fraud is, because sometimes people talk about rorting and fraud when they are really talking about something that probably does not quite fit into that category but is of the lower order of some looseness, if you like, in the way that the scheme operates. How much of that there is is difficult to say, but generally our view would be that a lot of claims made about those things are fairly exaggerated.

The Hon. GREG PEARCE: So you would agree with me that the Premier, when he said on 19 April on 2GB that rorting was responsible for the increase in the deficit, was probably exaggerating just a little.

Ms McKENZIE: I think you, quite unfairly, tried to put words in my mouth there, if I might say so.

The Hon. GREG PEARCE: Perhaps that is just my conclusion. Earlier today we heard some evidence from PricewaterhouseCoopers on their commutation report. I do not want to put words into your mouth, but they indicated that they did see some value in commutation at the higher end of severity of injuries, and in particular from 15 per cent up, and that up to 35 per cent savings were possible to WorkCover. Do you agree with that proposition?

Mr McINNES: I am not sure that is how they put the proposition.

The Hon. GREG PEARCE: It is in the table.

Ms McKENZIE: Based on that table, certainly there are savings to be made on average for those claims of high severity. That, clearly, is what that table shows.

Ms McKENZIE: Then you could also make out an argument that people at the higher end are being undercompensated, 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 Hon. GREG PEARCE: But you would not abolish commutation if you are already undercompensating people.

Ms McKENZIE: But once again, going back to what I said earlier, the difficulty is putting in place a regime that delivers a fair result in every case. I guess we formed the view that there is a big overreliance on commutations in the scheme at the moment, and that it is actually interfering with the focus on return to work and injury management because it reinforces the lump sum culture that you should hang around for your pool of money rather than focus on getting the best health outcome that you can, getting back to work and getting on with your life.

CHAIR: I would like to clarify a point you made earlier about rorting or fraud. Did you see the evidence that the Committee had from Andrew Ferguson, whose union seems to have conducted systematic audits of a number of companies that suggest hat many companies gave lower numbers and things like that? That is rorting, is it not?

Mr McINNES: It is. There are about 8,000 employers in the building industry and we have had about 150 matters referred to us from the CFMEU which include allegations of rorting. A high proportion of those turned out to be sustained allegations. But, in the context of 150 matters from 8,000 employers over the past four years, that is not a huge number.

Ms McKENZIE: We are not saying that rorting does not exist. When we get those sorts of complaints from the CFMEU or from anybody else, we investigate them as thoroughly as we can. There are particular difficulties, I think, in industries like the construction industry just because of the way in which the industry runs and the way that people set themselves up. There are a lot of companies coming and going, and people coming and going. There are difficult challenges, from a compliance point of view, in making sure that everyone is always paying the right premium.

CHAIR: The point he was making is that the CFMEU did those audits and you got those complaints, so why isn't WorkCover doing those audits? He did only a sample number.

Ms McKENZIE: We do a lot of that work as well. We have a whole range of initiatives under way at the moment.

CHAIR: Is the number of such incidents increasing?

Ms McKENZIE: Yes.

Mr McINNES: We are also trying to use more sophisticated techniques, based on data analysis, to identify which employers we should be auditing to give us a greater return and a greater chance of success.

CHAIR: You could presumably check tax records of something.

Mr McINNES: We cannot access Commonwealth tax records.

Ms McKENZIE: We certainly co-operate with other State-based agencies that have similar databases, so that we can crosscheck and look for irregular patterns that seem to warrant further investigation.

CHAIR: It would not be confidential information if it were about the number of employees who work in a company.

Ms McKENZIE: No.

The Hon. MICHAEL GALLACHER: Going back to the question of psychological impairment rating scales [PIRS], is it not the case that the Motor Accidents Authority is currently utilising and evaluating a scale similar to PIRS?

Ms McKENZIE: Yes.

The Hon. MICHAEL GALLACHER: I am told that the Motor Accidents Authority is not concluding its evaluation until WorkCover has finalised its position on PIRS.

Ms McKENZIE: I am not sure that is right.

The Hon. MICHAEL GALLACHER: Would it not be better to wait until the evaluation of PIRS is done by the Motor Accidents Authority before we proceeds?

Ms McKENZIE: I guess, in a sense, it is not really going to help. Obviously, we have talked to the Motor Accidents Authority about this, but it comes down to the question of what is the best system available. Whilst I am sure their valuation will throw up some criticisms and issues that need to be looked at, it is still the best scale that we have available at the moment.

The Hon. MICHAEL GALLACHER: Are you aware of a paper prepared by Dr Ian Gardiner and Dr Robin Chase titled "Compensable Injuries and Health Outcomes", which looks at the issues relating to back injuries" I think over quite a number of decades there has been a 140 per cent increase in back injuries.

Ms McKENZIE: Yes.

The Hon. MICHAEL GALLACHER: What would be the effect if evidence-based medical protocols like those in South Australia and Victoria were introduced in New South Wales, where about 30 per cent of all injuries claimed in this State are back injuries?

Ms McKENZIE: We are actually in the process of doing that now. We have just finished a pilot of a medical management model, in which we have involved the doctors, and we are in the process of rolling out now to all general practitioners the best practice guidelines, in the hope that we will be able to achieve some gains from better treatment of back injuries in the scheme.

The Hon. GREG PEARCE: Mr Chairman, on the last occasion she was here Ms McKenzie promised to provide to the Committee a number of pieces of information. Some of that information has not been forthcoming. Could we have an update on those?

Ms McKENZIE: I think almost everything is forthcoming.

The Hon. GREG PEARCE: There was the summary of the operation of the scheme.

Ms McKENZIE: I think we have provided all of that.

The Hon. GREG PEARCE: I am being advised that that has not come through.

Ms McKENZIE: I am being told that we had been given to the end of November to prepare an outline for the Committee. We have certainly done our level best to provide everything that was asked for, and in as timely a fashion as possible. In some cases that has proven difficult. In some cases we have had to get the consent of third parties to make information available. But we have put quite a lot of effort into making sure that we give you everything you asked for in a timely fashion.

CHAIR: We have a whole lot of information from you. We appreciate what has been supplied. Some of that, as you know, has been provided in confidence. That will remain in confidence with this Committee. Where companies have requested that, we have agreed to do that.

The Hon. MICHAEL GALLACHER: Will you continue to accept questions on notice between now and 5.00 p.m. tomorrow regarding matters arising from today's hearing or requesting information that was not asked for?

Ms McKENZIE: Sure.

The Hon. MICHAEL GALLACHER: Thank you.

(The witnesses withdrew.)

(The Committee adjourned at 5.10 p.m.)