CORRECTED

REPORT OF PROCEEDINGS BEFORE

GENERAL PURPOSE STANDING COMMITTEE No. 1

INQUIRY INTO THE NEW SOUTH WALES WORKERS COMPENSATION SCHEME

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At Sydney on Monday 3 June 2002

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The Committee met at 9.30 a.m.

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PRESENT

Reverend the Hon. Fred Nile MLC (Chair)

The Hon. Michael Gallacher MLC
The Hon. Greg Pearce MLC
The Hon. Henry Tsang MLC

CHAIR: I welcome members of the media and the public to this hearing of General Purpose Standing Committee No. 1 inquiring into the review and monitoring of the New South Wales workers compensation scheme. I ask that all mobile phones be turned off during the proceedings. The Committee has previously resolved to authorise the media to broadcast sound and video excerpts of its public proceedings. Copies of guidelines governing broadcasting of proceedings are available from the table by the door.

I point out that, in accordance with the Legislative Council guidelines for the broadcasting of proceedings, a member of the Committee and witnesses may be filmed or recorded, but people in the public gallery should not be the primary focus of any filming or photographs. In reporting the proceedings of this Committee, the media must take responsibility for what they publish and the interpretation that is placed on anything that is said before the Committee. Witnesses, members and their staff are advised that any messages should be delivered through the attendant on duty or through the clerks. I advise that under Standing Order 252 of the Legislative Council, evidence given before the Committee and documents presented to the Committee that have not yet been tabled in Parliament may not, except with the permission of the Committee been disclosed or published by any member of such Committee or by any other person.

TERENCE WILLIAM SHEAHAN, President, Workers Compensation Commission, Level 21, 1 Oxford Street, Darlinghurst, and

HELEN MAREE WALKER, Registrar, Workers Compensation Commission, Level 20, 1 Oxford Street, Darlinghurst, sworn and examined:

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

Justice SHEAHAN: Yes, I am.

Ms WALKER: Yes, I am.

CHAIR: You would both be aware of the provision that if either of you should consider at any stage during the evidence that, in the public interest, certain evidence or documents that 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 evidence will be heard in camera. Do you wish to make an opening statement?

Justice SHEAHAN: Not unless you would like me to. We are here to be of assistance to the Committee.

CHAIR: Could you please outline the features of the Workers Compensation Commission that are new or different from the previous dispute resolution system?

Justice SHEAHAN: The commission was established by part of a series of bills accepted by the Parliament during 2001 and commenced operation on 1 January 2002. I note that now before Parliament is bill to abolish the Compensation Court from 31 December 2003. The charter of the commission under the legislation is to resolve disputes arising after 1 January 2002 and gradually to phase in and pick up the work that might be generated by injuries or events prior to 1 January 2002. The details of the changes made in the basic thrust of the legislation are probably better known to the Committee than to the general public but, fundamentally, the focus of the commission's operations is that disputed workers compensation claims will be dealt with essentially by alternative dispute resolution mechanisms, culminating, if need be, in arbitration by independent arbitrators appointed by the President.

When a dispute is notified to the commission, it is the Registrar's function to determine which resolution path it should follow. Some would be subject to binding medical assessment by approved medical specialists in relation particularly to questions of permanent impairment. A general run-of-the-mill dispute which would be about weekly benefits and some out-of-pocket expenses and so forth would be generally regarded, I would expect, by the Registrar as appropriate to be referred by her to an arbitrator. The arbitrators have been appointed, and fundamentally cases will be allocated to them randomly subject to checking with them on each occasion that there is no potential conflict of interest as in something that would compromise the impartiality of the dispute resolution process.

The arbitrators are drawn essentially from the legal profession as to 90 per cent and as to 10 per cent from injury management specialists. It is intended that the general run of disputes will be referred to members of the legal profession appointed as arbitrators and that those of an injury management nature will be referred to the injury management specialists on the panel. The role of the President and the two Deputy Presidents is essentially to hear appeals against determinations by arbitrators. As yet, there have not been any appeals and the success rate in dealing with disputes that have been referred to arbitrators has been that several have already been resolved by agreement. In the case of agreement, there would be no appeal.

The statute also provides a limited right to raise, by leave, questions of law that the President must determine if they are novel or complex. That gives rise to an opportunity for the new regime to adopt or not adopt the jurisprudence of the old. The legislation provides currently for those questions of law to be dealt with only by leave and only by the President and not by the two Deputy Presidents, except in the absence from duty of the President. In a nutshell, that is how the commission is structured. There are no in-house personnel other than the Registrar who in certain circumstances would arbitrate disputes. We would expect that all in-house personnel would deal with interim payment directions and expedited assessments matters. The rest are all allocated on basically a contract basis to the arbitrators who are appointed under the statute.

CHAIR: There are six objectives laid down for the Workers Compensation Commission in section 367 of the 1998 Act. Are any of those areas in which you have been experiencing problems, or have you not yet been able to implement them?

Justice SHEAHAN: We regard to the objectives laid down by the statute for the commission as more or less, with no disrespect to you, Mr Chairman, the Bible for our organisation. In the materials presented to the arbitrators at their induction, those objectives are actually engraved on the cover of the manual. Everybody who has signed up as an arbitrator under my powers to appoint them are bound by those objectives. If you would like me to deal with each of the six objectives in brief terms, the first objective is a fair and cost-effective system. That is obviously the objective of most alternative dispute resolution-based systems and it is certainly the objective of ours. The cost regime has been laid down by the Minister and is not determined by the commission, but in terms of fairness it is our obligation and our absolute commitment to ensure that it is fair.

The second objective set out in section 367 is to reduce administration costs across the workers compensation system. As you would know, the Minister laid down essentially what is a 10-point plan for his reform program. A better and more efficient dispute resolution system was only one of those 10 points. So in so far as it is within our purview to meet that objective, we will be doing our best to do it. I do not think there is any doubt that, if properly managed, an alternative dispute resolution system will prove to be less expensive, in relation to transaction costs, than the full panoply of a court procedure. The third objective was a timely service ensuring workers entitlements are paid promptly. It would be my view—and I am sure it would be the view of most citizens in the State—that anyone who is actually to get compensation should be able to get it quickly, completely and without too much objection. Therefore, timeliness is important.

We have been designing our processes on the basis of meeting that objective. Certain things happen. If payment is not prompt—it can be a reason why disputes are generated—my understanding is that some of the other things that have been implemented as part of the Government's current plan, which seems to enjoy general cross-party support in this Parliament, are aimed at doing that. The provisional liability arrangements and so forth are part of timeliness. But in relation to our set up, we certainly want to have dispute resolution done in a timely manner. If that means that people get paid, that is what happens as a consequence. The next objective is to create a registry and dispute resolution service meeting the expectations of the worker and the employer in relation to accessibility, approachability and professionalism. So far as I am concerned, everything that the commission is doing is entirely transparent and is an absolute open book to your inquiry, to the media, to the Parliament and to any member of the public, subject to the rights of the privacy of people who do business with us.

There are arrangements in place to ensure that people who either have a difficulty with the language, with understanding legislation or who do not want to be represented by a lawyer, or whatever, there are all kinds of options available to them. We will shortly be publishing an accessibility charter, a service charter, which again will be open for everybody to see how we address all those issues on an individual basis. As I understand it, the next objective is to provide an independent dispute resolution service that is effective in settling matters and leading to durable agreements between the parties to a dispute. Prior to my appointment to the Land and Environment Court and, after my departure from this place, I worked essentially as an alternative dispute resolution specialist, doing mainly mediation work. So I certainly am committed in all respects to durable agreements being reached.

There is no way that people will be dragooned into doing something by the commission's processes. They may feel in certain circumstances that they should take a settlement that others might criticise, but that is entirely a matter for them. We are established as an independent agency. We see ourselves very much as independent either of the WorkCover Authority, the Government or the Department of Industrial Relations. I am sure that, as the workload builds up, we will demonstrate that our service is effective in settling matters and leading to those durable agreements in accordance with that objective. The last objective was communication and liaison with interested parties.

I have spent most of my time, since I took up my duties on a full-time basis on 18 March, going to conferences and meetings with various interest groups to establish that. We are open to invitations from groups on all sides in order to present material at conferences and answer questions. We are also in the process of developing a more proactive communication strategy to ensure that we communicate with all stakeholders and interested parties. We have a web site which I am told is receiving lavish praise from those who are expert in such matters.

CHAIR: As you know, you were given another job—to conduct an inquiry. The Sheahan inquiry made a number of recommendations. Have those recommendations been picked up by the commission? Have any recommendations not been picked up?

Justice SHEAHAN: When I made the recommendations I did not know that I would be President of the commission. I carefully read the report again after I was offered the position. Fundamentally, we are dealing with two different types of disputes. In general terms, in recent years there would have been 120,000 injuries that resulted in the payment of compensation. About only 2 per cent of those people have a demonstrable right to sue for damages. Against that background, I was commissioned to run the inquiry at about this time last year. My recommendation was that there should continue to be the right to sue an employer for damages, but that the heads of damages be reduced to what you might call net financial loss rather than economic loss widely defined, so basically, lost wages, past, present and future.

The trade-off for that would have to be an improvement in the statutory benefits available under the statutory scheme. As I understand it, the legislation introduced to implement my recommendations did that, including putting into the statutory scheme what might generally be referred to as a Griffith Kerkemeyer benefit for carers. That having happened, if people then decide to go down the common law path, my recommendation was that all such cases should be compulsorily put through a mediation process. It seemed to me to be sensible as the commission was then in the process of being established, and as the commission was, in the statutory scheme, to have a major focus on alternative dispute resolution, to put that pre-filing mediation process into the commission. The Government accepted that recommendation as well.

So in the course of the last few months, as well as appointing arbitrators for the statutory scheme, we have appointed mediators to stand by for those work injury damages claims, but there have been no such claims to date. Our commission does have some other roles in the common law area. It is possible to avail oneself of the approved medical specialist procedures, for example, if there is a dispute about whether or not the claiming worker in the damages environment has the requisite degree of impairment. So there is a bit of interaction between the general day-to-day work of the commission and the use of the pre-filing procedures. Several of the mediators have also been appointed as arbitrators under the statutory scheme, but some have not.

The Hon. MICHAEL GALLACHER: Justice Sheahan, have any of the aspects of your report been carried over into the scheme design areas of reform that are still to be addressed by the Government?

Justice SHEAHAN: I do not quite understand that. What I designed, with the help of Mr O'Grady—and that is all published in my report—was what I thought was a fairly novel not only pre-trial but pre-filing mediation system. As I understand it, the overwhelming majority, if not all, of those recommendations have been adopted.

The Hon. MICHAEL GALLACHER: Did you look at the role of WorkCover in all of that?

Justice SHEAHAN: Yes, I did. It was not a specific term of reference but there was, during the course of the inquiry, a lot of criticism of WorkCover's involvement in the settlement of damages actions. I had evidence from WorkCover presented to me, none of which I can spontaneously recall now, that indicated that it would address those issues. As I said, the commission sees itself in all of its work as only part of an overall package of reform, in which the Legislature has played its part. When I say that we are operating totally independently of WorkCover, it does not mean that we are not in communication about matters of mutual interest. I think that is desirable.

The Hon. MICHAEL GALLACHER: Queensland separated certain roles for WorkCover. Was that one of the issues you looked at?

Justice SHEAHAN: Not in terms. I invited the Queenslanders to come and give evidence to the inquiry and that is recorded in my report. But I think the compensation scheme, the common law scheme and their interaction in Queensland, are very different from what they are in New South Wales.

The Hon. MICHAEL GALLACHER: Queensland most certainly divided up the roles of WorkCover. Some evidence has been given to this Committee that further consideration could be given, during the scheme design aspects of reform, to the ongoing role of WorkCover. I am keen to hear your views.

Justice SHEAHAN: I will not give a view on what is a matter of public policy. In terms of the commission we deal with WorkCover as an agency administering a scheme in respect of which we are responsible for the dispute resolution system.

The Hon. MICHAEL GALLACHER: Ms Walker, what matters have you had filed? As the Registrar, what numbers are we looking at?

Ms WALKER: We have had 318 matters filed, which have been registered either as applications for dispute resolution or applications for interim payment direction.

The Hon. MICHAEL GALLACHER: Are you, as Register, fielding or receiving calls from the business community on issues of complaint? Do you receive those, or do they go somewhere else?

Ms WALKER: No, I would receive those. There have not been issues of complaint, as such, from the business community.

The Hon. MICHAEL GALLACHER: None whatsoever?

Ms WALKER: No.

CHAIR: You mentioned that 318 cases had been filed. How many have been completed since January 2002?

Ms WALKER: Fifty-two have been resolved. There are a further 26 that are currently with arbitrators for resolution, and 266 are still within the initial information exchange.

Justice SHEAHAN: I point out that the bulk of the 318 were lodged during May. Something like 200 of the 318 were filed during May.

The Hon. MICHAEL GALLACHER: Ms Walker, prior to coming to the commission, were you involved in this area of injury, or have you had a background in workers compensation before?

Ms WALKER: I have a background in the Accident Compensation Corporation of New Zealand. I was appointed as project officer to WorkCover at the end of April last year.

The Hon. MICHAEL GALLACHER: So you have come straight from the New Zealand model to the New South Wales model?

Ms WALKER: Not exactly. I have had a number of career moves in between.

CHAIR: From the point of view of the ongoing role of the commission, what information and data have been collected by the commission to monitor its performance?

Justice SHEAHAN: We are collecting every piece of information that we can about all the matters before us. It will be for others to make judgments on what that material means. If there is anything in particular you want to know about, we will give you whatever information we have.

CHAIR: So there is a formal monitoring process within the commission to monitor its own success rate and so on?

Justice SHEAHAN: Absolutely

CHAIR: Are all the registrars doing that?

Justice SHEAHAN: I have been fortunate enough to secure the services of recently retired Justice Deirdre O'Connor to assist us. Her role is not so much to evaluate individuals or to evaluate particular cases because the cases are necessarily the responsibility of arbitrators under the supervision of the Registrar. But the system that we have designed, the process that we expect an arbitrator to go through once allocated a matter, is also on the web site. That is published as a Registrar's guideline. I want to evaluate how that runs, but I must evaluate how it runs independent of the subject matter of a case because, ultimately, I am the Court of Appeal, if you like, within the commission structure.

Our attitude to that is to have opportunities for the arbitrators to access Justice O'Connor during the course of the matter if they have got a particular issue and at the end of the arbitration process for them to have a meeting with her to de-brief on how the process actually worked. We have got about 80 arbitrators across the board of skills. So after the first, say, 100 cases, we will have a really good look to see how the model has worked. From that point of view we will be evaluating the system that we have designed but the case management system of the commission records all of the inputs and outputs and all the outcomes for every matter allocated into the commission, subject to privacy considerations.

CHAIR: So monitoring the procedure you have with Deirdre O'Connor, is there some reporting process that is aimed at the stakeholders so that the employee groups or union groups who, because it is a new system, may not have reservations, but would like to see it working effectively?

Justice SHEAHAN: I think the stakeholders will be more interested in the output of the case management system and the reports that that might generate. What I would be looking for from Justice O'Connor are indications of whether, if at all and in what way, we should amend the system guideline laid down for how they should conduct their matters.

CHAIR: So you will be making some sort of report to the stakeholders?

Justice SHEAHAN: What I would anticipate, although I do not think the statute requires us, nor the law of the State requires us, to publish an annual report, we would certainly want to be publishing some kind of review of our activities in a twelve month period but, as you can see, with limited filings up until 1 May and a gradual build up commencing now, the first six months would not be much value to the stakeholders I would not have thought.

CHAIR: I think a moment ago you were talking about the appeal process. If someone wants to lodge an appeal against a commission arbitrator's decision, what is the procedure there and how many appeals have been lodged?

Justice SHEAHAN: None are lodged to date. The process requires an aggrieved party to make an application for leave to appeal. That would be allocated by the Registrar in liaison with me as the President of the commission to one of the three Presidential members to deal with and leave would be either granted or not granted and if granted the appeal would then proceed. We would like to see as much of that done on the documents as possible. I do not propose to have the three Presidential members occupied by an argument presented orally that could easily be examined in a written form as to where indeed it was alleged that an error or an injustice had been worked below.

CHAIR: So it would be mainly questions of law?

Justice SHEAHAN: There are two separate issues there. There is a procedure to raise a question of law. There could be an issue raised during the running of a dispute that requires a legal ruling, if you like, before the arbitrators can actually finally determine the matter. We are trying to design it in a way that while that question is being resolved the arbitrator can process the dispute in the meantime. We have not seen yet a question of law posed. My experience in five years as a judge is that a lot of things that are presented to courts as questions of law are actually questions of fact dressed up as questions of law in order to get in through some gateway and that we have to be careful of that.

There is pretty strong law on that and much of that should be able to be dealt with on the papers, but subject to that leave application being granted it would be a full argument before a presidential member and a decision

would be made. In terms of appeal, a party can be aggrieved without necessarily an error of law and the Act provides a threshold amount remaining in dispute as a way of being required before you can have a successful leave application and we would expect a party relying upon it to also argue why there should be a full appeal in the event. The documentation and the practice notes for that are in the process of being finally developed at the moment.

CHAIR: As you know, the department recognised that there was a problem with high legal costs and there was some need to reform the system. That is why the commission came into place. On the other side, some of the unions were concerned whether the injured workers would have sufficient protection under this system. Do you believe there is sufficient protection for the injured worker?

Justice SHEAHAN: There is a presumption that the worker will have the benefit of advice and representation at all stages of dispute resolution. Now if the worker chooses to engage an agent other than a lawyer in traditional private practice, so be it. If the worker chooses to self represent there are bar codes in place elsewhere which we are adapting for our purposes to ensure that that injured worker gets as much assistance and service as you can get without pre-empting the outcome of the resolution of his dispute. So I am satisfied that we have done so far, and we will continue to do, as much as possible to assist people in that situation.

CHAIR: So when you said there was a system, would that be like giving them legal advice on an informal basis?

Justice SHEAHAN: There is a claims assistance system service provided outside of the commission. There are other mechanisms available. I understand there is funding available for employer and employee organisations to put advice services in place. There is no question that people are entitled to the services of an interpreter. In a lot of cases that is a very fundamental issue for even people who speak English passably well in order to understand some of the issues before them. So that has all happened. You might be interested to know that of the 318 matters that have been so far registered, only 12 have been commenced by self represented applicants. What we will do with these cases is that each dispute that is notified will have allocated to it a dispute management officer, that is an officer of the commission who would be the contact point, and we have written into our procedures several requirements at several stages for those officers to be proactive in helping the self represented applicant.

The Hon. MICHAEL GALLACHER: Following on from the point that Justice Sheahan made about the advisory service being separate from the commission, do you have an ongoing role in the provision of the service to ensure that the quality of the information that is going out is consistent with where you as the Registrar sees the commission moving?

Ms WALKER: The advisory service that Justice Sheahan is referring to is actually part of WorkCover, that is the claims advisory service. We liaise regularly with them to ensure that the information that they have about the commission is accurate and up to date.

CHAIR: Another matter that has been raised is the issue of the time limits for the resolution of disputes. Have you found any problems with that? Is it too tight or are some of the injured workers aware of the need to meet those deadlines?

Justice SHEAHAN: We have designed fairly tight timeframes. As yet nobody has been bounced as a result of not strictly complying with them. One has to be sympathetic with the members of the specialist profession and others who are assisting the workers and employers—not just workers—with these disputes, that at least during particularly 2002—but also looks like most of 2003—they will be dealing with two parallel systems which are very very different in their requirements. So what we are requiring—I think is the best way to put it to you, Mr Chairman—is these cases should not be filed with the commission until they are basically ready from the worker's point of view to be dealt with.

The case upon which the worker will be relying should be filed ab initio in that the process of the commission, therefore the reply to that case by the employer /insurer should be fulsome. Now something like 28 days is not an unreasonable period to expect that to be made available because this dispute is notified to the commission essentially because there has already been a refusal to pay. So one would have hoped that the person refusing to pay was in a position to argue fairly cogently why that refusal had been made at a time when the claim is initiated. So there is an opportunity — there is a cooling off process available at all stages in the dispute. I think the big change for a lot of people who do a lot of this work for workers will be the requirement to put most of the material on right at the outset, but that is a culture change. It is long overdue.

CHAIR: On the organisation of the commission itself, how many arbitrators have now been appointed?

Ms WALKER: Seventy-nine.

The Hon. MICHAEL GALLACHER: Out of how many?

Justice SHEAHAN: That is it.

The Hon. MICHAEL GALLACHER: You have got your full complement?

Justice SHEAHAN: Could I answer that? In the initial statement it was suggested that there be about 90 lawyers and nine injury management specialists. So the target was, in round figures, about 100. Setting the bar very high in terms of the mandatory criteria for appointment as an arbitrator, in the first intake out of 138 applicants I found only 35 applications acceptable. I understand there was some criticism that we only had 35 but when we had 35 arbitrators we had no cases. So it was not a difficulty for us. We then went out jointly for arbitrators and mediators, inviting people to apply for either or both of those appointments. In the second rush we have appointed approximately 46.

I think it was something like 35 in the first rush and the balance of the 79 appointed in the second wave. There are 79 people who have met very stringent criteria of competence and impartiality and relevant experience. I do not think we will need necessarily 90. I do not think there was a magic about the number 90. I knew that we would need more than 35 when we got up to speed but even at 200 filings a month—which is about what May was—we are more than adequately equipped to deal with the matters that we receive.

The Hon. MICHAEL GALLACHER: Have those 79 been circulated in the *Government Gazette*?

Justice SHEAHAN: They are not gazetted. There is no requirement for them to be gazetted. Their names are published on a website I think.

CHAIR: You mentioned lawyers. Are they working from their own offices or do they all work from 1 Oxford Street?

Justice SHEAHAN: They are engaged on the basis of their competence, not on the basis of their current mode of practice. Several of them are people who are still very actively involved in law firms. Those law firms often have very good facilities for the conduct of mediations and arbitrations. So each of those persons who is nominated for appointment has been given the opportunity to indicate where they would conduct these matters most comfortably and most conveniently to themselves. In addition to that, we have got access to good facilities on level 21 of No 1 Oxford Street where we have configured the space so that there are three hearing rooms; one each for the President and the two deputy presidents, and there is a large training room as well.

In addition to that there are 10 or 12 sets of rooms which have a larger conference room and a smaller, if you like, breakout room, known as a meeting room. So we do have facilities at "head office" but we are expecting these arbitrations to be done at a mutually convenient location for everybody concerned. Now in the case of where the worker lives, not too many of them live in 1 Oxford Street so what we will be hoping is that these non-threatening environments can be established for workers and for employers at places that are convenient to everybody. We will not be restricted, in terms of the Statewide operations of the commission, to the traditional circuit towns of the court.

CHAIR: I suppose it depends whether some of the arbitrators come from country regions?

Justice SHEAHAN: I did take some numbers out on that. Twenty-four arbitrators are located primarily outside metropolitan Sydney, including interstate.

The Hon. MICHAEL GALLACHER: Ms Walker, what process internally do you have in place, in so far as the distribution of the workload to the 79 arbitrators, to ensure that there is an even distribution of the work?

Ms WALKER: There is an allocation policy which is just going through its final drafting stages at the moment. In terms of an even allocation of the work the primary consideration is not an even allocation of the work to the arbitrators, it is ensuring that the arbitration is done in a place which actually suits the injured worker.

The Hon. MICHAEL GALLACHER: So if you have a large number of these arbitrators in the Sydney metropolitan area and they can move around quite easily within the Sydney metropolitan area, what checks and balances do you have in place to ensure that once again there are not some people who seem to be getting a larger percentage of work over others?

Ms WALKER: The allocation policy covers that in terms of ensuring that there is, to the extent possible, some equity there.

The Hon. MICHAEL GALLACHER: How do you propose to do that?

Ms WALKER: By monitoring the matters that are allocated and the arbitrators to whom those are allocated and the reasons for the allocation of those matters to those particular arbitrators.

The Hon. MICHAEL GALLACHER: Do you have responsibility for that?

Ms WALKER: Yes I do.

Justice SHEAHAN: Interestingly, on venues —early days yet—but of the 29 matters allocated, 20 have indicated a preference to deal with that matter at 1 Oxford Street.

The Hon. HENRY TSANG: Do you believe that the new dispute resolution system, of which the commission is an integral part, will have a significant impact on the overall level of scheme deficits? If so, what do you estimate the impact will be? If not, what remains to be done to improve the overall financial position of the scheme?

Justice SHEAHAN: That question is better directed to WorkCover than the commission, with respect.

The Hon. HENRY TSANG: You cannot comment on that?

Justice SHEAHAN: My expectation would be that benefits that are properly payable will be awarded by arbitrators in cases that are disputed. I have no way of predicting how the amounts of those benefits will relate to the amounts that are generated by the current scheme, but anecdotal evidence would indicate that lots of matters are settled fairly advantageously to people at a premium. That being the case, one would expect that the overall output would be less. Transaction costs, I have no doubt, will be less as a result of the dispute resolution system, but I have not been bound to any particular target, nor will I set one for those things.

The new dispute resolution scheme, as you put it, is obviously integral to a whole package of things that are happening, as I said before, with general support across the community and across the stakeholders and across the parliamentary process, and people will no doubt monitor the impact. I do not think there is any doubt that a speedy resolution of disputed claims is terribly important to scheme objectives. In the current system or the old system, in my 30 years of experience of it there is at least a perception that it is better to stay sick for longer if you have a claim running. That is an undesirable thing for a whole host of reasons, the latter is only one. In terms of general community wellbeing that is a bad outcome.

I had a lot of evidence given to me about these matters during the course of my inquiry, even though my jurisdiction was about common law disputes. But this issue is still the same. If you have a disputed claim, if you are able to get a speedy resolution of that, whether it be advantageous to you is a matter for you as an individual to judge, but the speedier that is, the less incentive there is to stay off work, the more incentive there is to get on with your life, and that seems to me to be demonstrated by the evidence of all the rehabilitation experts and so on with whom, no doubt, you have been dealing in your Committee as I did in my inquiry. I am completely optimistic about the impact from the proper working of the system, but I am not able to put a number on it and I would not accept a target for it.

CHAIR: Can you explain how the interim payment direction system you are using is operating?

Justice SHEAHAN: I will let Ms Walker explain that because that does not come under the appellate side of the operation. It is the day-to-day working of the commission.

Ms WALKER: Interim payment directions were enabled as a new provision within the legislation. They cover payments of medical expenses up to $5,000 and weekly payments for short periods, and the periods are

limited to 10 weeks retrospectively and 12 weeks prospectively. When a person is not being paid liability payments then the person can make application to the commission for an interim payment direction to cover those.

CHAIR: You have had five applications, is that correct?

Ms WALKER: No, there have now been 44 applications. The five that you are referring to were in a much earlier period.

CHAIR: Do you expect that to be the average number you will have per year?

Ms WALKER: It is very difficult to estimate. Obviously, the extent to which insurers are actually commencing provisional liability payments is inversely proportional to the payment request for applications for interim payment directions to the commission.

CHAIR: How many commutation agreements have been registered under division 9 of the 1987 Act? What is the average amount of commutations registered?

Ms WALKER: There have been no commutations under the 1987 Act. However, there have been eight agreements for redemption under the 1926 Act and the average amount of those agreements is $42,581.50, approximately $43,000

The Hon. MICHAEL GALLACHER: Do you have any idea what sort of time the 44 are running for?

Ms WALKER: Forty-eight hours.

The Hon. MICHAEL GALLACHER: Are you keeping a check of the matters that currently come before you as the Registrar, how many of them are running for up to a 10 to 12-week period?

Ms WALKER: In terms of the interim payment decisions, yes, those are recorded.

The Hon. MICHAEL GALLACHER: Do you have any early statistical information that could assist us in terms of what is happening there?

Ms WALKER: I do not have that with me, I am sorry, but I am very happy to take that on notice and provide it to the Committee.

The Hon. MICHAEL GALLACHER: Will you take that on notice and advise the Committee of the matters lodged with you until this date and provide an approximate breakdown as to how long the matters are running for in terms of provisional liability?

Ms WALKER: Certainly.

CHAIR: What is the average amount of a registered agreement under section 66A of the 1987 Act?

Ms WALKER: It is difficult for us to give you an exact figure on that in terms of the current reporting capabilities of the computer. What we have done, however, is obtain some information from WorkCover, which shows that in s.66 matters there has been no discernible difference. Again, with the short timeframe that we were given for the questions, it is literally a manual count and I am happy to do that for the Committee and report back with this other matter in terms of the actual amount under section 66A agreements. We have registered something like 2,100 since we have commenced operation.

CHAIR: Will you take that question on notice?

Ms WALKER: Certainly.

CHAIR: When you say "manual", you will be able to do it simply, will you? It will not use up the time of the commission?

Ms WALKER: It is literally a manual count on each file with the way the computer system is at the moment. That is because we inherited the system from WorkCover on those and that will be rectified by July, so we will be able to produce them very quickly then.

CHAIR: It will be on the computer system?

Ms WALKER: Yes.

Justice SHEAHAN: We will get some material to you, Mr Chairman, in answer to the question.

CHAIR: I was just wondering whether it was going to take a long time. When you mention "manual" these days—

Justice SHEAHAN: I seem to recall some questions on notice in the old days when I was here being answered like that: too much work involved in collating the information. We will get some information for you.

CHAIR: Thank you very much for appearing before the Committee. We thank you for your co-operation and all the work you have done in providing that background material.

Justice SHEAHAN: If there is anything else you require at any time, please do not hesitate to call on us. We are very happy to be available to assist in anyway.

(The witnesses withdrew.)

JAMES CHARLES ROBERT BENJAMIN, Solicitor, Level 15, 370 Pitt Street, Sydney, and

STEPHEN JOHN LANCKEN, Mediator, Arbitrator and Solicitor, 162 Albany Street, Stanmore, sworn examined:

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

Mr BENJAMIN: As President-elect of the Law Society of New South Wales.

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

Mr BENJAMIN: I am generally conversant with the terms of reference, yes.

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

Mr LANCKEN: I am a councillor of the Law Society.

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

Mr LANCKEN: Yes, I am.

CHAIR: Under our normal procedure, if either of you should be concerned 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 would be willing to accede to your request. The Committee would then go into camera and members of the public would be removed from the room. Do either of you wish to make an opening statement?

Mr BENJAMIN: Yes, we do. The commission has just started, and in our inquiries of practitioners very little work has been undertaken by it in terms of the arbitration or mediation. Our concern is that the real effect of it may not be clear for another few months until some data has come out of the work that has been undertaken by it. The comments we are making today are in the light of that lack of research to give a proper and valid analysis.

CHAIR: It is a preliminary assessment?

Mr BENJAMIN: Yes, it is. I note that you need to report by the end of this year, but it might be worthwhile bringing some people back in a month, or two, or three months once some of the material is coming out so that we can talk about how it is operating in real life rather than how everyone anticipates that it will operate.

CHAIR: From the overall policy view of the Law Society what is the level of involvement of lawyers in the Workers Compensation Commission?

Mr BENJAMIN: It has been extraordinarily high in the past, I suspect that in the future—and that is clearly government policy—the involvement of solicitors will diminish. Although, because of the nature of the dispute between a worker and employee, there will still need to be significant and proper representation of somebody who is injured at work. It is our view that legal practitioners are the best people to serve that particular need. One of our concerns is that insurers on one side will develop significant skills with greater resources to push their side and their particular views, and that people who are coming to the commission for the first time and people who are injured and, perhaps, have limited skills in terms of communication may be at somewhat of a disadvantage. Hopefully, that is what proper legal representation can overcome. Whether you have an arbitration or mediation it still needs both parties to come with an equality of power. If someone comes to that process and one is stronger, whether it is in terms of information or skills, it does not bode well—this is not criticism, this is an underlying philosophy—for the satisfactory resolution of that issue.

CHAIR: Would you be concerned about the earlier evidence that a number of workers were self-represented—I think there were 24?

Mr BENJAMIN: I am extraordinarily concerned with that. They will go there and they will be told things, not by the commission but by others, as to their expectations. If they are turning up without representation, what

standard do they have to judge what their entitlements are? Perhaps the commission may say, "We can assist by telling you", but if they are unable to properly set out what the injuries are and what they are going through it then means that the commission cannot assist them and tell them what it thinks their lawful and just entitlements are.

CHAIR: There was the suggestion that they would be getting advice from the Workers Compensation Advisory Group. If the purpose is to try to reduce the deficit there would be a disincentive to encourage the worker and say, "You are overlooking other ways of increasing your claim." That advice should be totally neutral.

Mr BENJAMIN: It needs someone to be able to dig out that information. Notwithstanding the public persona of people who make claims, Australians tend to understate their concerns about themselves. Lawyers, or legal practitioners, often are very good at digging through and finding out a lot more about what has happened to people than they see themselves. Often people are optimistic about how well they are or they have symptoms that they do not want to tell people about because they are embarrassed, or for whatever reason. You really need someone who is going to spend a little bit of time with them to draw out that material.

CHAIR: Mr Lancken, you are an arbitrator and a solicitor?

Mr LANCKEN: Yes, I am.

CHAIR: Could it be argued that if there are so many legal practitioners acting as arbitrators that they would ensure the protection of the injured worker?

Mr LANCKEN: It is difficult for an arbitrator to protect someone and still be fair to both parties. It is difficult to remain impartial, and the job of an arbitrator and a mediator is to remain totally impartial. In that capacity I have to hear what both parties have to say. If I am giving advice to one party and the other, how can I remain impartial? It is really not my role as an arbitrator or mediator to give advice on the law, in particular. Certainly my role is to assist the parties and to ensure that the process is fair and that everyone gets their opportunity to say what they want to say, and be heard. If I go much further than that I risk being unfair to one of the other parties.

CHAIR: You could make sure that the procedure is fair but it may not be a fair outcome. That is the distinction; you cannot interfere with the outcome.

Mr LANCKEN: I have to give a totally impartial determination. Ultimately, if I give a determination—and in assisting the parties in mediation I have to also be totally impartial and fair—I have to have dug behind the evidence that the parties have put into the case, and that may cause me significant difficulties in being impartial and fair.

The Hon. HENRY TSANG: If the injured worker is represented by lawyers at the arbitration, and also represented at WorkCover, that is like going back to the old days like when they went to court. Would it be a more difficult job for you to arbitrate or mediate if they were represented on both sides? Would it be easier if they came to you without lawyers and just told to what the problem was? Would that not be fairer than digging up what happened 10 years ago?

Mr LANCKEN: In my experience as an arbitrator in other jurisdictions I have found that, generally speaking, lawyers are of assistance in making a determination, and they do not cause difficulties. Most lawyers understand what is relevant and what is important to a case and they stick to those things.

The Hon. MICHAEL GALLACHER: Mr Benjamin, in relation to your earlier concern that about 24 per cent of workers were unrepresented and the suggestion that somehow the Workers Compensation Advisory Service is, therefore, available to workers to go to for advice, are you aware of anyone, not a union, giving advice to workers?

Mr BENJAMIN: Yes, I suspect that workers will seek advice from a range of areas. They will go to the advisory group, they will go to their local solicitor, probably to their local accountant or doctor. They will seek advice where they can find it. Members of a union clearly will go to the union probably as their principal source of advice. I am not sure of the numbers who are members of unions.

The Hon. MICHAEL GALLACHER: Currently, 75 per cent of workers are not members of unions.

Mr BENJAMIN: They all have to find their advice from somewhere, somewhere else. For those of us who are used to tracking down information, it probably will not be that hard. For those who do not have the research skills that some of us have, and perhaps do not have computers, it is very hard to track down that information. One problem we have, generally, is the shrinking of services, whether it be medical or legal, from different areas and the specialisation of the legal profession, so that the general practitioner legal firm, with the advent of this, may not have the ability to provide that level of service that was available in the past.

CHAIR: Do you believe that the costs that are payable to solicitors for Workers Compensation Commission work is adequate? I know that that is a leading question.

Mr BENJAMIN: No. For my sins I am also a cost assessor with the Supreme Court. A lot of cost determination between parties or between solicitor and client is referred to people such as me and Steve. We get to see an awful lot of legal bills. One of the roles we adopt is to work out what work needs to be done and what is fair and reasonable for that work. The basis of costs is predicated on a lump sum for a particular event. Whilst by colleagues may not be happy there may be some events in which that is entirely appropriate, because there is a very narrow issue of fact and law and a very short time span.

For other matters where you have multiple insurers, onset of injuries over a period of time, or people who have language, intellectual or emotional difficulties, those costs will not properly remunerate the legal practitioner. That means that the legal practitioner will either abandon that area of practice or try to do it in a much shorter way. Try as we might we cannot persuade our landlords to reduce our rent, we cannot persuade our secretaries to reduce wages, we also have workers compensation insurance to pay, and licensing fees and professional negligence insurance to pay. Our overheads are at a certain level and in most cases the cost will not allow deep analysis into the case at these scales.

My skill is as a generalist rather than as a specific practitioner in this area. After receiving your questions I spoke to some practitioners in the area. Their view was that the costs are certainly inadequate, there is no doubt that there is a deliberate strategy to force lawyers out of the system. There have been no fee increases since 1994. Barristers will not be appearing, as a brief fee cannot be separately recovered. In many instances a solicitor's disbursement bill would be more than the fees generated. There is a real disquiet within those practising in that area that it will not be remunerative. If people are not paid they will not provide the service.

CHAIR: It would be difficult to have an appeal system in which, as you mentioned with the model for insurers, there could be genuine heavy expenses for that solicitor.

Mr BENJAMIN: Absolutely.

CHAIR: But the solicitor should have some appeal method. You said a moment ago there could be a conflict over legal costs, it would be better if those cost could be tabulated and approved by the commission.

Mr BENJAMIN: We have a very good way of resolving costs at the moment. Years ago we put in place an assessment system in which the assessors determine what is reasonable to do and what is fair and reasonable. That has worked well particularly in workers compensation matters. It has also been guided by a scale so that the costs are kept within a fairly narrow confine. I suspect that with a bit of imagination and a bit of goodwill from both sides, a system could be put in place so that in appropriate cases there could be a method of properly remunerating solicitors. That is not to make money for lawyers, but to ensure that people are properly represented and their injuries are properly compensated.

The Hon. MICHAEL GALLACHER: Is it not also the case that employers have concerns about their access to legal advice in relation to professional liability? I am told that a number of them have sought legal advice and it is not financially as accessible as it was before.

Mr BENJAMIN: I suspect that would be the case. But because there is only a small number of them, in relative terms compared to workers, they will build up that expertise in professional or non-professional people working within their organisational network and they will be able to get the benefit of someone attending on five or six matters or having all of those skills. My suspicion is that they will build up a far greater bank of expertise and knowledge.

The Hon. MICHAEL GALLACHER: An employer or a member of a chamber of commerce, or like association, will have access to information?

Mr BENJAMIN: Yes.

The Hon. MICHAEL GALLACHER: If the person is one of the 25 per cent of the work force who are members of a union he will have access to information. However, if the person is one of the 75 per cent of the work force who are not members of a union, he will have to look at alternative measures to try to get advice?

Mr BENJAMIN: Yes. Often that will mean going to a solicitor, who may not be remunerated. If the solicitor is not going to be paid, that will not be a growing market and the level of interest and continuing legal education will not be great.

The Hon. MICHAEL GALLACHER: In 12 months time it will all be changed, the legislation moves so quickly. The practice within the commission will change so quickly that unless they are up to date it will be very hard for legal practitioners to keep on top of it.

Mr BENJAMIN: One of the hardest things we have to do, as a profession, is keep up to date. The change to law and the change to management of conflict have been extraordinary in every jurisdiction. The time and effort we have to put into place to keep up-to-date is astonishing. We are forced to do 10 hours a year, but in my firm, which is not in that area of practice, we expect our practitioners to do between 40 and 60 hours continuing legal education a year to keep up to date.

CHAIR: Has the Law Society had any complaints about the time limits involved with the commission's work?

Mr BENJAMIN: I am not aware of any.

Mr LANCKEN: I am not aware of any.

Mr BENJAMIN: But that may be a function of the early stages. We are not sure, so I could not say whether it is working or not.

CHAIR: The only way you would know would be to conduct a survey of your members who are involved in that area. Are you planning to do that?

Mr BENJAMIN: We are not planning to do that. Our members who practice in this field are very sensitive to changes and are quite happy to come to us with any concerns about this. When I contacted them over the weekend in relation to the evidence we are giving today they were very free with their assistance. We have not planned any specific analysis at this stage.

Mr LANCKEN: The Law Society has a personal injuries committee and one of its roles is to seek that information and to seek from the profession its views on those sorts of issues. I am sure that it will be doing that over time when cases are heard.

CHAIR: Perhaps at the end of the year?

Mr BENJAMIN: It will be a continuing monitoring of what is happening.

CHAIR: Do you believe that there are sufficient avenues for appeal of an arbitrator's decision?

Mr BENJAMIN: I do not think that the Law Society has formed a corporate view. Those who practice in the area tell me that they do not believe that there are proper avenues. It is their view, as in most other jurisdictions, that there should be a full appeal as of right from an arbitrator's decision to a judge. In the Federal system a determination by an arbitrator can involve a rehearing de novo, but I am not sure that that is the case here.

CHAIR: Appeals can be lodged on matters of law, but you do not think that is sufficient?

Mr BENJAMIN: I suspect that in this jurisdiction the law will not be difficult, once people get used to how the law applies. It will be the facts the cause people great aggravation. If I have an injury and it is held to be 5 per cent or 10 per cent—and in my view it should be 20 per cent—I have no right of appeal. That is where the rub will be, rather than whether a particular Act has been interpreted one way or another.

CHAIR: So you are saying there is no way to appeal?

Mr BENJAMIN: There may be, it may well be that if the decision is bad enough the parties may appeal to the Supreme Court on natural justice and one of the prerogative writs that it is a denial of natural justice. The problem with those is that they are hard and, quite frankly, a very expensive.

CHAIR: Mr Lancken, how many workers compensation matters have you arbitrated?

Mr LANCKEN: None so far.

CHAIR: Is there any reason for that?

Mr LANCKEN: There have not been enough cases to allocate to all. There are less cases than there are arbitrators, so far as my understanding goes. I think that President Sheahan and Registrar Walker told you how many cases have been allocated so far. It is less than the number of arbitrators.

CHAIR: How would that allocation work? Are they working through all the arbitrators in alphabetical order?

Mr LANCKEN: I am not sure.

CHAIR: You get a phone call one day?

Mr LANCKEN: My colleagues tell me I will get a phone call one day and I will be asked to do a case. But that is all I can tell you about that. It is a matter for the commission how it allocates.

CHAIR: It is not based on the experience of the arbitrators? There is not some ranking among the arbitrators?

Mr LANCKEN: Not as far as I am aware. Some arbitrators have legal qualifications and some do not, and they arbitrate different matters. As far as I know, that is the only differential within the arbitrators.

CHAIR: Does it cause you any concern that you have not been given any cases?

Mr LANCKEN: No, not at all. It is a function of workflow rather than anything else.

CHAIR: We asked Justice Sheahan earlier about most of the cases being heard at the head office. Apparently they can be arbitrated at the head office of the commission or at the lawyer's own office. I imagine you would be happy with that flexibility?

Mr LANCKEN: Yes. I have been to the commission's facilities and it does have some good hearing rooms. I intend to be using the commission's facilities in Oxford Street.

CHAIR: You would?

Mr LANCKEN: Yes. I do not have an office with those sorts of facilities. Some of my colleagues do, and they are happy to do them out of their offices. The flexibility is good.

CHAIR: There is a general question which you may not be able to answer. Obviously from the Government's point of view all this was designed to try to reduce the WorkCover deficit. Do you believe that these new procedures will do that or what impact they will have?

Mr BENJAMIN: I suspect that there will be a saving overall because of the restructure of the way we resolve dispute and the restructure in the way people are compensated. I would have thought it must bring about a saving. If you reduce significant benefits to people in employment, that must bring about a saving. The extent of that saving I do not think anyone can hazard a guess at the present time.

The Hon. MICHAEL GALLACHER: Were you in a position to form an opinion, in a sense? Were you shocked or surprised at the figure of $200 million saving on the scheme following the reforms when there were promises publicly of up to $1.3 billion worth of savings?

Mr BENJAMIN: Those who were involved in it always thought that the extent of the savings was somewhat illusory, but I do not think anyone has done any realistic assessment. We have not employed an actuary—perhaps we should have—to look at the real figures. In terms of the overall comment, over the weekend I emailed one of our members, who responded in this way:

> If the scheme is to be fully funded either premiums need to be adjusted upwards or the benefits reduced or a combination of both.

He was of the view that the scheme has done little more than shoot the messenger and goes on to say,

> The most alarming trend is the apparent direction from WorkCover to the insurers to reduce drastically the disputed claim rate. It has fallen from around the 20 per cent mark to around the 3 per cent mark. This may make the new system look good in the short term while adding massive amounts to the tail liability. The task will be to monitor the tail liability sooner rather than lately.

That is the view of that particular lawyer. I do not and cannot in honesty give my own views, because I do not know that I have analysed it to that depth.

CHAIR: Obviously the background to all these radical changes was to eliminate a lot of legal costs, and so on. I think the Government was claiming there would be no disadvantage to injured workers. In other words, they would be getting the same compensation under the new system as they would have under the old system. Do you think that is accurate?

Mr BENJAMIN: It was interesting when we started that Mr Tsang talked about the adversarial system and whether this would be better than the old adversarial system. The two systems are the inquisitorial system and the adversarial system. This fits into neither. If you want to put in place a full inquisitorial system, there would be no savings, because you still have to analyse and investigate the same issues fully. This system is neither one nor the other. I do not know where it will lead us. The Government certainly hopes it will reduce costs. I suspect the savings will be in the delivery of legal services and that will impact in other ways, but probably more significantly it will be in terms of the compensation paid to people who are injured at work.

CHAIR: I know you have not done any of these cases yet, Mr Lancken, but has the Law Society had any feedback from its members who are arbitrators? Are they happy with this system? Do they have any recommendations?

Mr BENJAMIN: I have tried to find one. I have probably made a dozen phone calls to the people I would have thought would have done these, and I am yet to find a practising solicitor who has undertaken one of these tasks yet. And I am talking about the most senior of them, the ones you would have expected would have received work. None of them received it. It might be that I just had a lousy pick of the dozen people I rang.

CHAIR: Unless it means that not many lawyers are acting as arbitrators. Other officials could be doing it, union officials?

Mr LANCKEN: It means not many cases have gone through the commission. There just have not been enough cases for people to have experience at this stage. The commission had a two-day training workshop to train its arbitrators and there was significant discussion about the process that arbitrators will be applying to determine workers compensation disputes. As I understand it, the commission is itself conducting a review of those procedures. Justice Deirdre O'Connor is going to do that review and will be interviewing arbitrators to see how the procedure is working. I think the commission is doing its best to monitor the way it is working but there just have not been enough cases for anybody really to have any anecdotal experience.

CHAIR: Do you have any recommendations yourselves as to what should be done or could be done to further improve the workers compensation scheme, and again particularly to make it more financially viable?

Mr BENJAMIN: Could I take that as a question on notice and put it to our personal injury committee and get them to come back to you with a formal response rather than an off-the-cuff response, because I think that would be more thoughtful and of more assistance to you?

CHAIR: We would appreciate that, thank you.

(The witnesses withdrew)

(Short adjournment)

DAVID SPRUELL, Investment Manager, Allianz, Level 14, 2 Market Street, Sydney, affirmed and examined, and

ROBERT JAMES THOMSON, Manager, Workers Compensation Insurance Council of Australia, Level 3, 56 Pitt Street, Sydney, and

CAMERON SCOTT McCULLAGH, Chief Executive Officer, Employers Mutual Indemnity, Level 6, 14 Martin Place, Sydney, sworn and examined:

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

Mr McCULLAGH: As Chief Executive, Employers Mutual.

Mr THOMSON: As a representative of the Insurance Council of Australia.

Mr SPRUELL: As a representative of Allianz Australia Group.

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

Mr SPRUELL: I am.

Mr THOMSON: Yes I am.

Mr McCULLAGH: I am.

CHAIR: If at any stage during your evidence you believe it is in the public interest that certain evidence or documents you may wish to present be heard and seen only by the Committee, the Committee will accede to your request and will proceed in camera. I mention at the outset that I do have policies with Allianz, but that will not affect my impartiality. We have some general questions relating to investment management. The mandate states that it is effective from 1 February 2002. Has the mandate been implemented? If not, when do you expect it to become effective?

Mr THOMSON: Mr Chairman, is it possible before answering questions to make a few comments at the outset?

CHAIR: Do you wish to make an opening statement?

Mr THOMSON: Yes, we just want to say a couple of things, if I may. So that I can clarify my role, I know I did this last time I was here, but I think it is important. In representing the Insurance Council of Australia [ICA] I am the manager for the workers compensation area within the ICA and a member of the Occupational Health and Safety Council, but the key point is that ICA is a representative body and not a regulatory body. It represents the eight managed fund insurers, of which two are here with me today, in the workers compensation market. The ICA does not manage nor have any control over the insurers or their operations. I wanted to say that again so that we are clear about that.

The other thing we thought would be worthwhile is if we could table a flowchart, which gives a brief description of how investments are managed within the scheme, but talk you through it so that you have a better understanding of the investment structures within the scheme, so that the roles and responsibilities are clear because I think that will give some context to some of your questions. I will ask David to run through that.

Mr SPRUELL: Looking at that diagram, the starting point is at the top obviously with WorkCover and its asset consultant. Together they will come up with a mandate for insurers to work through. The asset consultant gives advice to WorkCover as a specialist expert on what the asset structure of the fund should be, given the circumstances of the liabilities of the fund. Like all investment funds, you have to start with the liabilities and you are working towards that point as to how the fund is structured to meet those liabilities as best as possible. So, between them they come up with a mandate that is issued to the insurers. That mandate is a very comprehensive set of rules and regulations as to how we should run the fund.

I guess you would say it is the road rules for running the fund for which the insurers are responsible. It has some very defined parameters within which we must operate both at a higher level and at a very detailed level on particular securities we can and cannot buy. We have to always operate with that not just at the back of our minds; it is actually built into our systems so that we do pre-trade compliance to that manual. We do not just buy securities and then look afterwards to see if we have broken any rules. We are looking at the rules all the time, checking before we actually buy a security.

That is issued to us and, as I say, we keep it beside us when we are managing funds. As you know, the funds are run by each of the eight licensed insurers in proportion to the business they have accumulated over the years the scheme has been in place. Allianz is just one of the eight. Each is a statutory fund constituted under the Act and run according to the mandate above. A relatively recent addition has been to put a master custodian in place, Cogent Investment Services. It is an AMP company—it was; it has just been sold. They actually hold all the assets of the fund. When we undertake a transaction we will, say, for instance, buying shares, we will buy the shares through the stockbroker. The contract note will get issued to our back office and our back office will inform the master custodian, who will effect the settlement of the transaction. So, they hold the money as it were and they hold all the other assets, the records of the share et cetera that have been bought for the fund.

CHAIR: You said that was AMP?

Mr SPRUELL: It was an AMP company called Cogent Investment Services. It has been sold to Banque Nationale de Paris about a week or so ago.

CHAIR: And it now will take over?

Mr SPRUELL: They will own it and keep running it in the same manner. They look after all the accounting and compliance of the fund and the arrow back up to WorkCover is to represent the reporting that they do to the WorkCover Authority. It is available on a daily basis. I am not quite sure how often they get reports, but particularly if there are compliance breaches, they will get them on a daily basis.

CHAIR: Do they have a fee from WorkCover?

Mr SPRUELL: They charge a fee to the fund, yes.

CHAIR: Is that a percentage of investments?

Mr SPRUELL: Yes, it is a flat percentage fee across all funds. They present both individual insurance reports and a consolidated reporting package to the authority. If I could just mention the little circle on the left is from all the international assets of the funds; they are run to a common pool that the WorkCover Authority has organised that is managed by Barclays Global Investments.

Mr THOMSON: It is fair to say that that is a recent change. The amount that Barclays put into that has probably substantially increased. From January it has gone up to approximately $1.2 billion that has been moved in there.

CHAIR: It sounds as though the new master custodian company is also an international insurer. Is it is based in France?

Mr SPRUELL: The new owner is based in France, yes—the Banque Nationale de Paris. It will be part of its international custodian operations in the future, but it does run out of an operation in Sydney.

The Hon. HENRY TSANG: Just out of curiosity, how much of the WorkCover money is invested overseas, and how much is invested in Australia?

Mr SPRUELL: Twenty-five per cent is the benchmark allocation in the reference portfolio.

The Hon. HENRY TSANG: Twenty-five per cent is international?

Mr SPRUELL: International, yes. I have another document that I can table which shows what it was under the previous mandate and what it is under the current mandate. It shows the percentage breakups of the assets. That is what is called the reference portfolio which is how we get judged on our performance.

CHAIR: Does this chart show only what Allianz has?

Mr SPRUELL: No, that is for the whole mandate. Every insurer gets the same mandate and they structure it to say, in a sense, that you will be judged as if the funds were invested in this manner. We have some latitude either side of that reference portfolio, say, if we were particularly optimistic about Australian shares and we want to go up to 30 per cent in the Australian shares. That is where it gets down to the individual insurer.

CHAIR: That chart, even though it has the Allianz name on it, is actually from AMP?

Mr SPRUELL: It is from the mandate, yes.

CHAIR: It is from the master custodian?

Mr SPRUELL: No. This comes from the mandate. I just wanted to compare the old mandate with the new mandate for you. There was quite a big change when that happened this year.

CHAIR: That change originated with WorkCover as a policy decision?

Mr SPRUELL: Yes.

CHAIR: Were you happy with that? I suppose you carry out instructions.

Mr SPRUELL: We are humble servants.

CHAIR: Is it something that you recommended back to WorkCover?

Mr SPRUELL: No. This was a decision taken by WorkCover and its asset consultant. I assume—yes, they did have advice. They had a presentation to the insurers and the asset consultant was there. They talked about why they had made that choice. We are relatively indifferent to that choice. It does not really matter to us. We use these percentages as a reference point and, as I say, we manage the fund around those reference points.

Mr THOMSON: I guess it is fair to say that on the policy decision of how the mandate ends up, that is a WorkCover decision. As their agents, basically we implement in accordance with that mandate. They do not consult, really, in relation to whether that is right or wrong.

The Hon. HENRY TSANG: That current mandate is probably on a par with other big fund managers, is it not?

Mr SPRUELL: Not necessarily. The mandates for WorkCover—and it is the same for any other investment fund—would be constructed by looking at the liabilities of the fund. The WorkCover liabilities are fairly unique in the structure of them. I am not an expert in liability structure but my understanding is that it goes out for 30 or 40 years in relation to some of the liabilities. In relation to the particular drivers of those liabilities and how we will eventually turn them into payments out of the fund, the asset consultant should be taking all that into account in giving the WorkCover Authority advice as to how it should structure the assets. If it was a superannuation fund, they have a different set of liabilities, so the fund structure could turn out to be something that is different.

Mr McCULLAGH: That is a matter of large judgment, though, the percentage that goes into international equities versus Australian equities, for example. The asset consultant advises WorkCover on that. They do not seek our advice on it.

CHAIR: I assume that the purpose of the new mandate from WorkCover was to increase the income from investments or to provide greater security, was it?

Mr THOMSON: To increase the potential, I think—the return that they would achieve on the fund. Because it had moved more into international shares and more into equities, hopefully the view would be that there is likely to be a greater return in the short to medium term because that is where you are likely to potentially get better returns. The timing of that and whether it is appropriate or not is another issue.

Mr McCULLAGH: They have shifted to a growth portfolio or something like a growth portfolio rather than to something like a balanced portfolio, and there are higher risks and possibly higher returns with the growth portfolio.

The Hon. MICHAEL GALLACHER: So that people who are reading the transcript of today's proceedings tomorrow can understand this, you say that they have invested more money in shares. If the share market goes belly up, in quite simple terms there is now a greater risk. Is that correct?

Mr SPRUELL: They have brought greater risk into the portfolio in the expectation that there will be higher returns. It is a simple trade-off.

The Hon. HENRY TSANG: It is the judgment of the asset consultant that in the longer term there would be more growth in the value of shares rather than assets because assets are raised to a certain level. WorkCover took advice and moved into international shares?

The **Mr SPRUELL:** Yes, international and domestic. You can see the figures and the key ones are the bottom line of the table. Whereas it used to be 30 per cent in shares and property trusts, it is now 60 per cent.

The Hon. MICHAEL GALLACHER: Can you explain to me in international shares, unhedged and hedged, what would constitute an unhedged share and what constitutes a hedged share?

Mr SPRUELL: When you are buying international shares, in effect there are two elements to it. One is the actual investments in the individual share markets around the world. The second element is the currency exposure into those markets. With an unhedged fund, basically you send your money off and if it is invested. These days it is roughly half into the US and the other half is spread around the other markets, and you are also buying the currency of those markets at the same time. You have two opportunities to make money. One is on the movement in the market and the other is on the movement of the currency. A hedged fund basically hedges that currency risk or opportunity, and the return you get is purely from the share market return into which your money is invested. There is no currency return.

CHAIR: So it is a combination of currency and share market?

Mr SPRUELL: Unhedged is a combination of currency and share markets, and hedged takes the currency risk out of it and just leaves the investments to the share market.

The Hon. MICHAEL GALLACHER: For how long has WorkCover been into the hedged and unhedged shares?

Mr SPRUELL: Unhedged has been part of the portfolio for a number of years. My experience with the WorkCover portfolio goes back to early 1996, late 1995. I think at that time they had about 10 per cent in unhedged international. I think it was brought back to originally five per cent and then four per cent over the years following that until January this year when it was taken up to 12.5 per cent unhedged. At that time they brought in the hedged variant as well.

The Hon. MICHAEL GALLACHER: If they get it wrong with the increased risk—if the Government gets its speculation wrong—does that then add to the unfunded liability?

Mr SPRUELL: If the return to the fund is less than that assumed by the scheme actuary, yes.

The Hon. MICHAEL GALLACHER: So now we are gambling, basically, because there is a certain group carrying high risk?

The Hon. HENRY TSANG: You cannot say that it is gambling. They are taking a longer-term view.

The Hon. MICHAEL GALLACHER: Some people would suggest to you that going into the money market is fairly high risk. That is so, is it not?

Mr SPRUELL: No. I think you have to look at what you are trying to cover. Part of the risk of the WorkCover fund is that the liabilities grow faster than expected, say, due to inflation. Usually that would be covered by additional growth in the equity component or the property component of the fund. It is actually prudent to have

a mix of assets within the fund. We sit here today and we try to look forward, but in reality the only thing we have got to guide us going forward is past experience. Past experience has been that over the past 100 years we have made a lot more money out of investing in shares than in fixed interest or cash. That does not mean to say that that is what is going to happen over the next five years, but it is a reasonably good guide. There is a growth element in the returns from shares and property that give you an extra return. In the short term it adds risk to the fund, yes, but in the medium term it usually ends up with a much higher return for the fund.

Motion by the Hon. Michael Gallacher agreed to:

That the charts be incorporated in *Hansard.*

CHAIR: When you were talking earlier about trying to anticipate the currency market, I was thinking of what the Commonwealth Treasury tried to do.

The Hon. HENRY TSANG: But it was speculating purely on the foreign exchange. This is more balanced.

CHAIR: There are experts in Canberra but they seem to have a big problem with it.

The Hon. MICHAEL GALLACHER: What information is available to the average person in the community to give them an indication of how this investment strategy is travelling on a day-to-day basis?

Mr SPRUELL: It is relatively easy, if I can say that as a bit of an expert. For each of these asset categories there is an index that measures the movement on a day-to-day basis. They are reasonably easily available, particularly using the Internet. If you wanted to, you could sit at home and put together the daily movement on this fund to within a reasonable degree of accuracy. I am not sure what it gains, but you could do it day by day, just using the indices for each. There are reference indices that are contained in the mandate.

The Hon. MICHAEL GALLACHER: What impact did September 11 have on an investment strategy such as this?

Mr SPRUELL: The obvious thing is that the share markets fell heavily in the few trading days following events on 11 September. By year end, most of that had been recovered. That is why I said that it is dangerous looking at short-term movements on a fund like this.

CHAIR: What is the total amount of money actually invested by WorkCover?

Mr SPRUELL: It is approximately $5.2 or $5.5 billion.

Mr THOMSON: It is $5.7 billion, of which $1.2 billion is in overseas or international shares, or about 25 per cent of it.

The Hon. HENRY TSANG: It is a lot of money.

CHAIR: Who is the asset consultant now?

Mr THOMSON: It is Towers Perrin, an American company.

CHAIR: A lot would depend on the skill of that asset consultant and the advice that was given to WorkCover. The insurers are not involved in that process at all?

Mr THOMSON: No, we are not. That is a policy issue. That is left with WorkCover.

CHAIR: There is no consultation with insurers? Obviously, you have a lot of experience of investments within your companies?

Mr SPRUELL: We do that exercise for our own funds, where we carry the risk. In this instance, as you know, the risk is not carried by the insurance companies. So it is appropriate that we do not get involved in that exercise.

CHAIR: I did not mean that you should get directly involved. You must have gained a lot of practical experience of the investment market?

Mr SPRUELL: We would need to get a lot of information on the liability structure to do this exercise properly.

CHAIR: The investments that insurance companies make are to protect their own investments. Would you be more conservative than WorkCover?

Mr THOMSON: In some ways it is a bit hard. Individual companies are only seeing their relative percentage of the whole scheme portfolio. Allianz Asset Management is seeing the largest share, with about 30 per cent, or along those lines, and Employers Mutual Indemnity is seeing about 6 or 7 per cent of whatever the market share is. To gauge how that all fits together you can only see that in one spot and that is WorkCover. So it is difficult for insurers to actually provide a lot in that because they only see how their funds are going, relative to their management around the mandates. It is difficult because they do not see the total picture.

CHAIR: You and your companies have to make a lot of decisions about your investments. I did not want you to compare the percentage of WorkCover that you have. Your company has its own investment policy, does it not?

Mr SPRUELL: Yes, but we have a different structure of liabilities, so it is hard to make that comparison. As I said earlier, to compare it with a superannuation fund would be wrong. Certainly in Allianz' case, our underwritten book is very different from the WorkCover book.

The Hon. MICHAEL GALLACHER: Could you explain what the significant drop in liquid assets involves? It has gone from 25 per cent down to 2 per cent.

Mr SPRUELL: I guess it is tied up with this move to more growth assets in the fund. If it is in cash it is obviously low risk but low return. The authority seems to want to move from those sorts of assets to higher expected returns, albeit with a higher volatility of return.

The Hon. MICHAEL GALLACHER: So where would they have got that 25 per cent of liquid assets?

Mr SPRUELL: That was in a mixture of assets such as bank bills, overnight deposits with the banks, wholesale markets, floating rate notes, assets like that where the interest rate is reset every few months.

CHAIR: I refer again to WorkCover's investment policy. Do you believe it is appropriate, considering the long-tail nature of the scheme?

Mr SPRUELL: Unfortunately, as I have said before, without a detailed knowledge of the liability structure it is very hard for an outsider, as it were, who does not know that structure, to be able to say, yes, it looks good or it looks bad. I believe it is appropriate, given the long-term nature of the liabilities, that there are some growth assets in the fund. Beyond that, I would find it very hard without that analysis to say it should be 30 per cent, 50 per cent or 60 per cent.

CHAIR: WorkCover would produce that analysis, would it not?

Mr SPRUELL: Only the conclusions of the analysis that I have seen.

CHAIR: But you would need to know the background to the analysis?

Mr SPRUELL: To do that we would need to get information on the liability structure at a far more detailed level.

CHAIR: Do insurers not get that? Have you asked for it, or do you not want to get involved in it? Is it a case of the less you know the better?

Mr THOMSON: No, I do not think it is that. It is really not our role. We are not responsible for the liabilities. I guess that it goes back to what David said earlier, picking up on that point. We are there to perform a function—to carry out investments on behalf of WorkCover and in accordance with the policy direction that they, as the owners of the liabilities, want and how they want their funds invested. Obviously, if they ask for this input I

believe we would probably try to attempt to provide that. But they do not seek an input; they basically deliver an outcome and say, "This is the way the policy is going and that is what we will implement."

CHAIR: Would it be better for WorkCover in the long run if it had more of a consultative attitude and it sought your opinion, obviously without being directed? It would have to take responsibility for what it finally does.

Mr THOMSON: I guess that it comes back to the issue again of individual managers knowing what their portfolio is or is not doing. It is the amount of time that would be required to review the overall scheme data and come up with an assessment and the value that that would add with, say, eight different opinions. You could get eight different consultants who could potentially give you eight different views as well.

Mr SPRUELL: I suspect that, if we did the analysis, we would probably not come up with a dramatically different set of conclusions because we would tend to use the same sort of analysis as I assume the asset consultant would have used.

Mr McCULLAGH: I suggest that we would probably give it the same rating as an asset consultant might, but there is a lot of judgment involved in it. It is really that risk award trade-off that people have. As you go higher towards a growth portfolio you have more risk and more potential return. While you can do the analysis based on when the liabilities will have to be paid out and you can suggest the best match for investments, there is still a large degree of judgment involved in that.

CHAIR: I always think of insurance companies as being conservative by nature. You would not have that kind of investment attitude for your own assets, would you?

Mr McCULLAGH: If you look at any 10-year period in history, you will see that equities have performed better than any other investment. So if you are looking at a longer term return, as David said, based on the past, it is not always a guarantee of the future. Equities do, in fact, give better returns over longer periods of time. It is a long-tail insurance. So a growth portfolio is appropriate. There is judgment involved in how much growth you have. It is really between the asset consultant and WorkCover to determine that. It would be fair to say that that is a high percentage in shares and properties, strongly weighted towards growth for the portfolio now, particularly with the 25 per cent in international equities.

Mr THOMSON: If you had individual insurers and you looked at their general insurance portfolio, if they have a lot of short-tail business they probably would not have a lot in properties because the dollars are turning over relatively quickly. But if you get into long-tail classes like workers compensation liability, insurers would then have more growth-oriented assets in their portfolios because of the way they are doing their investment portfolios. Within the WorkCover scheme about 60 to 70 per cent of the claim payments made for a relevant accident year is at year five. So you still have, five years out, at least 30 to 40 per cent to be paid out. So you need to have some sort of growth to cover superimposed inflation costs because you only collect your premium once. You do not get a second bite.

CHAIR: That is why it is dangerous for some people to add up the premiums paid in one year and suggest that insurance companies have made a lot of money that year.

Mr THOMSON: That is correct. That is exactly the point.

Mr SPRUELL: It gets back to the risk tolerance of the owner of the assets. If they are prepared to take more risk on a year-by-year basis, then the usual expectation is that you make more return over the long run. But it does mean that the higher the proportion of growth assets in the portfolio the greater there will be the variability in returns on a year-to-year basis.

CHAIR: Does the new investment mandate provide opportunities for sufficient remuneration of insurers for managing the scheme's investments? What is a formula for your remuneration? Are you managing a percentage of the investments?

Mr THOMSON: The investment mandate is really probably not the key to driving the insurance remuneration. The mandate sets out the guidelines within which you have to operate. The issue really is whether the work involved in doing the whole portfolio analysis and managing the investments and the like, or the money that WorkCover puts on the table, is sufficient to cover that. I do not really think it is specifically the mandate that is the issue. I can be corrected if I am wrong. My understanding is that it is not the mandate that that is the key driver; it is

the overall structure around the diagram that we have tabled. That is the key that drives the costs that insurers have to wear and have to carry. Then the issue is whether the remuneration relative to that is sufficient.

CHAIR: Is it sufficient?

Mr THOMSON: That is an interesting question. I think it is fair to say that the existing remuneration, which is currently a flat fee of 25 basis points, in the past has probably been at the lower end of the scale relative to what is available in the marketplace or what the market has been providing.

Mr McCULLAGH: Twenty-five basis points is 0.25 per cent.

Mr THOMSON: Really I think we would say the information we have is that it is at the lower end of the market.

The Hon. HENRY TSANG: It is a big turnover.

Mr SPRUELL: This is relative to rates for big funds.

CHAIR: I assume that WorkCover was trying to provide greater incentives for the insurers. Did that not change?

Mr THOMSON: No, nothing has changed. Currently there is a proposed remuneration package on the table from WorkCover which brings in performance fees. It reduces the current 25 basis points flat structure to a proposed structure below that—think it is around 11 basis points flat with performance over and above that. You have to take into account the impact of the international movement because Barclays handles all of that. That is currently being negotiated with the insurers. We are in the middle of negotiations; there is no agreement in place that that will actually take effect at this point. At the moment an external review is being carried out in relation to whether what is on the table is appropriate or not. So the new remuneration structure that has talked about performance-based investment fees has not been agreed and is not operating.

CHAIR: Do you think that it is more generous? We were given the impression that WorkCover was providing a greater incentive to insurers. That is why you have not come to an agreement yet?

Mr THOMSON: I guess it is fair to say that from my understanding of it—sitting outside from the experts—that 25 per cent of the investments are sitting in equities, in Australian equities, and that is where you tend to get most of your growth. Actually 25 per cent of the 75 per cent you have got control of is trying to drive the total growth where you get your performance. So it is very difficult to outperform the market in the other 50 per cent—25 per cent is trying to drive 75 per cent. So we have got some concerns about that. WorkCover is aware of some of that but not all of it because we have not presented our position.

CHAIR: Is there any timetable as to when this agreement may be reached, or are you hinting that it may not be acceptable?

Mr THOMSON: I am not sure either way. Basically at this stage we are looking to probably commence negotiations with WorkCover next week.

CHAIR: You will make a counterproposal?

Mr THOMSON: It is not really a proposal. We just want to put on the table the issues as we see them from our side and to put a case to get them to reconsider some of the things that they are considering so that we can come up with something which is mutually acceptable to both parties.

The Hon. MICHAEL GALLACHER: Do we have the potential here of a re-creation of the home owners warranty scheme? If you cannot reach agreement on the remuneration package, is there potential for insurers to walk away from this scheme?

Mr THOMSON: We have got to be very careful with that question, if I can say so, because you are talking of the investment component only. What you are saying is if all the insurers said no to continuing the investments you have to go and check the licence conditions to see how they actually can do that. I think the way the 1998 Act changed the licensing arrangements for insurers, the insurers have to apply to WorkCover to change any of their

structure and how they are managed in that respect. So some legal issues need to be checked through. If they wanted to walk away from the investments, the impact on the other areas that they operate would have to be considered. So the question you asked is a lot broader than just that. The investment by itself, I guess that can be reorganised and could be managed in a different way, but one would hope that we do not get to that situation. I do not necessarily see it going that way.

CHAIR: There has been a proposal that it would be a bit more efficient to have specialist investment management firms handling the investments.

Mr McCULLAGH: Historically, asset consultants have not been particularly good at making individual investment decisions. For example, the decision recently or the recommendation to WorkCover to put a lot into international shares. Historically they have not been very good at making those sorts of calls because they are very much dependent on timing. Asset consultants are very good at saying these should be your upper and lower parameters, but they are not particularly good at making timely decisions. So if it was to go to individual fund managers, the asset consultant would select what they perceived as the best small cap fund manager, the best large cap fund manager, the best fixed-interest fund manager.

David mentioned before if you had a particularly good view of Australian equities, while 25 per cent is the point at which they judge our mandate, we can go either side of that within parameters. It is important that people have that ability to be able to swap in and out at critical times on a really timely basis. That is one thing you would lose by having discrete mandates rather than people having an overall portfolio in which they could shift between fixed interest and equities at different times.

CHAIR: So you would lose income?

Mr McCULLAGH: Over time you would lose income.

Mr SPRUELL: I think Price Waterhouse brought out a report about two years ago that indicated that the benefits of the specialist structure of using, say, the best share manager and things like that, tended to get lost because of the poor implementation of the moves between one asset category and another. At the moment the structure is very tight. If a premium is received at, say, Allianz today, we will be investing it tomorrow morning. So it is a very efficient way of managing the money rather than it being collected and moved around different people and allocated out. We will act on it immediately. The theory does look attractive, a specialist structure, but I think the practical implementation is found to be lacking a bit.

CHAIR: I felt when you were talking earlier that if it was moved to the specialist management area, this would have an impact on the insurers' willingness to be involved in the whole scheme. Would that have some effect on you?

Mr THOMSON: To answer the question about the home builders and home owners warranty situation, the question I was raising was the licensing issue with the insurers, the way they are structured. They are licensed to deal with premiums, underwriting, the issue of policies, claims management and investment management. To take one component out—which is where I think your question was coming from—what is the impact on that of the overall licensing arrangements? I am not saying that it would change anything else but I think it needs to be looked at to see what the implications are and how it can be managed. If the insurers maintain the other components, how do you then put the process in place to deal with the investments and on a timely basis, which David was just talking about?

Mr McCULLAGH: Speaking for Employers Mutual, if we lost the management investments it would certainly be an enormous concern to us how we manage the overall workers compensation. We are a specialist workers compensation provider. We only do New South Wales workers compensation; we only do it for WorkCover and the Thoroughbred Racing Board. To takeaway investments would be to take away some of our expertise in workers compensation. So if privatisation was to occur the Government would have done taken away something which is a core element of an overall operation and we would subsequently have to put it back in place again. So that would be an enormous concern to Employers Mutual. We have been a particularly good performer in claims and in investment performance. So I cannot see a good reason why we should be penalised for something that we have not done wrong.

CHAIR: In other words, it is an incentive to you to have the opportunity to manage the investments?

Mr McCULLAGH: It is.

Mr SPRUELL: I think it would be fair to say it is obviously revenue to the insurers. They tend to have their own asset management area like the one I run. At the margin we wanted to get as much revenue as we can. It helps run the whole business. So it would be a loss to the insurers if that was to go.

CHAIR: It would then make you evaluate whether you continue to provide that service in the insurance area.

Mr THOMSON: There may be different reactions from different suppliers. I think Cameron has given one; I think Allianz would have a different view. They might have the same view but it is hard to say exactly what the overall view would be. I think one impact for WorkCover is that different managers give them some diversity and protection. So if one is taking a more aggressive approach and another one is not, the whole market moves. You have actually got some protection because they are all counterbalancing themselves to get an overall performance across the fund. I think that is one of the benefits leading back to what you were talking about, Cameron.

Mr McCULLAGH: That is right. That is a very big benefit of having the diversity. There is a diversity of managers and they might all make the same call at the same time.

Mr SPRUELL: There are eight managers in each sector. Normally a specialist structure would not put eight managers in each sector.

CHAIR: Do the performance benchmarks make allowances for the size of the fund each insurer manages? Are those performance benchmarks part of what you are still reviewing?

Mr THOMSON: At the moment the fees are flat across all the investment managers.

Mr McCULLAGH: Under the proposal there is no difference, depending on the size of the portfolio, and that would be appropriate. There should not be a difference based on the size of the portfolio. It is not common practice. There is an argument that it is easier to get better returns with a smaller portfolio but all of the insurers are professional fund managers and should have to go against a standard benchmark.

The Hon. HENRY TSANG: Please explain the insurers' reporting package under the new investment mandate. From an insurer's perspective what duty does this impose and how has WorkCover assisted the insurers who are recruiting the funds?

Mr McCULLAGH: The master custodian is Cogent, the company now owned by BNP. It performs all of those roles, which is quite appropriate. There is an independent custodian that not only holds the assets but reports back on the individual performance of the insurance and the overall performance of that portfolio, which is quite an efficient and appropriate way to do it.

Mr SPRUELL: There is a particular pack that comes out every month called the insurer reporting package which the WorkCover authority gets from Cogent and then passes on to the insurers. That contains only relatively high-level information. It has some information on the market value of each statutory fund that each of the insurers run and the asset mix of those funds. It also has in it the monthly performance report for each individual insurer and it has a compliance report. If there have been any breaches that the custodian has picked up they are included in that compliance report each month. It is a relatively small report. Most of the information goes direct from Cogent to WorkCover.

CHAIR: There has been a proposal to have a management company doing investments and there has been another proposal to have a claims management company handling claims. What is your reaction to those suggestions?

Mr THOMSON: You are basically talking of unbundling the schemes so you have various components managed by various people. If you only had one claims manager handling the scheme I think you would potentially end up with the situation that you have seen in the Victorian situation. Victoria had a few. South Australia had one manager managing the whole scheme. It was then put out to agents in 1995 and the general reaction from the employers and the workers as a result of that was that it was an improvement, an increase in the level of service and a better outcome for the scheme. Under the scheme in New South Wales, if you have multiple companies, different players you actually lose something from the employer perspective.

The employers would be dealing with two different parties: one with their premium; one with their claims. That is where it is heading. We see them very much as being linked because the attitude of the employer in relation to how they handle and manage their claims has a direct impact on their premium. To get them to take ownership of accountability you need to have the two linked so that they can understand that scenario, hopefully have a better response so that they try to prevent accidents occurring and therefore improve their loss ratios along those lines. Also, if they do have claims they can manage them appropriately and realise the impact across the premium side. We see that very much as one way the total package provided in the end is a much better solution.

CHAIR: I got the impression that you gathered that everyone in South Australia was happy with it?

Mr THOMSON: I believe that the fact that they changed from a monopoly, where they had a monopoly claims agent, which was WorkCover, they then outsourced initially nine, now five, insurers as agents, has actually brought benefits to the scheme by having multiple functions. I think it could be enhanced even further if its agents were actually linked more to the premium side. But in South Australia it is not even a premium, it is a levy. It is regarded more as a tax, it is not even an insurance premium.

CHAIR: South Australia moved back to what we have in New South Wales?

Mr THOMSON: I think it would add some value to the employers, yes, in the scheme.

Mr McCULLAGH: We are now in the first year of a new scheme that WorkCover put in place. They got PricewaterhouseCooopers in as consultants to look at how the scheme should be managed, certainly from the remuneration perspective, and they changed it from being a remuneration perspective, which was not particularly focused on outcomes, to one that is very focused on performance indicators. They have brought into service capability index and a different payment basis. Given that we are currently in the first year of that new scheme, I think it would be very interesting to see how that goes, what the level of service is and the claims management under a scheme where you are being reported for good performance. Conversely, if someone is performing poorly it has been set up with the structure where they will not have sufficient remuneration to stay in the scheme. They are likely to be forced out. It has been changed, commencing 1 July 2001 to a scheme that should give the same outcome.

CHAIR: So you have agreed to what happened on 1 July?

Mr McCULLAGH: Fundamentally.

Mr THOMSON: The measures basically have not been signed off yet. They are very close. We nearly concluded that from when we were last here talking about remuneration basically, the industry is in agreement with the new package, the package is being implemented, the insurers will be assessed under the new arrangements and I guess it is fair to say that the new arrangements are probably as close as you will get to the conditions that would apply in a privately, underwritten environment that you can develop across a range of measures. It is very close to giving those sorts of tensions, and that is what it is trying to achieve to incentivate the providers to perform.

CHAIR: What is it that you have not agreed to: is it percentages of remuneration?

Mr THOMSON: No, it is probably three of the outcome of measures: the return to work, the loss ratio and the tail. The actuarial work that is required to be done to have those in place has not been done. The return to work is being done with the current scheme actuary. The loss ratio and tail measures, work for developing those measures will not even commence until after the period has actually completed when the new scheme actuary is appointed for WorkCover. The measures will not be commenced to be worked on until then. Preliminary work and discussions, but actual actuarial work to get the measures developed has not commenced.

CHAIR: All that causes problems from 1 July? It sounds partly agreed to, partly not agreed to. It will be phased in a way.

Mr THOMSON: No, details to be assessed.

Mr McCULLAGH: A good example, I guess, is the loss ratio, which is the ultimate test of insurance. It is the cost of claims divided by the premium. It was always planned that any insurer would not be paid until three to five years after the insurance year because it is a long-term insurance and the actuary needs quite some time to work out whether an insurer has done a good or bad job in claims management. We are still in a position where we know that we will get paid an amount based on whether we get a good loss ratio. We are incentivised to do as good a job

as possible. How that is implemented, and beyond the mechanics of how the actuary go through and calculate that loss ratio is still be negotiated with WorkCover. But that is not to say that the incentive is not already there to do as good a job as we possibly can with the claims management.

Mr THOMSON: I guess the key point out of that is that even though the measures have not been developed, they apply back from 1 July so that we are being assessed by them even though they are not there. The industry may not be totally happy, because it would be nice to have some monitoring tools on the way through but all the insurers have some methods of their own where they can monitor their business, know how they are actually operating and, therefore, can assess what is being achieved or not been achieved. Even though they have not developed the models would be applied and insurance would be assessed accordingly.

CHAIR: Does that create pressure on the insurance company when you do not get paid for, say, the three years it takes to assess the actuary to assess how successful you have been?

Mr THOMSON: Insurers have gone in knowingly.

Mr McCULLAGH: If we were privately underwriting workers compensation, which we used to do before 1987, then we would be in a similar position. I think PricewaterhouseCooopers and WorkCover have designed a good remuneration package for trying to make it as similar as possible to a privately underwritten scheme. Yes, we will not get paid for three to five years, but we are an insurance company. We would have that if we were privately underwriting.

Mr THOMSON: It is fair to say that it keeps the tensions on managing claims in the longer term and, therefore, trying to have a more positive impact on the tail. It is fair to say that the previous remuneration arrangements did not have enough of that tension. This is about producing some of that attention to ensure that claims are not just managed for the first year or two years, but that there is ongoing and more active claims management happening in the longer term.

Mr McCULLAGH: Although we would love to be paid in the first year, I would even more dearly love to have a scheme where if we performed well we would be well remunerated and if we do not perform well we have to change what we are doing or get out of New South Wales workers compensation. That is an ideal scheme.

CHAIR: Would it help in the long run for both the management of the scheme and the injured worker to have structured settlements rather than lump sum constructions?

Mr THOMSON: The structured settlements are an interesting debate by themselves, firstly, because you need the tax law to support it and, at the moment, it is not fair to support workers compensation, so a structured settlement—

Mr McCULLAGH: But is there for everything but workers compensation.

Mr THOMSON: There are some more issues about structured settlements because they can be of value in certain circumstances whereas in other circumstances it is not necessarily as much value. There needs to be some more thought put into the process as to how effective and whether it should or should not apply.

Mr McCULLAGH: I believe that structured settlements would be a significant advantage in workers compensation, as they are in other types of insurance. Historically, when people have got lump sums they blow that money. People will take the lump sum rather than a structured settlement unless the tax is equal for the two of them. The great benefit of a structured settlement is that it saves people from taking a second bite of the cherry. They take their lump sum, they blow it and the figures that are done are similar, I believe in Australia and America in that they blow the money not on assets but on consumption. They give it to people, they spend the money. By giving them a structured settlement, they are getting a small amount in perpetuity and it is protecting them but it is also protecting society.

Mr THOMSON: The only qualification I would put on that is that it depends a lot upon the actual legal process that is in place at the time because potentially if the court process and the dispute process, the way it is done, it can end up with greater amounts being paid when up-front instructions are in place. There are some counter tensions. I agree totally with what Mr McCullagh has said. There are some practical applications and how it is put in place, depending on the actual dispute and the legal system that applies and that needs to be taken into account. There are just some tensions that need to be thought through.

CHAIR: Are you aware whether they are redoing the taxation provisions for workers compensation payments?

Mr THOMSON: It was only recently that structured settlements came in for non-workers compensation to change tax treatment. As I understand it, where this has happened around the world workers compensation has followed some time thereafter. We are following that pattern of not having workers compensation initially and there is coming in later, because I can see no reason for a distinction between workers compensation and another type of insurance. I think it is a bad practice to give many people a lump sum where they are not accustomed to receiving that sort of money, which is to provide for the next 20 or 30 years, not be consumed in two years.

CHAIR: Are you making submissions to the Commonwealth Treasury? Is someone driving that issue?

Mr THOMSON: There were a lot of submissions in relation to structured settlements, which is why it has come about. The submissions included workers compensation. Yes, I guess there will be more submissions in relation to workers compensation.

CHAIR: Our Committee could also take up that issue in his recommendations. The other area was compliance and fraud. In your opinion, what is the extent of fraud and non-compliance in the scheme? What is this costing the scheme on an annual basis? Are you able to give us any figures on that?

Mr THOMSON: It is pretty difficult to give a definitive answer in relation to the question, and you have to look at it from a couple of angles. You have employee issues in relation to non-compliance and fraud from the employee perspective and you also have it on the employer perspective. Two parts of the issue need to be addressed. It is very difficult to come up with specific figures. I have a little bit of information because it is information about WorkCover provided to the advisory council a couple of meetings ago. Broadly, the extent of fraud and non-compliance if I go through them, firstly, the employee-related issues. Employee-related issues are probably the hardest to identify and the hardest to get information in relation to them. You can have a situation where the claim is fraudulent from the very outset, that is it was not work-related or did not occur but the claim has been lodged. There is also that it is a legitimate claim, but the severity of the injury is being overstated as they are looking for more compensation than they are potentially entitled to relative to the injury.

The industry's view is that probably not a high number of fraud cases are really prevalent in the scheme from the employee perspective, but when they are varied they are probably fairly expensive. One of the key issues has been that they are pretty hard to identify. Certainly, employers in the scheme tend to think that there is a lot of it going on, and a lot of them tend to think that nearly all claims are fraudulent. In some smaller employees I think it is a fair view that anecdotal evidence is around; a lot of them think that most claims are potentially fraudulent and not legitimate. One of the key things is that to prove fraud is very difficult. The level of proof to get it through the court and get the court to say that someone has been fraudulent is there has been an original injury and then there has been aggravation, then the courts are very loathe to exceed to that and the number of cases getting to court and being successful are very small. It is very difficult to get sufficient evidence.

One of the issues that will be interesting to watch over time in relation to that will be the impact of provisional liability in relation to the injured workers and how that actually comes through. It has the potential that more claims might come into the system in the short term, but they might last for only a short time. It would be interesting to judge those figures to see what impact that has on behavioural aspects within the scheme. I guess the other aspect is in relation to workers actually trying to get more. A lot of that comes back to the culture of the scheme. New South Wales up till now has very much been a lump-sum based scheme. With the commutation activity in the common law, and I know you have done a lot of work on that, but that has led to people wanting to stay in the system longer to try to maximise their benefits from the scheme.

Mr McCULLAGH: That certainly would not be my view. I think it is unproven that is being a lump-sum scheme as to the number of claims or the duration of claims.

Mr THOMSON: My view would be that the duration they actually stay on the benefits longer to try to get the lump sum payment as the end payout, and you are seeing an increasing level of duration within the scheme at the moment, and have been for some time. The duration levels are up.

Mr McCULLAGH: Duration levels are certainly up.

Mr THOMSON: The other issue is the area where you can get more information about it is on the employer side. Employer fraud and non-compliance comes from the fact that people are not insuring and that is identified usually either when a claim comes in or when WorkCover goes out and does spot audits in various areas. They identify them through there. You also have the major area where employers underdeclare their wages, their remuneration levels at the other area on top of that is where they actually split companies or change the company structure to avoid the potential of paying higher work rates, depending on the industry they are working in. The employer side can come from three aspects.

The extent of it is difficult to gauge from both perspectives, which is the second part of your question. WorkCover, I know, started to use some more sophisticated data mining tools, they call them on the employer side to identify potential areas where they can identify where people are defrauding the system, underpaying, or the like. That is producing some pretty reasonable results from initial indications. They have only small numbers, I gather, where they identify them to unemployed liability scheme and also where they go out and do their spot audits of people who are uninsured. Those sorts of issues are sitting out there. To link this in, the other area is overservicing by providers. In that area there is non-compliance and inappropriate behaviour, not fraudulent behaviour, per se. A lot of service providers keep providing services and there is very little control in the scheme to minimise that.

CHAIR: You said some employers are not insured. How can they operate without insurance?

Mr THOMSON: They are breaking the law. On the figures I have used before you can see that a large number of small businesses start up each year but 40 to 50 per cent of them are out of business within the first six months. They are looking at minimising costs and the like. If they do not receive the right advice they think that they can go into business, say a cleaning operation, and get some friends and start cleaning houses or factories. They do not initially go to an accountant or an adviser of some description. They would not necessarily think of public liability insurance, per se, or even workers compensation insurance. Therefore their employees are uninsured.

CHAIR: Is there any way that they could be forced to be insured? For instance, when they register the business name should they have to prove that they have insurance? That is, assuming that they registered the business name.

Mr THOMSON: That is right. One issue is the compliance green paper work, and we will probably touch on some of those issues. A closer link between WorkCover and State Revenue will help address a lot of that through paying payroll tax. However, if they are paying cash there is no way to identify them.

Mr McCULLAGH: A lot of those types of employers are below the pay roll tax threshold. That would not necessarily capture them.

The Hon. HENRY TSANG: When you said overservicing, what did you mean?

Mr THOMSON: Some of the providers on the claims side, such as physiotherapists for example. A person may need only five or six treatments but they may end up getting 10 or 15 treatments. Last year there was a case in which a worker got more than 1,000 treatments in 14 months.

The Hon. MICHAEL GALLACHER: The overservicing aspect is currently monitored by WorkCover. In the September 2000 report the Minister observed that insurers are pretty poor when it comes to monitoring servicing, for example, providers of rehabilitation, and therefore they should stay with WorkCover. Do you think you could do a better job than WorkCover?

Mr THOMSON: There are two parts to that. Yes, the insurers do have a role to play because they are authorising and approving some of the work that goes on. Some of the performance probably has not been appropriate in certain instances. A lot of it comes back to a point I raised when I was before the Committee previously; that is, whether the service providers' fee structure needs to go back to the basis of having a base fee and that their remuneration is based on outcomes, on actual performance that they deliver to the injured worker and the scheme. That sort of control in relation to the pricing and the way it is controlled, is out of the insurer's hands. WorkCover needs to deal with that. However, there needs to be a joint involvement in the process to achieve better outcomes.

The Hon. MICHAEL GALLACHER: How much pressure have the provisional liability changes put on the industry, especially for the determination you have to make regarding the liability of a claim?

Mr THOMSON: It is fair to say that in the January-February phase there was a lot of pressure, because the lead time for implementation was extremely short. A lot of the systems issues could not be addressed in that lead time. To make the decisions in the time frame, and Cameron can probably give specific examples, the information we are getting is that in the majority of cases the insurers are meeting the time frames and making appropriate decisions. They are not accepting everything, but reasonable excuses are being given. There is a balance and there definitely was concern that all claims would be accepted for a time. That is not the case. In a reasonable number of claims reasonable excuses were issued or denied. There is an appropriate tension within the way that the initial reports were managed. Certainly within seven days there is a lot of pressure on insurers to do things in that time frame.

Mr McCULLAGH: Professional liability is premised on the fact that if you accept more liability up front and start paying, you will have fewer disputes. So fewer go to court. It is acknowledged that there will be more paid out initially and there is a lot of pressure on insurers. We have had to make a lot of changes to our system and the way we do things and train our staff to change the way they go about things. It will be interesting to see how it works over time. There is a trade-off between paying more now and having those disputes, and, hopefully, having less in the courts and happier workers who are more happy to co-operate and go down the return-to-work path.

The Hon. MICHAEL GALLACHER: With the provisional liability and pressure to get matters finalised faster, and the point you made earlier, Robert—that it is very hard to prove a fraud case or an exaggerated case before a court—therefore greater weight will be placed on processing the matters rather than going through the slower investigative processes of a potential fraud or exaggerated claim. Is that your observation?

Mr THOMSON: No, there are some tensions that we were talking about with the remuneration package; the remuneration package builds in, because the insurers would not be keen to see that situation arise. The way that the remuneration package is now, it is based on a return to work as a significant component in getting people back to work in a timely fashion. If there is an increase in claims, and they stay on for a lengthy time, that will impact on the loss ratio that insurers are remunerated on. Even though the time is short, they need to take appropriate review action to determine what is going on with the claim and assess whether it is appropriate. That involves talking with the workers' doctor and employer about the circumstances to determine whether it is realistic.

Between the remuneration arrangements and the like there are reasonable tensions to ensure that appropriate decision making occurs. Already we have seen a number of reasonable executions and a small number of cases that have gone to the commission; about a 50-50 split whether any containment orders will be issued. A number have not been issued in accordance with the insurer's decision. Since 1 January the commission still has not had an arbitrator to make a decision on a matter, that is a significant reduction in the number of matters heading to dispute very early.

Mr McCULLAGH: I endorse the comments about the return to work ratio and the loss ratio, which means that insurers have the incentive to make the right decision. We are trying to make the right decision within seven days, rather than within 21 or 42 days, which we previously had. It makes it a lot harder to make a decision in that time. In a stress case it is very difficult to find a reasonable excuse, even though it could be a fraudulent claim. That annoys some employers. There is a balance between accepting that and paying it and hoping that you get less long-term claims.

Mr THOMSON: It is important not to miss part of the focus of what provisional liability is about. You have not actually accepted liability after the 12-week period, but you may have started to make some payments earlier. That gives you the chance to gather information, find out the appropriate detail to make a more informed decision. It has not been done within 21 days in the past and, yes, you may pay out some money in the short term but you might be able to stop something from going wrong long term by doing a better and more detailed investigation in the provisional period.

The Hon. MICHAEL GALLACHER: Cameron, if your organisation is conducting a fraud investigation do you refer the matter to WorkCover for prosecution or further investigation?

Mr McCULLAGH: For an employer or a worker we refer to WorkCover for prosecution.

The Hon. MICHAEL GALLACHER: What is your experience with WorkCover's preparedness if you have a matter that you believe is a fraud or an exaggerated matter and you wish to contest it? What has been WorkCover's approach?

Mr McCULLAGH: Under the Act there is not a lot that can be done about worker fraud, in general. If a worker commits a fraud by remaining employed, for example in the black economy, the greatest sanction against them is that they have to pay back the money. My belief is that they should be charged, prosecuted and sent to gaol, if they have committed fraud.

The Hon. MICHAEL GALLACHER: In New South Wales we have a bit of a limp-wristed approach to serious crime?

Mr McCULLAGH: I think so. It is serious crime and has an enormous impact on society. There is no great sanction against a worker who does that, equally with an employer who commits a fraud and does not insure or under-declares wages.

CHAIR: Does the same lack of action by WorkCover happen with employers?

Mr McCULLAGH: I do not know. Under the Act, particularly for the workers, there is not a great sanction against the worker. For employers, I think WorkCover has stepped up its efforts enormously. For example, under WorkCover instructions we used to do about 150 audits a year. We now do about 1,200 a year. The number of audits on employers has increased dramatically and WorkCover has become very good at placing orders. Previously if we did not get sufficient information we would hand it to WorkCover and it is now being very prompt in placing a $500 penalty for every warning on the employer to get extra information. That is very useful. The problem we have now with employers is that since we have gone from not auditing many to auditing a lot, where are having trouble finding auditors to do it. WorkCover is setting up a new panel of auditors.

CHAIR: What is the cost of that?

Mr McCULLAGH: The cost is more than recovered.

Mr THOMSON: This is relevant. It is fair to say that the data mining tool that WorkCover is using is targeting things and appears to be producing some reasonable results. For each dollar spent on audit costs in 2000-01, which were initiated or undertaken by insurers, there was a $2.75 return. However, under the data mining technique for the same period there is a $8.70 return. That is a significant improvement by that targeted approach.

The Hon. MICHAEL GALLACHER: You gave figures in relation to employer compliance. Over that same period how many employee fraud or exaggerated cases did your organisation bring to the notice of WorkCover?

Mr McCULLAGH: I could not give you a ballpark figure, but I can give an anecdotal example.

CHAIR: Could you take that question on notice? Could you find out the figures?

Mr McCULLAGH: We do not record the figures. I could show you the reason why we do not record the figures. This morning I was looking at the file of a worker who was legitimately injured and has a bad back. He travelled from New South Wales to another State and worked in that other State. We tracked him down and found that he was working, earning $900 a week. So his bad back had not impeded him from getting a job.

The Hon. MICHAEL GALLACHER: He did not go via Lourdes on the way, did he?

Mr McCULLAGH: No, he did not. I wish that he had. He has not been prosecuted, in fact there is no avenue in which to prosecute him. We are now getting a weekly recovery from him but it has cost us more in administration to recover that, than what we are getting.

CHAIR: Obviously the priority for WorkCover is to care for injured workers. Should this regulatory part of chasing up employers and employees for fraud be separated from WorkCover into a separate organisation?

Mr THOMSON: I am not really sure.

CHAIR: There is a tension within WorkCover to do both.

Mr THOMSON: Yes. There is a tension, but one of the key things that would have an impact is more effective communication about what results it is achieving. I know that WorkCover has put out a lot of press

releases about their convictions and the like. Getting a better understanding, for the employers to understand what is fraud, might lead to a better environment. If the WorkCover Act had different tests there might be a different environment. It is exceptionally difficult to prove that and getting a court to ratify it as fraud. The burden of proof is enormous.

Mr McCULLAGH: Whether it is WorkCover or another body their hands are pretty well tied at the moment. Once they go to the courts, the courts are exceedingly generous to workers. While ever that is the case it would not matter what WorkCover did. They would go to the courts and the courts would say that the poor worker can pay back $10 a week, because that is all he can afford, unless there is some sort of legislative change.

The Hon. HENRY TSANG: Would structured payments be a good way to stop that?

Mr McCULLAGH: In that particular case I do not think it would have changed the outcome. In other cases I think structured payments would help enormously.

Mr THOMSON: A lot of education potentially needs to be done, and communication. WorkCover is moving to improve and increase the level of communication, but the only way to get the message out to both employers and workers about the expectation of the community and the like is to get the message out there that people will be chased down—if you want the use those words or something along those lines—and convicted and taken through the process.

CHAIR: So we would have to look at the legislation. The point you are making is that the courts are operating on the current legislation and that seems to be loose or vague. It needs to be more specific?

Mr McCULLAGH: Yes, I think it does. WorkCover is trying to do the right thing and is trying to get examples it can take and use as public examples of what happens if you commit a fraud. I think that is very necessary, because there is a view at the moment within New South Wales that workers compensation is a bit of an easy game; that if you are an employer or a worker, you are not morally bound to do the right thing and you can get away with it.

CHAIR: So as well as tightening the law, increasing the penalties?

Mr McCULLAGH: Increasing not only the penalties but the publicity behind pursuing some of those penalties.

The Hon. MICHAEL GALLACHER: Do you think dealing with it under the Crimes Act as opposed to the Workers Compensation Act would be a big cultural change in this State?

Mr McCULLAGH: Not only would it be a big cultural change, I think it would be a very positive move, because it is a crime

The Hon. MICHAEL GALLACHER: And the onus of proof is exactly the same.

Mr McCULLAGH: Yes.

The Hon. MICHAEL GALLACHER: One piece of legislation treats it as a joke and the other is fair dinkum?

Mr McCULLAGH: Yes.

CHAIR: With your Employers Mutual Indemnity, are you involved with any of the self-insurers? How is that part of your role?

Mr McCULLAGH: We run the Thoroughbred Racing Board's specialised insurance. The Thoroughbred Racing Board, under active New South Wales Parliament requirements, everybody within the thoroughbred racing industry insures through the Thoroughbred Racing Board insurance pool. It is like a self-insurance but it is a self-insurance for the whole thoroughbred racing industry.

CHAIR: But you are not involved with any industries other than thoroughbred racing?

Mr McCULLAGH: No.

CHAIR: The self-insurers carry their own insurance, do they not?

Mr THOMSON: Individual insurers carry their own.

CHAIR: They do not have any involvement with insurance companies at all?

Mr THOMSON: They do. They do have an insurance policy to cover excess of loss. There is a limit to how much they can carry themselves for any individual loss or losses arising out of one occurrence. So there is an excess of loss cover protecting over and above that, otherwise it would be all going straight to their financial balance sheets, and as they are publicly listed companies I do not think the Stock Exchange would like it.

CHAIR: Do you get that reinsurance business? Where does that go?

Mr McCULLAGH: The reinsurance generally goes to some larger Australian or international insurers—people such as Allienz, Royal Sun and Liberty from the States.

CHAIR: So, do you get the reinsurance business?

Mr SPRUELL: I am sorry, I am the investment manager. It is beyond my expertise.

CHAIR: We were looking at whether we should expand the self-insurers scheme.

Mr THOMSON: The only comment I would make with self-insurance is in relation to financial stability and security. There have been samples in a couple of other States where the bank guarantees and the like have been insufficient to cover the potential losses that are sitting there by a significant margin. Therefore, when they go into liquidation and the like the rest of the scheme has to bail them out. I am not saying anything against them as there needs to be appropriate balances. If you drop it to too low a level, the financial security may not be there to support it.

The Hon. MICHAEL GALLACHER: Would you take any further questions on notice?

Mr THOMSON: Yes, we will.

(The witnesses withdrew)

(Luncheon adjournment)

DUNCAN BERNARD RAWLINSON, Actuary Consultant, Towers Perrin, Level 17, MLC Centre, Martin Place, Sydney, and

STEPHEN PAUL BRITT, Asset Consultant, Towers Perrin, 95 Bobbin Head Road, Turramurra, sworn and examined:

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

Mr BRITT: I am appearing as an independent expert on investment matters.

Mr RAWLINSON: I am here as a principal of Towers Perrin and to assist Stephen should he require it.

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

Mr BRITT: I am.

Mr RAWLINSON: I am.

CHAIR: If you 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 will proceed in camera. Do you wish to make an opening statement?

Mr BRITT: Yes, I do. It is short, but I would rather read it. Thank you for your invitation to appear today. I trust that my insights on investment-related matters will be of assistance to the standing committee. It is my understanding that Towers Perrin has been asked to appear before the standing committee in its capacity as an industry expert to provide comments and answer questions on general investment-related matters in which the standing committee has an interest. I am pleased to appear before you in this capacity.

You will be aware that Towers Perrin is presently retained by the WorkCover Authority of New South Wales and our asset consulting division has provided advice to WorkCover from time to time on a range of investment-related matters. I am a part of the asset consulting division. Given our existing engagement with WorkCover, we have considered carefully whether we have a professional conflict in appearing before the standing committee to discuss general investment-related matters. We are satisfied that such an appearance does not create a professional conflict for us. However, to avoid professional conflict, we will be unable to provide advice to the standing committee on matters specific to WorkCover or its operations.

As a separate matter, should the standing committee wish to hear evidence from Towers Perrin in relation to its investment-related advice to WorkCover, Towers Perrin would be pleased to consider this subsequently in conjunction with WorkCover. However, as I have been located overseas for much of the last three years, I have not personally been involved in much of the work my firm has undertaken for WorkCover during this period. Consequently, I am not familiar with the specifics of much of the work and I am therefore not currently in a position to be able to provide evidence related to the specifics of that work. My colleague Duncan Rawlinson does not work in our asset consulting division and, therefore, is not able to provide evidence related to these matters either.

Following our appearance today, in the event the standing committee wishes Towers Perrin to answer additional questions on notice in relation to general investment-related matters, we would be pleased to consider these subject to agreeing with the standing committee our standard terms of engagement for this work. To assist me today I have prepared a small hand-out entitled "Investment Issues" relating to some of the general investment-related matters that I understand you may wish to cover. This material forms part of my commentary today, and I have brought along copies for you to refer to as necessary during the course of my commentary. If you are comfortable with this suggestion, I would like to start by taking you briefly through some of the illustrations I have prepared.

Document tabled.

The Hon. GREG PEARCE: Point of order: I appreciate the statement you have just read out, but I think there has been a misapprehension as to the basis upon which you appear. You have been summonsed to appear and

unless you have a legal entitlement not to answer questions, you are bound under oath to answer any questions we put to you. So, I think that perhaps the statement you have just made is a little misguided. I do not know that there will be any questions that would be a problem, but I feel the witness needs to understand that he is not entitled to just come along and suggest that various areas of questioning are acceptable.

Mr BRITT: I understand that I am under oath and will need to answer all questions. My understanding from the discussion was that the questions we were to cover primarily were going to be of a general investment-related matter. I have not done any preparation or research.

The Hon. GREG PEARCE: I do not want to debate it with you. I just think you need to understand that this is a parliamentary inquiry; it is not just a matter of you choosing to give various answers. It may be that nothing would end up being a problem, but I do not want us to proceed with the witness misunderstanding the fact that something may well come up that we want to ask that is outside what the witness is currently thinking about. If he does not know—

CHAIR: The question can be asked. There is no necessity for the witness to answer the question. Committees normally do not press witnesses to answer a question. If that arises during questions, we will have to discuss it.

The Hon. GREG PEARCE: I do not think it is quite proper to say the witness is not required to answer, unless there is some—

CHAIR: The answer may be, "I cannot answer it."

The Hon. GREG PEARCE: That is fine.

CHAIR: They will answer the question but may not provide the information you seek.

The Hon. GREG PEARCE: That is right. I agree with that distinction.

Mr RAWLINSON: I think the point Stephen is endeavouring to make in the opening statement though is that he has not been practising in this market place for a period of time and should you have specific questions relating to WorkCover, in all likelihood Stephen is not going to be in a position to be able to provide you with answers on those specific questions related to WorkCover as opposed to seeking to provide answers on questions of general investment-related matters, in which Stephen is a member of our asset consulting team and well-placed to be able to answer such general questions.

The Hon. GREG PEARCE: I am sorry, I do not mean to debate the issue, but I would have thought that if we had witnesses from Towers Perrin we would have expected those witnesses to be au fait with issues that are the subject of the Committee's inquiry. You have a number of directors/consultants who would have the sort of information we would be interested in, and I would have thought they would be witnesses today.

The Hon. HENRY TSANG: Perhaps, Mr Chairman, we should proceed with the inquiry and there may be no problem. Let us not debate the issue. If a problem arises, we will confront it then.

CHAIR: The Committee asked for another person, who was more conversant, to be present, but that person is overseas.

The Hon. GREG PEARCE: Right. That makes more sense.

Mr BRITT: I will not go through each slide but there are a few I will cover now and if there are questions about the others, I may be able to help. The first slide, the point I would like to make here is that it is important in investment management to recognise that you may invest in such a way that you expect to get a higher overall return on your investments, but when you do so you have recognised that it is likely that you are going to have to accept more investment risk. This slide, which is based on internal work that we do, if we look at four different investment portfolios, the TP25 is one where the allocation to growth asset shares and so forth is a quarter of the portfolio; TP50, the allocation to growth assets is about 50 per cent; TP75 it is three-quarters; and TP90 it is 90 per cent. As you increase the exposure to growth assets the expected return on the portfolio will rise and the volatility, which is a measure and is indicative of the risk, will rise. When you select a reference portfolio for an insurance company you

need to balance the risk that can prudently be borne by the enterprise against the returns that you expect to take. They are my comments on this slide, but it is an important point.

The Hon. MICHAEL GALLACHER: Do we want to ask questions as we proceed?

CHAIR: Perhaps the witness may explain the document to the Committee and then we will have questions. It may be that the next slide answers your question.

Mr BRITT: The next slide covers the investment management cycle. When we as a firm advise institutional investors, we believe there are a series of steps that need to be considered both initially and on an ongoing basis. The WorkCover scheme has gone through each of these steps in various ways. Our firm has advised WorkCover in some of these steps and not in others. The first one is the investment objectives. The idea is if you do not know what you are trying to get out of your investments, you are unlikely to achieve your goals. The objective of such an investment enterprise is to give as high a return as possible, subject to providing the investors with almost instantaneous access to their money. When you do that, there are some constraints on the investments that we can undertake. For example, you cannot buy buildings.

You need to know what the objectives are. With the objectives, you can set the strategic asset allocation which is a reference portfolio, and this will determine the expected return and the volatility of the portfolio. You then go to the implementation stage where you choose managers which are the types of managers that you would be best placed to implement: Should they be active managers who are seeking to gain excess return on their assets, or should they be passively managed to reproduce some reference benchmark? The managers should be chosen and appointed, and then there is a monitoring process to make sure that the investment managers remain suitable. All of the work we do for our clients falls under one of the stages, and all the questions tie into one of those stages.

I will not go through four, five or six because they provide background that we have already covered. There were a number of questions on performance-based fees. I cover here some of the technical background to performance-based fees which may make it easier for the discussion later on. The aim of a performance-based fee is to align the interests of the investment manager with the client so that if the investment manager does very well, the investment manager is paid more than if they do not do very well. It is the same as a bonus paid to an employee only it is formulaic and it is based on investment returns.

If it is indeed designed well, it should provide a base fee which is adequate for an investment manager to live on but not be happy with. Then when the managers do well, they get extra return which will constitute excess profit and that should reward them. One of the advantages of the approach is that it pays active management fees only if the returns are greater than the benchmark. It encourages the managers to do well, and if they do well, they get extra funds and WorkCover is not paying fees to managers that are as high as if the managers were investing well. That is what a performance-based fee is all about. I may stop there and take questions.

The Hon. MICHAEL GALLACHER: In relation to the first chart, earlier we heard from Allianz's asset management and they spoke about their changes to the reference portfolio from the previous mandate to the current mandate. Page two is headed "Investment management is about the trade-off between risk and reward". Approximately where, between TP50 and TP90, would the previous mandate be?

Mr BRITT: Approximately where a straight line would be between TP25 and TP50, where that intersects with the seven on the vertical axis. The reference portfolio has a 60 per cent allocation, so it would be 40 per cent of the way up. My guess is that it will be somewhere upward of the 7.5.

The Hon. MICHAEL GALLACHER: On that point, do you handle any other Government investment strategies?

Mr BRITT: I have in the past, but I do not currently.

The Hon. MICHAEL GALLACHER: Is the current position—what is referred to as the current mandate—atypical of investment strategies utilised by the Government, or is that considered to be unique?

Mr BRITT: The 60 per cent?

The Hon. MICHAEL GALLACHER: Up to the 60 per cent, yes.

Mr BRITT: The 60 per cent would be consistent with the advice that I provided to similar public entities about three and a bit years ago.

The Hon. MICHAEL GALLACHER: Did they take up that advice?

Mr BRITT: Curiously, I do not know because I submitted my final report pretty much out the door and I flew off to the United States. I have not followed that up with the client, whether they followed that advice.

The Hon. GREG PEARCE: Would it be your current advice?

Mr BRITT: To give advice other than most general, I would like to do the sort of work that was involved. I would build a model of the liabilities and the way that the liabilities react to interest rates, inflation and so forth, and I would test whether the investment strategy will be suitable to meet the objectives of the fund, given the advice.

The Hon. MICHAEL GALLACHER: I take it that you were instrumental in this decision to move to the current mandate of 60 per cent?

Mr BRITT: I was not here for that exercise. I know the gentlemen involved and I feel confident that they would have followed the same process as I would have followed because it is a standard process.

The Hon. MICHAEL GALLACHER: Mr Rawlinson, you are a consultant to Towers-Perrin, but you are also an actuary.

Mr RAWLINSON: I am, yes.

The Hon. MICHAEL GALLACHER: Have you done any actuarial estimates of the benefits of moving to the 60 per cent at all?

Mr RAWLINSON: No. The field I work in does not relate to asset consulting, so I do not consult on investment performance or asset management.

The Hon. MICHAEL GALLACHER: Mr Britt, I suspect it would be very difficult for you to answer that question, having not been here for the past three years. Would you be able to tell the Committee what would be the anticipated increased revenues as a result of moving up to 60 per cent?

Mr BRITT: I would not be able to tell you. I am fairly confident that WorkCover should be able to address those issues.

CHAIR: For how long has Towers Perrin been advising WorkCover, and in what capacity?

Mr BRITT: Towers-Perrin has been advising WorkCover on investment issues since either late 1997 or early 1998. I think that was the first time I was involved. I am not aware of us providing investment advice prior to that time, and I do not know what other advice the firm gives to WorkCover, so I cannot talk about anything other than investments.

CHAIR: The capacity would be as an investment adviser—is that how you would describe it?

Mr BRITT: As an asset consultant.

CHAIR: An asset consultant rather than an investment adviser?

Mr BRITT: Yes. An investment adviser, to my mind, has more of a retail focus to it. We advise institutions rather than individuals.

CHAIR: You have outlined some of the performance-based fee structure for asset management that is now proposed for WorkCover. Is there anything else you wish to say about that?

Mr BRITT: Page 9 is headed, "Considerations in setting up by a Performance Based Fee", and shows that a performance-based fee structure should not be impacted by market returns. The fund managers cannot help it if the stock markets fall, so you need to design the system so that if the manager does better than the market, they are

rewarded. The base fee is important because it needs to be sufficient to ensure that the manager does not go out of business if they do not perform in excess of the target. A well-designed system would not offer too much profit on top of that, so an important part of the performance-based fee is to set that minimum level at the appropriate spot. The last thing is that it is relatively easy for investment managers to gain in a poorly designed system, so it is very important that the mechanics of the performance-based fees are implemented. We have done work on that. Our report to WorkCover was tabled earlier this year and there is an ongoing review between WorkCover and the insurers, based on that.

CHAIR: How would the reduction of performance-based fees be beneficial to WorkCover?

Mr BRITT: It will mean that if the managers do not perform well, the fees will be lower. If the managers perform very well, then there will be ample return with which to remunerate the managers.

CHAIR: So this would increase income for WorkCover?

Mr BRITT: It should increase income to WorkCover.

CHAIR: To what extent may a performance-based fee take into consideration an investment manager's past investment performance?

Mr BRITT: When we designed the performance-based system we did not look at the performance of managers themselves; we looked at the performance of competent managers in each of the fields and we looked at what we expected to be reasonable returns in excess of the benchmark in the various sectors, on a going forward basis. So we have not considered whether managers are good or bad and set the target accordingly.

CHAIR: Is there much scope within WorkCover investment policy for insurers and investment managers to add sufficient value to the assets and thereby earn significant performance-based fees?

Mr BRITT: The performance-based fee has not been finalised yet. So I cannot talk about what the final fee will be. The proposed performance-based fee, to my mind, offers scope to gain excess return in the Australian shares sector, in the listed property trust sector and in the Australian bonds sector. Probably half of the assets are asset classes where the managers should be able to create excess return and, hence, get the excess fees.

CHAIR: Is this performance-based fee approach being used in Australian States or overseas? Has part of the assessment been to establish a successful model somewhere else?

Mr BRITT: A performance-based fee structure is common in investment management. I am not aware of it being used, or not being used, in the implementation of workers compensation schemes in other States or overseas.

CHAIR: It could be, but you are not aware of it?

Mr BRITT: I do not know, yes.

CHAIR: What strategies might a fund manager employ to increase his return on investment?

Mr BRITT: The first one is to ensure that the reference portfolio or the strategic asset allocation is set right. If you increase the exposure to growth assets, as WorkCover has done from about 30 per cent up to 60 per cent, that move is likely to be the prime determinant of the extra return that you will get on your investments. Once you have that, then prudent and professional implementation can add extra return at the margin by reducing turnover, by making sure that the managers who are chosen to implement the strategy do a sound job or that they are capable of doing a sound job, and by making sure that the risk controls that the custodian has that are implemented by the custodian ensure that there are not losses due to accidental or fraudulent investing outside the mandate. All those procedures are procedures that WorkCover has implemented some time over the last three four years.

CHAIR: Could you explain the relative advantages and disadvantages of investing in the following: fixed interest and property trusts, shares with and without franked dividends, derivatives and convertible notes? I do not think that you have covered that in your submission.

Mr BRITT: Different asset categories have different characteristics. I was not entirely certain what this question was targeting. I did notice that the mandate makes reference to these asset classes and it comments that,

relative to a taxed investor, an untaxed investor would have a preference for fixed interest and listed property trusts over shares. That is because the tax impost on fixed interest is higher than on shares. If I buy a share, part of the return comes by way of a capital gain, which will be paid some years in the future.

CHAIR: Is it possible to relate that to how it would be an advantage or disadvantage for WorkCover to invest in these areas? Tax would not affect it, would it?

Mr BRITT: Tax does not affect WorkCover, so you would expect that, at the margin, the exposure to growth assets would be lower than if they were a taxed investor. You would expect that they would be indifferent between franked and unfranked income because they cannot derive the benefit of the dividend imputation without significant work. With regard to the convertible notes and so forth, these are small asset classes which, at the margin, WorkCover would find better than fixed interest and stocks. But they are so small that they will not make a material impact on WorkCover.

CHAIR: What proportion of funds do you consider appropriate to be invested offshore or internationally?

Mr BRITT: It depends on a number of things. One is the liabilities and the denomination in which they would be paid. The other is the overall allocation to growth assets. Our view, which we have researched, relates to an allocation to growth assets, that is, shares. About 50 per cent of the portfolio should be invested offshore to get the maximum of the diversification benefits that you could get. That would mean that, for a fund with 60 per cent allocation to growth assets, 50 per cent of those are in shares. So about a quarter of the portfolio should be in international shares and about a quarter in Australian shares.

Mr RAWLINSON: Just to clarify that issue, that depends ultimately on the profile of liabilities as well. So all other things being equal?

Mr BRITT: All other things being equal, that would be the case.

CHAIR: Are there any practical difficulties in looking at international shares? Obviously, for local shares you would have a good knowledge of how they progress. How do you assess the value of international shares? Is that on the advice of overseas experts?

Mr BRITT: We have a sister practice overseas. We have access to journals and to market data which is overseas. What WorkCover has done is to appoint an international shares manager who specialises just in international shares. That is managed in a passive manner, which means that it aims to replicate the performance of a broadly held portfolio of international shares rather than being a concentrated portfolio in just a few shares. So the active risks of international shares managing are not borne by that sort of approach. So you get what the market will give you.

The Hon. GREG PEARCE: Mr Rawlinson, are you familiar with the actuarial review of outstanding liabilities for the WorkCover scheme which is undertaken every six months or so by Tillinghast?

Mr RAWLINSON: It depends on what you mean by "familiar". I am certainly conversant with the fact that we have done that work. Is that in the area in which I specialise? No, it is not.

The Hon. GREG PEARCE: Would you be competent to discuss the methodology of that report as distinct from the numbers?

Mr RAWLINSON: The outstanding claims liabilities or valuation reports, no I would not.

The Hon. MICHAEL GALLACHER: What about the methodology that they use?

Mr RAWLINSON: No. There are a number of fairly discrete disciplines within the actuarial arena. I sit very firmly in what we call the financial services discipline, which is distinct from the general insurance discipline which has been generated by my colleagues within that field. Obviously, we have already appeared before you on matters relating to the liabilities. I think we made the offer again in a letter last week. We are conscious that there are some boundaries about what we were and were not able to discuss in a general capacity today, but if you wish to hear from us further, we would clearly be happy to consider with WorkCover how best we can meet your needs.

The Hon. GREG PEARCE: Who would we need to speak to in order to ask questions about the latest valuation?

Mr RAWLINSON: There is a question mark about whether you wish to speak separately with WorkCover. But if you mean within Towers Perrin, then it would be Andrew Cohen, who appeared before you in November last year and Robyn Bateup, who is our most senior consultant on the general insurance side. But I would stress that Robyn has not been involved in preparing that report; Andrew has.

CHAIR: Have you actually reviewed the investment performance of the Victorian and South Australian WorkCover schemes?

Mr BRITT: I have not reviewed it, although my colleagues in Melbourne advise the Victorian WorkCover scheme. I am unfamiliar with the work that they have done in all bar the most general sense.

CHAIR: I suppose that they may have different objectives to the objectives of WorkCover in New South Wales?

Mr BRITT: The objectives may be different and the funding level should be different. If you have a fund which has a surplus you can afford to invest more in shares because the volatility will change the level of surplus slightly, but you are still likely to be in surplus. Whereas if you are about even or you have a slight deficit you are less likely to be able to absorb the volatility that is associated with shares. If shares give you a zero per cent return in one year, that means you are not going to earn the hurdle that underlies the discount rate implicit in the liabilities. So your deficit is likely to grow. That may or may not be palatable to stakeholders.

CHAIR: So New South Wales, which has a large deficit, would have to take a conservative approach to investments?

Mr BRITT: It is likely to be conservative unless the stakeholders clearly understand the implications and can still afford a long-term view. If you have a small fund which has a large deficit but you are a large organisation, even large deficits are not a material item to the State as a whole. Under those circumstances it may be that an organisation may prefer to invest quite aggressively even though they have a deficit and they understand that the deficit could get worse. But, in the long run, they expect it to be recovered and they can afford to wait for the long run.

CHAIR: You said that your company gives the same advice in Victoria?

Mr BRITT: We give advice to the Victorian WorkCover scheme. I have not reviewed it for many years.

CHAIR: So off the cuff you probably would not know what the proportion invested in shares and property in Victoria and South Australia would be?

Mr BRITT: No. I was involved in a peer review process about four, maybe five, years ago. I just do not recall the details of the advice that we were given at that time, nor do I know whether it has changed since. It should be reviewed every three years or so.

CHAIR: As you said earlier, it may not be relevant to New South Wales. You cannot just copy what another State is doing.

Mr BRITT: You should not copy. You need to consider the objectives and the liabilities. Although in their nature they should be similar, [1]the funding level will mean that you should not just copy from one to the other.

CHAIR: Do you consider investment managers within the insurers are the most appropriate to manage the investment of the WorkCover scheme's funds?

[1] We would like to clarify that, although similar in their nature, important differences are likely to exist between the detailed profile of liabilities of different State schemes. For example, we consider it likely that some schemes will have a greater proportion of lump sums and a corresponding lesser proportion of annuity-type benefits. Such differences in the detailed profile of liabilities are additional factors, in addition tot he funding level, that we consider may make superficial comparisons of schemes' investment objectives and reference investment portfolios potentially misleading. *~ Duncan Rawlinson, 20 June 2002*

Mr BRITT: If the investment management was completely unfettered from the management of the insurance enterprise itself, then it is unlikely that the chosen investment managers would all be insurance investment companies but, having said that, if there is some link between the investment of the assets and the right to underwrite workers compensation then it becomes a constraint and you design your investment arrangements based on the fact that these are the people who will be investing. Having said that, there are a number of the insurers who also offer a professional investment management services into the market and clearly are people you would consider in an unfettered mandate.

CHAIR: You are saying they would be adequate? They would be satisfactory then to maintain that system?

Mr BRITT: You would certainly consider them in the first instance.

The Hon. HENRY TSANG: Who therefore would be the most appropriate to manage the investment of the WorkCover scheme's funds?

Mr BRITT: Since I do not know the reason why investments are currently managed by the insurers I cannot say whether that is a good reason or not. If the investments were unfettered and not related and were not tied to managing and underwriting in any way then we would recommend a number of professional fund managers do that, of which some of them are insurers and some are not.

CHAIR: So whatever we do we still finish up with insurers probably involved because they have the experience?

Mr BRITT: You may have some but you may have other fund managers who are not a part of the insurance arrangements.

The Hon. HENRY TSANG: More diverse?

Mr BRITT: You would also like to get people with expertise in managing Australian shares, people with expertise in managing bonds. Our view is that that gives a better overall result.

The Hon. GREG PEARCE: I just want to have it clear in my mind, Tillinghast and Tillinghast Towers Perrin are just trading names, are they, of the United States corporation Towers Perrin Forster Crosby, is that correct?

Mr BRITT: At the moment that is the case. We have different parts of the firm that do different things.

Mr RAWLINSON: Essentially different divisions within the one company. It is one legal entity worldwide at present. As you say, Towers Perrin Forster Crosby is generally thought of as synonymous with Towers Perrin. Tillinghast Towers Perrin is the risk specialist within the Towers Perrin group.

The Hon. GREG PEARCE: So I am clear, when WorkCover is getting services from Tillinghast Towers Perrin and Towers Perrin they are getting them from the same entity?

Mr RAWLINSON: Correct.

The Hon. GREG PEARCE: So you are providing both the valuation and actuarial services from the same entity?

Mr RAWLINSON: Ultimately from the same legal entity. If memory serves me correctly—I am pretty certain this is the case but I would need to check — the contract that we have with WorkCover is quite clear that the contracting party on our side is Towers Perrin Forster Crosby, as you would expect, and to date all of the divisions have been rendering their services under that consultancy contract.

Mr BRITT: That is changing. We are changing to have a separate contract for asset Consulting—which would only be asset consulting—and another contract which would cover other things.

The Hon. GREG PEARCE: So you are in the same position as some of the accounting firms that provide those auditing and consulting services to the same clients?

Mr RAWLINSON: I am not sure how. Our view would be no. I am not sure what basis you have for coming to the conclusion but fundamentally my point would be we are not an auditor. We provide a range of consulting services across a range of different but interrelated disciplines and for any one client we will bring to that client a whole range of different services, some of which are in the nature of very technical actuarial services around determinations of insurance liabilities; others might be advising on investment mandates, asset consulting advice or maybe even advising on employee benefits. We do not have an audit function within our company. We actually see ourselves as one of the few companies in the marketplace —certainly one of the few global companies—which on the face of it does not have that potential conflict I think you are alluding to which is obviously very common for discussion at the moment.

The Hon. HENRY TSANG: Do you see that as an advantage to your client because you have got various services; there is not a conflict?

Mr RAWLINSON: There are probably two questions there.

Mr BRITT: My observation is that Tillinghast guard their client base carefully and because I work for the same client I know about it in this instance, but I feel sure that I have worked for clients that Tillinghast has advised and I would not know about it. I may well have worked contrary to a client that Tillinghast has advised and I would not know about that either.

CHAIR: The divisions within Towers Perrin work separately, almost independently but within the same legal entity?

Mr BRITT: Yes unless there is a very good reason; unless the client asks for expertise in asset consulting and financial services. Our case could be where somebody is looking to purchase a funds management firm; they may ask the asset consulting group to review the bona fides of the underlying investment capabilities and I will ask financial services to advise on things like the profitability of the company.

Mr RAWLINSON: Just coming back to the question would we like to think that our clients would see that as a benefit? Yes, we would. Do we feel that the range of services we provide, the nature of our firm, particularly the global nature of our firm, without an affiliation to an accounting firm, if you like, sets us apart from many of the consultancy firms in the marketplace? Yes, we feel that as well. Do we feel that is all available to our clients? Yes, we do. But obviously in any situation you are in a very competitive environment; there are a whole range of firms out there who are looking to provide services and looking to put their best foot forward in setting out their wares and there are certainly some areas of our marketing, if you like, or the services that we provide which, as I said, we do see as setting ourselves apart from many of the—I was going to call them peer groups, but I think that might give an incorrect impression—many other firms out there who might be competing with us in different parts of the marketplace.

The Hon. GREG PEARCE: Will you take this question on notice—and the answer can obviously be confidential. I would like to know the fees that have been rendered by the actuarial division and the consulting side since the appointment of the firm as the scheme's valuer? I think that could be kept confidential by the committee.

Mr RAWLINSON: I would need to check the consulting side but I thought from the report from the third round of hearings there was already some detail in there on the actuarial fees.

CHAIR: We could get the fees from WorkCover. It would be better because any work they do will be charged for.

The Hon. GREG PEARCE: I am sure they would be kind enough to calculate that.

Mr BRITT: We like to provide value to our client base.

Mr RAWLINSON: It can come from either source. Clearly it is, as you have rightly said, confidential information. I would need to get across what WorkCover have already provided. So in that context it may be easier for them to do it if they already know what has been given and what has not. They will know which of the total fees have already been included within totals and which have not.

CHAIR: You might forward it through WorkCover. WorkCover is the final source of information. Thank you very much for appearing before the Committee. We appreciate your cooperation. Thank you for preparing this resource document too.

(The witnesses withdrew)

DAVID ZAMAN, Consulting Actuary, 143 Pacific Highway, Hornsby, 2077, sworn and examined:

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

Mr ZAMAN: As a consulting actuary giving opinion on the workers compensation system and in particular in relation to self-insurers, which I know a lot about.

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

Mr ZAMAN: I am.

CHAIR: 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, we will go into camera and clear the room. Do you wish to make any opening statement?

Mr ZAMAN: I would like to make a couple of comments. Thank you for this opportunity for me to talk. Just some quick background about myself, because you may know very little about me compared to the big firms: I qualified as a fellow of the Institute of Actuaries in the United Kingdom and Australia in 1979. I have been in my own consulting practice for 18 years now and I do a lot of work for the self insurers in New South Wales and some of the other States as well, so I am very familiar with that particular sector.

I would like to raise a couple of points: The first one is that earlier this year WorkCover gave you some information about the number of employees within the self insurers sector compared to the whole of the State. As at 1 July 2000. There have been a lot of changes since that time — in particular Campbelltown Council, McDonald's, OneSteel, Prestige, University of Wollongong, Woolworths and Coles Myer have all gone self-insured since that time. Further, as a specialised insurer, an industry's self-insured scheme has been set up to cover local government in this State, and I understand that around 70 per cent of the councils are within the scheme called Statecover. If we look at all those self-insured groups plus the ones before 2000, the Treasury-managed fund and also the other specialised insurers we are looking at may be 35 per cent or so of the New South Wales work force is outside the managed fund in some form of self-managed or self-insurance arrangement. That is a very significant group. Unfortunately, the impression I always have is that WorkCover tends to think about a managed fund and not about all the other sectors as well.

The second point I would like to make is something I am familiar within the self-insurance sector and that is commutation. I know legislation was passed at the end of last year restricting, very tightly, common law and commutations. WorkCover believes that commutations are a cost to the overall workers compensation system. I do not know what has exactly happened in the managed fund on which they have primary focus, but I know within the self-insurance sector that the self-insurers want to keep commutations. They believe that, overall, it saves them money. Commutations are a negotiated process between the injured worker and the employer. It is not something that can be forced from one side or the other, like going to court through common law.

If both sides have proper legal representation, which they do and certainly have done in the past, and they have made a negotiated settlement to close off a claim that might be going for sometime into the future and both parties are happy with that, I cannot see what is wrong with that. I would be pressing, if possible, for the Committee to consider the commutation facility at least with regard to those employers outside the managed fund and the actual situation there. At the moment I suspect it would be very tightly controlled by WorkCover under the actuarial process. That is basically all I want to say up front. I am open to any questions that you might like to ask.

CHAIR: Are you suggesting that if self-insurers want to have a commutation they should not, in anyway, have to be related back to WorkCover at all; that they could make that arrangement?

Mr ZAMAN: It has always been that you would have lawyers on both sides for the injured worker and for the self-insurer. They would check to see what is going on. That would prevent anything amiss from going on with regard to an injured worker taking too low a figure, for example. Certainly, that is the situation that applies in all other legal matters that are settled, whether it is in the medical liability, public liability or anything. There is nobody who refers to those situations, apart from claimants and their lawyers, and the defendants and their lawyers. No-one else comes into it. But here we could have a safeguard. We could have that put in front of the Commission to make sure that everything is okay. I have to admit that I am against WorkCover approving everything because its history is

such that it will be very tight about it. I prefer it to be pulled away from them and be reviewed by the new Commission.

CHAIR: There is some concern that we have heard from previous hearings, for example from trade unions, that there is a suspicion that commutations disadvantage an injured worker. But you said a moment ago that it saves money for the self-insurers. In what way can it save money, except by reducing the commutations amount? Or are you suggesting that it is saved in other ways through legal fees and so on?

Mr ZAMAN: Legal fees and so on would not really change very much. It depends on how you look at it. Somebody may be on, say, partial weekly benefits. They might be on $150 or $200 a week. That might be going for 10, 15 or 20 years. Most people really are not interested in getting a dribble of payments through like that all the time. Certainly, employers do not want to go through the costs of keeping up to date and every so often asking for medicals and all the rest of it to keep track of what is going on. That is an example of where you try to commute the thing out. Obviously, like in all other matters, if you get a cash sum up front you want to get some sort of discount on that compared to a continuous stream into the future. That is where it comes down to some negotiation that the money is up front, the person can take it away and use it how they want compared to an income stream. That is pretty normal. It will save money compared to the long-term cost; the long-term cost can be very high.

CHAIR: Is that the main saving, that administration?

Mr ZAMAN: Administration starts cancelling out that long stream of future payments.

CHAIR: They do not have to worry about that because that is a saving?

Mr ZAMAN: Yes.

CHAIR: It may not be a dramatic reduction in the actual amount of money that the injured worker gets?

Mr ZAMAN: It can be less because they get a payout, say, five or seven years worth, depending on the seriousness of the claim.

CHAIR: So there should be a discount?

Mr ZAMAN: Yes. That represents the overall wrap-up figure and that is what might be negotiated.

CHAIR: Is there a percentage for that discount? Does it seem to apply over many cases? Could you say it is 1 per cent or 10 per cent?

Mr ZAMAN: How do you mean a discount?

CHAIR: You said a discount. What do you mean by a discount?

Mr ZAMAN: I mean that, say you had $200 a week—

CHAIR: I took you to mean a lump sum, and the employer pays less than that lump sum.

Mr ZAMAN: No. What we are doing is we are cancelling out a future stream of weekly benefits, that is the main thing. We might miss on the medical costs and things like this on top. You are cancelling out a stream of income benefits and converting it to a lump sum, and the sort of formula that tends to be used depending on the particular case might be, say, five times the annual payment, seven times or a bit less. It just depends on the particular circumstance of that case. That would be negotiated between the two sides. But once you agree on a figure that is it.

CHAIR: That is what you are calling a discount?

Mr ZAMAN: That lump sum figure there is negotiated and would be less than the total of the future income stream.

CHAIR: That is a discount then?

Mr ZAMAN: That is a discount I am referring to.

CHAIR: I thought you might have meant that it was a percentage?

Mr ZAMAN: No.

CHAIR: A moment ago you mentioned that some of the stakeholders have become self-insurers. Which do you advise, or is that confidential?

Mr ZAMAN: I really regard it as confidential, but I suppose over the years, allowing for some people to stay with me and some who have gone to other actuaries, I have probably reviewed at least half of them in New South Wales. At this point in time I probably do about 40, 45 per cent of them.

CHAIR: Of self-insurers?

Mr ZAMAN: Yes.

The Hon. MICHAEL GALLACHER: Have you done any work for WorkCover at all?

Mr ZAMAN: I was actuary to the previous advisory council, so I have not done work for WorkCover as such, but I have done work for the advisory council and I advised them on different matters in relation to the managed fund and so on.

The Hon. MICHAEL GALLACHER: You are the actuary to the advisory council under its previous guise until the legislation went through?

Mr ZAMAN: That is right, yes.

The Hon. MICHAEL GALLACHER: That reformed it and made it a big superstructure?

Mr ZAMAN: That is right.

CHAIR: A moment ago you mentioned that a number of companies that have come into self-insurers since the figures were created by WorkCover. You mentioned McDonald's. Did they suddenly decide that they wanted to become self-insurers, or do people like you advise them that there could be savings for them? Is there some two-way action?

Mr ZAMAN: I have often advised large employers on whether or not they should self-insure. The process is complicated in the sense that, firstly, there needs to be analysis of the underlying claims experience and where it might be tracking. You then compared it to the fully insured premium that they are paying into the WorkCover system. Sometimes they may be subsidised through the premium system and, therefore, you do not go self-insured. Other times they may be paying too much with regard to premiums compared to the underlying experience, in which case they would obviously go self-insured. There can be things in between where they might be in a state of flux because of various reasons, things are happening. That is the basic process at fault. There is a lot of analysis behind it. Larger employers often go through that process in one form or another.

CHAIR: We heard earlier that self-insurers have to pass on risk to an insurance company. Is that correct? Do you advise them how to do that?

Mr ZAMAN: If you are self-insured WorkCover requires, and it is also wise, that you have a reinsurance policy. What this does is protect the employer against very large claims. The licence is to between $100,000 and $500,000 and that will be the limit. Recently, WorkCover increased that to $1 million because the reinsurance market has tightened up and you cannot get anything less than $500,000 anyway. If you have a very large claim that might cost, say, $700,000 the self-insurer will pick up the first $500,000 and the reinsurer will pick up the $200,000. There is a $500,000 excess on loss limit.

CHAIR: In view of the problems in the insurance industry, is it difficult to get that reinsurance coverage?

Mr ZAMAN: The market is shrinking, as you know. There are fewer and fewer insurers of the capacity to work in the Australian market. At last count there are only two, maybe three, insurers who could provide that market. Liberty was the one that came in last year from America. It is a very thin market.

CHAIR: What will happen if you need to have this under WorkCover's rules? Would you go overseas to get insurance directly?

Mr ZAMAN: WorkCover does not really allow that because it says that the reinsurer must be subject to APRA, which is the Australian Government requirement. If you are an overseas insurer you are not subject to that. At this point in time there is a thin market and it is working. Other conditions are becoming more onerous. The premiums are going up and so on. So far it is working but we do not know what is going to happen in a year or two years.

CHAIR: Especially if more and more companies want to become self-insurers.

Mr ZAMAN: That would probably help the reinsurance market because if they see more volume there for them to go for their very small business and it gives them a bit more margin for coping with the ups and downs, and the risk.

The Hon. MICHAEL GALLACHER: There is some concern in certain sectors within the whole debate on workers compensation in relation to the claims estimation guidelines that came out earlier in the year. Depending on who you talk to you will get a different view in terms of how it affects both the unfunded liability and also the future protection so far as premiums are concerned. Are you aware of the changes and if you are aware could you detail your knowledge of how they impact, if at all?

Mr ZAMAN: The reserving guidelines potentially can be used in two ways in relation to premiums and also in relation to costings for the liabilities and the whole scheme, valuation if you like. In regard to the first part, WorkCover has been criticised with regard to the estimates before that is used because they seemed too conservative, too high a figure. They would frequently say that you should work by the worst-case scenario basis and you would often have figures costed to age 66 when claims may well have settled and closed off much earlier than that. A lot of people thought that those figures were artificially inflated compared with reality. They were also inflated because, during that time, until these new guidelines came in from the beginning of this year we also had lump sums via common law and commutation. Often, claims would be settled down for much less than those big figures anyway.

Employers were also very unhappy with those big figures because they said that while it is affecting our premium we are paying too much. WorkCover has now come up with new guidelines and it has dropped the worst-case scenario basis, as I understand it. It is now working towards a more realistic-type basis where claims may be estimated up to seven or eight years into the future. But this seems perverse to me because we now no longer have a lump sum settlement route. We cannot commute common law claims out. It is a very restrictive now. We are now in a reverse situation where we are going to have outstanding estimates that may be too low in reality for some serious claims. What the impact is on premium valuations, with regard to premiums the estimates will probably come down on average, say, from 30 June this year onwards. On the surface, premiums should also come down for employers.

But in practice I would have thought the actuaries, the WorkCover actuaries would be aware of that and they would still be aiming for 2.8 per cent of wages as the overall premium for the scheme and, therefore, they will adjust the premium formula to bring the whole amount up again to the right balance. They do that through things like the tariff rate or through F factors, which are three-year factors that experience rate the actual claims experience for a large employer on their own experience. They will adjust it upwards. I do not think there is any real change there.

On valuation, these case estimates do not have an impact at all. A lot of people think that somehow all these guidelines affect the valuation itself, but they do not. The valuation actuaries, whether it is Trowbridge before, Tillinghast now PricewaterhouseCooopers, or when I did one myself we put very little weight on what those estimation guidelines are saying. We put most weight on the payment history of a number of claims, what is open and things like that, but not very much on the outstanding estimates.

The Hon. MICHAEL GALLACHER: If as a result of these changes premiums were to come down until the actuaries then use their mystical powers to make them go back up again, does that therefore mean that the real cost of premiums has come down? Therefore, by adjusting it back up again it increases the revenue to WorkCover?

Mr ZAMAN: No. The estimate guidelines do not have a lot of nexus to the valuation. There is not much of a link between the two.

The Hon. MICHAEL GALLACHER: Why have they done it? If it does not benefit anything, it looks to me like a rearrangement of the deck chairs on the *Titanic* by bringing it down to eight years. Where is the benefit?

Mr ZAMAN: Appearance, I suppose. You could ask WorkCover why they changed it. My view is that it was for appearance. Employers especially will see apparently lower figures on their open claims, which they think might be more realistic looking. As to whether it has any impact on their premium, that remains to be seen when the new premium parameters come out in a couple of weeks time.

CHAIR: Does it also mean that you can present a lower deficit?

Mr ZAMAN: No, because that is part of the valuation process.

The Hon. MICHAEL GALLACHER: Do you know where the incentive would have come from to move towards that? Has there been a call for changes to the guidelines?

Mr ZAMAN: I suppose the employers have been quite vocal about that. They generally say they want to pay less premiums. I suppose some employers would say that the way the estimates work on their calculation of premium formula they look high, artificial, and it will never be paid.

The Hon. MICHAEL GALLACHER: Did you say that at the end of the month the actuaries will calculate that?

Mr ZAMAN: They should have already done that. But it is not public knowledge and will not be for another two weeks, when the new premium statements come out.

The Hon. MICHAEL GALLACHER: Therefore would you be surprised to see on 1 July, when premiums go out, that there has been a marginal reduction in premium?

Mr ZAMAN: In total, with the managed funds I cannot really sure. The last time I saw detailed data for the fund was September 2000. There could have been a lot of changes in that time. On the basis of previous information I would expect the premium to come down, yes, especially with all the legislative changes from last year. I do not know about commutations. For self-insurers, I am confident that it will increase their costs. I cannot tell for the managed fund.

The Hon. MICHAEL GALLACHER: The cynic in me sees this as an announcement on 1July, or perhaps tomorrow night when the budget is announced, that the next 12-month announcement will start to turn the premiums around and, therefore, there will be a small reduction. There will be only a small reduction in the first year, of course, because we are trying to come to grips with everything. But the signals are that we will turn this around. Is that a fair assumption for me to make or is it based on political prejudice?

Mr ZAMAN: I am not quite sure what is going to come up. Politically, that would be very nice for the Government and for WorkCover, given all the heat that they have gone through.

The Hon. MICHAEL GALLACHER: Am I correct in assuming from what you have said that any changes are short term, not realistic?

Mr ZAMAN: The legislative package that went through last year?

The Hon. MICHAEL GALLACHER: No. The estimate guidelines have contributed to the view that we are now in a position to see reducing premiums by merely recalculating the overall impact on claims in determining premiums. Is it a change that has been made on a false premise, or is it indicative of a turnaround in the scheme?

Mr ZAMAN: I do not know what is there, that is the problem. There is no question that it is a loud signal that something has shifted and apparently for the better. Whether it is delivered in a premium formula in a couple of weeks time, I do not know. That is the measure.

The Hon. MICHAEL GALLACHER: You may not be aware of the promise of a $1.3 billion one-off saving, which we debated last January. It turns out that that $1.3 billion did not quite make it. Instead, it was $200 million. Are you in a position to form an opinion on how small the saving was? What was your expectation?

Mr ZAMAN: When I considered the package of reforms from the end of last year, in my mind I thought it could be worth a lot of money, if it was implemented in a tight way, for example. The new Commission was structured in a different way from the previous Court and made tough decisions in the dispute process, binding medical is, et cetera, that will be worth quite a lot and could change the culture. I would have thought it could be worth a lot of money, a billion or more if it is done in a tight structure. But that remains to be seen.

The Hon. MICHAEL GALLACHER: We were promised a $1.3 billion one-off saving.

Mr ZAMAN: That was the upper limit that Tillinghast gave.

The Hon. MICHAEL GALLACHER: Yes, as a result of the end of commutations and also changes to common law. Last year Tillinghast told us that there would be no significant impact on the scheme in the short term. Surprisingly, on 7 January we were told that there had been a recalculation and it is now $1.3 billion one-off, straight away. That did not materialise. In recent weeks we have been given a figure of $200 million. Were you aware of that?

Mr ZAMAN: No. I knew about the earlier figure because I have seen the transcripts on the web site. I did not know about the $200 million.

The Hon. HENRY TSANG: Did you agree that the changes made to the commutation system in 2001?

Mr ZAMAN: No.

The Hon. HENRY TSANG: What additional steps should be taken to improve the scheme's outcome?

Mr ZAMAN: The other changes to the system on the whole were good ones. They will keep costs down. The unions have different views from that of the employers about some of these things, but if we are talking about costs and nothing else such as the binding medicals, the new dispute process, all those things will streamline the processing and get rid of a lot of rubbish in the system. It just clogs it up. I am not sure about the other changes. The restrictions on common law will make a small saving, maybe $70 million or $100 million a year maximum. That is out of an annual premium of maybe $2.2 billion. I personally believe that commutations will cost money by removing them, not the other way around, which is what WorkCover thinks.

I am not sure what is happening with managed fund because I have not seen data. I know with self-insurers, and I am starting to advise them now on cost increases, to their outstanding liability up to 30 June this year for their books, and to budget for increased premiums for budgeting next year. The amount I am advising is that it could be anywhere between plus 8 per cent, maybe plus 15 or 20 per cent on their annual costs.

CHAIR: Is it possible to compare the self-insurers' premium with WorkCover's?

Mr ZAMAN: No.

CHAIR: What is the average for the self-insurers?

Mr ZAMAN: I have not worked that out, because they are all different. Even if I look at two different councils who may be self-insured, they are in the same industry but can have radically different rates.

The Hon. HENRY TSANG: What is the top and bottom of the scale?

Mr ZAMAN: With councils, I have seen figures down to an underlying risk rate of 1.2 or 1.5 per cent of wages, up to 6 per cent. It can vary a lot and that can be partly because of the work that they are doing. They may have garbage collectors on site or a lot of manual labourers, say water board type of activity, others may have contracted those out. It can make a difference.

CHAIR: WorkCover has that same variation, does it not?

Mr ZAMAN: It can do, yes.

CHAIR: Depending on the industry?

Mr ZAMAN: The industry tariff rate for all councils is about 4 or 5 per cent. I have seen some huge changes when they become self-insured or if they have been self-insured for a long time and run a very passive arrangement with their administration and decide to shift it can become much more proactive, I have seen big changes in the underlying cost.

CHAIR: Do the self-insurers have the same incentive, are they paying a lower premium than those within WorkCover?

Mr ZAMAN: The main reason for them going out is to save money. Plus extra control and the ripple effect through industrial relations. Sometimes it does not work very well but other times it can. It depends on the people involved. You can get closer to the unions and sometimes you can get antagonistic, it depends on the style of the approach that the self-insurer takes.

CHAIR: It is unlike dealing with a third party, it is direct?

Mr ZAMAN: It is direct, and that is the main advantage. The person who is running the workers compensation department for the employer will know the employees. If they are not familiar with the employees they can go and see them. They get a good feel for what is going on and what is happening in the workplace. That provides extra information about the overall claim and how to manage it. That is almost impossible for a fund manager to do.

The Hon. MICHAEL GALLACHER: How long were you a member of the advisory council?

Mr ZAMAN: I joined about April or May 1999 until the advisory council was changed in December 2000.

CHAIR: You were advising it, not a member of it?

Mr ZAMAN: I was advising it, yes.

The Hon. MICHAEL GALLACHER: You were part of the team in those early days following the adoption of the Wisconsin model that was very much involved with the examination of the problems facing WorkCover?

Mr ZAMAN: The decisions about injury management had been made before hand, with the 1998 legislation. They were looking at how to implement that and improve it and getting extra information from the Workers Compensation data. So they were monitoring it the way through, yes.

The Hon. MICHAEL GALLACHER: Earlier today you said that you expect commutations to increase the cost. Is that because of the number of the medium- to long-term claims that will stay in the scheme?

CHAIR: It will not increase the costs.

The Hon. MICHAEL GALLACHER: Yes, it will increase the costs of the scheme.

CHAIR: The change preventing commutations, the restriction on commutations, will increase the costs.

Mr ZAMAN: Claims become longer and that was the reason why they considered bringing in commutations in the first place. The duration was increasing.

The Hon. MICHAEL GALLACHER: If this one-off impact that we were promised earlier in the year is not as strong and there has merely been a slowing down of the pace at which the unfunded liability increases, and as you said the virtual removal of commutations from the scheme will simply add to it, what future does the Government have for further changes if it is not prepared to increase premiums?

Mr ZAMAN: That is the $64 question.

The Hon. MICHAEL GALLACHER: Is there anything left on the injured workers side of the ledger?

Mr ZAMAN: You can get injury management work as best you can, suitable duties, return to work, and there is always more you can do especially on the managed fund side. Eventually, if all else fails, the Government says that it tried commutation and that did not work so they were removed. What does it have left to do? That is what will happen. Then they will talk about increasing premiums or cutting benefits.

The Hon. MICHAEL GALLACHER: You were there in 1999. Do you agree that part of the problem has been the Government's lack of preparedness to deal with these problems earlier when it had the opportunity? It is now increased to such a degree that it will be harder to pull back?

Mr ZAMAN: I am not sure what is in the managed funds because I have not seen the data for 18 months. Taking the actuarial figures reasonably on face value, I suggest there is a deterioration. A lot of that is caused by the WorkCover fund manager relationship and whether it is performing. Further, basically the Government stated publicly that it is going to change the system. Everyone in New South Wales, lawyers and injured workers, have known for at least 12 months, even at Easter last year at the demonstration outside Parliament House, that big changes are coming. That will have a big impact on the behaviour and claims experience since then. I imagine there is a huge surge in claims to come forward that were logged before the end of the year to try to beat the deadline. All those things would impact on what is happening. What the extent of it will be, I do not know. It might be just a bring forward and then there is nothing afterwards, in which case it is just acceleration, nothing more, or it may bring on extra claims somehow to make small claims bigger. I do not know.

The Hon. MICHAEL GALLACHER: When do you expect to see that spike, that surge, in common law claims show up in the figures?

Mr ZAMAN: It should be there now. It should already be there, because they had to put the claims in by November last year. So, that should already be visible. The question is what is coming through after that, and it should drop right away. It if it has not, that is something that should be monitored right now.

The Hon. MICHAEL GALLACHER: Have you any opinions at all in relation to fraud in the scheme?

Mr ZAMAN: Fraud in relation to which area?

The Hon. MICHAEL GALLACHER: The overall cost of fraud on the scheme. As an actuary, have you ever had a opportunity to look at it? I know they talk about fraud by employers, but there is very little evidence of any work ever being done on employees or compliance by employees.

Mr ZAMAN: There is no hard data whatsoever on soft, grey issues—fraud or anything like that—on the employer side or for injured workers. You hear stories and anecdotal evidence about employers cooking the books with regard to underdeclaration of wages, for example, and you hear stories about the building industry being very bad, and that, but nobody really knows, nobody has checked it out. Likewise, with regard to grey claims, again you hear stories about videos and it being dismissed by court, and so on, for whatever reason. Maybe these claims are on the edge. We do not know, there is no measurement of it.

CHAIR: Do you think there should be an increase in incentives to encourage self-insurance?

Mr ZAMAN: Overall it seems to work.

CHAIR: How about the limitation on how many employees, and so on? There is a limitation, is there not?

Mr ZAMAN: You cannot have too small an organisation. The minimum size, really, is around $1 million in normal premiums, not the number of employees. You will have to pay all the on-costs for running the system, and below that it just starts chewing into any savings you might get on the claims management side.

CHAIR: Unless you did the same as you mentioned with councils, unless a group of employers—

Mr ZAMAN: Industry schemes and so on are good.

CHAIR: You all joined together in a geographical area?

Mr ZAMAN: Yes, that is a good way of doing things, pool resources. They are talking about this now with public liability issues, where there is a big crunch with insurance. Pool resources get rid of the overhead on individual policies. Have one big policy and it is going to save money. It is economy of scale. It is just commonsense.

The Hon. MICHAEL GALLACHER: There are some areas within the insurance companies that have to stand alone but obviously there will be some departments that could pool their resources with the same outcome.

Mr ZAMAN: Yes.

CHAIR: I suppose you would like to get as much business as you can.

Mr ZAMAN: I have enough at the moment, actually.

CHAIR: Do you have any promotional material that spells out those sorts of ideas?

Mr ZAMAN: No, I do not. I do not give out to clients. If I talk to clients, I talk to them directly about different issues.

The Hon. HENRY TSANG: Have you written any papers, for instance, in your profession that could be of assistance to the inquiry?

Mr ZAMAN: I am preparing a paper possibly soon, a short paper on commutations, that I was going to give to self-insurers and maybe they would provide that to you. But that is not ready yet. There have been odd things I have prepared for the advisory council in the past. I know I was asked by your administrative people to get that through, but I have not had time yet.

CHAIR: Like the value of self-insurance, have you done something on that?

Mr ZAMAN: Not so much about self-insurance but commentary about the main managed fund, and things like that. I do not know if you want to get that.

CHAIR: If you have anything like that you can send to us, we would appreciate it.

Mr ZAMAN: I would have to get authorisation from WorkCover. Strictly speaking, when I did the work for the advisory council, I got claims data on the managed fund. I had all sorts of access to information, and I had to sign a confidentiality arrangement where I would not disclose anything to anybody apart from WorkCover or the advisory council. It is no longer in force. I do not know who is going to authorise me to release information. I assume you can get it somehow from WorkCover, or get them to say, yes, get it from David Zaman.

The Hon. MICHAEL GALLACHER: If we can get the names of documents we can approach WorkCover, and I would say it is okay.

(The witness withdrew)

(The committee adjourned at 3.35 p.m.)