

General Purpose Standing Committee No. 1

NSW Workers Compensation Scheme

Fourth Interim Report

Ordered to be printed according to the Resolution of the
House

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Terms of Reference

- 1) *That General Purpose Standing Committee No. 1, have the following functions:*
 - a) *to monitor the financial position of the workers compensation scheme under the Workers Compensation Act 1987 and the Workplace Injury Management and Workers Compensation Act 1998,*
 - b) *to monitor and review the implementation and operation of the Workers Compensation Legislation Amendment Bill 2001 (No. 2), and as finally passed by the Parliament, and the Workers Compensation Further Amendment Bill 2001 as finally passed by the Parliament,*
 - c) *to investigate and report on the efficiency of the operation of the workers compensation system and the administration of the WorkCover Authority,*
 - d) *to monitor the impact on premiums of the Bill.*
- 2) *That the Committee be authorised to engage the services of:*
 - a) *an actuary, who is a member of the Institute of Actuaries of Australia, and*
 - b) *an accountant, who is a member of the Institute of Chartered Accountants in Australia or the Australian Society of Certified Practising Accountants,*
 - c) *for the purpose of advising and assisting the Committee, as the Committee thinks fit, in relation to the Committee's functions.*
- 3) *That the Committee:*
 - a) *provide interim reports to the House each 3 months, and*
 - b) *finally report to the House by 3 September 2002.*
- 4) *Nothing in this resolution authorises the Committee to investigate a particular compensation claim—put and passed.*

(Minutes of Proceedings No. 111, 28 June 2001, Item No. 21, as amended by Minutes of Proceedings No 134, 29 November 2001, Item No. 23 and Minutes of Proceedings No 8, 9 April 2002, Item No 8.)

These terms of reference were referred to the Committee by the House.

Committee Membership

The Revd the Hon Fred Nile MLC Christian Democratic Party (*Chairman*)

The Hon Tony Kelly MLC Australian Labor Party (*Deputy Chairman*)

The Hon Michael Gallacher MLC Liberal Party^{1,2}

The Hon Greg Pearce MLC Liberal party³

The Hon Janelle Saffin MLC Australian Labor Party⁴

The Hon Henry Tsang MLC Australian Labor Party

The Hon Dr Peter Wong MLC Unity

Participating Members

The Hon Ron Dyer MLC Australian Labor Party

-
- ¹ Correspondence received 6 July 2001, the Hon Richard Colless MLC will replace the Hon Patricia Forsythe MLC for the duration of this inquiry.
- ² Correspondence received 29 October 2001, the Hon Mike Gallacher MLC will replace the Hon Richard Colless MLC for the duration of this inquiry.
- ³ Correspondence received 6 July 2001, the Hon Greg Pearce MLC will place the Hon Don Harwin MLC for the duration of this inquiry.
- ⁴ Correspondence received 8 Aug 2001, the Hon Janelle Saffin MLC will replace the Hon Peter Primrose MLC for the duration of this inquiry.

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Chairman's Foreword

On 26 August 2002 the Committee resolved to table a fourth interim report as part of its inquiry into the NSW workers compensation scheme. This report focuses on three main areas: the financial impact of the 2001 legislative reforms; continued implementation of key reforms including the establishment of the Workers Compensation Commission, compliance and insurer remuneration; and the management of the Scheme's investments. In this report the Committee draws conclusions in relation to each of these main areas. I look forward to tabling the Committee's final report containing the inquiry's recommendations on 3 September 2002.

As foreshadowed in the Committee's third interim report, the Committee has looked at the 31 December 2001 Scheme evaluation by Tillinghast, WorkCover's actuaries, for an indication of the one-off impact of the 2001 reforms. Two alternative scenarios were predicted – an optimistic \$1.33 billion based on WorkCover's "targets mainly achieved" scenario and a second, more realistic \$810 million based on an actuarial central estimate. The 31 December 2001 evaluation estimated the one-off impact to be \$757 million, which is significantly less than WorkCover's "targets mainly achieved" estimate of \$1.33 billion but very close to the actuary's best estimate of \$810. Based on the actuarial best estimate, the Scheme actuaries predict the deficit will continue to grow without further reforms, albeit at a slower rate, resulting in a deficit of \$3.917 billion in June 2006.

In regards to insurer remuneration, the Committee is concerned that over one year after the commencement of a new insurer remuneration package, three important measures have not been finalised. WorkCover was unable to give the Committee a definitive time frame for completion of the measures. It is important to finalise these measures if WorkCover is to effectively achieve some of the goals of the 2001 reforms which require significant changes in insurer performance.

The performance of WorkCover's substantial investments (\$5.864 billion at 30 June 2001) can have considerable impact on the overall financial position of the Scheme. The Committee heard evidence relating to a change in WorkCover's investment policy aimed at increasing investment return in the medium to long term. The most significant change is an increase in the proportion of the Scheme's assets invested in shares and other growth assets. This has doubled from 30% to 60% under the new Investment Mandate. The result of this change could be decreased return on investment in the short-term due to the volatility of growth assets such as shares, however there should be an increased return over the medium to longer term which would have a positive impact on the Scheme's overall financial position.

The Committee heard evidence from the President and Registrar of the Workers Compensation Commission which commenced operation on 1 January 2002. Although the number of matters lodged before the Commission does not provide sufficient basis for the Committee to determine whether or not the Commission is meeting its objectives, early signs are that the new dispute resolution procedures will have a beneficial impact on the Scheme and the Scheme's overall financial position.

I take this opportunity to thank my fellow Committee Members for their continued hard work during this extensive inquiry. I also thank the Committee secretariat, in particular Senior Project Officer Ms Rachel Simpson, who drafted this report and organised the Committee's public hearings in preparation for this stage of the inquiry and Committee Officers Ms Natasha O'Connor and Ms Ashley Nguyen for their valuable assistance in formatting the report and in administering all aspects of the inquiry. My

thanks also goes to Committee Director, Mr Steven Reynolds for overseeing the inquiry and Mr Peter McCarthy from Ernst & Young for his continued actuarial advice and assistance.

The Rev the Hon Fred Nile MLC
Chairman

Summary of Conclusions

Conclusion 1 **12**

The Scheme actuary's best estimate indicates that the 2001 legislative changes will not, all other things remaining equal, lead to a reduction in the Scheme deficit, although the actuary's 31 December 2001 Scheme Evaluation recognises that the liability estimate would have been \$757 million greater without the reforms of 2001. The deficit will continue to increase, although at a slower rate.

The actuaries concluded that WorkCover's optimistic "targets mainly achieved" scenario will see the deficit continuing to increase in the short term, although at a much lower and more controllable rate than under the best estimate scenario, and, all other things remaining equal, will result in an estimated zero deficit position in the Scheme (ie the Scheme is fully funded) in approximately 10 to 15 years.

The Committee notes the optimistic "targets mainly achieved" scenario preferred by WorkCover has not proven to be an accurate estimate to date.

Conclusion 2 **13**

If implemented by WorkCover, the action points identified by Tillinghast in their December 2001 Scheme evaluation should assist controlling the Scheme's claims outcomes and further stabilize the Scheme.

Conclusion 3 **18**

As the number of matters lodged before the Commission increases, it will then be more appropriate to determine whether or not the Commission is meeting its objectives, and the impact of the new dispute resolution structure on the Scheme generally.

Conclusion 4 **20**

As the number of matters heard before the Commission increases, it will become necessary to determine whether the new dispute resolution system gives sufficient weight to the balance between reducing the cost of legal involvement and protection of injured workers' rights.

Conclusion 5 **24**

The need to finalise the insurer remuneration package has not diminished since the issue was first raised in the Committee's previous reports. The Committee notes that it is important to resolve these issues so that WorkCover is able to effectively pursue some of the goals of its reforms. On the other side, it is clearly important to the continued participation of insurers in the Scheme that the issue of how their remuneration is to be assessed is resolved.

Conclusion 6 **30**

Fraud and non-compliance continue to be a significant problem in the Scheme. The initiatives contained in WorkCover's Compliance Report should help reduce the incidence of fraud and non-compliance. Many of the recommendations require structural or legislative changes which may be slow to occur.

The need for tougher sanctions for fraud and non-compliance by all participants in the Scheme is examined in further detail in the Committee's final report.

Conclusion 7 **33**

WorkCover appears to be committed to improving its database system.

Until implementation of the IT strategy in 2003 the Committee is unclear as to whether the current strategy will address the concerns raised in the third interim report.

The Committee will make recommendations about the issue of a centralised database system in the final report.

Conclusion 8 **44**

WorkCover's reasons for changing their investment strategy in view of the Government's policy that privatisation will not happen in the near future appears to be regarded as appropriate by experts consulted by the Committee.

In the short term WorkCover's new investment strategy, with an increased proportion of funds invested in growth assets, however there is concern that this may result in losses which will impact on the overall Scheme deficit. However in the medium term expert opinion, such as Towers Perrin and Mr Spruell from Allianz suggests that there should be an increased return on investments and subsequent improvement in the deficit resulting from this strategy.

Conclusion 9 **51**

Expert opinion appears to support performance based fees as a means by which the interests of the Scheme and the interests of the investment managers (insurers) may be more closely aligned. Based on the evidence received the Committee is concerned that WorkCover may experience some difficulties in implementing the new remuneration package which may adversely impact on investment performance.

Conclusion 10 **53**

There are differing views as to whether WorkCover should move to specialist investment managers. This may be a suitable issue to be considered in depth by the Scheme Design Review or another suitable body.

Glossary & Abbreviations

Glossary

The following definitions of key terms and concepts was provided to the Committee by the Committee's consultant actuaries, Ernst & Young ABC.

Actuarial report	Is simply a report by an actuary. The scope of the actuarial report can cover many aspects. WorkCover obtain actuarial reports on a regular basis for the actuarial estimate of the outstanding claims liabilities and the estimated premium rate to fund the cost of claims and related expenses in a year. Less regular reports are obtained on such matters as costings of changes to the scheme (e.g. common law), remuneration for insurers, review of the premium rating system and industry premium rate relativities.
Claims management	The effective co-ordination of all tasks (e.g. medical management, legal management, rehabilitation management, payment of entitlements, claim strategy, co-ordination of claim management with the employer, injury management, etc) associated with the just and economic resolution of a claimant's rights pursuant to the <i>Workers Compensation Act</i> .
Commutations	Workers compensation pays ongoing weekly, medical and related benefits. Under the Act an insurer, with the consent of the worker and approval of the court, can commute all future weekly and other regular payments and receive the lump sum equivalent. After the commutation all ongoing payments cease. In theory the worker still retains the right to sue at common law but normally when negotiating the level of the commutation the worker signs a common law deed of release and gives up the right to common law action. The S66/67 lump sums are usually settled at the same time as the commutation. In many ways commutations could be viewed as an out of court settlement of a common law action.
Deficit	The deficit of the scheme is the difference between the value of its assets and liabilities. If the value of assets exceeds the value of liabilities the scheme is in surplus and if the value of liabilities exceed the value of assets the scheme is in deficit. The funding ratio is the value of assets divided by the value of liabilities. The largest asset are investments including cash and the next largest item are unpaid premiums. The largest liability item is the estimate of the value of outstanding claims liabilities as estimated by the actuary including the value of the claims handling expenses.
Injury management	Restoration of workers pre-injury physical condition, or alternatively to provide assistance to attain optimal recovery (i.e. return to work). Also to co-ordinate and support workers' attempts to mitigate secondary economic loss through effective rehabilitation.
Premium leakage	Is a subset of system leakage .
Provisional Liability	Provisional liability allows an insurer to make weekly and medical expenses payments without admitting liability. This enables an insurer to make early payments to the worker without delay.

Recoveries	Under workers compensation in NSW an insurer is entitled to seek recovery from another party where the other party contributed to the injury of the worker. Examples include recoveries from a CTP insurer where the worker was involved in a car accident while working, recoveries from a product liability insurance policy where a product the worker was faulty and caused an injury to the worker (a good example is asbestos) and recoveries off other workers compensation insurers which insured the employer over different periods over which the injury occurred (a good example is deafness which may have arisen over a period of 30 years from 1971 to 2001 and the employer was insured by 5 different insurers over that period).
Redemptions	Under the <i>NSW 1926 Workers Compensation Act</i> commutations were known as redemptions. Redemptions became known as commutations under the 1987 Act.
Risk free rate of return	In the actuarial valuation of the scheme's outstanding claims liabilities the future liability cash flow (i.e. future claims payments) are discounted using an appropriate interest rate. The interest rate normally used is the risk free rate of return being the market interest rate on Government bonds for the length of the liability cash flows. APRA (Australian Prudential Regulation Authority) in the amendments recently pasted to the <i>Insurance Act</i> require the use of the risk free rate of return for discounting all insurers claims liabilities (note APRA does not apply to the NSW workers compensation scheme liabilities under the managed fund).
Section 66 benefit	Is compensation for permanent injury (e.g. loss of an eye, loss of an ear) and is sometimes referred to as a Table of Maims. The benefit paid is calculated as a percent of the maximum amount of \$100,000 with the percent depending on the nature and extent of the injury.
Section 67 benefit	Is compensation for Pain and Suffering and is equivalent to the non-economic loss benefits paid under common law. Like Section 66 the loss is based on a table and is a percent of the maximum amount of \$50,000 with the percent depending on the extent of the pain and suffering. Claimants can only gain access to Section 67 compensation if they pass a threshold being the ability to receive compensation of at least 10% of the maximum amount under Section 66. <i>Section 66 and Section 67 benefits are referred to as Statutory lump sum payments.</i>
Sufficiency Level	Refers to the extent to which the organisation's capital reserves are sufficient to cover outstanding claims.
Significant Injury	A workplace injury that is likely to result in the worker being incapacitated for a continuous period of more than 7 days, whether or not any of those days are work days and whether or not the incapacity is total or partial or a combination of both.
System leakage	Leakage is a vague term and can refer to a variety of different matters and have different interpretations. In its simplest form it can refer to employees receiving compensation that they strictly should not have received and to employers that strictly have under paid premiums. Both situations adversely impact the financial status of the scheme and there are many, many examples. Leakage occurs from the actions of many stakeholders in the scheme including

employers, employees, WorkCover, insurers, doctors, lawyers, and all others. Leakage can refer to direct fraud or to avoidance or to malingering and other views. Employer and employee fraud is one form of leakage. Examples of direct fraud include a worker claiming compensation for an injury that did not occur and an employer under declaring wages or not insuring for workers compensation or an employer deliberating using the wrong industry classification for premium calculation. Other examples of leakage include workers staying on compensation when they are strictly well enough to return to work using doctors medical certificates to substantiate the injury, employer splitting the company into smaller legal entities to reduce premiums paid, putting pressure on insurers to reduce case estimates to reduce the employers premium, incorrect classification of employer industry classification by insurers. Insurer's poor management is the cause of leakage and can include poor claims management, not undertaking wage audits of employers, not following WorkCover guidelines on case estimating. WorkCover poor management of insurers and stakeholders is a form of leakage. An example is not taking action to improve insurer management of claims.

Abbreviations

1987 Act	<i>Workers Compensation Act 1987</i>
1998 Act	<i>Workplace Injury Management and Workers Compensation Act 1998</i>
2001 Act	<i>Workers Compensation Amendment Act 2001</i>
31 December Evaluation Report	Actuarial Review of the Outsanding Liabilities of the WorkCover Scheme Statutory Funds as at 31 December 2001
AIG	Australian Industry Group
APRA	Australian Prudential Regulation Authority
CFMEU	Construction, Forestry, Mining and Energy Union
Commission	Workers Compensation Commission
Ernst & Young	Ernst & Young ABC, the Committee Consultant Actuaries
Further 2001 Act	Workers Compensation Legislation Further Amendment Act 2001
GPSC No 1	General Purpose Standing Committee No 1
Grellman Report	Report of the Inquiry into Workers Compensation System in NSW 1997
GST/NTS	Goods and Services Tax/New Tax System
ICA	Insurance Council of Australia
Insurance Act	<i>Insurance Act 1973 (Cth)</i>
IT	Information Technology
OH&S	Occupational health and safety
OH&S Act	<i>Occupational Health and Safety Act 2000</i>
OH&S Reg	Occupational Health and Safety Regulation 2001
PDS	Premium Discount Scheme

PWC

Pricewaterhouse Coopers

Scheme

NSW Statutory Workers Compensation Scheme

Tillinghast

Tillinghast Towers-Perrin (Scheme actuaries)

WorkCover

WorkCover Authority of NSW

Chapter 1 Introduction

Background to this report

- 1.1** The Committee resolved on 26 August 2002 to publish a fourth interim report focussing on the areas of investment management, fraud and non-compliance and dispute resolution⁵. The final report, due to be tabled on 3 September 2002, will focus solely on the Committee's recommendations. The history and conduct of the Inquiry leading up to this fourth interim report, is summarised at the end of this introductory chapter.

Structure of the Committee's fourth interim report

- 1.2** The body of this report consists of four chapters. Chapter Two continues the Committee's monitoring role by examining the financial impact of the 2001 legislative reforms. Chapter Three evaluates the implementation of the 2001 legislative reforms to date. The early progress of the Workers Compensation Commission ("WCC") is considered in detail, drawing on evidence received from the President of the Commission, Mr Justice Sheahan and Registrar, Ms Helen Walker as well as evidence from the NSW Law Society in relation to the operation of the WCC. Chapter Three also continues the Committee's review of insurer remuneration arrangements begun in the second interim report. Chapter Three goes on to explore the incidence of fraud and non-compliance in the Scheme. It also considers the appropriate sanction for fraud and non-compliance and some means by which the incidence may be reduced. Chapter Three concludes with an issue that has been raised throughout the inquiry, namely the adequacy of WorkCover's IT and data management.
- 1.3** Chapter Four examines WorkCover's new investment mandate that became effective on 1 February 2002 and focuses on the rationale for the substantial changes from the previous investment strategy that the new mandate represents. The role of WorkCover and insurers under the mandate is outlined and the specific issue of the remuneration of insurers for managing the Scheme's investments is considered.
- 1.4** The Committee draws important conclusions at the end of each section where relevant and appropriate. Recommendations will be made in the final report, and will include issues discussed in this report.

⁵ *Minutes of Proceedings of General Purpose Standing Committee No 1*, No 91, 26 August 2002, item No 5.

Conduct of the fourth stage of the Inquiry

Additional submissions

- 1.5** The Committee received one additional submission to the inquiry since the date of the third interim report. A full list of submissions is presented as Appendix One.

Public hearings and questions on notice

- 1.6** The Committee conducted two public hearings in preparation for its fourth interim report. The first hearing, on 3 June 2002, focussed on the areas of dispute resolution, investment management and non-compliance. Particular reference was made to the operation of the new Workers Compensation Commission, and the management of the Scheme's investments by insurers. Justice Terry Sheahan, President and Ms Helen Walker, Registrar, Workers Compensation Commission gave evidence as did representatives of the Law Society of NSW. The Scheme's investment advisers, Towers-Perrin, gave evidence about good investment management practices and the background to the new investment mandate and representatives of the insurers involved in the Scheme presented evidence on all areas relevant to the hearing.
- 1.7** The Committee heard evidence from WorkCover at a second hearing on 7 June 2002, focussing on investment management and WorkCover's IT strategy. A full list of witnesses for the fourth stage of the inquiry appears as Appendix Two.
- 1.8** A list of documents tabled during the public hearings appears as Appendix Three
- 1.9** Witnesses at the Committee's hearings agreed to take a number of questions on notice providing further information to the Committee. The Committee found this process useful in obtaining additional and more technical information than that which could be presented orally. Answers to questions on notice are include in the text of the report where relevant. Questions on notice to the Minister arising out of the public hearing on 7 June 2002 and responses received to date are presented as Appendix Four.

Minutes of the proceedings of the Committee

- 1.10** The Committee considered the Chairman's draft fourth interim report at its meeting on Monday 26 August 2002. The Minutes of Proceedings of the Committee, since the third interim report was tabled on 17 April 2002, are presented as Appendix Six.

History and conduct of the full inquiry

Terms of reference

1.11 On 28 June 2001 during debate in the Legislative Council on the Workers Compensation Legislation Amendment Bill 2001 (No 2), the House passed a resolution referring the following terms of reference to General Purpose Standing Committee No 1:

1. *That General Purpose Standing Committee No. 1, have the following functions:*
 - (a) *to monitor the financial position of the workers compensation scheme under the Workers Compensation Act 1987 and the Workplace Injury Management and Workers Compensation Act 1998, and*
 - (b) *to monitor and review the implementation and operation of the Worker's Compensation Legislation Amendment Bill 2001 (No. 2), as finally passed by the Parliament,*
 - (c) *to investigate and report on the efficiency of the operation of the workers compensation system and the administration of the WorkCover Authority,*
 - (d) *to monitor the impact on premiums of the Bill.*
2. *That the Committee be authorised to engage the services of:*
 - (a) *an actuary, who is a member of the Institute of Actuaries of Australia, and*
 - (b) *an accountant, who is a member of the Institute of Chartered Accountants in Australia or the Australian Society of Certified Practising Accountants,*

for the purpose of advising and assisting the Committee, as the Committee thinks fit, in relation to the Committee's functions.
3. *That the Committee:*
 - (a) *provide interim reports to the House each 3 months, and*
 - (b) *finally report to the House by 30 June 2002.*
4. *Nothing in this resolution authorises the Committee to investigate a particular compensation claim.⁶*

1.12 On 29 November 2001, the terms of reference were amended to include the Workers Compensation Further Amendment Bill 2001 as finally passed by Parliament. Term of Reference 1(b) was affected. The amended term of reference reads:

⁶ *Minutes of the Proceedings of the Legislative Council*, No 111, 28 June 2001, Item No 21. and No 134, 29 November 2001, Item No 23. Resolution passed by the Legislative Council based on the original motion of Mr Gallacher MLC as amended by the motion of Rev Nile MLC, further amended on the motion of Rev Nile MLC.

- b) *to monitor and review the implementation and operation of the Worker's Compensation Legislation Amendment Bill 2001 (No. 2), and the Workers Compensation Further Amendment Bill 2001 as finally passed by the Parliament,*

1.13 Reporting requirements stipulated in the Committee's terms of reference require provision of interim reports every three months and a final report by 30 June 2002. Following a motion in the House by the Chairman, the Rev the Hon Fred Nile MLC, the reporting date for the final report was changed to 3 September 2002.⁷ The Committee identified the date of assent by the Governor of New South Wales to the Workers Compensation Amendment Legislation Bill 2001 (No 2) as the date at which the Committee commenced its review and monitoring functions with respect to this legislation and other parts of the terms of reference.⁸ The Committee has agreed to the following timetable for completion of its interim and final reports based on the original assent date of 17 July 2001.

Inquiry reporting timetable

Report	To be completed on or before
First interim report	17 October 2001
Second interim report	17 January 2002
Third interim report	17 April 2002
Fourth interim report	29 August 2002
Final report	3 September 2002

First three interim reports

1.14 The Committee's first, second and third interim reports were tabled in accordance with the Inquiry's reporting timetable. The first interim report included an overview of the workers compensation system in New South Wales and identified key issues and priority areas that the Committee intended to examine in subsequent interim reports and the final report. The Committee's second interim report focussed on areas of scheme design, including possible mechanisms for reducing the Scheme's deficit. It also continued to investigate the financial position of the Scheme and any financial impact on the Scheme of the 2001 legislative reforms. The third interim report focussed on scheme management, and in particular the roles and regulation of insurers, looking closely at injury management and assessment. The incidence of occupational health and safety and some injury prevention strategies was also considered. Information Technology and data management and the timely availability of key data was identified by the Committee as an area of concern.

1.15 The reports are available by telephoning the Committee Secretariat on (02) 9230 3544 or via the Internet at www.parliament.nsw.gov.au following the links to General Purpose Standing Committee No 1.

⁷ *Minutes of the Proceedings of the Legislative Council*, No 8, 9 April 2002, Item No 8.

⁸ *Minutes of the Proceedings of General Purpose Standing Committee No 1*, No 57, 6 July 2001, Item No 4.

- 1.16** Each of the Committee's interim reports is intended to follow on from previous interim reports. While it is intended that each interim report examines discrete issues and thus stands alone, they rely on previous reports for background and context. Readers might find it particularly useful to refer to the reports of the Committee's consultant actuaries, Ernst & Young ABC which appears as Appendix 4 of the first interim report, Appendix 1 of the second interim report, and Appendix 3 of the third interim report.
- 1.17** As with many industry fields, there are a number of key terms and concepts within workers compensation that have specific meaning and relevance. A Glossary of some such terms, developed in consultation with the Committee's consultant actuaries, Ernst & Young ABS ("Ernst & Young") are presented at the front of this report to assist readers.

Chapter 2 Financial impact of 2001 legislative reforms

2.1 The Committee concluded in its third interim report that it:

... would look to the 31 December 2001 Scheme evaluation for an indication of the one-off impact on the deficit of the 2001 reforms in light of the estimated, optimistic, \$1.33 billion one-off impact and the more realistic estimate of \$810 million one-off impact.⁹

2.2 The report, *Actuarial Review of the Outstanding Liabilities of the WorkCover Scheme Statutory Funds as at 31 December 2001* ("The Evaluation Report") was received by the Committee on 18 July 2002, and is appended to this report as Appendix Seven. In the Evaluation Report, the Scheme actuaries, Tillinghast-Towers Perrin ("Tillinghast") estimated the one-off impact of the reforms:

The "stand alone" impact of the 2001 reforms on the outstanding claims liabilities is an improvement of approximately \$757M.¹⁰

2.3 Practically, this means that "the liability estimate would have been \$757M greater without the reforms of 2001".¹¹ This represents a difference of \$53M from Tillinghast's \$810M best estimate of the impact of the reforms.

2.4 This figure of \$757M one-off impact of the reforms represents Tillinghast's best estimate, or the central estimate. Tillinghast explained their central estimate to mean:

a probability of around 50% that an amount equal to the estimate will prove to be sufficient to meet the liability for outstanding claims.¹²

2.5 The Evaluation Report summarised the effect of the reforms on the Scheme deficit:

The estimated post-reform deficit in the Scheme as at 31 December 2001 is \$2,558M. (Total liabilities (including unexpired risk reserve) of \$9,346M less total assets of \$6,788M). The estimated post-reform deficit is \$198M less than the June 2001 estimated deficit of \$2,756M. Without the reforms of 2001 the estimated deficit in the Scheme as at 31 December 2001 would have been \$3,425M; i.e. \$867M greater than the 30 June estimate. This \$876 reduction can mainly be attributed to the reduction in the outstanding claims liability estimate (\$757M) and to a lesser extent, to the reduction in the unexpired risk reserve (\$110M), due to a lower projected post-reform breakeven premium.¹³

⁹ General Purpose Standing Committee No 1, *NSW Workers Compensation Scheme Third Interim Report*, Conclusion 3, p 12.

¹⁰ 31 December 2001 Evaluation Report, p 10.

¹¹ 31 December 2001 Evaluation Report, p 7.

¹² 31 December 2001 Evaluation Report, p 8.

¹³ 31 December 2001 Evaluation Report, pp 7-8.

2.6 Based on Tillinghast's central estimate, the Evaluation Report projected the Scheme's deficit would continue to increase. Without further reforms, the deficit is predicted to increase to \$3.917 billion by June 2006.¹⁴ This is represented by a deterioration in the funding ratio, currently 73%, to 63% over the same period, and is illustrated in Table 1.1 below:

Table 1.1 Estimated WorkCover Balance Sheet after allowing for reforms (\$M) (Figure 4.9)

	Balance Date					
	Dec-01	June-02	June-03	June-04	June-05	June-06
Total assets	6,788	5,990	5,836	6,097	6,422	6,761
Total liabilities	9,346	8,739	8,844	9,386	10,013	10,678
(Deficit)/Surplus	(2,558)	(2,750)	(3,009)	(3,289)	(3,591)	(3,917)
Funding Ratio	73%	69%	66%	65%	64%	63%

Source: Actuarial Review of the Outstanding Liabilities of the WorkCover Scheme Statutory Funds as at 31 December 2001, vol 1, figure 4.9

2.7 The assumptions upon which this prediction was based are:

- Actual premium rate of 2.87% of wages for future policy years;
- Continuing "risk-free" returns on investments;
- Post-reform breakeven premium rate (i.e. cost of claims and expenses) of 2.96% of wages implicitly assumed for future policy years, and
- Wageroll grows at a rate of 4% p.a for the first year of projection, rising to 5% p.a thereafter (reflecting an increase in the assumed employment growth rate) and no new self-insurers.¹⁵

2.8 Even with a 1% increased return on investment, reflecting WorkCover's new investment strategy (see Chapter Four), Tillinghast predicts the deficit will continue to grow, although at a slower rate. The estimated deficit at June 2006, taking into account a 1% increased return on investment, is \$3.638 billion, representing a funding ratio of 66%¹⁶, compared to \$3.917 billion and 63% under the current investment strategy.

2.9 Tillinghast also projected the optimistic "targets mainly achieved" scenario. The Committee noted in its third interim report that the \$1.33 billion one-off savings was "based on

¹⁴ 31 December 2001 Evaluation Report, p 23.

¹⁵ 31 December 2001 Evaluation Report, p 23.

¹⁶ 31 December 2001 Evaluation Report p 25.

WorkCover achieving their implementation targets.¹⁷ Tillinghast describes the “targets mainly achieved” scenario as assuming:

... the reforms operate as intended and are effectively implemented, so the targets and objectives for the reform process are mostly met.¹⁸

2.10 Tillinghast noted in the Evaluation Report that the optimistic “targets mainly achieved” scenario “does not represent our best estimate”.¹⁹ Tillinghast concluded in relation to the deficit, on a “targets mainly achieved basis”, that:

the estimated deficit of the Scheme will continue to increase in the short term ... but at a much lower and controllable rate than ... our best estimate scenario. Projecting the “targets mainly achieved” scenario with a 1% p.a increase in the assumed investment return ... would reduce the estimated deficit in 5 years by a further \$304M and would result in an estimated zero deficit position in approximately 10-15 years, all other things remaining equal.²⁰

2.11 The Committee questioned Ms Kate McKenzie General Manager, WorkCover NSW and Mr Rod McInnes, Assistant General Manager, Insurance Division, WorkCover NSW on the targets that need to be met if WorkCover is to fulfil the “targets mainly achieved” scenario. Ms McKenzie and Mr McInnes were unable to provide detailed answers during evidence. They undertook to provide in writing the targets given by WorkCover to Tillinghast that formed the basis for Tillinghast’s estimates of the “targets mainly achieved” scenario. WorkCover subsequently provided the Committee with the following definition of the “targets mainly achieved” scenario:

The targets in the relevant scenarios refer to:

Statutory Claims

The targets set out in relation to statutory claims are as follows:

- Reducing the number of disputes over statutory claims by half to approximately 15,000 per year.
- Resolving approximately 80% of the disputes through conciliation, assessment and medical assessment.
- No more than 2,000 statutory benefit matters per year proceeding to determination.

¹⁷ General Purpose Standing Committee No 1, *NSW Workers Compensation Scheme Third Interim Report*, Conclusion 3, para 2.21.

¹⁸ 31 December 2001 Evaluation Report p 24.

¹⁹ 31 December 2001 Evaluation Report p 24.

²⁰ 31 December 2001 Evaluation Report p 25.

Common Law

The target performance for the Common Law system was set so as to be consistent with that of the Motor Accidents Scheme:

- 90% of Common Law matters should be resolved through assessment, with only 10% of matters proceeding to Court.²¹

2.12 The estimated balance sheet under the “targets mainly achieved” scenario is illustrated in Table 1.2:

Table 1.2 Estimated WorkCover Balance Sheet on “Targets Mainly Achieved” Scenario (\$M) (Figure 4.11)

	Balance Date					
	Dec-01	June-02	June-03	June-04	June-05	June-06
Total assets	6,788	6,142	6,205	6,682	7,251	7,871
Total liabilities	8,661	8,120	8,167	8,625	9,169	9,754
(Deficit)/Surplus	(1,893)	(1,977)	(1,963)	(1,944)	(1,918)	(1,883)
Funding Ratio	78%	76%	76%	77%	79%	81%

Source: Actuarial Review of the Outstanding Liabilities of the WorkCover Scheme Statutory Funds as at 31 December 2001, vol 1, figure 4.11

2.13 This prediction is based on the following assumptions:

- Post-reform breakeven premium rate (i.e. cost of claims and expenses) of 2.71% of wages implicitly assumed for future policy years, and
- Reduction in deficit at December 2001 of \$665M due to a lower projected outstanding claim estimate and unexpired risk provision (as a result of a lower projected breakeven premium rate).²²

2.14 The Committee did not receive evidence during the final stage of this Inquiry from the Scheme actuaries Tillinghast, who prepared the report. However the Committee did have the opportunity to ask Ms Kate McKenzie whether or not she was satisfied with the level of savings. In response to a question from the Committee, asking why the deficit did not decrease by up to \$1.33 billion as the Minister predicted, Ms McKenzie stated:

I do not think that we ever indicated in the past that that would be the exact number. Those figures were estimates of the savings that would be made from the scheme reform. As we have discussed before, in pulling all of this stuff together in the valuation report, which is the report that you have referred to, there is a whole lot of other factors that come into play that make up - this is what

²¹ Answer to questions on notice, Mr Pearce to Ms McKenzie, 14 February 2002.

²² 31 December 2001 Evaluation Report, p 25.

you have now got in assets and this is what you have now got in liabilities and therefore this is what your deficit is, and there were deteriorations in other areas which led to a different number coming out.²³

... It is very early days in terms of the reform kicking in and very difficult to predict what the future might hold. So they have done their usual thing of taking a fairly conservative view of that, and in the light of other deteriorations in the scheme, in the end they have given us \$757 million credit, one-off impact on the deficit from the scheme reform, and made some fairly conservative estimates about what the future holds.²⁴

2.15 Ms McKenzie confirmed that, despite the 2001 Scheme reforms, it appeared from the Evaluation Report that the deficit had not fallen significantly – from \$2.756 billion at June 2001 to \$2.558 billion at December 2001, which represents a reduction of \$198 million. In response to a question from the Chair asking whether or not WorkCover is concerned that the deficit did not reduce by more than \$198 million, Ms McKenzie answered:

Obviously, we would have much preferred to see it reduce by more. ... we would have liked to have seen a bigger number and probably we would have been expecting to see a bigger reduction than we got, but I guess not really all that surprised in the light of what I have just said about the uncertainty attached to this and the difficulty for the actuaries in trying to predict the future when we have made so many changes and we have not really seen what that has led to in terms of changed behaviour in the scheme, and we probably will not for a couple of years. I would not want to place too much reliance on one evaluation report. I think we need to see what the trends and the patterns are over the next couple of years.²⁵

²³ Evidence of Kate McKenzie, General Manager, WorkCover , 7 June 2002, p 20.

²⁴ Evidence of Kate McKenzie, General Manager, WorkCover , 7 June 2002, p 20.

²⁵ Evidence of Kate McKenzie, General Manager, WorkCover , 7 June 2002, p 21.

Conclusion 1

The Scheme actuary's best estimate indicates that the 2001 legislative changes will not, all other things remaining equal, lead to a reduction in the Scheme deficit, although the actuary's 31 December 2001 Scheme Evaluation recognises that the liability estimate would have been \$757 million greater without the reforms of 2001. The deficit will continue to increase, although at a slower rate.

The actuaries concluded that WorkCover's optimistic "targets mainly achieved" scenario will see the deficit continuing to increase in the short term, although at a much lower and more controllable rate than under the best estimate scenario, and, all other things remaining equal, will result in an estimated zero deficit position in the Scheme (ie the Scheme is fully funded) in approximately 10 to 15 years.

The Committee notes the optimistic "targets mainly achieved" scenario preferred by WorkCover has not proven to be an accurate estimate to date.

2.16 Tillinghast included a number of "action points" which they suggest WorkCover consider to ensure a control on claims outcomes:

- Continuing examination of reform needs – given that our best estimate of the effects of the 2001 reforms does not return the Scheme to fully funded status, if the premium rate remains unchanged, at any stage in the future.
- Guidance given to Licensed Insurers on direct reform implementations and close monitoring and enforcing of the reform aims by WorkCover in concordance with higher level actuarial monitoring.
- Close monitoring of the Licensed Insurer's remuneration package to confirm the incentives are having the appropriate effect on Scheme liabilities.
- Close investigating and monitoring of the "cultural" effects of the reform package – particularly weekly benefit continuance and impairment benefit climates. The projections in Section 4.9 and 4.10 clearly illustrate the importance of full and efficient application of the recent reforms on the Scheme's financial position. This is particularly relevant because of potential cultural "knock-on" effects from effective implementation that could further improve the position.
- The need for collection of better information generally, and most importantly in the following areas:
 - Common law claims run-off (eg the statement of claim date to ensure post- and pre-reform claims can be identified);
 - Rehabilitation payments (split between vocational, social and other where possible);

- Legal payments (split between the cause of occurrence, for example: common law, disputes, s66);
- S66 and s67 claims, information relating to the type of injury a payment relates to and the level of impairment assessed. This would be particularly useful to monitor surges in certain types of injuries;
- Reform monitoring information.²⁶

Conclusion 2

If implemented by WorkCover, the action points identified by Tillinghast in their December 2001 Scheme evaluation should assist controlling the Scheme's claims outcomes and further stabilize the Scheme.

²⁶ 31 December 2001 Evaluation Report, p 27.

Chapter 3 Implementation of 2001 legislative reforms

This chapter continues the Committee's monitoring role begun in the second and third interim reports in relation to the implementation of the 2001 legislative reforms. WorkCover's legislative reform implementation plan for 2001/2002 was reproduced in Appendix 5 of the second interim report. Further information provided to the Committee in relation to the legislative reform implementation programmes was included in Appendix 4 of the Committee's third interim report.

3.1 In its Plan WorkCover identified sixteen discrete projects that it will undertake in 2001-2002 to implement the 2001 reforms. As part of the preparation for this report, the Committee heard specific evidence in relation to a number of the projects. These are:

- Project 1 – Establishment of the Workers Compensation Commission;
- Project 3 – Insurer remuneration, and
- Project 15 – Compliance

3.2 In addition, the Committee heard evidence from WorkCover in relation to its Information Technology and Data Management Strategic Plan, the executive summary of which was included as Appendix 8 of the third interim report.

Establishment of the Workers Compensation Commission

Objectives of the Workers Compensation Commission

3.3 The Workers Compensation Commission ("the Commission") was established by the *Workers Compensation Legislation Amendment Act 2001* ("the 2001 Act") and commenced operation as scheduled on 1 January 2002. From 1 April 2002 all workers compensation disputes are dealt with by the Commission, regardless of the date of the claim. Prior to that date disputes arising before 1 January 2002 were dealt with by the Compensation Court.

3.4 The objectives of the Commission are set out in section 367(1) of the *Workplace Injury and Workers Compensation Act 1998* ("the 1998 Act"). They are:

- A. to provide a fair and cost effective system for the resolution of disputes under the Workers Compensation Acts.
- B. to reduce administrative costs across the workers compensation system
- C. to provide a timely service ensuring that worker's entitlements are paid promptly
- D. to create a registry and dispute resolution service that meets worker and employer expectations in relation to accessibility, approachability and professionalism

E. to provide an independent dispute resolution service that is effective in settling matters and leads to durable agreements between the parties in accordance with the Workers Compensation Acts

F. to establish effective communication and liaison with interested parties concerning the role of the Commission.

3.5 Referring to these objectives, the President of the Commission, Justice Terry Sheahan, told the Committee:

We regard to the objectives laid down by the statute for the Commission as more or less, ... the Bible for our organisation.²⁷

3.6 The Committee asked Justice Sheahan to what extent he considered the objectives are being met. He responded:

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.²⁸

3.7 Justice Sheahan continued:

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.²⁹

3.8 He concluded:

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.³⁰

Claims processed by the Commission

3.9 The number of claims lodged before the Commission is increasing each month. The registrar of the Commission, Ms Helen Walker, told the Committee in evidence on 3 June

²⁷ Evidence of Justice Terry Sheahan, President, Workers Compensation Commission, 3 June 2002, p 3.

²⁸ Evidence of Justice Terry Sheahan, President, Workers Compensation Commission, 3 June 2002, p 3.

²⁹ Evidence of Justice Terry Sheahan, President, Workers Compensation Commission, 3 June 2002, p 3.

³⁰ Evidence of Justice Terry Sheahan, President, Workers Compensation Commission, 3 June 2002, p 4.

2002 that 318 matters had been filed before the Commission at that date. Of these 318, Justice Sheahan stated that:

... the bulk of the 318 were lodged during May. Something like 200 of the 318 were filed during May.³¹

3.10 In relation to the status of the claims, Ms Walker told the Committee:

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 stage.³²

3.11 It is too early to determine what impact the Commission will have on the Scheme deficit. In response to a question about the impact of the new dispute resolution system and the Commission on the overall level of Scheme deficit, Justice Sheahan stated:

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.³³

and

The new dispute resolution scheme ... is obviously integral to a whole package of things that are happening ... 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.³⁴

3.12 Mr Rod McInnes, Assistant General Manager, Insurance Division, WorkCover told the Committee that it is in fact difficult to predict the success of the new dispute resolution system, particularly while the level of disputes going to the Commission is still unknown:

There are obviously a lot of unknowns. We do not really have any clear indication of what the level of dispute will be going into the new Commission and that is going to be a key factor for us, but again it is very early days with that. We have

³¹ Evidence of Justice Terry Sheahan, President, Workers Compensation Commission, 3 June 2002, p 6.

³² Evidence of Ms Helen Walker, Registrar, Workers Compensation Commission, 3 June 2002, p 5.

³³ Evidence of Justice Terry Sheahan, President, Workers Compensation Commission, 3 June 2002, p 10.

³⁴ Evidence of Justice Terry Sheahan, President, Workers Compensation Commission, 3 June 2002, p 10.

talked about common law and so forth taking a long time to settle down and resolve and you will see from the report that there is some expectation of disruption to normal patterns.³⁵

Conclusion 3

As the number of matters lodged before the Commission increases, it will then be more appropriate to determine whether or not the Commission is meeting its objectives, and the impact of the new dispute resolution structure on the Scheme generally.

Legal representation at the Commission

- 3.13** An area of concern raised by the Law Society is the diminished involvement of solicitors in the new dispute resolution system, and the consequent disadvantage to claimants. Mr Charles Benjamin, President-Elect, Law Society of NSW, told the Committee:

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.³⁶

- 3.14** Mr Benjamin asserted that it is the general belief of the legal profession that the level of fees available to lawyers working in the area are deliberately low, and a strategy to force lawyers out of the system:

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

³⁵ Evidence of Mr Rod McInnes, Assistant General Manager, Insurance Division, WorkCover Authority, 7 June 2002, p 23.

³⁶ Evidence of Mr Charles Benjamin, President-Elect, Law Society of New South Wales, 3 June 2002, pp 13-14.

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.³⁷

3.15 Mr Steven Lancken, an arbitrator appointed to the Commission, told the Committee that in his experience lawyers are actually of assistance rather than making arbitrations more difficult:

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.³⁸

3.16 Of particular concern to Mr Benjamin is the potential imbalance of power that may develop without the involvement of lawyers. Mr Benjamin suggested that employers will be able to build up expertise in workers compensation matters which will not be available to employees, particularly those not represented by a union:

But because there is only a small number of them [employers], 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.³⁹

3.17 The impact of the reduced involvement of lawyers may be a reduction in costs, according to Mr Benjamin. The biggest saving, however, will more likely be in the amount of compensation paid to injured workers:

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.⁴⁰

3.18 In response to these criticisms, Justice Sheahan outlined the anticipated advice and representation that will be available to claimants in the Commission. He told the Committee:

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

³⁷ Evidence of Mr Charles Benjamin, President-Elect, Law Society of New South Wales, 3 June 2002, p 15.

³⁸ Evidence of Mr Stephen Lancken, Mediator, Arbitrator and Solicitor, 10 June 2002, p 15.

³⁹ Evidence of Mr Charles Benjamin, President-Elect, Law Society of New South Wales, 3 June 2002, p 16.

⁴⁰ Evidence of Mr Charles Benjamin, President-Elect, Law Society of New South Wales, 3 June 2002, p 19.

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.

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.⁴¹

Conclusion 4

As the number of matters heard before the Commission increases, it will become necessary to determine whether the new dispute resolution system gives sufficient weight to the balance between reducing the cost of legal involvement and protection of injured workers' rights.

Insurer remuneration

3.19 The Committee examined the issues of insurer licenses and insurer remuneration in its third interim report (see paragraphs 5.9 to 5.30 of that report for further detail). The Committee noted that WorkCover was in the process of implementing new insurer remuneration arrangements aimed at aligning more closely WorkCover's objectives with insurer remuneration. At the time the third interim report was tabled the arrangements had still not been finalised. In this respect, the Committee concluded:

The implementation of the new remuneration arrangements should improve insurers' outcomes.

3.20 During the final stage of its inquiry, the Committee heard further evidence from representatives of the insurers and also WorkCover in relation to the new remuneration arrangements. Mr McCullagh, Chief Executive Officer, Employers Mutual Indemnity, stated on 3 June 2002:

⁴¹ Evidence of Justice Terry Sheahan, President, Workers Compensation Commission, 3 June 2002, p 6.

We are now in the first year of a new scheme that WorkCover put in place. They got Pricewaterhouse Coopers 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.⁴²

3.21 Although the insurers had agreed fundamentally to the new package, Mr Rob Thomson, Workers Compensation Manager, Insurance Council of Australia, informed the Committee that the package had still not been signed off when he gave evidence on 3 June:

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 incentivise the providers to perform.⁴³

3.22 Mr Thomson explained that there are three areas in which there has not been agreement:

... 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.⁴⁴

3.23 Mr McCullagh further explained the problem in relation to one of the undetermined measures –the loss ratio:

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

⁴² Evidence of Mr Cameron McCullagh, Chief Executive Officer, Employers Mutual Indemnity, 3 June 2002, p 28.

⁴³ Evidence of Mr Rob Thomson, Manager, Workers Compensation, Insurance Council of Australia, 3 June 2002, p 28.

⁴⁴ Evidence of Mr Rob Thomson, Manager, Workers Compensation, Insurance Council of Australia, 3 June 2002, p 28.

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.⁴⁵

3.24 As explained by Mr Thomson, even though the measures have not yet been developed, they apply from 1 July 2001, after which date the insurers' performance is being measured against the new measures:

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 [been] developed the models would be applied and insurance would be assessed accordingly.⁴⁶

3.25 When questioned by the Committee in relation to WorkCover's views on the insurers' remuneration, Ms McKenzie replied:

... all the short-term measures have been finalised, but some of the longer term measures, like hail claims, the loss ratio and return to work measures are not quite finalised yet. It has been a fairly long and painful process and it is fairly complicated to try to balance up the views. The insurers have had disparate views about what is a fair way of measuring all of this. They have had a lot of legitimate issues that we have had discussions with them about, people saying, "It is unfair to judge us because we have a different portfolio and a different client base to this insurer over there and we are going to be disadvantaged by this way of measuring it". So it has been quite difficult to come up with, particularly for the longer term measures, a consistent and fair set of arrangements that is going to be fair across the insurer portfolio.⁴⁷

3.26 Although unable to give the Committee a definitive answer to the question of when the remuneration package would be finalised, Mr McInnes told the Committee that the insurers:

⁴⁵ Evidence of Mr Cameron McCullagh, Chief Executive Officer, Employers Mutual Indemnity, 3 June 2002, p 28.

⁴⁶ Evidence of Mr Rob Thomson, Manager, Workers Compensation, Insurance Council of Australia, 3 June 2002, p 29.

⁴⁷ Evidence of Kate McKenzie, General Manager, WorkCover, 7 June 2002, p 33.

... have signed up to an agreement to the extent that we have agreed what the elements will be, but to actually set up a modelling and the rules in relation to those longer term things requires more work and obviously take the time.⁴⁸

3.27 Ms McKenzie added:

But we need to say too that although it is true that the detailed work is not finalised, the direction is clear and the principles of what we are judging and measuring are agreed and are in place. It is just the very detailed sort of modelling about exactly how that is going to be judged is still requiring a bit more work. It is not as though we are inventing some new system. The system is clear and the insurers understand exactly what the measures are. It is just the very detailed level.⁴⁹

3.28 The Committee Chair wrote to both the Minister and the Insurance Council of Australia on 11 July 2002 to inquire as to the reasons for the delays in finalising the package. The response from the Minister, the Hon John Della Bosca MLC, was that detailed specification of the measures is awaiting the modelling on the return to work, tail management and loss ratios:

While conceptual arrangements for these measures have been agreed, they are based on actuarial models which require substantial development, particularly the loss ratio model which will require up to 12 months development work.

The timing for development of these measures was considered less critical because of their longer term nature, than resolving the shorter term operational measures...⁵⁰

3.29 The response from Mr Rob Thomson on behalf of the Insurance Council agreed with WorkCover as to the three fundamental issues still requiring resolution, and that these required substantial work. However the insurers appeared to regard these as very important issues for their participation in the Scheme:

It is difficult to determine when there will be final agreement on the total package due to the issues surrounding the actuarial measures of return to work, tail and more importantly for the loss ratio. Broadly speaking the industry would contend that the fundamentals of the remuneration arrangements for 2001/2002 have been finalised. However, as noted above there is still a significant amount of work to be completed that has significant amounts of remuneration allocated to it, and this is of real concern to the industry.⁵¹

3.30 There are clearly important issues for WorkCover to address in the area of insurer remuneration and there appears to the Committee to be some difficulties ahead in the

⁴⁸ Evidence of Mr Rod McInnes, Assistant General Manager, Insurance Division, WorkCover Authority, 7 July 2002, p 36.

⁴⁹ Evidence of Kate McKenzie, General Manager, WorkCover, 7 June 2002, p 36.

⁵⁰ Correspondence to Committee from Minister, 31 July 2002.

⁵¹ Correspondence to Committee from Rob Thomson, ICA, 24 July 2002.

implementation of the new remuneration package. If insurers do not have agreed performance measures to be assessed against their efforts may not be directed to the objectives sought by WorkCover. (Specific issues relating to remuneration for investment management are also discussed in Chapter 3 of this report.)

Conclusion 5

The need to finalise the insurer remuneration package has not diminished since the issue was first raised in the Committee's previous reports. The Committee notes that it is important to resolve these issues so that WorkCover is able to effectively pursue some of the goals of its reforms. On the other side, it is clearly important to the continued participation of insurers in the Scheme that the issue of how their remuneration is to be assessed is resolved.

Compliance

Nature and incidence of non-compliance

3.31 The Committee has heard evidence previously that the level of fraud and non-compliance in the Scheme is difficult to measure. One of the difficulties is understanding what the terms 'fraud' and 'non-compliance' encompass. Fraud and non-compliance may be manifest in a number of ways by employers, employees and service providers in the Scheme.

3.32 On behalf of employees, fraud and non-compliance may take the form of making false claims, exaggerating the level of injury or prolonging the amount of time for which benefits are claimed. Mr Richard Gilley, Managing Consultant, RiskNet Group, stated in his submission to the Inquiry that fraud by exaggeration is one means by which employees can commit fraud. In relation to the incidence of employee fraud Mr Gilley stated:

Whilst there is no empirical evidence to prove the extent of fraud by exaggeration, it is widely estimated within the workers compensation insurance industry to represent at least 10% of claims costs, ie \$200 million each year.⁵²

3.33 The Committee was not able to substantiate this level of employee fraud during public hearings with most stakeholders agreeing that it is difficult to estimate. Ms McKenzie told the Committee:

A lot of the assertions that are made about roorting are very much anecdotally based. Certainly, if you look at the number of prosecutions in which we have been successful and the number of sustained complaints of that kind that come to our attention, they are very, very small numbers.⁵³

⁵² Submission No 4, Richard Gilley, Managing Consultant, The Risknet Group, 13 August 2001.

⁵³ Evidence of Evidence of Kate McKenzie, General Manager, WorkCover , 11 November 2001, p 65.

3.34 The most significant means of fraud by service providers is over-servicing. Mr Thomson explained to the Committee:

... the other area is over servicing 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.⁵⁴

3.35 Mr Thomson provided an example of over-servicing:

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.⁵⁵

3.36 Under-payment of premiums is the major form of fraud and non-compliance by employers. Under-payment may result from a number of practices. These include reducing premium paid to under \$3,000 per annum to avoid experience adjustment or maintaining premiums below \$112,000 per annum so that the 2T rule applies. The 2T rule limits premium liability to twice the industry average rate of premium payable.⁵⁶ Company splitting, under declaration of employee numbers and/or wages paid or incorrect classification of the work performed are means by which companies can minimise their premiums. There is also evidence of companies who create separate administration companies in order to access lower premium rates for clerical, administrative and managerial employees in industries where the overall industry rate is high.⁵⁷ Attempts to minimise workers compensation premium payments may even go as far as not registering companies in short term existence (known as 'phoenix companies').

3.37 Chapter 3 of the Committee's first interim report summarises some of the stakeholders' views in relation to fraud. Mr Andrew Ferguson, State Secretary, CFMEU, summed up his major concerns with non-compliance:

There is certainly hundreds of millions of dollars which is revenue, but the far more important issue from our point of view is fair competition and a level playing field. Companies that comply with the law either break the law to survive or will go out of business, and it is just so unsustainable for the Government to allow what is going on.⁵⁸

⁵⁴ Evidence of Mr Rob Thomson, Manager, Workers Compensation, Insurance Council of Australia, 3 June 2002, p 34.

⁵⁵ Evidence of Mr Rob Thomson, Manager, Workers Compensation, Insurance Council of Australia, 3 June 2002, p 31. Mr Thomson's evidence did not contain any further details about this statement.

⁵⁶ P Le Couter & N Warren, *Review of Employers' Compliance with Workers Compensation Premiums and Payroll Tax in NSW*, interim report commissioned by WorkCover NSW and the Office of State Revenue, 22 March 2002, p 28.

⁵⁷ P Le Couter & N Warren, *Review of Employers' Compliance with Workers Compensation Premiums and Payroll Tax in NSW*, interim report commissioned by WorkCover NSW and the Office of State Revenue, 22 March 2002, p 51.

⁵⁸ Evidence of Mr Andrew Ferguson, State Secretary, CFMEU, 10 October 2001, p 9.

3.38 In contrast, Ms McKenzie told the Committee that WorkCover's compliance blitzes had shown that the level of non-compliance is generally very low:

All the objective evidence from the blitzes we have done is that the level of non-compliance in particular is very low. Most employers do the right thing.⁵⁹

3.39 Mr Rob Thomson, Manager, Workers Compensation, Insurance Council of Australia, elaborated on the difficulties inherent in trying to come up with a definitive figure for the level of fraud and non-compliance in the Scheme:

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. ... 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.⁶⁰

3.40 Mr Thomson continued that some employers hold the view that almost all claims are potentially fraudulent:

... 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. One of the key issues relates to the level of proof required to meet the requirements of the court to prove that a fraudulent act has occurred. This threshold is increased when the matter relates to an aggravation of a previous injury and the courts appear very reluctant to rule against a worker in these circumstances. The ability of obtaining sufficient evidence in the current environment is very difficult and therefore the number of cases run in the Courts is very small. It is very difficult to get sufficient evidence.⁶¹

Initiatives to improve compliance

3.41 The 2001 Act contained a number of provisions aimed at increasing compliance in the Scheme. One of the most significant changes in WorkCover's practices involves the use of data mining techniques to conduct wage audits to detect under insurance. WorkCover's

⁵⁹ Evidence of Kate McKenzie, General Manager, WorkCover, 24 September 2001, p 25.

⁶⁰ Evidence of Mr Rob Thomson, Manager, Workers Compensation, Insurance Council of Australia, 3 June 2002, p 33.

⁶¹ Evidence of Mr Rob Thomson, Manager, Workers Compensation, Insurance Council of Australia, 3 June 2002, p 34.

wage audit database came on line in September 2001 and was completed in early 2002. The database replaced hard copy wage audit results previously lodged monthly by insurers. The database is intended to consolidate all existing electronic data on wage audits held by insurers. The intention of wage audits is to increase premium billed as a result of correctly calculating the total wages paid by an employer. Mr Thomson elaborated on the data mining techniques:

WorkCover ... started to use some more sophisticated data mining tools ... 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.⁶²

3.42 Mr McCullagh, Chief Executive Officer, Employers Mutual Indemnity, told the Committee that insurers have also stepped up their non-compliance detection. WorkCover has instructed insurers to undertake more audits than in previous years:

... 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, we are having trouble finding auditors to do it. WorkCover is setting up a new panel of auditors.⁶³

3.43 The cost of the additional audits is, according to Mr McCullagh, “more than recovered”.⁶⁴

3.44 In response to a question from the Chair regarding the level of additional premium WorkCover is expecting to collect as a result of the new compliance initiatives, Mr McInnes answered:

Additional premium from client activities 2000-2001 was \$15 million and we are targeting \$25 million for this year and we are on track to achieve that.⁶⁵

3.45 Data mining activities undertaken by WorkCover have proven to be a very efficient means of increasing compliance, and have resulted in significant additional returns, that is \$8.70

⁶² Evidence of Mr Rob Thomson, Manager, Workers Compensation, Insurance Council of Australia, 3 June 2002, p 35.

⁶³ Evidence of Mr Cameron McCullagh, Chief Executive Officer, Employers Mutual Indemnity, 3 June 2002, p 37.

⁶⁴ Evidence of Mr Cameron McCullagh, Chief Executive Officer, Employers Mutual Indemnity, 3 June 2002, p 37.

⁶⁵ Evidence of Mr Rod McInnes, Assistant General Manager, Insurance Division, WorkCover Authority, 7 July 2002, p 35.

for each dollar spent in 2000/01. This compares to \$2.75 for each dollar spent by insurers on audit costs. Mr Thomson explained:

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.⁶⁶

3.46 A particular issue is uninsured employers. In response to a question from the Chair asking whether or not employers could be forced to be insured for workers compensation, Mr Thomson responded:

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.⁶⁷

3.47 Voluntary compliance is another area in which WorkCover is focussing. WorkCover undertook a small pilot project in 2001 examining the benefits of sending letters to employers warning them that their policy is being reviewed and reminding them of their obligations under the legislation. The hope is that employers will provide more accurate wage declarations. This strategy has been shown by the Minnesota Department of Revenue to achieve improved levels of compliance in a cost effective manner. Preliminary evaluation by WorkCover indicates that a Scheme-wide voluntary compliance programme may result in savings of up to \$3 million.⁶⁸

3.48 The Compliance Report made a number of recommendations including those aimed at improving compliance with workers compensation premiums in NSW. The Executive Summary and Recommendations from the Compliance Report are reproduced as Appendix Five of this report.

Penalties for non-compliance

3.49 The following offences are contained within the 1987 Workers Compensation legislation:

- Failure to have policy of insurance – s 155
Maximum penalty – \$55,000 fine and/or 6 months imprisonment or a penalty notice of \$750.

⁶⁶ Evidence of Mr Rob Thomson, Manager, Workers Compensation, Insurance Council of Australia, 3 June 2002, p 37.

⁶⁷ Evidence of Mr Rob Thomson, Manager, Workers Compensation, Insurance Council of Australia, 3 June 2002, p 35.

⁶⁸ WorkCover NSW, *Workers Compensation Compliance Report*, July 2001-April 2002, pp 5-6.

WorkCover may also recover double the avoided premium under s 156 of the 1987 Act (providing the amount does not exceed \$55,000).

- Failure to respond to notice requesting details of policy of insurance – s 161
Maximum penalty – penalty notice of \$750.
- Fraudulently altering a certificate of currency – s 163A
- Maximum penalty – \$5,500.
- Employers knowingly supplying false or misleading information to an insurer – s 164
Maximum penalty – \$11,000.
- Person knowingly supplying false or misleading information to an insurer – s 173A
Maximum penalty – \$5,500.
- Failure to maintain or provide access to wage records – s 174
Maximum penalty \$55,000.
- Workers’s failure to notify commencement or change in employment while on weekly benefits – s 57
Maximum penalty – \$2,200.

3.50 The 1998 legislation also contains a new offence of obtaining financial advantage by deception (by injured worker, employer, insurer or medical or other service provider), under s 235A . The maximum penalty for this new offence is \$55,000 fine and/or 2 years imprisonment.

3.51 The Committee heard evidence criticising the penalties available for non-compliance. It was also asserted that the difficulties facing WorkCover in prosecuting perpetrators of fraud in particular. Mr McCullagh stated that in his opinion:

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.⁶⁹

3.52 In circumstances where the worker is convicted, Mr McCullagh stated that the courts are exceedingly generous to workers:

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

⁶⁹ Evidence of Mr Cameron McCullagh, Chief Executive Officer, Employers Mutual Indemnity, 3 June 2002, p 36.

week, because that is all he can afford, unless there is some sort of legislative change.⁷⁰

3.53 In relation to assertions that the sanctions for fraud are insufficient to provide an adequate deterrent, Mr McCullagh stated:

It is serious crime and has an enormous impact on society. There is no great sanction against a worker who does that [commits fraud], equally with an employer who commits a fraud and does not insure or under-declares wages.⁷¹

Conclusion 6

Fraud and non-compliance continue to be a significant problem in the Scheme. The initiatives contained in WorkCover's Compliance Report should help reduce the incidence of fraud and non-compliance. Many of the recommendations require structural or legislative changes which may be slow to occur.

The need for tougher sanctions for fraud and non-compliance by all participants in the Scheme is examined in further detail in the Committee's final report.

Information technology and data management

3.54 The Committee's third interim report identified information technology and data management as a key issue affecting WorkCover's performance and transparency within the Scheme (see paragraphs 5.31 to 5.46 of that report for more detail). The Committee concluded:

It is important that WorkCover's IT and data management systems are adequate.

The Committee is concerned that WorkCover's data and information management systems are currently inadequate to properly fulfil one of its primary roles as regulator of the workers compensation scheme.

The Committee notes that WorkCover has announced the development of a new IT strategy to address these concerns. (Conclusion 11)

3.55 The Committee received an overview of WorkCover's information management and technology strategic plan which it appended as Appendix 8 of the third interim report. The strategic plan was produced in early 2001 and is in the process of being implemented, with implementation expected to be completed in 2004.⁷² In preparation for this report, the

⁷⁰ Evidence of Mr Cameron McCullagh, Chief Executive Officer, Employers Mutual Indemnity, 3 June 2002, p 38.

⁷¹ Evidence of Mr Cameron McCullagh, Chief Executive Officer, Employers Mutual Indemnity, 3 June 2002, p 36.

⁷² Evidence of Mr Peter Hole, Director, Information Management Branch, WorkCover NSW, 7 June 2002, p 29.

Committee heard evidence from WorkCover in relation to the development of its new IT strategy. The key drivers for change in the IT area, Ms McKenzie told the Committee, are that:

We [WorkCover] want better information, not more data, we need better information to manage smarter. Inconsistent and poor quality of data has been restricting our analytical capabilities and we are working hard to turn that around.⁷³

3.56 Additional drivers for change identified by WorkCover in their presentation to the Committee include:

- a new work force (48% potential loss of staff resulting from WorkCover's move to Gosford);
- a growing demand for internet services;
- aging hardware at the end of its useful life;
- isolated and overloaded systems, and
- too many small systems and disparate databases that must be addressed from a whole of WorkCover perspective.⁷⁴

3.57 Ms McKenzie recognised that in the past WorkCover had been criticised for its inability to provide stakeholders with relevant and timely information:

... historically we have been quite justifiably criticised for not being able to make a lot of information available, and certainly not being able to make a lot of information available in a timely fashion. [and] ... historically we have had lots of data but difficulty translating the huge amounts of data that we have in the scheme into useful information. So that is another aim.⁷⁵

3.58 One of the most important initiatives identified by WorkCover is the development of a single virtual database to replace the multitude of separate systems within WorkCover. Ms McKenzie acknowledged the multitude of databases and also the difficulties involved in consolidating them:

When you look at the number of databases we have, it is a very data dependent organisation, so these are big systems and it does take a long time and a lot of effort. At one level you have to get right down to the micro-level of exactly what bits, each little tiny bit of information you are going to keep on each one of these systems and how does that sort of add up. It does get quite tricky.⁷⁶

⁷³ Evidence of Ms Kate McKenzie, General Manager, WorkCover NSW, 7 June 2002, p 26.

⁷⁴ Document tabled by Ms Kate McKenzie, General Manger, WorkCover NSW, 7 June 2002.

⁷⁵ Evidence of Ms Kate McKenzie, General Manager, WorkCover NSW, 7 June 2002, p 26.

⁷⁶ Evidence of Ms Kate McKenzie, General Manager, WorkCover NSW, 7 June 2002, p 30.

3.59 Ms McKenzie outlined for the Committee why a single virtual database would be an improvement for WorkCover:

... we are redeveloping WorkCover systems into a single virtual data base. ... In doing this one of the things we are trying to do is combine the data from the occupational health and safety side of the organisation and the insurance side. At the moment there is lots of duplication. We figure if we can stop that duplication and have systems that can operate more seamlessly, our capacity to have useful information, as opposed to a whole lot of data that does not help very much, should be dramatically improved. We want to leverage data from a range of different sources, such as claims, licensing, accidents and notices, with the aim of having a much more complete picture about what is happening out there in the world with individual businesses, particularly with a view to trying to target our resources a bit better down the track and for us to be able to make better and faster judgments about what is happening with the scheme.⁷⁷

3.60 To facilitate the provision of information, WorkCover has decided to base their IT development on web technology. Ms McKenzie explained the advantages that would flow from adopting this approach:

The development is based on web technology to allow access from within and outside the organisation. Historically, one of our problems has been because we have not had a lot of confidence in the accuracy and the timeliness of the data. There has been a reluctance to make a lot of it available, quite rightly, because we do not know if it is right or not. But what we are aiming to do in the future is, using the web technology so that we do not get as many errors in the transmission of the information, be able to make a lot more of that information available to people who are interested in tracking what is going on in the scheme.⁷⁸

3.61 WorkCover's new system is called 'e-Life' – Exchanging Living Information For Employment. Ms McKenzie briefly outlined the nature of the new system for the Committee:

It is a single, integrated system initiative which is aiming to have a single store of insurance and occupational health and safety data, where we can get multiple business views of the data. Using data warehouses and that sort of thing, we hope that we will be able to get to a point where for different users they can have a different interface into the system but without having to maintain a whole myriad of separate data bases with separate front ends to them, a modern and flexible technical platform that will enable us to take component parts and move them from place to place.⁷⁹

⁷⁷ Evidence of Ms Kate McKenzie, General Manager, WorkCover NSW, 7 June 2002, p 27.

⁷⁸ Evidence of Ms Kate McKenzie, General Manager, WorkCover NSW, 7 June 2002, p 27.

⁷⁹ Evidence of Ms Kate McKenzie, General Manager, WorkCover NSW, 7 June 2002, p 27.

3.62 The Committee has heard evidence supporting a centralised computer system used by all participants in the Scheme, including insurers. Ms McKenzie commented on this suggestion:

Some people have said that we should build a central database which we have never had, and I guess insurers have mixed views about that. Rather than having a philosophical view about whether you should have a central database or a decentralised thing, we have tried to focus on the practicalities of how can we just make it so that it does not actually make that much difference because really the argument in favour of that issue is that you need standards for what sort of data you are going to keep, standards for what sort of format you are going to keep it in and systems in place that mean the interface is automatic, so you do not have all these difficulties with transmitting the information from us to them, and that is really what we are focusing on at the moment.⁸⁰

3.63 The need for a centralised computer system is examined in further detail in the Committee's final report.

Conclusion 7

WorkCover appears to be committed to improving its database system.

Until implementation of the IT strategy in 2003 the Committee is unclear as to whether the current strategy will address the concerns raised in the third interim report.

The Committee will make recommendations about the issue of a centralised database system in the final report.

⁸⁰ Evidence of Ms Kate McKenzie, General Manager, WorkCover NSW, 7 June 2002, pp 29-30.

Chapter 4 Investment management

On 1 February 2002, WorkCover's new investment mandate became effective. The mandate outlines the investment strategy that insurers investing the Scheme's assets must follow pursuant to their obligations under section 198 of the *Workers Compensation Act 1987* ("the 1987 Act"). The aim of the new strategy has been described to be:

to improve expected outcomes with the acceptance of some increase in risk. The [WorkCover] Board's main reason for selecting this objective is that the current reduced level of risk tolerance (and Strategic Asset Allocation) was based on private underwriting commencing. As private underwriting legislative provisions are soon to be repealed, [the provisions were repealed in the *Workers Compensation Legislation Further Amendment Act 2001* ("the Further 2001 Act")] the Board decided that the WorkCover Scheme can accept some increase in risk as a trade off for expected better investment returns.⁸¹

In this Chapter the Committee discusses factors which are considered in setting an investment strategy, and looks at the strategy under the new investment mandate. The Committee notes the level of return on investment of the Scheme's assets in previous years and examines the issues of the management of the investments and insurer remuneration for investment management.

Investment strategies

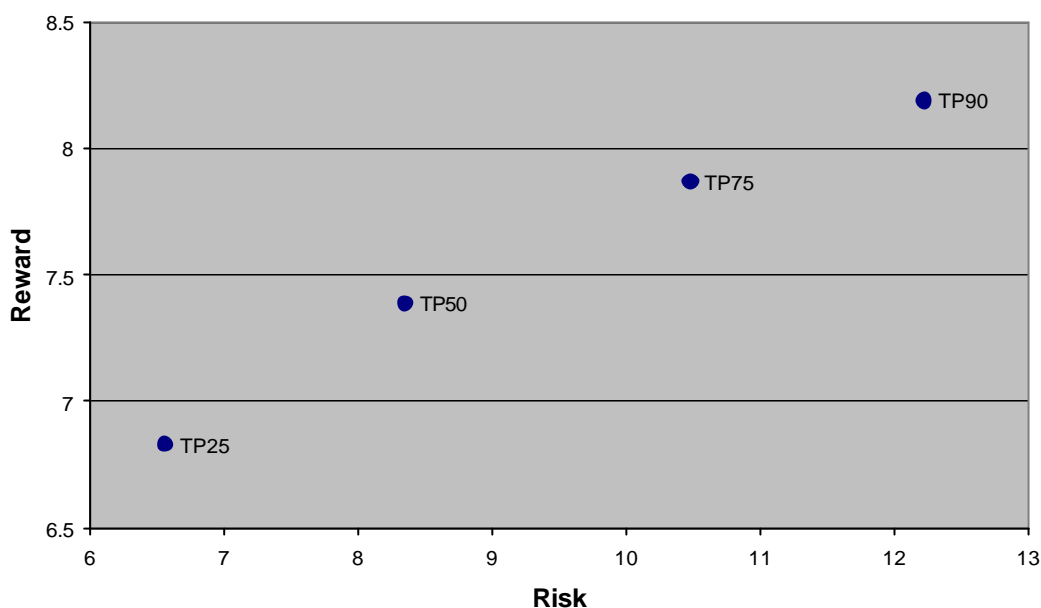
4.1 When determining an investment strategy, a balance must be struck between the rate of return on the investment and the associated risk. Generally, a greater exposure to growth assets will result in an increased return, but it will also carry greater risk. This balance was illustrated in a slide provided to the Committee by Mr Stephen Britt, Asset Consultant, Towers-Perrin in evidence before the Committee, reproduced on the following page as Figure 4.1. Mr Britt noted that the slide is illustrative only.

4.2 Mr Britt explained the balance illustrated in the graph:

... 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 [Towers Perrin] 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.⁸²

⁸¹ Licensed Insurers Guideline 01/23, 10 December 2001, p 1.

⁸² Evidence of Mr Stephen Britt, Asset Consultant, Towers Perrin, 3 June 2002, p 42.

Figure 4.1 Investment management is about the trade-off between risk and reward

Source: Document tabled by Mr Steven Britt, Asset Consultant, Towers Perrin, 3 June 2002

- 4.3** WorkCover has previously adopted a ‘conservative’ investment approach, where there had been a relatively small proportion of assets invested in growth assets – 30%. Under WorkCover’s new investment mandate the allocation to growth assets has doubled to 60%. From the graph above, the relation between the increased reward and risk are evident. The ‘new’ investment mandate is discussed in further detail below, from paragraph 4.12.

Performance of WorkCover Scheme investment

- 4.4** At 30 June 2001, the total Scheme’s investments was \$5.864 billion. This represents an increase of \$64 million from the previous financial year when the total value of the Scheme investments was \$5.799 billion.⁸³ Investment income for the financial year ending June 2001 was \$451,220, which was a decrease of \$76,837 from the previous financial year’s return of \$528,057.⁸⁴ The decrease in interest rates and a falling stock market have partly accounted for the smaller return.

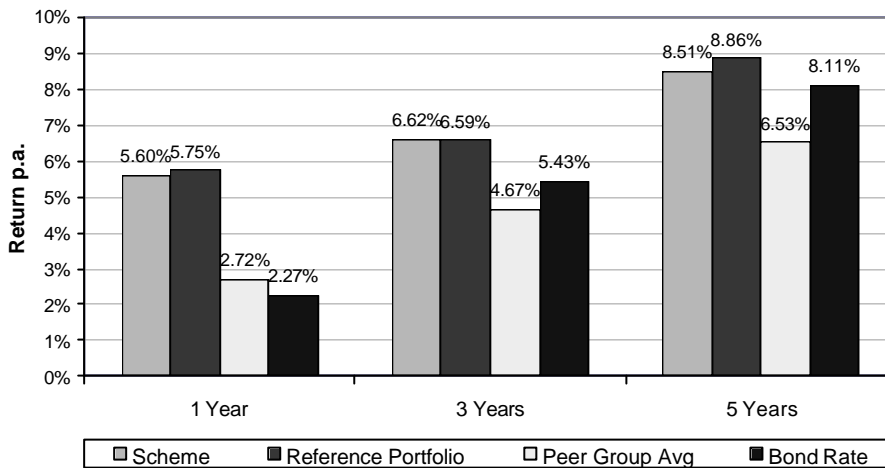
⁸³ WorkCover Annual Report 2000-2001, p 118.

⁸⁴ WorkCover Annual Report 2000-2001, p 115.

4.5

In her presentation to the Committee, Ms McKenzie, General Manager, WorkCover NSW, provided two graphs illustrating the Scheme's investment performance. The first graph depicts the Scheme's investment return compared against the reference portfolio, peer group average and bond rate (see para 4.6 below for an explanation):

Figure 4.2 Investment return for period ending March 2002



Source: Document tabled by Ms Kate McKenzie, General Manager, WorkCover, 7 June 2002.

4.6

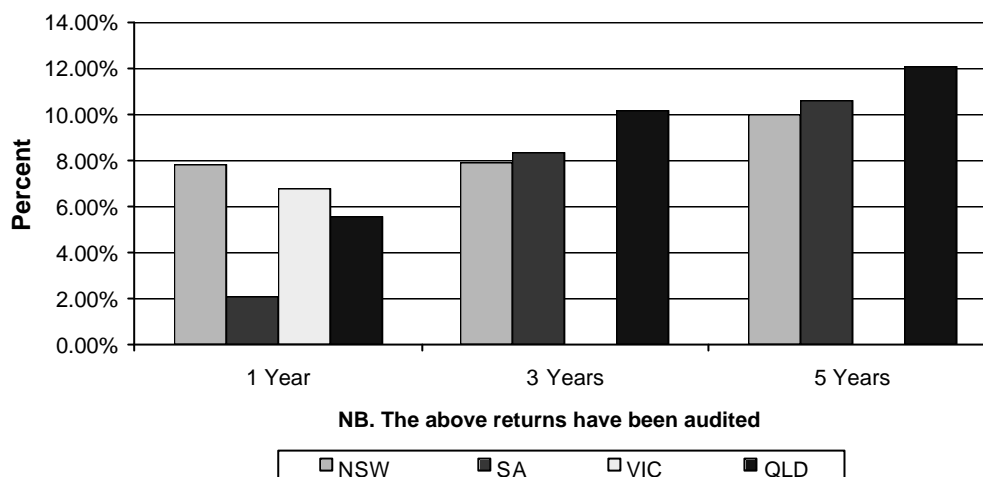
Ms McKenzie explained the different portfolios against which the Scheme's return on investment is measured:

The scheme's investment performance is benchmarked against the reference portfolio, which ... is just a return for the standard asset mix, the peer group, which is Towers Perrin pooled funds survey, and the adjusted Government bond rate, which ... is what we would get for a risk free return on the scheme investments. So we benchmark against all of those things, and the aim obviously is to outperform all of those indexes.⁸⁵

⁸⁵ Evidence of Ms Kate McKenzie, General Manager, WorkCover NSW, 7 June 2002, p 3.

4.7 The second graph compares the NSW Scheme's performance to other statutory workers compensation Schemes over the past 5 years.

Figure 4.3 Comparison of Scheme performance to other jurisdictions, March 2002



Source: Document tabled by Ms Kate McKenzie, General Manager, WorkCover, 7 June 2002.

4.8 The NSW investment strategy until February 2002 has been described as 'conservative' in comparison to other jurisdictions. Mr Rod McInnes, Assistant General Manager, Insurance Division, WorkCover NSW explained the differences in investment returns:

... these are actually the results to June last year, which is the most recent information we were able to get from the other States, and which is why, because we had a more conservative strategy, we have performed better in the last year because of the downturn in that period, whereas over the longer term, because they had a more aggressive strategy, the other States have performed better, so again it is that balance of volatility versus risk.⁸⁶

4.9 Ms McKenzie continued by noting that in the most recent year, the Scheme actually outperformed the other jurisdictions because of NSW's conservative strategy, which illustrates the importance of acknowledging the balance between short term stability and long term gains:

... under the more conservative investment strategy you get less volatility, so whereas some of the other jurisdictions, because they had higher growth assets, got shrinking returns because of the drop in the share market, we were less affected because we had less money in shares.⁸⁷

⁸⁶ Evidence of Mr Rod McInnes, Assistant General Manager, Insurance Division, WorkCover Authority, 7 June 2002, p 4.

⁸⁷ Evidence of Ms Kate McKenzie, General Manager, WorkCover NSW, 7 June 2002, p 6.

- 4.10** The difference in investment strategy among jurisdictions is illustrated in another slide presented to the Committee by Ms McKenzie:

Table 4.2 NSW Scheme investment strategy compared to other jurisdictions, March 2002

Asset class	NSW	SA	Vic	Qld
Liquids	2.0	7.5	0.4	6.4
Australian fixed interest	23.0	10.0	15.5	16.0
CPI bonds	15.0	20.0	9.5	0
International fixed interest	0	0	0	8.0
Listed Property	10.0	10.0	7.6	10.0
International shares (unhedged)	12.5	12.25	23.9	22.0
International shares (hedged)	12.5	22.75	0	0
Total growth assets	60.0	62.5	64.6	70.0

Source: Document tabled by Ms Kate McKenzie, 7 June 2002

- 4.11** Ms McKenzie commented on the slide:

This slide compares our scheme investment strategy to the other jurisdictions. In summary, you can see that there are some variations between the various jurisdictions about how they choose to break up their investment portfolio, although there is a reasonable degree of consistency and I suppose that is not surprising given you would expect that the investment strategies for most of the schemes would be broadly similar, but obviously people are going to make different judgments about the right scheme investment strategy depending on the financial position of the scheme and other parameters attached to their scheme compared to our scheme.⁸⁸

WorkCover's new investment strategy effective February 2002

- 4.12** WorkCover engaged Towers Perrin to undertake a review of their investment strategy in 2001. Ms Kate McKenzie described the process in evidence before the Committee:

Towers Perrin conducted a review using their asset liability modelling techniques. That models the volatility and the duration of the liabilities and the volatility and return for the different asset classes. So basically it is really about trying to match up your liability profile with your asset profile so that you have got the right mix

⁸⁸ Evidence of Ms Kate McKenzie, General Manager, WorkCover NSW, 7 June 2002, p 4.

of things for the kind of scheme that we have got, and also trying to maximise the investment return for any given risk.⁸⁹

4.13 Mr Britt explained further the process that is involved in reviewing an investment management strategy:

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.⁹⁰

4.14 The investment mandate was described as the “road rules” by which the insurers invest the Scheme’s assets by Mr David Spruell, Investment Manager, Allianz Australia:

I guess you would say it [the mandate] 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.⁹¹

and further:

That [the mandate] 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

⁸⁹ Evidence of Ms Kate McKenzie, General Manager, WorkCover NSW, 7 June 2002, p 3.

⁹⁰ Evidence of Mr Stephen Britt, Asset Consultant, Tillinghast-Towers Perrin, 3 June 2002, p 42.

⁹¹ Evidence of David Spruell, Investment Manager, Allianz, 3 June 2002, p 21.

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. ... 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.⁹²

- 4.15** The previous mandate was considered appropriate for the Scheme in the context of possible future privatisation. The effect of privatisation would be that the statutory scheme would be closed off and there would be no provision for new claims. Mr McInnes explained the significance of the decision to move away from privatising the Scheme to the Committee:

Because at the time the scheme was scheduled to actually come to a close and we were planning to move to private underwriting, so the scheme would close off, it would no longer have any income and you would be then just in run-off mode and paying out claims and the duration in which you would be making those payments would be much shorter than where you have an ongoing scheme and, as I said, you do not have any income to support it, so you need to have a more conservative approach to your investment strategy because of the shorter time frame and also there is an increased need for liquid assets because, as I said, you do not actually have income coming in so you need to have a much higher proportion in liquid assets that you can use to pay out claims.⁹³

- 4.16** The strategy is no longer considered appropriate for the Scheme in the absence of privatisation. A medium to long term outlook is believed to be more appropriate for the long-tail nature of a workers compensation scheme where the premium paid must fund compensation payments for up to 40 years into the future. A particular problem affecting long-tail schemes arises when liabilities grow faster than expected. The answer to this problem, suggested Mr Spruell, is to have a mix of assets within the fund aimed at increasing returns:

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

⁹² Evidence of David Spruell, Investment Manager, Allianz, 3 June 2002, p 21.

⁹³ Evidence of Mr Rod McInnes, Assistant General Manager, Insurance Division, WorkCover Authority, 7 June 2002, p 7.

risk to the fund, yes, but in the medium term it usually ends up with a much higher return for the fund.⁹⁴

4.17 Ms McKenzie summarised the aim of the new mandate:

Our investment objectives are to be risk averse, to ensure there are always sufficient funds available to meet claims; we have a medium to long-term outlook to match up with the length of our liabilities; we try to align the investment outlook with the average duration of liabilities in the scheme; and we try to be balanced to maximise the returns available from the investments at the same time as minimising the risk.⁹⁵

4.18 When asked to comment on the new investment mandate representatives of the insurance industry acknowledged the desire for greater returns from the Scheme's investments, and its associated increased risk. Mr Spruell stated:

They [WorkCover] have brought greater risk into the portfolio in the expectation that there will be higher returns. It is a simple trade-off.⁹⁶

If they [WorkCover] 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.⁹⁷

4.19 Similarly, Mr Cameron McCullagh, CEO, Employers Mutual Indemnity, stated:

They [WorkCover] 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.⁹⁸

4.20 The volatility and risk described by Mr Britt is illustrated by a response to a previous question on notice from the Committee in which the Minister through WorkCover provided an analysis prepared by the then Scheme actuaries, Tillinghast, of the net effect on the Scheme's deficit of a 0.25% drop in interest rates.⁹⁹ The analysis calculated the impact on the deficit of a 0.25% reduction in interest rates for all future periods, assuming that all other assumptions and economic effects (such as movements in CPI, wage inflation etc) are kept constant. The net effect on the deficit, based on 30 June 2001 Scheme data, would be an increase in the deficit of \$8 million. The table on the following page was provided to illustrate this change:

⁹⁴ Evidence of David Spruell, Investment Manager, Allianz, 3 June 2002, p 24.

⁹⁵ Evidence of Ms Kate McKenzie, General Manager, WorkCover NSW, 7 June 2002, p 2.

⁹⁶ Evidence of David Spruell, Investment Manager, Allianz, 3 June 2002, p 23.

⁹⁷ Evidence of David Spruell, Investment Manager, Allianz, 3 June 2002, p 27.

⁹⁸ Evidence of Mr Cameron McCullagh, Chief Executive Officer, Employers Mutual Indemnity, 3 June 2002, p 23.

⁹⁹ That advice is reproduced at page 87 of the Committee's first interim report.

Table 4.1 Calculation of the effect of decrease in interest rates by 0.25% on WorkCover deficit


LIABILITIES affected by interest rate movements		ASSETS affected by interest rate movements	
Net Value @ 30/6/01	\$8,284 m	Fixed interest	\$4,027 m
		Non-fixed interest	\$1,838 m
		TOTAL	\$5,865 m
DMT	3.0 years	DMT	4.0 years
CHANGE interest rates	0.25%	CHANGE interest rates	0.25%
VALUE change in liabilities	\$62 million	VALUE change in assets	\$54 million
EFFECT ON DEFICIT	\$8 million		

Source: Answer to question on notice provided by the Minister 15 October 2001.

- 4.21** A similar effect would be felt by a downward movement in the share market, although this effect was not quantified by WorkCover or Tillinghast.
- 4.22** The table below illustrates the change in the asset mix of the WorkCover reference portfolio from the previous mandate to the current mandate, effective February 2002:

Figure 4.4 Changes to WorkCover reference portfolio – effective 1 February 2002

Allianz Asset Management Australia Limited

Allianz 

Changes To Reference Portfolio

Asset Sector	Previous Mandate	Current Mandate
	%	%
Liquids	25.0	2.0
Fixed Interest	30.0	23.0
Inflation-Linked Bonds	15.0	15.0
Australian Shares	17.5	25.0
Property Trusts	8.5	10.0
International Shares (Unhedged)	4.0	12.5
International Shares (Hedged)		12.5
	100	100
Total Shares and Property	30.0	60.0

Source: document tabled by Mr David Spruell, Investment Manager, Allianz 3 June 2002.

- 4.23** Most notable is the difference in the proportion of shares and property, which has increased from 30% to 60% of the total assets. Investment in international shares has increased from 4% to 25%, while the increase in Australian shares has been a more modest

one from 17.5% to 25%. Liquids are the asset class that has been most reduced – from 25% to 2%.

4.24 In response to a question from the Committee regarding the most appropriate proportion of funds to be invested off-shore, Mr Britt answered:

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.¹⁰⁰

4.25 Mr McCullagh agreed that an increase in equities is appropriate for a long-tail scheme:

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.¹⁰¹

Conclusion 8

WorkCover's reasons for changing their investment strategy in view of the Government's policy that privatisation will not happen in the near future appears to be regarded as appropriate by experts consulted by the Committee.

In the short term WorkCover's new investment strategy, with an increased proportion of funds invested in growth assets, however there is concern that this may result in losses which will impact on the overall Scheme deficit. However in the medium term expert opinion, such as Towers Perrin and Mr Spruell from Allianz suggests that there should be an increased return on investments and subsequent improvement in the deficit resulting from this strategy.

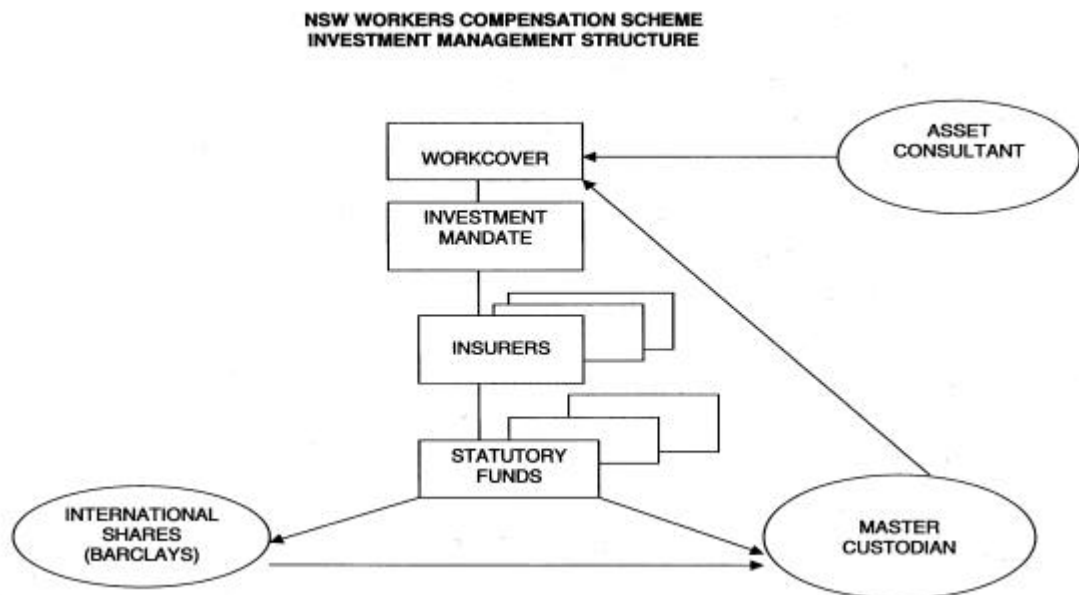
¹⁰⁰ Evidence of Mr Stephen Britt, Asset Consultant, Tillinghast-Towers Perrin, 3 June 2002, pp 45-46.

¹⁰¹ Evidence of Mr Cameron McCullagh, Chief Executive Officer, Employers Mutual Indemnity, 3 June 2002, p 27.

Investment responsibilities in the Scheme

4.26 The investment management structure in the NSW Scheme was diagrammatically presented to the Committee in evidence by Mr Robert Thomson, Workers Compensation Manager, Insurance Council of Australia:

Figure 4.5 NSW workers compensation scheme investment management structure



Source: Document tabled by Mr Robert Thomson, Manager, Workers Compensation, Insurance Council of Australia, 3 June 2002

4.27 In explaining the diagram, Mr Thomson said:

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.¹⁰²

4.28 The breakdown of responsibilities was also outlined by Ms McKenzie. The responsibilities are shared between WorkCover who determines the overall investment strategy and the asset mix for the Scheme, and the insurers who are responsible for stock selection and management:

In terms of the investment responsibilities for the WorkCover scheme, they can be categorised into three main areas: the overall scheme investment strategy, the

¹⁰² Evidence of Mr Rob Thomson, Manager, Workers Compensation, Insurance Council of Australia, 3 June 2002, p 18.

tactical asset allocation and stock selection. WorkCover sets the asset mix for the scheme and this determines the allowable asset classes, and that means, for example, how much in property, that kind of thing, and the standard mix of those classes, that is what percentage of those things we are going to have. The standard asset mix is used as a benchmark to monitor investment performance.¹⁰³

When it comes to tactical asset allocation decisions, the insurers make those decisions. It is a variation from the standard asset mix. There is limited variation allowed. We give them benchmarks and we give them a range, if you like, within which they can choose to invest. They are generally short-term and take advantage of market trends. For example, they will move their asset mix around to take advantage of changes in the market place or they might at some points in time increase their weightings in shares or bonds or reduce them, depending on what is happening in the market.¹⁰⁴

The next aspect is stock selection, and once again insurers are responsible for stock selection, and that basically means they select the individual securities that they are going to buy and sell, and we have just given an example there: Are we going to buy Westpac shares or sell them; are we going to buy Rio Tinto shares or sell them? They are decisions that the insurers make. The securities that they are allowed to pick from, however, are restricted to the ASX 200, and that is once again in the interests of making sure that they do not get involved in investments that are too risky, they only get the blue chip companies, if you like.¹⁰⁵

4.29 Mr Thomson stated that although WorkCover did not seek the insurers' input when devising the new mandate, it is not the insurers' role to determine the investment policy. Rather, the role of the insurers is to manage the fund's investments in accordance with the investment mandate:

We [insurers] are not responsible for the liabilities. ... 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."¹⁰⁶

4.30 Mr Spruell explained to the Committee the scope for insurers to make investment decisions within the 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

¹⁰³ Evidence of Ms Kate McKenzie, General Manager, WorkCover NSW, 7 June 2002, pp 2-3.

¹⁰⁴ Evidence of Ms Kate McKenzie, General Manager, WorkCover NSW, 7 June 2002, p 3.

¹⁰⁵ Evidence of Ms Kate McKenzie, General Manager, WorkCover NSW, 7 June 2002, p 3.

¹⁰⁶ Evidence of Mr Rob Thomson, Manager, Workers Compensation, Insurance Council of Australia, 3 June 2002, p 26.

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.¹⁰⁷

4.31 The reference portfolio is the benchmark against which insurers' investment performance is measured. There is, however, a small range within which insurers may make their investment choices. This is illustrated in the table below:

Table 4.3 Reference portfolio and asset selection minimum and maximum parameters

Asset sector	Minimum	Reference Portfolio	Maximum
Liquids	0%	2%	40%
Fixed interest	10%	23%	40%
Inflation-linked bonds	10%	15%	30%
Australian shares	15%	25%	35%
Property trusts	5%	10%	15%
International shares (unhedged)	10%	12.5%	15%
International shares (hedged)	10%	12.5%	15%
Total shares and property	40%	60%	70%

Source: Licensed Insurers Guideline 01/23, 10 December 2001, p 7.

4.32 An additional participant in the Scheme is the master custodian, whose function is to actually hold the assets. The master custodian role is currently being performed by Cogent:

WorkCover determines the level of risk it will bear, and that investment strategy was approved by the board. Compliance and performance monitoring, which is a very important aspect of this, we have in the scheme a master custodian called Cogent. Cogent actually holds all the individual investment securities and it administers investment transactions and it provides performance reports on the insurers' investment performance. The reason for having a master custodian arrangement is really to do with making sure that the insurers are sticking with the investment mandate, so they can give us reports on any non-complying investments, and also it avoids the possibility of rogue trading because you have got an independent third party overseeing what is going on with the investment.¹⁰⁸

¹⁰⁷ Evidence of David Spruell, Investment Manager, Allianz, 3 June 2002, p 22.

¹⁰⁸ Evidence of Kate McKenzie, General Manager, WorkCover, 7 June 2002, p 3.

Remuneration levels

4.33 Complementing the new investment mandate, WorkCover has proposed a new remuneration package for insurers managing the Scheme's funds. The existing remuneration is calculated as a flat rate of 0.25% of funds invested. The central features of the new package centre around a reduced base fee and additional performance based fees dependent on increased investment returns. The package is currently being negotiated and, although there has been general agreement on the basis for the package, the details have not yet been finalised. The status of the new package was explained to the Committee by Mr Thomson:

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. ... 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.¹⁰⁹

4.34 Rather than impose a remuneration structure onto the insurers, Ms McKenzie stated that WorkCover considers it desirable for close consultation with insurers in relation to that package:

... if we want the new insurer remuneration package to work, we need to take the insurers with us and they need to understand at a quite detailed level how it is that we will be measuring their performance, because what we hope to do is change the way that they behave so that they can reach the kind of levels of performance that we are hoping for, and if we want that to happen, the reality is we have taken the view that we have had to persevere with some quite long and detailed discussions with them.¹¹⁰

4.35 Mr McInnes informed the Committee that it was WorkCover's intention to enter into the new remuneration arrangements with the insurers from 1 July 2002. Despite this intention, however, the new arrangements are still not in force:

The previous fee was a flat fee which was just 25 basis points, which is 0.25 percent of the funds invested. So that was a fee that was paid regardless of the level of return. The proposed fee is a base fee plus a performance component, and ... we are still in discussions with the insurers to finalise that performance arrangement, but the intention is to move to a performance based arrangement, ideally from 1 July, so that there is some incentive for the insurers to improve their investment return and some reward if they achieve the targets.¹¹¹

¹⁰⁹ Evidence of Mr Rob Thomson, Manager, Workers Compensation, Insurance Council of Australia, 3 June 2002, p 28.

¹¹⁰ Evidence of Ms Kate McKenzie, General Manager, WorkCover NSW, 7 June 2002, pp 35-36.

¹¹¹ Evidence of Mr Rod McInnes, Assistant General Manager, Insurance Division, WorkCover Authority, 7 June 2002, p 11.

4.36 Although he was unaware of performance based fees being used in other workers compensation schemes, Mr Britt stated that this type of fee is common in investment management generally:

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.¹¹²

4.37 The remuneration package was designed by PricewaterhouseCoopers and is intended to replicate as closely as possible asset investment in a privatised scheme. Mr Britt outlined the aim of performance based fees to the Committee:

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.¹¹³

4.38 Mr Britt continued that, if designed well, performance based fees should encourage insurers to 'do well'. Even if they do not perform well, Mr Britt stated that the fee structure should still provide sufficient for the investment manager to live on:

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.¹¹⁴

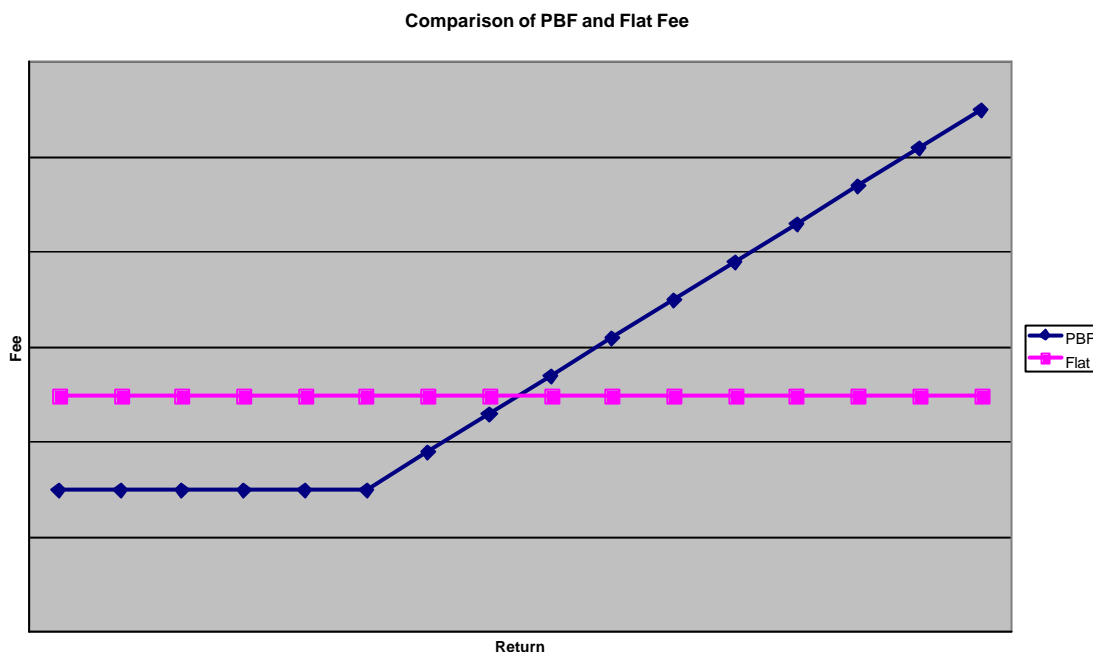
¹¹² Evidence of Mr Stephen Britt, Asset Consultant, Tillinghast-Towers Perrin, 3 June 2002, p 40.

¹¹³ Evidence of Mr Stephen Britt, Asset Consultant, Tillinghast-Towers Perrin, 3 June 2002, p 38.

¹¹⁴ Evidence of Mr Stephen Britt, Asset Consultant, Tillinghast-Towers Perrin, 3 June 2002, p 38.

4.39 Mr Britt provided the Committee with a slide illustrating the difference between a performance based fee structure and a flat fee structure:

Figure 4.6 Illustration of how the performance based fee works



Source: Document tabled by Mr Steven Britt, Asset Consultant, Towers Perrin, 3 June 2002.

4.40 Insurers raised some concerns about the level of remuneration available to them under the new remuneration package. Of particular concern is the limited opportunity for investment managers to outperform the reference portfolio given the large proportion of assets invested in international shares and managed by Barclays instead of the insurers. Mr Thomson stated:

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.¹¹⁵

¹¹⁵ Evidence of Mr Rob Thomson, Manager, Workers Compensation, Insurance Council of Australia, 3 June 2002, p 28.

Conclusion 9

Expert opinion appears to support performance based fees as a means by which the interests of the Scheme and the interests of the investment managers (insurers) may be more closely aligned. Based on the evidence received the Committee is concerned that WorkCover may experience some difficulties in implementing the new remuneration package which may adversely impact on investment performance.

Specialist investment managers

4.41 The possibility of specialist investment managers looking after the Scheme's investments has been raised by the Committee. The apparent advantages of using specialist investment managers is that they have the detailed knowledge and experience to perhaps increase returns on the Scheme's investments. The suggestion has been to select the best manager in each of the asset classes that make up the Scheme's portfolio:

... 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.¹¹⁶

4.42 In contrast to this view, the Committee heard much evidence supporting the current arrangements where insurers also invest the Scheme's assets. One of the greatest benefits is perceived to be the diversity that is a result of having different investment managers managing portions of the whole portfolio:

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.¹¹⁷

4.43 The ability to swap in and out of different investments is also considered to be an advantage of retaining the current arrangements. Mr McCullagh explained to the Committee:

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

¹¹⁶ Evidence of Mr Cameron McCullagh, Chief Executive Officer, Employers Mutual Indemnity, 3 June 2002, p 29

¹¹⁷ Evidence of Mr Rob Thomson, Manager, Workers Compensation, Insurance Council of Australia, 3 June 2002, p 30.

portfolio in which they could shift between fixed interest and equities at different times.¹¹⁸

4.44 Mr Spruell emphasised to the Committee that some of the apparent advantages of using specialist investment managers could be lost because of inefficiencies in moving between asset classes:

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.¹¹⁹

4.45 Ms McKenzie also believes there is virtue in retaining the current arrangements:

... if there is a virtue in having this set of arrangements it is that you have the opportunity for some competition amongst the insurers and some variation in the way that they manage these things and you have the capacity to assess over time what that is doing to their returns, but I do not know that you can form a particular view about whether outsourcing it as compared to doing it in house is better or worse. It depends a lot on who is involved--¹²⁰

4.46 One insurer told the Committee that if the ability to manage the Scheme's investments was taken away it would have a considerable impact on that insurer's overall business. Mr McCullagh stated:

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 take away 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.¹²¹

¹¹⁸ Evidence of Mr Cameron McCullagh, Chief Executive Officer, Employers Mutual Indemnity, 3 June 2002, p 29.

¹¹⁹ Evidence of Mr David Spruell, Investment Manager, Allianz, 3 June 2002, p 29.

¹²⁰ Evidence of Ms Kate McKenzie, General Manager, WorkCover NSW, 7 June 2002, p 14.

¹²¹ Evidence of Mr Cameron McCullagh, Chief Executive Officer, Employers Mutual Indemnity, 3 June 2002, p 26.

4.47 Mr McCullagh concluded that:

Over time you would lose income.¹²²

4.48 Mr Thomson added that, if specialist insurers were to be considered for the Scheme, it would need to be done as part of a broader reorganisation. The current licensing system is very difficult to amend in part, meaning the whole licensing system would need to be reviewed. He told the Committee:

... 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.¹²³

Conclusion 10

There are differing views as to whether WorkCover should move to specialist investment managers. This may be a suitable issue to be considered in depth by the Scheme Design Review or another suitable body.

¹²² Evidence of Mr Cameron McCullagh, Chief Executive Officer, Employers Mutual Indemnity, 3 June 2002, p 29.

¹²³ Evidence of Mr Rob Thomson, Manager, Workers Compensation, Insurance Council of Australia, 3 June 2002, p 28.

Appendix 1

Submissions

Submissions

No	Author
1	Mr Mark Williams
2	Mr P Woods
3	Dr John Graham, <i>Graham Occupational Medicine Pty Ltd</i>
4	Mr Richard Gilley, <i>The RiskNet Group</i>
5	Dr Ian Gardner
6	Mr Greg Pattison
7	Mr Mark Richardson, <i>The Law Society of New South Wales</i>
8	Dr Hannah Middleton, <i>Australian Plaintiff Lawyers Association Ltd (APLA)</i>
9	Mr Alex Salomon, <i>NSW Self Insurers Association</i>
10	Ms Elizabeth Crouch, <i>Housing Industry Association (HIA)</i>
11	Mr Fred Morris
12	Mr Rod Gribble, <i>Australian Grain Harvesters Association Inc</i>
13	Mr John Tucker, <i>NSW Minerals Council</i>
14	Dr Lyn Littlefield, <i>The Australian Psychological Society Ltd</i>
15	Mr George Cooper, <i>Injuries Australia</i>
16	Mr Rodney Stinson, <i>Occupational Analysis</i>
17	Ms Ruth McColl, <i>The New South Wales Bar Association</i>
18	Ms Helen Weston, <i>Kairros Pty Ltd</i>
19	Mr Doug Pearce, <i>NRMA</i>
20	The Hon Morris Iemma MP, <i>Minister for Public Works and Services</i>
21	Mr Harry Neesham, <i>WorkCover Western Australia</i>
22	Mr Tony Hawkins, <i>WorkCover Queensland</i>
23	Mr Bill Mountford, <i>WorkCover Victoria</i>
24	Mr Robert Taylor

Appendix 2

Witnesses

Witnesses

Monday, 24 September 2001 (Parliament House, Sydney)

The Hon John Della Bosca MLC	<i>Special Minister of State, Minister for Industrial Relations, Assistant Treasurer, Minister Assisting the Premier on Public Sector Management, and Minister Assisting the Premier for the Central Coast</i>
Ms Kate McKenzie	<i>General Manager</i> WorkCover Authority NSW
Mr Rodney McIness	<i>Assistant General Manager</i> Insurance Division of WorkCover

Wednesday, 10 October 2001 (Parliament House, Sydney)

Mrs Mary Yaager	<i>Workers Compensation and Occupational Health and Safety Officer</i> Labor Council of New South Wales
Ms Rita Mallia	<i>Senior Legal Officer</i> Construction, Forestry, Mining and Energy Union (CFMEU)
Mr Andrew Ferguson	<i>New South Wales Secretary</i> Construction, Forestry, Mining and Energy Union (CFMEU)
Mr Jonathan Fowler	<i>National Spokesman</i> Small Business Association of Australia
Mr George Katsogiannis	<i>New South Wales Workers Compensation Manager</i> QBE Insurance
Mr Gregory McCarthy	<i>Director</i> Workplace Injury Management Services
Mr George Cooper	<i>Director</i> Injuries Australia Ltd
Mr Christopher Wynyard	<i>Barrister</i> Australian Plaintiff Lawyers Association (APLA)
Ms Allison Robertson	<i>Solicitor</i> Australian Plaintiff Lawyers Association (APLA)
Ms Eva Scheerlinck	<i>Public Affairs Manager</i> Australian Plaintiff Lawyers Association (APLA)

Wednesday, 21 November 2001 (Parliament House, Sydney)

Mr Richard Grellman	<i>Former Chairman</i> Motor Accidents Authority
Mr John Walsh	<i>Actuary and Partner</i> PricewaterhouseCoopers
Mr Michael Playford	<i>Actuary and Director</i> PricewaterhouseCoopers
Mr Daniel Tess	<i>Actuary and Director</i> PricewaterhouseCoopers
Mr Dave Finnis	<i>Principal</i> Tillinghast-Towers Perrin

Mr Andrew Cohen	<i>Manager</i> Tillinghast-Towers Perrin
Mr Gary Moore	<i>General Manager, Commercial</i> NRMA Insurance Ltd
Mr Douglas Pearce	<i>Chief General Manager, Commercial Insurance and Financial Services</i> NRMA Insurance Ltd
Ms Kate McKenzie	<i>General Manager</i> WorkCover Authority NSW
Mr Rodney McInnes	<i>Assistant General Manager, Insurance Division</i> Insurance Division of WorkCover NSW

Thursday, 22 November 2001, (Parliament House, Sydney)

Mr Richard Gilley *Managing Consultant*
RiskNet Group

(via tele-conference)

Mr Anthony Hawkins *Chief Executive Officer*
WorkCover Queensland

(Department of Information Technology and Management, Sydney, via video-conference)

Mr William Mountford *Chief Executive Officer*
Victorian WorkCover Authority

Mr Henry Neesham *Executive Director*
WorkCover Western Australia

Thursday, 14 February 2002 (Parliament House, Sydney)

The Hon John Della Bosca MLC *Special Minister of State, Minister for Industrial Relations, Assistant Treasurer, Minister Assisting the Premier on Public Sector Management, and Minister Assisting the Premier for the Central Coast*

Mr Robert Sendt *Auditor-General*
Audit Office of NSW

Mr Lee White *Assistant Auditor-General*
Audit Office of NSW

Ms Kate McKenzie *General Manager*
WorkCover Authority NSW

Mr Rodney McInnes *Assistant General Manager*
Insurance Division of WorkCover Authority NSW

Wednesday, 6 March 2002 (Parliament House, Sydney)

Mr David Finnis *Principal*
Tillinghast-Towers Perrin

Ms Sally Wijesundera	<i>Manager</i> Tillinghast-Towers Perrin
Mr Leighton James	<i>Principal</i> Tillinghast-Towers Perrin
Ms Kate McKenzie	<i>General Manager</i> WorkCover Authority NSW
Mr Brian Russell	<i>Director, Strategic Operations Group</i> WorkCover Authority NSW
Ms Siew Kiang	<i>Director, Insurance Service Delivery Group</i> WorkCover Authority NSW
Ms Mary Hawkins	<i>Manager, Workplace Injury Management Branch</i> WorkCover Authority NSW
Mr Robert Thomson	<i>Manager, Workers Compensation</i> Insurance Council of Australia
Mr Colin Fagen	<i>General Manager of Workers Compensation</i> QBE Insurance
Mr Ken Young	<i>Representative</i> Self Insurers Association
Mr Mick Franco	<i>Representative</i> Self Insurers Association
Mr Graham Layt	<i>Representative</i> Self Insurers Association

Thursday, 7 March 2002 (Parliament House, Sydney)

Dr Julian Parmegiani	<i>Forensic Psychiatrist</i>
Dr Jim Stewart	<i>Chair</i> Permanent Impairment Coordinating Group
Mr Robert Wilkes	<i>Psychologist</i> Australian Psychological Society
Dr Jack White	<i>Registered Psychologist</i> Australian Psychological Society
Professor Paul Martin	<i>President</i> Australian Psychological Society
Dr Olav Nielssen	<i>Chairman</i> Forensic Branch, Royal Australian and New Zealand College of Psychiatrists

Monday, 3 June 2002 (Parliament House, Sydney)

Justice Terry Sheahan	<i>President</i> NSW Workers Compensation Commission
Ms Helen Walker	<i>Registrar</i>

	NSW Workers Compensation Commission
Mr Robert Benjamin	<i>Solicitor – Councillor</i>
	Law Society of NSW
Mr Steve Lancken	<i>Arbitrator & Solicitor - Representative</i>
	Law Society of NSW
Mr David Spruell	<i>Chief Executive Officer</i>
	Allianz Asset Management
Mr Cameron McCullagh	<i>Chief Executive Officer</i>
	Employers Mutual Indemnity
Mr Robert Thomson	<i>Manager, Workers Compensation</i>
	Insurance Council of Australia
Mr Steven Britt	<i>Asset Consultant</i>
	Towers-Perrin
Mr Duncan Rawlinson	<i>Consultant</i>
	Towers-Perrin
Mr David Zaman	<i>Consulting Actuary</i>

Friday, 7 June 2002 (Parliament House, Sydney)

Mr Rod McInnes	<i>Assistant General Manager, Insurance Division</i>
	WorkCover NSW
Ms Kate McKenzie	<i>General Manager</i>
	WorkCover NSW
Mr Rod McInnes	<i>Assistant General Manager, Insurance Division</i>
	WorkCover NSW
Mr Peter Hole	<i>Director, Information Management Branch</i>
	WorkCover NSW
Ms Kate McKenzie	<i>General Manager</i>
	WorkCover NSW
Mr Rod McInnes	<i>Assistant General Manager, Insurance Division</i>
	WorkCover NSW
Mr Peter Hole	<i>Director, Information Management Branch</i>
	WorkCover NSW

Friday 15th March 2002

Public Forum “The Way Forward on Scheme Ownership & Design” – Delegates

The Hon John Della Bosca MLC	<i>Special Minister of State, Minister for Industrial Relations, Assistant Treasurer, Minister Assisting the Premier on Public Sector Management, and Minister Assisting the Premier for the Central Coast</i>
Mr David Bowen	<i>General Manager</i>
	Motor Accidents Authority
Professor Michael Fearnside	Westmead Specialist Medical Centre

Mr Mark Goodsell	<i>Director</i> Australian Industry Group
Mr Howard Harrison	<i>Partner</i> Carrol & O’Dea Solicitors (Plaintiff Law Firm)
Mr Gregory McCarthy	<i>Chairman</i> WorkCover Advisory Council
Ms Kate McKenzie	<i>General Manager</i> WorkCover Authority NSW
Dr Tom Parry	<i>Chairman</i> Independent Pricing and Regulatory Tribunal
Ms Nancy Carl	<i>Industrial Officer</i> Labor Council of NSW
Mr Bob Sendt	<i>Auditor-General</i> The Audit Office of NSW
Mr Lee White	<i>Assistant Auditor-General</i> The Audit Office of NSW
Sir Laurence Street	<i>Facilitator</i>
Mr Robert Thomson	<i>Manager, Workers’ Compensation</i> Insurance Council of Australia
Mr John Walsh	<i>Partner</i> PricewaterhouseCoopers

Appendix 3

Answers to Questions on Notice

Answers to Questions on Notice

Rev Nile asked Ms Kate McKenzie, General Manager, WorkCover NSW–

Implementation of 2001 legislative reforms

1. Can you please update the Committee on the implementation of the 2001 legislative reforms?

Answer:

The first quarterly monitoring report on the operation of the 2001 NSW Workers compensation Scheme reforms was tabled at the Committee's public hearing on Friday 7 June 2002. The aim of this report is to provide information on key performance indicators for the reforms. The report covers provisional liability, the Claims Assistance Service, WorkCover Assist, The Workers Compensation Commission, common law, commutations and permanent impairment.

The early signs are encouraging with for example:

- Provisional liability requirements being met in 85% of cases
- Claims Assistant Service resolving 90% of cases received
- Numbers of disputes in the new system minimal

It should be recognised that the report only covers the first 3 months operation of the reforms and the results may not necessarily be indicative of long-term results. In many cases 12 months or more will be required for the honeymoon effects of the changes to flow out of the system and longer-term trends to emerge. In some cases, for example common law, longer-term trends may not emerge for 3 to 5 years.

2. Are the early indicators of the claims experience since 31 December 2001 favourable or adverse?

Answer:

The first quarterly monitoring report on the operation of the 2001 NSW Workers Compensation Scheme reforms includes key performance indicators for common law claims, commutation claims and section 66 claims. These early indicators are encouraging, although, it is still too early to draw any firm conclusion.

3. What are the major issues for WorkCover arising out of the March quarterly monitoring report from the Scheme's actuaries, Tillinghast-Towers Perrin?

Answer:

The key issues highlighted by Tillinghast in the Executive Summary of their March quarterly monitoring report are:

- Claim numbers reported in the March quarter were 5% below expectations, although they were 1% higher than the previous quarter on a comparable basis (i.e. after adjustment for the estimated effects of the newly self-insured Coles Mayer);
- Total claim payments for the quarter were 5% (\$35M) higher than the previous quarter and were 6% higher than expectations. Common Law payments increased by \$15M (15%) and commutation payments by \$31M (18%) in comparison with the December 2001 quarter. Offsetting this increase to a limited extent, weekly payments fell by \$4M (3%), Section 66/67 claim payments fell by \$4M (11%) and investigation payments fell by \$2M (5%);
- The average premium rate for 2001/2002 renewals to date (net of GST) is 2.73%, compared to WorkCover's target premium rate of 2.88% at the same stage of premium rate development – an under-

collection of 0.15% of wages (or \$98.4M). Wages declared to date are in line with expectations. For policy renewal year (PRY) 2000/2001, the average premium rate increased from 2.80% in the previous quarter to 2.83% (net of GST) but is still 0.05% short of the target (2.88%) at the same development rate.

Premium rates for 2002/03

4. What average premium rate will WorkCover be charging in 2002/03?

Answer:

The target average premium rate for 2002/2003 is 2.8% (excluding GST and NTS related effects).

5. In past years, premium collections have been lower than 2.80% and therefore have increased the Scheme deficit. What steps, if any, is WorkCover taking in 2002/03 to ensure premium collections are 2.80% of wages?

Answer:

The premium rates for 2002/2003 have been adjusted so that the target rate of 2.8% is expected to be achieved.

6. Can you please provide the Committee with a copy of Tillinghast's premium rating report for 2002/03.

Answer:

A copy of the report will be provided directly to the Committee Secretariat.

Insurer remuneration

7. Can you please provide the Committee with a copy of the insurer remuneration package as finally agreed to by WorkCover and the insurers?

Answer:

This question has been supplemented by correspondence to the Minister from the Committee Chairman dated 11 July 2002 requesting additional details concerning the new insurer remuneration arrangements. It is anticipated that the Minister will respond to the Chairman's request separately as soon as possible.

Case estimate guidelines

8. Can you please confirm if the changes to the WorkCover's Case Estimate Guidelines will reduce premium collections in 2001/02 and in 2002/03 and therefore increase the Scheme deficit? If they will can you please provide an estimate of the financial impact on premium collections?

Answer:

Changes to WorkCover's case estimate Guidelines are not expected to adversely impact premium collection levels.

Self insurers and specialised insurers

9. Self insurers and specialised insurers do not form part of the Scheme Design Review. Is WorkCover intending to review the prudential regulation of self-insurers and specialised insurers in light of the Committee's third interim report? If so, how will it conduct a review and when?

Answer:

The Scheme Design Review will inquire into and make recommendations for the optimum underwriting/insurance arrangements that will support the delivery of the Scheme's objectives as outlined in the workers compensation legislation and the Special Minister of State's parliamentary statement of 8 June 2000. This will include arrangements for self insurance and specialised insurance.

The Review will consider the Committee's reports and any relevant conclusions and recommendations as part of its deliberations.

10. What steps, if any, is WorkCover considering to improve the prudential regulation of self insurers and specialised insurers?

Answer:

See answer above.

Investment management

11. Can you please explain the insurers' reporting requirements under the new investment management arrangements?

Answer:

A copy of the New Insurer Investment Mandate (effective 1 February 2002) including details of insurer reporting requirements was provided to the Committee on 12 March 2002. Please see also WorkCover's Outline of Insurer Performance Measures that was provided to the Committee on 5 April 2002 and published at page 245 of the Committee's 3rd interim report.

12. Can you please provide the Committee with a copy to Towers Perrin's report on implementing the performance based fee structure? (page 11 of the draft transcript)

Answer:

A copy of the report will be provided directly to the Committee Secretariat.

Mr Gallacher asked Mr Rod McInnes, Assistant General Manager, Insurance Division, WorkCover NSW-

13. How long have South Australia, Victoria and Queensland had the more proactive or aggressive investment strategy? (page 6 uncorrected transcript)

Answer:

Advice from the relevant States indicates that:

- WorkCover South Australia started on 55% growth assets (roughly 15 years ago) and over time has progressively moved to its present 63% growth assets;
- WorkCover Victoria has had the same investment strategy for the past 3 years; and
- WorkCover Queensland has always maintained a balanced portfolio. Approx. 10 years ago the portfolio split was 50/50 and over time it has progressively moved to 70% growth. However, it is understood that the WorkCover Board is presently reviewing the investment strategy.

14. What is the anticipated financial cost of the common law spike? Please provide either a range of the bottom figure and the top figure or an actual figure. (page 25 of the draft transcript)

Answer:

In the absence of an assessment of claims on a case by case basis it is not possible to readily differentiate between 'spike' claims and other claims. Tillinghast have estimated that total common law liabilities for all common law claims lodged prior to the 27 November 2002 cut off to be \$627M.

Mr Gallacher asked Ms Kate McKenzie, General Manager, WorkCover NSW–

15. What has the overall cost of running the claims assistance service been to date? (page 38 of the draft transcript)

Answer:

The Claims Assistance Service (CAS) commenced operations on 1 January 2002. The objectives of CAS are to:

- Prevent disputes about claims for workers compensation by providing an interface between injured workers, employers and insurers;
- Promote the prompt processing of workers compensation claims and entitlements; and
- Provide a fair, impartial and timely service to injured workers and employers.

CAS cost \$440,000 during the 2001/02 financial year.

Mr Jobling asked Mr Rod McInnes, Assistant General Manager, Insurance Division, WorkCover NSW–

16. Could you please provide the individual results that make up the average peer group result against which the WorkCover investment return is compared? (page 8 of the draft transcript)

Answer:

A copy of the Towers Perrin Pooled Fund Survey as at 31 March 2002 will be provided directly to the Committee Secretariat. The new WorkCover investment strategy (effective 1 February 2002) changed the asset mix composition from 30% in growth assets to 60% growth assets. Prior to 1 February 2002 the appropriate peer group was the "Capital Stable Fund" survey. After 1 February 2002 the appropriate peer group is the "Below Average Volatility Manager Fund" universe in the Towers Perrin Pooled Fund Survey. Measurement of performance for periods overlapping this date will be based on a hybrid of the 2 surveys.

Mr Jobling asked Ms Kate McKenzie, General Manager, WorkCover NSW–

17. What is the fee paid by WorkCover to the fund's master custodian, Cogent? (page 10 of the draft transcript)

Answer:

For the 12 months to 31 March 2002 the master custodian (Cogent) was paid \$1,120,767 (including GST). The fees paid are for safekeeping, performance and compliance reporting and processing transactions. Fees paid are based on a combination of fixed fees for reporting functions and fees based on numbers of transactions.

Custodian fees are paid by insurers directly out of statutory funds under a tripartite (i.e. WorkCover, Insurers and Cogent) contract arrangement with Cogent. Cogent was appointed as the master custodian following a competitive public tender in early 1999. The fees paid to Cogent are strictly commercial in confidence and the Committee is therefore requested to receive this evidence in camera.

18. Can you please provide the Committee with a copy of WorkCover's full IT strategy? (page 32 of the draft transcript)

A copy of the strategy will be provided directly to the Committee Secretariat.

Appendix 4

Tabled Documents

Tabled Documents

24 September 2001

Ms Kate McKenzie

WorkCover New South Wales

NSW Workers Compensation Scheme – An explanation of how the Scheme works

10 October 2001

Mrs Mary Yaager

Labour Council of NSW

NSW Workers Compensation System - PowerPoint Presentation

Mr Andrew Ferguson

CFMEU

- *Correspondence*
- *Response to the Government's Green Paper on compliance by the Construction, Forestry, Mining and Energy Union, 10 October 2001*

Mr George Cooper

Injuries Australia

AMA Media release

Mr John Wynyard

Australian Plaintiff Lawyers Association Workers Compensation Group

- *Workers Compensation Legislation Amendment Bill part 7*
- *Graph*

21 November 2001

Mr John Walsh

Partner, Price WaterhouseCoopers

PwC Actuarial work in NSW Workers Compensation

22 November 2001

Mr Richard Gilley

The Risk Net Group

- *Workplace Relations Ministers' Council Comparative Performance Monitoring Third Report Australian & New Zealand Occupational Health and Safety and Workers' Compensation Schemes August 2001.*
- *Risk Net Group – PowerPoint Presentation.*
- *Guidelines for the management of employees with compensable low back pain, Victorian Workcover Authority.*

Wednesday 6 March 2002

Mr David Finnis

Tillinghast-Towers Perrin

Report: "Response to Standing Committee"

Mr Robert Thomson

Insurance Council of Australia

NSW WorkCover Insurer Remuneration Proposed Structure 2001/02

Thursday 7 March 2002

Dr Julian Parmegiani

Forensic Psychiatrist

- *Curriculum Vitae*
 - *A paper entitled "Degree of Permanent Impairment"*
 - *Participants list: NSW Conference on Psychiatric Impairment*
-

Dr Jack White	Australian Psychological Society <i>A paper entitled "Approaches to Measurement of Mental Impairment in WorkCover matters"</i>
Mr Robert Wilkes	Australian Psychological Society <ul style="list-style-type: none"> • <i>Report entitled "Sprains and Strains – Care Model Framework"</i> • <i>Published pamphlet entitled "WorkCover Victoria – The Case for Change"</i> • <i>Presentation overheads by Brendan Wood, WorkCover Victoria</i>
Dr Olav Nielssen	Chairman, Forensic Branch, Royal Australian and New Zealand College of Psychiatrists <i>Paper entitled "Australia and New Zealand Journal of Psychiatry, August 2001, vol 35, No.4"</i>
Monday 3 June 2002	
Mr Robert Thomson	Insurance Council of Australia <ul style="list-style-type: none"> • <i>NSW Workers Compensation Scheme Investment Management Structure</i> • <i>Changes to Reference Portfolio – Allianz</i>
Mr Steven Britt	Towers-Perrin <i>Investment Issues, Review and Monitoring of the NSW Workers Compensation Scheme</i>
Friday 7 June 2002	
Ms Kate McKenzie	WorkCover New South Wales <ul style="list-style-type: none"> • <i>Presentation: Information Management Technology and Strategy</i> • <i>Presentation: Setting Investment Strategy and Monitoring Performance of WorkCover Scheme Investments</i> • <i>Performance Monitoring of WorkCover Dispute Prevention & Resolution Reforms – March 2002 Quarterly Report</i> • <i>Review of Employers' Compliance with Workers Compensation Premiums and Pay-roll Tax in NSW</i>

Appendix 5

Minutes

Minutes

Meeting No. 76

Monday 3 June, 2002

At Parliament House (Jubilee Room) 9.30am

1. **Members Present**

Rev Nile (Chairman)

Mr Gallacher

Mr Tsang

Mr Pearce

2. **Apologies**

Mr Kelly

3. **Public hearing**

Resolved, on motion of Mr Tsang, that in accordance with the Resolution of the Legislative Council of 11 October 1994 the Committee authorises the sound broadcasting and television broadcasting of its public proceedings held today.

The public and media were admitted.

The Chairman welcomed the gallery and reminded the media of their obligation under Standing Order 252 of the Legislative Council in relation to evidence given before, and documents presented to, the Committee. The Chair also distributed copies of the guidelines governing broadcast of proceedings.

Mr Justice Terry Sheahan, President, Workers Compensation Commission, was sworn and examined.

Ms Helen Walker, Registrar Workers Compensation Commission, was sworn and examined.

Justice Sheahan gave an opening statement.

Justice Sheahan and Ms Walters undertook to take questions on notice from the committee.

Evidence concluded and the witnesses withdrew.

Mr Robert Benjamin, President-elect, Law Society of NSW, was sworn and examined.

Mr Steven Lanckin, Representative, Law Society of NSW, was sworn and examined.

Mr Benjamin undertook to take questions on notice from the committee.

Evidence concluded and the witnesses withdrew.

The Committee adjourned at 11.00am.

The Committee resumed at 11.15am.

Mr David Spruell, Chief Executive Officer, Allianz Asset Management, Allianz Australia, was sworn and examined.

Mr Cameron McCullagh, Chief Executive Officer, Employers Mutual Indemnity, was sworn and examined.

Mr Robert Thomson, Manager, Workers Compensation, Insurance Council of Australia, was sworn and examined.

Mr Thomson made and Mr Spruell an opening statement. Mr Thomson tabled two documents.

Resolved, on the motion of Mr Gallacher, that the documents be tabled and incorporated into Hansard.

Mr Spruell, Mr McCullagh and Mr Thomson undertook to take questions on notice from the Committee.

Evidence concluded and the witnesses withdrew.

The Committee adjourned at 12.35pm.

The Committee resumed at 2.05pm.

Mr Steven Britt, Asset Consultant, Towers-Perrin, was sworn and examined.

Mr Duncan Rawlinson, Consultant, Towers-Perrin, was sworn and examined.

Mr Britt made an opening statement. Mr Britt tabled one document.

Resolved, on the motion of Mr Tsang, that the document be tabled.

Mr Britt and Mr Rawlinson undertook to take questions on notice from the Committee.

Evidence concluded and the witnesses withdrew.

Mr David Zaman, consultant actuary, was sworn and examined.

Mr Zaman made an opening statement.

Mr Zaman undertook to take questions on notice from the Committee.

Evidence concluded and the witness withdrew.

Resolved, on motion of Mr Tsang, that: pursuant to the provisions of section 4 of the *Parliamentary Papers (Supplementary Provisions) Act 1975* and under the authority of Standing Order 252, the Committee authorises the Clerk of the Committee to make corrected submissions (where applicable), tabled documents and corrected transcripts of today's hearing and briefings publicly available.

4. Next meeting

Friday 7 June 2002 at 9am in Room 814/815.

The Committee adjourned at 3.40pm.

The Rev Hon Fred Nile MLC
Chairman

Meeting No. 77
Friday 7 June, 2002
At Parliament House (Room 814/815)

- 1. Members present**
Rev Nile (Chairman)
Mr Kelly
Mr Gallacher
Mr Jobling (Pearce)
Ms Saffin
Mr Tsang
Dr Wong

- 2. Apologies**
Mr Pearce

Inquiry into Workers Compensation

A PUBLIC HEARING

The Chairman noted correspondence received from the Opposition Whip, dated 7 June 2002, advising that Mr Jobling would be replacing Mr Pearce for the purposes of today's meeting.

Resolved, on the motion of Mr Kelly, that in accordance with the Resolution of the Legislative Council of 11 October 1994 the Committee authorises the sound broadcasting and television broadcasting of its public proceedings held today.

The public and media were admitted.

The Chairman welcomed the gallery and reminded the media of their obligation under Standing Order 252 of the Legislative Council in relation to evidence given before, and documents presented to, the Committee. The Chairman also distributed copies of the guidelines governing broadcast of proceedings.

Ms McKenzie, General Manager, WorkCover NSW, Mr Rod McInnes, Assistant General Manager, Insurance Division, WorkCover NSW and Mr Peter Hole, Director, Information Management Branch, WorkCover NSW, were sworn and examined.

Ms McKenzie made a presentation to the Committee on WorkCover's investment management.

Ms McKenzie made a presentation to the Committee on WorkCover's IT strategy.

Ms McKenzie tabled four documents in support of her evidence. Resolved, on the motion of Mr Jobling, that the documents be accepted.

Ms McKenzie, Mr McInnes and Mr Hole undertook to answer questions on notice from the Committee.

Evidence concluded and the witnesses withdrew.

The public hearing concluded and the public withdrew.

Resolved, on the motion of Mr Kelly, that pursuant to the provisions of section 4 of the *Parliamentary Papers (Supplementary Provisions) Act 1975* and under the authority of Standing Order 252, the Committee authorises the Clerk of the Committee to make tabled documents and corrected transcripts of the day's hearings publicly available.

B DELIBERATIVE MEETING**4. Confirmation of minutes**

Resolved, on the motion of Mr Gallacher, that the draft minutes of meeting no. 72 be confirmed.

Resolved, on the motion of Mr Tsang, that the draft minutes of meeting no. 76 be confirmed.

5. Correspondence sent

The Chairman tabled the following items of correspondence sent:

- Letter to Mr Peter McCarthy, Director, Ernst & Young ABC, dated 19 April 2002 advising Ernst & Young of the Committee's decision to take up its option to extend Ernst & Young's contract to provide actuarial services to the Committee for the remainder of its inquiry.
- Letter to the Minister dated 8 May 2002 regarding the Government's Workplace Safety Summit.
- Letter to the Minister, dated 9 May 2002, requesting copies of actuarial reports and clarification of the provision of actuarial advice to WorkCover NSW.
- Letter to Mr George Cooper, Director, Injuries Australia, dated 21 May 2002 in response to his letter of 9 May 2002.
- Letter to Mr Rodney Stinson, Principal Analyst, Occupational Analysis, dated 21 May 2002 in response to his letter dated 13 May 2002.
- Letter to the Minister dated 28 May 2002 regarding Ms Simpson and Ms Lawson's attendance at the OH & S Summit in Bathurst in July 2002.

6. Correspondence received

The Chairman tabled the following items of correspondence received:

- Letter from Mr Peter McCarthy, Director, Ernst & Young ABC, dated 10 April 2002 advising the Committee of the outcome of its tender to the ICA to conduct a review of Tillinghast's insurer remuneration work.
- Letter from Mr Peter McCarthy, Director, Ernst & Young ABC, dated 11 April 2002 regarding Ernst & Young's fees to assist the Committee with its fourth stage of inquiry.
- Letter from Mr Peter McCarthy, Director, Ernst & Young ABC, dated 15 April 2002 advising the Committee that Ernst & Young intends to submit a tender to provide actuarial services to WorkCover NSW.
- Letter from the Minister dated 29 April 2002 and attached executive summary of Tillinghast's 31 December 2001 Scheme evaluation.
- Letter from Mr George Cooper, Director, Injuries Australia, dated 9 May 2002, commenting on the progress of the Committee's inquiry.
- Letter from Mr Rodney Stinson, Principal Analyst, Occupational Analysis, dated 13 May 2002, commenting on the progress of the Committee's inquiry.

- Letter from Mr Peter McCarthy, Director, Ernst & Young ABC, dated 21 May 2002, relating to potential conflicts of interest with Ernst & Young's work for the Committee).
- Letter from Mr Peter Gerrard, NSW Government Actuary, dated 27 May, containing some comments on the Committee's second interim report (confidential).
- Letter from Mr Steven Britt, Asset Consultant, Towers-Perrin, dated 31 May 2002, in relation to Towers Perrin's appearance at the Committee's public hearing on 3 June 2002.

7. Workers Compensation Summit

Rev Nile and Mr Gallacher indicated their intention to attend the Workers Compensation Summit on 3, 4 & 5 July 2002, in Bathurst. Mr Kelly, Ms Saffin and Dr Wong indicated their intention to attend part of the Summit.

...

9. General business

10. Next meeting

Friday 28 June 2002, Room 814/815.

**The Rev Hon Fred Nile MLC
Chairman**

Meeting No. 91
Monday 26 August 2002
Room 1108, Parliament House

1. Members present

Rev Nile (Chairman)
Mr Tsang
Mr Gallacher
Mr Wong
Ms Saffin
Mr Dyer
Mr Pearce

2. Apologies

Mr Kelly

3. Substitution

Chair noted advice received from the Government Whip that Mr Dyer would be substituting for Mr Kelly during the deliberative meeting.

4. Confirmation of draft minutes

Resolved on the motion of Mr Pearce that the draft minutes numbered 77 and 89 be confirmed.

INQUIRY INTO THE NSW WORKERS COMPENSATION SCHEME

5. Tabled documents

The Chairman tabled the following items of correspondence as sent:

6. Correspondence sent

- Letter to Ms Kate McKenzie, General Manager, WorkCover NSW dated 3 July 2002 requesting information on the Scheme Design Review's terms of reference in relation to the Committee's draft recommendations (attached)
- Letter to the Hon John Della Bosca MLC, Minister for Industrial Relations, dated 11 July 2002, requesting information about the new insurer remuneration arrangements (attached)
- Letter to Mr Rob Thomson, Manager, Workers Compensation, Insurance Council of Australia, dated 11 July 2002, requesting information about the new insurer remuneration arrangements (attached)
- Letter to the Hon John Della Bosca MLC, Minister for Industrial Relations, dated 14 July 2002, requesting information about the timetable for the announcement of the successful tenderer for the Scheme Design Review (attached)
- Letter to the Hon John Della Bosca MLC, Minister for Industrial Relations, dated 14 July 2002, requesting permission to append the 31 December Scheme Evaluation Report to the Committee's report (attached)

7. Correspondence received

The Chairman tabled the following items of correspondence received:

- Letter from Justice Terry Sheahan, President, NSW Workers Compensation Commission, dated 17 June 2002, in response to questions on notice (attached)
- Letter from Mr Michael Playford, Director, Pricewaterhouse Coopers, dated 12 July 2002, in response to questions on notice (previously circulated)
- Letter from Ms Kate McKenzie, General Manager, WorkCover NSW, dated 12 July 2002, in response to the Committee's letter requesting information about the Scheme Design Review's terms of reference (previously circulated)
- Letter from Ms Kate McKenzie, General Manager, WorkCover NSW, received 22 July 2002, in response to questions on notice (previously circulated)
- Letter from Mr Rob Thomson, Manager, Workers Compensation, Insurance Council of Australia, dated 24 July, in response to the Committee's letter requesting information about the new insurer remuneration arrangements (previously circulated)
- Letter from Mr Rob Thomson, Manager, Workers Compensation, Insurance Council of Australia, dated 24 July, in response to questions on notice (previously circulated)
- Letter from the Hon John Della Bosca MLC, Minister for Industrial Relations, dated 31 July 2002, in response to the Committee's letter requesting information about the new insurer remuneration arrangements (previously circulated)
- Letter from Ms Kate McKenzie, General Manager, WorkCover NSW, dated 2 July 2002, advising the Committee of the appointment of Pricewaterhouse Coopers Actuarial as the new Scheme actuarial advisers (previously circulated)
- Letter from Ms Kim Cull, President, Law Society of NSW, dated 5 July 2002, in response to questions on notice (previously circulated)
- Letter from Mr Greg Donnelly, Branch Secretary, Shop, Distributive & Allied Employees' Association, dated 2 August 2002, in relation to restrictions on the availability of commutations in NSW (attached)
- Letter from Ms Mary Yaager, OHS and Workers Compensation Coordinator, NSW Labor Council, dated 6 August 2002, in response to questions on notice (attached)
- Letter from Ms Kate McKenzie, General Manager, WorkCover NSW, dated 15 August 2002, advising the Committee that McKinsey & Company have been selected to undertake the Scheme Design Review (previously circulated)
- Letter from Justice Terry Sheahan, President, NSW Workers Compensation Commission, dated 19 August 2002, containing Workers Compensation Commission statistics up to 30 June 2002 (attached)
- Letter from Mr Peter McCarthy, Director, Ernst & Young, dated 19 August 2002, in response to the Committee's request for information on the impact on the Scheme from inadequate premium collections (attached)
- Letter from Mr Bill Mountford, Chief Executive Officer, Victorian WorkCover Authority, dated 24 June 2002 (previously circulated)

- Letter from Ms Kim Cull, President, Law Society of NSW, dated 27 June 2002 (previously circulated)
- Letter from Mr Alex Salomon, Chairman, NSW Workers Compensation Self-Insurers Association, dated 8 July 2002 (previously circulated)
- Letter from Mr Greg Pattison, General Manager Workplace Solutions, dated 25 July 2002 (previously circulated)
- Additional information received from WorkCover, 7 August 2002 (attached)

8. Consideration of motion to seek leave of the House to present a fourth interim report

Resolved on the motion of Mr Dyer that the Chairman move the following motion in the House to amend the terms of reference for the Committee's Inquiry into the NSW workers compensation scheme to enable the Committee to table a fourth interim report:

That the resolution of the House of 28 June 2001, requiring General Purpose Standing Committee No. 1 to monitor and review the NSW Workers Compensation Scheme, be amended by inserting after "3 months" in paragraph 3 (a), the words "including a fourth interim report if necessary prior to the tabling of the Committee's final report".

(Note: To be rescinded by the Committee on advice that it was no longer necessary.)

9. Consideration of the Chairman's draft fourth interim report

The Chairman tabled his draft report entitled "NSW Workers Compensation Scheme Fourth Interim Report". Once circulated, the draft report was accepted as being read.

The Committee deliberated.

Resolved on the motion of Mr Pearce that: a paragraph be inserted stating that although WorkCover was unable to provide a definition of "Targets Mainly Achieved" in evidence, they subsequently provided this information in answers to questions on notice.

Resolved on the motion of Mr Pearce that: the definition of "Targets Mainly Achieved" provided by WorkCover be inserted following the above statement.

Resolved on the motion of Mr Dyer that: Conclusion 1 be amended by inserting the following sentence at the end of the first sentence of the first paragraph:

Although the actuary's 31 December 2001 Scheme Evaluation recognises that the liability estimate would have been \$757 million greater without the reforms of 2001.

Resolved on the motion of Mr Pearce that: a quote from Ms McKenzie stating a figure for employee fraud is inserted after paragraph 3.32.

Resolved on the motion of Mr Pearce that: Conclusion 8 be amended by inserting "however there is concern that this" after the word "assets" and before the words "may result" in the first sentence of the second paragraph.

Resolved on the motion of Mr Pearce that: the words “such as Towers Perrin and Mr Spruell from Allianz” be inserted after the words “medium term expert opinion” in the second paragraph of Conclusion 8.

Resolved on the motion of Mr Pearce that: Conclusion 10 be amended by inserting “or another suitable body” at the end of the second sentence.

Resolved on the motion of Ms Saffin that the report, as amended be adopted.

Resolved on the motion of Mr Dyer that the report be signed by the Chair and presented to the House on 29 August 2002 in accordance with the resolution establishing the committee of 13 May 1999.

Resolved on the motion of Mr Gallacher that pursuant to the provisions of section 4 of the Parliamentary Papers (Supplementary Provisions) Act 1975 and under the authority of Standing Order 252, the Committee authorises the Clerk of the Committee to publish the report.

...

11. Next meeting

Friday 30 August 2002, at 10am in Room 1108, Parliament House.

Meeting concluded at 5.00pm

**The Rev Hon Fred Nile MLC
Chairman**

Appendix 6

Review of Employers' Compliance with Workers Compensation Premiums and Pay-roll Tax in NSW

Interim Report - Commissioned by
WorkCover NSW
Office of State Revenue
22 March 2002

Review of Employers' Compliance with Workers Compensation Premiums and Pay-roll Tax in NSW - Executive Summary and Recommendations

Executive Summary

Australia has a long history of reviews and recommendations for improvement in employers' compliance with workers compensation premiums and pay-roll tax. It is believed that significant premium and tax revenues are being lost, although it is impossible to quantify the extent of the problem.

The Terms of Reference for this review seek recommendations which will result in a substantial improvement in compliance. The introduction of the commonwealth Government's New Tax System, combined with increased inter-governmental cooperation, provide levers which can be used to *break through* these longstanding problems.

Guiding principles for this review

In order to provide a strong basis for the recommendations, the review has been based on the following guiding principles:

- Contemporary solutions, that recognise ongoing changes to work and business practices.
- Simple, and not over-engineered legislative proposals.
- Cost effective, so that compliance costs do not increase.
- Economically neutral in the treatment of income sources and employment environments.
- Building towards inter-jurisdictional cooperation with a view to harmonisation.
- Phased, so that immediate and short term improvements can be made with a view to a long term outcome.

The strong similarities between pay-roll and workers compensation premiums are noted in this review. Aligning approaches between pay-roll and workers compensation, and where possible alignment with Commonwealth income tax definitions, will bring significant benefits in terms of improving compliance at source, and reducing its cost, and increasing the effectiveness of data exchange for compliance purposes.

Single definition of wages from 1 July 2002

The current definitions of wages for workers compensation and pay-roll tax purposes differ substantially. It is recommended that both definitions adopt the approach for the Commonwealth income tax, for simplicity of compliance and administration. For reasons of economic neutrality, the definition should include all elements of remuneration, i.e. wages, the grossed up value of fringe

benefits and superannuation payments. This recommendation will expand the definition of wages for both pay-roll tax and workers compensation in NSW.

Single definition of worker/employee from 1 July 2003

Based on the single definition of wages above, it is possible to identify a worker/employee as someone in receipt of wages. This is the first element of this review's recommended definition.

The increasing use of contractors, particularly in some industries with a poor record of compliance, means that for reasons of economic neutrality it is necessary to include some contractors in the definition of a worker/employee. It is recommended that the employer/principal contractor will be liable for pay-roll tax and workers compensation premiums calculated on the labour content of contracts, unless the contracts are exempted under four simple tests.

1. *the services provided are ancillary to the supply of goods (less than 50% in value).*
2. *the provision of services is ancillary to the use of the contractors vehicle (owners/drivers).*
3. *the services are provided by two or more people, at least one of whom is an employee of the contractor.*
4. *for workers compensation purposes only, the contract is with an incorporated body.*

All the information to carry out these tests would ordinarily be known to the principal contractor without the need for further inquiry. This approach simplifies the relevant contract provisions used in pay-roll tax, and will provide clarity as to who is included.

In addition, there are a limited number of special cases which require categories of individuals to be deemed as workers.

Single definition of employer from 1 July 2003

At present, there are many legal avenues for companies to reduce their workers compensation premiums through company splitting to minimise the impact of past claims on future premiums. Pay-roll tax uses a workable definition of a company group, based on common control or common employees. Application of this definition to workers compensation premium calculation is recommended.

Collection and Audit

Once definitions are aligned, audit activity for pay-roll tax and workers compensation can be streamlined into a single activity. It is recommended that OSR undertake audits on behalf of WorkCover from 1 July 2002, initially for employers above the pay-roll tax tax-free threshold, and moving to cover all employers by 1 July 2003.

In the longer term, the NSW Government should explore the long term possibility of working with the ATO, which could act as an agent for reporting and collection purposes. A single declaration of wages, on a modified BAS, leading to a single, timely collection through the ATO has the potential to

significantly increase the extent of initial compliance and reduce the need for subsequent compliance activities.

Administrative approach to penalties from 1 July 2002

WorkCover is criticised for delay in prosecution of blatant examples of non-compliance. Introducing administrative penalties to workers compensation will create a more immediate and visible deterrent and therefore encourage compliance. This will allow a common approach to penalties following the common audit process recommended above.

Data Exchange

Alignment of definitions between pay-roll and workers compensation, as recommended in this report, will allow far more powerful use of data for compliance purposes. It is recommended that one central agency, OSR, build a centre of excellence in compliance with workers compensation premiums and pay-roll tax, using all possible sources of data.

Inter-jurisdictional harmonisation

Alignment of definitions within NSW allows significant compliance gains. We recommend further moves to harmonise with legislation in other states and/or the Commonwealth.

Education and Awareness

Ignorance is a significant reason for non-compliance with workers compensation amongst small employers. In addition, the implementation of these recommendations will cause significant change to both systems. OSR and WorkCover should embark on a targeted education campaign to address both issues.

Conclusion

In combination, these recommendations address all the issues raised by the Terms of Reference, and have the potential to deliver substantial improvements in compliance with workers compensation premiums and pay-roll tax in NSW.

Recommendations

Immediate

Definition of Wages

Effective 1 July 2002 – It is recommended that the definition of ‘wages’ in the *Pay-roll Tax Act 1971* and the *Workers Compensation Act 1987* be amended to include the grossed-up value of fringe benefits as defined in the *Fringe Benefits Tax Assessment Act 1986*. The definition of ‘wages’ contained in the *Workers Compensation Act 1987* must also be amended to include superannuation contributions (in all forms) and long service leave and to remove exclusions which are inconsistent with the guiding principle of economic neutrality.

Definition of employees/workers

Before 1 July 2002 – It is recommended that all interested parties are notified of the intention to clarify the position of employees, employers and contractors for the purposes of workers compensation and pay-roll tax.

Definition of employer groups

Before 1 July 2002 – It is recommended that notice of intent is given to introduce the payroll tax grouping provisions to workers compensation from 1 July 2003. It is also recommended that OSR review the provisions in relation to their application to all types of entities, and to simplify the language in relation to shared staff.

Collection and Audit

Before 1 July 2002 – It is recommended that OSR undertake audits for WorkCover in respect of wages and industry classifications declared by employers with wages greater than \$600,000.

Administrative Approach to Penalties

Before 1 July 2002 – It is recommended that the workers compensation legislation be amended to introduce administrative penalties for premium non-compliance, with appropriate avenues for appeal.

Data exchange

Before 1 July 2002 – It is recommended that OSR make greater use of ATO data for compliance activities.

Education and Awareness

Before 1 July 2002 – It is recommended that WorkCover embark on an education and awareness campaign targeted at small business advisers, to ensure that they are properly advising their clients as to their obligations. It is also recommended that WorkCover and OSR negotiate with the professional accounting associations to include workers compensation and pay-roll tax requirements in the continuing professional development requirements for their members.

Short Term

Definition of wages

Effective 1 July 2003 – It is recommended that the definition of ‘wages’ in relevant pay-roll tax and workers compensation legislation be aligned.

Definition of employees/workers

Effective 1 July 2003 – It is recommended that the definitions of ‘worker’ in workers compensation and ‘employee’ in pay-roll tax legislation be harmonised as follows:

- Step 1 If an employer is required to withhold income tax from a payment under the PAYG-Withholding system, provides fringe benefits or makes superannuation contributions then the recipient of the payment or benefit is to be treated as a worker/employee; otherwise
- Step 2 Identify any contractor deemed to be a ‘worker’. The labour content of payments made to these contractors is also treated as wages paid to a worker/employee.
- Step 3 *For workers compensation purposes only*, identify those categories of individuals deemed to be workers but for whom there may or may not be payments made or contracts recognising their work.

Definition of employer groups

Effective 1 July 2003 – It is recommended that the modified pay-roll tax grouping provisions be introduced for workers compensation and pay-roll tax.

Collection and Audit

Before 1 July 2003 – It is recommended that OSR expand the scope of its audit on behalf of WorkCover to include those below the pay-roll tax tax-free threshold.

Data exchange

Before 1 July 2003 – It is recommended that WorkCover and OSR identify and build relationships with other agencies to access their data for use in compliance enforcement activities using the new common definitions recommended.

Long Term*Definition of wages*

It is recommended that the concept of ‘wages’ used for pay-roll tax and workers compensation purposes be aligned with terminology used in Commonwealth tax legislation where appropriate.

Definition of employees/workers

It is recommended that inter-jurisdictional and Commonwealth definitions be harmonised and improved where possible.

Collection and Audit

It is recommended that the NSW government investigate the possibility of appointing the ATO to collect pay-roll tax and workers compensation premiums as an agent for NSW, using a modified BAS.

Data exchange

It is recommended that OSR build a centre of excellence in compliance of NSW based collections, which enhances their expertise in compliance enforcement generally.

Appendix 7

Tillinghast-Towers Perrin

Actuarial Review of the Outstanding
Liabilities of the WorkCover Scheme
Statutory Funds as at 31 December
2001

Actuarial Review of the Outstanding Liabilities of the WorkCover Scheme Statutory Funds as at 31 December 2001