COMPAS

WORKERS COMPENSATION AND OH&S NEWSLETTER
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In this Issue

NSW Compo scheme—Australia's least competitive

One observer likened making changes to the workers compensation system to a balloon. You push it in on one side and it bulges out on another.

This is precisely what is likely to happen as a result of the recent changes to workers compensation benefits enacted by the Carr Government.

With little prior consultation about their content or timing, the Government introduced changes which have very far reaching impacts on benefit entitlements and the culture of NSW workers compensation. Without doubt, the changes will put further upward pressure on NSW employers' premiums, costing jobs and threatening new investment.

In this article we analyse some of the ramifications of the changes and identify pitfalls for employers.

On 28 December 2001, Minister Della Bosca's promise to reform workers compensation came a step closer to fruition. Sweeping changes to the system's operations have been introduced effective from 1 January 2002.

Among the more important changes are those to the way that disputes will be dealt with and the manner in which benefits will be delivered. The right of an employee to make a claim under common law has been severely restricted by the introduction of new impairment assessment procedures and thresholds. This change (we believe) was introduced to help reverse the lump sum nature of the scheme and return it to a pension type of benefits regime as well as reducing the fund's cash haemorrhage resulting from higher than expected numbers of common law claims.

Since 1999/2000 the rules on commuting claims had been relaxed, in fact insurers had been positively encouraged by the Government to settle as many outstanding claims as possible and were paid 8% of any savings they made.

In a sudden about face by the Government, heavy restrictions on commutations have been reintroduced and it will be very difficult in future to commute claims. Again, we believe that this change was introduced to change the lump sum nature of the

(Continued on page 2)

(Continued from page 1)

scheme and to stem the flow of funds in order to preserve scheme assets.

Those observers who are close to the management of the scheme will recall that the encouragement of all parties to commute long term claims was a tail management strategy developed by WorkCover. Prior to the decision to unfetter commutations, settling a claim in this manner was severely restricted.

Ramifications of Common Law Changes

The Government gave early notice that changes recommended by the Sheehan Inquiry into Workers Compensation Common Law would be introduced into Parliament on or about 27 November 2001. In other words the Government gave claimants and their lawyers until November 27 to file a common law claim.

In his second reading speech Minister Della Bosca stated❶ "I have been advised by WorkCover that in 2000-2001 there were approximately 2,000 common law claims. However, in view of proposed changes, these claims have been rising rapidly and are currently being filed at the rate of approximately 500 per month."

Anecdotal sources suggest that the surge of common law claims lodged as a result of the expected changes was in the order of 2,000 to 3,000.

In evidence to the Upper House Workers Compensation Inquiry❷, the General Manager of WorkCover Ms Kate McKenzie, stated that "My information is that at the moment we have about 6,000 common law claims all up in the system."

Unless there has been a massive change in the Courts' activities, Ms McKenzie's evidence appears to conflict with that of WorkCover's own actuaries who in September 2001 reported❸ that there were 12,289 outstanding common law claims in the system with an undiscounted cost of $2,709 billion.

If the figures as noted by Minister Della Bosca above are correct, the surge in claims lodged in the months leading up to 27 November 2001 has brought forward an estimated $1 billion in the liabilities of the scheme.

The ramifications of the acceleration in the lodgment of common law claims are significant for employers. The District Court has implemented a risk management plan to assist with the processing of the surge in claims' filings and most of the surge claims will probably come before the Courts over the next 24 to 36 months. This will mean that claims' costs of up to $1 billion over and above those which would normally be expected for this period (approximately $2 billion) will need to be funded.

With premium receipts at or around 2.76% of NSW's wage roll (anticipated to be in the order of $90 billion by 2004) there is likely to be a funding shortfall of up to $1 billion.

There are five possible funding mechanisms to make up the claims payment shortfall. These are: reduce benefits (anathema to a Labour Government); realise scheme assets (further evidence of prudential mismanagement); fund the shortfall from consolidated revenue (ratings agencies would review NSW's credit rating); increase premiums or implement a deficit reduction levy.

(Continued on page 3)

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❶ Page: 18961 NSW Hansard. The Hon. John Della Bosca, Minister for Industrial Relations. Second Reading Speech, Workers Compensation Legislation Further Amendment Bill 2001.

❷ Report of Proceedings Before General Purpose Standing Committee No. 1 Inquiry into the Review and Monitoring of The New South Wales Workers Compensation Scheme Wednesday, 6 March 2002.

❸ Actuarial Review of the Outstanding Liabilities of the WorkCover Scheme Statutory Funds as at 30 June 2001, Tillinghast—Towers Perrin. Volume 1 page 61.

Common Law

Changes

Ramifications

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❶
ANZSIC based premium rating was introduced in 2001 and will be phased in over a three year period.
Maximum rate increases as a result of the introduction of ANZSIC have been pegged at 15%.
It is unclear whether the 15% will apply to all rate increases or only those resulting from ANZSIC rating.

❷
Most employer's premiums are not confirmed until the second instalment and adjustment premium notices have been issued. This is typically 2 to 3 months after the commencement of the new policy year following submission by the employer of the estimated wages for the year and actual wages for the previous year.

❸
Legislative Council GPSC 1 Report 18 April 2002, Page 12 Conclusion 3.

(Continued from page 2)

We believe that the Government will probably choose to increase premiums or implement a reduction levy.

If employers are to believe Premier Carr and Minister Della Bosca when they say that there will never be a deficit reduction levy imposed on employers, then why did the Government not choose to remove all doubt and repeal Section 207 of the Workers Compensation Act 1987 when the latest changes to the system were introduced? Section 207 of the Act allows the Government to impose the levy through the premiums regulation process. It should be noted that the Government did choose to repeal those sections of the legislation which dealt with private underwriting.

Another ramification (in this case read sting) of the changes to common law on employers is delivered through the accelerated claims lodgment phenomenon. Bringing forward the filing of a common law claim in order to meet the 27 November 2001 deadline has meant that many employers have unexpected common law claims now included in their claims experience for this and future insurance policy periods.

Most of the accelerated common law claims filings have been in the District Court which has a benefit ceiling of $750,000. This will mean that most of the claims are estimated by insurers accordingly, elevating the affected employer's claims experience to new heights. The inflated claims experience is used to calculate the employer's premiums for the next three years.

When combined with the second tranche❶ of premium rate rises for many employers due to the introduction of ANSZIC based premium rating last year, many employers will see premium hikes of at least 100%.

CFOs of affected employers need to make provision for these potential premium hikes which will not be evident until later this year when premiums are calculated by insurers❷.

Positive ramifications of the changes to common law are the potential reduction in the average costs of each claim and the frequency of claims filings. The common law changes will continue to exert downward pressure on scheme costs unless there are future amendments or the legal profession discovers ways of accessing claims not anticipated by the legislative draftsmen.

Minister Della Bosca has claimed that there will be a one-off impact on the scheme deficit of $1.33 billion as a result of the changes. The General Purpose Standing Committee No. 1 Inquiry into Workers Compensation❸ has estimated a more realistic impact as being in the order of $810 million.

Ramifications of Restricting Commutations

Commuting certain types of claim where liability is not an issue, is probably the most economical and fairest means of their settlement. The problem with unfettered commutation of claims is that there is a temptation for all parties concerned to negotiate a quick cash offer which doesn't always take the interests of the injured worker into account. This has two major long term ramifications. The first is that the worker fritters away the commutation award quickly and is left with no financial support thereby being forced into the Federal safety net systems. The second is that it re-establishes the lump sum expectation culture in the scheme.

By giving notice of pending changes which severely restrict commutation as a claims settlement strategy, the Government unwittingly introduced another

(Continued on page 4)

Commutations
Changes
Ramifications

NOTES

❶ See Part 1Rules, WorkCover Provisional Liability and Claims Guidelines under the Workplace Injury Management and Workers Compensation Act 1998.

❷ A has researched back pain on the internet and now knows common symptoms and treatments. See "Common Simple Emergencies" Buttaravoli & Stair. www.ncemi.org/cse/contents.htm

❸ WorkCover NSW Claims Estimation Manual v 4 1.3.2002.

(Continued from page 3)

upward cost pressure into the scheme. This is because of the accelerated lodgment of commutation applications.

There are no publicly available data on numbers of commutation applications brought forward before the restrictions came into effect, anecdotal evidence from insurers suggests that the numbers are significant and will be taken into account in future premium calculations.

Benefit Delivery Changes and their Ramifications

The changes in the manner in which weekly benefits are now delivered have the greatest potential to change the culture of the workers compensation system. By introducing provisional liability payments the Government has removed any claimant risk of not receiving a benefit and has imposed even greater long term cost burdens on employers.

The new provisions which commenced on 1.1.2002 have removed the need for a medical certificate or a claim form to be provided by an injured worker to lodge an initial notification of work injury❶. They also permit insurers to pay benefits for 12 weeks without admitting liability.

The new provisional payment provisions only require verbal notification by a worker or his/her agent to lodge a claim for benefits. This notification can be given to the employer or directly to the insurer. In cases where more than 7 days off work are expected, the insurer must commence weekly payments within 7 calendar days of notification.

By introducing these new provisions the Government has (we trust) unwittingly given unscrupulous workers an avenue for massive rorting of the workers compensation system. This how a rort might work.

Worker (A) complains to supervisor (B) of back pain following a relocation of a work station. A was asked to help move a number of boxes of files and office equipment during the relocation. B recommends to A that he sees his doctor.

A sees his local MD complaining of severe back pain and after a brief examination which reveals leg pain as well as back pain❷, the treating doctor suspects disc herniation. The doctor refers A to an orthopædic specialist for investigation and treatment advice and gives A four weeks off work. because A cannot see the specialist for four weeks.

A returns to work and tells B what has happened at the doctors. B calls his insurer and gives it details of the alleged injury and circumstances leading to the injury and the time off work now required. B complains that he doesn't believe that the injury is as bad as is claimed.

The insurer calls A to confirm the nature of the condition and the treatment which has been prescribed. The insurer then calls the treating doctor to discuss the case and any options for return to work on suitable duties. The treating doctor explains that it would be dangerous to return A to work until he has seen his specialist. The insurer approves provisional liability payments for up to 12 weeks in accordance with WorkCover's Estimation Manual❸ and commences weekly wages paymentswithin 7 days.

The insurer also decides to seek a second opinion on the injury claimed by A and refers him to another orthopædic specialist. Coincidentally the second opinion appointment is in the same week as the first consultation by the treating specialist.

A sees his treating specialist who, following an MRI, confirms that no abnormality can be detected and recommends continuing conservative treatment. A convinces his treating specialist that he is not yet fit enough to return to work and a course of physiotherapy is ordered.

(Continued on page 5)

Provisional Benefits Payment Ramifications

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❶ Reasonable excuse includes:
- Insufficient medical evidence (can't identify treating doctor);
- Worker is not a "worker" under the Act;
- Insurer is unable to contact the worker;
- Worker refuses access to information;
- Injury is not work related;
- Injury is not significant (likely to require more than 7 days off normal duties);
- Injury has not been reported within 2 months of the date of injury.

(Continued from page 4)

A further month off work is prescribed by the treating specialist. On the day that A is due to see the insurer's specialist, he consults his local MD complaining of stomach pains and diarrhea from eating a "crook oyster" the night before. The local MD gives A a sickness certificate for the day.

A calls the insurer and explains that he is sick and can't attend the second opinion specialist appointment. The insurer makes another appointment two weeks hence.

The day before the second insurer's specialist opinion appointment A returns to work saying he is now feeling fully fit and able to work. A has now taken 6 weeks off work on workers compensation on full pay.

Many observers believe that it is only a matter of time before all NSW workers realise that it is no longer necessary to take personal leave, time can be taken off work on workers compensation instead.

The inequity for employers in the new provisional payment system lies in the lack of risk to employees staging the sort of rort described above. Unless the insurer can prove fraud, the costs of the provisional payments are borne by employers.

Under the pre 1.1.2002 workers compensation system, payments did not commence until the insurer was satisfied that a genuine claim existed and they were allowed up to 42 days to gather medical and other evidence to dispute a claim.

Under the new system, insurers must commence weekly payments within 7 calendar days unless they have a reasonable❶ excuse not to do so. Unsupported or anecdotal information received from any source (includes employer) does not constitute "reasonable excuse".

When an insurer is able to gather evidence to cease provisional weekly payments (e.g. discovers that the injury is not substantially work related), payments already made cannot be recovered from the claimant.

In cases where an employer's premium is calculated using claims experience, (premium is greater than $3,000) the costs of provisional liability payments are included in the employer's claims experience thereby increasing premium charges.

Claims Estimation changes and their Ramifications

The most controversial change to the way that insurers must estimate the future costs of claims is contained in Rule 12 of the new Claims Estimation Manual. Rule 12 deals with estimating disputed claims and directs insurers to estimate disputed claims in the same way that they would with a claim which is not disputed.

Under the previous regime, insurers discounted the cost of a disputed claim by 25%, providing employers and insurers with an incentive to properly investigate a claim to determine if it was genuine or not. The new estimating procedures remove that incentive.

By removing the discount on disputed claims the effectiveness of one of the keystones of workers compensation has also been put in jeopardy.

Previously it was worth while for an employer to make every effort to return an injured worker to suitable employment on the understanding that if the worker refused to cooperate, the claim could be disputed and a discount in its estimated future cost would be applied. That encouragement has now been removed with the likely consequence that injury management will be downgraded.

New insurer remuneration arrangements work against many employers

Previous issues of COMPAS❶ have discussed the inadequacy of the remuneration paid to insurers by WorkCover. This inadequate remuneration has forced insurers into providing lower levels of services than they would have preferred, thereby increasing claims costs. In an effort to improve insurers' service levels, WorkCover has introduced new remuneration arrangements which both increase the level of "base remuneration" and incentive-based fees.

One of the new remuneration measures is based on the insurers' portfolio loss ratio. If an insurer's loss ratio meets benchmarks set by WorkCover, the insurer is eligible for extra fees. Theoretically, the loss ratio incentive fees encourage insurers to provide employers which have poor loss ratios with extra prevention and claims management services. In this way the employer improves its workers compensation performance, claims costs, premiums and loss ratios reduce and the insurer is rewarded with increased remuneration. Market practice however is developing in a different direction.

Insurers are beginning to select against employers with a poor loss ratio. We know of at least three insurers which have begun to discourage poor performing employers from insuring with them. There is nothing overt in the manner of the discouragement, it is manifested in a decreasing service level and the insurer's new business marketing tactics.

This emerging market behavior by insurers which is driven by the new loss ratio incentive fee, risks approximately 400❷ poor performing employers being shunted between insurers from policy year to policy year, never understanding why they don't receive services from their insurer. They will continue to perform poorly and burden the scheme.

Those insurers which have determined that an entire industry sector has a poor loss ratio (e.g. transport) will select against all employers in that industry. This anti-selection has significant ramifications for small business and therefore the overall success of the workers compensation system.

90% of businesses in NSW are SME employers, whose average claims frequency is 1 in 17 man years. Most SMEs never develop any skills in injury management or accident prevention, relying on their insurer for these services when they are required. Currently, the average claims costs for SMEs are twice as high as those of larger employers and there is a massive cross subsidy between larger business and SMEs.

As insurers withdraw services from poor loss ratio industry sectors, SME claims costs will rise further, imposing even greater cross subsidisation on the larger employers in that industry. This will put upwards pressure on the industry sector premium rate which is now ANZSIC based.

Incentive based remuneration in a centrally managed fund workers compensation scheme does not work unless and until all of the financial incentives are aligned with scheme objectives. Paying insurers on loss ratio encourages selection against poor performing employers. It does not encourage insurers to provide greater levels of service.

NOTES

❶ See COMPAS May 2001 Issue, Page 3 - **Profit and Loss, the Keys to Insurer Performance** "WorkCover pays its insurers as little as half of what would be expected in other insurance systems. Not only is the remuneration inadequate to do the job effectively, payments are up to two years in arrears."

❷ See COMPAS October 2000 Issue, Page 4 - **Introduce Market Initiatives to Reduce Incidence of Workplace Injury** "Two years ago the WorkCover Authority was given information by insurers on 436 policy holders whose safety record appeared (from their claims experience) to be significantly worse than their industry average performance.

WorkCover has still not acted to investigate or manage these 400 poor performers whose collective claims costs are equal to 10% of the total costs of claims in the scheme."

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