COMPAS

WORKERS COMPENSATION AND OH&S NEWSLETTER
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In this Issue

Holding the line

The scheme reforms proposed in the Workers Compensation Legislation Bill 2001 have not been welcomed universally. The vast majority of workers compensation disputes are medical in nature and are currently resolved through a convoluted and very expensive legal process which is also adversarial.

The proposal to change the dispute resolution process through the introduction of binding medical assessments has the most potential to fix the NSW scheme and is common practice in other jurisdictions (Queensland has used medical panels for a number of years and has the cheapest workers compensation scheme, NSW uses binding medical panels to assess hearing loss).

In a vicious campaign to protect its future income, the legal lobby has sought to destabilise the Government and have the reform proposals withdrawn.

This article explores the reasons why the legal fraternity so jealously guards the prevailing, cumbersome and unfair workers compensation dispute resolution process.

In 1987 the Unsworth Government introduced a new workers compensation system to replace a scheme which had been operating since 1926. The catalyst for the new system was the withdrawal of most of the private insurers who were prohibited by the Government from charging premiums representative of the risk. 1926 Scheme costs had spiraled out of control due in large part to the common law claims explosion.

The 1987 scheme outlawed common law and introduced a much fairer benefit structure which relied on income protection. In 1990 the Coalition Government reintroduced limited common law access for seriously injured workers (minimum 33% impairment) on a strict election basis. Access to common law has since (1991, 1997) been broadened and this in conjunction with the recent abolishment of commutation restrictions has resulted in the re-establishment of a pot of gold culture.

There has only been one winner in this process and that is the legal services provider.

In the early stages of the 1987 scheme, common law claims represented approximately 0.2% of total claims. In 2000 2.7% of claims lodged are estimated to be at common law. Legal costs now outstrip all other claims costs apart from benefit payments to injured workers.

Most observers would now be aware that the 1987 workers compensation scheme is in significant deficit. The 2000 NSW WorkCover Authority Annual Report shows total workers compensation fund assets of $6.317 billion compared to

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The changes to the dispute resolution process must be allowed to proceed.

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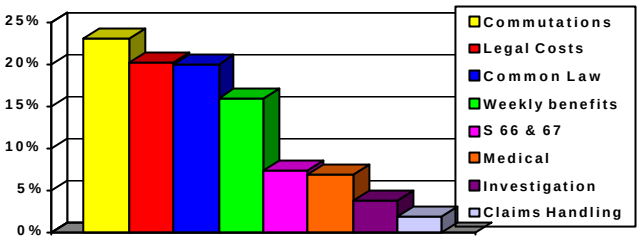
liabilities of $7.956 billion (as at June 2000). Latest estimates put the deficit at $2.18 billion.

Readers may be interested to note the break up of the estimated liabilities① and to see just where the money must eventually go.

Estimated outstanding liability as % of total claims provisions



The fact that the legal profession stands to receive an estimated $1.4 billion (over 20% of total claims cost provisions) from future payments on existing claims may come as a shock to some. If you are a member of the legal profession then it would be a pleasant shock. If you are already a claimant you might ask "Why can't I get a bit more?" If you are an employer you might want to know why you have to pay all of these legal costs for what is essentially a no fault system.

In an exposé published recently in the popular press②, much was made about the costs that law firms charge to represent injured workers. One issue that was not raised in the articles was that the majority of workers compensation claims are settled "on the steps of the Courts", they are not put into Court. Thus much of the work done by the legal firms representing injured workers is administrative in nature and undertaken by para-legal employees. There is an excellent chance that its value will never be tested.

Barristers must still be briefed even though they know that there is a strong possibility that they will not be called on to cross examine any witnesses nor appear in Court.

It is easy and very lucrative work for the profession and for these reasons many law firms have invested significant resources in marketing to unions and potential claimants. They are not going to let it go at the stroke of a Parliamentary Draftsman's pen.

The struggle that the Government and in particular Minister Della Bosca, has in front of them is to hold the line and to ensure that the dispute resolution proposals are carried through. Disputes which belong in the medical arena must be decided there and not through a costly and unfair legal process which only benefits legal practitioners. A major difficulty for the Government will be convincing the Cross Benchers that the labour lawyers are the ones who will really benefit if the proposed changes are defeated.

NOTES

① Extracted from "Tail Reduction Tender Package" WorkCover Authority 2000.

② The Sydney Daily Telegraph, 8.5.2001 pp. 1, 4 & 18.

Profit and Loss - The Keys to Insurer Performance

NOTES

① Extracted from "Tail Reduction Tender Package" WorkCover Authority 2000.

② See WorkCover Authority Annual Report 2000, pp 5 & 7, Board of Directors and Senior Management.

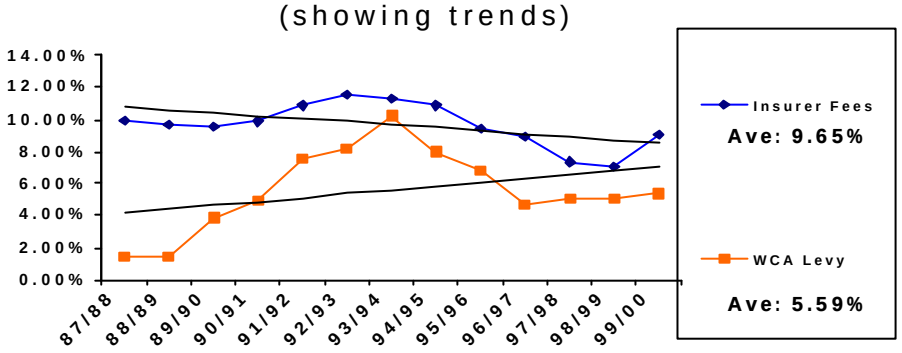
③ PwC Insurance Facts and Figures 2000

In the search for reasons for the NSW workers compensation system's woes, we realised that there was one design flaw which affected every aspect of the scheme's operation. It is the performance of the insurers.

The WorkCover Authority appears to have fallen into a trap avoided by every other successful insurance scheme. That trap is to reduce claims handling expenses to the detriment of claims outcomes.

COMPAS has discovered that the WorkCover Authority pays its agents (the 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. It also appears that payments to insurers have declined significantly over the last decade while the fees that WorkCover pays itself have risen steadily①.

Insurer Fees and WCA Levy as % of Premiums (showing trends)



We understand that there are no senior managers in WorkCover with insurance company management experience, nor are there any insurance industry representatives on the WorkCover Board②. Had there been some insurance management experience at WorkCover, fees for claims handling and other expenses incurred in managing the system might have been set at more realistic levels. This in turn would have meant improved levels of service and decreases in claims costs.

In insurance parlance, the costs of running the business are simply referred to as "expenses" and include such things as staffing, computer systems, marketing, premium assessment and collection and product distribution. The general insurance expenses to premium ratio lies between 23% and 33%③.

WorkCover pays insurers approximately 10% of premiums collected and employers are now seeing the result of this underpayment in increased claims costs and thereby soaring premiums.

Insurers have learnt (often to their cost) that to cut down on claims staff and proper systems means that claims costs increase accordingly. Hence most insurers wishing to improve their underwriting results concentrate on managing claims better or being more selective in their underwriting.

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Claims Managers under resourced

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Cutting back on insurers' remuneration has forced them to minimise claims handling staff numbers in order to make a profit.

On average, NSW insurers' claims staff are handling 222 claims each[①]. Because much of the insurers' remuneration is incentive based and paid on achieving certain WorkCover determined benchmarks, up to 20% of claims staff time is taken up on benchmark compliance. When this time is factored out of claims management time, (i.e. 810 minus 20%) the ratio of claims to staff rises to a massive 277:1.

In the USA, workers compensation insurers have found that their claims adjusters cannot efficiently manage more than 150 claims at any one time and 75 of those need to be medical expenses only claims (in other words very simple matters).

More evidence of how marginal the NSW WorkCover agency business is can be found by looking at returns on expenses indicators[②]. A reasonable rate of return for a service-based (low-skill) company, e.g. cleaning services, is 20% to 25% on expenses. A professional services company, e.g. medical/ legal services, would require an expected return on expenses of in excess of 30% and up to 50%.

The following chart shows that an insurer acting as a WorkCover agent can't make money if it has a small employer client portfolio. Even insurers with a majority of large employer clients struggle to make acceptable returns given the remuneration structure.

Return on expenses as a profitability indicator

	Premium <$10K "Small"	Premium >$10,000 "Medium/Large"	Total
Total Premium Revenue	493.2	1,506.8	2,000
Total Insurer Fees	65.8	100.0	165.8
Total Insurer Expenses	72.1	86.3	158.9
Insurer Profit	(6.3%)	13.7%	6.9%
Return on Expenses	(8.7%)	15.8%	4.3%

There can be no doubt that insurers have a great deal of influence over how successfully the workers compensation system operates but only to the extent that they are appropriately funded. Most of the problems employers encounter in premium assessments, claims and injury management and payments are directly related to insufficiently trained or resourced insurance company personnel.

If the scheme's regulator, employers, employees and Government want a more efficient and better managed compensation system, then they must be prepared to pay for it.

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① There are approximately 180,000 active claims at any one time in NSW. Staffing figures provided to COMPAS by insurers indicate that 810 claims management personnel are employed by insurers. A further 100 staff are employed in injury management activities—these are not included in the average because their role is limited to one specific activity.

② See paper "Portfolio Selection Strategies for Insurer/Agents in Workers Compensation Managed Fund Markets" by Mireille Campbell, Christopher Wallace and Yan Zhao, 8th Australian Institute of Actuaries Accident Compensation Seminar 2000.

Rehabilitation frustrated by over zealous lawyers

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One of the cornerstones of the NSW workers compensation system is the concept that return to work as early as possible following an accident is good for all parties and in particular the injured worker.

The benefit structure has been designed to encourage a worker to return to work quickly, the premium methodology encourages employers to take workers back as soon as possible. This early return to work is achieved through a system of injury management with workplace based rehabilitation the principal mechanism.

In an accident on 12.3.2001, a worker who had taken it upon himself to weld a damaged component, suffered burns to both legs. He was admitted to hospital but discharged later that same day. In follow up examinations it was decided that he would need skin grafts and he was readmitted and treated.

On 2.4.2001, 16 working days after the accident, lawyers acting for the injured worker filed an Ordinary Statement of Claim① in the District Court claiming $750,000 losses and damage. Instructions must have been taken from the hospital bed, the injury has not been assessed nor has the future potential economic loss, if any.

① Matter no 2767/01 District Court of NSW

This case demonstrates two things which are all too common. The first has already been alluded to earlier, it is the cupidity of some legal firms. The second and more serious issue is that this legal action has probably condemned the injured worker to the employment scrap heap and totally frustrated any rehabilitation efforts.

In order to maximise his compensation for future economic loss, the worker will be advised that an early (or any sustained) return to work must be avoided at all costs until the case is heard.

The employer, on seeing the extent of the common law claim and what he is accused of, is rightly upset. He will quickly realise that any attempt to bring the worker back on a return to work programme will have no impact on extra premiums he will be forced to pay as a result of the claim. After the six months mandatory employment period has elapsed, the employer will probably terminate the services of the injured worker and get on with his business.

The legal action will run its course, probably taking at least three years and after negotiations the injured employee will probably settle his claim for around $450,000 net of all expenses. This may seem to be a great deal of money but in relative terms it represents eight years pay, or a gross income of $865 per week (provided interest of 10% can be earned indefinitely).

For someone who is unlikely to be employed ever again is it a good or fair result (employers who are good risk managers tend to shun disabled workers where fully fit ones are available)?

Would it not have been better for all concerned had the injured worker been assisted back into the workforce as quickly as possible, if necessary being retrained?

Sadly this scenario is being played out with ever increasing frequency.

The deficit and fraud

A number of authorities and insurance industry sources have referred to the incidence of workers compensation fraud. It is now widely accepted that employer and employee fraud combined, amount to more than 20% of premiums or approximately $400 million each year.

Not as widely realised is the potential effect of fraud reduction on the WorkCover deficit. Had fraud been effectively managed from the outset, the WorkCover deficit would now be a surplus.

Employers who fraudulently under declare wages pay less premium. Under declaration across the WorkCover scheme is estimated at 10%. If, over the last 11 years, the reported wages in NSW had been inflated by 10% and then applied to the average premium rate for each successive year, a further $1.333 billion in premiums would have been generated.

Employees who exaggerate the extent of their injuries are guilty of fraud and receive more benefits than they would otherwise be entitled to.

Claims exaggeration across the WorkCover scheme is estimated to be 10%. If , over the last 11 years, the breakeven premium rate (the amount needed to fully fund scheme costs) is discounted by 10% and then applied to the reported wages for each successive year, the deficit of actual premium collected compared to premium required would have been $1,053 billion. By combining the premium surplus ($1.333 billion) with the premium deficit, an overall surplus of $280 million results.

Premium Discount Scheme— Misguided Policy

The premium discount scheme (PDS) announced by Minister Della Bosca continues to concern many observers. Targeted towards employers who employ more than 20 workers the scheme is modeled on the Massachusetts Assigned Risk Pool Qualified Loss Management Program (the assigned risk pool is used by employers who are refused insurance by licensed insurers because of their poor risk).

The Massachusetts workers compensation system is beginning to show signs of stress. The Assigned Risk Pool is growing not shrinking[①] .

The NSW PDS is intended to be utilised by all employers not just the poor performers.

NSW employers who pay premiums between $10,000 and $100,000 cumulatively pay 33.01% of total premiums, their claims amount to 30.86% of total claims. Employers who pay premiums between $100,000 and $500,000 cumulatively pay 20.92% of total premiums and incur 19.89% of claims. Employers paying more than $500,000 cumulatively pay 19.98% of premiums and incur 17.61% of claims.

Surely it would make more sense and be more equitable to cut premium rates for employers whose premiums exceed their claims rather than offer a PDS, participation in which will only cost more to the employer?

NOTES

① Extract from Introduction, Massachusetts Workers Compensation Rating Bureau Rate Filing 9.1.01.

"There are already signs that the system's hard-won balance is in danger: the DIA is reporting longer time frames for case resolution, and backlogs have levelled off after a long period of decline. Assigned risk pool activity is picking up as well: monthly applications are running at a rate 20-30% higher than last year's, and the percentage of large accounts ($25,000+ in premium) assigned to the pool more than doubled from 1999 to 2000."

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