



**REPORT TO THE MINISTER FOR
LABOUR RELATIONS**

ON THE

**REVIEW OF WORKERS' COMPENSATION
INSURANCE ARRANGEMENTS IN WESTERN
AUSTRALIA**

Prepared by
Mr Campbell Ansell (Chairman)
Mr Kim Mettam and Mr Frank Michell (Members)

30 JUNE 2000

EXECUTIVE SUMMARY

The introduction of an independent regulatory authority together with greater transparency and alternative insurance options should provide workers with fair benefits and employers with the most economic costs.

The Review of Workers' Compensation Insurance Arrangements in Western Australian was essentially required to examine:

- ◆ the current insurance structure;
- ◆ the regulatory framework supporting the insurance structure; and
- ◆ opportunities available to stimulate competition in the insurance market.

It is clear that until the 1999 financial year, Western Australian employers were, in general, satisfied with the cost of workers' compensation. Employers enjoyed the benefits of decreasing recommended premium rates and significant discounts by approved insurers, peaking at 30% below the recommended premium rates during 1995 and 1996.

In the period post-1993 legislative amendments, the market was optimistic that the amendments would significantly reduce the cost of common law claims, which would particularly translate into reduced premiums for employers. The expected positive results encouraged insurers to improve market share through significantly discounting premiums.

Based on the recommended premium rates employers enjoyed average premium rates 2.4% to 2.73% of wage roll costs in 1995 to 1999.

The latent nature of common law claims meant the market was not aware of the changed behaviour of claimants and of insurers towards the finalisation of claims which emanated from the 1993 amendments, for at least two to five years following the date of the injury.

The combined effect of discounting recommended premium rates together with the increasing cost of claims in the areas of common law, weekly benefits, medical expenses and rehabilitation expenses, over an extended period of time, resulted in insurers not collecting sufficient premium to cover the cost of claims for the same year. Approved insurers advised that approximately \$400 million has been lost by the industry over a period of 7 years.

Internationally and nationally there have been four significant mergers of approved insurers for the period 1999 to 2000. On 1 July 2000, the number of approved insurers will reduce to thirteen, including two of the licence approvals held in the name of the same organisation. Downsizing of the market will have some impact on competition in the Western Australian workers' compensation insurance market. More significantly however, is the current trend by some approved insurers to shed workers' compensation underwriting business which no longer conforms with an insurer's portfolio profile.

Moreover, the losses experienced have caused approved insurers to become conservative in their assessment of workers' compensation premiums, specifically affecting the small to

medium business sector and high risk industries. Insurer portfolios seem to have a limited capacity or willingness to spread the risk over a period of time, particularly with reference to small to medium and high risk businesses.

The effects of these trends have caused volatility in the cost of premium for employers, specifically in these businesses. Moreover, employers do not possess an understanding of how their industry claims experience impacts on the cost of their employers' indemnity policy. Employers believe surcharging by insurers above the recommended premium rates are not properly explained.

Employers from small to medium and high risk business sectors have faced rising premium costs and an inability to forecast and budget for their workers' compensation costs. These spiraling costs have had serious consequences on the profitability of their business and their capacity to employ.

No strategic plan for the worker's compensation system has been devised with benchmarks and outcome based performance indicators for participants and service providers to provide a clearer understanding of the needs of the scheme. Consequently, while there has been an increase in complaints concerning insurer behaviour, the degree to which the current concerns of employers and workers are justified is difficult to assess, particularly in a system which is partly reliant on goodwill, behaviour in accordance with the intent of the legislation, and doing what is right.

The Committee undertaking the Review of Workers' Compensation Insurance Arrangements in Western Australia has examined all of the terms of reference required of the Review and has sought solutions which are practical and address the challenges specifically faced by the Western Australian workers' compensation system. Above all, the Review has recommended transparency to ensure employers and approved insurers alike, understand their specific role and responsibilities within the workers' compensation system.

Findings and recommendations for each term of reference has been documented in the report. The major recommendations of the Review of Insurance Arrangements are as follows:

1. Establishment of an independent Accountable Regulatory Authority (ARA), reporting to Government and chaired by an independent chairperson. Board Members of the ARA should be selected based on their expertise in defined competency areas, as opposed to the current requirement where Members represent stakeholder groups.

The ARA will be responsible for all the regulatory functions required under the *Workers' Compensation and Rehabilitation Act 1981* and associated legislation, including those currently undertaken by the Workers' Compensation and Rehabilitation Commission and the Premium Rates Committee.

The regulation of the insurance industry and self insurers will be the responsibility of the ARA.

Advice sought from key stakeholders, particularly in relation to the regulation of insurers and self insurers, will occur through the formation of special advisory committee/s with specialist representation from stakeholders, participants and service providers.

2. Introduction of approved insurer licensing agreements is recommended in order to provide greater accountability of expected standards of service required of approved insurers under the *Workers' Compensation and Rehabilitation Act 1981*.

A licensing agreement will be between the ARA and the accountable officer representing the approved insurer in Western Australia and will:

- ◆ Define the consequences if the licensing agreement is not achieved;
- ◆ Impose *immediate Fines for serious infringements (which will be imposed on employers and insurers dependent on the nature of the offence)* including unlawful discontinuance of weekly payments and non payment of weekly payments of workers' compensation.
- ◆ Identify the period of the licence issued to each insurer which will be directly dependent upon the performance of the insurer (points system);
- ◆ Provide for an internal or independent evaluation of performance, which is to be undertaken and forwarded to the ARA. All insurer audits required by the ARA to be co-ordinated and completed at the same time, if specified; and
- ◆ Provide the ability to independently evaluate an insurer's performance at the discretion of the ARA, if performance is not up to standard.

New insurance approvals will be issued initially for a period of 12 months and renewal will be in accordance with the approved insurer's ability to achieve the performance standards outlined in the licensing agreement.

Dependent upon performance approvals will be issued for:

- ◆ 3 years;
- ◆ 2 years; or
- ◆ 1 year.

Development of best practice performance indicators, in consultation with approved insurers, will result in the implementation of an outcome based performance monitoring programme.

3. The workers' compensation scheme continues to be privately underwritten up to a five year period. However, the role of insurers will continue to be defined and the performance of insurers will be stringently monitored on a progressive basis.

A review of the performance of insurance arrangements is to be undertaken regularly (at least every 2 years). At the conclusion of the five year period, evaluation against pre-determined performance indicators, established by the ARA in accordance with its strategic plan, will be undertaken.

If approved insurers are unable to achieve the established performance measures the ARA will consider the option of an alternative insurance structure, which may respond better to the role and level of performance demanded by employers, workers and the community.

4. Small to medium employers will be encouraged to explore the opportunities to seek group insurance, whereby an approved insurer underwrites the risk and manages the claims for groups of employers. Alternatively, employers may wish to seek opportunities for an approved insurer to underwrite the risk and have claims managed by the employer.
5. Smaller to medium employers to be provided with the opportunity to seek self insurance through group self insurer mutual schemes.

The ARA is to develop guidelines appropriate for the regulation of group self-insurance mutuals.

Non discretionary mutuals are groups of employers pooling their resources into a vehicle which allows for individual employers to take control and ownership of their workers' compensation to levels defined by each employer.

The key characteristics of a mutual is the ownership and involvement by member employers in injury management, risk prevention and workers' compensation matters.

Peer pressure and participation by senior management combine as a natural dynamic to encourage favourable cost performance, including the stability of mutual costs over many years and the provision of a culture of care for workers covered by the mutual.

Mutuals usually engage a professional management company to provide the necessary systems and resources. Managers also facilitate shared services and administer cash, under the discretion of the member companies. Reinsurance is used as a *shock absorber* for major unexpected risks and to limit cost exposures for any particular employer.

6. To ensure employers are aware of the relationship between insurance companies and brokers, it is recommended commissions and/or incentives payable related to workers' compensation insurance, be disclosed on renewal notices issued by the insurer.

The implementation of these recommendations (together with the remaining recommendations listed in the report) should provide an environment which stimulates greater competition, accountability and transparency in the insurance arrangements available to the workers' compensation scheme. Employers and workers alike should benefit from a workers' compensation scheme which strives to achieve best practice.

TERMS OF REFERENCE FOR THE REVIEW OF INSURANCE ARRANGEMENTS

- i. Assess the appropriateness of establishing an independent regulatory body to co-ordinate all regulatory aspects of the insurance industry including insurance brokers and self insurers.
- ii. Provide options to Government on an appropriate means of evaluating and monitoring performance, including the merits of elements of a Code of Performance for insurers particularly as it relates to interaction with employers, injured workers, treatment providers and the regulatory authority.
- iii. Review whether existing insurance management practices provide for administrative efficiency, exemplary performance and consistency of services to employers and workers, and whether a privately underwritten scheme is the most appropriate structure to achieve these requirements.
- iv. Evaluate the merits of providing greater scope, flexibility and choice of workers' compensation policy terms to employers or groups of employers and the impact of this on the integrity and cost of the workers' compensation system.
- v. Assess the impact and viability of extending self insurance to groups of small employers including an evaluation of the effect on the integrity of costs and the long term stability within the system.
- vi. Examine the role of brokers within the system, including the relationship with employers and insurers, the cost benefits of the service and the need for licensing arrangements.

A. SUMMARY OF THE REVIEW OF WORKERS' COMPENSATION INSURANCE ARRANGEMENTS RECOMMENDATIONS

Term of Reference No. 1

The Reference Group has concluded the Best Practice Regulation of insurers and self insurers operating in the Western Australian worker's compensation and rehabilitation system would be achieved as follows:

1. The organisation accountable for the administration/management of the system/scheme should also be responsible for all regulatory functions relating to employers, service providers, approved insurers, self-insurers and group self insurers.
3. The Accountable Regulatory Authority (ARA) should be an independent statutory authority accountable to Government and be chaired by an independent chairperson chosen at large.

The ARA will be responsible for all the regulatory functions required under the *Workers' Compensation and Rehabilitation Act 1981* and associated legislation, including those currently undertaken by the Workers' Compensation and Rehabilitation Commission and the Premium Rates Committee.

The regulation of the insurance industry and self insurers will be the responsibility of the ARA.

- ◆ Board Members of the ARA to be selected based on their expertise in defined competency areas, rather than the current system where Members represent stakeholders.
- ◆ The Chief Executive Officer will be a member of the Board and report to the Board of the ARA.
- ◆ The Board will also be responsible for monitoring the effectiveness of the Chief Executive Officer of the ARA and the performance and conduct of the Authority.
- ◆ Advice is to be sought from key stakeholders, particularly in relation to the regulation of insurers and self insurers, through the formation of special advisory committee/s with specialist representation from stakeholders, participants and service providers.

The Advisory Committees would provide the opportunity for the ARA to consult with workers and employers, scheme participants and service providers on the performance of the scheme.

- ◆ The ARA is to continue to rely upon the responsibilities and expertise of APRA for prudential regulation of approved insurers.

- ◆ The ARA will be charged with developing:
 - Service Quality Regulation;
 - Data Provision Regulation;
 - Information Sharing;
 - Complaints Mechanism (as opposed to dispute resolution); and
 - Accountability (defined consequences if licensing agreements are not achieved).
- ◆ The ARA will need to be provided with powers to impose penalties, including fines if the above standards are not achieved, in addition to the power to revoke approvals.
- ◆ Premium pricing will be regulated by the ARA, in order to minimise pricing volatility particularly for the small to medium business sectors and high risk industry. The system will provide an environment for employers to seek the most competitive pricing structure dependent upon their claims experience and risk.
- ◆ The independence of the scheme will be recognised by its self funding arrangements which will be in the form of a levy on premiums paid by employers.
- ◆ Appendix E provides an outline of the role and responsibilities expected of the ARA.

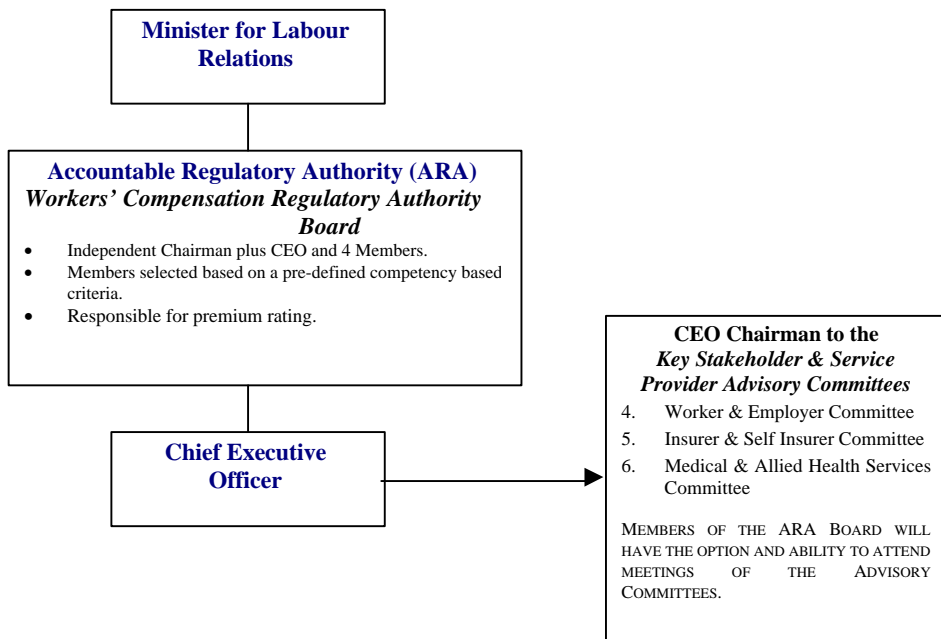


Figure 2 Western Australian Workers' Compensation and Rehabilitation System – New Regulatory Structure

Term of Reference No. 2

In order to address the challenges required of this term of reference, it is recommended:

1. The introduction of licensing agreements is recommended in order to provide greater accountability of expected standards of service required of approved insurers under the *Workers' Compensation and Rehabilitation Act 1981*.

The licensing agreement will be developed in consultation, between the ARA and the accountable officer representing the approved insurer in Western Australia, and will:

- ◆ Define consequences if licensing agreements are not achieved;
 - ◆ Impose *immediate fines for serious infringements* (which will be imposed on employers and insurers dependent on the nature of the offence). Examples include non-payment of weekly workers' compensation payments and unlawful discontinuance of weekly payments.
 - ◆ Identify the period of the licence issued to each insurer which will be directly dependent upon the performance of the insurer (points system);
 - ◆ Provide for an internal or independent evaluation of performance, which is to be undertaken and forwarded to the ARA. All audits required by the ARA to be co-ordinated and completed at the same time, if specified; and
 - ◆ Provide the ability to independently audit an insurer's performance at the discretion of the ARA.
2. New insurance approvals will be issued initially for 12 months and will be renewed in accordance with the approved insurer's ability to achieve the performance standards outlined in the licensing agreement. A greater initial approval period is possible in extenuating circumstances.
 3. Insurance approval renewals will be issued based upon the insurer's ability to achieve the performance standards outlined in the licensing agreement. The re-approval period will be directly linked to the level of performance achieved by the approved insurer.

Dependent upon performance approvals will be issued for:

- ◆ 3 years;
- ◆ 2 years; or
- ◆ 1 year.

A weighted point scheme will be developed in conjunction with license agreement and performance indicators. The three and two year licensing options are preferred in order to provide a degree of stability in the system due to the long-tail nature of workers' compensation claims.

4. Development of best practice regulation, in consultation with approved insurers, which is to result in the implementation of the following suggested performance monitoring programme:

4.1 Prudential Regulation

The ARA will rely on the prudential regulation undertaken by the Australian Prudential Regulatory Authority (APRA).

The ARA will receive a copy of all reports and correspondence forwarded by approved insurers to APRA to ensure an approved insurer's solvency position falls within the ARA's prescribed limits and therefore able to maintain its approval status under the *Workers' Compensation and Rehabilitation Act 1981*.

4.2 Service Quality Regulation

Performance indicators to be outcome based with specific minimum targets set by the ARA relating to:

- ◆ Legislative process and timeframes;
- ◆ Use of service providers to manage the claim;
- ◆ Cost efficiency indicators (*to be developed following the completion of the ARA's Strategic Plan for the Workers' Compensation System*);
- ◆ Return to work outcomes (*to be developed following the completion of the ARA's Strategic Plan for the Workers' Compensation System*);
- ◆ Customer satisfaction surveys; and
- ◆ Staff competencies (to be evaluated through customer evaluations).

These indicators are explained in further detail in Appendix F. However consultation is required between the ARA and industry to finalise the performance monitoring package and set targets.

4.3 Data Provision Requirements

Data requirements are to be identified (standards, targets for timeliness and accuracy of data to be identified). A reliable data set is required by the ARA to measure the performance of the scheme, participants and service providers.

4.4 Premium Methodology

Performance indicators to be developed for the methodology adopted for premiums paid by employers including:

- ◆ Payment of premium based on the actual gross declaration of wages;
- ◆ Disclosure for claims payments and claims experience on a year arising basis on policy renewals; and
- ◆ Brokerage disclosure.

4.5 Internal Review and Dispute Resolution

- ◆ An internal review system will be made available in-house within the offices of the approved insurer, to review claims which may have the potential to develop into a dispute or has resulted in a dispute.

The intent of the internal review system is to ensure approved insurers are better positioned to minimise and resolve disputes without reference to the Conciliation and Review Directorate (to be renamed *the Office of Dispute Resolution, Workers' Compensation*).

The internal dispute resolution system must include a process to involve the employers in the resolution of disputes with their workers.

This system should discourage the use of the Conciliation and Review Directorate by approved insurers as a claims management tool.

- ◆ Only disputes which cannot be resolved through the internal review system to be lodged before the Conciliation and Review Directorate.

The approved insurer is to include a process to involve employers in the resolution of disputes with their workers.

Term of Reference No. 3

In order to address the challenges required of this term of reference it is recommended:

1. The workers' compensation scheme continues to be privately underwritten for up to five years, however the role of insurers will be defined and the performance of insurers will be stringently monitored on a progressive basis.
2. A review of the performance of insurance arrangements to be undertaken regularly (at least every two years) and at the conclusion of a period up to five years, against pre-determined performance indicators, established by the ARA, in accordance with its strategic plan an evaluation will be undertaken.

If approved insurers are unable to achieve the established performance measures the ARA will consider the adoption of an alternative insurance structure which will respond to the role and level of performance demanded by employers, workers and the community.

3. The role of insurers will be that of a service provider:
 - ◆ Providing employers with financial protection in return for premiums against the employers' statutory and common law workers' compensation responsibilities.

- ◆ Maintaining their contractual obligations and responsibilities to employers. Thus, ensuring all claims costs are efficiently and fairly managed in partnership and consultation with employers, through providing a service which properly and effectively manages claims for all clients, or the provision of an alternative service, if a claims management service cannot be provided.

If insurers choose not to provide an effective claims management service then they will have the option to out-source their claims management service to an approved service provider.

- ◆ Insurers who seek approval to operate as a workers' compensation underwriter in Western Australia will be required to sign a licensing agreement which specifies the code of performance and performance targets which will form the basis of their approval. The insurer's continued approval to operate within the scheme will be totally dependent upon achieving their licensing agreement within the scheme.

4. The "Employers' Indemnity Policy" as defined in the *Employers' Indemnity Policy (Premium Rates) Act 1990* must provide compulsory insurance cover for both statutory workers' compensation and common law benefits.
5. The recommended premium rates issued by the ARA will be inclusive of statutory and common law costs. The provisions of section 152 and 153 of the *Workers' Compensation and Rehabilitation Act 1981* will apply to the recommended premium rate issued for the Employers' Indemnity Policy.
6. Premiums be paid on the actual gross wages for each employer only. The actual amount of gross wages to be certified by the employer's public officer.
7. Premium rates to be determined by the ARA and be based on the risk associated with each industrial classification exclusive of the underwriter's service cost/margin, brokerage, stamp duty and GST. The risk rate will form the future recommended premium rate.
8. The maximum loading of 100% of the new recommended premium risk rate will be maintained.
9. Surcharging of 50% or more of the recommended premium risk rate to be explained on the policy renewal, based on a transparent methodology which takes into account:
 - ◆ Risk management plan in operation;
 - ◆ Occupational health and safety procedures;
 - ◆ Gross estimated wages which has been certified by the Public Officer;
 - ◆ Average claim size for the employer;
 - ◆ Average claim size as a percentage, above/below when compared with rating class average;
 - ◆ Claim frequency as a percentage; and
 - ◆ Claim frequency as a percentage, above/below when compared with rating class average

The methodology used to load recommended premium rates will form the basis for the determination of appeals by employers.

10. Employers continue to have the right of appeal against their industry classification and premium assessment. Premiums will be paid up-front and payments or refunds to be paid following the result of the appeal/s.
11. The statistical results of the annual actuarial assessment at ANZSIC classification level will be made available publicly to assist the industry to understand the performance of the scheme and for employers to understand their performance against their industry group.
12. The Authority's Employer Registration Number to be incorporated with the employer's ANZSIC classification code as the basis for current and future premium rating purposes, and to maintain the accuracy of the data to the scheme through the appropriate declaration of wages and claim costs.

Term of Reference No. 4

Strategies adopted must focus on correcting the problems experienced by Western Australia, rather than adopting methods, which at face value appear to offer solutions. Consequently, it is recommended:

1. Insurers should be encouraged to enter long-term agreements with employers, providing up-front discounts for claims experience and on a three year rolling basis.
2. Small to medium employers should be encouraged to explore the opportunities to seek group insurance, whereby an approved insurer underwrites the risk and manages the claims for groups of employers. Alternatively, employers may wish to seek opportunities for an approved insurer to underwrite the risk but their claims are managed by the employer.
3. The ARA develops strategies to clearly target a reduction of the cost of long-term claims duration in partnership and in consultation with industry, individual employers and their insurers.
4. The ARA develops educational strategies which focus on:
 - ◆ Encouraging all employers to focus on injury prevention; risk management and injury management;
 - ◆ Targeting industries and employers with poor performance by highlighting the opportunities and resources to improve injury management practices and either contain or reduce costs; and
 - ◆ The provision of an interactive information service by the ARA including an exchange of information with other regulatory bodies, including WorkSafe Western Australia.

5. Provide opportunities for group self insurance including mutuals.

Term of Reference No. 5

Opportunities can be made available to responsible employers or groups of employers who are committed to competent management philosophies relating to human resource management, prevention and injury management. This is particularly in view of the capacity to expand the self insurance market from 9.5% to 20-25% of the Western Australian notional premium. Therefore, it is recommended:

1. Smaller to medium employers to be provided with the opportunity to seek self insurance through group self insurer mutual schemes.

The ARA is to develop guidelines appropriate for the regulation of group self-insurance mutuals.

The ARA is to develop performance indicators for monitoring the performance of group self-insurance mutuals. The performance indicators will reflect the requirements of the strategic plan which will be developed by the ARA and should add value for the operation of the group self insurance mutuals.

2. The ARA be given the discretionary powers to approve new applications for self insurance and applying a bond which has regard to:
 - ◆ Structure and extent of retained risk within the mutual and the quality of reinsurance;
 - ◆ The corporate values of the employer particularly towards the management of its workforce;
 - ◆ Past claims experience of individual group members; and
 - ◆ Proposed claims management.

The financial position of the prospective self insurer will be determined by employer's ability to acquire a bank guarantee.

3. The current guidelines for approving new applications for self insurance and for reviewing their performance be maintained with modifications to the claims management component of the performance indicators in line with the strategic plan which will be developed by the ARA.
4. Annual performance reviews of self insurers and group self insurers be continued by the ARA.

Term of Reference No. 6

Following an examination of the role of insurance brokers in the workers' compensation system together with an analysis of the nature of the services they provide employer, it is recommended:

1. Costs of optional services provided by insurance brokers to be transparent, therefore the allowance for brokerage in the recommended premium rate be removed and commissions and all incentives related to or for workers' compensation insurance, paid or payable, be disclosed on renewal notices issued by the approved insurer.
2. A copy of the original renewal notice from the insurer to be forwarded to employers by the insurance brokers to ensure the insurance company is known to the employer.

OTHER WORKERS' COMPENSATION ISSUES

The issues particularly relate to the current operation of the Conciliation and Review Directorate (Directorate) concerning:

1. The perception that the Directorate does not operate independently of the regulator or approved insurers because it is funded by the insurers.

Strategies need to be developed to emphasise the independence of the Directorate, that is, it is directly accountable to the Minister for Labour Relations and administratively responsible to WorkCover WA.

Further the Reference Group suggests the changing of the name of the Directorate from the WorkCover Conciliation and Review Directorate to the *Office of Dispute Resolution, Workers' Compensation (ODR)*.

The fact funds are provided by employers in the form of a levy on premium also needs to be widely publicised.

2. The perception Conciliation and Review Officers lack independence in the dispute resolution procedures because of their familiarity with insurer personnel.

Review participants suggested it may be appropriate to draft a code of conduct for Conciliation and Review Officers operating at the Directorate to minimise the perception that these officers are overly friendly with staff from insurance officers and therefore there is a degree of bias towards insurers.

3. Conciliation Officers are to be given the power, under the Act, to cease or adjust weekly payments of workers' compensation.

Conciliation Officers have the power to order commencement of weekly payments of compensation, a reciprocal power to cease payments is consistent.

4. There is a need for an advisory service at the Directorate.

An advisory service is required to inform injured workers and employers regarding the process and procedures used by Conciliation and Review Officers.

Workers have advised that the dispute resolution process is daunting, particularly without legal representation. Many of these workers have had no experience with dispute resolution of any kind.

Both workers and employers would also benefit from the provision of a self service information system which outlines typical disputed cases and specifies the process and likely outcomes of the case.