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Mr Mike Woods  
Presiding Commissioner  
Inquiry into National Workers Compensation and OH&S Frameworks  
Productivity Commission  
Po Box 80  
**Belconnen ACT 2616**

18 February 2004

Dear Commissioner

ICA makes this further Submission to the Inquiry into National Workers Compensation and OH&S Frameworks on behalf of ICA members, all of whom are licensed insurers and subject to the *Insurance Act 1973*.

Specifically, this submission expresses ICA's views on various parts of the Commission's Interim Report and it also responds to some questions asked of the ICA.

## **1. ICA response to the Interim Report**

For the most part, ICA supports the recommendations made by the Commission in its interim Report. Specific comments are made briefly below:

### **Occupational Health and Safety**

ICA sees three key areas of OH&S, namely standards setting, the provision of information, assistance and education, and enforcement and prosecution. In spite of the fundamental tension between these objectives, they tend to each remain the responsibility of the relevant authority in each jurisdiction. Therefore, ICA believes that it is important for processes to exist whereby employers have the capacity to seek assistance, either in terms of just gathering information or assistance directly on the work site, without fear of potential prosecution.

Given the obvious resource constraints of regulators, the insurance process can make a significant contribution to identifying effectively unsafe workplaces (through claims) often before regulators are able to formally conduct inspections. The important interaction of the insurance process with those of OH&S authorities needs to be recognised, with steps being taken to ensure those links are in place and operate effectively.

### **The prudential regulation of self insurers in any national Workers' Compensation framework**

ICA supports the concerns of the Australian Government Actuary, Mr Peter Martin, where he draws attention to the very long-tailed nature of workers' compensation liabilities under the current Comcare model, including the real prospect of periodic payments for an injured employee

through to retirement age. This has enormous implications for the prudential regulation of self-insurers under a self insurance model.

In addition to establishing the value of the liabilities, the prudential regulation of self insurers requires that you continually assess the financial viability of their business - a task that no regulatory authority in Australia currently attempts. It is unavoidably difficult to ascertain the long term viability of a corporation - to which the failures of Ansett, HIH and One-Tel testify.

One solution to this problem is through the appropriate use of insurance to either a low, or perhaps even ground, level of internal exposure, with cover being provided by APRA licensed insurers. As the law currently stands, it is only through APRA licensed entities that the Commonwealth Government can be assured of effective prudential regulatory oversight of the balance sheet of the organisation carrying the long term financial risk.

### **The capital required for a privately underwritten national Workers Compensation Scheme**

ICA supports the Commission's Interim Report recommendations that a staged approach to nationally consistent workers' compensation be implemented. A major advantage of such an approach is that it gives the insurance industry a gradual increase in exposure to those financial risks over time and negates the need for significant amounts of capital immediately.

The extent to which the risks and costs are predictable and manageable over time will strongly influence the degree to which both insurers and the providers of capital to insurers are prepared to be involved in and carry the financial risks underwritten by the insurance process. . it is currently the case that four of the five largest general insurers in Australia are listed on the Australian Stock Exchange, with the capital for those Australian listed corporations coming largely from domestic investors and international investors. If the benefit structure and the scheme's operations are reasonably stable and can be priced with confidence, it is certainly likely that capital will be made available for this type of business.

It is also worth noting that owing to its long tailed nature, workers' compensation is extremely capital intensive and requires the provision of capital of between 100 to 150 percent of premium income. In contrast, short tailed lines of business (motor vehicle property / householders) might be adequately supported by capital of between 35-40 percent of premium income.

### **Competitive private provision - Western Australia (Box. 10.1, p. 247)**

ICA believes that the experience in Western Australia was not an issue relating to private underwriting of insurance, but rather one of scheme design.

The amendments in 1993, which were intended to deal with the high costs of common law claims, included a new provision for access to common law damages, which became known in the industry as "the second gateway". There was already a common law threshold introduced as a primary gateway for access to common law, which was an impairment threshold, and the second gateway was intended to allow a very small number of claims where the impairment threshold was not met but common law damages were still thought to be appropriate.

It was anticipated that the second gateway would permit approximately 100 claims a year, yet when it was closed in 1999 it was allowing around 2500 claims a year. The full extent of the

problem only became apparent in 1997/98 and once this was so, insurers had little choice but to increase premiums significantly. The government was given advice, from ICA and their own actuaries, that if nothing was done, insurers would need to continue to increase prices. Consequently the WA Government did act to close the second gateway.

While the difficulties in that scheme were not a problem arising from private underwriting, it was the private insurance process that forced the government to examine and remedy the issue and proved the catalyst for positive change. This was because the increasing claims costs would have to be passed on to employer in the form of higher premiums, unless steps were taken to fix the scheme design issue. We note that in other jurisdictions, governments have been reluctant to find remedies for cost increases, resulting in large unfunded liabilities.

## **2. Specific questions raised of the ICA by the Commission**

**Were a national scheme for (large) self-insureds to be established - by how much would premiums rise in the state/territory jurisdictions owing to the administration costs (overheads) of those jurisdictions being spread over a smaller pool?**

As many major corporations are already self insurers in the various jurisdictions across Australia, it would appear to be the case that there would be little change in premiums as a result of a national self insured scheme. A caveat to that statement, however, is where a significant industry player currently not self insured seeks to become self insured. That is, if a single employer represents the bulk of employment in a particular industry and they became a self insurer, then there may be some escalation in rates for that particular ANZIC code owing to the loss" of that large employer (or employers).

To give the Commission some indication as to the current level of scheme administration costs, WorkCover Tasmania currently charges an administration levy of 2.125% to insurers, and the market has around \$100 million in premiums. While the effect on remaining employers arising from self insureds opting into some national scheme is hard to quantify, it does appear minor given the low level of administration costs currently incurred.

**What data can ICA provide on the leakage from Workers' Compensation to Public Liability as a result of contracting and other forms of "non-traditional" employment relationships?**

ICA is not aware of any specific data. It is an issue that has been raised on a number of occasions and warrants further study to determine what exactly is happening to non-traditional employees, and the extent to which public liability insurers are in fact bearing the cost of work related injury.

**What are the effects that access to common law payments have on the incentive to return-to-work?**

It is important to note that it isn't just common law payments, but also lump sum payments that can be attractive to some claimants. It is essential that any access to lump sums does not interfere with injury management objectives.. It is highly desirable that the overall design is geared towards the primary focus being effective injury management and return-to-work outcomes, rather than financial compensation.

Lump sum payments can be a disincentive to the effective operation of the injury management process and ICA is firmly of the view that lump sum access should be dependant full cooperation in a rehabilitation and return-to-work program. ICA makes special note of the NSW CTP compensation scheme which is a common law scheme, but nonetheless places strong emphasis upon early and effective injury management. For further information, please refer to the NSW Motor Accidents Authority (MAA) website: <http://www.maa.nsw.gov.au>.

**Can ICA provide the Commission with information on the premium setting process under the insurance model and how premiums are set for small / medium / large entities and the extent of any pooling and cross-subsidisation?**

In the privately underwritten jurisdictions there is no set methodology to calculate premiums and the process remains a commercial matter for each insurer. However, ICA expects that there would be few, if any, cross subsidies in a privately underwritten model unless forced upon insurers by some regulatory process. The reason for this is that the competitive dynamic of the market would act as an effective restraint on the "loading up" of certain policies so that others could effectively be underpriced.

However, cross subsidisations in some jurisdictions do occur and NSW CTP is an excellent example of mandated cross-subsidisation. MAA premium filing guidelines prevent insurers from charging a full-risk premium to young male drivers thereby forcing the industry to operate on a cross-subsidised basis in favour of young males but to the detriment of other drivers.

What follows is an extract from our initial submission that may also assist in answering the Commission's question.

### **5.2.1 Small, medium and large businesses**

**There are differing risk properties of small and large firms and insurers treat each differently and reflective of their profile.**

**A large corporate, that is a major employer either within or between jurisdictions, has, among other things, a significantly different risk profile to an individual small business. This is because as a large employer their workers compensation risk is, in effect, pooled and therefore more stable and predictable over time. A claim against a large employer is also mitigated by the opportunity to recoup premium revenues.**

**Conversely, it is often necessary to "pool small business risks, such that the premium level reflects a category based on some common element, such as size or industry. As individual employers, each represents a significant risk to an insurer. The probability of a claim, although perhaps low, could result in a payout far in excess of any expected premium income. If a small employer were individually risk rated, a one-in-ten year claim would have an enormous effect on its future premium levels. Hence insurers collect these risks and price premiums according to the industry or group. This has clear mutual benefits, as the bigger the pool, the less the volatility for both the insurer and the insured.**

**For small businesses, the prime factor is the risk of the industry, whilst for the large employers, it is their individual (corporate) risk. Within the ambit of medium sized businesses, it is a combination of claims based and industry experience. It holds that the smaller the business is, the greater weight is placed upon industry, rather than individual experience, and vice-versa for larger employers.**

*Source: ICA, 2003, Submission to the Productivity Commission Inquiry Into National Workers Compensation and Occupational Health & Safety Frameworks, June 2003, pp. 19-20.*

Should ICA be able to provide the Commission with any further assistance, please do not hesitate to contact us.

Yours sincerely

   
Dallas Booth  
**Deputy Chief Executive**