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# The Role of Incentive Measures in Workers' Compensation Schemes

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## **The Role of Incentive Measures in Workers' Compensation Schemes**

### **Abstract**

Workers' Compensation Schemes have a large number of participants, including injured workers, employers, administrators and external service providers. The behaviours of these participants have a significant impact on the outcomes achieved and costs incurred by the scheme. Incentive Measures are one way schemes can influence participant behaviour.

For each participant in a Workers' Compensation Scheme, in the context of specific scheme outcomes, we summarise key participant behaviours and the factors which influence those behaviours, with a focus on Incentive Measures. We draw on examples from both the Australian and international environments.

We propose an Incentive Measure management framework that describes the establishment and management of incentives. We then discuss challenges such as the potential for gaming, barriers to optimal decisions, measurement of success and getting buy-in from participants.

*Keywords: Incentives, Outcomes, Accident Compensation, Scheme Design, Workers' Compensation*

# The Role of Incentive Measures in Workers' Compensation Schemes

## Table of Contents

1.	Introduction.....	4
1.1.	A Working Definition of “Incentives” .....	4
1.2.	Roadmap for the Paper .....	4
2.	Incentives in a Workers' Compensation Context .....	5
2.1.	Who are the Scheme Participants we need to Incentivise?.....	5
2.2.	What is an “Incentive Measure”? .....	6
2.3.	Prevention of Workplace Injuries or Illnesses.....	6
2.4.	Optimising Injury Outcomes through Return to Work.....	8
3.	Managing Incentive Measures .....	10
3.1.	Scheme Objectives .....	10
3.2.	Identify Behaviours that you want to Change .....	12
3.3.	Identify and Assess Appropriate Incentive Measures .....	13
3.4.	Implement Incentive Measure .....	15
3.5.	Monitor Behavioural Impacts and Measure Outcomes .....	16
3.6.	Conclusion.....	17
4.	Workers' Compensation Incentive Measures Used in Australia .....	18
4.1.	Employer .....	18
4.2.	Injured Worker .....	25
4.3.	Medical and Rehabilitation Providers .....	27
4.4.	Scheme Agents .....	30
4.5.	Legal Providers.....	31
5.	Some Incentive Measures Used Overseas .....	33
5.1.	North America.....	33
5.2.	Europe .....	37
6.	Specific Incentive Challenges in Workers' Compensation .....	39
6.1.	Perverse Incentives and Unintended Consequences.....	39
6.2.	Measurement of Benefits.....	40
6.3.	Specific Design Challenges for Small and Medium Sized Employers.....	41
6.4.	Getting Buy-in from Scheme Participants.....	41
6.5.	Interactions with Other Systems.....	42
7.	Conclusion & Summary .....	43
8.	Acknowledgements.....	44
9.	References.....	45
10.	Endnotes .....	47

# 1. Introduction

## 1.1. A Working Definition of "Incentives"

Incentives are widely used in society today and come in many different shapes and forms. Incentives can be defined as:

*“any factor (financial or non-financial) that enables or motivates a particular course of action, or counts as a reason for preferring one choice to the alternatives. It is an expectation that encourages people to behave in a certain way.”<sup>1</sup>*

Incentives arise in many different situations and have many different structures in order to influence behaviours. Incentives may be *reward* incentives or *fear of penalty* incentives.

Some examples of non-workers' compensation incentive schemes that have been used or proposed within Australia include:

- Reward schemes are now commonplace in Australian society<sup>2</sup>, where buyers are incentivised for their purchasing loyalty to a company or group of companies through the accrual of rewards.
- The Home Insulation Program<sup>3</sup> was introduced in February 2009 to incentivise homes to install ceiling insulation in an effort to reduce future carbon emissions.
- The First Home Owner Grant was introduced in 1 July 2000 to offset the effect of the Goods and Services Tax on home ownership in an attempt to incentivise new home building behaviours of first home buyers.
- The Australian Government's plan to introduce a Carbon Tax<sup>4</sup> is aimed at incentivising investment in clean and renewable energy sources.

These incentives are well known within Australia and each scheme has had, or is likely to have, behavioural impacts on our society.

## 1.2. Roadmap for the Paper

This paper focuses on incentives used in workers' compensation schemes. Incentives have been used as a part of scheme design for many years to influence scheme participant behaviours. There is a wide array of literature that has analysed the success, or otherwise, of these incentives. Many principles discussed in this paper may be suitably transposed for use within other accident compensation schemes, while other principles remain specific to workers' compensation schemes. Where appropriate, we draw on examples from sources other than workers' compensation.

The rest of this paper is structured as follows:

- Section 2 describes incentives in a workers' compensation context.
- Section 3 introduces a framework for managing incentives.
- Sections 4 and 5 describe incentives used in Australian and overseas workers' compensation schemes respectively.
- Section 6 discusses some challenges in managing incentives.
- Section 7 provides a summary of the key conclusions.

## 2. Incentives in a Workers' Compensation Context

Workers' compensation insurance provides wage replacement and medical and rehabilitation benefits for employees who suffer from workplace injury or disease. Each state in Australia has some form of compulsory workers' compensation, although the benefit structure and operational model varies between jurisdictions.

Two key objectives of these schemes are generally: the prevention of workplace injury and disease through the provision of safer workplaces, and ensuring a timely return to work after injury. We discuss this further in Sections 2.3 and 2.4.

Perhaps ironically, the existence of an insurance based workers' compensation benefits system can create a number of perverse incentives which may act counter to these scheme objectives. This occurs through the creation of moral hazards, for example:

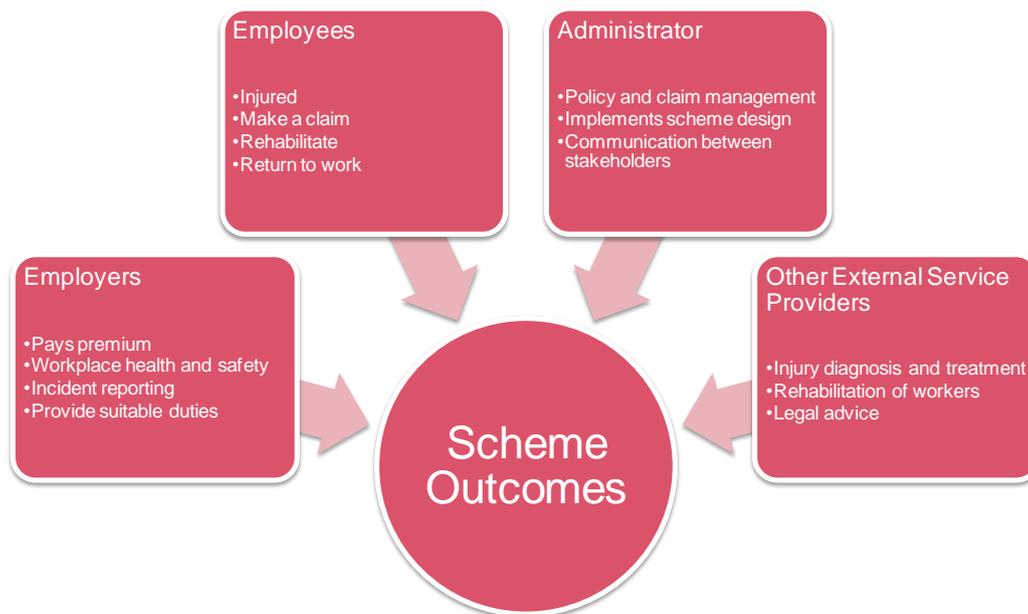
- Employers may pay less attention to workplace safety if they know that they are covered by insurance in circumstances of workplace injury or disease
- Once a worker is on compensation benefits there may be a reduced incentive to return to work if the insurance benefits are overly generous
- Workers may have a financial incentive to falsely report non-work related injuries as workers' compensation claims

There are a number of ways for schemes to counteract these perverse incentives, and the use of incentives to influence participant behaviours is one possible response.

### 2.1. Who are the Scheme Participants we need to Incentivise?

There are a number of key participants in a workers' compensation scheme with differing roles in the prevention of injuries and the recovery of injured workers. The following diagram shows some of these participants and their roles within a workers' compensation scheme.

Figure 1- Participant Roles in a Workers' Compensation Scheme



We note that private sector insurers may be active participants in the scheme in a number of different capacities, including being the primary providers of insurance (in the case of private

## The Role of Incentive Measures in Workers' Compensation Schemes

sector schemes) or as administrators (in the case of public sector schemes that outsource their administration functions).

The behaviours that participants demonstrate while performing their roles has a large influence on scheme outcomes. The design of appropriate incentives should encourage participant behaviours that are aligned with the schemes objectives.

### 2.2. What is an “Incentive Measure”?

In this paper we refer to an “Incentive Measure” as a component of a workers' compensation scheme's design that rewards or penalises a participant for certain behaviours or outcomes. Incentive Measures may be used to influence a variety of different types of behaviour. The most commonly used Incentive Measures in workers' compensation schemes target improved workplace injury and disease outcomes, and these are the focus of this paper.

For an Incentive Measure to be effective in improving injury and disease outcomes it should be successful in either the:

- i. Prevention of injuries or illnesses - by improving the safety of the surrounding workplace environment; or
- ii. Optimisation of longer term injury recovery or disease management once an injury has already occurred – this may be achieved by either improved recovery outcomes or reduced costs for a similar outcome.

Other types of Incentive Measures may also exist within workers' compensation schemes to achieve other scheme objectives or to support broader social initiatives.<sup>5</sup>

### 2.3. Prevention of Workplace Injuries or Illnesses

There have been significant reductions in scheme incidence rates over the last two decades. For example, the following chart shows the reduction in claim frequency per 1,000 workers within the WorkSafe Victoria Scheme over the last 9 years.

Figure 2- WorkSafe Victoria Claims per 1,000 Workers over Time



Source: WorkSafe Victoria Annual Reports

## **The Role of Incentive Measures in Workers' Compensation Schemes**

The WorkCover NSW 2009/10 Annual Report notes a 38% reduction in major workplace injuries since 1999/00 and a 58% reduction in work related fatalities incidence rate since the scheme commenced.<sup>6</sup>

What is less clear is the attribution of the causes of these improvements. Much of the improvements are likely due to improved Occupational Health and Safety (OHS) regulations, technological advances, employers taking a more active interest in workplace safety and a changing industry mix.

However, part of this improvement is likely to be due to the use of Incentive Measures. As this paper highlights in Sections 4 and 5, the use of Incentive Measures to change the behaviour of scheme participants is common and can be a powerful tool in pursuing scheme objectives.

We now describe some of the forces that influence workplace safety.

### **2.3.1. Labour Market Forces**

Economic theory suggests that the labour market will act as an OHS regulator over time. The employer has an incentive to improve OHS when the marginal cost of making jobs safer outweighs the cost of increased remuneration that is required to be paid to employees for the perceived risks of the job. One way they may do this is by utilising safer technologies. This incentive is most obvious in highly hazardous industries where the risk of injury can be a real consideration in whether to accept a job. As a result, high risk occupations may require large increases in remuneration to attract labour. This theory is discussed in more detail in many other papers.<sup>7</sup>

There are some obvious limitations to this theory:

- There is an assumption that employees are able to accurately assess the level of occupational risks. It may be difficult for employees to adequately assess occupational risks, especially for disease related risks.
- There is an assumption of the perfect transferability of employment. In practice there are significant frictional costs associated with changing employment.

Nonetheless, labour market forces may be regarded as a form of Incentive Measure that should gradually improve OHS practices over time.

### **2.3.2. Regulation**

Governments can legislate OHS requirements through their regulatory framework. There is a strong incentive to comply with these OHS regulations because it is the law. Non-compliance is breaking the law and can lead to severe financial penalties or, in more extreme cases, lead to a company going out of business. There are also reputational risks associated with non-compliance.

The use of regulation can be an effective way to manage known and important risks. Some good examples of regulations that have worked well in targeting specific known risks can be found within the Compulsory Third Party (CTP) environment. Regulation has been effective in helping to reduce risks associated with speeding, drink driving and traffic light infringements. Further, the success of these regulations has been influential in changing general societal attitudes to some of these risks, as a result of both the "fear of penalty" and through targeted media education campaigns over sustained periods of time.

Similarly, regulation has been successful in Workers' Compensation schemes. For example, McInnes et al (2009) describes some of the major reasons for the reduction in the NSW claim incidence experience over the last 20 years. A large proportion of this improvement is

## **The Role of Incentive Measures in Workers' Compensation Schemes**

attributed to the creation of safer workplaces that have been achieved within the policy framework created by the *Occupational, Health and Safety Act 1983*.

There are some limitations to the effectiveness of regulation:

- It may be difficult to efficiently enforce regulations and pick up non compliance. Workplace audits, for example, can be both time consuming and expensive.
- Regulations are not firm specific and may not take into account important variations in work practices, for example technological variations between employers.
- Employers may need to spend time and energy in compliance rather than responding to underlying safety issues.
- The threat of penalty may not be sufficient incentive to improve OHS practices unless there is a high enough probability of inspection.
- Regulation can respond well to known risks but can be less effective in managing emerging risks.

The regulatory approach can be enhanced through the use of financial disincentives such as fines or other penalties, to the extent that these are significant enough to incentivise behaviours. In any case, it makes good business sense for employers to comply with regulations because it leads to safer workplaces (and hence lower injury and disease rates within the workplace), satisfies employer's moral responsibilities and can be used to enhance an employer's brand as an employer of choice.

### **2.3.3. The Use of Incentives Measures in OHS**

Incentives are another tool that can be used to provide continuous improvement to both known and emerging risks. This is one of the key advantages of using incentives rather than direct regulation, which generally only prescribes a minimum standard of OHS. A well set up and managed set of Incentive Measures can be used to promote better practice OHS risk management.

### **2.4. Optimising Injury Outcomes through Return to Work**

Once an injury or disease has been sustained, the management of the injury or disease is of great importance. There is a growing acceptance that early intervention in an injury, appropriate treatment and early return to work is crucial in ensuring an optimal outcome for the injured worker.

There are a number of challenges in optimising injury outcomes as a result of a worker's compensation scheme. These include:

- There may be a perverse incentive for employees to remain off work and access additional compensation benefits. For example, there are various time and impairment thresholds that may need to be attained to access certain lump sum benefits, and weekly compensation may be seen as an attractive remuneration substitute while off work.
- There is a need to balance long term outcomes against short term costs. There may be the temptation to minimise short term treatment costs, however this may not be in the best long term interests of the worker. Thus, the trade-off between bulk billed standardised treatments versus more tailored and potentially more expensive approaches needs to be considered. Long term sustained recurrence of injury can be a major scheme cost.
- The interaction of a workers' compensation scheme with other social security systems needs to be considered. For example, Selander (2006) discusses the

## **The Role of Incentive Measures in Workers' Compensation Schemes**

disincentive for some cohorts of Swedish workers to return to work. This is because once workers' compensation benefits are considered in conjunction with other social security benefits, some workers may be just as well off financially whether they are at work or not.

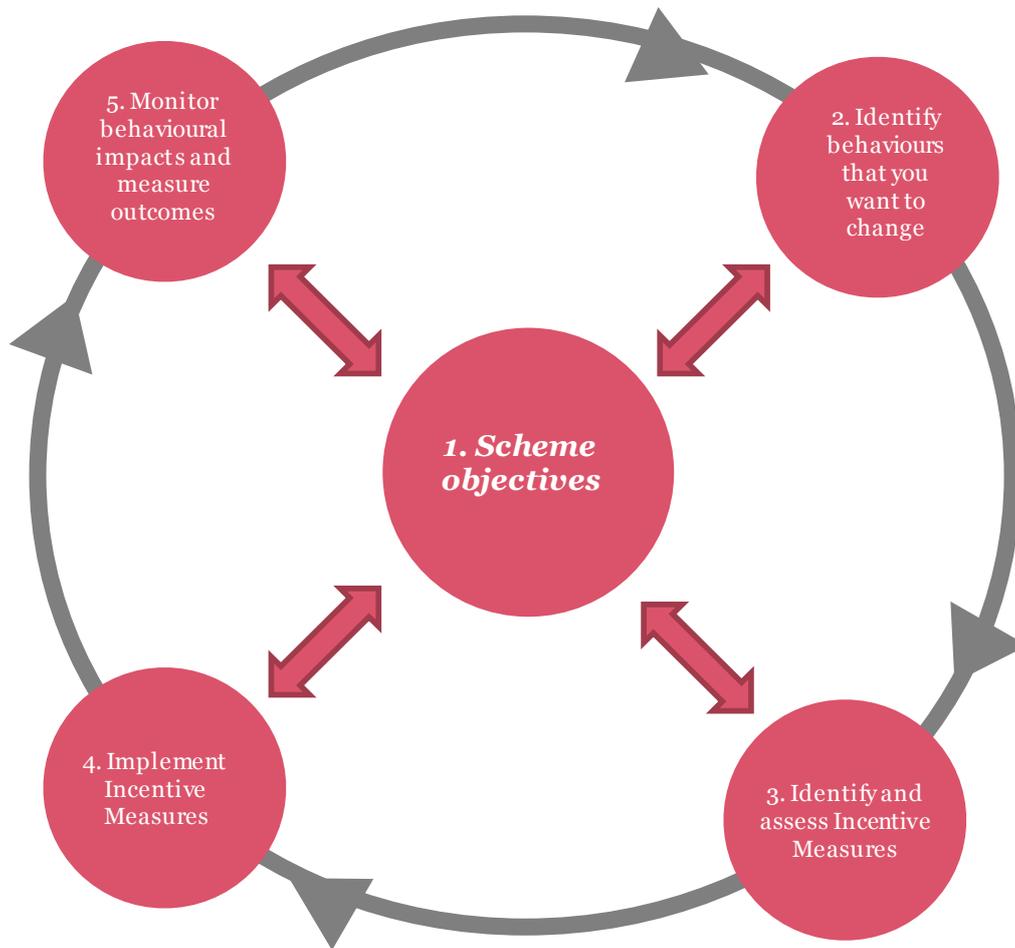
These challenges can lead to undesired behaviours by the scheme participants and can work against the return to work goals of the scheme. Incentive Measures can be used to address these behaviours and achieve better injury recovery outcomes.

### 3. Managing Incentive Measures

We have reviewed an array of literature that discusses the use of incentives within workers' compensation schemes, as described in Sections 4 and 5 of this paper. This review has led us to observe certain themes and trends which appear to influence the success or otherwise of Incentive Measures.

This section proposes a framework to assist in the successful design, implementation, assessment and management of an effective Incentive Measure. The following diagram is a summary of this framework.

Figure 3- Incentive Measure Management Framework



#### 3.1. Scheme Objectives

No two workers' compensation schemes are the same. Each scheme has its own objectives, its own strategies to align the direction of the scheme with those objectives and its own execution challenges. The first step in the proposed framework is to establish the objectives of the scheme and express them as a number of measurable targets.

Table 1 provides hypothetical examples of the opportunities that could be targeted by a scheme to progress with its objectives.

## The Role of Incentive Measures in Workers' Compensation Schemes

**Table 1: Examples of Targeted Opportunities**

Scheme Objectives	Targeted Opportunities
<i>Reduce the number of workplace injuries or disease</i>	<ul style="list-style-type: none"> <li>• Reduce claim frequency for musculoskeletal injuries</li> <li>• Reduce agricultural industry claim rates to comparable levels with other jurisdictions</li> <li>• Reduce claim frequencies for smaller employers</li> <li>• Target reduced deafness claims using preventative measures</li> </ul>
<i>Improve the return to work rates of injured workers</i>	<ul style="list-style-type: none"> <li>• Reduce the delay between injury and first medical treatment to allow early intervention in treatment of injuries</li> <li>• Improve the rates of redeployment of injured blue-collar workers to white collar roles</li> <li>• Respond to the increasing emergence of newer injury claim types, such as stress claims</li> </ul>
<i>Provide a fair level of compensation and support, proportionate with the level of impairment</i>	<ul style="list-style-type: none"> <li>• Improve the effective management of lifetime care and support claimants to comparable benchmark schemes</li> <li>• Reduce the utilisation of common law or lump sum benefits</li> </ul>

Targeted opportunities can exist at a number of different levels. Table 1 gives examples of opportunities for specific injury types and industry groups, as well as scheme wide opportunities (e.g. common law utilisation).

There are likely to be a number of good starting points for identifying these opportunities, such as:

- Scheme monitoring reports
- The findings of targeted claim file reviews
- The commentary contained in actuarial valuation reports
- Data mining and other statistical analysis
- Benchmarking experience with comparable schemes

It is important for the scheme to establish targets for each opportunity, and use Key Performance Indicators (KPI's) to monitor the success, or otherwise, of the Incentive Measure. These targets can be short or long term in duration, but should represent the end outcome that is desired. These targets should be established prior to implementing an Incentive Measure and be SMART, that is (S)pecific, (M)easurable, (A)chievable, (R)ealistic and (T)imebound.<sup>8</sup>

## The Role of Incentive Measures in Workers' Compensation Schemes

Table 2 gives examples of setting a KPI for two example opportunities.

**Table 2: Example of SMART Target**

Targeted Opportunity	SMART Target
<i>Reduce the claim frequency for small employers</i>	Frequency, defined as claim numbers from small employers divided by wages to fall by 10% over two years. Quarterly reductions in the observed claims frequency of 1.25%.
<i>Improve the rates of redeployment of injured blue-collar workers to white collar roles</i>	Reduce the average return to work duration for the most recent accident year by 5%, compared to the previous year, measured at a one year development period

### 3.2. Identify Behaviours that you want to Change

Once targeted opportunities to improve scheme performance have been identified, the next step is to determine the stakeholder behaviours that might limit the success of these opportunities. Thus, the relevant stakeholders that will play a role in the targeted opportunity need to be identified, and then the behaviours that you need to overcome in order for the strategy to work need to be listed. We give an example in Table 3.

**Table 3: Identification of Behaviours that are Inconsistent with Scheme Objectives**

Targeted Opportunity	Relevant Stakeholder	Adverse or Inconsistent Behaviour(s)
<i>Improve the rates of redeployment of injured blue-collar workers to white collar roles</i>	Employers	<ul style="list-style-type: none"> <li>Not cost effective to hire a worker with an injury history. Retraining is costly and there is a risk of re-injury that could result in higher workers' compensation premiums, excess costs and disruption to the business.</li> </ul>
	Injured workers	<ul style="list-style-type: none"> <li>A reluctance to change from blue collar to white collar roles.</li> <li>Do not have the skills for the new role and it requires significant effort to develop them.</li> </ul>

Identification of the stakeholders' behaviours that are inconsistent with scheme objectives is a crucial part of the framework, as it is these behaviours that the introduced Incentive Measures will need to change.

A good example of the successful targeting of specific behaviours that are inconsistent with scheme objectives has been in the CTP industry where drink driving behaviours were a significant contributor to road fatalities. The introduction in the late 1980's of various mass media campaigns acted as a moral incentive to change behaviours. This was also supplemented by significant financial penalties, potential loss of licence and an increase in the enforcement of these penalties through the introduction of booze buses and other breath testing equipment. These initiatives have contributed to almost halving the fatalities on the road in Victoria from these causes between 1989 and 2007.<sup>9</sup> This has also been successful in changing many societal attitudes towards drink driving and it is now more common to have designated non-drinking drivers within drinking groups or to make it more acceptable to take public transport or taxis when under the influence of alcohol. This is not to say that these campaigns and penalties have been fully successful, and while these reductions are significant

## The Role of Incentive Measures in Workers' Compensation Schemes

there are still ongoing campaigns that target specific drink driving behaviours, such as drink driving of those near the legal limit.

### 3.3. Identify and Assess Appropriate Incentive Measures

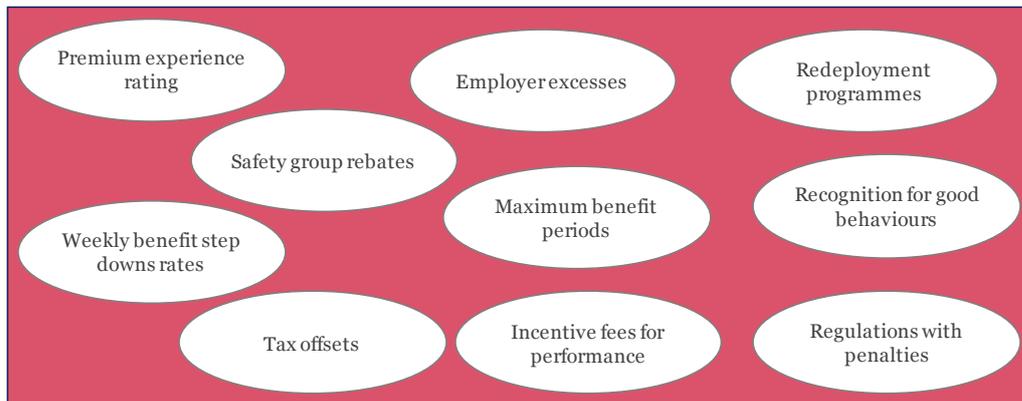
Incentive Measures are one tool that can be used to change the behaviours of individuals and organisations. This section discusses how to select the Incentive Measure that will best suit the opportunities that the scheme is pursuing.

We recognise that there are many ways to change behaviours, and there may be other non-incentive responses that can be used. Here we consider the options in those cases where Incentive Measures are considered the most appropriate course of action.

#### 3.3.1. Types of Incentive Measures

There are many different ways to incentivise behaviours. Sections 4 and 5 of this paper highlight a range of Incentive Measures that are used locally and overseas. The following diagram shows a summary of some of these types of incentives.

**Figure 4- Types of Incentives**



Selecting an Incentive Measure that best contributes to the scheme's objectives requires a number of considerations. The following section looks at the common characteristics that effective Incentive Measures share.

## The Role of Incentive Measures in Workers' Compensation Schemes

### 3.3.2. Characteristics of Effective Incentive Measures

Table 4 summarises the authors' thoughts on the design characteristics of effective Incentive Measures. Whilst some of these features are relatively straightforward, others are considered in greater detail below.

**Table 4: Design Characteristics of Effective Incentive Measures**

<b>Specific Outcomes</b>	<ul style="list-style-type: none"><li>• The Incentive Measure should relate to a specific tangible objective or outcome that has a high upside benefit.</li><li>• The reward or penalty provided by the Incentive Measure should be strong enough to change the targeted participant behaviour.</li></ul>
<b>Simple</b>	<ul style="list-style-type: none"><li>• The incentive should be simple to understand and implement. For example, can the Incentive Measure be explained and understood in less than a minute?</li><li>• It should not pose a significant administrative burden on either the scheme or the stakeholder, otherwise stakeholders may be unlikely to invest the time to understand the system, and hence to change behaviours.</li></ul>
<b>Cost and Benefit Analysis</b>	<ul style="list-style-type: none"><li>• The gain from the Incentive Measure should be commensurate with the cost of implementing it.</li><li>• The gains should be consistent with the KPI's set prior to implementing the Incentive Measure.</li></ul>
<b>Alignment with Other Incentives</b>	<ul style="list-style-type: none"><li>• The Incentive Measure should not detract from other Incentive Measures currently being used.</li><li>• The Incentive Measure should consider behavioural responses from all stakeholders, not just the targeted stakeholder – for example injured workers, employers, claim managers, administrators, medical providers, rehabilitators and solicitors.</li></ul>
<b>Support Innovation</b>	<ul style="list-style-type: none"><li>• The Incentive Measure should not necessarily constrain stakeholders to only deal with a problem in a certain way.</li><li>• The Incentive Measure should enable innovative strategies which lead to better outcomes to continue.</li></ul>
<b>Evidence Based</b>	<ul style="list-style-type: none"><li>• As far as possible, Incentive Measures should be designed using evidence based approaches.</li></ul>

### 3.3.3. Cost and Benefit Analysis

One of the more challenging aspects of making sure that an Incentive Measure is effective is measuring the costs and benefits of implementing it. Here we list some of the key issues that a scheme should consider.

## **The Role of Incentive Measures in Workers' Compensation Schemes**

### **Measuring the Cost**

There will generally be a cost associated with the introduction of an Incentive Measure and this should be affordable and sustainable. The assessment should include all costs associated with the Incentive Measure, and this may include:

- Education and communication costs associated with implementing the Incentive Measure.
- Up-front capital costs such as Incentive Measure development and Information Technology (IT) costs associated with managing the Incentive Measure.
- Ongoing administration costs including IT costs and reporting costs.
- Any expected future payments that would be paid to stakeholders as financial incentives.

### **Measuring the Benefits**

The anticipated benefits of the Incentive Measure should be direct and substantial. There are a number of challenges when assessing the benefits of introducing Incentive Measures and we provide a more thorough discussion of these in Section 6.2.

The starting point to measuring the expected benefits is to make sure the projections are consistent with the KPI targets you have set for the Incentive Measure.

For public sector schemes a broader societal perspective may be justified when assessing benefits. That is, benefits need not only be measured from a “premiums” or “claims costs” perspective but from potential gains in other publicly run “systems”, such as reduced public medical costs and reduced unemployment costs.

## **3.4. Implement Incentive Measure**

There are a number of issues to consider before implementing an Incentive Measure.

### **3.4.1. Testing of Incentive Measure**

It may be appropriate to trial the expected outcomes of the Incentive Measure on a subset of the scheme. This may be achieved through a number of different ways:

- The scheme could undertake a stakeholder consultation process with targeted workshops to test how stakeholders intend to change their behaviours in response to the Incentive Measure. Both intended and unintended consequences of the Incentive Measure need to be tested for and considered, including the potential for gaming, and any third party behavioural impacts.
- Pilot schemes are an effective way to test an Incentive Measure, although it is acknowledged that it can be difficult to evaluate pilot schemes in cases where there are long lead times between implementation and outcome.

These actions may enable the scheme to better understand which aspects of the Incentive Measure require further refinement. Should the Incentive Measure not perform as expected then a costly roll out to the entire scheme can be avoided.

### **3.4.2. Education and Buy-in**

Stakeholders who are impacted by the Incentive Measure need to be educated in advance of the Incentive Measure becoming “live”. Stakeholders need to trust and understand the Incentive Measure will react in the right way in order to commit to changes in behaviour.

Allowing voluntary participation in an Incentive Measure can help improve buy-in from stakeholders. In this case, the educative process is more important as stakeholders need to be aware of the initiative so that they can participate and adjust their behaviours accordingly.

## **The Role of Incentive Measures in Workers' Compensation Schemes**

Where the Incentive Measure is voluntary, the challenge is ensuring that there is sufficient uptake of the Incentive Measure to warrant implementation.

### **3.4.3. Administration**

The preparation of administration and monitoring systems should be completed so that the Incentive Measure can be implemented in a timely fashion. It may require time and money to set up appropriate IT systems or other infrastructure, such as audit capabilities or measurement capability.

### **3.5. Monitor Behavioural Impacts and Measure Outcomes**

Once an Incentive Measure has been implemented it is important to understand and be able to objectively evaluate the impact that the Incentive Measure has had. A scheme should monitor the outcomes resulting from the Incentive Measure and reassess its effectiveness periodically:

- The behavioural impacts of the Incentive Measure on stakeholders should be monitored against the KPI targets following implementation. This is important to ensure that the anticipated behavioural responses are occurring and there is appropriate stakeholder engagement.
- The coverage or uptake of the Incentive Measure should be assessed, especially for any voluntary Incentive Measures. It may be useful to gauge stakeholder engagement through surveys or discussions with stakeholders to understand how they view the Incentive Measure according to criteria such as:
  - knowledge of the existence of the Incentive Measure
  - understanding of how the Incentive Measure works
  - trust that the Incentive Measure will reward appropriate behaviours.
- Audits may be required to make sure that the Incentive Measure is being implemented correctly and as anticipated. This is especially important for Incentive Measures that require OHS hurdles to be satisfied to get rebates, subsidies or offsets.
- The emergence of any unintended behaviours should be considered. This can occur when the Incentive Measure creates perverse incentives that reward scheme participants for undesired behaviours. These behaviours may emerge from participants not directly targeted by the Incentive Measure.
- It is also useful to identify any indirect benefits in any cost and benefit analysis. This may include putting a benefit on absenteeism and “presenteeism<sup>10</sup>” A societal view of cost and benefits may also provide a different view to valuing stakeholder benefits. This would more completely measure the outcomes associated with improved OHS conditions, such as the lower reliance on other medical treatments that may arise from wellness programs.

This monitoring makes it possible to improve the effectiveness of the Incentive Measure by addressing any identified shortcomings of the Incentive Measure. The effectiveness of Incentive Measures should be retested over time, as each initiative may have a limited life span, as stakeholders better understand, and potentially game, the Incentive Measures, and as technological, social, and legislative conditions change. For example:

- The Incentive Measure may lose its appeal to stakeholders if the requirements (such as paperwork) become too onerous. The Incentive Measure may be too routine over time and become an expectation rather than being earned.
- Changing injury types, such as lower prevalence of acute trauma and higher incidence of musculoskeletal injuries, may require different strategies.

## **The Role of Incentive Measures in Workers' Compensation Schemes**

- Changing industry mix within a scheme may require different industries to be targeted over different periods of time.

### **3.5.1.Exit Strategy / Useful Life**

Incentive Measures which have lost their effectiveness in changing stakeholder behaviour, whether through flaws in design or changes to the environment, should be removed.

Implementing an Incentive Measure without a planned exit strategy can result in discontent for the stakeholders who benefited from the incentive once it is removed. This can make future incentives more difficult to implement as trust has been lost.

### **3.6. Conclusion**

The use of Incentive Measures is becoming more widespread within workers' compensation schemes to influence a range of stakeholder behaviours. An effective framework that assists in the design, implementation and management of these Incentive Measures, such as that proposed in this section of the paper, is important in ensuring that sound governance is maintained when managing these tools.

Our proposed framework covers the following key aspects:

1. Identify opportunities with SMART targets that are consistent with scheme objectives.
2. Identify the behaviours that you want to change that align with these opportunities.
3. Identify appropriate Incentive Measures to change these behaviours and ensure an adequate assessment of costs and benefits is performed.
4. Ensure that appropriate testing of the Incentive Measure is completed and that stakeholders are educated, with appropriate systems put in place prior to implementation.
5. Monitor the impacts of the Incentive Measure to ensure that it is having the correct behavioural impacts and remains appropriate for the times.

## 4. Workers' Compensation Incentive Measures Used in Australia

In this section we give a description of some of the main Incentive Measures used in Australia today. For each scheme participant, we list the Incentive Measures and behaviours they are most likely to impact. We have also subjectively rated the relationship between the Incentive Measure and the behaviour using the following symbols:

Symbol	Impact on behaviour
✓	Weak
✓✓	Strong
✗	Perverse

There are a variety of operating models used within Australia's workers' compensation schemes and this has influenced the types of Incentive Measures that are used to change stakeholder behaviours. For example:

- **Private Sector versus Public Sector Schemes**

Privately underwritten schemes typically involve a competitive environment where a number of insurers provide workers' compensation insurance. The insurers are generally motivated by profit and market share, to maximise their shareholders' value. This motivation may not necessarily align with better workplace safety outcomes. The use of workplace safety incentives outside of the workers' compensation scheme through a higher use of regulation may therefore be required.

Public schemes generally operate as a monopoly and may be able to take a broader approach. Their motivations may therefore be better aligned with wider societal outcomes, such as improving longer term health outcomes, in addition to any direct scheme benefits.

- **Scheme Administration**

The use of outsourced policy and/or claims administration providers, such as is currently used in NSW and Victoria, is another example of scheme structure that may require different incentive approaches. Care is needed to ensure that the motivation of these third party Agents are aligned with broader scheme objectives.

### 4.1. Employer

A workers' compensation scheme offers insurance coverage for an employer's workers on the occurrence of workplace injury or disease. The scheme coverage may also include self employed workers and contracted workers.

As discussed in the introduction of Section 2, the existence of an insurance scheme can create perverse incentives for employers and promote behavioural changes detrimental to OHS. An employer may have a limited incentive to improve OHS if covered by insurance in circumstances of workplace injury or disease.

Incentive Measures exist to counteract the perverse incentives created through the introduction of a worker's compensation scheme. It is important for Incentive Measures to

## The Role of Incentive Measures in Workers' Compensation Schemes

promote the right behaviours and limit the ability for participants to “game” or “cheat” the system.

The following table summarises some of the main employer Incentive Measures used in Australia today and the behaviours they are trying to change. We follow with discussion on each of these Incentive Measures.

**Table 5: Incentive Measures for Employers**

Incentive Measure	Targeted behaviour				
	Operational Health & Safety	Provision of Suitable Duties	Timeliness of incident reporting	Payment of Premium	Healthier workforce
Experience Rating	✓	✓			
Employer Excess	✓	✓	✓		
Return to Work		✓✓			
OHS inspections	✓✓				
Premium Discounts	✓				
Early claim reporting			✓✓		
Timeliness of premium payment				✓✓	
Internal Employer Incentives	✓	✓	✓	✓	✓
Workplace wellness	✓				✓✓

### 4.1.1. Experience Rating

Experience rating is a premium rating process where the claims experience of an employer is used in setting the premium paid by that employer. Most jurisdictions in Australia have a form of experience rating, with the form depending on both the operating structure of the scheme and the history behind the development of the scheme.

Experience rating may take several forms and different components may include:

- Future or historic employer claim performance may be included in the premium calculation.
- The period of claims experience assessment may vary, for example it may be the year the premium relates to or an average over previous years.
- The level of credibility given to an employer's experience will generally vary by employer size according to a credibility formula.
- There may be caps and limits applied on individual claims cost contributing to the experience rating to limit the impact of random large claims.
- The assessment of claims cost generally requires open claims to be increased for future expected claims development and the method used to do this may vary.
- There may be limits on the overall experience discounts or surcharges applied to the premium.

## The Role of Incentive Measures in Workers' Compensation Schemes

### Behaviours Targeted

There are three main justifications for the use of experience rating:

1. Claims cost can be more equitably allocated between employers, enabling those industries and employers with higher risks to pay a premium appropriate to their size and risk.
2. Allows greater competition between insurers in a competitive workers' compensation market.
3. Acts as an incentive to improve an employer's claim outcomes, indirectly incentivising employers to improve their OHS and return workers to employment sooner.

The last point is of significance to this paper, as experience rating tries to incentivise employers to provide safer workplaces and more effective return to work options. This should minimise both claim occurrences and the claims cost once injuries have occurred.

### General Discussion

There are mixed views on the ability of experience rating to improve OHS. There is a wide body of literature that contests the notion that experience rating significantly improves OHS.<sup>11</sup> There are also other significant limitations of experience rating. These include:

- Experience rating is only suitable for larger employers because smaller employers are subject to statistical fluctuation of claim outcomes, meaning that good luck rather than good management can lead to favourable claim outcomes.
- Even for larger employers the claim cost outcomes may reflect random injury outcomes in both the type of injury and the severity of the injury sustained. For this reason most experience rating programs will limit the contribution from large losses.
- The structure of the experience rating formula may result in significant lags between the outcome of the claims experience and the incentive result.
- There is some evidence that better "claim outcomes" can be achieved through experience rating. Although claims can be used as a proxy for OHS, there is no direct link between the two.
- Perhaps one of the greatest criticisms of experience rating is the perverse incentive of claims suppression and potential adverse behaviours for return to work:
  - The operation of experience rating may lead to claim suppression and this may lead to worse longer term outcomes where early injury intervention is not provided.
  - Employers may focus on the rewards of the experience rating rather than aiming to improve OHS and /or optimise injury or disease outcomes.
  - For industrial disease there may be no clear link to experience as the latency period may be upwards of ten years, providing a weak incentive to undertake preventative measures.
  - Once a worker is injured, an experience rating program may incentivise employers to either bring workers back to work too early or to have an adversarial relationship with injured workers due to the impact that additional claim cost may have on the employer's workers' compensation premium.

In summary, literature reviews of studies show moderate evidence that a well constructed experience rating scheme may lead to better claim outcomes. However, whether this incentivises behavioural changes that lead to safer workplaces is not clear.

## The Role of Incentive Measures in Workers' Compensation Schemes

### 4.1.2. Employer Excesses

Employer excesses operate by the employer bearing the initial cost of each claim up to a specified limit. This commonly operates as either a fixed dollar amount or a fixed number of days compensation since the injury has occurred. Each jurisdiction in Australia has different levels of excesses<sup>12</sup>.

#### Behaviours Targeted

Justifications for employer excesses may include:

- Like experience rating, employer excesses provide an incentive for employers to improve OHS and prevent injuries from occurring, as part of the initial injury cost is borne by the employer. The excess represents the financial cost that the employer has for each claim and acts to counteract one part of the perverse incentives of the existence of the insurance scheme.
- They prevent small claims from entering the main scheme. These claims can be frequent and relatively costly to administer. Any improvements in OHS in response to better managing the frequency of small claims can have flow in impacts by also reducing the frequency of larger claims.

#### General Discussion

The selected level of excess should balance the goals of being high enough that improvements in OHS are worthwhile to reduce the cost of claims, but not so high that small employers can get into financial difficulties as a result of a reasonable number of claims reaching the excess.

One of the potential problems with employer excesses is that if small claims are not reported then they may not receive appropriate medical treatment. They may develop into more serious injuries than if they had received the proper medical treatments in the first place.

We are not aware of any quantitative research into the relative effectiveness of different levels of employer excess, although we note that some literature exists on large deductible schemes available in the US.

### 4.1.3. Return to Work Employer Incentives

Return to Work Employer Incentives recognise that a swift return to work following recovery from injury is in the best interests of both the scheme and the injured worker. Employers play a key role in this process by providing a suitable position for the injured worker to return to.

Return to work incentives are typically financial incentives such as payments or discounts to an employer for a timely return to work for their employee. Non-financial incentives are also possible however, such as:

- Occupational rehabilitation support to assist the employer in preparing for the return of the injured worker (such WorkSafe Victoria's Original Employer Services<sup>13</sup>).
- Recognition of employers with good return to work experience, which can have a positive impact on their brand or reputation. This may be through Safe Work Awards which exist in many Australian states.

Incentives may exist for both the original employer, and new employers.

#### Behaviours Targeted

Justifications for return to work incentives include:

- Reduced cost to the scheme as full income replacement benefits are not required once the injured worker has returned to work.

## The Role of Incentive Measures in Workers' Compensation Schemes

- Alignment of employers interests with that of the scheme and worker.

### General Discussion

For original employers, there are often obligations to provide a suitable position for an injured worker. This regulation approach can be coupled with free occupational rehabilitation advice for the employer in order to make the transition back to work as smooth as possible for both employer and employee.

Some employers, typically smaller ones with limited alternative duties, may be unable to provide a suitable position for the injured worker. The injured worker may, however, be able to find work with another employer, and incentives may be paid to encourage these new employers to take on previously injured workers – such workers typically have a higher likelihood of requiring workers' compensation benefits in the future.

The Re-employment Incentive Scheme for Employers (RISE)<sup>14</sup> in South Australia is an example of this. The key elements of this incentive package are:

- reimbursement of 40% of the injured employees wages for their first year of employment with the new employer;
- consideration of payments for minor workspace modifications and equipment; and
- any aggravation of the previous injury is recorded against the original employer, not the new employer.

### 4.1.4. Operational Health and Safety Inspections

OHS refers to the conditions workers face in their workplace environment. Whilst good OHS will be reflected in improved workers' compensation claims experience, OHS is a much broader concept, and has many benefits beyond workers' compensation claims.

OHS inspectors are employed by schemes to enforce the regulated OHS requirements. The inspectors may have the ability to issue citations or penalties for workplaces that do not comply with the standards. The fear of inspection and penalty provides an incentive to employers to maintain minimum safety standards.

#### Behaviours Targeted

The justification for OHS inspections is that it can lead to improved safety in the workplace, which can lead to lower frequency and severity of claims (among other benefits).

#### General Discussion

Studies such as Tompa et al (2007) have shown that specific deterrence (firms that get a penalty) is more effective in changing claim frequency and severity than general deterrence (existence of a penalty).

Employer behaviour is also dependant on the size of any penalty and the frequency of inspections. A small penalty may be insignificant compared to the cost of improving OHS, limiting the impact of the incentive. Very infrequent inspections may lead employers to 'take the risk' and not comply, knowing they are unlikely to be caught out.

### 4.1.5. Premium Discounts and Exemptions

Premium discounts and exemptions can be used to reward almost any behaviour, as they are essentially a cash payment.

We consider two examples of premium discounts / exemptions. The first is the Apprentice Incentive Scheme in NSW<sup>15</sup> which exempts Apprentices from the workers' compensation costs of an employer.

## The Role of Incentive Measures in Workers' Compensation Schemes

The second example is the Premium Discount Scheme in NSW, which rewarded employers who met certain workplace safety thresholds.

### Behaviours Targeted

For the two examples we consider the behaviours targeted are:

- Apprentice incentive scheme: encourage employers to hire apprentices
- Premium Discount Scheme: improve OHS

### General Discussion

The Apprentice Incentive Scheme is an interesting example, as there is no direct benefit to the scheme by exempting apprentices from workers' compensation premiums. There are however other benefits of more apprentices from a societal perspective, such as improved productivity, jobs for young workers, skilled workforce, etc. This example shows how incentive schemes may consider wider impacts on behaviour than those measured directly through claims costs.

The Premium Discount Scheme (PDS) in NSW was a voluntary scheme, started in 2001, that provided premium reductions to employers who implemented workplace safety programs and return to work strategies for injured workers. The PDS was closed after 3 years, as there was mixed reaction from stakeholders regarding its ongoing value.

One of the difficulties faced by Incentive Measures which rely on the achievement of specific OHS hurdles is ensuring a rigorous audit of employer performance. If the audit process does not sufficiently differentiate between employers who commit to the program and those who do not, the incentive to change behaviour may be lost.

#### 4.1.6. Incentives to Improve Reporting Speed

Incentives to improve reporting speed may provide a benefit, such as reduced employer excess, for employers who report claims promptly.

### Behaviours Targeted

The justifications for incentives to improve report speed are:

- Reduced claims suppression
- Earlier treatment of claims leading to improved return to work outcomes
- More complete data on which to identify emerging trends

### General Discussion

Early reporting incentives are not new, however little literature exists on the effectiveness of reporting speed improvements in improving claim outcomes, or reducing claims suppression.

WorkCover SA runs an *Incentive for early reporting of injuries (Waiver of employer excess)*<sup>16</sup>. This incentive waives the two week employers' excess on weekly benefits for claims reported to WorkCover SA within 2 business days of the employer being notified.

#### 4.1.7. Prompt Payment of Premium

To incentivise prompt payment of premium, schemes may impose penalties for late payment, or discounts for early payment. WorkCover Queensland, for example, offers a 3% premium discount for early payment, and imposes a 5% penalty for late payment.

## **The Role of Incentive Measures in Workers' Compensation Schemes**

### **4.1.8. Internal Employer Incentives**

There are a number of incentives which employers can create for themselves, particularly for larger employers or self insurers. These include:

- Linking remunerations (such as bonuses) for internal OHS staff to improvements in claims experience.
- Safety jackpot lotteries or other incentives to encourage safety awareness.
- Internal programs to provide suitable alternative duties in other departments

These incentives are very important to the successful operation of the scheme. They can be thought of as the actions which underlie the more general 'improve OHS' incentives, however they are not the focus of this paper.

### **4.1.9. Workplace Wellness Incentives**

Society is exhibiting increasing trends in the prevalence of chronic diseases and mental health.<sup>17</sup> Some of these chronic diseases are preventable, for example type 2 diabetes and heart disease. Risk factors linked to these diseases include poor diet, stress, obesity, and a sedentary lifestyle.

There is growing evidence that the presence of chronic diseases and mental stress can both increase the risk of workplace injury and slow rehabilitation and recovery from an injury.<sup>18</sup> It also leads to other costs for employers such as absenteeism and "presenteeism" (not fully functioning at work when unwell). This therefore creates an opportunity to incentivise employers to promote wellness initiatives to improve the health of employees. Improved wellness amongst employees can also indirectly increase staff retention which would have other indirect benefits to employers.

Victoria has offered WorkHealth checks through their WorkHealth<sup>19</sup> initiative where free health checks are provided to employees. They have also introduced Workplace health promotion grants where employers can access a grant to fund health and wellbeing activities for their workers, if they have previously offered health checks to the majority of their employees.

#### **Behaviours Targeted**

Workplace wellness incentives encourage employers to improve the health of their workforce.

#### **General Discussion**

There are some difficulties in providing these types of programs, especially within a worker's compensation scheme. These include:

- There can often be a long lag time between the program initiatives to the subsequent change in behaviours to the final benefit outcomes.
- It may be difficult to measure the benefits, although the monitoring of key performance indicators such as absence rates, retention rates, employee health indexes, OHS claim rates and staff satisfaction ratings can all be useful measures.
- The initiatives can be costly and / or time consuming to administer, with the best solutions often requiring to be tailored to individual organisations or industries.
- Some of the benefits will not directly impact the employer or workers' compensation scheme. For example, many of the benefits arise from improved longer term health outcomes associated with the prevention of chronic diseases and hence benefit society in general.

## The Role of Incentive Measures in Workers' Compensation Schemes

More service providers are offering such initiatives, either tailored or off-the-shelf, making these more accessible to a range of employers (for example, Medibank, BUPA etc.).

These types of initiatives may be well suited to larger self insurers.

### 4.2. Injured Worker

Workers' compensation schemes provide a range of support for employees injured in the workplace, including compensation for lost income and / or impairment, medical and rehabilitation benefits and access to common law. The existence of this support may provide a disincentive for the injured worker to return to work.

In order to balance the need to provide fair compensation with the need to have a financially sustainable scheme, Incentive Measures are needed to encourage injured workers return to work as soon as they are able to.

**Table 6: Incentive Measures for Injured Workers**

Incentive Measure	Targeted behaviour			
	Safety awareness	Propensity to Claim	Return to work	Fraud
Evidence of initial injury		✓✓		✓✓
Replacement ratio		✓✓	✓✓	✓
Maximum benefit periods			✓✓	✓
Existence of lump sums	✗	✗	✗	
Advertising and awareness	✓✓			

Whilst workers' compensation legislation in each jurisdiction establishes workers rights to compensation as a result of a workplace injury, there is a social stigma of being 'on benefits' that provides a natural incentive for return to work or a disincentive to lodge a claim.

The effectiveness of this natural incentive can vary for a range of reasons:

- There may be a weaker incentive to pursue workers' compensation benefits during periods of economic downturn.<sup>20</sup>
- The influence of lawyers in schemes with common law access can reduce the effect of this social stigma as claimants are made fully aware of their right to compensation.

#### 4.2.1. Evidence of Initial Injury

Establishing a process to discourage false or fraudulent claims is common across all workers' compensation jurisdictions. It is important to ensure that the process isn't overly bureaucratic or time consuming for genuine claims, but discourages the lodgement of false claims. Enforcing sign off from the worker's treating doctor and the employee's safety officer are common practice and widely used.

#### 4.2.2. Weekly Benefit Replacement ratio

The primary mechanism for compensating injured workers for their loss of income in Australia is through weekly benefits. The level of weekly benefits varies by scheme, but most

## **The Role of Incentive Measures in Workers' Compensation Schemes**

schemes pay weekly benefits as a fixed percentage of the workers' pre-injury earnings or the average weekly earnings of the State.

A common feature of workers' compensation schemes is that the level of weekly benefits claimants are entitled to receive reduces the longer the claimant is off-work. The purpose of these "weekly step downs" is to incentivise return to work through a direct financial penalty.

The primary challenge with this Incentive Measure is establishing step down rates that incentivise return to work while still providing a reasonable weekly benefit to claimants with longer term injuries.

The scheme will also need to be aware of external influences that may reduce the effectiveness of this Incentive Measure. Some examples include:

- The interaction of weekly benefits with other social security benefits received by the claimant.
- In some cases, employers may have workplace agreements with particular employee groups to "top up" weekly benefits to 100% of the pre-injury earnings in the event that the worker is injured.
- Death and disability schemes provided to workers performing dangerous public service such as Police and Fire Fighters often provide additional benefits to workers and their families.<sup>21</sup>
- Other societal factors such as the cost of child care compared to receiving less than 100% of pre-injury earnings.

### **4.2.3. Maximum Benefit Periods**

A common feature in a number of the State schemes is the cessation of income replacement benefits at a certain time if claimants have a capacity to work. The cessation of benefits provides an incentive to return to work because claimants who do not return to work beyond this point are forced to rely on other forms of welfare in order to generate an income. This income is likely to be significantly less generous than the benefits available under workers' compensation.

For example, WorkCover SA apply "Work Capacity Reviews<sup>22</sup>" for all claims that reach 130 weeks on benefits. This review determines the injured workers capacity for work, and may lead to cessation of weekly benefits if the worker is found to have capacity to work.

### **4.2.4. Existence of Lump sum Benefits**

Access to common law or lump sum benefits is available in some form in most Australian workers' compensation jurisdictions.

- Claimants with injuries causing permanent impairment and pain and suffering are entitled to lump sum compensation in a number of States.
- Several States offer claimants, with some restrictions, the ability to commute future benefits in lump sum form.
- Access to pursue common law damages is also widely available, although often with restrictions on access to ensure only the more severely incapacitated claimants are able to pursue these benefits. Commonly used restrictions are:
  - Access thresholds based on impairment assessments.
  - Minimum periods on weekly benefits before access is permitted.

The presence of lump sum compensation can act as a perverse incentive for claimants to avoid or delay returning to work. Whilst the impairment thresholds go some way to

## **The Role of Incentive Measures in Workers' Compensation Schemes**

minimising this behaviour, there are situations where these may not work as intended. By way of example, claimants with impairment levels below the impairment thresholds may be able to establish a higher degree of impairment over time. Another example observed in some schemes has been the emergence of secondary injuries which emerge as a result of the primary injury. (i.e. secondary psychological injuries, damage to the digestive system as a side effect of prescribed medication for the primary injury).

### **4.2.5. Advertising and Awareness Campaigns**

While the responsibility of providing a safe workplace lies with employers, personal safety is a priority that all workers should practice.

Advertising aimed at safety awareness has been used in a number of schemes to reduce the number of injuries. These campaigns range in form from television and radio advertisements, workplace posters to sponsorship of sports and athletic teams. In NSW, these campaigns have recently focused on the consequences to the worker and their families in the event of a workplace accident.

These campaigns can be thought of as moral incentives as they are a way of influencing employee behaviour. The campaigns make employees aware of the potential consequences of a workplace accident, and fear of such consequences can influence behaviours.

### **4.3. Medical and Rehabilitation Providers**

Workers' compensation schemes include medical and rehabilitation benefits for injured workers, consistent with the goals of the scheme. The provision of these benefits is commonly outsourced to third party providers whose motivations may differ from that of the scheme, such as an objective to grow their businesses and maximise profit. As a result, provider behaviour may not necessarily align with the objectives of workers' compensation schemes, for example:

- Providers may service injured workers beyond the level required by the injured worker in order to return to work. Or, in the case that the provider represents the insurer or scheme, encouragement to return to work before the worker is sufficiently recovered.
- Providers may focus on rehabilitation as the end objective, with less focus on return to work than is consistent with the scheme objectives.
- There is the potential for the provision of inappropriate treatment and inaccurate invoicing, as providers seek to maximise profits.

Incentive Measures are one way to encourage provider behaviours which are better aligned to the objectives of the scheme. Some examples of these are provided below.

## The Role of Incentive Measures in Workers' Compensation Schemes

**Table 7: Incentive Measures of Medical and Rehabilitation Providers**

Incentive Measure	Targeted behaviour			
	Treatment of difficult cases	Over-servicing	Focus on return to work	Inappropriate treatment or billing
Fee for outcomes	✘	✓✓	✓✓	✓✓
Performance benchmarking	✘	✓✓	✓✓	
Regulation	✓	✓	✓	✓

### 4.3.1. Fee for Outcomes

A “fee for outcomes” arrangement is an approach to align the medical and rehabilitation fees paid with the objectives of the scheme. These arrangements differ from the standard convention of paying fixed fees for service and hourly rates. Rather, service providers are remunerated based on the rehabilitation or return to work outcomes of the claimants they treat. It is becoming an increasingly popular mechanism for incentivising quality improvement globally.<sup>23</sup>

#### Behaviours Targeted

Accordingly, this Incentive Measure directly addresses provider over-servicing and appropriateness of treatment as well as promoting return to work.

#### General Discussion

The primary concern with this is that it can create a perverse incentive for service providers to avoid difficult cases and focus on providing service to injured workers with easily achieved rehabilitation and return to work outcomes. There are other challenges with this type of incentive including the difficulty defining appropriate outcomes and the costs associated with measuring these outcomes.

In practice, fee for outcomes arrangements are generally blended with fixed fee and hourly rate arrangements. To support this kind of arrangement, the scheme also needs to develop a suitable framework for monitoring provider success at achieving claimant outcomes. This should also be supported by a claims triage model to ensure that claimants are passed on to case managers with the right qualifications and experience to manage these providers.

One example in Australia is WorkSafe Victoria’s Original Employer Services<sup>24</sup> incentive, which provides an incentive payment (in addition to prescribed fee for service payments) when an injured worker achieves sustained return to work outcomes.

### 4.3.2. Performance Benchmarking

Benchmarking can be used as an indirect measure to incentivise desired behaviours in the scheme’s service providers. Medical and rehabilitation practitioners rely on their reputation in order to receive ongoing business and future referrals. Public acknowledgment of their success in achieving the desired outcomes of the scheme can enhance this.

## The Role of Incentive Measures in Workers' Compensation Schemes

### Behaviours Targeted

The behaviour targeted is specific to the criteria used to compare the performance of the providers. Typically the criteria will be an outcome measure (such as proportion of injured workers returning to work) coupled with a cost measure (such as average rehabilitation spend per worker). The behaviours targeted are generally:

- a focus on return to work through the outcome measure
- a reduction in over servicing through the cost measure.

### General Discussion

The success of a good provider benchmarking system relies on the results being transparent and easily accessed by the scheme's users. The measured benchmarks also need to be consistent with the scheme's objectives and the opportunity for gaming by the providers should also be tested.

Q-Comp's "Return to Work Awards"<sup>25</sup>, for example, have a "Health Provider Achievement Award" which can recognise good performing occupational rehabilitation providers. These awards have been used by provider firms on their websites which shows providers are aware of the positive impact such awards can have on their perception by the public.

### 4.3.3. Regulation

The regulation of service providers can be an effective tool to ensure that providers meet minimum standards with respect to pursuing the schemes objectives. There are a variety of approaches to regulating service providers:

- One approach is to only allow providers which meet specific accreditation standards to operate within the scheme. Accreditation incentivises providers to meet a minimum standard, with the incentive being a penalty of exclusion from providing services should standards not be met.

WorkCover WA, for example, adopt the "Nationally Consistent Approval Framework for Workplace Rehabilitation Providers"<sup>26</sup>, along with some additional requirements relating to performance and data entry.

- Expert panels may adjudicate where there is a difference of opinion between two providers, possibly one acting for the scheme, and one for the injured worker. The intention of the medical panel is to be a source of a consistent expert opinion, and the existence of this can be a useful incentive to encourage best practice among providers.

One example of an expert panel is Medical Panels SA which is specifically set-up to deal with workers' compensation medical disputes arising from the WorkCover SA scheme.

- Guidelines for the treatment of an injured worker are common, and are useful to provide a consistent framework for providers to work from. An injured worker should expect to receive a quality service regardless of the provider used. Communication of the recommended course of action outlined in the guidelines also helps claimants understand the reasoning for the recommended treatment.

One specific example is NSW WorkCover's "Treatment Principles For The Provision Of Psychological And Counselling Services"<sup>27</sup>, which promotes evidence based practice and the use of objective functional outcome measurement in clinical practice.

Regulation attempts to increase the overall quality of providers in the scheme. As a result, its impacts can be less focussed than other Incentive Measures. However, a good regulatory framework can lead to provider behaviours that are more in line with scheme objectives.

## The Role of Incentive Measures in Workers' Compensation Schemes

### 4.4. Scheme Agents

**Table 8: Incentive Measures of Scheme Agents**

Incentive Measure	Targeted behaviour		
	Focus on return to work	Treatment of difficult cases	Gaming
Performance linked remuneration	✓✓	✓✓	✗

#### 4.4.1. Performance Linked Remuneration

Some workers' compensation schemes in Australia have appointed third party administrators to provide ongoing management of policies and to manage claims.<sup>28</sup> These "Scheme Agents" receive remuneration in exchange for the provision of these services. These remuneration arrangements, like many other outsourced underwriting arrangements, require careful thought in order to provide incentives that align administration practices with scheme objectives.

In some instances the Scheme Agents may be private insurers. They may have existing insurance relationships with the employers covered under the workers' compensation policies being administered. Some behaviour's of the Scheme Agents may be related to ensuring that their existing relationships are catered for, rather than optimising the workers' compensation scheme outcomes.

Remuneration arrangements in these situations are generally structured to provide incentives to the Scheme Agents to achieve scheme objectives. This may be achieved by linking remuneration to:

- Achievement of KPI targets, which are typically quality gates to incentivise Scheme Agents to perform quality work. Audits are usually completed to make sure these quality gates are adhered to.
- Linking remuneration to claim outcomes, such as a return to work measure or estimated claim liability assessment. A baseline measure may be established according to which favourable assessments would receive higher levels of remuneration.

There are a number of challenges with implementing and managing these types of arrangements:

- The Incentive Measure needs to be objective and understandable. Assessment either needs to be over long periods of time or performed in a manner that is trusted and accepted by Scheme Agents. Scheme Agents need to believe that they'll be adequately remunerated for better claim outcomes.
- Measurement of outcomes may be difficult. Ongoing assessment needs to be consistent over time and the operation of different investment conditions and identification of assessment measure requires careful thought. For example:
  - If a return to work measure is implemented then careful thought needs to be given to the definition used to assess performance.
  - Assessment of claim performance may be problematic because of the long tail nature of many of these liabilities. Assessment of future liabilities needs to be simple enough to be understood by Scheme Agents to drive the correct behaviours, but responsive enough to capture subtleties in changes in claim management initiatives that lead to better outcomes.

## The Role of Incentive Measures in Workers' Compensation Schemes

- If the remuneration is based on the number of claims settled then there is little incentive for Scheme Agents to spend appropriate amounts of time on the treatment of difficult or complex cases.
- It may be costly to administer the remuneration arrangements and assessment of incentive fees or KPI-related fees. For example, the assessment of return to work measures, claim measures and file quality reviews can be both costly and time consuming.
- If the scheme is performing poorly, perhaps from circumstances that are either fully or partially outside of the Scheme Agents control, and their incentive remuneration becomes small and difficult to improve then it may be difficult to incentivise Scheme Agents to improve performance.
- The remuneration arrangements need to be structured to limit the potential for gaming. This may happen under a number of circumstances including:
  - A Scheme Agent may believe that they can optimise their remuneration by trading off any incentive based remuneration with the number of staff that they use to administer the portfolio. Quality KPI's are therefore important inputs in ensuring that quality administration is maintained.
  - In other cases Scheme Agents may attempt to administer claims to maximise their own remuneration rather than to achieve the best outcomes.

A further incentive for the Scheme Agents may be the threat of the loss of market share if the Scheme Agent is performing poorly. If a poor job is being performed by a Scheme Agent then the Scheme may transfer all or part of their administrative function to another provider. Healthy competition in this area makes this a credible Incentive Measure.

### 4.5. Legal Providers

Aligning the behaviours of legal providers with the objectives of a workers' compensation scheme is a challenging task. Legal providers have a responsibility to ensure their client receives fair compensation for the injury they have suffered. Schemes however, are generally focused on ensuring that injured workers receive the best return to work and injury rehabilitation outcome. There can be conflict in the pursuit of these two objectives, as demonstrating ongoing incapacity can be difficult if the worker has returned to their job.

Regulation is the tool most commonly adopted by schemes to change the behaviours of the participating legal providers. Here are a few examples:

- Workers' compensation schemes in some states have scheduled rates that lawyers are able to charge at different stages of a claimant's progression through the common law and lump sum processes. These rates can act as a disincentive for lawyers to pursue some types of claims, particularly those with likely return to work capacity. The introduction of a minimum impairment threshold that claimants are required to meet before pursuing common law can produce a similar outcome.
- In 2003 the Compensation Court of NSW was replaced by the Workers' Compensation Commission. As part of this change, determination of statutory lump sum benefits was changed from being a negotiation process between lawyers based on the table of maims, to a more objective, medical assessment of impairment. There were also changes to the fees that legal providers could charge. Incidentally, prior to the closure of the Compensation Court there was a significant spike in the number of S66 payments.

While each of these examples has been widely used across the states, the extent to which the legislation has withstood the test of time is often debatable. Scheduled rates may not work if claimants and lawyers enter private agreements to pass on a percentage of the claimants

## **The Role of Incentive Measures in Workers' Compensation Schemes**

awards to the providers. Impairment thresholds may not survive in the long run as loop holes are exposed by case precedence.

### 5. Some Incentive Measures Used Overseas

It is valuable to learn lessons from other countries to see what Incentive Measures are working and which are not working well. We have included some background on Incentive Measures used in European and North American countries. We have restricted our commentary to Incentive Measures which are not commonly used in Australia.

It is important to understand that some of these schemes are comparable to Australia while other countries have very different workers' compensation structures. For example, some countries overseas do not have specific workers' compensation schemes. This results in many incentives being provided outside of any workers' compensation scheme. These Incentive Measures may operate through separate government mechanisms that may include:

- **Funding schemes:** for example, subsidies or grants for a range of practices that support improved OHS such as for materials, tools or OHS management systems.
- **Matching funds:** the government may match funds for OHS related improvement initiatives.
- **Tax reductions:** where investment is made in OHS activities.

The insurance and OHS functions may either be the same body or a separate body, depending on the jurisdiction. This may also influence the choice of Incentive Measures. Where it is part of the same body then the premium system may be more easily used for Incentive Measures, while for external bodies other Incentive Measures may need to be implemented.

#### 5.1. North America

There are many similarities in some aspects of operational structure between Australian and some North American workers' compensation schemes. There are also some slightly different and interesting approaches that are being taken in regard to the design of Incentive Measures for some of these North American schemes.

One of the authors recently accompanied WorkSafe Victoria on a premiums research tour of Canada. On this trip we were able to speak to the management of some of the Canadian schemes about their premium systems and, in particular, Incentive Measures that are being used or developed within these schemes. This section therefore contains some information arising from these discussions, with a particular bias on premium incentives.

##### 5.1.1. Voluntary Prevention Programs

Some workers' compensation boards in North America have a specific injury and illness prevention mandate.<sup>29</sup> This has seen the introduction of a number of voluntary prevention incentive programs. These programs typically provide a premium participation rebate which is payable after an employer achieves specific OHS objectives, sometimes in tandem with specific claim experience outcomes. This may be seen as an "advance" on experience rating, especially for those where it may be hard for employers to otherwise invest in improved OHS.

In addition, the employer may also be recognised through the issue of a Certificate of Recognition (CoR<sup>30</sup>). This may only be available to employers in good standing with the Authority. The program may be supported and partly administered through an independent Safety Group.

While the Incentive Measure is generally marketed as the premium rebate, other benefits of the programs are also marketed, to increase the incentive for employers to participate, such as lower absenteeism, higher employee retention and helping to lower operating costs from improved OHS.

We now discuss some of the key aspects of these programs in more detail.

## **The Role of Incentive Measures in Workers' Compensation Schemes**

### **Safety Groups**

A number of jurisdictions in North America have voluntary industry-focused safety associations responsible for driving OHS initiatives specific to their industry. These Safety Groups are in the business of prevention (supporting OHS) but may also have a secondary function to support return to work and injury management. They often prepare their own documentation, and have their own training courses and awareness programs.

The premise of Safety Groups is for the individual industries to develop tools to enable both risk identification and risk mitigation. The groups develop OHS programs around the key risks specific to their industry. Some programs are specifically designed to cater to the needs of small to medium employers or newer employers.

They may be funded by an additional premium rate collection on top of the normal workers' compensation premium. These fees are invested in areas of OHS initiatives that are considered appropriate for their industry.

While a rigorous statistical comparison of experience for employers participating in these schemes compared to those not participating does not appear to have been prepared to date, the reductions in claim rates of participants appears to indicate some very strong benefits. What is not clear is whether there is an element of self selection in that those employers that participate in Safety Programs would have had significant reductions in any case.

### **Certificate of Recognition**

Employers who are able to complete OHS courses or meet pre-requisite OHS standards may be eligible to receive a CoR. The employer generally needs to be certified through an audit process. Most programs tailor an appropriate level of scrutiny for different sizes of employer. One of the main challenges is keeping the cost affordable, especially for smaller employers. Different jurisdictions have different operating models. Some use external auditors while others have specific attendance criteria for OHS workshops, often operated through industry groups.

One of the most promising aspects of these programs is that in some provinces in Canada we have been told that it is influencing behaviours outside of the workers' compensation scheme:

- A CoR is being used in some industries (for example, oil, mining and construction) as a requirement for employers to tender for specific contract works. The CoR demonstrates that the employer is in good standing with the workers' compensation board, has good OHS standards and may be viewed as a general good moral indicator.
- Some private insurers are using the CoR as a rating factor for some forms of insurance (e.g. public liability).

### **Example 1 - Voluntary Prevention Program: Ontario**

In Ontario the Safe Communities Incentive Program (SCIP<sup>31</sup>) is a two-part health and safety incentive program for small business. The first part of the program targets newer employers who will typically be facing many challenges associated with starting up a new business. These initial challenges include:

- 1) Management of assets and capital
- 2) Talent acquisition and retention
- 3) Legislation compliance.

SCIP contains material on each of the above topics and also includes material on the importance of OHS. The OHS course gives employers an introduction on how to identify and manage risks. We have been told that one of the key challenges of the program is in targeting

## The Role of Incentive Measures in Workers' Compensation Schemes

the right amount of time for smaller employers to be able to participate in already busy business schedules.

Ontario also has Safety Group Programs (SGP) for larger employers.

### Example 2 - Voluntary Prevention Program: Alberta

Alberta enables an industry to voluntarily determine the aggressiveness of industry rating through its "Industry Custom Pricing" (ICP<sup>32</sup>) option. This program applies where an industry collectively wants to vary the responsiveness of experience rating according to an industry's risk tolerance and preferences. An industry participates through polling of industry if 50% of payroll agrees.

The two main ICP options are:

- Experience rating option preferences can be changed to control the limits and aggressiveness of experience rating to enable the opportunity to receive greater discounts or surcharges. The preferences provide flexibility and can react differently to different sized employers.
- Cost relief option for claims due to aggravation of a pre-existing condition. Employers are able to take claims off their own experience record and these are then applied to the industry as a whole. The intention is to promote RTW for these cases. The biggest issue is the potential for gaming by classifying more and more claims as having aggravation of pre-existing injuries.

### 5.1.2. Additional Employer Premium Surcharges

Many Canadian schemes have employer premium surcharges for those employers that have claim cost outcomes consistently worse than their industry peers. The premium surcharge generally operates over and above any standard experience rating.

The surcharges are quite aggressive, often being a multiple of the base premium. The scheme will generally communicate the expectation of a surcharge well before it is due to be charged, often a year or more prior to the premium surcharge applying. This provides an incentive for the employer to enact OHS changes in response.

Some schemes meet with employers flagged for future premium surcharges to better understand the cost pressures for each individual employer. There may be different cohorts of employers in these surcharge schemes:

- Employers may have poor OHS that is contributing to poor claims experience and they may require help in implementing change.
- Employers may not fit well into their relatively blunt industry classification in which case the surcharge may be appropriate but no OHS changes are required.

The intent is to drive behavioural changes to get employers out of the surcharge scheme over time. One scheme mentioned that having the size of the premium surcharge high enough to incentivise improved OHS behaviours was a key factor in the success of the program.

### 5.1.3. Small Employer Premium Incentives

#### Small Employer Discounts

Some North American schemes have introduced small employer discounts for employers that have been claim free over specified time periods. More complex systems have also been developed which have discounts or surcharges based on a table of claims versus employer size.<sup>33</sup>

## **The Role of Incentive Measures in Workers' Compensation Schemes**

We are not aware of any research to indicate that that these discounts lead to improved workplace safety. However, anecdotally it does act as an effective panacea to “keep employers happy” with the insurance process. Smaller employers are familiar with the operation of no claim bonus discounts that may be used in other forms of personal insurance.

Some considerations arising from these types of Incentive Measures are:

- Some schemes have experienced problems arising from the blending of employers who change programs, from small employer programs (generally simpler) to large employer programs (generally more complex) as their premium rate may change significantly.
- It is generally acknowledged that there is no real science to the calibration of these models, as luck probably contributes as much towards the employer discount or surcharge as does the underlying risk. It is also generally acknowledged that there is no evidence that these Incentive Measures directly improve OHS.
- These Incentive Measures can introduce cross subsidies into the scheme from large to small employers because of the skewed distribution of possible claim outcomes and the undesirability of using harsh penalties, given the volatile experience of small employers.

### **Small Employer Group rating**

Small employers by themselves may not have statistically credible claims experience due to the volatility of their own experience. One way to experience-rate smaller employers is to aggregate the claims experience of smaller employers. This has been tried in a couple of states in the US<sup>34</sup>, although some have had significant issues in implementing them successfully.

There are several issues to consider prior to introducing a group rating programme:

- This type of structure can lead to significant gaming issues unless the structure is well thought out. For example, we are aware of one instance where groups of good performing smaller employers banded together to attract significant premium reductions, and then pressured any employers with deteriorating experience over time to leave the group.
- There may be significant brokerage and frictional costs involved with setting up the small employer groups and this should be compared to the potential benefits of group rating.
- Consideration should be given to whether the rebates are allocated directly to an employer, or to the third party administrator of the group. It is possible that the administrator may only pass back discounts to some employers, and not all.

### **5.1.4. Large Deductible Plans**

Some states within the US have used the concept of large deductible schemes as an Incentive Measure.<sup>35</sup> Under these schemes, large employers self insure the cost of each claim up to their deductible, which can be set at a high level. This therefore has an element of self-insurance to its structure, with the scheme acting as a reinsurer for the employers.

Anecdotally we have been told that in some cases this has had unintended behavioural consequences where the behaviour of the firm to the individual claimant has changed once the threshold has been reached. For example, in some cases an adversarial relationship ensues as the employers may encourage employees to quit or take severance pay so that their experience does not impact future employer premiums.

## The Role of Incentive Measures in Workers' Compensation Schemes

The large deductible plans were found to improve claim rates and average claim sizes in Shields et al, 1999. However, the potential for unintended consequences mentioned above needs to be offset against the potential gains.

### 5.1.5. Other North American Incentives

#### Safety Consultation

Ohio takes the approach of safety consultation rather than enforcement. The types of services they offer include air quality testing, ergonomics, and safety culture programs. The Safety Intervention Grant Program allows employers who want to purchase equipment that substantially reduces or eliminates the risk of injuries and illnesses to apply for financial assistance. Successful employers can receive up to a 2-to-1 matching grant. We have been told that there have been significant reductions in claim frequency following safety grants made to some employers. However, it is acknowledged that these types of programs can be expensive to monitor and administer.

## 5.2. Europe

The scheme structure of many systems in Europe is different to Australia. A summary of economic incentives used in Europe is documented in *Economic incentives to improve occupational safety and health: a review from the European perspective* issued by the European Agency for Safety and Health at Work in 2010.

Many of the Incentive Measures in Europe work outside of the workers' compensation schemes and some countries don't operate a workers' compensation scheme. Some of the key findings of the paper were:

- Funding schemes are commonly used in Europe. Subsidies or grants are available to be used for a range of practices that contribute towards improved OHS. This may include the purchase of new OHS materials, safety tools or OHS management systems. The schemes are generally managed by public bodies. Subsidy schemes can be good at promoting innovative solutions for specific OHS areas.
- Tax reductions are not commonly used but are seen as a potentially good incentive to promote employer financial investment in OHS initiatives. However, there are limitations to this approach because it does not motivate those who do not pay tax (for example not for profit organisations or unprofitable organisations).
- Matching fund programs where governments provide funds in proportion to the organisational OHS spend are also seen as promising, although they are generally associated with high administration costs.
- OHS regulations should be supported by appropriate incentives to make them effective. Direct measures to ensure compliance with legislation are generally considered the best way to achieve this through inspection and penalties, such as fines for non-adherence. This therefore requires linking OHS to audits to ensure that the risk of getting caught for non adherence is not trivial. It is noted that there are limits to regulations because they are not employer workplace specific and do not respond well to emerging risks. Increasing the probability of inspection is generally seen as a more effective incentive than increasing the size of penalty.
- For smaller employers the availability of free training and OHS materials is seen to be an effective way to change OHS behaviours. Trust is also an important aspect of the relationship between the employer and the regulator that works well in being able to influence behaviours.
- Insurance strategies, such as experience rating, are seen as providing moderate success in reducing claim frequency, but require careful consideration in structure

## **The Role of Incentive Measures in Workers' Compensation Schemes**

and design. There are some good case studies available that show where insurance rating has improved outcomes, such as for the German butchery industry, which used a simple, focussed impact, and targeted approach to achieve some good outcomes, primarily some reductions in skin disease.

- Employer led wellness schemes can be successful in preventing workplace injuries. The mix of effectiveness, efficiency and political feasibility, as well as the choice of instruments, are seen as important considerations.

## 6. Specific Incentive Challenges in Workers' Compensation

There are a number of challenges in managing Incentive Measures within workers' compensation schemes and we discuss some of the main ones below.

### 6.1. Perverse Incentives and Unintended Consequences

While an Incentive Measure may be designed to address specific unwanted behaviours, the implementation of the Incentive Measure can result in the participants behaving in unintended ways. There are many examples of changes in behaviour in response to incentives that proved to be either counter-productive to the original goal of the incentive or resulted in behaviours that were not fully anticipated.

A non workers' compensation example is the Home Insulation Program. This had the goal of incentivising homes to install ceiling insulation to reduce the reliance on home heating and cooling which was expected to reduce future carbon emissions. The introduction of the Home Insulation Program saw a rapid increase in consumer demand and, in some cases, the operation of illegal or inexperienced operators which led to significant fire hazards and exposure to serious safety issues from installers.<sup>36</sup> The unintended consequences from this program were the tragic death of four young installation workers by electrocution or heat stroke and many roof fires. This prompted the establishment of the Home Insulation Safety Program in order to address some of these unintended adverse outcomes.

This example highlights the need to have adequate controls governing the operation and design of incentives. These controls should be maintained over time as behavioural responses may change.

Sections 4 and 5 of this paper give a number of workers' compensation examples where perverse incentives have been created from the implementation of Incentive Measures. In some circumstances these perverse incentives are created as a result of scheme participants attempting to "game" the Incentive Measure.

"Gaming" occurs when scheme participants change their behaviours (in response to the Incentive Measure) in order to meet their targets, but not in a way that is consistent with the objectives of the scheme. This may occur when the Incentive Measure targets issued to scheme participants are poorly constructed.

The following table gives some examples of unintended behaviours that could emerge from poorly constructed Incentive Measures.

**Table 9: Examples of Unintended Behaviours from Poorly Constructed Incentive Measures**

Targeted Behaviour	Incentive Measure	Unintended Behaviour
Reluctance of employers to employ previously injured workers because of fear of recurrence of existing injuries	Remove second injury claim payments from employer experience rating	Participants spend a disproportionate amount of time seeking to prove existence of secondary injury
Improve OHS for larger employers	Introduce employer claims experience rating based on number of claims	Employer suppresses claims to maximise experience rebate payments
Reduce over-servicing arising from fee for service medical providers	Introduce a fee for outcome arrangement	Avoidance of treatment of difficult cases
Faster treatment of claims by Scheme Agent	Scheme Agent remuneration is based on the number of claims finalised	Claims finalised too quickly and claimants return to work too quickly, leading to a high number of reopened claims

## **The Role of Incentive Measures in Workers' Compensation Schemes**

These simple examples illustrate some potential unintended behaviours and consequences that could emerge as a result of poorly constructed Incentive Measures. Workshopping these issues with scheme participants may help to establish more robust Incentive Measures.

### **6.2. Measurement of Benefits**

One of the key aspects of our proposed Incentive Measure management framework is to periodically compare the costs of an Incentive Measure against the benefits arising from the Incentive Measure being in place. The end result may be placing a dollar value on the impact to the scheme if the Incentive Measure were included or excluded.

We acknowledge that some forms of subjective assessment may be needed in the measurement process. However, the measurement process is an important step in understanding the impacts that Incentive Measures are having on scheme outcomes and the Incentive Measure should be evidence based as much as possible. Estimating this benefit has a number of challenges.

#### **Normalising for Other Influences**

Scheme outcomes will generally emerge as a result of the combined impact of a number of different influences. The attribution of benefits arising from each influence (an Incentive Measure being one such influence) can be problematic. For example, improved scheme outcomes may be the combined result of the introduction of new OHS regulations, changing societal attitudes towards OHS, technological advancements or from a change in industry mix of business. While some of these factors may be normalised for, it can be problematic to normalise results for other factors.

There are ways that the Incentive Measure may be implemented to help mitigate some of these measurement issues. It may be appropriate to have pilot programmes or voluntary trials that test the Incentive Measure over a limited cohort of the scheme. Where this occurs it may be easier to normalise results for other influences. For example, a sample of “good performing” and “poor performing” employers within a specific industry could be selected prior to the implementation of a new Incentive Measure, where the distinction between “good” and “poor” is based on a specific KPI result. The success of the Incentive Measure could be measured by looking at the resultant KPI's for each of the cohorts separately (and in particular the “poor performing” employers) compared to those not participating in the incentive program.

#### **Estimation of Long Term Benefits**

It may be difficult to measure scheme outcomes due to the long term nature of some workers' compensation benefits. Depending on the scheme, income replacement benefits may be payable up to retirement age and other medical costs may be payable for life. This can make it difficult to estimate the value of any improvements in scheme outcomes, as the final benefit may not manifest itself for a long period of time.

In circumstances where improvements in claim durations are impacted, there is also the chance for recurrence of existing injuries and a reopening of existing claims. This may be significant in some circumstances and should be considered as a potential offset to improvements in existing claim results if claims are finalised too quickly.

The measurement of benefits arising from OHS incentives that target disease mitigation are also difficult to quantify given that latency periods may be of a significant duration.

#### **Dead Weight Loss**

Even well constructed implementation programs may suffer from the issue of identifying “dead weight” loss. This may occur where voluntary programs are taken up by employers who would probably have implemented OHS systems regardless of the Incentive Measure.

## **The Role of Incentive Measures in Workers' Compensation Schemes**

Measurement of this “dead weight” loss is important for proper evaluation of the Incentive Measure to understand the net change in behaviours.

### **6.3. Specific Design Challenges for Small and Medium Sized Employers**

It can be difficult to incentivise small and medium sized employers (SME's). Workplace accidents, and hence claims, may not necessarily be expected over shorter periods and luck may have as much a role as good OHS in claims occurring.

SME's typically have claims experience that is worse than that of comparable larger employers. It is important to understand the reasons for this different experience so that appropriate responses can be formulated. Data mining techniques may be used to better understand any key differences that may be present for SME's versus larger employers.

Some particular challenges for SME's include:

- Some SME's may view workers' compensation premiums as an additional tax and OHS may not be a high priority within their business. They may fear the high cost and extra work involved with any specific Incentive Measure. Therefore the Incentive Measures need to be simple to understand, easy to respond to and focus on key risks and outcomes.
- If a particular Incentive Measure is voluntary, then incentivising SME's may be difficult if they are not made aware of the particular incentive. It is therefore important to ensure that there is adequate promotion of the existence of the Incentive Measure for SME's.
- SME's may not be aware of the potential benefits of an Incentive Measure. The scheme can take a proactive approach here by actively marketing the up-side benefits associated with the Incentive Measure. For example, there may be direct benefits (perhaps in the form of subsidies, insurance premium rebates or tax offsets), but there may also be large indirect benefits associated with improved staff retention, lower injuries, and less absenteeism. In circumstances where the direct benefits may be very small, it is the promotion of these indirect benefits that can be effective in improving stakeholder engagement. Acknowledgement of these benefits may often be required to justify employers joining voluntary groups, especially for smaller employers where the premium rebate of itself may provide little incentive.

Europe is responding to some of these design challenges through the use of subsidised OHS systems, workshops, education, project funds (subsidies), tax offsets, and safety management systems based on continuous improvement principles. For example, Austria has introduced subsidies so that companies are able to better access low cost consulting advice on OHS.<sup>37</sup>

The involvement of professional unions, industry bodies or other interest groups can also help to maximise participation and understanding of the benefits of Incentive Measures.

### **6.4. Getting Buy-in from Scheme Participants**

The presence of a financial incentive alone may not be enough to encourage buy-in from participants when an Incentive Measure is introduced. Employers, employees and external service providers need to understand the Incentive Measure. A complex system can act as a barrier to participant take up. Educating participants in the details of the Incentive Measure can reduce this barrier, but implementing a simple and easy to understand Incentive Measure may be more effective.

Successful implementation of Incentive Measures often requires co-operation between employers, employees and external service providers. In particular there needs to be a certain element of trust established between the various stakeholders. This trust and co-operation can be one of the main factors in the success or failure of an Incentive Measure.

## **The Role of Incentive Measures in Workers' Compensation Schemes**

Consultation with the schemes participants when designing the Incentive Measure can help in this regard. The benefit of allowing participants to contribute to the design of the Incentive Measure is two-fold. Firstly, the consultation process can engender trust between the scheme and its participants. The feedback provided by the participants may also help identify the strengths or weaknesses of the proposed Incentive Measure. Difficulties can emerge however, when the consultation process becomes adversarial. This can result in the premature demise of an Incentive Measure before it is introduced into the scheme.

Schemes will also be challenged by ensuring that participants continue to be engaged in the behavioural changes encouraged under the Incentive Measure. Providing clear and transparent monitoring to stakeholders can assist in this regard, particularly when the incentive is a financial reward. This can be more challenging when participants reach the extremes of the incentive. By way of example, it is difficult to encourage further improvement from a participant who is receiving the maximum financial reward under an Incentive Measure.

### **6.5. Interactions with Other Systems**

Workers' compensation systems do not operate in isolation from the other systems used by individuals and organisations in our society. In reality, the participants of the workers' compensation schemes may also interact with other schemes or systems that shape their behaviour. It can therefore be difficult to predict the behaviours of the schemes participants based only on the incentives presented in the workers' compensation scheme.

A good example of this is the Death and Disability Schemes that provide benefits to workers injured performing dangerous public services such as policing and fire fighting<sup>38</sup>. In some circumstances, these schemes top-up the weekly benefits provided to claimants to be 100% of pre-injury earnings. In this example there is little financial incentive for the claimant to return to work when their situation is considered from more than just the workers' compensation point of view.

If a scheme was to consider introducing a fee for outcome arrangement with its medical and rehabilitation providers, it would need to consider that injured workers are just one of many sources where medical and rehabilitation providers generate an income. Care would be needed to ensure that the rates paid are still competitive enough to prevent providers from overlooking workers' compensation claims and focusing on patients from other systems.

### 7. Conclusion & Summary

Incentives can be a powerful tool used to influence behaviours and they are relatively commonplace in our society today.

There is a need to use incentives in workers' compensation schemes to counteract some of the perverse incentives created from the introduction of workers' compensation schemes and to help achieve scheme objectives. Labour market forces and regulations enforced with penalties can also be viewed as forms of incentives.

While the design of effective incentives is achievable, there are many examples of incentives that have led to undesirable outcomes and behaviours. It is for this reason that a sound governance framework needs to be applied to effectively manage incentives. We therefore present an Incentive Measure management framework, which has the following steps:

1. Identify opportunities with SMART targets that are consistent with scheme objectives.
2. Identify the behaviours that you want to change that align with these opportunities.
3. Identify appropriate Incentive Measures to change these behaviours and ensure that an adequate assessment of costs and benefits is performed.
4. Ensure that appropriate testing of the Incentive Measure is completed and that stakeholders are educated, with appropriate systems put in place prior to implementation.
5. Monitor the impacts of the Incentive Measure to ensure that it is having the correct behavioural impacts and remains appropriate for the times.

The existing literature, both locally and overseas, contains a number of examples where Incentive Measures have been successful and other instances where they have not achieved their goals. Some key learnings from this literature review include:

- A mix of different Incentive Measure strategies can work best for different opportunities and to target different stakeholders.
- There are many examples of Incentive Measures gone wrong indicating that it is important to have a strong governance framework around design, implementation and ongoing management.
- It is important to engage with, and get buy-in from, stakeholders so that they understand the Incentive Measure and trust that favourable outcomes will be rewarded.
- For regulations to effectively drive behaviours, there should be a non-trivial chance of being investigated, and the penalties or rewards need to be large enough to encourage compliance.
- Trust remains an important factor in Incentive Measures and more complex Incentive Measures can erode trust, especially for SMEs.
- There is a growing trend for more voluntary Incentive Measures, especially in North America, to help engender a more trusting relationship between scheme and stakeholders.

There are many challenges associated with managing Incentive Measures successfully. However, the potential rewards arising from the successful implementation of Incentive Measures can be significant and there is a growing trend to explore a wider range of options. An effective framework, such as that proposed in this paper, can make a significant difference to the overall scheme outcomes achieved.

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### 10. Endnotes

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<sup>1</sup> Source: Wikipedia - <http://en.wikipedia.org/wiki/Incentive>

<sup>2</sup> For example, FlyBuys, Everyday Rewards, MYER one, Qantas frequent flyer etc.

<sup>3</sup> The Australian Government provided assistance of up to \$1,600 to allow homeowners and tenants to have ceiling insulation installed in their homes. The \$1,600 should cover the cost of insulating an average home, so most people will not need to pay anything.

<sup>4</sup> Source: Clean Energy Australia

<http://www.cleanenergyfuture.gov.au/clean-energy-future/our-plan/clean-energy-australia/>

<sup>5</sup> For example, the NSW WorkCover scheme incentivises employers to hire more apprenticeship employees by providing a premium reduction for NSW employers of apprentices.

<sup>6</sup> Page 2 of the 2009/10 NSW WorkCover Annual Report

<sup>7</sup> This concept is discussed more fully in sources such as Clayton (2002) and EASHW (2010).

<sup>8</sup> SMART / SMARTER is a mnemonic used to set objectives, for example for project management, employee performance management and personal development.

[http://en.wikipedia.org/wiki/SMART\\_criteria](http://en.wikipedia.org/wiki/SMART_criteria)

<sup>9</sup> Drink Drive Campaign History - In 1989, the year that the TAC commenced its campaigns, 114 drivers and riders died in road crashes with an illegal blood alcohol concentration. This figure had dropped to 62 in 2007. <http://www.tacsafety.com.au>

<sup>10</sup> This concept is described in many places including NERA Economic Consulting (2006). Presenteeism refers to where the employer has additional costs associated with absence from injury and illness or has lower productivity from employees returning to work in an unwell state where further treatment may provide a better long term outcome.

<sup>11</sup> Much has been written about some of the perverse incentives that can result from Incentive Measures. This is especially the case in terms of experience rating. For example, Carter, Clayton and Walsh (1996) contests the notion that experience rating is effective in improving OHS. Many other sources acknowledge an improvement in claim experience although there is limited evidence that this relates to improved OHS.

<sup>12</sup> The current arrangements are described in the latest Comparison of Workers' Compensation Arrangements in Australia and New Zealand issued by Safe Work Australia dated March 2011.

<sup>13</sup> More detail on WorkSafe Victoria's Original Employer Services can be found on their website <http://www.worksafe.vic.gov.au>

<sup>14</sup> Further information is available on the WorkCover SA website at the following link [http://www.workcover.com/site/employer/contactsother\\_useful\\_information/rise\\_reemployment\\_incentive\\_scheme\\_for\\_employers.aspx](http://www.workcover.com/site/employer/contactsother_useful_information/rise_reemployment_incentive_scheme_for_employers.aspx)

<sup>15</sup> Further information is available on the NSW WorkCover website at the following link <http://www.workcover.nsw.gov.au/insurancepremiums/premiums/Calculatingpremiums/Pages/Apprenticeincentivescheme.aspx>

<sup>16</sup> Further details may be found on the WorkCover SA website at the following link [http://www.workcover.com/site/employer/contactsother\\_useful\\_information/incentive\\_for\\_early\\_reporting\\_of\\_injuries\\_waiver\\_of\\_employer\\_excess.aspx](http://www.workcover.com/site/employer/contactsother_useful_information/incentive_for_early_reporting_of_injuries_waiver_of_employer_excess.aspx)

<sup>17</sup> "Workplace wellness in Australia Aligning action with aims: Optimising the benefits of workplace wellness" 2010 discusses some of these trends as a result of both aging population and lifestyle changes.

## The Role of Incentive Measures in Workers' Compensation Schemes

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<sup>18</sup> “Workplace wellness in Australia Aligning action with aims: Optimising the benefits of workplace wellness” 2010 discusses some references to obesity and alcohol consumption associated with increased workplace injury, while the presence of chronic conditions can slow rehabilitation and injury recovery.

<sup>19</sup> More detail on the WorkHealth initiative is shown in the following website link.

<http://www.worksafe.vic.gov.au/wps/wcm/connect/WorkHealth%20Internet%20Content/workhealth-internet/home>

<sup>20</sup> A summary of this research was provided by Lisa Simpson at the 2010 Personal Injury Education Seminar in her presentation titled “Personal Injury Compensation Schemes and the GFC “

<sup>21</sup> A summary of the benefits paid under the NSW Police Death and Disability scheme is shown here:

<http://bourkelove.com.au/wp-content/uploads/2011/07/Link-3-Police-Death-Disability-Award-2005.pdf>

<sup>22</sup> Further details may be found on the WorkCover SA website at the following link

[http://www.workcover.com/site/treat\\_home/the\\_workcover\\_system/work\\_capacity\\_reviews.aspx](http://www.workcover.com/site/treat_home/the_workcover_system/work_capacity_reviews.aspx)

<sup>23</sup> Many examples of paying for performance in both the UK and US are described in PricewaterhouseCoopers (2008), “Paying for Performance – Incentives and the English Health System”.

<sup>24</sup> See end note 13

<sup>25</sup> Further details on the Q-Comp Awards may be found at the following link

<http://www.qcompconference.com.au/awards.aspx>

<sup>26</sup> Further details may be found on the WorkCover WA website at the following link

<http://www.workcover.wa.gov.au/Service+Providers/Workplace+rehabilitation+providers/Default.htm>

<sup>27</sup> Further details may be found on the WorkCover NSW website at the following link

[http://www.workcover.nsw.gov.au/formspublications/publications/Documents/treatment\\_principles\\_provision\\_psychological\\_counselling\\_2292.pdf](http://www.workcover.nsw.gov.au/formspublications/publications/Documents/treatment_principles_provision_psychological_counselling_2292.pdf)

<sup>28</sup> For example NSW and Victoria both have appointed a mix of insurers and other administrators to manage claims and to provide general policy administration.

<sup>29</sup> For example WorkSafeBC has a specific mandate that requires the scheme “To promote the prevention of workplace injury, illness, and disease.” In other states in North America this specific mandate may lie outside of the workers compensation authority.

<sup>30</sup> For example, WorkSafe British Columbia and the Workers’ Compensation Board of Alberta issue Certificates of Recognition.

<sup>31</sup> SCIP and other Safety Group programs are described in more detail within the Workplace Safety & Insurance Board website <http://www.wsib.on.ca>.

<sup>32</sup> ICP and other incentive programs are described in more detail within Alberta’s Workers’ Compensation Board website <http://www.wcb.ab.ca>.

<sup>33</sup> For example, Ontario has a Merit Adjustment Program (MAP) that has a table of rebates or surcharges based on the average premium of the employer and the number of non-trivial claims over a three year period. There are also adjustments for employers that have had a fatal injury claim.

<sup>34</sup> Ohio’s Bureau of Workers’ Compensation (BWC) has used a number of different forms of group rating programs. Washington State also has a group rating program under the Department of Labor & Industries.

<sup>35</sup> Many states within the US introduced the concept of workers’ compensation deductibles in the early 1990’s. For example Ohio’s BWC currently has a voluntary deductible program and BWC’s website contains the current arrangements in more detail <https://www.ohiobwc.com>

<sup>36</sup> Australian Government Department of Climate Change and Energy Efficiency website <http://www.climatechange.gov.au/government/programs-and-rebates/hisp.aspx>

## The Role of Incentive Measures in Workers' Compensation Schemes

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<sup>37</sup> This initiative is explained in more detail in Section 4.3.3 of the European Agency for Safety and Health at Work (2010).

<sup>38</sup> See end note 21.