

# **12th Accident Compensation Seminar 2009** Rising to the Challenge

**Melbourne 22nd – 24th November 2009**



Institute of Actuaries of Australia



## **Premium Reform in NSW: Past, Present & Future**

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## Overview

- Premium models: purpose and key principles
- Challenges in premium design
- The NSW experience
  - 2005 reform initiative (small and medium employers)
  - 2008 reform initiative (large employers)
- Future directions – NSW and beyond



## Premium Models: Purpose

- In a managed fund environment, a premium system should:
  - cover the costs of running the Scheme
  - set out a method of cost allocation, matching premiums with liabilities
  - provide for collection of these funds
  - influence employer behaviour
  - be easy to understand and provide comparative performance



## Premium Models: Key Principles

- May 1997: HWCA finalises a 2 year national study into best practice workers compensation design
  - premium systems should be based on the key principles of
    - equity
    - stability
    - prevention
    - simplicity
  - broad definitions of remuneration should be used for calculating premium
  - standardised industry codes should be used for determining base rates



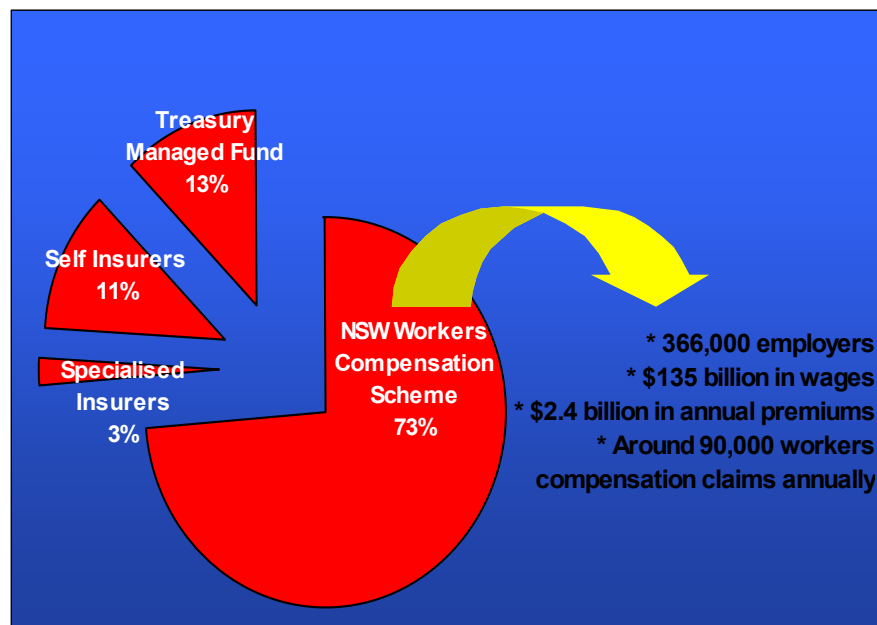
## Premium Design Challenges

- Simple and obvious design principles *but* applying them can be problematic
- An effective premium system must address vexing issues such as:
  - cross subsidisation
  - premium evasion and under insurance
  - balancing exposure to risk with insurance protection
  - complexity especially of principle definitions (*e.g. worker, wages*)
  - changing labour market/employment relationships
  - inter-jurisdictional interaction/ harmonisation
  - employer (and other stakeholder) expectations



## NSW System Overview

### NSW Workers Compensation System



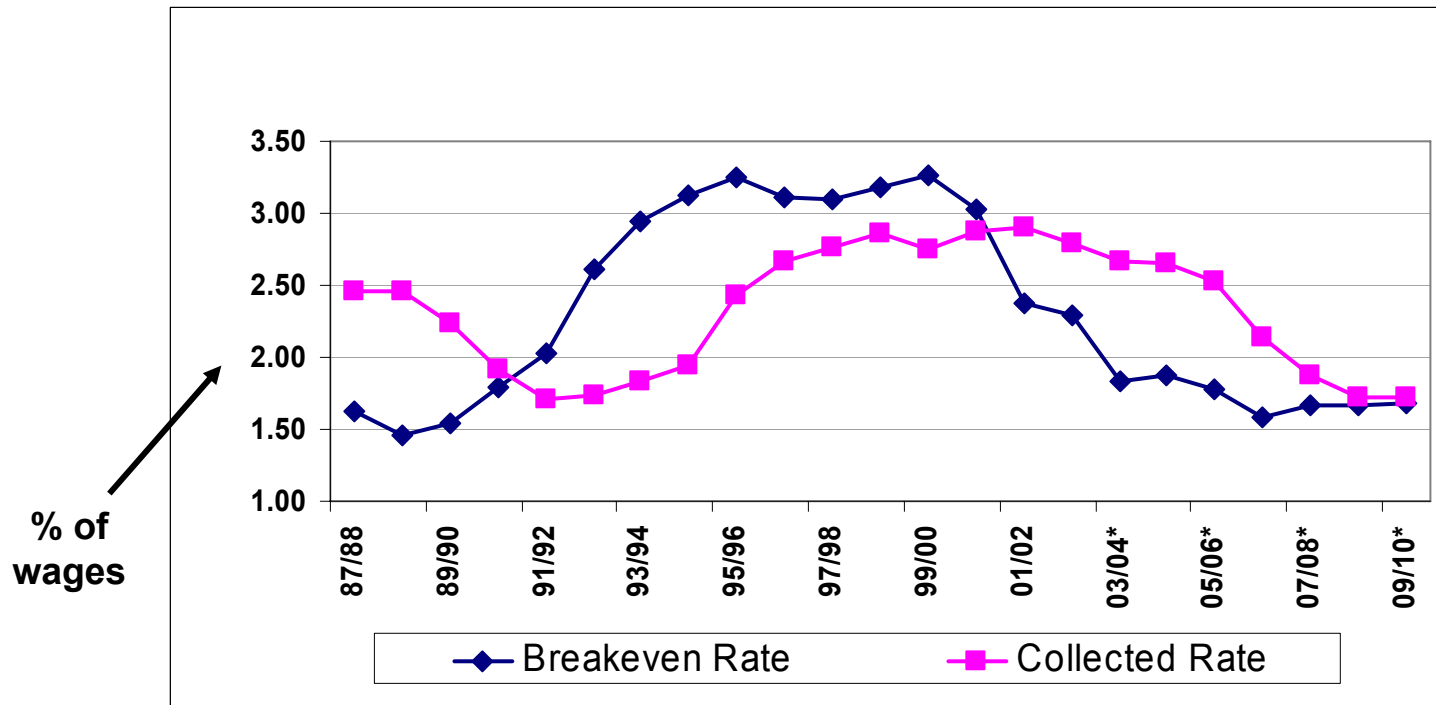
- **Benefits** - Hybrid regime
- **Disputes** - Workers Compensation Commission
- **NSW WorkCover Scheme** - Agency scheme
- **61 self-insurers** including Treasury Managed Fund (public sector)
- **7 specialised insurers**

Note – number of Scheme policies reduced from approx 366,000 to around 250,000 during 2008/09 due to deemed coverage for very small employers



## NSW Historic Premium Levels

*Ultimate collected & breakeven premium rates by policy renewal year*



\* Definition of wages changed





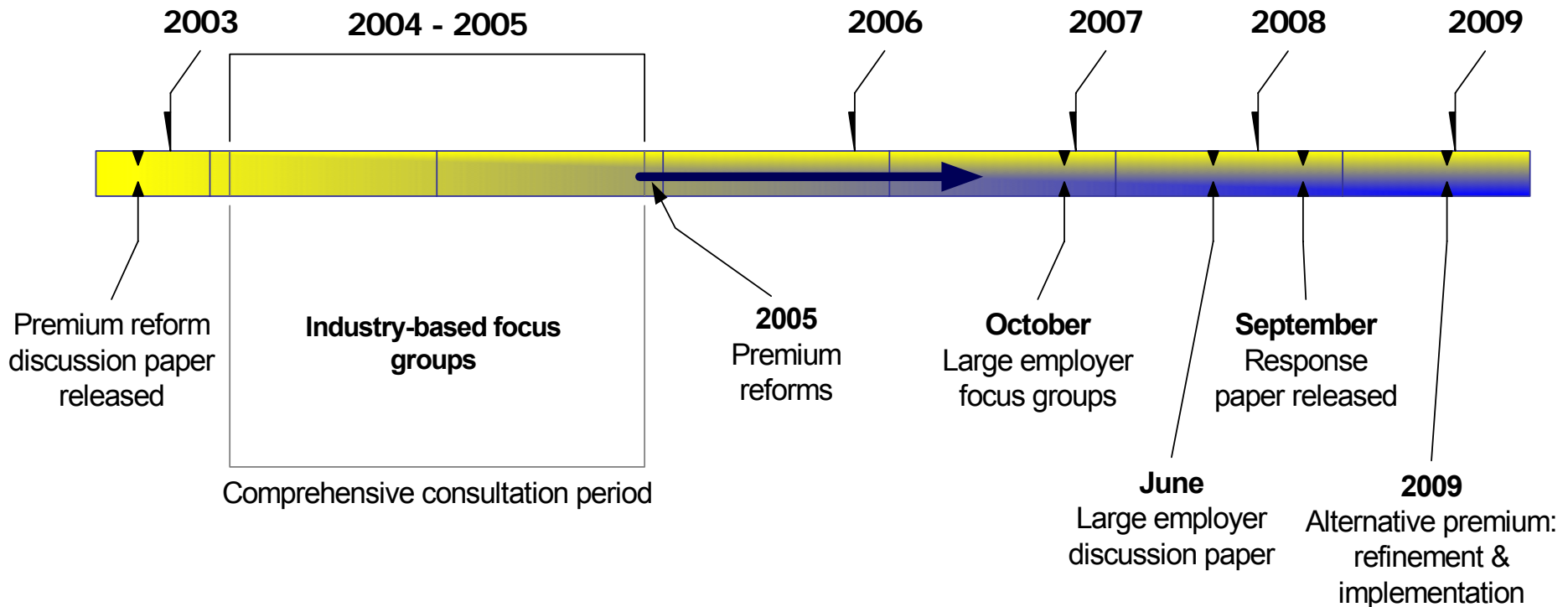
## Milestones in Premium Design 1987-2003

- June 1987 – Scheme commences, private underwriting ceases
- 1997 Grellman enquiry recommended
  - privatisation with a file and write premium method
  - recognition of injury management and prevention by premium system
  - industry classification system to ANZSIC
- June 2000 principles to guide further reform laid down including
  - premium compliance focus
  - injury reduction incentives (Premium Discount Scheme)
  - ANZSIC based pricing structure (introduced July 2001)
- January 2002 WCA and OSR commissioned compliance review
- 2003 series of consultative premium review and reform initiatives commence





## Consultative Reform Approach





## 2005 Premium Reform

30 June 2005

- Greater protection for small businesses
  - experience rating to apply to those employers with a basic tariff premium greater than \$10,000
  - previously experience rating applied to employers with a basic tariff premium greater than \$3,000
- Premium Discount Scheme wound down
  - abused by some employers
  - no substantiated improvement in performance
- Refunds to employers where claims proven fraudulent



## 2005 Premium Reform

31 December 2005

- Better protection for small and medium businesses
- Claims excess changed to one week worth of wages, waived if reported within 5 days
- Removed excess buy out option for small employers

### **SMALL EMPLOYERS**

Premium  $\leq$  \$10,000  
or wages  $\leq$  \$300,000

Not experience adjusted  
92% employers

### **MEDIUM EMPLOYERS**

Premium  $>$  \$10,000 but  
 $\leq$  \$500,000 and  
wages  $>$  \$300,000

Experience adjusted  
7.5% employers

### **LARGE EMPLOYERS**

Premium  $>$  \$500,000

Experience adjusted  
0.5% employers



## 2005 Premium Reform

31 December 2005

- Rebalancing insurance protection and risk exposure for medium sized employers

Basic tariff premium <\$50,000	Basic tariff premium ≥\$50,000 and <\$150,000	Basic tariff premium ≥\$150,000 and <\$300,000
Total premium cannot exceed 1.5 times the basic tariff premium (1.5T)	Total premium cannot exceed 2 times the basic tariff premium (2T)	Premium cannot exceed 2.5 times the basic tariff premium (2.5T)



## 2005 Premium Reform

31 December 2005

- Replaced F-Factors with ICCRs
  - experience based on individual performance relative to industry
  - enhanced financial incentives for improved OHS and return to work performance
  - reduction in cross subsidisation



## 2005 Premium Reform

30 June 2006

- Grouping
  - related employers with combined wages over \$600,000 will be grouped for premium assessment purposes
  - charitable and not-for-profit organisations may apply to WorkCover for exemption to grouping status for those related employers who are not in direct competition with the private sector
  - costs of claims and wages of group members who close or do not renew their policies proportionally allocated among remaining group members

30 June 2007

- Payments by instalment





## 2005 Premium Reform

- 2005 reforms primarily benefited small and medium sized employers
- Large employer concerns identified but not resolved:
  - responsiveness of premium formula
  - capacity to allow risk vs reward choices, including variation in claim caps and excesses
  - estimates and hindsight adjustments
- WorkCover agreed to consult further on these issues and in 2007 commenced a *Large Employer Premium Project*



## Large Employer Premium Reform

- **Retro-Paid Loss Premium Method** now operational
  - alternative premium calculation method for very large employers
  - hybrid method based on commercial burning cost arrangements
  - commenced 30 June 2009
  - initially 13 successful applicants (71 policies)
  - very large national employers from
    - transport industry
    - logistics and storage
    - facilities management
    - healthcare
    - labour hire
    - construction
    - manufacturing
    - mining



## Retro Paid Loss: Features

- Features a uniform and predictable link between premium payable and individual employer claim cost
- Premiums may be significantly higher or lower than under conventional formula, depending on individual employer experience
- Incentives for recovery and durable return to work - claims impact over five years (not three)



## Retro Paid Loss: Development

Strategic industry consultation and participation in distinct phases:

- **Conceptual phase**
  - to test level of interest, appetite for and awareness of commercial model
- **Development phase**
  - modifying the commercial model for a managed fund environment
  - eligibility parameters, application and assessment criteria, KPIs
- **Implementation phase**
  - introduction of legislative framework and supporting arrangements
  - assessment process
  - employer performance targets and monitoring
- **Post implementation phase**
  - peer support forums
  - engagement with potential applicants



## Retro Paid Loss Modifying a Commercial Model

- Poor management of commercial burning cost method contributed to deterioration in pre-1987 financial performance
- Challenge was to preserve the benefits of the commercial model, while increasing predictability, transparency and security
- This was achieved through the addition of new features including
  - selection criteria and eligibility parameters mean participants more likely to succeed
  - KPIs and targets to ensure employer issues are managed early
  - premium formula with selection between two protection levels/ large claim caps - provides transparency and predictability with flexibility
    - incorporates industry rates – but only for setting maximum and minimum premium
    - based on detailed actuarial modelling and extensive industry contributions
  - managed fund pooling of journey and recess claims (as per conventional)
  - strengthened financial guarantees
  - annual CEO/Board sign off
  - exit procedures (cannot reapply for 4 years) to minimise potential for gaming



## Retro Paid Loss Formula

- Provided employers don't exceed the maximum or minimum caps, premium payable is  
*(cost of claims minus recoveries) × adjustment factor + dust diseases levy + mine safety premium adjustment – premium paid received to date*
- Adjustment factors are inclusive of all loadings, including IBNR and IBNER costs
- Two adjustment factors are available, subject to applicable claims cap (chosen by the employer)

Month	Adjustment factor \$500,000 claim cap	Adjustment factor \$350,000 claim cap
15	295%	305%
24	200%	210%
36	170%	180%
48	167%	175%
60	167%	175%





## Retro Paid Loss Formula

- Where the premium formula returns a result outside the minimum and maximum range, the premium payable is capped

<b>Maximum premium</b>	Maximum premium is 2.5 times the basic tariff premium
<b>Minimum premium</b>	$T \times (1-S) \times \text{year 5 adjustment factor}$ <ul style="list-style-type: none"><li>• Where 'T' is the basic tariff premium, equal to wages multiplied by the WorkCover Industry Classification rate</li><li>• 'S' is the experience adjustment factor</li></ul>



## Future Directions: Retro Paid Loss

- There is industry support for a more national approach
  - NSW participants are national companies, several also utilise commercial burning cost in privately underwritten states
  - federal industrial relations agenda
  - an alternative to national self insurance?
- Hybrid NSW design can assist take up by publicly underwritten jurisdictions
  - proven premium formulas in place
  - development of standardised bank guarantees with major banks
  - existing legislative framework
  - NSW willing to share information, actuarial modelling



## Future Directions: Medium Sized Employers

- Coming soon in 2010!
- WorkCover will consult on the premium method for medium sized employers
- Issues for consideration include
  - large claim limit
  - experience adjustments
  - estimating methodology
  - shape of "s" curve
  - late reporting penalties

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## **Thank You**

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