Premium Reform in NSW: Past, Present & Future

Rob Thomson
A/CEO, WorkCover NSW
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

- **2003**: Premium reform discussion paper released
- **2004 - 2005**: Comprehensive consultation period
- **2005**: Industry-based focus groups
- **2006**: 2005 Premium reforms
- **2007**: October Large employer focus groups
- **2008**: September Response paper released
- **2009**: June Large employer discussion paper
- **2009**: Alternative premium: refinement & implementation
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

<table>
<thead>
<tr>
<th>SMALL EMPLOYERS</th>
<th>MEDIUM EMPLOYERS</th>
<th>LARGE EMPLOYERS</th>
</tr>
</thead>
<tbody>
<tr>
<td>Premium ≤ $10,000 or wages ≤ $300,000</td>
<td>Premium &gt; $10,000 but ≤ $500,000 and wages &gt; $300,000</td>
<td>Premium &gt; $500,000</td>
</tr>
<tr>
<td>Not experience adjusted</td>
<td>Experience adjusted</td>
<td>Experience adjusted</td>
</tr>
<tr>
<td>92% employers</td>
<td>7.5% employers</td>
<td>0.5% employers</td>
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</tbody>
</table>
# 2005 Premium Reform

31 December 2005

- Rebalancing insurance protection and risk exposure for medium sized employers

<table>
<thead>
<tr>
<th>Basic tariff premium</th>
<th>Basic tariff premium</th>
<th>Basic tariff premium</th>
</tr>
</thead>
<tbody>
<tr>
<td>&lt;$50,000</td>
<td>≥$50,000 and</td>
<td>≥$150,000 and</td>
</tr>
<tr>
<td></td>
<td>&lt;$150,000</td>
<td>&lt;$300,000</td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th>Total premium</th>
<th>Total premium can</th>
<th>Premium cannot</th>
</tr>
</thead>
<tbody>
<tr>
<td>cannot exceed 1.5</td>
<td>cannot exceed 2</td>
<td>cannot exceed 2.5</td>
</tr>
<tr>
<td>times the basic</td>
<td>times the basic</td>
<td>times the basic</td>
</tr>
<tr>
<td>tariff premium (1.5T)</td>
<td>tariff premium (2T)</td>
<td>tariff premium (2.5T)</td>
</tr>
</tbody>
</table>
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
  
  \[(\text{cost of claims minus recoveries}) \times \text{adjustment factor} + \text{dust diseases levy} + \text{mine safety premium adjustment} – \text{premium paid received to date}\]

- 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)

<table>
<thead>
<tr>
<th>Month</th>
<th>Adjustment factor $500,000 claim cap</th>
<th>Adjustment factor $350,000 claim cap</th>
</tr>
</thead>
<tbody>
<tr>
<td>15</td>
<td>295%</td>
<td>305%</td>
</tr>
<tr>
<td>24</td>
<td>200%</td>
<td>210%</td>
</tr>
<tr>
<td>36</td>
<td>170%</td>
<td>180%</td>
</tr>
<tr>
<td>48</td>
<td>167%</td>
<td>175%</td>
</tr>
<tr>
<td>60</td>
<td>167%</td>
<td>175%</td>
</tr>
</tbody>
</table>
Retro Paid Loss Formula

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

<table>
<thead>
<tr>
<th>Maximum premium</th>
<th>Maximum premium is 2.5 times the basic tariff premium</th>
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<tbody>
<tr>
<td>Minimum premium</td>
<td>T × (1-S) × year 5 adjustment factor</td>
</tr>
<tr>
<td></td>
<td>• Where ‘T’ is the basic tariff premium, equal to wages multiplied by the WorkCover Industry Classification rate</td>
</tr>
<tr>
<td></td>
<td>• ‘S’ is the experience adjustment factor</td>
</tr>
</tbody>
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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
Thank You

Rob Thomson
A/CEO, WorkCover NSW