

# The Australian Self-Insurance Summit

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## Keynote Address:

**Developing A National Framework For Workers Compensation In  
Australia,  
Sydney, 31 May 2004**

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The Minister for Employment and Workplace Relations will release the Productivity Commission's National Workers' Compensation and Occupational Health and Safety Frameworks Inquiry Report, and presumably the Commonwealth's response, on 27 June 2004. I am therefore limited in my remarks to those recommendations made by the Commission in its Interim Report. However, I can tell you that these differed in only minor ways from the Final Report, especially in the field of self-insurance.

Allow me a brief reminiscence! In 1994, as Special Minister of State, I released the Commonwealth's response to the Industry Commission's Report on Workers' Compensation in Australia.

It seems to me that the overriding goal of the 1994 Report was a desire to achieve a 'uniform compensation package in all jurisdictions'. The vehicles for this goal were, a national scheme incorporating Comcare, with the opportunity for self-insurance, the retention of individual state schemes, setting agreed national standards, and the establishment of a National WorkCover Authority to oversee the nationally available scheme.

It could best be described as an 'unfortunate orphan'. Apart from my own enthusiasm, no-one wanted to adopt it.

The overriding goal of the 2004 Report is, in my opinion, more focused and strategic. It is a desire to facilitate access by eligible firms to an existing scheme. Those who sign up will do so for its efficiency and cost advantages. In turn, they will inevitably create a new constituency for change to elements of the scheme, of which they will be stakeholders. The new constituency will help the drive for a nationally available scheme. In the absence of that constituency, no committee consisting of the States and the Commonwealth will do so.

## National Framework Proposals

In 2004, this is what the Commission has in mind.

National uniformity in OHS regulation should be established as a matter of priority. In essence, all jurisdictions agree with the fundamental principle of 'duty of care'. There are no compelling arguments against a single national OHS regime, and there are significant benefits from a national approach, particularly for multi-state employers and for the increasingly mobile workforce.

For workers' compensation, each scheme reflects community norms, evolving workplace arrangements and the legal and medical practices of that particular jurisdiction. However, this leads to compliance and cost issues for multi-state employers that should, and can, be addressed. The solution is the progressive expansion of a scheme offering alternative national coverage, which would operate alongside those of the individual jurisdictions.

In addition, all jurisdictions should collectively pursue improvements to workers' compensation by establishing a formal review mechanism similar to that already in place for OHS. This should lead to an increasing level of national consistency (and perhaps for some scheme elements, national uniformity) over time.

Existing national coordinating mechanisms have proven ineffective in resolving the compliance complexities and costs for multi-state employers. Over the last five years, Heads of Workers' Compensation Authorities primary output has been the provision of comparative information about the schemes. The Workplace Relations Ministers' Council, whilst also generating comparative performance monitoring information, has been primarily concerned with industrial relations matters.

With these observation in mind, the Commission has recommended four models of national frameworks for workers' compensation arrangements. The first three are to be introduced consecutively and the fourth to be implemented independently.

A. The Australian Government offers to license employers who qualify under the current competition test to *self-insure under the Comcare scheme*.

B. The Australian Government establishes, for all corporate employers, an *alternative national scheme of workers' compensation self-insurance* to operate in parallel to existing State or Territory schemes.

C. The Australian Government considers, at a later date, an *alternative national premium-paying insurance* scheme for all corporate employers who wish to join, to operate in parallel to existing schemes. It would be privately underwritten.

D. The Australian Government, States and Territories establish a *national workers' compensation body* that would develop

nationally consistent scheme elements for adoption by individual jurisdictions.

The Commission has no evidence of support by the States and Territories for a single uniform national workers' compensation scheme. Many of the stakeholders at the individual jurisdiction level have suggested that concessions won in hard fought negotiations would not be willingly surrendered for the sake of national uniformity.

Importantly, the Commission does not support national uniformity of workers' compensation for its own sake. In arriving at this view, the Commission recognizes that the vast majority of employers (who are predominantly small to medium enterprises) and their employees operate only within a single jurisdiction. To them, national uniformity has little relevance.

Further, it is not apparent that there is any single perfect or best scheme. Best practice can be reflected in a number of different ways. Innovation and learning should be encouraged, with the consequent reforms benefiting workers and employers.

### **A National Scheme To Operate In Conjunction With Existing Schemes**

#### **Step 1: Actively encourage self-insurance applications under Comcare (model A)**

Currently, the Australian Government's *Safety Rehabilitation and Compensation Act 1988*, which establishes the Comcare scheme, enables private employers to apply for a licence to self-insure. The Minister has discretionary power to declare as 'eligible', employers who are 'carrying on a business in competition with a Commonwealth authority or with another corporation that was previously a Commonwealth authority'. This test could potentially apply to the banking, telecommunications, air transport, defence, broadcasting and postal sectors. The granting of a licence is then subject to approval by the Safety Rehabilitation and Compensation Commission (SRCC) under certain prudential and other criteria.

Four public policy principles that guide the Minister in exercising discretion are the impacts of the grant of a licence on: employees; the employer; the integrity of the Comcare scheme; and the operations of State and Territory schemes.

Employees would become eligible for benefits as provided under Comcare. Employers will self-select, but will need to comply with the rigorous prudential and other requirements.

Of direct concern to the Australian Government is the risk to itself associated with granting a self-insurance licence to a company which is subsequently declared bankrupt or is otherwise unable to meet its workers' compensation liabilities. Based on advice sought by the Commission, the Australian Government Actuary proposed specific prudential requirements that would reduce the residual risk to the Government.

The Commission proposes that the cost of any residual risk be internalised to self-insurers by a post-event levy, as has been recommended for insurance by the HIH Royal Commission.

The Commission has also proposed that the existing regulatory framework provided by the SRC Act be modified and developed progressively to support the expansion of national insurance under this and the subsequent steps, with the SRCC being developed as a stand-alone regulator.

Actuarial advice to the Commission is that the impact on the State and Territory schemes is unlikely to be significant. Many of the employers eligible for self-insurance under the proposed national scheme are likely to be self-insured under existing State and Territory arrangements and are thus already outside the premium pools in those jurisdictions. However, the national scheme would extend to some employers who currently pay into some premium pools for various reasons, such as not meeting minimum employee criteria for self-insurance of particular jurisdictions. Queensland's threshold of 2000 local employees is a case in point.

Some participants expressed strong concern that small businesses, in particular, could be disadvantaged by the loss of premiums from their risk pools by large firms self-insuring. The concerns related to the effects that the loss of premiums could have on the viability of some risk pools and on the ability to provide cross-subsidies from within a scheme. There could be some changes in premiums for those remaining if risk pools were to be reformulated, but, of itself, this would be unlikely to systematically increase (or decrease) premiums.

In privately underwritten schemes, the nature and extent of any existing cross-subsidies is likely to be limited by commercial considerations and competition between licensed insurers. Accordingly, the loss of premiums from large employers would have little, if any, effect on the premiums of those remaining. For publicly underwritten schemes, and notwithstanding policies to minimize the extent of cross-subsidies, actuarial advice was that any increase in average premiums on remaining employers would be very small, even if those employers who were to exit were providing quite large cross-subsidies.

Without further legislation, private employers self-insured under the Comcare scheme would continue to operate under State and Territory OHS arrangements. The Australian Government Solicitor has advised that the Australian Government, drawing on its constitutional heads of power, could enact legislation that enabled all employers self-insured under the Comcare scheme to elect to be covered by Australian Government OHS legislation.

### **Step 2: Establish an alternative national self-insurance scheme (model B)**

The Australian Government could also commence, at the same time, the drafting of legislation to establish an alternative national self-insurance scheme (administered by the SRCC) for all employers who so wish and who meet certain prudential and other requirements. The Australian Government Solicitor has advised the Commission that this could be covered under the Commonwealth's corporations' power under the

Constitution.

In terms of scheme design, the Australian Government could offer the current Comcare arrangements, or redesign particular elements of the scheme, such as the current long-tail benefit structure and the dispute resolution procedures. Actuarial advice, as noted earlier, is that this step is also likely to have little impact on existing schemes as the relevant employers are predominantly self-insurers. The initiative may pick up the smaller premium paying State or Territory offices of some firms.

Again, as with step 1, employers opting into this scheme could be covered by Australian Government OHS legislation.

### **Step 3: Establish an alternative national premium-paying insurance scheme (model C)**

Following consideration of the success achieved under steps 1 and 2, and the outcome of cooperative institutional reform (model D), the Australian Government could extend its alternative national scheme to be available to all corporate employers, involving both self-insurance and premium-paying insurance. As with the previous step, it would require the exercise of the Commonwealth's constitutional powers and the passage of new legislation.

In the Commission's view, private underwriting of this expanded scheme would be desirable. Although research into the relative merits of public and private underwriting suggests that sound management can be more important than the form of underwriting, the characteristics of private underwriting are nevertheless attractive. These include: the capital risk being accepted by the capital markets; competition in the marketplace, with incentives for efficiency and innovation; and greater transparency of any governmental influence over premiums.

Employers covered by the national insurance scheme would also be eligible for coverage by Australian Government OHS legislation.

The opening up of an alternative national insurance scheme to all corporate employers could have potentially significant impacts on existing State and Territory schemes, if there was widespread uptake. Those public schemes with large unfunded liabilities may need to impose appropriate 'exit' arrangements. Some of the smaller schemes may ultimately become unviable on a stand-alone basis if a significant number of employers switch to the national scheme.

Nevertheless, the operation of a number of private underwriters in small jurisdictions such as Tasmania, the Northern Territory, and the Australian Capital Territory attests to the capacity of insurers to operate with small premium pools for any one class of insurance. Further, if introduced in the staged form recommended, then it is unlikely that the changes would occur at a pace that precluded the steady rationalization of existing arrangements.

### **National Cooperative Institutional Reform (Model D)**

Independent of and in parallel to the Australian Government's own initiatives as set out above, the Commission is proposing that the States and

Territories join with the Australian Government to strengthen and upgrade the national institutional infrastructure relating to workers' compensation. This model centres on formalising cooperation between the jurisdictions.

I will not provide details of the model as there were a number of changes between the Interim and final reports, but more importantly, the Minister has already indicated, in broad terms, his direction in this regard.

### **Self-Insurance**

So much for the models, what are the specific requirements for self-insurers?

The inquiry was asked to identify and report on a regulatory framework that would allow suitably qualified employers to obtain national self-insurance coverage that is recognized by all schemes.

To self-insure, employers must meet certain requirements. Although jurisdictions vary, their self-insurance requirements cover the following four broad areas:

- prudential standards;
- claims management capability;
- OHS performance; and
- in some jurisdictions, a requirement that the employer has a minimum number of employees in that jurisdiction.

A number of participants (particularly employers and self-insurance associations) have expressed concerns about particular aspects of these legislative requirements, as well as the extent of inconsistency across jurisdictions. Many supported the incorporation of self-insurance into a national framework.

### **Prudential Requirements**

As self-insurance provides for the risk of workplace fatality, injury and illness to be paid for by employers on a pay-as-you-go basis, there are legitimate concerns about their ability to meet all claims costs in all circumstances in the future.

A number of participants raised concerns that the prudential requirements were insufficient to reduce the risk that self-insurers would bring to a scheme. The most probable risk is that the company self-insuring collapses and the bank guarantee is not sufficient to cover all the claims liability.

### **Instruments To Deal With Residual Risks**

If the bank guarantee and reinsurance policy were insufficient to cover the

claims liability of a collapsed self-insurer, then, in the absence of other prudential arrangements, injured workers would bear the burden of not having their claims met. To avoid this, all the State and Territory schemes explicitly guarantee to pay claims arising from a collapsed self-insurer. Although the Australian Government does not explicitly provide such a guarantee, it is very likely that there would be pressure for it to take responsibility if such an event occurred.

The available Australian and international evidence suggests that the probability of the Australian Government being exposed to the claims liability of a self-insurer under the Comcare scheme is relatively low. The most likely exposure would first require a self-insurer to collapse and then for the bank guarantee to be insufficient. Although such a combination of events is unlikely, it is important to recognize that it is still possible.

The Australian Government Actuary noted several conceptual reasons why a bank guarantee may be insufficient, including that the self-insurer experiences an increased number of claims and that there are claims which are unforeseen. There is some evidence of bank guarantee insufficiency, as this occurred in the cases of both of the Australian self-insurers that collapsed.

Given that there are residual risks, the Commission considers it prudent for the Australian Government to consider additional risk management instruments. It is recognized that such instruments involve a transfer of risk from the Australian Government to the remaining self-insurers, at their cost, and that the efficacy and efficiency of the transfers are important considerations. The Commission considered three instruments---scheme reinsurance, a security fund, and a post-event levy.

As time is short, suffice to say that the first two were not considered useful instruments, but the post-event levy was.

### **Post-Event Levy**

The cost of financing any liabilities arising from the failure of a self-insurer and their guarantees/reinsurance can be recouped by way of a levy on the remaining self-insurers. There is increased certainty as to the amount of funds required and the administration cost can be relatively low.

While it would add a cost to the remaining self-insurers, it internalizes the cost of self-insurance failure to self-insurers as a category. If the prudential arrangements operate as intended, the costs are likely to be small and imposed infrequently. The internalization of the costs would act to ensure individual and mutual support for prudential regulation among self-insurers.

The post-event levy does not require the ongoing administration of a pool of funds or the continual purchase of insurance scheme reinsurance. The administrative costs that would be incurred, however, would arise from the scheme administrator being empowered to accept and pursue recovery of the self-insured's scheme liability. The funding could be dealt with in a variety of ways, such as by a Government loan or guarantee of loans (as

occurred for Ansett employee entitlements).

In the Commission's view, a post-event levy is the most suitable approach.

### **Claims Management Requirements**

The jurisdictions require self-insurers to have appropriate procedures for managing workers' compensation claims. Most jurisdictions allow for self-insurers to engage third parties to manage the claims. However, in Queensland, only local governments are allowed to contract out their claims management processes.

Self-insurers are required to demonstrate that they employ suitable staff and engage service providers approved by the scheme. This is to ensure that employees of self-insuring employers have their claims managed in a professional manner in accordance with scheme benefit structures. The differing requirements generate compliance problems and costs for multi-state employers.

Most jurisdictions require self-insurers to have claims managers located in that jurisdiction. A number of self-insurers noted that this prevents them from operating a national claims management centre, which would reduce claims management costs.

Multi-state self-insurers are required to have detailed knowledge of up to eight different claims management processes and benefit structures, with the associated information technology costs.

The employer may also need a different claims manager in each jurisdiction (and perform its own claims management in Queensland). Telstra notes that 'there is a shortfall of national claims managers who are accredited in each State/Territory jurisdiction. As a result, a national company would be required to have different claims managers in various States'.

Some Union participants raised concerns about the claims management practices of self-insured employers. In part, this is seen as being a consequence of the strong incentive self-insured employers face to minimize the occurrence of workplace injury, fatality, and illness and the subsequent cost of any accidents. Whilst the Commission has received other anecdotal evidence of self-insured employers inappropriately managing claims, there is no evidence of systematic failure. Robust administration of claims management practices, however, remains important.

### **OHS Requirements**

OHS regulations apply to all employers, irrespective of whether or not they self-insure. However, most jurisdictions place an added requirement on self-insurers to demonstrate, through an audit, that they have appropriate OHS management systems to prevent work-related injury and illness. These systems and audit processes differ between the schemes. They constitute an

added cost for multi-state employers.

Expressing concerns about their appropriateness, CSR argued that the additional OHS requirements are inefficient because they do not target employers with the greatest risk of work-related fatality, injury, and illness (which is somewhat independent of whether they are self-insuring or paying premiums).

The National Council of Self Insurers argued that OHS management systems should be determined on the risks of an organization, rather than general OHS management systems applied to all employers.

For multi-state employers, the problem of additional OHS requirements is exacerbated with the additional expense of multiple audits and the differences between audit requirements. This makes it difficult and costly for multi-state employers to develop uniform OHS management systems.

For example, Woolworths has different OHS management systems in each state because of the difficulty of developing a single OHS management process that meets the different requirements. Woolworths estimates they could save approximately \$400 000 per annum if they could have a single national OHS management system.

The Commission does not support OHS requirements for self-insurers that are additional to those applying to other employers.

### **The Minimum Employee Requirement**

In order to self-insure in some jurisdictions, employers are required to have a minimum number of employees in that jurisdiction. Where such a requirement is not specified, the number of employees of a self-insurance applicant may be taken into account when assessing eligibility for a licence.

Justifications for a minimum employee requirement include: that it helps gauge the financial strength of the employer; that a minimum number of employees is required for self-insurance to be cost effective; and that the quality of claims management will not be assured in firms with small numbers of employees.

A central concern with the requirement is that, if it is set too high, it can restrict otherwise eligible employers from obtaining the benefits of self-insurance. Employers who can obtain a self-insurance licence in one jurisdiction may not be able to obtain a licence in another jurisdiction because they do not meet the minimum employee requirement in that particular jurisdiction.

The justifications for a minimum employee requirement are not strong given that there is no direct link between the number of employees and the financial strength of an employer.

Whilst a minimum number of employees may act as a guide for the scheme to assess the appropriateness of self-insurance for an organisation, on

balance, the Commission concludes that setting a minimum number of employees as a requirement to self-insure is a poor proxy for the more fundamental requirements of effective prudential standards and claims management processes.

If prudential regulations focus on the ability of the employer to meet all future claims and manage them effectively, then the individual employer, not the regulator, should decide whether it is cost effective to self-insure.

### **Other Requirements**

There is a range of other self-insurance licensing requirements that, although they may not be individually significant, can have a collective impact.

Self-insurers are required to pay an application fee and ongoing levies for each licence. These fees and charges include the recovery of self-insurance administration costs and contributions to OHS functions. For employers self-insuring in more than one state, there may be unnecessary replication in the payment of some components of these fees. There is also concern from self-insurers that the fees and levies are not based on the administration cost they bring to the scheme. As an example, the contribution fees Pacific National pays to the New South Wales and Comcare schemes are 'very different' despite there being almost the same number of employees covered by each licence.

Self-insurers are required to supply data to the regulator on an ongoing basis. Whilst the collection of data is appropriate, self-insurers feel that the schemes do not adequately use the data that is collected.

The collection of data imposes costs on multi-state self-insurers because each scheme requires a different data set and software to supply the data, thus preventing self-insurers from operating an integrated computer system to satisfy the various scheme requirements. BHP stated that each State system costs \$50 000 to purchase and is required to be tailored to each scheme's definitions, which themselves vary.

### **Conclusion**

For multi-state employers, the costs generated by the replication and differences in self-insurance requirements provide a justification for a regulatory framework that would allow them to obtain a single self-insurance licence to cover all of their workers.

The Commission recommends that eligible employers be allowed to obtain a single self-insurance licence under the Comcare scheme, or under an alternative national self-insurance scheme, to cover all their workers throughout Australia. Relating these observations to the models, the requirements are as follows:

Model A. The existing self-insurance requirements of the SRC Act administered by Comcare would apply. The Commission, along with advice from the Australian Government Actuary, has assessed the self-insurance requirements of the SRC Act and have found them to be sound. It is also noted that the prudential requirements have been strengthened in response to the advice from the Government Actuary.

Model B. As new legislation would be required to implement an alternative national self-insurance scheme, the Australian Government could use the current Comcare self-insurance requirements as a sound base and take the opportunity to refine certain of its requirements. Although the most important prudential and claims management requirements may not need to be changed, the minimum employee requirement should be dispensed with.

Model C. If the proposed alternative national insurance scheme is introduced, the self-insurance arrangements under model B would be incorporated in it. In each of the steps one to three, self-insurers under the national scheme should withdraw from, rather than be recognised under, any or all other schemes.

Model D. Self-insurers have argued the benefits of common licensing and audit requirements. The above recommendations could form a basis for the States and Territories to develop consistent requirements across their schemes.