

**The Department of Treasury and
Finance – Victoria**

**National Competition Policy Review of
Victorian Workplace Accident
Compensation Legislation**

20 December 2000

Executive Summary

This report presents the analysis and recommendations of the independent Review Team that conducted the National Competition Policy (NCP) legislation review of Victoria's workplace accident compensation legislation. The Review Team comprises personnel from PricewaterhouseCoopers' Economic Studies & Strategies Unit (ESSU) and Health and Casualty Unit (HCU) and MinterEllison Lawyers. The review covers the following Victorian workplace accident compensation legislation and associated regulations:

- the *Accident Compensation Act 1985*;
- the *Accident Compensation (WorkCover Insurance) Act 1993*; and
- the *Accident Compensation Regulations 1990*.

Together these form Victoria's workplace accident compensation scheme, administered by the Victorian WorkCover Authority (VWA). The scheme has many features of an insurance product, and is often known in Victoria as WorkCover insurance. However as this report explains, the scheme also has 'non-insurance' features, and hence should not be viewed as a simple insurance product.

Public consultation occurred as part of this review. On 12 August 2000 the Victorian Minister for WorkCover called for submissions in relation to this review. This was advertised in *The Age* and *Herald Sun* newspapers as well as on the Department of Treasury and Finance web site. Members of the Review Team held discussions with a number of parties, including those that made submissions.

1 Legislation Review

Legislation review arises under Clause 5 of the Competition Principles Agreement (CPA), which is one of the inter-governmental agreements underpinning NCP. Under Clause 5, Australia's Governments have committed to review, and where appropriate reform, all legislation (including subordinate legislation such as regulations) that restricts competition. The guiding principle underlying legislation review is that legislation should not restrict competition unless it can be shown that the benefits of the restriction to the community as a whole outweigh the costs and that the objectives of the legislation can only be achieved by restricting competition.

However, NCP legislation review does not require that the pursuit of competition should take precedence over public policy objectives. An important component of the various processes agreed to under the CPA

involves assessing whether existing provisions and proposed reforms will produce a net public benefit.

Each jurisdiction has produced guidelines to assist persons conducting legislation reviews. In Victoria these guidelines are the *Guidelines for the Review of Legislative Restrictions on Competition* (The Victorian Guidelines). The Review Team was also guided by a Terms of Reference (Appendix A). In accordance with the Victorian Guidelines, the Review Team has developed recommendations that seek to provide the greatest potential public benefit.

It is also important to recognise what is not covered by an NCP legislation review. In particular the Review Team has not analysed whether the workplace accident compensation scheme itself generates a net public benefit or whether alternative schemes might perform better. Further, this is not a review of the performance of any agency or organisation. Thus while a description of the functions of the VWA is provided, this is solely for the purpose of clarifying the range of activities undertaken and to understand the range of activities to which the restrictions on competition might pertain.

2 Objectives

The Review Team's first task was to clarify the objectives of the legislation under review and examine their ongoing relevance. Specifically, the objectives of the *Accident Compensation Act 1985* as outlined in section 3 are:

- to reduce the incidence of accidents and diseases in the workplace;
- to make provision for the effective occupational rehabilitation of injured workers and their early return to work;
- to increase the provision of suitable employment to workers who are injured to enable their early return to work;
- to provide adequate and just compensation to injured workers;
- to ensure workers compensation costs are contained so as to minimise the burden on Victorian businesses;
- to establish incentives that are conducive to efficiency and discourage abuse;
- to enhance flexibility in the system and allow adaptation to the particular needs of disparate work situations;
- to establish and maintain a fully funded scheme; and
- in this context to improve the health and safety of persons at work and reduce the social and economic costs to the Victorian community of accident compensation.

The *Accident Compensation (WorkCover Insurance) Act 1993* does not contain express objectives. Its purpose as set out in section 1 (of the Act as amended) is to:

'provide for compulsory WorkCover insurance for employers under WorkCover insurance policies and the payment of premiums for WorkCover insurance policies'.

The Review Team found no evidence to suggest that the objectives of both pieces of legislation under review are no longer relevant.

3 Restrictions on competition

The Review Team, with the assistance of participants, identified five key restrictions on competition arising from the legislation under review. These are:

- the compulsory requirement for employers to purchase what is known as a WorkCover insurance policy;
- that the workplace accident compensation scheme is managed by a single manager (the VWA);
- centralised premium setting;
- the approval of providers of occupational rehabilitation services; and
- provisions relating to self-insurance requirements.

4 Recommendations

The Review Team conducted a public benefit assessment of each restriction on competition, including an assessment of one or more alternative approaches. The alternatives examined included ways of introducing more competition, either by abolishing or modifying the existing restriction on competition.

The final recommendation in each case is that which the Review Team considers will provide the greatest potential public benefit. In some cases observations are made of additional matters that the Victorian Government may wish to consider. These additional observations provide important context to the recommendations.

The following table summarises each restriction on competition and presents the Review Team's recommendations in respect of that restriction. The derivation of the recommendations can be found in the body of the report.

Restriction on Competition	Recommendations
<p>Compulsory Insurance: The WorkCover Insurance Act obliges employers to obtain a WorkCover insurance policy, under which the VWA covers their statutory liabilities and common law liabilities.</p>	<p>The Review Team recommends that the compulsory requirement to purchase a WorkCover insurance policy for both statutory and common law benefits be retained.</p>
<p>Single Manager: The workplace accident compensation scheme is managed by a single manager (the VWA). WorkCover insurance policies can only be purchased from that manager (via an agent). This is, in effect, a legislated monopoly.</p>	<p>The Review Team recommends that the single manager arrangement be maintained for the workplace accident compensation scheme in Victoria at this time.</p> <p>However, the Review Team notes that the Victorian Government may wish to consider the scope for improved market testing of some of the services provided.</p>
<p>Centralised Premium Setting: Sections 15, 16 and 17 of the WorkCover Insurance Act regulate the setting and calculation of premiums.</p> <p>Employers must pay the premium which is calculated in accordance with the premiums order made by the Governor in Council on the recommendation of the VWA.</p>	<p>The Review Team recommends that the Act be amended to require that an independent third party review of the VWA's proposed premiums occur prior to the making of a premiums order.</p> <p>The independent review of proposed premiums should be made public prior to the making of the premiums order.</p> <p>The review should examine and report on the premium methodology, ensuring that the overall level of proposed premium collections is sufficient to cover the long term liabilities of the workplace accident compensation scheme. The review should also examine and report on cross subsidies within the premium structure to ensure that the community is fully aware of those cross subsidies.</p>

<p>Approval of Occupational Rehabilitation Service Providers: Under section 163 of the ACA, the VWA may approve providers of occupational rehabilitation services.</p>	<p>The Review Team recommends that the ability to approve occupational rehabilitation service providers be retained.</p>
<p>Self-insurers: The workplace accident compensation scheme permits certain classes of employers to elect to self-insure (and hence manage) their liabilities under the scheme.</p>	<p>The Review Team recommends that self-insurance requirements be adjusted to increase flexibility and promote the expansion of self-insurance.</p>

Clearly the Review Team has recommended the retention of some key restrictions on competition at this time, particularly the retention of the single manager. The Review Team recognises that, technically, it would be possible to permit a range of approved insurers to write policies in a manner that would appear, at face value, to be in accordance with the current workplace accident compensation scheme.

However, the Review Team has been mindful of the requirement to seek to provide the greatest potential public benefit. The Review Team is firmly of the view that a move to competitive provision of insurance under the workplace accident compensation scheme at this time would not provide the greatest potential public benefit. This view is based upon a number of considerations that are outlined in the report. Key issues include:

- the workplace accident compensation scheme creates a statutory benefits scheme for persons who sustain a workplace injury or illness. This is akin to a welfare system of benefits. Worker access to that part of the scheme does not necessarily depend on the purchase of a policy by their employer – thus the scheme is not a simple insurance product. Competitive provision, while technically possible, would require changes to the nature of the benefits available under the scheme, rather than just changes to its delivery. Changing the nature of the benefits available under the scheme is outside the scope of this review;
- the workplace accident compensation scheme provides some injured parties with access to the benefit stream for an entire lifetime. Unlike most insurance products there may be no end point, no final settlement. This long tail of claimants requires a long term commitment to the provision of benefits;

- past experience with competitive provision in such a scheme has shown that the social benefits and broader OH&S objectives have not been a priority for private providers; and
- current premiums may still be lower than those required to fully fund the scheme, thus a move to competitive provision may introduce a significant price shock to employers. The current scheme has approximately \$579 million in unfunded liabilities. Competitive provision of the scheme would seek to have a zero amount of unfunded liabilities which would inevitably result in premium adjustments to amend the current deficit.

The Review Team observes that focussing reform efforts on self-insurance provisions is likely to achieve more significant outcomes than seeking to reform the single manager arrangement. This is because self-insurance permits a greater emphasis to be placed on innovative OH&S and worker outcomes than the insurance product approach.

The Review Team also notes that while it has examined each restriction on competition separately, it has recognised that the workplace accident compensation scheme involves many complex interrelationships. Thus change in any one area will impact upon the way the rest of the scheme operates. As such, the Review Team has sought to be mindful of the possible system wide effects of its recommendations.

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Introduction

1.1 Introduction

This report presents the findings and recommendations of the independent Review Team conducting the National Competition Policy (NCP) review of the Victorian *Accident Compensation Act 1985*, the *Accident Compensation (WorkCover Insurance) Act 1993* and the *Accident Compensation Regulations 1990*. Collectively referred to here as the workplace accident compensation legislation, the legislation establishes Victoria's workplace accident compensation scheme.

The Review Team comprises personnel from PricewaterhouseCoopers Economic Studies & Strategies Unit (ESSU) and Health and Casualty Unit (HCU) and MinterEllison Lawyers. It was appointed by the Victorian Department of Treasury and Finance (the Department). The appointment and the subsequent review process were overseen by a Steering Committee appointed from within the Victorian Government.

The findings and recommendations contained within this report are those of the Review Team only. They have been formed after consultations with a number of interested parties, consideration of written submissions made by a variety of participants and analysis of information from other sources. Written submissions are available for viewing on the Department's website at:

<http://www.vic.gov.au/treasury/ncpvwatac.html>

The analytical framework upon which these findings and recommendations are based is that provided under the NCP. Further guidance on the conduct of this review is found in clause 5 of the Competition Principles Agreement, the Terms of Reference for the review (see Appendix A) and in the Victorian Government (1996) *Guidelines for the Review of Legislative Restrictions on Competition* (the Victorian Guidelines).

1.2 Report structure

This report is set out as follows:

Chapter 2 describes the role of legislation reviews under National Competition Policy.

Chapter 3 describes the review process, including key dates and the consultation process adopted for this review.

Chapter 4 provides an overview of the Victorian workplace accident compensation scheme.

Chapter 5 provides an overview of insurance markets and various workplace accident compensation insurance markets in Australia and overseas, an overview of the legislative requirements of the scheme in Victoria and the background to the formulation of the current legislation.

Chapter 6 clarifies the objectives of the *Accident Compensation Act 1985*, the *Accident Compensation (WorkCover Insurance) Act 1993*, the Accident Compensation Regulations, and the objectives for the Victorian WorkCover Authority as outlined in the legislation.

Chapter 7 provides a discussion of the economics of workers' compensation. This includes a discussion of the potential market failures that may lead private markets to under or not provide certain goods and services, in particular workers' compensation insurance.

Chapter 8 identifies the potential restrictions on competition that arise from the legislation under review and presents the Review Team's analysis of the costs and benefits of each restriction. Alternative courses of action are also presented for discussion and form part of the final recommendations.

Appendix A contains the Terms of Reference for this Legislative Review as provided to PricewaterhouseCoopers and MinterEllison Lawyers by the Department.

Appendix B contains a consultation statement, which details the consultation processes adopted for this review.

Appendix C contains a summary of the key features of workplace accident compensation schemes in other jurisdictions.

**Legislation Reviews under National
Competition Policy**

2.1 Legislation reviews and the Competition Principles Agreement

In April 1995, the Commonwealth, State and Territory Governments agreed to implement the National Competition Policy (NCP). In practical terms this represented a commitment by all Australian Governments to adopt a consistent approach to improving the competitiveness of the Australian economy. Part of the Agreement to Implement the National Competition Policy between the Commonwealth, States and Territories includes around \$5 billion of payments from the Commonwealth to the States and Territories, with payment depending upon suitable progress being made in terms of implementation.

As part of the process the Governments signed the Competition Principles Agreement (CPA). Under the CPA the Governments committed themselves to undertaking a number of competition reform processes. These include:

- prices oversight of government business enterprises;
- competitive neutrality between government and private businesses;
- structural reform of public monopolies;
- legislation review; and
- access to services provided by significant infrastructure facilities.

The legislation review component of the CPA commits Governments to review and, where appropriate, reform all legislation (including subordinate legislation such as regulations) that restricts competition. Subclause 5(1) of the CPA states that the guiding principle of legislation review is that legislation (including Acts, enactments, Ordinances or regulations) should not restrict competition unless it can be demonstrated that:

- the benefits of the restriction to the community as a whole outweigh the costs; and
- the objectives of the legislation can only be achieved by restricting competition.

The process of legislation review does not imply that the pursuit of competition should take precedence over public policy objectives. Restrictions on competition commonly exist in legislation in order to achieve aims that are of public benefit. Legislation review provides an opportunity for these restrictions to be reassessed or reevaluated and to determine whether they are still the most appropriate means of achieving the legislated objectives.

This occurs through the examination of public benefits as part of the legislation review process and the other processes arising under the CPA. Subclause 1(3) of the CPA requires that, in assessing public benefit, a broad range of matters be taken into account where relevant, including:

- ecologically sustainable development;
- social welfare and equity;
- Occupational Health and Safety (OH&S);
- industrial relations;
- access and equity;
- economic and regional development;
- consumer interests;
- business competitiveness; and
- the efficient allocation of resources.

The CPA also allows for legislation reviews to be conducted on a national basis. Specifically, subclause 5(7) provides for a Government to conduct a national review where the review has a national dimension or national effects on competition. This assists where it would be impractical for each State and Territory to review its adoption of particular Commonwealth legislation individually

The CPA provides guidance as to an appropriate terms of reference for a review. Subclause 5(9) provides that a review should:

- 1 clarify the objectives of the legislation;
- 2 identify the nature of the restriction on competition;
- 3 analyse the likely effect of the restriction on competition and on the economy generally;
- 4 assess and balance the costs and benefits of the restriction; and
- 5 consider alternative means for achieving the same result including non-legislative approaches.

The Terms of Reference for this review set out eight steps, based upon the five from the CPA:

- 1 clarify the objectives of the legislative arrangements and determine whether these objectives remain relevant;
- 2 identify the nature and extent of any restrictions on competition contained in those legislative arrangements;
- 3 analyse the likely effect of any restrictions in the legislative arrangements on competition and on the economy generally;
- 4 identify any alternatives to the legislative arrangements, including non-legislative approaches, that achieve the objectives of the legislative arrangements;

- 5 assess and balance the benefits, costs and overall effects [public interest] of the legislation and any alternatives;
- 6 determine a preferred option for regulation, ie. whether the legislation should be repealed, modified, or maintained, and if modified the suggested modifications;
- 7 identify changes in legal obligations, liabilities and revenue to the Governments that might be expected to arise out of the preferred option for regulation; and
- 8 advise on any transitional arrangements which might be necessary in implementing the preferred option.

2.2 What NCP reviews do not cover

As outlined above, NCP reviews are designed to analyse and assess if, how and why provisions contained within the legislation provide a restriction on competition. Specifically, NCP reviews are designed to provide commentary on identified restrictions, a discussion on the costs and benefits to the community of each restriction identified and provide a view on whether or not the net benefit to the community is greater than the net cost of having that restriction in place.

Although some provisions in the act may lead to a restriction on competition through stipulated operational processes of regulatory and managing bodies, NCP reviews generally do not set out to make recommendations in regard to the specific structure or design of operational processes. Rather, an NCP review seeks to address the restrictions and make recommendations regarding how the legislation may be altered should it be found that the net costs to the community outweighs the net benefit of that restriction.

Further, an NCP legislation review such as this does not examine whether the complete legislative package provides a net public benefit. In the case of this review, there is no attempt to determine whether the workplace accident compensation scheme itself provides a net public benefit. Such matters are outside the scope of this review.

The Review Process

3.1 Consultation and participation

In order to meet the Terms of Reference, the Review Team has undertaken a series of consultations. Consultations form an important part of a review such as this and include:

- **Submissions.**
On 12 August 2000, the Minister for WorkCover called for public submissions via the print media and Department's web site. Details of the advertising campaign are included in Appendix B. Depending upon the classification of the review according to the Victorian Guidelines it may be a requirement to advertise the details of the review. Submissions were due by 13 September 2000. Six submissions were received. The list of submissions received is included in Appendix B. Copies of the submissions received are available on the Department's website at:

<http://www.vic.gov.au/treasury/ncpvwatac.html>
- **Targeted consultations.**
Between late September and early October members of the Review Team discussed aspects of the review with representatives of a number of organisations to discuss the review and the structure of submissions. The list of organisations visited is included in Appendix B. Not all parties visited presented submissions.

3.2 The analytical process

The eight stages of the Terms of Reference describe in broad terms the analytical process the Review Team has used in developing its findings. The major analytical elements are outlined below.

3.2.1 Clarifying legislative objectives

The objectives of legislation may be explicitly stated or implied in policy statements, parliamentary speeches and in legislation itself. Clarifying the objectives enables the Review Team to understand the types of outcomes, and hence benefits, that the legislation is intended to provide. It is not the purpose of the review to question the merits of the objectives of the legislation, although the Terms of Reference of the review ask the Review Team to consider the continued relevance of the objectives. The review provides an opportunity to examine whether the objectives of the legislation are being pursued efficiently.

3.2.2 Identifying restrictions on competition

There are many ways in which legislation may restrict competition. The second stage of the legislation review process is to identify where and how restrictions on competition arise in the legislation under review.

The Terms of Reference for this review identified a number of matters for the Review Team to consider in identifying restrictions on competition, including:

- the need to protect the interests of injured workers, and to maintain the affordability of insurance arrangements to cover workplace injuries;
- the effect the current insurance arrangements have or might have on the activities of insured parties;
- the restrictions and conditions on approval of self-insurers and occupational rehabilitation providers;
- the effect of the current arrangements on occupational health and safety in workplaces; and
- the outcomes of similar reviews in other jurisdictions.

The Victorian Guidelines describe a number of common restrictions that may arise from legislation. Some of these restrictions arise in the legislation under review here, including:

- legislated monopolies;

- licensing schemes, which restrict who may conduct a certain business;
- occupational limits, reserving the right to work in certain fields to those with particular qualifications or skills; and
- regulation of service standards.

Having examined the legislation, the Review Team considers that the main restrictions that arise under the legislation are:

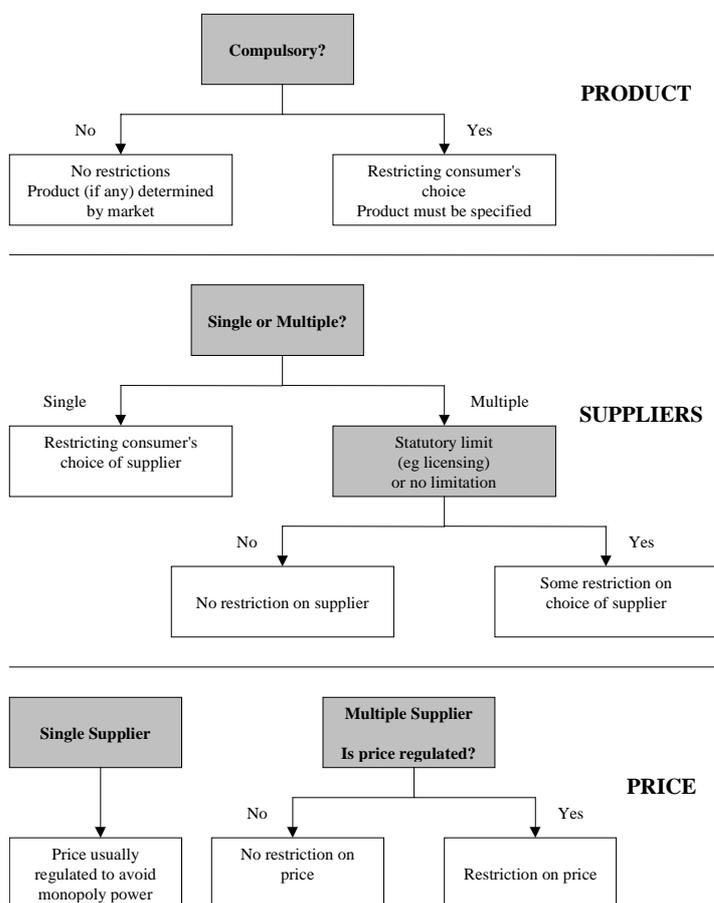
- the compulsory requirement for employers to purchase what is known as a WorkCover insurance policy;
- that the workplace accident compensation scheme is managed by a single manager (the VWA);
- centralised premium setting;
- the approval of providers of occupational rehabilitation services; and
- provisions relating to self-insurance requirements.

Figure 3.1 provides the decision process applied in the analysis of Victoria's workplace accident compensation legislation. The Review Team's initial task was to determine if the nature of the product was compulsory. The second part of the analysis focused upon the current single manager of the workplace accident compensation scheme. Given the existence of the single manager, the Review Team also considered the impact of the current premium setting arrangements.

The Review Team also took note of the recent publication by the National Competition Council (NCC) on Workers' Compensation Insurance¹ as this also provides some guidance on the identification of restrictions on competition and the assessment of public benefits. However, the Review Team noted that the publication appeared to equate workplace accident compensation schemes with insurance products. Whilst this accords with common understanding it does not necessarily capture the essence of the Victorian scheme.

¹ National Competition Council 2000, *Workers' Compensation Insurance*, NCC Community Information 2000.

Figure 3.1: The decision process



3.2.3 Public benefits and costs

There are a number of ways in which to assess whether a restriction on competition produces a net public benefit. A net public benefit approach is required because just as markets fail in fairly predictable ways, there can exist identifiable government failures that either add indirectly to the costs of market intervention or cause such market intervention to fail outright. The Victorian Guidelines set out some specific matters to be considered in particular circumstances. For example when assessing the impact of statutory marketing schemes, one must consider the costs and benefits associated with control over production, monopoly marketing, the stabilisation and setting of prices, price equalisation schemes, pooling, market development and promotion, product grading and labeling and the effects on research and development.

By its nature, a public benefit analysis considers the balance of both costs and benefits created by a restriction. Sometimes these may be measured quantitatively, for example in terms of dollars lost or gained. However,

there are many situations in which only some of the costs and benefits can be measured quantitatively. Many of the matters to be considered as a requirement of subclause 1(3) of the CPA may only be measured qualitatively. For example access and equity and social welfare. This also occurs in the case of workplace accident compensation, where the benefits of many of the regulations deal with, for example, the prevention of injury and illness. Consequentially econometric modelling, such as dynamic equilibrium modelling, estimations of changes to consumer and producer surplus or linear programming were not relevant to this review. A combination of qualitative and quantitative measures (as opposed to modelling) have been used to assess the costs and benefits of the restrictions on competition in this review. Where possible figures have been provided in relation to administration costs, premium rates, fatalities and injuries and other relevant data.

3.2.4 Alternative approaches

The Terms of Reference asks the Review Team to consider alternative approaches to achieving the objectives of the legislation under review, including non-legislative alternatives. Such alternatives are sought in recognition of the possibility that the same objectives may be achieved in lower cost ways, preferably without restricting competition.

3.3 Transitional issues

The Terms of Reference asks the Review Team to advise on any transitional arrangements which might be necessary in implementing the preferred option.

It is particularly important to identify and carefully consider transitional arrangements where the Review Team recommends the repeal of the current legislative scheme be introduced. This is because the removal of the existing scheme may significantly impact upon the existing rights and obligations of individuals and groups in the community and it is essential to ensure that the transition from the existing to a new scheme is properly managed. For example, if the recommendation was to repeal the compulsory obligation to obtain and maintain WorkCover insurance it would be necessary to ensure an appropriate legislative framework existed for a number of years to manage the rights and obligations of parties that arose prior to the change. Where a recommendation is to maintain the existing legislative framework, it is not necessary to consider transitional arrangements.

**The Victorian Workplace Accident
Compensation Scheme**

4.1 Overview of the scheme

The Victorian WorkCover Authority (VWA) is the manager of Victoria's workplace safety system, of which the workplace accident compensation scheme is a part. The system in Victoria aims to reduce the risk of workplace injury and illness, provide just compensation to people injured at work, rehabilitate injured workers and facilitate their return to paid employment.

The Victorian workplace accident compensation scheme combines a no-fault, statutory benefits scheme in addition to an injured worker's right to claim damages from their employer for negligence. All employers who pay above a prescribed level of remuneration must take out a WorkCover insurance policy with the VWA, (via an authorised agent), to insure themselves against compensation claims for workplace injuries and potential awards of damages against themselves as employers for negligence.

Employers are required to pay a premium based upon their annual remuneration, individual workplace risk and industry rating. The premium is calculated by the VWA and, depending upon the amount, may be required to be paid in full or in partial instalments throughout the year.

In addition to taking out a WorkCover insurance policy with the VWA, employers also have separate obligations by law to keep their workplaces safe. Employers must make sure that activities of workers are safe, the way activities are performed are safe and their working environment is safe. Employers must also provide their employees with the necessary information they will need if they are injured or become ill from work related practices.

4.1.1 When an injury or illness occurs

When an employee suffers a work-related injury or illness, they are required to report it in writing to their employer as soon as possible but within 30 days of becoming aware of it. Failure to do so may result in the removal of entitlements to make a compensation claim.

All employers are required to keep a register of injuries, or an injury report book. If the incident is recorded in the register this is considered to have been reported to the employer in writing. The employer must acknowledge in writing that he or she has been notified of the employee's injury or illness. If an incident results in any workplace death or serious injury or any incident that could have caused death or

serious injury, the employer must notify the VWA immediately by telephone. In addition the VWA must be notified in writing within 48 hours and a copy of the written notification must be kept by the employer for five years.

4.1.2 The claims process

Employees are entitled to make a claim for WorkCover compensation if they suffer a work-related injury or illness. For an injury or illness to be considered work-related, it must have significantly been contributed to by their employment. Claims may be made for the reasonable cost of treatment and/or time off work.

Upon a workplace injury or illness occurring, the appropriate sections of a specified claim form is completed by the employee and then given to the employer along with other relevant documents (such as medical certificates). The employer is not permitted to refuse to receive the form or dismiss an employee for making a claim. The employer is then obliged to send the material provided by the employee to the WorkCover agent within 10 days of receiving it from the employee.

The agent must accept or reject a claim for weekly benefits within 28 days of receiving the claim from the employer. If a claim is for medical and like costs only, the agent must accept or reject the claim within 60 days.

An employer is required to pay for minor claims (ie where the worker is off for 10 days or less and the medical expenses are less than \$430). However these claims still required to be reported. After these costs have been paid, the claim becomes a standard claim and the VWA will pay for further expenses.

If a claim is accepted or in the process of being evaluated, medical and like costs are to be sent from the employee's doctor directly to the employer. If the claim is accepted, WorkCover will pay reasonable medical costs and like costs. In addition, an employee may also be eligible for weekly benefits, which are calculated based upon the time off work and the employee's current work capacity.

If a claim is rejected, an injured employee has the right to have the decision reviewed by a senior manager who was not involved in the original decision. If an injured employee still disagrees with the outcome, they can contact the VWA for advice or seek conciliation. If the claim is ultimately rejected, the medical expenses become the responsibility of the injured employee.

4.1.3 Return to work

If an employee is absent from work for 20 days or more because of a work-related injury or illness, the employer is required to prepare a return to work plan for the employee. This allows the employer to monitor the employee's conditions and progress and detail the various types of occupational rehabilitation services that may be best suited to help the injured or ill employee. In addition, if the employee is absent from work for 20 days or more, a return to work coordinator must be appointed to assist the injured or ill employee to return to work.

If an employee's doctor indicates that the injured or ill employee has some capacity for work, the employer is required to offer suitable employment if it is available. If an employee has fully recovered within a twelve month period, the employer must offer the employee his/her old job back or another equivalent position.

4.2 The VWA

As noted above, the VWA is the sole manager of Victoria's workplace safety system. The VWA performs many of its own functions, with the exclusion of claims management. Whilst it does not perform the role of rehabilitation services provider (as specialist skills and qualifications are required to perform this task), it does manage the provision of these services.

The mission of the VWA is to:

“work with all Victorians to progressively reduce the incidence, severity and cost to the community of work-related injury and disease.”

To achieve this the VWA not only provides and manages the services required by an injured worker, it also promotes and administers OH&S policy for the government. Specifically the VWA administers the following legislation in addition to the workplace accident compensation legislation:

- *Occupational Health and Safety Act 1985;*
- *Dangerous Goods Act 1985;*
- *Equipment (Public Safety) Act 1994;*
- *Accident Compensation (Occupational Health and Safety) Act 1996;*
- *Mines Act 1958 – Division 2 of Part III (jointly administered with the Minister for Agriculture and Resources);*
- *Road Transport (Dangerous Goods) Act 1995;*
- *Road Transport Reform (Dangerous Goods) Act 1995 (Commonwealth) – section 6 and parts 3,4,5,& 6 (by virtue of the Victorian Act which adopts that section and those parts of the Commonwealth Act; and the term “Minister” referring to the responsible Minister of the jurisdiction concerned by virtue of section 9 of the Commonwealth Act 1958); and*
- *Workers Compensation Act 1958.*

The introduction of the *Occupational Health and Safety Act 1985*, was based upon the findings of the Roben Committee of Inquiry in the United Kingdom. Amongst other things, the *Occupational Health and Safety Act 1985* sought to:

- focus the attention of workplace parties on the need to prevent work related injury, illness and death; and
- impose general duties on the parties in the workplace to ensure that, so far is practicable, they exercise their responsibilities in a way that

is not harmful to the health and safety of any person; and it provides a mechanism for consultation between employers and employees on health and safety issues.

The Dangerous Goods Act 1985 aims to minimise the possibility of serious incidents involving dangerous goods and to minimise the impact of any incidents which may occur. *The Equipment (Public Safety) Act 1994* mirrors the provisions of *the Occupational Health and Safety Act 1995* in relation to certain types of equipment used in non-workplace situations.

The VWA's corporate plan for the period July 1998-June 2001 focuses on strategies to achieve the vision of making Victoria's workplaces the safest in the world and the VWA a world leader in the management of workplace health and safety systems. The major initiatives of the corporate plan seek to:

- reduce workplace incidents, injury and illness;
- improve return to work outcomes;
- return the compensation scheme to surplus;
- improve stakeholder satisfaction with and support for the system in the interests of all stakeholders; and
- increase the VWA's on-going capacity to manage Victoria's workplace health and safety.

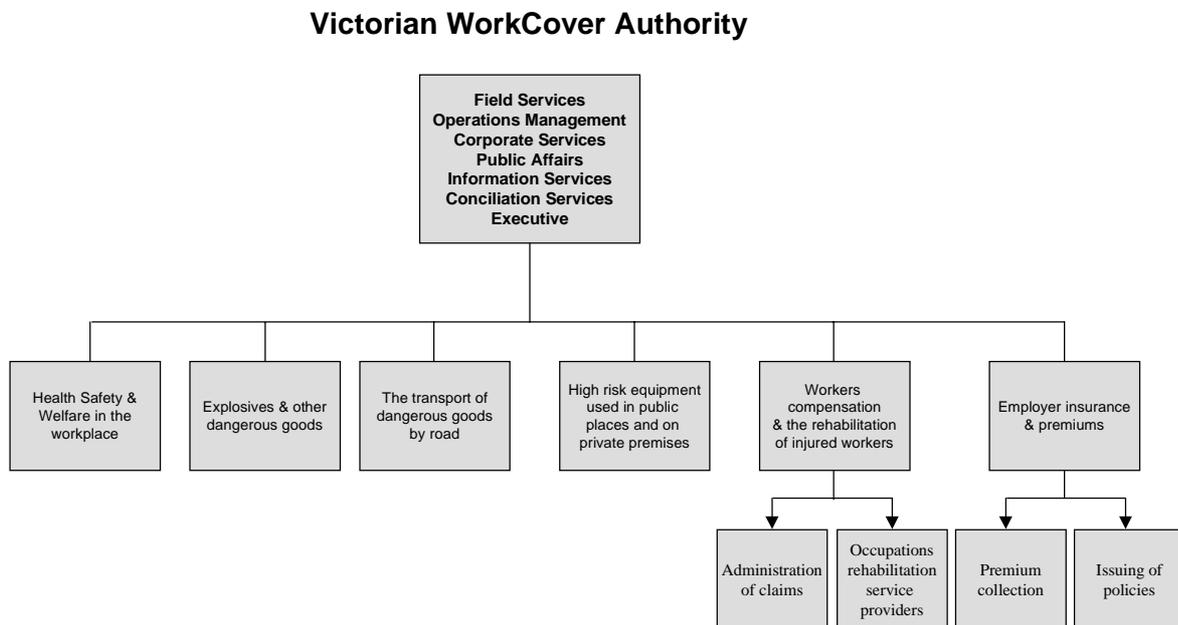
Amongst other things, some of the specific policies and programs administered by the VWA in addition to the administration of the workplace accident compensation scheme include:

- the Major Hazards Unit;
- Farm Safety 2000;
- focus on back injury;
- zero-tolerance approach to health and safety breaches on construction sites;
- focus on falls;
- focus on overhead powerlines;
- Transport Industry Safety System;
- Tree Felling safety group; and
- the provision of guidelines for safe workplace design.

On 1 July 1999, the VWA released a new manual handling code in response to the introduction of the Occupational Health and Safety (Manual Handling) Regulation 1999.

Figure 4.1 below sets out the workplace accident compensation and OH&S functions of the VWA.

Figure 4.1: Structure of VWA



The range of functions undertaken by the VWA give some identification to the nature of the restrictions on competition addressed in this report. However, the key restrictions identified relate more to the design and management of the scheme than the delivery of particular services within it. Further, many of the functions of the VWA relate to activities other than the workplace accident compensation scheme. As a result, the Review Team has not adopted a functional analysis as a basis for identifying restrictions on competition.

Background to the Review

5.1 Overview of the Australian general insurance industry

The insurance industry in Australia has developed based on branches of foreign (mainly British and the United States) operations, mutual life insurers, State Government insurers and some local stock company insurers.

Recently, the industry has seen examples of privatisation of State Government insurers, demutualisations, mergers and acquisitions and an increase in listed insurers.

The rules for the general insurance industry are outlined in the WorkCover Insurance Act 1973. The prudential regulator since 1 July 1998 is Australian Prudential Regulation Authority (APRA) which has taken over as the prudential regulator of insurance companies, as well as authorised deposit-taking institutions, superannuation funds and friendly societies.

Australia has one of the “softest” insurance markets in the world with many players and a small population base. In 1997, there were 150 non-life insurers in Australia with a premium income of US\$14.048 billion. This equates to 60% of number of all the insurers, but only 39% of the premium dollars at the time². The five largest operators account for approximately 60% of the general insurance market.

General insurance is sold either direct or via insurance brokers or agents. Typically, commercial insurance such as workers’ compensation insurance is sold via brokers, whereas personal insurance, such as compulsory third party insurance is sold directly by the insurers themselves.

² PricewaterhouseCoopers, *Asia Pacific Insurance Handbook* (internal publication), June 1999, page 15

Table 5.1: Major Lines of Insurance in Australia

Insurance Line	Net written premium 31/12/98 (\$m)	Percentage of total industry
CTP motor vehicle	2,343.9	13
Workers compensation	4,024.7	23
Motor vehicle (domestic & commercial)	3,697.0	21
Houseowners/householders	1,914.0	11
Other	5,889.0	32

Workers' compensation insurance nationally, including the values of the publicly underwritten workplace accident compensation schemes, is the largest line of general insurance products as illustrated in table 5.1.. The table illustrates an approximate distribution of products based on the available information about privately and publicly underwritten schemes for all general insurance products.

The data contained in the table is a guide only, as its representations of the various categories are not directly comparable. Some of the underlying values have been sourced from APRA reporting as at 31/12/98, some numbers from annual reports with year ending 30/6/98 or 30/6/99 and some are based upon general knowledge about each of the represented general insurance markets.

The nature of workers' compensation insurance is often different to other general insurance products since the requirement to obtain the policy is dictated by legislation. Other aspects that are legislated are the prescribed benefits, and who is allowed to carry the risk, and whether access to benefits is linked to the purchase of a policy.

5.2 Workplace accident compensation schemes

Workplace accident compensation schemes have evolved in the post industrial world as a way for the State to ensure that workers injured at work are adequately compensated for their injuries and associated loss of earnings. In more recent times, and as the cyclical nature of these schemes has caused premiums to rise, the focus has turned towards loss control and prevention. At the same time the “duty of care” for safe and healthy workplaces has shifted to employers, arising from Roben’s approach to legislative reform in OH&S.

Workplace accident compensation schemes, whilst theoretically framed by Governments to achieve similar policy objectives, vary considerably both in their philosophical underpinnings and the way in which they are delivered. The common features of most schemes around the world are that they have benefits prescribed by legislation and that they are predominantly mandatory.

The balance between social policy and economic policy objectives is viewed differently by different governments, and in large part derives from legislative and cultural history in the jurisdiction concerned. This in turn influences the extent to which premiums paid under workplace accident compensation systems are considered to be insurance premiums or a type of risk rated government levy, or tax, on employers on behalf of their employees. These type of issues influence both the structure and content of the legislative framework as well as the type of delivery mechanism and whether it is monopolistic or competitive.

In European countries schemes vary in their delivery mechanisms but tend to have two characteristics which differentiate them from the North American and Australian systems. Firstly, workplace accident compensation schemes in most European countries are single jurisdictional schemes for the entire country and secondly, the schemes tend to be regarded as an integral part of the country’s social insurance system. As neither of these circumstances apply in Australia, the Review Team have considered comparisons between Australia and North America to be more relevant, whilst at the same time referring to European schemes as and when required.

On the continuum of competitive to monopolistic workplace accident compensation schemes there are many different models for scheme delivery ranging from Government monopoly to minimally regulated competitive insurance markets with little Government involvement.

The following sections describe the three broad categories of schemes that exist for workplace accident compensation and, within each section, the differences that can occur within each of these broad categories are explored.

5.2.1 Competitive schemes

This model, in its various forms, is the dominant model in the United States. All but four State schemes operate in competitive environments, many of which also include a State Fund (Government insurer) competing with private insurers.

These markets are very different from Australia which has a limited number of insurers competing for business. By way of example, when the Nevada system was opened to competition there were over 200 insurers seeking a licence to write workers' compensation in a State where the premium pool is in the order of US\$26.14 billion³. By way of size comparison Western Australia which is the largest competitive market in Australia has a premium pool of \$463 million⁴ has 14⁵ licensed workers' compensation insurers. Victoria has a premium pool of \$1,244 million and 12⁶ authorised agents.

The regulatory environment within these competitive markets in the USA varies between those which are highly regulated and those which have minimal regulation, particularly in relation to pricing.

There is little recent evidence available which compares social benefits such as level and utilisation of benefits and delivery of services to injured workers where different levels of regulation exist. However there has been research carried out recently in a number of competitive schemes in the USA on financial benefits alone and concludes that premiums are lowest in less regulated environments and highest in partly regulated environments⁷. Appendix C contains a detailed comparison of workers' compensation arrangements in other jurisdictions.

The Wisconsin scheme is sometimes cited by both employer and workers organisations as one of the most effective of the competitive workplace accident compensation schemes from both a financial and social benefits perspective. However, the evidence to support this contention tends to be either financially focussed or anecdotal and the available data is, as

³ source: www/scripts/appnswsn.exe?story=26728&database=prod

⁴ WorkCover, *Annual Report* 1998/99, page 48

⁵ www.workcover.wa.gov.au/SchemeInfo/inslist.asp

⁶ Accurate at June 2000, Source Victorian WorkCover Authority, *Annual Report*, 1999-2000

⁷ Burton, J. and Thomason, T *The Impact of De-regulation on Prices* Presented at the 4th International Congress on Medical and Legal Aspects of Work Injuries, Toronto, Canada June 1999

always, difficult to compare with other schemes given the differences in benefit regimes.

5.2.2 Hybrid schemes

These schemes are unique to Australia. Hybrid schemes combine monopoly pricing with varying degrees of competitive service provision.

The Victorian WorkCover system was the first of these hybrid models to be introduced into an Australian jurisdiction. Following the Report of the Committee of Enquiry into Workers' Compensation in Victoria (Cooney Report)⁸, the WorkCare scheme was established. It was the product of compromise between:

- the government, some powerful employer associations and the trade union movement wishing to remedy the problems of the competitive market at that time by centralising workplace accident compensation into a State owned monopoly; and
- other employers, the insurance industry and the Financial Services Union which sought to retain some elements of competition and a role for insurance companies. This public/private hybrid system was later adopted by the NSW and South Australian Governments.

The models for each of these three States is different in the extent to which various services essential to workplace accident compensation systems are delivered by the government monopoly provider or other providers in the market.

NSW is the system which has arrangements for most services to be provided in a competitive environment ranging from the collection and investment of premium funds right through to the management of claims. However the NSW WorkCover Authority retains control of premium setting and the regulatory roles normally associated with State based workplace accident compensation authorities.

South Australia is at the opposite end of the hybrid system spectrum in that it contracts out only claims management services. Victoria lies somewhere in between the two.

5.2.3 Monopolistic systems

In Australia, Queensland is the only State in Australia with a workplace accident compensation scheme which operates in a fully monopolistic

⁸ *The Report of the Committee of Enquiry into Workers' Compensation in Victoria* (known as the Cooney Report), Melbourne, 1984

environment. The monopoly scheme was established in 1916 and whilst there have been changes to the benefits structure over the years, the most significant change impacting on the monopoly was the introduction of self-insurance in the *WorkCover Queensland Act 1996*.

The monopoly model means that the VWA acts as both regulator and service provider in the areas of premium setting, claims management, compensation payments and rehabilitation. Essentially workplace accident compensation is seen as a public service and is provided by a government agency.

The monopoly model has been adopted by all Canadian provinces, however the number of State workplace accident compensation monopolies in the United States has reduced over time so that only five remain; North Dakota, Ohio, Washington, West Virginia and Wyoming. The most recent system to move to a competitive system was Nevada in 1999. Some of these monopolies allow self-insurance.

North American researchers have for many years attempted to determine whether competitive or monopolistic systems are more cost effective. The evidence is conflicting, which only points to the difficulty of making legitimate comparisons between systems with different laws, cultures, histories and governance structures.

A study⁹ reported in 1995 based on Best's 1993 Statistical Abstract, showed that

“private and competitive systems have been able to maintain benefit levels while placing a lighter burden on employers through lower average WC premiums per employee”.

However, a more recent , and smaller scale, study by Burton and Thomason¹⁰ concluded that:

“workers’ compensation costs under the provincial monopoly systems of Ontario and British Columbia are not higher, and indeed may well be lower, than they are in the more private, competitive systems that exist in the United States..... Whilst it is not a result that we expected, it suggests that cost reductions need not occur- indeed costs may increase- by shifting from monopoly provision to a US model of private insurance.”

In Australia, there has been little research available on the costs and benefits of monopoly as compared with competitive systems. A report on the trends in OH&S performance in different systems in Australia

⁹ *Unfolding Change: Workers' Compensation in Canada Vol 4*, Commissioned by Liberty International, Canada 1995

¹⁰ Thomason, Terry. and Burton, John F. Jnr. *The Cost of Workers' Compensation in Ontario and British Columbia* published in ??? 1997book

(proceedings of the 12th General Insurance Seminar in 1999)¹¹ showed that

“the data showed a clear trend toward better occupational health and safety performance in competitive privately underwritten workers’ compensation schemes.”

5.2.4 Comparison of premiums between jurisdictions

One measure used to compare the performance of different jurisdictions is to provide a comparison of the average premium rates, as a percentage of wages, for each state. The table below provides a comparison of the average premium rates for each state, the Australian Capital Territory and Northern Territory¹².

Table 5.2 Average Premium Rates Across Australia

	1994/95	1995/96	1996/97	1997/98	1998/99	1999/00
VIC	2.25%	1.98%	1.80%	1.80%	1.90%	1.90%
NSW	1.80%	2.50%	2.80%	2.80%	2.80%	2.80%
SA	2.86%	2.86%	2.86%	2.86%	2.86%	2.86%
WA	2.71%	2.61%	2.67%	2.40%	2.73%	3.44%
QLD	1.70%	1.85%	2.02%	2.15%	2.15%	1.85%
TAS	2.85%	3.02%	3.20%	3.10%	2.70%	2.90%
ACT	2.34%	2.41%	2.50%	2.12%	2.12%	2.60%
NT	1.70%	1.60%	1.50%	1.53%	n/a	n/a

Source: Workplace Relations Ministers’ Council (April 2000), *Comparative Performance Monitoring*, Canberra.

Whilst average premiums can prove a basis for comparison between jurisdictions, there are dangers in this approach. As the source document for the above data states:

“It can be misleading to simply compare published average premium rates levied on employers for workers’ compensation in the different jurisdictions. Some of the main reasons are:

- 1 benefits and coverage for certain types of injuries differ between schemes;
- 2 there are different levels of accident frequency and severity;
- 3 claims management arrangements differ between schemes;
- 4 the funding arrangements for delivery of OH&S services vary between schemes with a degree of cross-subsidisation existing in some jurisdictions;

¹¹ Neary, J., Stephens, M. and Wong, D. *OH&S Performance Competitive Private vs Public Workers’ Compensation systems in Australia 1999*

¹² Current data was not available for the Northern Territory

- 5 different definitions of wages for premium setting purposes, different deductibles, the extend of self-insurance and different industry mixes;
- 6 the definition of wages, on which levies or premiums are based, differs between schemes;
- 7 premium calculation methodology differs between schemes, for examples, some schemes have experience rating formulae, and some have exemptions for employers with low wage-rolls;
- 8 premium rates can be calculated suing different actuarial assumptions and some premium rates;
- 9 some premium rates include stamp duty.¹³”

The rates presented above have been standardised to some extent to remove the variations associated with items 5, 6 and 7. Standardisation has been used to attempt to remove the effects of different coverage, wage definitions, premium bases and actuarial assumptions. It should be noted however, that the effects of the other matters notes have not been removed.

¹³ Workplace Relations Ministers' Council (April 2000), *Comparative Performance Monitoring*, Canberra.

5.3 Legislative history of workplace accident compensation arrangements in Victoria

This section provides a brief overview of the situation prior to the introduction of Victoria's first workplace accident compensation scheme and summarises the schemes in place prior to the introduction of the *Accident Compensation Act 1985* (the ACA) and the *Accident Compensation (WorkCover Insurance) Act 1993* (the WorkCover Insurance Act). This section then describes the workplace accident compensation legislation, highlights significant amendments made to the legislation and concludes with a description of the current scheme.

5.3.1 Workplace accident compensation pre-1914

Prior to the introduction in 1914 of Victoria's first workplace accident compensation scheme, injured workers could only seek compensation from their employer (or another person) if their employer (or the other person) was found to be negligent.

5.3.2 The 1914 scheme

The *Workers Compensation Act 1914* (No. 2496) ('1914 Act') established that an employer was liable to pay compensation and benefits set out in the 1914 Act to a worker who suffered personal injury by accident arising out of and in the course of employment.

Under the 1914 Act all employers were required to obtain insurance (from either a State insurer or a private insurer approved under the Act) to indemnify the employer against its liability to workers. It was possible under the 1914 scheme to be exempted from the requirement to obtain insurance if an employer received certification from a County Court judge.

In 1946 the ability for employers to be exempted from the requirement to obtain a contract of insurance was restricted to those employers certified prior to 1946.

5.3.3 The 1958 scheme

In 1958 the *Workers' Compensation Act 1958* (Vic) ('1958 Act') was introduced. Under this scheme employers remained obliged to obtain a policy of accident insurance or indemnity for the full amount of their liability to pay compensation from either a State insurer or an approved

private insurer. The Victorian government continued to underwrite all policies of insurance made by the State owned insurer.

The 1958 scheme continued to restrict an employer's ability to be exempted from the scheme. It also made it possible for employees to challenge whether an employer's certified scheme should continue.

The Workers Compensation Board was established to regulate and manage the accident compensation scheme.

5.3.4 The 1985 scheme

The Victorian Government introduced the *Accident Compensation Act 1985 (Vic)* ('ACA') shortly after the release of the Cooney Report. The Cooney Report recommended by a 3-2 majority that the system of multiple agents which existed prior the ACA be retained. The Government rejected this suggestion and created a single Accident Compensation Commission which was responsible for the administration of the Accident Compensation Scheme as a whole.

Under the ACA, employers remained obliged to obtain insurance for the full amount of liability to pay compensation to workers under the ACA. Those employers who had taken out insurance would also receive an indemnity for their liability to pay damages to injured workers who could establish a common law action.

Employers were able to obtain insurance from WorkCare agents who were required to reinsure their liability under the Act with WorkCare. They therefore did not have any financial risk.

Employers were able to self-insure rather than obtain insurance from an agent if they met the criteria set out in the ACA.

All employers other than self-insurers were required to pay a levy to WorkCare which was calculated by reference to industry amounts rather than reflecting the employer's own risk profile.

In 1987 the Department of Management and Budget conducted a review which highlighted wide-spread employer dissatisfaction with the performance of claims administration agents. Employers complained about delays in reimbursement, poor claims review, irregularity in ordering medical examinations and a lack of follow up in relation to return to work or referrals. In 1987 a new remuneration system for claims administration agents was introduced and the ability of employers to change agents was enhanced.

In 1992 WorkCare had an unfunded liability of \$2.1 billion and funding ratio of under 50%. It was a system under which:

- more than 25,000 Victorians were in receipt of workers compensation benefits; and
- more than 16,000 workers had been on workers compensation for a year or more and in the case of some 8,000 workers, more than three years.

The return to work rates were dramatically inferior to those prevailing in the New South Wales Work Cover Scheme.

5.3.5 Introduction of the VWA

In 1992 the ACA was amended by the *Accident Compensation (WorkCover) Amendment Act 1992* (Vic). This abolished the Accident Compensation Commission and established the VWA to administer the new system and a new WorkCover Authority Fund.

5.3.6 1993 changes

In 1993 the *Accident Compensation (WorkCover Insurance) Act 1993* (WorkCover Insurance Act) was introduced. The purpose of the WorkCover Insurance Act was:

- to impose the liability to pay compensation under the ACA on employers and to require employers to hold WorkCover insurance against that liability;
- to provide for the licensing of authorised insurers for the purpose of issuing and renewing WorkCover insurance policies;
- to provide for the levying and collection of premiums;
- to transfer the existing liability of the VWA to authorised insurers;
- to require authorised insurers to reinsure against their liability with the VWA; and
- to further improve the operation of the ACA.

The WorkCover Insurance Act required employers to obtain and maintain an insurance policy with an authorised insurer who was required to reinsure its liability with the VWA.

The WorkCover Insurance Act required the VWA to establish and maintain a statutory fund for each authorised insurer.

Under the WorkCover Insurance Act the insurance risks of authorised insurers' were pooled. The rationale was to ensure that all liabilities were

able to be met under the policies and that authorised insurers were not at ultimate risk until private underwriting occurred. It was the Government's intention for the authorised insurers to bear the insurance risk after full privatisation.

5.3.7 Further amendments and significant events

In 1996 the *Accident Compensation (Health and Safety) Act 1996 (Vic)* was introduced which transferred the responsibility for the administration of Victoria's health and safety legislation to the VWA.

In 1997 the *Accident Compensation (Miscellaneous Amendment) Act 1997 (Vic)* completely abolished common law damages except in actions brought by dependents of a deceased worker.

In 1998 the *Accident Compensation (Amendment) Act 1998 (Vic)* ensured that the provision of accident compensation reverted exclusively to WorkCover with authorised insurers (and others) acting as agents for WorkCover in both insurance and compensation aspects of the scheme. The reasons for implementing the change were explained by the Minister in his second reading speech:

*'Because of a number of factors, including the reinsurance and premium setting arrangements within the scheme, the substance of the Victorian WorkCover Authority's current relationship with the authorised insurers in many ways closely resembles a principal-agent relationship. Following amendments made by the bill, the Authority's relationship with WorkCover agents (whether they be insurance companies or other bodies) will be formally on this basis.'*¹⁴

The 1998 Amending Act required each of the previous authorised agent's statutory funds to become part of the WorkCover Authority fund and all licenses granted to authorised insurers were cancelled. The VWA became the successor in law of each authorised insurer.

In May 2000 the Victorian Government introduced the *Accident Compensation (Common Law and Benefits) Act 2000* which has restored workers' common law rights to recover damages against negligent employers.

In October 2000, the Minister for WorkCover announced that independent actuaries had confirmed that the current scheme had approximately \$579 million in unfunded liabilities. It would appear that

¹⁴ Parliament of Victoria Hansard, 8 October 1998, page 446

this deficit reflects, in part, government policy aimed at setting premium levels that are competitive with other states (so as to attract investment to Victoria) and do not unfairly burden small businesses.

5.4 Features of the current workplace accident compensation scheme

Under the current scheme workers who suffer injury or death resulting from a workplace accident (or the dependants of a deceased worker) are entitled to no fault compensation under the ACA. Compensation is both for loss of earnings whilst the worker is absent from work and for the reasonable costs of road accident rescue, medical, hospital, nursing, personal and household, occupational rehabilitation and ambulance services received because of the injury. Some types of benefits such as occupational rehabilitation and personal and household services are only payable if they are provided by a person approved by the VWA.

The ACA provides that the VWA assumes the liability to pay no fault compensation to an injured or deceased worker if that worker's employer has a leviable remuneration below a prescribed level.

A worker who suffers a serious injury can bring an action for common law damages against a negligent party.

The WorkCover Insurance Act requires employers whose rateable remuneration is above a prescribed level to obtain and maintain WorkCover insurance from the VWA which insures the employer for:

- any liability to pay compensation under the ACA; and
- any liability for common law claims brought by a seriously injured worker.

If an employer has not obtained a policy then they have committed an offence under the legislation. The VWA still assumes the liabilities and will deal with an injured worker as for any insured employer. However, the VWA may then seek recovery of costs from the employer, as well as pursue the employer for the offence committed. Similarly the VWA takes on liabilities for employers that cannot be found or have ceased to exist. These are important features of the scheme as they are not necessarily characteristics of typical insurance products and reflect the statutory structure of the scheme.

An employer remains liable for the first \$430 in medical expenses in respect of each claim and compensation for a workers absence from work for the first 10 days. An employer may increase, reduce or eliminate their excess in accordance with the ACA.

VWA's insurance obligations are funded through an insurance premium which is payable by employers in respect of the WorkCover insurance

policy. The premium is calculated in accordance with the premiums order issued by the VWA. The VWA has moved towards a risk reflective based premium rather than industry specific premiums. It is now expected that an employer's history of claims lodged for compensation will directly affect the employers premium. It is intended that this experience based calculation will encourage employers to implement all necessary health and safety measures to reduce the incidence of work place death or injury.

The VWA may appoint any person to be its authorised agent. Agents are appointed by an instrument in writing and must comply with the conditions of their appointment. As at 30 June 2000 the VWA had appointed 12 authorised agents to perform its functions including:

- receiving and assessing and accepting or rejecting claims for compensation;
- defending actions against employers under the ACA and at common law;
- collecting and recovering premiums payable for WorkCover insurance policies;
- collecting and recovering levies payable under the Acts.

Authorised agents are obliged to:

- commence performance of their obligations effectively upon the Commencement Date as specified in the agreement between the authorised agent and the VWA;
- at all time comply with the terms of the agreement between the authorised agent and the VWA;
- may only permit or authorise natural persons in its employ to carry out its obligations; and
- comply with the code of conduct as prescribed in the agreement between the authorised agent and the VWA.

The VWA is responsible for evaluating the authorised agents' ongoing compliance with their obligations.

It is possible under the current scheme for certain employers to be self-insurers. A self-insurer is not obliged to obtain and retain a WorkCover insurance policy. The ACA allows any body corporate or partnership who has met the prescribed minimum requirements as to financial strength and viability to apply to the VWA to be approved as a self-insurer. The Regulations state that a person would meet this requirement if it is and will be capable of meeting its claims liabilities as and when they fall due. A fee of at least \$30,000 must be paid on application.

The ACA sets out the following matters which the VWA must take into account in considering whether to approve an employer as a self-insurer:

- whether the insurer is, and is likely to continue to be, able to meet its liabilities;
- whether the employer has sufficient resources available to administer claims for compensation;
- the incidence of injuries to workers and the cost of claims; and
- the safety of working conditions for workers.

Employers who are approved as self-insurers must also comply with the following terms and conditions of approval set out in the Regulations:

- a self-insurer must estimate its expected claims liability for each new reported claim and review each estimate at least every 6 months;
- a self-insurer must keep accessible copies of claims forms approved by the VWA;
- a self-insurer must use risk management services where appropriate to achieve accident prevention;
- a self-insurer must refer all appropriate cases to an approved occupational rehabilitation service;
- a self-insurer must advise the VWA of all common law proceedings brought by its workers;
- a self-insurer must pay an annual audit fee to the VWA comprising both a flat fee of \$10,000 and \$20¹⁵ for each open claim against the self-insurer in the previous year; and
- a self-insurer must also pay a contribution to VWA, as a nominal fee for VWA services that it utilises.

An examination of the current scheme shows that it shares some characteristics with insurance products, and hence an insurance market may be the most appropriate context in which to examine the scheme in this review. However, the statutory structure of the scheme also means that whilst WorkCover insurance carries the outward appearance of an insurance product, it contains complexities and subtleties which the Review Team has kept in mind when examining restrictions on competition and the scope for change.

¹⁵ As specified in Schedule 5 of the Accident Compensation Regulations 1990.

Objectives of the Legislation under Review

6.1 Statement of objectives

The objectives of legislation are sometimes found stated in the legislation itself. However, sometimes objectives must be clarified through an examination of policy statements relating to the legislation. In the case of the workplace accident compensation legislation the objectives are clearly defined and often measurable.

The objects of the ACA as set out in section 3 are:

- to reduce the incidence of accidents and diseases in the workplace;
- to make provision for the effective occupational rehabilitation of injured workers and their early return to work;
- to increase the provision of suitable employment to workers who are injured to enable their early return to work;
- to provide adequate and just compensation to injured workers;
- to ensure workers compensation costs are contained so as to minimise the burden on Victorian businesses;
- to establish incentives that are conducive to efficiency and discourage abuse;
- to enhance flexibility in the system and allow adaptation to the particular needs of disparate work situations;
- to establish and maintain a fully funded scheme; and
- in this context to improve the health and safety of persons at work and reduce the social and economic costs to the Victorian community of accident compensation.

The above list has a number of items that could be considered as tasks that are aimed at achieving more broader policy objectives, rather than as objectives in their own right. To fully appreciate the principle goal of the legislation, the Review Team has closely examined the above list to determine what the real policy objectives of the ACA are. To this end, the Review Team considers that the objects of the ACA can be summarised into four primary objectives, these being:

- the prevention of work-related injury and illness;
- provision for the effective occupational rehabilitation of injured workers and their early return to work;
- the provision of fair and just compensation for workers who suffer a work-related injury or illness; and
- the reduction in costs to the community in general.

6.2 Relevance of the objectives

The Victorian workplace accident compensation scheme was introduced to address the social and economic cost of workers who were injured or died at work. The general objectives of the scheme are deemed to be consistent with the objectives of similar workplace accident compensation schemes around the world.

It is sometimes necessary to clarify whether the objectives of the Act are effectively fulfilling the needs of society or if they are not, to consider whether the objectives continue to be relevant.

Notwithstanding that the ACA has operated (in various forms) for now over 15 years, the social problem of persons being injured and dying at work continues to exist. For example, in the 1998/1999 financial year:

- 125 claims for compensation were lodged for work related deaths;
- 3,091 claims were reported for traumatic injuries which result from an impact to the body from an external force;
- 7,917 back claims were lodged; and
- 14,983 claims were reported that involved more than 10 days of compensation.¹⁶

Activities continue to be directed at reducing the occurrence of workplace death or injury, which the Review Team considers to be relevant given the desire of society to prevent workplace injury and death and provide for those who do suffer a workplace injury or illness. In the 1998/1999 financial year, \$50 million was invested in health and safety activities.¹⁷

A strategy used to reduce the social cost of workplace injury or death is to encourage workers to return to work. During the 1998/1999 financial year 85% of injured workers had returned to work within 8 months of injury and 76% of those were still at work 8 months after injury.¹⁸

The Review Team is not aware of any evidence that supports the view that the objectives of either the ACA or the WorkCover Insurance Act are no longer relevant. However, the Review Team does note that the objectives can sometimes conflict with each other. The objectives may also conflict with other policy objectives governed by other legislation, such as general OH&S policy.

¹⁶ VWA 1998-1999 Annual Report, pages 8,9

¹⁷ VWA 1998-1999 Annual Report, page 14

¹⁸ VWA 1998-1999 Annual Report, page 9

6.3 Clarification of objectives

6.3.1 Reduction of workplace accidents and diseases

The VWA's objectives include to assist employers and workers in achieving healthy and safe working environments. The VWA's functions as set out in the ACA include:

- to foster a co-operative consultative relationship between management and labour in relation to the health, safety and welfare of persons at work;
- to monitor the operation of OH&S at work; and
- in performing its functions, to promote the prevention of injuries and diseases at the workplace and the development of healthy and safe workplaces.

VWA employs field officers who inspect work sites and assist employers minimise the risk or workplace injuries. During the 1998/1999 financial year VWA employed 268 persons in its field services division.

6.3.2 Rehabilitation of injured workers

VWA's objectives include to promote the effective rehabilitation of injured workers. VWA's functions as stated in the ACA include to:

- provide assistance in relation to the establishment and operation of occupational rehabilitation programs of employers;
- facilitate the development of rehabilitation plans and facilities to assist injured workers;
- monitor the operation of rehabilitation arrangements; and
- in performing its functions to ensure the efficient, effective and equitable occupational rehabilitation of persons injured at work.

The ACA also imposes obligations on employers who have a rateable remuneration exceeding \$1m to establish and maintain occupational rehabilitation and risk management programs. The VWA also has the power to require a worker to submit a program to the VWA proposing the worker's occupational rehabilitation needs.

6.3.3 Return to work and suitable employment duties

The ACA's objective is to make provision for both a worker's early return to work and the availability of suitable duties to enable their early return to work. Under the ACA, employers also have a statutory obligation to:

- provide the same or equivalent employment to a worker who is injured at work; and
- provide suitable employment for a worker who has no current work capacity.

One of the functions undertaken by the VWA is to identify and as far as practicable minimise or remove disincentives for injured workers to return to work or for employers to employ injured workers. For example the VWA has a WorkCover Incentive Scheme for Employers ('WISE')¹⁹. This is a subsidy program that gives employers an amount of money up to a prescribed amount when they offer a job to an injured worker.

6.3.4 Provision of adequate and just compensation

In regards to the ACA's objective to provide adequate and just compensation to injured workers, VWA's statutory functions include to receive, assess, accept or reject claims and to pay compensation to persons entitled under the ACA.

The ACA contains a number of provisions to ensure that only those persons who are entitled to compensation receive compensation. For example, persons who self inflict their injuries sustained at work are not entitled to compensation. Similarly, persons who have engaged in serious and willful misconduct are also disentitled to compensation under the ACA. The ACA ensures however that workers who gradually sustain injury at work can access compensation as the ACA deems that the injury was an injury arising out of or in the course of employment.

All statutory amounts of compensation which are expressed as dollar amounts in the ACA are subject to indication.

6.3.5 Costs of compensation

The cost of compensation to the community is reflected most directly by the premiums payable by employers to the VWA. Those charges are set by the VWA to fund its obligations to compensate injured workers and indemnify their employers under the ACA. This cost to the community is affected by a range of factors but particularly:

¹⁹ VWA Annual Report, 1998-99, page 44

- the number of claims for compensation lodged by an employer's workers;
- the assessment of claims for compensation in accordance with the requirements of the ACA;
- the conduct of common law claims;
- the cost of the VWA's internal administration (including the reimbursement of its authorised agents); and
- the investment performance of the WorkCover Authority Fund.

6.3.6 Incentives for efficiency and against abuse

The VWA's functions include to:

- ensure the efficient operation of the workers compensation arrangements; and
- implement measures to detect and deter fraudulent workplace accident compensation claims.

Under the ACA the VWA may require a worker to submit to a medical examination. The purpose of this is to validate the worker's alleged injuries. Persons who have fraudulently obtained compensation under the ACA will commit an offence and may be required to return the compensation received under the ACA.

6.3.7 Flexibility and adaptation to workplaces

During 1999/2000 the VWA introduced the Safety Management Achievement Program. This is a voluntary do-it-yourself audit tool which was designed by the VWA to allow organisations to objectively assess their health and safety management systems against best practices.

6.3.8 Establish and maintain a fully funded scheme

The VWA is required under the ACA to determine, collect and recover premiums and to ensure the financial viability of the workers compensation arrangements.

6.3.9 Improved health & safety and reduce social and economic cost of compensation

The VWA is required to monitor the operation of OH&S and workers compensation arrangements. In performing its functions the VWA is also

required to promote the prevention of injuries and diseases at the workplace and the development of healthy and safe workplaces.

6.4 Accident Compensation (WorkCover Insurance) Act 1993 objectives

The WorkCover Insurance Act does not contain express objectives. Its purpose as set out in section 1 (of the act as amended) is to:

'provide for compulsory WorkCover insurance for employers under WorkCover insurance policies and the payment of premiums for WorkCover insurance policies'.

Perhaps the most significant implied objective of this WorkCover Insurance Act is to introduce premiums based on an employer's own claims experience. As stated by the Minister in the Insurance Bills second reading speech:

'Under WorkCare employer levies do not adequately reflect the individual performances of work places.

There were substantial cross subsidies not only among industries but also, because of the way the bonus and penalty scheme operated, between large and small employers. The new WorkCover premium system has been designed to effectively eliminate cross subsidies among industries and among employers on the basis of size.

Under WorkCover industry rates will largely cease to be relevant in determining premium: instead, an employers premium will reflect his or her own claims experience. The extent to which an employers claims experience can be reflected in the premium will vary according to the size of the employer. Nevertheless, over time all employers will pay premiums that reflect their true underlying risks.'

Market Failure and Government Intervention

7.1 Market failure and government intervention

Government intervention in workplace accident compensation arrangements needs to be understood in light of contemporary competition and policy objectives. Government intervention in the form of legislative and policy initiatives often exist to address market failure and imperfections. To justify government intervention, the costs of public intervention must not exceed the benefits which may result as a consequence of that intervention. As noted previously by the Review Team, it is often difficult to quantify all benefits and costs, hence the justification for government intervention must consider both quantitative and qualitative costs.

As noted by the Industry Commission²⁰ governments have an active role in regulating workplace risks via OH&S requirements and workplace accident compensation arrangements. The Commission notes that the role of government should focus upon specifying the key attributes of both OH&S requirements and workplace accident compensation arrangements, most notably²¹:

- mandating the responsibilities of the various parties, including who bears what costs;
- deciding on the extent (and time profile) of compensation payable to those suffering work-related injury or illness;
- specifying acceptable dispute resolution procedures, with the emphasis on the fairness and cost-effectiveness of the processes proposed;
- spelling out prudential rules for underwriters/agents;
- improving the collection and dissemination of information on OH&S risks including their likely consequences; and
- provide a 'safety net' in cases where people nevertheless fall between the cracks.

The Commission also notes²² that the government can be of assistance more generally by:

- assuming a leadership role and promoting a culture of care within the community through the public promotion of workplace safety issues; and
- ensuring that those who are responsible for workplace safety, both employers and their employees, are provided with the appropriate

²⁰ Industry Commission (1984) *Workers' Compensation in Australia*, Canberra

²¹ op cit;

²² op cit;

incentives to encourage appropriate behaviour which will aid in the prevention of workplace injury and illness.

In addition to the government, workplace accident compensation schemes have other key stakeholders. They include:

- employers, who should have an incentive to reduce the incidence of workplace injury and illness, due to the costs associated with reduced productivity, labour replacement, damage to the firm's reputation and the inability to attract workers to high risk jobs. As noted by some of the parties consulted, this is not always reflected in practice as employers may have perverse incentives through the minimisation of costs to not take adequate precautions to reduce workplace accident and illness risks;
- employees, who have a natural incentive to avoid injury and illness due to the potential loss or reduction of income, and the intangible effects associated with pain, suffering and discomfort associated with injury and illness;
- regulators, in this case the VWA, whose role it is to ensure that the key system-design features determined by the government are implemented; and
- agents, who can be expected to operate schemes according to incentives offered by the regulator and the provisions of the legislation.

As noted in Chapter 5 it is appropriate to examine the Victorian workplace accident compensation scheme in the context of insurance products and insurance markets – though noting the complexities and subtleties that set the scheme apart from many other insurance products.

There are several market failures which may exist in workplace accident compensation arrangements which may require direct regulation in order to ensure efficient and equitable workplace accident compensation exists. These market failures may exist simultaneously in some industry sectors or may be to a particular industry. Market failures which may exist in the in workplace accident compensation insurance are:

- information failures;
- information asymmetries
- externalities;
- incomplete markets;
- third party transactions; and
- monopoly pricing.

The following discussions assume that workplace accident compensation schemes operate in an insurance type market.

Information failures

Information failure refers to the situation where the market on its own will provide too little information to market participants.

Many government activities are motivated by the belief that the market on its own will provide too little information. A regulatory regime may be required to provide information to consumers regarding consumer protection issues, however the provision of information also aims to address markets failures which may be associated with the provision of public goods. Information, in many respects can be considered a public good. A public good has two critical characteristics; it does not cost anything for an individual to enjoy the benefits of the public good and secondly it is generally very difficult to exclude individuals from the enjoyment of the public good.

Related to information failures is the existence of imperfect information. Imperfect information represents a situation where not all facts may be known at any given time. For example in health insurance, and more specifically in workplace accident compensation, the full effects of some diseases or injuries may not be known for a very long period of time. Hence in the absence of such information, it is difficult for market participants supplying insurance to set premiums to cover the symptoms of all injuries and illnesses.

Information asymmetries

Asymmetric information occurs when participants within the market place do not have access to the same level of information. Usually, in a two party transaction, one party will possess superior information over the other party, and may use this to their advantage. Information asymmetries directly affect the behaviour of market participants and can result in adverse selection or moral hazard dilemmas. Adverse selection in the insurance industry is characterised by a disproportionate share of consumers from 'high risk' groups purchasing insurance, whilst moral hazard manifests itself through the alteration of behaviour of individuals.

This may occur in the case of an employer who, once insured, may not take adequate steps to prevent injury or illness in the workplace or to invest in appropriate return to work programs, or the employee, who once injured and receiving financial benefits, may have few incentives to return to work. Both adverse selection and moral hazard are a consequence of asymmetric information and the inability of one party to monitor or observe the behaviour or actions of the other party.

Externalities

Externalities arise when the actions of one individual or employer impose a cost or a benefit on other individuals or employers. That is, the action of the firm or individual has an 'external' effect beyond the original purpose of the action. In the case of negative externalities (those which impose a cost on other agents), the firm or individual imposing the cost does not compensate the other party upon whom the cost is imposed. Regulation is usually required to eliminate or reduce the cost to the other party or to arrange some form of compensation between the inflicting party and the inconvenienced party.

In the case of the workplace accident compensation insurance, externalities may exist in the form of additional costs imposed on society as a result of workplace injuries or accidents.

In the case of the workplace accident compensation, the most commonly quoted example is over the indirect costs as a result of the incident that is not compensated for by the workers' compensation system. They are worn by three different groups of people:

- co-worker to the injured worker
- family of the injured worker
- employer of the injured worker

The cost for the co-workers and the family are mainly of an intangible nature and is in form of grief or suffering. There are however occasions when the people surrounding the worker might have to take time off work to assist the worker, without there being compensation for this. Other arrangements might also have to be made by the family such as baby-sitting.

For the employer, it is recognised that the indirect costs as a result of a workplace injury are higher than the direct costs. Employers generally only track direct costs and so underestimate their real costs. Different studies have been made to try to quantify the value and in the Industry Commission's 1995 review the findings were that the indirect costs of an injury are three times bigger than the direct costs across jurisdictions²³.

Examples of the indirect costs are:

- loss in production due to the interruption;
- loss of morale of the co-workers since they might feel that they could be injured too;

²³ Industry Commission, *Work, health and safety: Inquiry into occupational health and safety: Report no 47*, vol 1, p 23, Ausinfo, Canberra, 1995

- costs of work modifications that might be required to be done to prevent further injuries and thereby counter the impact of morale issue outlined above;
- costs of replacing personnel if the worker will be away from work for some time; and
- damage to property (which might not be covered by other insurance products or the value might be below the excess).

In some cases an injured workers may not be able to ever return to work. The indirect costs of this is felt by society as a whole as it may lose trained, educated and skilled workers for the workforce.

Incomplete markets

A fourth market failure which could potentially exist in workplace accident compensation insurance is the existence of incomplete markets. Incomplete markets arise when private, usually unregulated markets, fail to provide particular goods or services to a category of consumers, even though the cost of providing the good or service is less than the amount the consumer is willing to pay. The provision of compulsory workplace accident compensation insurance is legislated. However if this was not the case it could be quite plausible that there may be an under provision of insurance in certain circumstances. For example insurance companies may be reluctant to provide insurance to employees in high risk industries such as mining, agriculture or manufacturing or to employers who have had a frequent history of significant claims.

Third party transactions

There are many examples of third party transactions (otherwise known in economic literature as the principal/agent problem), however those prevalent in insurance markets represent transactions where one party purchases insurance on behalf of another party. The Victorian workplace accident compensation scheme is characterised by three key participants; the employer, the employee and the VWA (who is the insurer). The premium is paid by the employer to the VWA, who in turn provides specific benefits to the injured or ill employee (via the employer). This type of third party transaction may have direct implications concerning incentive mechanisms for the provision of benefits to employees. There may be inadequate incentives provided to employers to invest in adequate preventative measures and rehabilitation programs as they are not the direct recipients of the financial benefits. In addition employers may seek to pay the lowest possible premiums, whilst employees will seek the greatest possible benefits. Additionally, the use of third party transactions defies the economic assumption of ‘consumer knows best.’

Monopoly pricing

The existence of the VWA and its associated powers are as a result of a government created monopoly, rather than as a result of an observed natural monopoly. A natural monopoly refers to the situation where the most efficient option is to have one producer supplying the entire market. Natural monopolies are often present in industries where there are high fixed set up costs required to enter an industry.

Whilst the aim of the privately operated monopoly may be to maximise profits, this may not be the aim of the public monopoly. The aim of the public monopoly may be to maximise budgets or revenues. Characteristics associated with private monopolies include higher prices than may otherwise exist in a competitive market, higher costs of production, decreased levels of service and few incentives to innovate. These characteristics may also be associated with public monopolies and additional independent regulation may be required to ensure quality standards are met and pricing is not excessive.

7.2 Insurance markets: a special case?

Insurance, and particularly workplace accident compensation insurance, is a product with a number of special features that make it a candidate for effective regulation, using the models outlined above.

First, workplace accident compensation insurance is compulsory, a result of the government's role in protecting consumers with respect to public health and safety. This feature functions as a "positive externality", in that society as a whole can benefit from the fact that an employer buys workplace accident compensation insurance. Also, in one aspect of workers compensation insurance, the buyer of the product (the employer) is not the ultimate beneficiary (the injured worker). Thus there is a natural tension in the purchase and service provision of insurance between stakeholders who demand low cost and others who demand high levels of service, and government can play a role in regulating this balance.

Second, most buyers of accident insurance never have a claim, and thus will never need the fundamental service they are purchasing. This is a peculiar information deficiency in that most consumers cannot actually know first hand what they are buying with their premiums, and may serve to prevent insurers from competing on service. The government may have a duty to ensure that purchased potential claims service conforms to a reasonable standard, again in its role of overseeing issues of public health and safety. A related regulatory duty is to insure that any required medical or rehabilitation services are provided competently and effectively.

A particular feature of workplace accident compensation insurance is the existence of 'long tail' care cases. The long tail refers to cases where the payment stream to a recipient occurs over a long period, sometimes over a lifetime. Thus not all claims are settled by just the one payment or short term payments in terms of immediate treatment. Long tail payments are particular to those injuries that are permanent, such as acquired brain injury and paraplegia.

Such lifetime care needs can place a massive burden on the care system due to the frequency of treatment that such injuries generally require. Private markets may be less willing to provide long tail treatment services, or the funding for such due to the large costs that they impose upon the company and the ongoing financial commitment that they require.

This is an information constraint on market efficiency. Thus, while for a manufacturing or retail goods company the main balance sheet risk is the value of assets (inventory), the balance sheet risk for an insurer is mainly the value of liabilities (claim reserves), and is much larger. There may be a case for consumers needing regulatory intervention to ensure that the promise of future claims service can be kept, and government responds to this by introducing an artificial barrier to entry, in the form of specialised insurance capital and solvency regulation. Thus, while private insurers may compete on price, they would not do so to the extent of undermining their own financial position.

Another peculiar feature of insurance is that the cash flows of the insurance product are reversed from those of most “normal” products. Ordinarily soap manufacturer must pay for the cost of raw materials, plant, labour and distribution up front before selling its product. On the other hand, an insurance company collects premiums for coverage first, sometimes years in advance of actually servicing the resulting claims. The ultimate cost of these claims is not actually known in advance, and companies must rely on actuarial projections of future cost to set current prices and reserve levels. This is an information constraint on market inefficiency. Thus, while for a manufacturing or retail goods company the main balance sheet risk is the value of assets (inventory), the balance sheet risk for an insurer is mainly the value of liabilities (claim reserves), and may be much larger. There may be a case where consumers need regulatory intervention to ensure that the promise of future claims service can be kept, and government responds to this by introducing an artificial barrier to entry, in the form of specialised insurance capital and solvency regulation. Thus, while private insurers may compete on price, they would not do so to the extent of undermining their own financial position.

Perhaps the most important feature of insurance as concerning competition policy is that the unit product cost depends on the buyer. Again, consider the soap example. The cost of a bar of soap may be fixed independent of the buyer. In contrast, the cost of an insurance policy is based on the particular rating characteristics of the buyer. Governments must balance the objectives of competitive free-market pricing principles with social equity considerations and the objective of full coverage.

It is interesting to note that the uncertainty of future unit costs for insurance led to the unique regulatory treatment of insurance in the United States, where insurance is the only industry which is exempt from particular aspects of federal competition laws. This exemption was provided by the McCarren-Ferguson act, which exempts insurance from the Sherman anti-trust act provided that it is specially regulated by the individual states. This exemption was provided in recognition of the

need for insurers to pool claims information in order to generate class rates, as individual insurers could not at that time develop enough claims experience to rate on the basis of their own portfolios. This is not unlike the system in Australia. The individual states must ensure that this pooling of data does not result in price-fixing or other unfair trade practices.

Finally, the issue of rating variables has been the focus of considerable research. It is generally recognised that in a free pricing market, an insurer will generally use, (as many as practicable, all statistically valid rating variables) in pricing or it will be subject to *adverse selection*, which will ultimately lead to its failure. However, it is socially unacceptable to use certain rating variables such as race, and sometimes gender or marital status. Regulation of this principle is difficult, as availability problems often ensue once the government restricts the use of certain variables in pricing. In addition, full pricing of risk provides incentives for safety, and this socially desirable incentive can be reduced when the impact of rating variables is restricted.

Analysis of the restrictions

Identifying restrictions on competition

This section identifies the broad categories of restrictions on competition that arise in the workplace accident compensation legislation under review. As noted in Chapter 3, to assist in the review process the Review Team has categorised the restrictions into broad categories, rather than reviewing each individual section contained in the legislation that may potentially restrict competition.

Restrictions upon competition can exist in many forms. In determining whether they provide a net benefit or net cost to society it is useful to present key aspects of the structure of the Victorian workplace accident compensation scheme before embarking upon an analysis of the restrictions.

The Victorian workplace accident compensation scheme is characterised by the provision of a relatively uniform product at a price dependant upon workplace and industry risk profiles, provided by one organisation. Insurance is purchased from the VWA (via agents), all funds are managed by the VWA, premiums are set by the VWA with minimum approval and all insurance is publicly underwritten by the VWA.

The Review Team has identified two broad categories of restrictions on competition that arise from Victoria's workplace accident compensation legislation. They are:

- the compulsory requirement for employers to purchase what is known as a WorkCover insurance policy; and
- that the workplace accident compensation scheme is managed by a single manager (the VWA).

Figure 3.1, presented in Chapter 3, illustrates the decision process on how restrictions on competition arise from Victoria's workplace accident compensation legislation.

There are a number of restrictions on competition that arise within the general operation of the scheme. Some of these restrictions are derived from within the legislation, whilst others arise as a result of particular legislative provisions which have an impact upon particular procedures and policies. These potential restrictions include:

- centralised premium setting;
- the approval of providers of occupational rehabilitation services; and
- provisions relating to self-insurance requirements.

Each of these restrictions are discussed in turn below. In addition to these, a general discussion on Ministerial directions has been included as section 8.7 of this chapter. The Review Team considers that this area is not currently a significant issue, however, should be highlighted as an area for general consideration that could become prominent in the future.

8.1 Compulsory workplace accident compensation insurance

8.1.1 The restriction on competition

Under the current regime an employer whose rateable remuneration is above a prescribed level must obtain and maintain a WorkCover insurance policy in respect of all the employer's liability under the ACA and at common law in respect of workplace accidents. Specifically section 7(1)(a) of the Insurance Act stipulates:

An employer who in any financial year employs a worker within the meaning of section 5(1) of the Accident Compensation Act 1985 –

(a) must obtain and keep in force a WorkCover insurance policy with the Authority in respect of all of the employers liability under the Accident Compensation Act 1985 and at common law or otherwise in respect of all injuries arising out of or in the course of or due to the nature of all employment with that employer on or after 4 p.m. on 30 June 1993;.....

An employer remains liable for the first \$430 in medical expenses in respect of each claim and compensation for a workers first 10 days absence from work. An employer may increase, reduce or eliminate their excess in accordance with the ACA, by adjusting their premium accordingly.

The elements of the product

The *Accident Compensation Act 1985 (Vic)* ('ACA') provides that:

- workers who suffer injury or death resulting from a workplace accident are entitled to no fault compensation;
- in respect of an employer who has a leviable remuneration exceeding the amount which is twice the exemption limit, (\$7,500) the employer assumes the liability to pay the compensation to a worker or to a worker's dependants under the ACA and for all other employers, the insurer assumes the liability to pay the compensation;
- only workers who suffer a serious injury can bring an action for common law damages against a negligent party.

The WorkCover Insurance Act requires employers to obtain WorkCover insurance from the VWA which insures the employer for:

- any liability to pay compensation under the ACA; and
- any liability for common law claims brought by a seriously injured worker.

The ACA introduces a statutory right for injured workers to be paid compensation for loss of earnings and reimbursement for reasonable costs of road accident rescue services, medical, hospital, nursing, personal and household, occupational rehabilitation and ambulance services received because of the injury. It is not necessary for the injured worker to establish that his or her employer was at fault; the compensation is available on a no fault basis. Compensation is also payable to the dependents of a worker who dies as a result of a workplace accident.

Under the ACA, the obligation to pay compensation is imposed generally on employers. Employers are required by the WorkCover Insurance Act to obtain WorkCover insurance which insures the employer against liability to pay compensation under the ACA.

A person who is seriously injured as a result of a workplace accident may bring a common law action for damages against a negligent person who caused the accident (in addition to receiving compensation). Again, under the WorkCover Insurance Act employers are required to obtain WorkCover insurance from the insurer which insures the employer against any liability for common law claims brought by a seriously injured worker.

It is apparent that the nature and form of the obligations created by the ACA and the WorkCover Insurance Act are twofold. First, the ACA creates a statutory right for workers who suffer injury or death as a result of a workplace accident to receive compensation on a no fault basis. This obligation has social welfare characteristics. It is comparable to medical and hospital benefits payable pursuant to Medicare, as well as unemployment or similar benefits paid to persons who are unable for a period to earn a wage or salary. In the first instance the liability is with the employer.

Secondly, the WorkCover Insurance Act obliges employers to obtain WorkCover insurance in respect of their liability to pay compensation and common law damages. These insurance arrangements are similar to ordinary insurance arrangements. However, the WorkCover Insurance Act imposes an obligation on the employer to acquire a WorkCover insurance policy (whereas ordinarily a person has a choice whether or not to insure against various liabilities).

Further, if an employer does not take out insurance then the injured worker can still receive compensation from the VWA. In this case the employer will have committed an offence, and may also be pursued by the VWA for recovery of costs.

The compulsory requirement for employers to obtain a WorkCover insurance policy, covering both statutory and common law benefits, is a restriction on competition as it imposes the manner in which an employer can manage their workplace accident liabilities. The requirement essentially imposes the compulsory transfer of the risk associated with the provision of statutory and common benefits from the employer to the insurer. It should be noted that there is an option for some firms to self-insure. Self-insurance is covered in section 8.6 of this report.

8.1.2 Benefits

The benefits of compulsory workplace accident compensation insurance can be directly linked to the objectives of the legislation. One of the stated objectives of the ACA, amongst other things, is

to improve the health and safety of people at work and reduce the social and economic costs to the Victorian community of Accident compensation.

The provision of compulsory workplace accident compensation insurance aims to ensure that all workers who become ill, injured or die as a direct consequence of a work related incident, are entitled to:

- a minimum level of compensation and reimbursement for specified benefits; and
- receive appropriate treatment and rehabilitation to assist them to return to work.

In the absence of a compulsory scheme with a defined stream of statutory benefits, there may be spill over effects, or negative externalities that eventuate. For example, a compulsory scheme has the benefit of reducing the pressure imposed upon the welfare and public health care system together, while ensuring that all workers are provided with equal and equitable protection.

Statutory regulation of the provision of workplace accident compensation aims to provide an enforceable, transparent regime that employees can rely upon.

8.1.3 Costs

The requirement that employers must obtain a WorkCover insurance policy and pay the applicable premium generates the following costs.

First, the compulsory requirement removes an employer's ability to choose whether to acquire the product or fund its own liability.

Second, the requirement to pay a premium to an insurer imposes direct financial costs on employers that they may not otherwise choose to incur. For small employers or employers with limited funds, this may prevent them from investing in other OH&S measures. Compulsory insurance can diminish the incentive to undertake OH&S measures, as injury and compensation may be seen to be the insurer's problem.

The third cost arises because the compulsion is imposed upon employers and calculated based upon the rate of remuneration paid by the employer. It is possible that some employers may not pay a premium which reflects their true risk if they employ workers on an illegal 'cash in hand' basis.

Fourth, employers incur indirect costs in complying with the regime and maintaining the necessary administration procedures.

Fifth, there is also a cost associated with the VWA's role to monitor and enforce scheme.

Table 8.1 below shows the administration costs for the Victorian workplace accident compensation scheme for the period 1995-96 to 1998-99. The table also provides data for the gross premium for the same period and also provides a comparison of the data by way of providing the administration costs as a percentage of the gross premium.

Table 8.1 Administration costs

	1995/96	1996/97	1997/98	1998/99
Administration Costs (\$m)	174	183	199	215
Gross Premium (\$m)	897	931	995	1177
Administration costs as a percentage of gross premium (%)	19.4	19.7	20.0	18.3

8.1.4 Alternatives

The Review Team has identified two alternatives to compulsory insurance:

- compulsory insurance for statutory benefits only; and
- voluntary insurance for both common law and statutory benefits.

Each of these alternatives are discussed in turn below.

Alternative 1: Compulsory insurance for statutory benefits only

The most common feature of all workplace accident compensation schemes in the developed world is that they are compulsory. All but two states in the United States, all jurisdictions in Australia, New Zealand and most European countries all have some form of compulsory cover.

As discussed above, the current regime in Victoria is comprised of two parts – compulsory coverage for both statutory benefits and common law damages. An alternative to the current scheme is to make it compulsory for employers to insure only against their liability under the ACA to pay no fault compensation. Employers could then choose whether to obtain insurance to protect against the risk of damages at common law.

The Review Team is not aware of any jurisdiction where this model has been implemented.

Benefits

There are four benefits of implementing this alternative model. The first and most important benefit is that this model reduces the scope of the product which an employer is required to obtain. An employer is only required to obtain a product which protects against their liability to pay statutory compensation and benefits. Employers are free to choose whether to obtain insurance to protect against their common law liability.

Second, the reduction in the scope of the compulsory product should also lead to a reduction in the cost of obtaining the compulsory product. Common law expenses make up a large proportion of the total workplace accident compensation costs in Australia and the proportion has increased in most jurisdictions over the past decade. The Review Team analysed Victorian scheme data, and noted that the cost of common law claims has increased in nominal terms from \$26.3m (3.5%) in 1989/90 to \$354.5m (33.1%) in 1998/99²⁴. If the compulsory product was not

²⁴ Statistical Report of the Victorian WorkCover Authority for 1998/99, table 11a

required to fund liability for common law claims the cost of the WorkCover insurance premium would decline.

Third, as an employer would become directly responsible for paying the costs of common law damages awarded against it (unless it chose to obtain insurance for this risk) the employer may try to better manage this financial risk by taking steps to reduce the incidence of workplace death or injury.

The fourth benefit of this alternative is that employers will still benefit from a statutory compensation scheme which aims to provide suitable and just compensation in an equitable manner. Employees can be confident that if they sustain a workplace injury or illness their medical expenses will be covered and they may receive what is deemed to be fair and just compensation.

Costs

The Review Team has identified five significant costs of this alternative.

First, if the requirement to obtain insurance to protect against the liability to pay common law damages is removed, there is a risk that injured workers may be unable to recover funds from their employer (or another negligent party) if that party is unable to pay the debt.

Second, there is also significant risk that some employers may consider themselves as having safe workplaces and therefore underestimate their risk of having to pay common law damages. If there is a serious incident and the employer is sued, the amount might be significant enough to cripple, or even bankrupt, the employer.

Third, where an injured worker is unable to recover damages from a negligent employer, the injured worker may have to rely upon social security or other Government benefits which will impose direct financial costs upon the Government and taxpayers. This reflects that the statutory benefits available under the ACA are calculated to provide a minimum level of compensation in the event of an injury but are not intended to be generous.

Fourth, if employers are directly liable for their common law liability they (or their insurer if they choose to obtain insurance) may be more inclined to dispute liability than a single insurer. This may place greater pressure on the legal system and result in prolonged trials, cases being delegated to inexperienced legal counsel and an increase in the cost of legal advice.

Fifth, the injured worker will be required to follow different paths and deal with different parties in relation to a single injury as common law damages would no longer be sought through the VWA. This will add cost to the worker's claims process.

Alternative 2: Voluntary insurance

If the compulsion to obtain WorkCover insurance was removed, employers would be able to choose whether to obtain insurance to protect themselves against liability to pay:

- no fault compensation imposed under the ACA; or
- damages imposed by common law.

Employers may either have the option of purchasing a workplace accident compensation product from an insurance company (or the VWA) or have the option of self-insurance.

There are few jurisdictions which allow employers to choose whether or not to take out a workplace accident compensation policy. All but two states in the United States make it compulsory for employers to take out workplace accident compensation coverage²⁵. In Wyoming it is only compulsory if the employer is engaged in extrahazardous occupations and Texas where it is only compulsory for certain transport industries²⁶.

Benefits

The main benefit under this alternative is that an employer is given total choice whether to acquire insurance for statutory benefits or insurance for their common law liability or whether to carry the risk themselves through self-insurance. Furthermore employers may choose the level of insurance they wish to acquire. This can have a positive impact upon cash flow as employers are not required to pay a premium in advance (from which they may receive no benefit in the absence of a claim), but rather pay out benefits to claimants as the expenses become known.

As discussed in the previous alternative, the absence of compulsion to insure may actually provide an incentive to encourage safer workplaces as employers will try to avoid a claim being made. As already noted by the Review Team, the absence of compulsion to insure does not equate with the absence of liability. Employers are still liable to provide statutory benefits to their employees should a work-place illness or injury be incurred. Hence employers should have a natural incentive to reduce work-place risk.

²⁵ Office of Workers' Compensation Programs, State Workers' Compensation Laws 1 Jan 2000

²⁶ Office of Workers' Compensation Programs, State Workers' Compensation Laws 1 Jan 2000

A voluntary scheme also has direct benefits in terms of creating a workplace accident compensation insurance market in Victoria. As will be discussed in the following section, the presence of competition due to the voluntary nature of the product may actually promote cheaper premiums than may exist under the compulsory scheme. The voluntary nature of the scheme can also provide opportunities for other forms of insurance (such as income protection or specific forms of health insurance) to address any gaps created by the market.

Costs

The costs associated with this alternative are similar to those discussed above for the alternative of making it compulsory to insure for statutory benefits only. Workers may be disadvantaged if their employer is unable to meet its liabilities and may need to rely upon the social security system and other government benefits for income. Second, as employers will be directly liable for either statutory benefits or common law damages payable to an injured worker, the employer may deny liability or question the severity of a worker's injury. This may place additional pressure on the legal system.

A further cost of this alternative arises from the possibility that insurers will offer true risk reflective premiums to employers. Some employers may represent such a great risk that they are unable to afford their insurance premium. In such circumstances there may be demand for an insurer of last resort to exist which is usually a taxpayer funded public body.

This model also eliminates the universal coverage that the compulsory systems aims to achieve. It is possible that some high risk or unsafe employers would classify themselves as safe or low risk and may not seek coverage. In the event of an accident they would be faced with high costs. There is also the risk that insurance products may not actually exist for high risk or unsafe employers. This may result in the creation of an insurer of last resort (further discussed in this chapter), which is usually a taxpayer funded public body.

Recommendation

The *Workers Compensation Act 1914* established compulsory statutory benefits for workers who sustained work-related injury or illness, in addition to the compulsory requirement that employers insure against their common law liability. Although some exemptions were granted, the general aim of the scheme was to gain universal coverage of all employees.

Since the introduction of the compulsory purchase of workplace accident compensation insurance by employers in 1914, there has not been a period in the history of the Victorian scheme where there has not been a compulsory element to the purchase of workers compensation insurance.

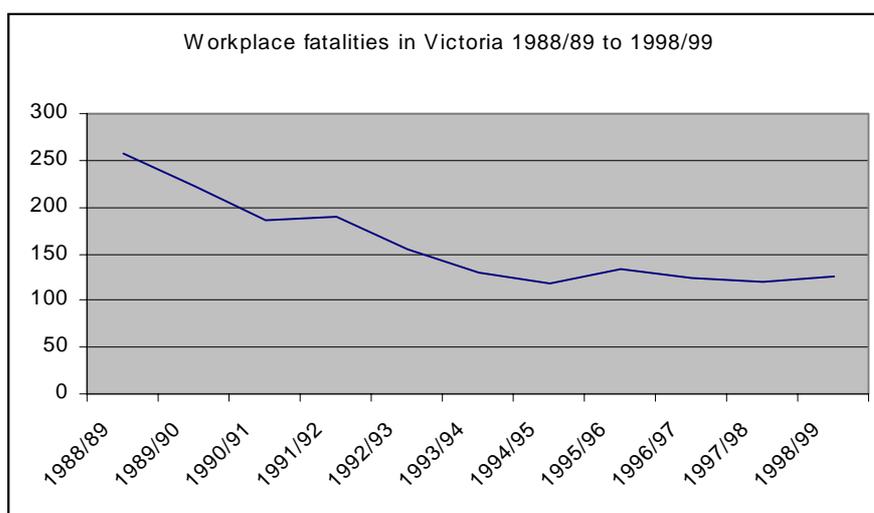
Specifically, the compulsory purchase of the product seeks to achieve one of the fundamental objectives of the scheme; the provision of fair and just compensation to employees who sustain a work-related injury or illness.

In the absence of compulsion, it is unlikely that this objective will be met as not all employers will feel inclined to take out cover. As previously noted by the Review Team this approach can impose costs on the employee, employer and the wider community.

A second key objective which may be addressed through the provision of compulsory workers compensation insurance is the reduction of the incidence of accidents and diseases in the workplace.

One of the factors impacting the number of fatalities in the workplace is assumed to be the money spent on prevention activities. As can be seen in Figure 8.1 the number of fatalities in Victoria has decreased over the last 10 years²⁷, quite significantly. This is however in line with a similar trend in other jurisdictions in Australia and is commonly explained to be a direct result of the Roben's approach to OH&S legislation and the resulting requirement for employers to have a duty of care.

Figure 8.1: Workplace fatalities in Victoria 1988/89 - 1998/99



²⁷ Statistical Report of the Victorian WorkCover Authority for 1998/99, table 10b

It is likely that other objectives of the scheme may not be able to be achieved in the absence of compulsory cover due to the removal of incentives to achieve them or due to the potential lack of funds to achieve them. Particular objectives which may not be achieved in the absence of compulsory workplace accident compensation insurance include:

- to make provision for the effective occupational rehabilitation of injured workers and their early return to work;
- to ensure workers compensation costs are contained so as to minimise the burden on Victorian businesses;
- to establish incentives that are conducive to efficiency and discourage abuse;
- to establish and maintain a fully funded scheme; and
- in this context to improve the health and safety of persons at work and reduce the social and economic costs to the Victorian community of accident compensation.

In particular it is likely that it would be quite difficult to achieve the last objective stated above. In the event of a work-place injury or illness, an employer may have to resort to more costly and time consuming methods to seek compensation such as common law remedies.

The Review Team reached the view that the compulsion for employers to purchase an insurance policy under the Victorian workplace accident compensation scheme delivers a net public benefit. The key elements of this conclusion were that:

- the compulsion ensures that employers are able to cover their liabilities under the legislation;
- lack of compulsion would be likely to see additional legal proceedings pursued to defend claims; and
- a lack of compulsion would make meeting the objectives above more difficult (though the Review Team notes that compulsion alone does not ensure objectives are met).

Recommendation 8.1

The Review Team recommends that the compulsory requirement to purchase a WorkCover insurance policy for both statutory and common law benefits be retained.

As a separate item, the Review Team notes that in recommending the compulsory requirement to purchase a WorkCover Insurance policy be retained, the recommendation is not advocating the current provisions for self-insurance be abolished. The current requirements for self-insurers are examined separately in section 8.6.

As the Review Team recommends that the compulsion remain, no transitional arrangements are necessary to implement this preferred option.

8.2 Single manager of the workplace accident compensation scheme

8.2.1 The restriction on competition

Section 7 of the WorkCover Insurance Act requires that employers must obtain and keep in force a WorkCover insurance policy with the VWA. All employers who are not approved as a self-insurer under the ACA are therefore compelled to obtain insurance from the VWA only. Although neither of the Acts prohibit another person issuing an identical policy of insurance to an employer, the requirement that the policy be obtained from the VWA removes the demand from employers to obtain the policy elsewhere. This means that the workplace accident compensation legislation creates a single manager of the scheme, a single provider of many of the services required under the scheme and a single underwriter of workplace accident compensation insurance in Victoria.

Requiring an employer to purchase workplace accident compensation insurance from the VWA effectively prevents any other insurance company from providing workplace accident compensation insurance and hence restricts competition.

The statutory creation of a single manager for the provision of workplace accident compensation insurance to the entire Victorian market, and the absence of substitutes, essentially means that we are observing the monopoly provision of workplace accident compensation insurance in Victoria.

The VWA is able to appoint authorised agents to perform some of its functions. Specifically, section 23(1) of the ACA states:

“The Authority may for the purposes of this Act or the Accident Compensation (WorkCover Insurance) Act 1993 –

(a) appoint by an instrument under its common seal any person to be an authorised agent of the Authority; and

(b) terminate any such appointment by an instrument under its common seal.”

This permits the VWA to outsource any of its functions as described in Chapter 5. As an example, the VWA appoints insurance agents to undertake claims management services. At present, each of the agents is

elsewise an insurance company. WorkCover insurance policies are sold via these agents.

However, the outsourcing is limited to the various administrative functions of the VWA, rather than outsourcing the actual insurance risk. None of the insurance agents carries any insurance risk and hence none are workplace accident compensation insurers. The insurance risk is retained by the VWA (and hence the Victorian Government).

Thus, while the Review Team has noted that the legislation creates a single provider of some services, it has formed the view that the key restriction is the creation of the single scheme manager, a single underwriter of the scheme. The provision of services is subordinate to that role.

8.2.2 Benefits

There are seven distinct benefits arising from the existence of a single manager of workplace accident compensation insurance.

First, public underwriting aims to provide protection from the costs of private insurance company failure. Workplace accident compensation insurance is characterised by long tailed claims. That is, the symptoms of many diseases may not become apparent for several years after an incident has occurred, or an employee may require compensation for the rest of their life after sustaining a workplace injury or illness. Hence unlike other insurance schemes, the payout may not be immediate or be made as a once off payment. By publicly underwriting the scheme the Government protects workers' entitlements to compensation by ensuring that funds are available for rehabilitation and compensation and that injured workers receive uniform treatment over long periods.

Second, as the statutory benefits available to injured workers are paid on a no fault basis, this element of the cover would make private provision very difficult. The existing system has an embedded welfare element, in that even if an employer has failed to take out a policy (which is illegal and for which they would be penalised), an injured employee is still entitled to the same level of statutory benefits, had their employer paid the premium. Under a system of private underwriting, this element would be removed, as private insurers could not be expected to pay out benefits to uninsured parties. Alternative arrangements would therefore be required.

Third, public underwriting also aims to ensure the stability of the system by not passing on premium increases or decreases as they immediately occur, hence reducing the volatility of the system to employers. The

1985 reforms of the Victorian workplace accident compensation scheme were largely driven by (in conjunction with the lack of focus upon general OH&S issues), the premium volatility of the early 1980's. The period between 1981 and 1983 saw the average Australian premium for workplace accident compensation insurance increase by more than 49.3 percent. In addition, further evidence presented to the Cooney Committee of Enquiry suggested premium increases were even more severe in Victoria²⁸.

Fourth, increased operating efficiencies may result if there are economies of scale and scope to be captured by the existence of the single manager. As discussed in the previous chapter, natural monopolies may result if the most efficient outcome is for one producer to be the provider of a particular product or service. It may also be possible for vertical economies of scale to be captured between operating divisions. In the case of insurance operations, however, it is difficult to make a definitive judgement on economies of scale and scope as insurance markets contain a wide range of insurance companies in terms of both size and scope.

Fifth, the existence of a single public manager may assist in the monitoring of employers to ensure that they have the appropriate workers compensation insurance coverage. If there were multiple managers of workplace accident compensation insurance, a body would be required to monitor and assess the multiple managers. The existence of one manager aims to address information asymmetries in relation to coverage that may exist in a privately underwritten market. For example in Western Australia where the provision of workplace accident compensation insurance is privately underwritten, it was estimated in 1996/97 that there were approximately 1,200 employers without appropriate insurance. During the same period, only 12 employers were prosecuted in Victoria for failing to take out appropriate workplace accident compensation insurance²⁹.

Sixth, on a broader policy level, the existence of a single manager of workplace accident compensation insurance can provide a direct relationship between workplace accident compensation and the Government's broader OH&S objectives. For example the emergence of experience-adjusted premiums seeks to provide a direct link between OH&S and workplace accident compensation. Employers are encouraged to modify their OH&S strategies to reduce the number of workplaces injuries and illnesses in return for lower premiums. Although this is the objective of experience based premium setting, the Review Team understands that this does not always occur in practice, especially in the case of smaller employers. During consultations it was noted by

²⁸ WE.Upjohn Institute for Employment Research, (1997) Victorian Workers' Compensation System: Review and Analysis (Michigan).

²⁹ Victorian Trades Hall Council Submission

some stakeholders that the best examples of a link between broader OH&S objectives and workplace accident compensation insurance is self-insurance. As self-insurers incur the direct costs of workplace injuries and illness they have a greater incentive to invest in practices that will minimise the costs associated with workplace injury and illness.

Finally, the existence of a single manager of workplace accident compensation insurance attempts to ensure that any potential market failures associated with incomplete markets are addressed. A scheme which is privately underwritten and not stringently regulated may not provide insurance for those employers considered as high risk, or alternatively, may set premiums at a rate which employers cannot afford. This in turn leads to spillover costs, or externalities, associated with the potential closure of businesses that cannot afford the premiums, or employers may simply not purchase a WorkCover insurance policy.

8.2.3 Costs

Prices charged by a monopolist are typically higher than would otherwise exist under competitive conditions. Ordinarily one would expect to see high returns generated by a monopolist, however this is not so in the case of the VWA. The Victorian workplace accident compensation scheme currently has an unfunded liability of some \$579 million, which is a direct result of keeping premiums low for employers.

Secondly, the absence of competition may reduce the pressure on the single manager to increase services standards, or even provide adequate service standards in the first instance. This may have a direct impact on the injured or ill worker who may not receive timely and appropriate treatment. Although there is some scope for this cost to be dealt with in the current system with the delegation of claims management to authorised agents, there may be other facets under the current regime which are not dealt with by authorised agents. As a result, there may exist no pressure on the VWA to provide adequate service standards for those services.

Thirdly, public underwriting essentially means that all risks are borne by the VWA, hence any losses would need to be borne by the Government. This in turn means that there is a direct cost to the community in general as taxpayers may ultimately bear a significant proportion of the risk. In practice, this may not actually eventuate as the losses from the previous WorkCare scheme were passed onto employers in the form of a levy. However, it may result in generational inequity: a subsequent generation of employers paying for the workplace accidents of a previous generation.

Fourthly, as VWA is a public body, there is the ability for political influence that may not be consistent with the objectives of the scheme. The Minister is, however, required to act in accordance with the governing legislation and is subject to parliamentary scrutiny. This is discussed further following the discussion in section 8.7 of this chapter.

Fifthly, employers do not have the ability to bundle several insurance products together or for national employers to bundle workplace accident compensation across jurisdictions. This may remove the opportunity for employers to obtain premium discounts that may otherwise exist if they were able to purchase all of their insurance needs from the one insurance provider. In turn, insurance companies cannot bundle workplace accident compensation with other insurance products and brokers cannot aggregate employers to find improved insurance package costs.

Sixthly, as there is only one insurer providing workplace accident compensation insurance, there is no incentive for the single manager to provide personalised premiums to employers based upon their individual risk profiles. Hence, anti-selection is not possible of workplace accident compensation insurers, which provides no incentive to the single manager to price in a competitive manner. Although experience adjusted premiums aim at providing an incentive for all employers to modify their OH&S practices, this will not always have a significant impact upon premiums for small employers in high risk industries. This in turn leads to the use of cross subsidies, which results in premiums which do not reflect the true cost of preventing work place injury and illness. Consequentially, employees do not receive the correct market signals required to incent them to provide a safe working environment.

Seventh, the VWA only sells one product: workplace accident compensation insurance. Economies of scope, which could exist if the VWA was able to offer more than one insurance product, thus cannot be captured and any potential efficiency that could be realised from such an arrangement are non-existent.

Not only is the VWA a monopoly manager of workplace accident compensation insurance in Victoria, it is also a monopsony³⁰ (single) purchaser of services in other markets. For example the VWA is the single purchaser of rehabilitation service providers for workplace accident compensation cases. Although there are other purchasers of rehabilitation services for other purposes (i.e. for traffic related accidents), this still may allow the VWA to exert excessive power in this market.

³⁰ A monopsony refers to the market situation where there is a single purchaser of a defined good or service.

8.2.4 Alternatives

The review team has identified the following options as alternatives:

- privately tendered single manager;
- multiple insurance providers; and
- multiple insurance providers with the inclusion of a public body as an insurer of last resort.

Each of these options is discussed in turn below.

Alternative 1: Create a private tendered single manager

The current regime is based upon the provision of workplace accident compensation insurance through a single manager. The single manager is a statutory monopoly, which has as its primary feature public underwriting. Hence the risk of the regime is borne publicly, rather than privately.

To remove some of the risk (depending upon the extent of the agreement) to the private sector, but still retain some of the benefits of the current single manager regime, it would be possible for the Government to tender out the entire scheme to a private organisation. This would essentially result in the creation of a regulated monopoly through a competitive bidding process. Competitive bidding for the right to supply workplace accident compensation insurance could, in principle, ensure that the most efficient provider services the market.

To the Review Team's knowledge, there is no example of this model for the provision of workplace accident compensation insurance in the developed world. However, there is an example in a related field. In the ACT, the NRMA has been engaged as the single manager of compulsory third party personal insurance, providing insurance to approximately 200,000 vehicle owners.

Benefits

The general economic benefits for the provision of workers compensation insurance by a single manager has been examined in the discussion relating to the current regime, as VWA is the single manager. Many of these benefits are relevant to this model, as the principle model is still founded upon the basics of monopoly provision. These benefits, the merits of which were discussed in the previous section, include:

- avoidance of increased costs associated with monitoring and assessing multiple providers;
- potential capture of economies of scale; and

- uniform treatment of claims.

There are, however, particular potential benefits which may arise from this model that are not features of a statutory monopoly. As stated above, the tendering of a private manager would involve a competitive tendering process. This would introduce some competition into the process, and in principle, should result in the appointment of the most efficient manager. Additionally, the competitive nature of regular contract renewal can provide incentives for innovative and efficient services to be maintained.

As the insurance function will be separated from the government, this may provide an incentive to more closely scrutinise the setting of premiums and regulate the activities of the regulated monopoly. As there is still only one manager, as opposed to a fully competitive market with many providers, the Government only has to monitor one party to ensure compliance with any agreements.

Depending upon the conditions of the appointment, the risk may be transferred from the public to the private operator. However this benefit can often be overstated because in the event of insolvency under statutory benefits, the Government, and hence most often the taxpayer, will end up with the liability.

There is the possibility that premiums may more accurately reflect risk, especially in the case of the high risk employer. The private single manager will have the incentive to be profit maximising and will aim to fully recover the cost of any liability it may potentially have. This may result in more accurate premiums being charged where there is currently undercharging. In addition, if premiums are more accurately calculated this may send the correct economic signal to employers to invest in programs and policies to actively reduce workplace accidents.

If the contract is long term it may provide adequate incentives for the single manager to invest in appropriate prevention strategies and mechanisms to reduce the number and severity of claims.

Costs

As with the benefits of the regulated monopoly, some of the costs of this model are duplicated in the discussion of the current regime. In particular, the following have been addressed in the discussion of the current regime:

- restrictions on consumers' choice of service provider;
- possible reductions in the efficiency of processes or service delivery as there is no other alternative available (especially if a long term contract is not offered); and

- monopsony purchaser of a number of services allows the single manager to exert market power in other makers.

There are, however, additional costs to market participants associated with the appointment of a single private manager. It is possible that if the Government did invite tenders for the provision of workers compensation insurance there may not actually be a market for the provision of such a service. This could result in a direct financial cost to the government associated with the tendering process, as the absence of a market would only be known upon conducting the tender process. Alternatively, should there be a response to the tender, it is likely that the successful appointment of a single manager would require agreement to various guarantees and warranties by both the VWA and the potential single manager. This could make the cost of compliance to the tenderer significant and may act as a deterrent to potential bidders. Further, associated with the appointment of a tenderer may be high transaction costs in establishing the scheme with a new manager and the transfer of existing claims.

The existence of long tailed claims in the workers compensation market may present costs to injured workers, the single manager and society in general. Long tailed claims traditionally require additional case management needs and care in transition, both at first and when future changes are made to the systems. Long tailed claims are one of the major distinguishing features of workplace accident compensation insurance from other forms of insurance. In the case of workplace accident compensation insurance, payments can occur for many years, rather than as a lump sum at the time of the settlement. This can mean that there may be the tendency for injured workers to engage in activities that ensure they are eligible to receive benefits for periods longer than they otherwise should.

However there are very real costs, which are often intangible, that the injured worker may incur. If the newly appointed single manager does not receive all information regarding claims in the transition period, it may be possible that the injured worker does not receive the adequate rehabilitation services they require in order to return to paid employment. This can impose costs to society in general as the injured worker is delayed from returning to the workforce and contributing to society.

Finally, there may be the very real risk of the appointed private single manager not performing to the agreed standards upon which they agreed to at the time of the appointment. If the Government determines that the single manager's performance is not satisfactory, in the extreme case it may be necessary to terminate the agreement with the single manager and re-tender for a suitable replacement. Associated with this are monitoring and enforcement costs. Although these costs may be less than if the

scheme was fully competitive and there were many participants in the market, currently the VWA bears no such cost as it does not have to monitor any other insurance provider(s).

Alternative 2: Multiple private insurance providers

A second option for consideration is the introduction of competition in the workplace accident compensation insurance market. Features of this model would normally incorporate decentralised funds management and premium setting in conjunction with private underwriting. Essentially insurance providers would compete with each other to provide workplace accident compensation insurance. The purchase of the product would still be compulsory, however an employer could choose to purchase the product from a number of accredited insurers. In turn, the workplace accident compensation insurer, as a condition of their accreditation, would be required to accept all policy applications.

In Australia, there are four jurisdictions that are privately underwritten: Western Australia, Tasmania, ACT and Northern Territory. In the United States, 25³¹ States have only private insurance carriers and another 21 have competitive state funds.

Benefits

The existence of many firms in a market can encourage competition between them. If the firms were all selling identical products, this situation would be typical of perfect competition. However perfect competition very rarely exists in practice, as it is likely that each insurer will be able to differentiate their product from the rest of the market. This may take the form of service provision, price or innovative practices such as bundling insurance products.

The benefits of this model can be summarised as:

- generic benefits of competitive markets; and
- benefits specific to the insurance industry from increased competition.

The generic benefits of competition are related to the presence of more than one firm supplying products which are close substitutes. The existence of several firms provides an opportunity for employers to ‘shop around’ to purchase the workplace accident compensation insurance policy that is most likely to meet their needs. This in turn creates an opportunity for insurers to attempt to offer the most attractive product to prospective buyers. In the absence of a regulator, price may be one of

³¹ Office of Workers' Compensation Programs, State Workers, Compensation Laws, 1 Jan 2000

the major features of the product on which insurers attempt to compete. Additionally, as the insurer bears the financial risk of the scheme this can provide an incentive to the insurer to optimise the results of the scheme. This benefit could potentially address the social and welfare objectives of the scheme which relate to providing adequate rehabilitation to return employees back to work and fair and just compensation.

The existence of price competition may have specific benefits for employers. Premiums may more accurately reflect an employer's risk profile if premiums are set by individual insurers. This may be particularly true in the case of larger employers as they will be able to influence their premiums more than smaller employers whose risk is predominantly calculated on industry risk profiles. As premiums may more accurately reflect workplace risk, this can provide incentives to employers to invest in strategies to reduce workplace hazards and risks where possible. This may provide the opportunity for insurers to 'reward' good performing employers through innovative pricing structures. In conjunction with more accurate premiums, insurers may be able to provide incentives to employers to reduce risk by other means, including emphasising the link between OH&S activities and workplace safety.

Costs

The transfer of the current system to the private market essentially alters the characteristics of the current insurance product purchased by employers. Under the current regime, a worker is entitled to a defined statutory benefits scheme if they sustain a workplace injury or illness. The current regime has some characteristics of a social security benefits regime, in that if an employee is entitled to workplace accident compensation, but the employer has not paid a premium, the injured worker will still receive their benefits. If the provision of workplace accident compensation insurance was transferred to several multiple providers, the social policy objectives would be removed from the regime. For example, if an employee sustained a workplace injury or illness and their employer has not renewed their premium, it is likely the injured worker will not be able to enjoy the benefits stream to which they are entitled unless alternative arrangements are in place. In the instance that this occurs under the public single manager model, it is likely that in addition to the injured workers still receiving their entitlement, the employer would be fined.

Prior to 1985, the Victorian workplace accident compensation scheme was privately underwritten. There were a number of private insurance companies providing workplace accident compensation insurance to employees, however there were two significant shortcomings of this model of provision. As noted by the Minister in his second reading

speech to in relation to the Accident Compensation Bill 1985, there was a complete lack of focus upon preventative measures and rehabilitation of the injured worker. Secondly, as previously noted by the Review Team, the premium volatility during the early 1980's was so extreme that government intervention resulted.

A market structure which is characterised by many participants providing workplace accident compensation insurance will require close performance monitoring if the social welfare objectives of the scheme are to be met. In the absence of sufficient monitoring there may be perverse incentives for insurers to serve the needs of employers (as they are the purchaser of the insurance), at the expense of the needs of injured workers. This results from information asymmetries associated with the fact that the purchase of insurance is a third party transaction; the purchaser of the product is not the direct beneficiary. Direct impacts upon injured employees include the potential loss of consistency in the award of compensation, rehabilitation provision and claims management. If monitoring is provided this places additional costs on both the government and the insurers. Government will face monitoring and enforcement costs that it may not face under other regimes, whilst insurers will face new and/or increased compliance costs.

There may also be direct costs of open competition to employers, as smaller employers may receive inferior service to larger employers who are paying higher premiums, or high risk employers may be charged premiums they simply cannot afford. If insurers are able to compete on price (i.e. prices are not regulated), insurers may be less inclined to compete on service and the provision of general OH&S advice as price competition may be more attractive.

Although illegal, smaller employers may actually fail to be captured by the system or may not make the effort to insure. The Victorian Trades Hall Council raised in its submission:

“..in Western Australia (which has private underwriting and insurance), there are significant numbers of employers who fail to insure, let policies lapse or under declare the amount of wages paid in order to avoid premiums. This can present a direct financial cost to employers as they will be required to meet their liabilities in the event of a workplace injury or illness. In special trades areas 8.2% of employers failed to insure; whilst in fast food or restaurants 5.4% did not hold policies; and in general construction 4.8%. Despite compulsory insurance, more than 1200 WA employers were without appropriate insurance in 1996/97. Over the same period only 15 employers were prosecuted for failing to insure.”

Search costs are also increased for employers as they search for the most cost effective premium. Search costs may have some financial impact, however there are likely to be opportunity costs associated with searching as employers may be more productive undertaking other pursuits.

Finally, as the financial risk of the scheme is transferred to the private insurance operators, the consequences of insolvency may have very significant costs to both injured workers and the public in general. Considering the long tailed nature of workplace accident compensation schemes, in the event that a private insurer becomes insolvent the question arises as to who will take on the case management of the injured worker and continue the rehabilitation process and payment of compensation. The Government, and, in turn the public may also incur costs as the case management of the insolvent insurer's injured workers may need to be publicly administered.

Alternative 3: Insurer of last resort

The insurer of last resort option is very similar to that described above for multiple insurers in a competitive market, with two fundamental differences. First, one of the insurers is a public body controlling a central fund which provides insurance to those employers whose workplace accident risks are significantly high and may result in the need to provide high premiums. This feature essentially transfers some of the risk back to the public sector. Second, it is not compulsory for insurance companies to accept applications for workplace accident compensation insurance. Hence, in some instances there may not even be a private insurer willing to provide workplace accident compensation insurance to insurers who are deemed to be bad risks.

The costs and benefits of this model are similar to those described above for the fully competitive scheme. There are however some additional costs and benefits unique to this model.

Benefits

There are generally three motives for states to run a central fund; these address the main potential costs of a purely private competitive market:

- high claims service standards;
- price stability; and
- full coverage.

Stakeholders sometimes feel that proper claims service can best be delivered by a government agency which has a fundamental employee

welfare motive above that of a private for-profit insurer. A state fund competitor may be in a position to “raise the bar” on claims service standards with a beneficial effect on the rest of the market.

As already noted by the Review Team, purely private markets are sometimes subject to high levels of price volatility. This is due both to the uncertain nature of the long-tailed workplace accident compensation costs, and to the wide cyclical price swings of the world reinsurance market. The presence of a single significant competitor (the state fund) which changes price levels may make it difficult for other (private) competitors to greatly increase price levels. However, if the insurer of last resort is not a significant player in the market, it may be difficult for them to have any significant influence upon price.

Perhaps the most important function of a central state fund is to alleviate any coverage availability problems (incomplete market problems) which may exist in a purely private market. Since insurers partially compete on underwriting selection and pricing accuracy, some industry sectors may not be able to find coverage at affordable prices (or even at all) from private insurers. As workplace accident compensation is a compulsory product, and full coverage is a primary objective of any workplace accident compensation scheme, state regulators have a stake in facilitating coverage for difficult classes.

Costs

The most obvious cost of this scheme, in addition to those costs described for the fully privatised market, is the administration cost of the central fund. This cost can be eliminated by passing it through to the premiums charged, as is the case for private insurers. However, this may cancel out any potential benefits of stabilised premiums, as discussed above.

Another potential cost in this model is the lack of obvious profit motive for a central state fund, which can lead to “unfair” competition from the competitive fund. Private insurers must charge profit margins in their premiums which are expected to generate a target return to their capital providers (investors). If a central fund does not also load an equivalent amount into premiums, employers may flock to the lower-priced competitive fund and undermine the private underwriting system. The most effective solution for this is to require the competitive fund to be publicly capitalised and to target a return on this capital in line with required private market returns. In addition, the Review Team notes, as with other public bodies, the public insurance provider would be expected to comply with competitive neutrality requirements.

Competitive neutrality is another component of National Competition Policy which aims to ensure government businesses compete fairly in the market when it is in the public interest for them to do so. Under the CPA, Victoria, like other jurisdictions, is obliged to apply competitive neutrality policy and principles to all significant business activities undertaken by government agencies where the benefits of applying competitive neutrality principles exceed the costs.

Another way to solve the issue of “unfair” competition is to restrict the state fund to the function of “insurer of last resort”. Under this approach, the state fund targets only the third potential benefit discussed above, that of full coverage. The state fund only underwrites employers who can show that they have been unable to find affordable coverage in the private market, or provides coverage only to market segments or sectors which have been determined to suffer systematic availability affordability problems.

The insurer of last resort approach can lead, however, to other potential costs. If the state fund is providing affordable coverage where the private market is unable to do so, it is likely that the fund’s premiums for these risks will not cover actual costs. This is of concern as part of the risk has been transferred from the private market to the public sector. This can lead to severe (though intentional) deficits for the fund insurer. State funds in the US which serve the “last resort” function generally correct for this problem by charging a levy on the rest of the privately insured market, sufficient to cover the fund deficit.

A further potential cost from the intentional under-funding in the “last resort” approach is that employers are not forced to pay for the full cost of their workers compensation risk, which can reduce incentives for workplace safety. To address this problem, the competitive fund must be judicious in selecting employers/sectors eligible for subsidised coverage, and within the fund pool must still apply competitive pricing principles to spread the subsidisation as fairly as possible among the pool employers. The fund should also try to develop targeted “exit” plans which address the safety issues that cause the employers/sectors to be uninsurable.

Recommendation

Multiple workplace accident compensation insurance providers have not existed since 1985, when the Victorian Government rejected the recommendations of the Cooney Report, which recommended by a 3-2 majority that this system be retained.

Prior to the introduction of the ACA in 1985 there were several providers of workplace accident compensation insurance in Victoria. In the decade

prior to the introduction of the ACA it was recognised by Government and employer groups that the current situation was not the most effective means of providing workplace accident compensation insurance in Victoria. As noted by the Minister in his second reading speech:

“The internal contradictions in the present workers compensation system have brought it to the brink of collapse.

The iniquitous system of compensation payments, coupled with the disturbing long delays and the explosion in premium costs has led to universal recognition that the system is in need of a fundamental overhaul.”

In particular, the Minister was referring to the both the medium and short term factors that had a significant impact upon the provision of workplace accident compensation insurance in Victoria. Between 1974 and 1981 there were significant premium fluctuations. The introduction of the *Insurance Act 1973* had a significant impact upon a number of insurers who as a consequence of this Act faced problems financing the solvency requirements laid down under the Act within their existing capital structures. The outcome was a market where insurers failed to accept workplace accident compensation insurance related business in order to meet the new solvency margins.

In the late seventies, there was very fierce competition between workplace accident compensation insurance providers due to a number of factors. In the period 1975/76 to 1981/82 premiums increased on average by 1 percent, however general costs (as measured by the Consumer Price Index) had doubled over this period in addition to claims costs increasing by 120 percent³².

This period of ferocious rate cutting combined with the real increase in the cost of goods and services led to a dramatic attempt by insurers to regain some of the losses they had incurred in the late seventies. The result was a massive increase in premiums which occurred during 1981/82 and 1982/83. As noted in the Upjohn Report, this had the effect of “alienating the business community and making that community amenable to other solutions”³³. As previously noted by the Review Team, the average Australian premium for workplace accident compensation insurance between 1981 and 1983 increased by more than 49.3 percent. Further, there was evidence presented to the Cooney Committee of Enquiry that the premium spiral was even more severe in Victoria³⁴.

³² WE.Upjohn Institute for Employment Research, (1997) *Victorian Workers' Compensation System: Review and Analysis* (Michigan).

³³ *ibid*

³⁴ *ibid*

In addition to the problems facing employers, there were also issues of concern regarding the treatment of injured workers. As noted by the Minister in his second reading speech, there were particular social concerns with the workplace accident compensation system prior to 1985 with which the scheme was not adequately dealing. These concerns included:

- *“the absence of a coherent preventative strategy for occupational health and safety, and consequently an unacceptable level of work-related injury and disease believed to be the highest in the country. In the past decade one Victorian was killed at work each working week due to dangerous machinery, falling objects, falls and other causes;*
- *an equal absence of an emphasis on restoring injured and ill workers to the workplace, compounded by a lack of proper facilities, resources and staff; and*
- *a highly litigious system of settling claims that encourages hostility, excessive delays and professional overservicing, and provides benefits that do not adequately meet the needs of the severely injured worker.”*

In support of the above point the Upjohn Report notes that by October 1983 there was a backlog of some 14,000 cases and the average time between lodgment of a claim and the claim being brought before a hearing was 24 months. The Upjohn Report went on to note that by October 1984 the backlog of claims had increased to 17,000 awaiting to be presented to the Workers’ Compensation Board.

As a consequence of these concerns the Accident Compensation Act 1985 was proclaimed, which essentially handed over the provision and administration of the workplace accident compensation insurance scheme to a public body.

The VWA has been recognised formally as the single manager of workplace accident compensation insurance since 1998, when *the Accident Compensation (Amendment) Act 1998* (Vic) reverted the provision of accident compensation to the VWA from the existing authorised insurers. Prior to this employers were required to obtain and maintain an insurance policy with an authorised insurer. However, the authorised insurer was required to reinsure its liability with the VWA. The rationale was to ensure that all liabilities were able to be met under the policies and that authorised insurers were not at ultimate risk. The outcome of this was that, essentially, the VWA was really the single manager of workplace accident compensation, as all risk was reinsured with the VWA. Similar arrangements existed under the WorkCare

scheme, which also required WorkCare agents to reinsure their liability under the ACA with the Accident Compensation Commission.

The provision of workplace accident compensation insurance by a single manager was introduced by the Government to address the failure of the market to provide adequate remedies and rehabilitation to injured workers as noted above. Indeed, government intervention did not have an immediate positive impact upon the scheme either.

In 1992, WorkCare had an unfunded liability of \$2.1 billion and a funding ratio of under 50%. At the time more than 25,000 Victorians were in receipt of workplace accident compensation benefits. Of those receiving benefits, more than 16,000 had been on workplace accident compensation for a year or more and in the case of some 8,000 workers, more than three years.

As noted in Chapter 6, the objectives of the legislation can be broadly categorised as:

- the prevention of work-related injury and illness;
- the provision of effective occupational rehabilitation of injured workers;
- the provision of fair and just compensation for workers who suffer a work-related injury or illness; and
- the reduction in costs to the community in general.

The existence of a single public manager of workplace accident compensation insurance aims to actually address each of these four objectives.

First, due to the externalities associated with workplace injury and illness it is in the public interest that the Government takes an active role in the prevention of workplace injury and illness. There are associated social policy objectives that the Government can seek to address by being the single manager of workplace accident compensation insurance. As noted earlier, in the absence of a single public manager prior to 1985, the workplace accident compensation scheme failed to provide a coherent preventative strategy for OH&S.

Second, it is in the public interest that injured workers who are capable of returning to work, be encouraged to do so and that the correct mechanisms are in place to facilitate this process. In the absence of sufficient government intervention, rehabilitation may not be a priority for private insurers. Prior to the commencement of the ACA in 1985 and the single manager of workplace accident compensation insurance, there was an obvious lack of emphasis on restoring injured workers to the workplace. Further, as noted above, there was a serious lack of

appropriate facilities, resources and trained staff to assist injured workers back to work.

Third, the single manager is publicly underwritten to ensure that employers can fund their liabilities under the ACA. This aims to ensure that injured employees can receive the statutory benefits to which they are entitled and may also assist in the stabilisation of premiums. It was primarily the premium volatility of the early 1980's that led to the severe dissatisfaction of employers and employers groups that gave rise to the need for dramatic change in the mid 1980's. It is unlikely that if alternative one was to be considered that a private manager of workplace accident compensation insurance could guarantee that the scheme would be fully funded. If this was to occur (as is currently the case) under the operation of a public monopoly, at least there would be some scope for government policy to attempt to ensure that either the scheme is fully funded, or at least capable of meeting its liabilities by diverting funds from elsewhere.

Finally, if a community wide approach is an objective of the scheme, sufficient incentives may not exist in a fully privatised market to ensure that the social and economic costs of workplace injury and illness are reduced for the benefit of the broader community. The market may fail to provide workplace accident compensation insurance at an affordable price to smaller employers or to those in high risk industries.

The Review Team notes that whilst the VWA is the single manager of workplace accident compensation insurance, it does delegate some of its functions, as permitted by the ACA, to authorised agents. In particular, the VWA currently delegates the following tasks to its agents:

- premium collection;
- issuing policies; and
- administration of claims.

The Review Team understands that in South Australia, these tasks can actually be performed in-house by employers, who have been authorised as self managers.

The following case study provides an overview of the current arrangements between the VWA and the authorised agents.

Information Box 8.1

The Victorian WorkCover Authority pay the agents fees for the services they provide. The fee structure is broadly split up into two components: a base fee and the performance fee. The base fee is meant to be a fee for service whereas the performance fee is only paid if certain pre-set criteria are met. The base fee used to be a significant part of the remuneration package for the agents, but since 1 October 1998, the structure has changed quite significantly³⁵. The service fee is aimed at covering the costs for the agents for serving customers and it is driven by the number of employers being serviced and the size of those employers, measured by the size of the remuneration they pay to their employees. Below is a table outlining the distribution of the fees for the last 5 years³⁶.

Year	Base Fee	Performance Fee
1995/96	88%	12%
1996/97	93%	7%
1997/98	85%	15%
1998/99	85%	15%
1999/00	45%	55%

Even the nature of the performance fee has changed, from being more focussed on processing such as the number of disputed claims in relation to the number of reported claims onto being more focused on outcomes. Linked with this is also an extension of the length of the agreements regarding remuneration structures from one year to four years. The current performance fee is based on calculating a true risk performance ratio for each insurer which shows the level of costs being saved for the scheme for claims reported on or after 1 July 1993.

Based upon the assessment of the costs and benefits of the current model of workplace accident compensation insurance and the alternatives, and the ability of these alternatives to meet objectives of the scheme, the Review Team formed the view that moving away from a single manager arrangement under the current scheme would not provide the greatest net public benefit. Some of the key factors underlying this conclusion are:

- the workplace accident compensation scheme creates a statutory benefits scheme for persons who sustain a workplace injury or illness. This is akin to a welfare system of benefits. Worker access to that part of the scheme does not necessarily depend on the

³⁵ The Boston Consulting Group, *Insurer remuneration Document*, 14 July 1998

³⁶ Information obtained from discussions with Victorian WorkCover Authority

purchase of a policy by their employer – thus the scheme is not a simple insurance product. Competitive provision, while technically possible, would require changes to the nature of the benefits available under the scheme, rather than just changes to its delivery. Changing the nature of the benefits available under the scheme is outside the scope of this review;

- the workplace accident compensation scheme provides some injured parties with access to the benefit stream for an entire lifetime. Unlike most insurance products there may be no end point, no final settlement. This long tail of claimants requires a long term commitment to the provision of benefits;
- past experience with competitive provision in such a scheme has shown that the social benefits and broader OH&S objectives have not been a priority for private providers; and
- current premiums may still be lower than those required to fully fund the scheme, thus a move to competitive provision may introduce a significant price shock to employers. The current scheme currently has approximately \$579 million in unfunded liabilities. Competitive provision of the scheme would seek to have a zero amount of unfunded liabilities which would inevitably result in premium adjustments to amend the current deficit.

As a result the Review Team presents the following recommendation.

Recommendation 8.2

The Review Team recommends that the single manager arrangement be maintained for the workplace accident compensation scheme in Victoria at this time.

The Review Team recognises that for so long as there remains a single manager, there will remain some doubt as to the efficiency with which its services are provided. The Review Team is satisfied that the benefits of the single manager outweigh the costs at this time. However, the case for retention of a single manager may change over time.

The VWA currently contracts out some services, which provides the opportunity to 'market test' the price for those services. The Government may wish to consider whether any other (and if so which other) functions of the VWA should be 'market tested' in an appropriate manner. The experience of market testing could provide data for analysis in any future examination of the case for retention of the single manager.

The Review Team also notes that the retention of a single manager may also call into question certain structural issues, particularly where a single manager also has regulatory functions. Structural issues are a central

matter for National Competition Policy, with Clause 4 of the Competition Principles Agreement devoted to the need to examine Structural Reform of Public Monopolies. A structural review would examine such issues, regardless of whether there was a single manager or multiple provision. However, structural reform is not a matter for a Legislation Review under Clause 5, unless the structural issue is also a restriction on competition.

As the Review Team recommends that the single manager arrangement be maintained for the workplace accident compensation insurance system in Victoria, no transitional arrangements are necessary to implement this preferred option.

8.3 Centralised premium setting

8.3.1 The restriction on competition

The aim of centrally regulating premiums is to:

- ensure that the workplace accident compensation scheme is fully funded;
- contain volatility that exists within the insurance industry generally;
- maintain affordable workplace accident compensation premiums for Victorian employees; and
- ensure the provision of appropriate incentives for injury and illness prevention in the workplace.

Specifically sections 15, 16 and 17 of the WorkCover Insurance Act regulate the setting and calculation of premiums. Specifically s.16(1)(c) of the WorkCover Insurance Act stipulates that:

*(1) A premiums order –
(c) applies to a WorkCover insurance policy which is in force in respect of a policy period commencing on or after the date of commencement of the premiums order.*

Employers must pay a premium which is calculated in accordance with the premium orders issued by the VWA. It is now expected that an employer's history of claims lodged for compensation will directly affect the employers premium. It is intended that this experience based calculation will encourage employers to implement necessary health and safety measures to reduce the incidence of work place death or injury.

To meet the objectives of the scheme, the VWA is able to cross-subsidise between workplace and industry risk profiles. The set premiums are based upon the workplace and industry risk of the employer. Hence it is possible to set the premium at a rate for the low risk employer that is actually greater than it may be in the competitive market where price is a true reflection of workplace risk. Conversely, the premium for a high risk employer may actually be lower than what it is in the competitive market, as the VWA is able to subsidise the difference with the excess received from the low risk employer. It is not unlikely that in a competitive market some degree of cross subsidisation would exist, as a pooling effect is required to operate an insurance scheme. However, in a competitive market the structure of cross subsidies would be driven by commercial decisions rather than other non-commercial factors.

The workers compensation premium for each employer is calculated for each workplace operated by the employer.

The calculation is dependent on the following key characteristics of the workplace:

- industry;
- total remuneration to staff at the workplace;³⁷ and
- claims experience of the workplace.

The industry rate for each workplace is determined by the main activity carried out there. This means that if the employer is a manufacturer with 80% of the staff involved in the production and the remaining 20% are office workers in supporting roles, the whole workplace will be classified as a manufacturer.

The most appropriate industry is selected from the Australian Bureau of Statistics Australia Standard Industry Classification code which contains approximately 500 different industries. The rates for the different industries ranged from 0.33% to 7% during 1999/2000³⁸.

Each employer has to report the value of the total remuneration both at the beginning of the premium year (running 1 July to 30 June), giving an estimate of the value of the remuneration and after the end of the premium year, then supplying the actual value of the remuneration. Based on this actual information, a final premium is determined. If this is less than what was calculated based on the estimate, a refund will be processed. If it is more, additional premium will need to be paid.

The claims experience of the workplace is recorded by the agents as a result of processing the claims reported by the employer. The experience included is the value on the claims reported over the last 3 years. The value is a combination of payments made for the reported claims, but also an estimated value for future payments that are likely to be required to be made on claims for the workplace.

Based on the above, the only factor in the equation that the employers can impact on is the size of the claims costs.

For larger employers, the individual workplace's claims experience is the biggest factor in the size of the overall workplace accident compensation premium. For smaller employers, the industry experience is the most crucial.

³⁷ The definition of what is included in the figure for remuneration is outlined in appendix C.

³⁸ Victorian WorkCover Authority, *WorkCover Industry rates 1999/2000*

For a smaller employer, there is therefore less incentive to improve their own performance, but due to the nature of smaller employers, it is also more difficult for them to manage claims. An example is that it is harder for a smaller employer to find suitable duties (and thereby be able to reduce the benefits paid to the worker) since there are not likely to be many positions overall with the employer. Another issue is that smaller employers are less likely to have a workplace accident compensation claims and would therefore not necessarily have processes in place or resources available to manage the claims process. What the small employers can do however, is to influence the behaviour for the industry overall, via industry associations etc.

To protect smaller employers from too high workplace accident compensation costs, there are certain measures in place:

- the first \$15,500 of the value of the remuneration is not included; and
- there is a cap of 20% on premium increases from one year to the next.³⁹

Centralised premium setting is a restriction on competition because it controls the price offered in the market to consumers, rather than allowing market forces to determine the market price.

As previously noted, the workplace accident compensation insurance market can be characterised as a monopoly. That is, the existence of one firm (in this case the VWA) acting as single manager removes all forms of competition that may exist if there were other providers in the market. In particular the VWA not only provides insurance by publicly underwriting the scheme, but also determines at what price the insurance will be sold. This is what is essentially referred to as centralised premium setting and as a result of this market structure there is no price competition within the market.

8.3.2 Benefits

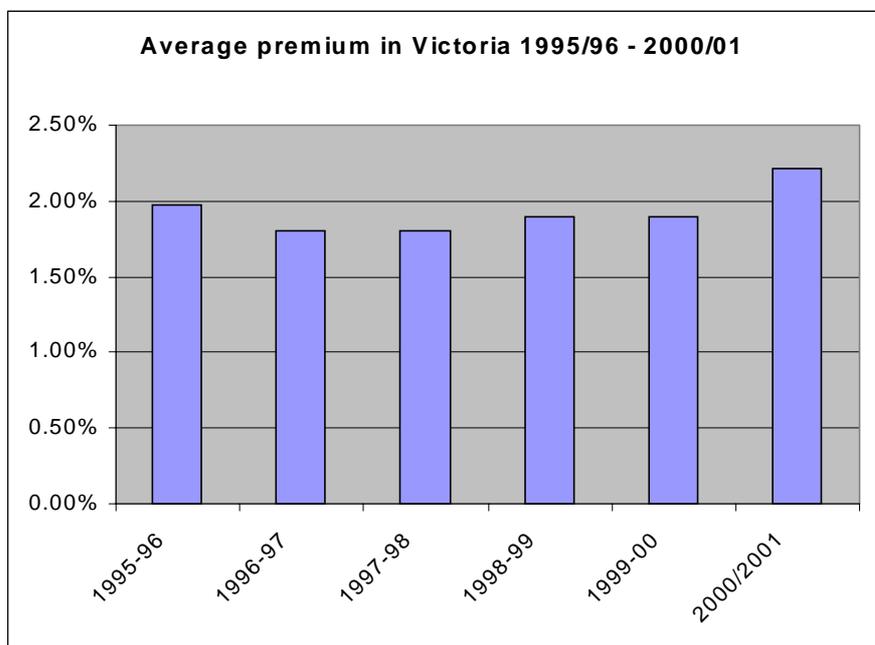
As mentioned above, the main aim of centralised premium setting is to ensure that the workplace accident compensation scheme in its entirety is fully funded. This ensures that rather than relying upon individual agents to meet claims, the fund as a whole is able to meet claims made against it. Secondly, centralised premium setting can allow the price of worker compensation to reflect workplace risk (particularly for larger employers), rather than other factors such as returns to investment. This may aid to contain costs for employers and may have flow on effects

³⁹ www.workcover.vic.gov.au/vwa/employer.nsf/all/premium

such as attracting new business to Victoria or conferring a competitive advantage on Victorian business. Centralised premium setting can provide direct benefits to employers.

Centralised premium setting can avoid excessive premium volatility, which can aid employers in accurately predicting their workplace accident compensation insurance costs for the forthcoming financial year. This has been the case in Victoria, as demonstrated in Figure 8.2, where premium levels have remained relatively stable over the last five years.

Figure 8.2 Average Premium in Victoria – 1995/96 – 2000/01



Finally, centralised premium setting also reduces search costs that may otherwise exist in a competitive market, as employers do not have to search for the most cost effective insurance policy.

8.3.3 Costs

The major costs of centralised premium setting are derived from the absence of price competition. The centralised setting of premiums provides few incentives for authorised agents to control administrative and operating costs. Although by controlling administrative and compliance costs agents may be able to increase their profit margins, there is no guarantee that this strategy will provide benefits to agents in the long run, as premiums are adjusted on an annual basis. In the pursuit of increasing profit margins, centralised premium setting may also

provide a perverse incentive for agents to reduce costs directly related to the provision of benefits to injured or ill employees.

Under the current regime, which uses cross subsidies to provide affordable premiums to employers with high risks who may not be otherwise able to afford their premium, the extent of the cross subsidies are not readily known to employers, employees or the public in general. On the basis of our consultations with stakeholders, the Review Team understands that there is some level of cross subsidisation between larger and smaller employers. However, the Review Team did not have access to information detailing the level and nature of the existing cross subsidies.

Also related to small employers is the fact that whilst centralised premium setting may be able to quite accurately determine premiums for larger employer, this is not necessarily true for smaller employers. Smaller employers' premiums are predominantly determined by their industry classification rather than the risk profile of their specific workplace. As noted in discussion with VECCI, the recent increase in premiums for the 2000/2001 financial year has had a significant impact on many smaller business.

8.3.4 Alternatives

The Review has identified the following alternatives to the current centralised premium setting regime

- premium set by an independent regulator;
- independent premium review;
- market set premium subject to regulator approval; and
- private insurance providers set premium.

Each of these alternatives are discussed in turn below.

Alternative 1 - Premium set by independent regulator

This alternative is not dissimilar to the current model in terms of the method of premium setting, the fundamental difference being that the premium would be set by an independent party to the insurer. This model can apply equally to the current single manager model or to a competitive environment where several insurers may be present. This model would delegate the functions of both the establishment of the premium formula and the value of the various variables within the formula to a separate body, independent of the manager(s) of workplace accident compensation insurance. Effectively the insurer(s) would not

participate in the premium setting process and would be obliged to charge the premium set by the independent body.

As with the current regime, central premium setting does not equate to one price for all employers. The premium is based on the total annual remuneration of the employer combined with industry risk and past performance data.

Additionally, there are sometimes options available to vary the excess.

As an example, the premium formula in NSW is set based on the size of the wages, the industry and prior claims experience of the employer. There is an option for smaller employers to pay an additional 3% on the premium to avoid paying the excess of the first \$500 of weekly benefits for each claim during the year. It is important to note that this option is only available if the industry premium is less than \$3,000. The industry premium is the amount based on multiplying the industry rate with the size of the remuneration.

Case Study – The United States

The Review Team did not find any examples of monopoly markets where the premium is set by an independent body. However, in the US, there is an independent body setting the rates on behalf of the insurance companies, the National Council of Compensation Insurers (NCCI).

In the US, 45 of the 50 states have a competitive underwriting market for workplace accident compensation insurance. In all these competitive states, individual insurance companies are allowed to set their own premiums and pricing structures. However, all states except Illinois require companies to file their pricing structures in advance, and in some states insurers must gain the regulator's approval before using the filed premiums. State regulators generally retain the power and responsibility to ensure that insurers are following their filed pricing methodology and applying it in a fair way to individual employers.

Workplace accident compensation pricing structures are generally the most complex of any primary general insurance coverage line. This is because employers are generally "experience rated". This process combines a tariff rate, based on an employers business category, and an experience rate, based on an employers past claims experience (generally the 3 prior years). These two rates are "blended" using a credibility factor, which is roughly based on the employer's size. For small employers, full weight is given to the tariff rate. As an employer gets larger, more weight or credibility is given to their experience premium. A large amount of research is required to parameterise this system, it requires a large number of rating factors or variables to implement. In

addition, the entire pricing process is complicated by the long-tailed nature of workplace accident compensation, which causes pricing to be more uncertain and based on older data and results than for other shorter-tailed lines.

Although they are allowed (at least in theory) to file their own rating structures, most insurers do not have enough data or resources to produce proprietary pricing structures from scratch. In response to this, insurers set up the NCCI as a central statistical pooling agency for workers compensation data. The NCCI is now an independent for-profit entity funded by insurance company subscription and service fees. Through a combination of industry agreements and state regulatory requirements, virtually all workplace accident compensation insurance data must be submitted to the NCCI. The main exceptions to this rule are self-insured employers and self-insurance groups, and the state of California which runs its own central statistical agency (the WCRB).

The NCCI files a full set of rating factors each year with the regulator of each competitive underwriting state (except California), based on the pooled industry data for that state. Most state regulators have established the policy that any licensed insurer in that state may use the (approved) NCCI filings for pricing on a “pre-approved” basis. In addition, most regulators allow individual insurers to file NCCI “exceptions” only. That is, a company may use the NCCI filing as a base, except for certain specific proprietary factors which it files with the regulator. This prevents companies and the regulators from wasting resources re-examining and re-approving every component of each company’s rating structure.

Some companies do, however, file full proprietary rating structures. Some state regulators require insurers to follow the basic NCCI rating structure, while others have additional requirements on the rating structure.

Benefits

In light of the previous recommendation to retain the single manager of workers compensation insurance, this option may have specific benefits relating to transparency. The potential exists for the independent third party to set the premium formula and assumptions based upon actuarial information, rather than being influenced by other government objectives or the need to raise a prescribed level of revenue. However at the same time the independent regulator would have the ability to disregard influences upon premium setting which may be irrelevant and may also be able to smooth out premiums to avoid volatility.

In general, this system takes advantage of significant economies of scale, both in the administrative effort of the NCCI and in the “critical mass” of volume from pooled industry data. It allows individual regulators flexibility in exerting only as much control over pricing as needed in their specific market, while minimising the administrative burden of the regulatory review process.

Costs

Although this model separates the premium setting functions from the workplace accident compensation insurance manager in an attempt to make the process more transparent, it is quite possible that the process may not be any more transparent than the current regime. There is no provision in this model (as there is for the following alternative) for an independent party to monitor or review the actual premium setting process. Asymmetric information problems may also exist, as insurers may not provide adequate information to the price setting authority, which may result in inaccurate premium setting. Trends in workplace accident compensation premiums may be disguised as they occur (as the market is unable to set the premium), which may result in a significant premium increase at the end of the period to account for several movements within the period. Employers may not be prepared for this, and the result may be a significant impact upon their cash flow when the premium for the following year is due.

Costs will also be associated with the establishment a body to perform the task. In the event that there already exists an appropriate body to perform the task, additional administration costs will still be incurred by this body as it takes on the additional task of reviewing the premium setting process. Costs may include systems upgrades, additional staff and training costs. The independent body will also incur costs associated with data collection, given that data sets will have to be recreated by the regulator, as all information will be held by the insurer(s).

Alternative 2 - Independent Premium Review

This model is based upon the premium being calculated by the insurer, however it would be subject to review by an independent third party. The use of an independent third party is of particular relevance to the recommendation made to retain the single manager of workplace accident compensation insurance. The model can impose various regulatory requirements upon the insurer, including the review of the framework, structure and principles of the premium setting process. At one extreme, the workplace accident compensation insurer may have to comply with a defined guiding set of principles in order to receive approval. The other extreme the independent third party may merely review the process and approve it without any particular requirements.

Hence it may be possible for the insurer to set both the premium formula and the value of the various variables within the formula, subject to approval by the independent third party.

Benefits

The use of a third party to review the premium setting process for the single manager of workplace accident compensation effectively separates, depending on the extent of the regulation, the premium setting function of the insurer from its other functions. In practice it should create an environment which is more transparent and may even highlight cross subsidies. The model allows the independent body to consider the achievement of the objectives of the scheme, without considering allowing other government policy or funding objectives to be considered, which may prevent the objectives of the scheme from being met. As the role of the independent third party is strictly defined in terms of reviewing the premium setting process, in principle there should be no interference by the independent party to attempt to achieve other non-financial objectives of the scheme. Finally, the use of an independent third party should also prove useful as a checking device to ensure that that the set premiums will be adequate to fully fund the scheme.

Costs

The most significant costs associated with the use of an independent third party will be the costs associated with establishing a body to perform the task. In the event that there already exists an appropriate body to perform the task, additional administration costs will still be incurred by this body as it takes on the additional task of reviewing the premium setting process. Costs may include systems upgrades, additional staff and training costs.

There may also be additional costs imposed on the workplace accident compensation insurance manager. If the independent third party requires that the insurer comply with particular guiding principles. This may give rise to compliance costs in the form of additional actuarial advice, potential systems upgrades and costs associated with acquiring information relating to the independent party's requirements.

Alternative 3 - Market Set Premium Subject to Regulator Approval

This model is only relevant where there are several workplace accident compensation insurance providers in the market. Briefly, this regime involves all market participants setting their own premiums, the principles of which are subject to the approval of an independent party.

In Australia, Tasmania has a file-and-write system that was introduced in 1996 when the licence conditions were revised. As part of the performance standards of the licence, the insurers had to incorporate certain factors in the premium calculation:

- claims experience;
- commitment to OHS/survey results;
- employer commitment to provide suitable duties; and
- size of employer⁴⁰.

The insurers had to develop a premium methodology incorporating the above factors to a varying degree and come up with suitable rates. The rates were submitted to Workplace Safety Tasmania for evaluation before they could be used.

Based on the evaluation of the performance of different measures, the insurer received a licence for between 1 and 3 years.

The costs and benefits are similar for those presented for the independent premium review of the single manager.

Alternative 4 - Private insurance providers set premium

As with the model described above, this model is only relevant where there are several providers in the market. Essentially private insurance providers would be able to set premiums without any regulation. In principle market forces related to the existence of competition would encourage providers to set premiums in response to market demand.

Some particular costs and benefits of this regime are not apparent in the other models. They are briefly outlined below.

The benefits of private insurers setting premiums include:

- as the insurer bears the responsibility of the financial viability of the scheme, in principle the insurer should have an incentive to reduce the number and severity of claims;
- premiums cannot be used as a quasi payroll tax, unless the government applies a levy to the premiums; and
- innovation may be encouraged to bundle various insurance products together.

⁴⁰ Licence conditions for the approval and review of insurers under the Workers Rehabilitation and Compensation Act 1988,

Costs

The costs of such a regime include:

- the possibility of a reduction in reported claims as it may be cheaper for the insured employer to bear the risk rather than claim under its policy, and potentially face an increased premium the following year;
- possible increased premium volatility; and
- increased search costs for employers as they may have to devote more time to finding an insurer with an attractive premium.

Recommendation

The VWA has been responsible for setting workplace accident compensation premiums since the introduction of WorkCare in 1985. Premiums were purely industry-reflective rather than calculated upon a combination of industry and workplace risk.

The Review Team notes that where there exists a single manager of workplace accident compensation insurance, the most common premium setting structure is one that is based upon a centralised premium calculation. Examples include New Zealand, New South Wales, Queensland, Canada and the monopolistic states in the United States.

The centralised premium setting process awarded to the VWA has been granted in order to achieve the following objectives of the Act:

- to ensure workers compensation costs are contained so as to minimise the burden on Victorian businesses; and
- to establish and maintain a fully funded scheme.

In the absence of a centralised premium setting process, and in conjunction with the recommendation that the single manager of workplace accident compensation insurance be retained, it is likely that the setting of the premium by any other method would create a significant administrative cost to the Government. It may be feasible for premiums to be set by an independent party however this could create additional, and perhaps unnecessary, costs associated with information gathering, systems establishment, additional staffing requirements and education and training.

Whilst it is recognised that central premium setting has particular benefits, especially in terms of the recommendation made to retain the single manager, sentiments were expressed to the Review Team seeking

a more transparent process which details the actual methodology and principles applied in setting the premiums. The Review Team itself notes that there was a paucity of publicly available data to explain premiums.

Whilst the Insurance Council of Australia in its submission to this review did not explicitly state that the process should be more transparent, it did note:

“...premium rates should not be taken as a true reflection of costs. There has often been too much talk of low premium schemes being low cost schemes. Too much has been made of claims that if a switch were made to private competitive suppliers of workplace accident compensation, premiums would inevitably rise. If they were to rise, it is because current arrangements are unfunded.”

Transparency refers to the degree to which parties are able to observe and understand the decision making process. This includes members of the public, as well as parties with other direct interests. Improving transparency of processes and decisions has been an important element in many reforms flowing from NCP. This is because transparency tends to impose rigour into decision making processes and requires decision makers to justify their actions.

In the case of the WorkCover premiums, transparency could be improved simply by having all of the detail of the current decision making process tabled in Parliament. However, the technical nature of premium determination means that the information would remain inaccessible to many people. In these circumstances it is common for transparency to also be improved by the introduction of an independent expert, who's opinion can add to the assurance that a decision is sound and that due processes have been followed.

Therefore the Review Team is attracted to the idea of an independent third party checking process to ensure that the premiums adopted are delivering best outcomes to the community through the most efficient pricing level possible being set.

Specifically, the Review Team sees the role of an independent review party being similar to that of a pricing regulator. The role of a pricing regulator involves the assessment of three key factors:

- the methodology for premium setting;
- the overall level of premiums; and
- the structure of the premiums, for example identifying cross subsidies.

It is not envisaged that a review body would be able to over-ride premium proposals from the VWA. Rather, the independent report and the VWA's proposals would be placed in the public domain before the premiums order is made.

The Review Team is of the view that it is important that the independent review report be made public before any decision is made in order to put greater transparency into the premium setting process. This will encourage the VWA to justify both the premium setting process and the premiums that it proposes in any given year. Should the Governor in Council choose to ignore elements of the independent report, then this would be a public decision.

There are, of course, many particular arrangements that can be designed to introduce independent oversight and transparency into a premium setting process. However, the Review Team has chosen to recommend a simple example of how and when this could occur in this case. Practical needs of any process include:

- that the independent third party has access to the information necessary to complete its task;
- that the independent third party has the skills and resources to examine the information;
- that the independent third party has clear terms of reference or other set of directions defining its task;
- that the report of the independent third party be made public; and
- that the report of the independent third party be included in the decision making process.

In view of these opinions, and the costs and benefits that have been discussed, the Review Team puts forward the following recommendation.

Recommendation 8.3

The Review Team recommends that the Act be amended to require that an independent third party review of the VWA's proposed premiums occur prior to the making of a premiums order.

The independent review of proposed premiums should be made public prior to the making of the premiums order.

The review should examine and report on the premium methodology, ensuring that the overall level of proposed premium collections is sufficient to cover the long term liabilities of the workplace accident compensation scheme. The review should also examine and report on cross subsidies within the premium structure to ensure that the community is fully aware of those cross subsidies.

In moving forward, should it be decided at some point in time to permit private insurers into the workplace accident compensation insurance, the independent third party could retain its regulatory role. This type of review process currently exists in the utilities sector, where it is accepted as an integral part of the price setting process.

As the Review Team has recommended some alterations to the current premium setting arrangements for workplace accident compensation insurance, appropriate amendments to the WorkCover Insurance Act will be required.

8.4 Approval of providers of occupational rehabilitation services

8.4.1 The restriction on competition

Under section 99 of the ACA the VWA or a self-insurer is liable to pay as compensation the reasonable costs of road accident rescue services, medical, hospital, nursing, personal and household, occupational rehabilitation and ambulance services received because of the injury. As the VWA is only required to pay the reasonable costs of services which are provided by approved persons, the approval of persons may be a restriction on competition. The ACA does not contain factors which the VWA should take into account in deciding whether to approve a person.

The requirement that providers of rehabilitation services gain approval from the VWA serves to act as a form of statutory occupational licensing regime. The Victorian Guidelines note that occupational regulation:

“..refers to provisions of certification, registration or licensing (referred to as ‘licensing’ in a general sense unless a particular distinction is to be drawn) that attach to an individual, are non-transferable and are generally based on qualifications which are reasonably proximate to the conduct of a trade profession or recognisable occupational grouping.”

The presence of an occupational licensing regime requires assessment as a potential restriction on competition as it may present a barrier to entry to that occupation or profession.

In this case the ‘occupation’ is that of the provision of occupational rehabilitation services. These services are often provided by persons from a range of professions, some of which are from registered professions and some of which are not. For example, an occupational rehabilitation team may involve:

- rehabilitation counsellors;
- vocational counsellors;
- psychologists;
- physiotherapists;
- occupational therapists;
- job placement counsellors; and
- medical practitioners.

Occupational licensing, in its various forms, is usually used to limit the delivery of particular services to persons with certain training, skills and qualifications. Where justified, this normally reflects a combination of:

- specific skills and requirements to undertake the occupation or deliver the services in question;
- poor consumer ability to identify and select the providers; and
- high costs associated with poor service delivery.

The VWA's approval application form requires specific information concerning the professional qualifications of the service provider and proof of professional indemnity insurance for all professions except medical practitioners and physiotherapists. The rationale for this relates to both the level and standard of service required to be provided to an employee with a work-related injury or illness. The aim is to provide a comprehensive service focused on the workplace.

8.4.2 Benefits

The following benefits may apply to the approval of rehabilitation service providers by the VWA:

- That rehabilitation service providers are able to meet a defined minimum standard before being permitted to provide services. This element provides employers, employees and the general public with assurance and confidence of the standards that can be expected from rehabilitation service providers.
- Approvals, authorisations and other regulatory controls provided by way of statute can facilitate transparent independent models of regulation, with the sole purpose of maintaining operational standards unaffected by commercial considerations.
- A statutory authorisation regime aims to address information asymmetry issues by providing a universal measure by which rehabilitation service providers can be evaluated and, in conjunction with employers, employees and the wider community, provides assurances as to the bench mark being applied.
- It is understood that at present injured workers have little input into the selection of their rehabilitation provider. The approval system may assist to ensure that the appointed provider focuses on the needs of the injured worker.

8.4.3 Costs

Major potential costs of a statutory approval regimes include:

- Entry to the market may be restricted through the imposition of requirements and standards which rehabilitation service providers are required to meet and as such may impede competition.
- Licensing requirements may be duplicated for some professionals, which in turn may duplicate administration costs. Many health professionals are required to be licensed within their own professions. The requirement to be accredited by the VWA as a rehabilitation service provider may not actually achieve any outcomes that are not already achieved through the individual occupational licensing requirements of various health professions, other than imposing additional administrative and compliance costs upon service providers.
- Occupational licensing may impose additional costs to the government sector and the community in general, as public funding is usually administered to fund the monitoring and enforcement of such regimes.

8.4.4 Alternatives

The Review Team considers that the following alternatives are available for this restriction:

- abolishing the approval of rehabilitation service providers;
- introducing voluntary accreditation; and
- negative licencing.

These alternatives are discussed in further detail below.

Alternative 1 - Abolish approval of rehabilitation service providers

This option would involve the elimination of the VWA's power to approve rehabilitation service providers. In this case anyone would be able to seek to supply occupational rehabilitation services to injured or ill employees. There would be no specific minimum standards prescribed and hence no enforcement associated with the compliance of such standards. The regulatory, monitoring, enforcement and administration costs would be eliminated for all respective parties.

Under abolition it would be up to employers to select their preferred rehabilitation provider. In practice it is understood that the insurance

companies that provide claims management services under contract to the VWA also have a role in the selection of rehabilitation providers. A cost to this approach arises through the third party agency situation, whereby the rehabilitation provider is hired to assist the injured worker, but is appointed by the employer, perhaps with input from the insurance company, the injured worker has little say in the matter. It could be argued that the abolition of approval may expose injured workers to the risk of rehabilitation providers focussing on the needs of the employer and/or insurance company, to the detriment of the worker.

Alternative 2 - Voluntary accreditation

Under this option, anyone is allowed to provide an occupational rehabilitation service. The option is available to service providers to gain accreditation from the VWA, however it is not compulsory. Accreditation is granted provided the organisation/person is able to meet agreed accreditation standards. These standards may be set similar to those as prescribed under the existing approval system. However, in contrast to a statutory regime, the voluntary accreditation model generally operates without legislative support.

Benefits

Major potential benefits of third party accreditation include:

- elimination of regulatory costs associated with administering the mandatory approval system;
- reduction in compliance costs to occupational rehabilitation service providers; and
- injured or ill workers may experience a higher standard of care than under the mandatory approval system as accreditation authorities are more able to develop optimum standards that reflect contemporary consumer and stakeholder views.

Costs

Major potential costs of this system include:

- non-enforceability of standards. Occupational rehabilitation service providers who are unable to meet accreditation or authorisation standards or who are subject to complaints investigation may continue to operate in an unsafe manner;
- lack of universality of standards. Not all service providers are accredited as the process is a voluntary one. Furthermore, different accreditation bodies may adopt different standards if more than one accreditation body was to operate; and

- voluntary accreditation may not be a transparent process and may not adequately inform the public.

Alternative 3 - Negative Licensing

Under this option, minimum standards are set, to which rehabilitation service providers are expected to adhere. Anyone would be able to provide rehabilitation services unless excluded. Exclusion occurs when complaints made by consumers or other parties about the quality of service are found to be justified. Complaints can be made to a designated complaints body.

The negative licensing scheme operates in a similar manner to the first alternative where any person is free to set up a rehabilitation service which is not subject to any specific standards imposed under a licensing or accreditation arrangement.

Benefits

The major benefits of a negative licensing regime include:

- Lower compliance costs as it imposes fewer costs on service providers which may aid in resource allocation.
- Lower administrative costs. While the Government would still incur some continuing administrative costs under negative licensing, a small net saving would be realised relative to the costs incurred in running a system of positive occupational licensing.
- Lower entry barriers for those who wish to set up new rehabilitation services as the costs associated with entry are lower.
- The threat of revoking approval may be enough to provide service providers with the incentive to provide high quality service.

Costs

The major potential costs associated with negative licensing include:

- As no positive screening occurs, the number of inappropriate rehabilitation service providers initially entering the sector may be higher than under a licensing or accreditation system.
- Some sub-standard operators may be able to operate undetected or act inappropriately before they are detected.
- Enforcement activities may need to be increased, hence, increasing monitoring costs.
- The use of negative licensing is retrospective in nature, it penalises service providers upon complaints being received rather than being proactive in nature and promoting OH&S.

Recommendation

The Review Team notes that providers of occupational rehabilitation services are required to be authorised by the VWA. As outlined in the application form, the VWA requires that a potential provider of occupational provide specific information relating to qualifications, professional indemnity insurance and professional membership of the providers respective profession. As there are a number of professionals who may be eligible to register as rehabilitation service providers, these requirements differ slightly between the professions.

The Victorian Guidelines note that in some cases occupational licensing is required where the public interest may be best served by regulating those markets where market failure may exist in the absence of such regulation. For example in the absence of authorised service providers, it is feasible that employers or injured workers may not have access to adequate information to determine the reputability of a rehabilitation service provider. This may result in high search costs being incurred to find an appropriate provider, and high costs being incurred by the injured worker in particular if a poor service provider is appointed.

A licensing regime which is consistent with NCP should be capable of serving the public interest by addressing any relevant market failures with minimal impact upon competition.

As noted, the presence of a licensing regime can restrict competition by creating barriers to entry and imposing additional administration and compliance costs upon service providers. The Review Team notes that whilst many of the professions eligible to apply to become authorised service providers are also required to be registered with their own respective professional bodies, there are those professions which do not require professional registration. It is therefore likely that any additional compliance costs are more likely to be imposed on those professions not required to register, than those professionals who are already registered with their respective professional bodies. The administration associated with becoming registered is likely to be minimal as applicants are only required to complete a single page application and to provide copies of existing documentation. In the case of service providers for household services, applicants are required to read and sign a copy of the Code of Conduct in addition to completing the application form.

As not all professionals who are eligible to become occupational rehabilitation service providers are required to be registered within their own professions, the authorisation process required by the VWA serves to ensure that all service providers of occupational rehabilitation services

are suitably qualified to perform the tasks required of them. In the absence of an authorisation scheme, the provision of occupational rehabilitation services could be open to any party wishing to provide these services. However, the Review Team notes that in requiring occupational rehabilitation service providers be authorised, the VWA process should specify additional requirements that are not currently met through the existing registration requirements of each of the individual professions.

On balance, the Review Team considers that the benefits associated with the power given to the VWA to approve occupational rehabilitation service providers outweigh the costs. In light of this and the NCP requirements in relation to occupational licensing as stipulated in the Victorian Guidelines, the Review Team concludes the following recommendation.

Recommendation 8.4

The Review Team recommends that the ability to approve occupational rehabilitation service providers be retained.

As the Review Team recommends that the ability to approve occupational rehabilitation service providers be retained, no transitional arrangements are necessary to implement this preferred option.

8.5 Eligibility requirements for self-insurers

8.5.1 The restriction on competition

The workplace accident compensation scheme places particular restrictions on those employers who wish to self-insure. Previously restrictions were placed upon employers in relation to the number of employees within the organisation. Until July 1998 the requirement was that an employer had to have a minimum of 500 employees⁴¹.

The current regime, as specified in section 141 of the ACA, states that:

“(1) An employer that is a body corporate and is not a subsidiary of another body corporate (other than a foreign company within the meaning of the Corporations Law, that when the application is made, is not a registered foreign company within the meaning of that Law) may make application in writing to the Authority for approval as a self-insurer for-

- (a) workers employed by it; and*
- (b) if it is a holding company – workers employed by each of its subsidiaries.*

(1A) For the purposes of this section if a holding company satisfies the requirements of sub-section (2) but does not itself employ any workers, the holding company is deemed to be an employer.

(2) A body corporate shall not make an application under sub-section (1) unless it satisfies the prescribed minimum requirements as to financial strength and viability.”

The eligibility criteria are further specified in the Accident Compensation Regulations 1990. Specifically, provision 29(2) states in relation to financial viability”

“For the purposes of sections 141(2) and 142B(3A) of the Act, the prescribed minimum requirements as to financial strength and viability that the body corporate or partnership respectively must satisfy are that it is and would be capable of meeting its claims liabilities as and when they fall due.”

⁴¹ Heads of Workers' Compensation Authorities, *Comparison of Workers' Compensation Arrangements in Australian Jurisdictions*, July 1998, page 45

Further, the current regime examines the following, as outlined in VWA policy documents, to determine whether an employer is regarded as fit and proper to be a self-insurer:

- financial viability – whether the employer is able to meet its liabilities;
- capacity to administer claims for compensation;
- incidence of injuries to workers and the employer’s costs of claims in respect of such injuries;
- the safety of the working conditions for the employer’s workers;
- compliance with the ACA regulations; and
- any other matters that the VWA thinks fit.

In addition self-insurers are still required to contribute funds to the VWA to cover the cost of shared services that they are required to use or other resources that they may utilise.

The essence of self-insurance is that the self-insurer be able to provide at least an equivalence to having WorkCover insurance. It is not intended to permit employers to avoid the essential objectives of the compulsory insurance discussed in section 8.2.

The provision of specific eligibility requirements for self-insurers imposes restrictions on competition by preventing some employers from being able to self-insure when they could reasonably manage their workplace accident liabilities.

8.5.2 Benefits

The most significant benefit of self-insurance is that the employer takes on direct liability of their workplace accident compensation responsibilities. Assuming that the eligibility requirements ensure that the employer can fund those liabilities, this delivers a direct incentive for the employer to manage their overall OH&S environment. A number of parties (not only self-insurers) commented to the Review Team that this improved OH&S outcome was usually observed.

The benefits of imposing eligibility requirements upon self-insurers attempts to ensure that those prospective self-insurers are able to meet their obligations when presented with a claim. Additionally, the VWA expects that self-agents should be role models for other employers in terms of workplace safety, claims management and occupational rehabilitation by virtue of their special rules under the ACA. Further, by limiting the number of employers permitted to self-insure the pooling effect of the insurance system is maintained, hence assisting to maintain the affordability of premiums for employers.

8.5.3 Costs

Whilst some employers may be able to meet the assessment criteria for self-insurance, there may be several employers who consider that they too are capable of self-insurance but may only marginally fail to meet the assessment criteria. To the extent that these employers are considered “better risks”, they are essentially subsidising the higher risk employers by not being able to self-insure. This situation is undesirable as some employers do not bear the full costs of their claims and are able to free ride on the contributions and risk reduction strategies of other employers.

By restricting self-insurance to a limited number of employers incentives to adopt accident prevention strategies may be reduced. As self-insurers bear the full cost of their risks, they are provided with the correct incentives to invest in injury and illness prevention methods and dispute resolution policies and procedures.

Finally, the inability to self-insure may place cash management constraints on those employers who consider that are capable of self insuring. Instead of paying an annual premium some employers may prefer to address workplace accident compensation incidents on an as needs basis.

8.5.4 Alternatives

The Review Team has identified the following alternatives to the current eligibility requirements for self-insurance:

- not allow self-insurance;
- less restrictive criteria for employers; and
- more flexible excess provisions.

Alternative 1 - Not allow self-insurance

It is possible for a system to exist which prohibits the existence of self-insurance. Essentially all employers would be required to take out WorkCover insurance policies

There are two states in the US, both monopolies, where self-insurance is not permitted: North Dakota and Wyoming (however this is only relevant to some industries classified as extrahazardous).⁴²

The costs and benefits of a prohibition on self-insurance are similar to those provided in the discussion for the single manager of workplace

⁴² Employment Standards Administration, www.dol.gov/esa/public.regs/statutes/owcp/stwclaw/stwclaw.htm

accident compensation insurance. However, there are some particular costs and benefits that are unique to the removal of the scheme entirely.

Benefits

The prohibition of self-insurance enables data capture to be complete. As all employers would be required to take out insurance with the single manager (theoretically it is possible that self-insurance could be prohibited in the open market however the Review Team is not aware of a model in practice with these features) all data pertaining to all workplace injury and illness could be collected by the one agency. This can assist in designing prevention campaigns and targeting industries or individual employees with high accident or illness rates.

Related to complete data capture, as all participants in the labour force would be participating in the one scheme, industry risk rates may more accurately reflect the experience of each individual industry. As self-insurers are typically large employers, the absence of their risk profile from the data pool can potentially skew the risk profiles of the industries remaining in the pool.

Costs

The prohibition of self-insurance may remove the incentives that may exist for self-insurers to reduce claims and promote a safe workplace as discussed in the benefits section of the current regime. Considering one of the drivers as to why a corporation may wish to self-insure is the belief that they can achieve better results than the insurer, it is important that a scheme without self-insurance is able to create incentives that are capable of achieving the outcomes that may arise from self-insurance.

Alternative 2 - Less restrictive eligibility criteria for employers

The eligibility criteria for which employers are given the opportunity to self-insure varies between the different jurisdictions within Australia and overseas. Although there is no minimum number of employees specifically stated as the minimum requirement, the Review Team understands that the current criteria equates to a minimum requirement of approximately of 500 employees. If the current list of self-insurers is considered, it would appear that the majority of these employers employ well in excess of 500 workers. The Review Team notes that in South Australia the minimum number of employees required to be eligible for self-insurance is 200.

Benefits

The benefits associated with the introduction of less restrictive eligibility criteria for self-insurers include:

- the potential for greater opportunities to combine OH&S objectives with workplace accident compensation requirements as the self-insurer is able to exert control over both matters. It has been noted by a number of the parties consulted that the performance of self-insurers is significantly better than the non self-insurers because OH&S objectives can be directly linked with workplace accident compensation expenditure. However, it was also noted that this may just be co-incidental, as all of the 31 self-insurers are large companies that may be able to afford to fund a wide range of accident prevention measures;
- possible increased incentives to invest in preventative measures as the self-insurer is able to directly reap any benefits from investments in accident prevention;
- the provision of choice between the compulsory product supplied by VWA and the option to self-insure to those who are eligible;
- potential direct cash flow benefits for those who take up the option to self-insure as they may be able to run their own workplace accident compensation scheme more efficiently. This may result in:
 - direct financial savings; or
 - greater returns from OH&S investments; and
- consistency in claims handling across jurisdictions if the employer operates nationally.

Costs

Relaxing the eligibility criteria may have specific costs to the government, other employers and the public in general. They include:

- self-insurers may experience increased compliance costs than they may otherwise experience if they obtained their workplace accident compensation insurance from the VWA. It was noted to the Review Team during consultations that self-insurers were often subject to additional audits and required to use prescribed systems, such as SafetyMAP. There may also be strict requirements placed on self-insurers to ensure that they provide adequate data relating to claims;
- if the number of employers opting to self-insure increased as a result of relaxing the eligibility criteria this would lead to a reduction in the size of the insurance pool. Incentives may be provided for employers in low risk industries with good track records to leave the common pool. This may make it difficult for the remaining funds to cover the liabilities of the remaining participants;

- related to the previous cost, depending upon the extent to which the self-insurance criteria are relaxed, there may be the potential for the VWA to become the insurer of last resort. The costs and benefits of which have already been addressed; and
- ultimately, due to unforeseen circumstances there is no ultimate guarantee that self-insurers will be able to meet their liabilities. Consequently funds may need to be provided by a public body for compensation and rehabilitation to ensure that the social welfare objectives of the scheme are met. However, the Review Team notes that this is also a risk to any publicly funded insurer, as it is impossible to account for all possible contingencies.

Alternative 3 – More flexible excess provisions

In accordance with section 146(1)(b) of the ACA and the Accident Compensation Regulations, self-insurers are required to have in force at all times appropriate insurance in respect of their contingent liabilities. Specifically, section 146(1)(b) of the ACA states:

“A Body corporate that is approved as a self-insurer shall – have in force at all times a contract of insurance in respect of its contingent liabilities in accordance with the regulations and no other contract of insurance in respect of those liabilities.”

Further, provisions 28(2) and 28(3) respectively of the Accident Compensation Regulations 1990 state:

“(2) The contract of insurance effected in accordance with these regulations shall be for an unlimited amount in excess of the self-insurers liability for any one event or series of events arising out of any occurrence during the policy period

(3) The self-insurer’s liability under the contract shall be an amount chosen by the self-insurer which is not less than \$500,000 or greater than \$2,000,000.”

The self-insurer’s liability as defined by the regulations is essentially the excess that the self-insurer must fund in the event that a self-insurer requires contingent liability insurance. At present the self-insurer can choose a minimum excess of \$5,000,000 or a maximum excess of \$2,000,000 or any amount within this range. The Self-insurers Association of Victoria (SAIV) has indicated that some members may be interested in opting for a different excess amount if this was permitted. However the SAIV has also indicated that allowing a zero excess (that is, insuring the total risk with an insurance provider) is not a viable option

for consideration as this essentially contradicts the purpose of self-insurance.

Benefits

The benefits of allowing more flexible excess options for contingent liability insurance include:

- more flexible options concerning the minimum liability borne by the self-insurer may actually provide greater opportunities for more employers to self-insure. The benefits of allowing a greater number of employers to self-insure have been discussed above in alternative one;
- by providing more flexibility to self-insurers in the selection of their preferred level of excess, self-insurers may be able to more closely align their excess with their risk profiles. For example a more risk averse employer may choose an excess well below the current minimum, whilst a risk-seeking employer may actual choose an excess significantly greater than the current maximum of \$2,000,000; and
- the current maximum and minimum levels of liability may not actually equate with what the market is willing to offer. There may be insurers who would be willing to accept a minimum excess less than the current minimum.

Costs

By allowing greater flexibility to self-insurers to choose the level of excess that may best suit their business needs, the following costs may arise:

- if indeed a reduction in the current minimum level of excess did permit more employers to self-insure, then the costs described in alternative one, in relation to an increased number of self-insurers, would also be relevant in this case; and
- employers may not accurately identify their risk profiles and hence may opt for a higher level of excess than they may be able to afford.

Recommendation

From the introduction of the first workplace accident compensation insurance for employers to indemnify themselves from their liability to their workers, it was possible for an employer to gain exemption from a County Court Judge. In 1914 the ability to gain an exemption was removed. The ability to self-insure was not introduced until 1985 with the introduction of the ACA.

There are essentially two elements to the restriction of access to self-insurance.

Firstly, as already discussed, certain eligibility criteria must be met before an employer can be granted permission to self-insure. Although the eligibility criteria makes no specific reference to a minimum number of employees (this requirement was removed in 1998 with the support of the Self-insurance Association of Victoria (SIAV)), the Review Team notes that criteria essentially makes it difficult for an employer with less than 500 employees to self-insure. There are currently 31 self-insurers in Victoria.

In discussions with the Review Team the SIAV indicated that it was supportive of particular requirements associated with safety, rehabilitation, claims and prudential requirements. However sentiment was expressed that the requirements could be better aligned with business aims rather than being process driven, which may achieve very little in terms of preventing work-place injury and illness and injury and providing adequate rehabilitation.

Secondly, once an employer is granted self-insurance status, there are a number of audit and other requirements that must be adhered to for a self-insurer to maintain their status, in addition to the current restrictions on the level of liability to be carried by the self-insurer.

Assuming that the purpose of the eligibility and other criteria is to ensure that self-insurers are capable of achieving the same outcomes as those employers who must purchase their workplace accident compensation insurance from the VWA, then it is imperative that the eligibility criteria achieves this. In discussions with SIAV it was noted that SIAV members have suggested that some of the reporting and auditing requirements of self-insurers are particularly time consuming and administratively burdensome. In addition, it was noted that self-insurers should have flexibility in selecting safety systems (the existing requirement is to use SafetyMAP) and other audit tools. These tools are somewhat generic and not necessarily adaptable across all industries. Hence there is the possibility that a self-insurer may be rated as non-compliant as they may not meet all of the VWA's audit requirements, yet had they been evaluated on criteria specific to their industry, then the outcome to the audit may have been somewhat different.

The Review Team recognises that the VWA needs to ensure that self-insurers are able to meet their obligations, and that determining this can be a difficult exercise.

The Review Team also notes the earlier observation that the general OH&S performance of self-insurers has been reported to have been better than non-self-insurers. This indicates that there could be scope for broader self-insurance options in Victoria.

In light of the costs and benefits presented for the current access to self-insurance and the alternatives and the comments received from the SIAV and other parties consulted, the Review Team presents the following recommendation.

Recommendation 8.5

The Review Team recommends that self-insurance requirements be adjusted to increase flexibility and promote the expansion of self-insurance.

The Review Team notes that focussing reform efforts on self-insurance provisions is likely to achieve more significant outcomes than seeking to reform the single manager arrangement. This is because self-insurance permits a greater emphasis to be placed on innovative OH&S and worker outcomes than the insurance product approach.

However, it would be appropriate for the detail of an expansion of self-insurance to result from either a specific review of self insurance arrangements or as part of a broader review of the nature and structure of the workplace accident compensation scheme itself.

As the Review Team has recommended that self-insurance requirements be adjusted to increase flexibility and promote the expansion of self-insurance, appropriate amendments to the ACA and Accident Compensation Regulations 1990, should be required.

8.6 Further Matters

Ministerial Direction

Description

Under section 20C of the ACA the VWA is required to exercise its power and perform its functions under the Acts subject to:

- the general direction and control of the Minister; and
- any specific written directions given by the Minister in relation to a matter or class of matter specified in the directions.

The powers given to the Minister under the ACA are very broad. The only limitation is that the Minister cannot direct the VWA to act beyond the statutory powers of the VWA as set out in the ACA.

Accordingly, there is the potential for the Minister to direct the ACA to act in a manner which may result in a restriction on competition.

It should be noted that the potential to restrict competition through a Ministerial direction is somewhat limited, given that the VWA is the compulsory provider of workers compensation benefits and insurance under the ACA in any event. However, potential Ministerial directions which may involve restrictions on competition could include:

- directions to the VWA in relation to the authorisation of self-insurers;
- directions to the VWA in relation to the approval of rehabilitation service providers; and
- directions to the VWA in relation to the manner in which it funds or approves the provision of other services to injured workers.

It is understandable that the Government, as the effective owner of the VWA, will wish to retain a degree of control over the exercise of the VWA's powers and functions. This is a usual statutory power in respect of statutory corporations. The question which arises is whether the existence of this power, which may be used in a manner which restricts competition, gives rise to concern in the context of national competition policy.

The review team is not aware of any direction given by the Minister pursuant to section 20C of the ACA which does involve a restriction on competition. Accordingly, it remains only a possibility that the power could be used in this manner.

The review team does not believe it is necessary to alter the power contained in section 20C of the ACA. Any exercise of the power by the Minister will itself be subject to clause 5 of the CPA. As any Ministerial directions given under section 20C will be subject to review and assessment under this clause 5, the review team does not believe any amendment to section 20C is required.

Appendix A

Terms of Reference

GOVERNMENT OF VICTORIA

NATIONAL COMPETITION POLICY REVIEW OF
LEGISLATIVE
RESTRICTIONS ON COMPETITION

REVIEW OF WORKPLACE ACCIDENT COMPENSATION
LEGISLATION

TERMS OF REFERENCE

An independent review of the regulation of workplace accident compensation legislation in Victoria has been commissioned by the Minister for WorkCover.

Background

The current role of the Victorian WorkCover Authority (VWA) and legislative restrictions on underwriting by private insurers are set out in the *Accident Compensation (WorkCover Insurance) Act 1993*, *Accident Compensation Act 1985*, and accident compensation regulations (“the WorkCover legislation”).

A review of the WorkCover legislation in accordance with National Competition Policy was undertaken in 1998. The then Victorian Government rejected the review recommendation to remove the role of the VWA as the single provider of workplace accident compensation insurance in Victoria.

Scope of the review

The review of the WorkCover legislation will be undertaken in accordance with the requirement of the *Competition Principles Agreement* that legislation or regulation which restricts competition should only be retained if the benefits to the community as a whole outweigh the costs, and if the objectives of the legislation or regulation cannot be achieved through other means, including non-legislative means.

The review will determine whether and to what extent public underwriting by the VWA and centralised premium setting are in the *public interest* of the Victorian community. The Government’s reintroduction of common law rights to workplace compensation will be taken into account.

Without limiting the matters that may be considered, an assessment of the public interest will have regard to the costs and benefits in relation to:

- the need to protect the interests of injured workers, and to maintain the affordability of insurance arrangements to cover workplace injuries;
- the effect the current insurance arrangements have or might have on the activities of insured parties;
- the restrictions and conditions on approval of self-insurers and occupational rehabilitation providers;
- the effect of the current arrangements on OH&S in workplaces; and
- the outcomes of similar reviews in other jurisdictions.

Methodology

The review will be undertaken in accordance with the methodological requirements for assessing legislative restrictions set out in the *Competition Principles Agreement* and the Victorian Government's approach to legislation review.

Without limiting the terms of reference, the review should:

- clarify the objectives of the legislative arrangements, and determine whether these objectives remain relevant;
- identify the nature and extent of any restrictions on competition contained in those legislative arrangements;
- analyse the likely effect of any restrictions in the legislative arrangements on competition and on the economy generally;
- identify any alternatives to the legislative arrangements, including non-legislative approaches, that achieve the objectives of the legislative arrangements;
- assess and balance the benefits costs and overall effects [public interest] of the legislation and any alternatives;
- determine a preferred option for regulation, ie. whether the legislation should be repealed, modified, or maintained, and if modified, the suggested modifications;
- identify changes in legal obligations, liabilities, and revenue to Governments that might be expected to arise out of the preferred option for regulation; and
- advise on any transitional arrangements which might be necessary in implementing the preferred option.

Appendix B

Consultation Statement

Submissions to the review were invited by the Department through advertisements placed in the Herald Sun and The Age on August 12 2000. The Department also invited submissions via its website at <http://www.dtf.vic.gov.au>.

Submissions were received from the following parties:

- Clarke, PS, Workplace Safety and Health Management Economic Cost Benefits Analysis and Planning;
- Insurance Council of Australia;
- Law Institute Victoria;
- Victoria Police;
- Victorian Trades Hall Council; and
- Willis, Judith, Melbourne.

In addition, the Review Team consulted with the following parties:

- Law Institute Victoria;
- Self-insurers Association Victoria;
- Victorian Employers Chamber of Commerce and Industry;
- Victorian Trades Hall Council; and
- the Australian Industry Group.

Appendix C

Workplace Accident Compensation Schemes in Other Jurisdictions

C.1 Australian workplace accident compensation schemes – State by State Breakdown*

	NSW	VIC	SA	QLD	WA	TAS	ACT	NT
General information ⁴³								
Population (June 1999)	6.4m	4.7m	1.5m	3.2m	1.8m	0.5m	0.3m	0.2m
Labour force	3.1m	2.4m	0.7m	1.8m	1.0m	0.2m	0.2m	0.1m
Unemployment rate	5.3%	6.6%	7.7%	7.4%	6.4%	9.6%	5.6%	3.4%
Gross earnings	\$23,107.7m	\$16,194.9m	\$4,158.3m	\$10,559.3m	\$6,033.9m	\$1,217.2m	\$1,514.1m	\$740.9m
Average weekly earnings	\$635.70	\$602.60	\$560.40	\$587.00	\$576.00	\$537.60	\$644.20	\$617.50
Schedule details ⁴⁴								
Responsible organisation	WorkCover NSW	Victorian WorkCover Authority	WorkCover Corporation	WorkCover Queensland	WorkCover Western Australia	Workplace Safety Tasmania	ACT WorkCover	Work Health Authority
Relevant legislation	Workplace Injury Management and W/Comp Act 1998; W.Comp Act 1987; W/Comp (Bush Fire, Emergency & Rescue Services) Act 1987; W/Comp (Dust Diseases) Act	Accident Compensation Act 1985; Accident Compensation (WorkCover Insurance) Act 1993	Workers Rehabilitation and Compensation Act 1986	WorkCover Queensland Act 1996	Workers' Compensation and Rehabilitation Act 1981	Workers Rehabilitation and Compensation Act 1988	Workers' Compensation Act 1951 (reprint January 1998)	Work Health Act 1986

⁴³ Heads of Workers Compensation Authorities, *Comparison of Workers' Compensation Arrangements in Australia Jurisdictions*, July 1999, page 4

⁴⁴ Heads of Workers Compensation Authorities, *Comparison of Workers' Compensation Arrangements in Australian Jurisdictions*, July 1999, page 6

	1942; Sporting Injuries Insurance Act 1978							
Fund type	Managed Fund	Central Fund	Central Fund	Central Fund	Approved Insurers	Approved Insurers	Approved Insurers	Approved Insurers
Funding position	30/06/99: Assets: \$5,920M Liabilities: \$7,550M Funding Ratio: 78%	30/06/99: Assets: \$4,013M Liabilities: \$4,309M Funding Ratio: 93.1%	30/06/99: Assets: \$715M Liabilities: \$744M Funding Ratio: 96%	30/06/99: Assets: \$2,411M Liabilities: \$2,111M Funding Ratio: 114.2%	N/A	N/A	N/A	N/A
Number of insurers/agents	10 ⁴⁵	13 (30/06/99) ⁴⁶	5 ⁴⁷	N/A	14 ⁴⁸	10 ⁴⁹	15-10	<5
Self-insurance ⁵⁰								
Criteria	≥ 1000 NSW workers Prudential requirements	Prudential requirements	≥ 200 workers Prudential requirements	≥ 500 full-time workers (existing and applicants prior to 3/3/99) ≥ 2000 full-time workers (new applicants) Prudential requirements	Prudential requirements	Prudential requirements	Prudential requirements	Prudential requirements
Number	45 self-insurers 9 group self-insurers 5 specialised insurers	28 self-insurers	57 self-insurers plus Government Departments and Authorities	22 self-insurers	16 self-insurers	16 self-insurers plus the state service	6 self-insurers	6-self-insurers
Coverage ⁵¹								

⁴⁵ www.workcover.nsw.gov.au/faq/topfaq_hm.html

⁴⁶ Victorian WorkCover Authority, *1998-1999 Annual Report*, page 41

⁴⁷ WorkCover Corporation, *Annual Report 1998-1999*, page 20

⁴⁸ www.workcover.wa.gov.au/SchemeInfo/inslist.asp

⁴⁹ www.wsa.tas.gov.au/wsa/annual/1998_99/wsb110.htm

⁵⁰ Heads of Workers Compensation Authorities, *Comparison of Workers' Compensation Arrangements in Australian Jurisdictions*, July 1999, page 8

⁵¹ Heads of Workers Compensation Authorities, *Comparison of Workers' Compensation Arrangements in Australian Jurisdictions*, July 1999, page 10

<p>Definition of remuneration</p>	<p>Includes salary: overtime; shift and other allowances; over-award payments; bonuses; commissions; payments to working directors; payments for public and annual holidays (including loadings); sick leave payments; value of board and lodgings provided by employer for worker; any other consideration in money or money's worth given to the worker under a contract of service or apprenticeship. It does not include: Any sum that the employer has been accustomed to</p>	<p>Gross wages; salaries (including over time and all pay loadings); bonuses; commissions; allowances; items included as part of employment package; any other fringe benefits and any superannuation benefits. The following are exempt: apprentice & trainee remuneration; workers' compensation payments; shareholder dividends; partners' drawings; payments to Construction Industry Long Service Leave Board and Redundancy Payments Central Fund (only if not taxable as fringe</p>	<p>As a guide: Payments made to or from the benefit of a worker (quantified in monetary terms) but excluding: workers' compensation payments; termination payments or severance payments; payments as a reimbursement for a specific expenditure by worker on behalf of employer; motor vehicle allowance for use of worker's own vehicle in the course of employment which is less than 56 cents per kilometre traveled; accommodation allowance which is less than \$127.60 per day.</p>	<p>Wages; salary; other earnings by way of money or entitlements having monetary value, but does not include; allowances for travelling; car; removal; meal; education; living away from home or in the country; entertainment; clothing; tools; vehicle expenses; employer contributions to superannuation; lump sum payments on termination; an amount payable under Section 70 of the <i>WorkCover Queensland Act 1996</i> – employer's liability for excess period. Any benefits and allowances, such as additional superannuation, motor vehicle usage, etc,</p>	<p>All gross wages; salaries; remuneration; commissions, bonuses; over time; allowances and the like; director's fees and all other benefits paid to, or in relation to, a worker before the deduction of income tax. Termination payments; retirement pay; retrenchment pay in lieu of notice, superannuation payment(s); pensions; "golden handshakes" or weekly payments of compensation do not have to be declared.</p>	<p>Gross wages; salaries (including overtime and pay loadings); bonuses; commissions; allowances; items included as part of the salary package; voluntary superannuation contributions (salary sacrifice); car allowance (if part of taxable income). Exempt are: workers' compensation benefits; termination payments; company car or house; director's fees; ex gratia payments; entertainment allowance; other fringe benefits; long service leave and sick leave.</p>	<p>Salary; overtime; shift and other allowances; over-award payments; bonuses; commission; payments to working directors; public and annual holiday payments (including loadings); sick leave payments; value of board and loading for worker; and any other money or money's worth given to the worker under a contract of service or apprenticeship. Also includes: payment (whether commission, fee, reward or otherwise) under a contract (whether termed a contract,</p>	<p>Gross wages; salaries (including over time); bonuses, allowances, commission and all other remuneration paid; including pay in respect of holidays, sickness and long service leave.</p>
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	<p>pay the worker because of the nature of the employment; and allowance to reimburse costs arising out of an obligation incurred under a contract; any amount expended on behalf of the worker; directors' fees; compensation under the Act; any payment for long service leave or any payment under the <i>Building and Construction Industry Long Service Payments Act 1986</i>.</p>	<p>benefits); termination payments; and exempt benefits under the <i>Fringe Benefits Tax Assessment Act 1986</i>.</p>		<p>provided under salary sacrifice arrangements are declarable.</p>			<p>agreement) to a person deemed to be a worker. Does not include any payments for special expenses incurred by the worker because of the nature of the employment; reimbursement allowances for costs arising from obligations incurred under a contract; amount expended on behalf of the worker; director's fees; compensation under the <i>Workers' Compensation Act 1951</i>; or payment for long service leave; a lump sum payment instead of long service leave or any payment under the <i>Long Service Leave (Building &</i></p>	
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							<i>Construction Industry) Act 1981</i>	
No of workers covered	1998/99: 2,400,000	1998/99: 1,753,300 (estimate based on ABS data for March quarter 1999)	1998/99: 671,870 (approx 36% are employed by exempt employers)	1998/99: 1,267,100 (based on ABS data, employed wage and salary earners, QLD, as at February 1999)	1998/99: 746,741.5 (from ABS data)	1998/99: 155,000	1998/99: 73,700 (Note ACT Public Service covered under Comcare)	1998/99: 74,000 (approx)
Premium setting								
System: who sets, who regulates	WorkCover NSW sets and regulates the rates	Victoria WorkCover sets and regulates the rates	WorkCover Corporation sets and regulates the rates	WorkCover Queensland sets and regulates the rates	Essentially private insurance. Loading of 100% allowable in set premium and full discounting allowed. The W/Comp and Rehabilitation Commission may approve a loading in excess of 100%	Private insurers need to file the rates they will use. Workplace Safety Tasmania approves them based on criteria outlined in licence conditions	Private insurers (no regulation)	Private insurers (no regulation)
Description of principles	Industry premium is a percentage of remuneration. 105 industry groups with 28 premium pools. Experience premium is	Industry True Risk Rate is based on ratio of industry's cost to remuneration over the last 3 years.	Considers an individual employer's experience over a 30 month period	WorkCover industry Classification Rates	Set rates based on ANZSIC. Loading/disco units made to market rates	Market rates	Market rates	Market rates

	based on the last 3 years.							
Benefits⁵²								
Common law rights	Election between Table of Disabilities/pain and suffering under the Act or modified common law for injuries after 30 June 1989	Common law rights were abolished from 12/11/1997, but re-introduced again from 20/11/1999	Common law rights against employer abolished for injuries occurring on or after 3 December 1992	Limited	Limited	Unlimited	Unlimited	Common law rights against employer or fellow worker abolished for injuries occurring after 1 January 1987
Common law threshold	Economic loss: Awarded only for death or "serious injury: where compensation under Table of Disabilities is greater than 25% of maximum amount or entitlement under noneconomic loss is greater than \$56,600.00. Non-economic loss: No award if loss assessed at less than \$42,450.00. Award is	Serious injury test meaning a whole person impairment of at least 30% as assessed under the American Medical Association Guides (4 th edition)	N/A	A worker who sustains a permanent impairment of at least 20% or more of statutory maximum compensation is entitled to lump sum compensation and access to common law. A worker who sustains a permanent impairment of less than 20% of statutory maximum compensation must make an irrevocable	From 5 October 1999: Common law access available only if it is agreed or determined the worker has either: • A 16%-30% disability ("significant disability") and the worker must have elected between statutory benefits and common law normally within 6 months from the date	No	No	N/A

⁵² Heads of Workers Compensation Authorities, Comparison of Workers' Compensation Arrangements in Australian Jurisdictions, July 1999, page 28

	reduced where the loss is between \$42,450 and \$56,600			election between accepting the lump sum offered or access to common law	weekly payments commenced (statutory benefits cease as from date election is registered); or • 30% or more disability (if 30% or more the worker does not have to make an election)			
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C.2 Table for overseas schemes

Information provided without detailed source resources are gathered from knowledge of PricewaterhouseCoopers' staff. N/A means not applicable.

	Texas	Wisconsin	Washington	British Columbia	New Zealand
General Information					
Population	20.0m	5.3m (Nov 1999) ⁵³	5.6m (1997)	4.0m	3.8m (June 98) ⁵⁴
Labour force	10.4m	\$3.1m (July 2000) ⁵⁵	2.9m (1996)	2.0m	1.0m (Dec 98)
Scheme details					
responsible organisation	Tax Department of Insurance and Texas Workers' Compensation Commission	Workers' Compensation Division	Department of Labour and Industry	Workers Compensation Board	Accident Compensation Corporation
Relevant legislation	1989 Texas Workers' Compensation Act	Wisconsin's Workers' Compensation Act	Not available	Workers' Compensation Act	Accident Insurance Act 1998
Compulsory	No	Yes	yes	Yes	yes
Fund type	Privately underwritten with competitive State Fund	Privately underwritten	Monopoly	Monopoly	Monopoly (recently changed back)
Number of insurers/agents	Approx 300	>450	N/A	N/A	N/A
Self-insurance					

⁵³ www.dhfs.state.wi.us/population/98demog/wisconsin.htm

⁵⁴ Heads of Workers Compensation Authorities, *Comparison of Workers' Compensation Arrangements in Australian Jurisdictions*, July 1999

⁵⁵ www.dwd.state.wi.us/dwelmi/alus_clf.htm

Criteria	Prudential requirements, security deposit for claims reserves and evaluation of safety program ⁵⁶	Security bond of US\$500k and need to buy excess insurance policy for insurer	Minimum <ul style="list-style-type: none"> • 3 years of operation, • not worth of \$2m • operating accident prevention program for 6 months⁵⁷ 	Not available	There is no longer self-insurance, but there is an ability to apply to partnership programme. This means to manage own claims and choose from different premiums options. The criteria focus on quality injury and claims management and prudential requirements ⁵⁸
Number	55	196	2,521	5	Not available
Premium setting					
System	Each insurer develops its own premium rates and file then with TDI	The rate filing is recommended by a special actuarial committee of the Wisconsin Compensation Rating Bureau. The Rating Bureau is a not-for-profit entity that has been established to assist with the rate system	Premium set by regulator	Premiums set for full funding by regulator	Premiums set for full funding by regulator
Structure of premium	350 industry classifications, Texas specific. Experience premium for larger employers	700 industry classifications. Experience premium applies to any employer with a premium \$5,750/year	Premium based on hours worked, not remuneration. All employers are charged both based on industry classification and own claims experience	Capping policy with differences amortised over 5 years. All employers have some experience rating	Premium classification based on accident risk groups. Additional levy to fund injuries occurring before July 1999. ⁵⁹

⁵⁶ www.prd.twcc.state.tx.us/commission/divisions/selfins.html

⁵⁷ www.wa.gov/Ini/home/downloads.htm

⁵⁸ www.acc.co.nz/employers/partnership.html

⁵⁹ Accident Compensation Corporation, Consultation on 2001/02 Employer Premium Regulations, October 2000

