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Self Insurance, Workers Compensation & Workplace Law

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WORKCOVER 2011

THE YEAR OF THE RABBIT OR THE YEAR OF UNCERTAINTY?

Employers and workers alike face another year of uncertainty with a range of issues likely to impact upon the troublesome WorkCover Scheme.

Towards the end of last year there were a number of announcements made and decisions taken which, together with judicial interpretation of the Scheme, will impact this year and beyond.

Scheme Performance

The Annual Report was released on 30 September 2010 for the financial year 2009/10. WorkCover announced a profit of $77 million for the financial year, a reduction in the unfunded liability to $982 million at 30 June 2010 and an increase in the funding ratio to 61.5%. The Annual Report confirmed the intention to reduce the average levy rate from 3% to 2.75% for the 2010/11 financial year. The results for the six months to December 2010 showed a profit driven mostly by an $88 million improvement in investment income and the scheme funding ratio increased to 65.9%, but the average levy rate paid by employers will remain at 2.75% for the coming financial year. On its face a positive result – but more of that later.

Legislative Change

The Honourable Paul Holloway foreshadowed a draft Bill to reform WorkCover's dispute resolution processes to "*create a more equitable process with speedier outcomes for injured workers, without undermining the financial strength of the WorkCover Scheme*". The draft Bill sets out a wide range of amendments which will significantly impact the dispute resolution process and are heavily reliant upon effective Medical Panel processes – more of this later.

WorkCover Performance Review

In March 2007 the government revealed that the WorkCover Board had proposed radical amendments to the WorkCover Scheme in South Australia. That radical legislative reform resulted in an overhaul of the Act in 2008. At the time MLC John Darley was successful in incorporating into the legislative change a review of the impact of the changes. The review is in process now and submissions were accepted until 4 March. The review is headed by Bill Cossey AM, a former senior public servant and it can be expected to be a political hot potato because many in the union movement feel that the reforms have not achieved the aim of increasing the return to work rate and reducing the unfunded liability but they **have** unfairly penalised injured workers. They may well be right.

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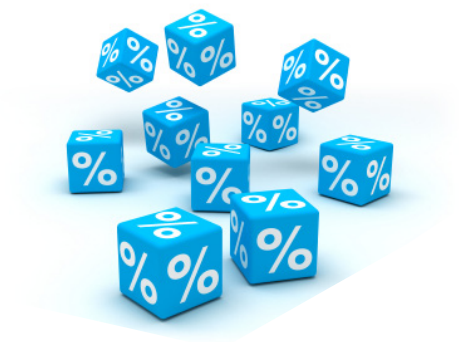
Participants in the Scheme

Towards the end of last year, decisions were taken by the WorkCover Board in relation to contracts for claims management and the provision of legal services. In each case the incumbents remain in place until 31 December 2012, ensuring a period of stability, at least, in relation to claims management and the provision of legal services.



Levy Rate

When the government committed to the reform package which led to legislative change in 2008, one of the objectives was that the average employer levy rate be reduced to a range of 2.25% to 2.75% by 1 July 2009. The Global Financial Crisis took care of that and it is proposed that the average levy rate will remain at 2.75% in the next financial year. In the meantime WorkCover is developing a new employer premium payment system for South Australia to replace the bonus penalty scheme which ceased on 30 June 2010. It was originally hoped by WorkCover that the changes would be implemented by 30 June 2011. It can be expected that there will be winners and losers out of any change but more about that later.

Scheme Performance

The generally positive commentary by WorkCover around the release of the Annual Report hides some worrying factors.

Unfunded Liability – although the unfunded liability fell from $1.059 billion to $865 million at 31 December 2010, the turnaround largely came as a result of a positive return on investment. Investments grew and delivered a return of $88 million in the 6 months to 31 December 2010, but there are some worrying signs. There was an underwriting loss of $18 million in the 2009/10 financial year. The underwriting loss is the shortfall between levy collected from registered employers and the cost of claims. In contrast the previous year delivered a positive result to the tune of $107 million. During the 2009/10 year there was a $109 million increase in the cost of claims!

The Chairman's Statement in the annual report, highlights a claims liability saving, rather than the underwriting loss. The claims liability result reflects the difference between the projected liability at the start of the period, the actual liability at the end of the period and the payments made in the period. He describes claims management as the core business that WorkCover is responsible for and the one factor influencing WorkCover's unfunded liability that is within its control and he expresses pleasure that, "*we have reduced the number of long term claims (ie, claims greater than three years old) to 1,718, which is the lowest number of long term claims since August 2001*". It should be noted that the claims liability saving at 31 December 2010 was only $73 million and down from $81 million for the previous half.

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The reduction in claims liability and the reduction in the number of long term claims is, heavily influenced by the very high level of redemption payments made pursuant to Section 42 of the Act. Section 42 of the Act was amended amongst the raft of changes implemented in 2008 and it is the clear intention of the legislation to significantly limit redemptions in order to change the "*lump sum culture*" which was blamed by WorkCover for the deterioration in the Scheme over the last 10 years. It is interesting to note, therefore, that in 2008/9 total redemption payments made were $147 million (an average of $83,000.00 per payment) and in the 2009/10 year total redemption payments were $123 million with an average amount of $95,000.00 per redemption. The "*savings*" on claims liability in the last two years and the reduction in the number of long term claims seems to have come about as a consequence of a significant increase in total redemption payments over recent years ($76.6 million in 2007/8 and only $34 million in 2006/7).

The actuarial review which accompanies the Annual Report refers to the reduction in liability of $81 million and tells us that "*this favourable movement arises from continued execution of the tail redemption strategy, as well as some favourable experience for the 2005/06 accident year (where some claims had been managed under the tail claim management strategy, and some managed toward a WCR outcome under the new legislative provisions)*". It must be questioned whether a reduction in the liability of $81 million is a good result when it has been achieved by a payment of $123 million as a result of "*continued execution of the tail redemption strategy*". It also poses a serious challenge to the viability of the Scheme when legislative change severely restricts WorkCover's ability to use a redemption strategy as the main lever to reduce the number of long term claims. The clear intent is to replace a redemption strategy with one that utilises the effect of the amendments and the role of the Medical Panel to reduce the number of long term claims. The effectiveness of the amendments and the Medical Panel in achieving the Government's aim is questionable.

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An analysis of the reported return to work rate also gives cause for concern. Despite the high cost of rehabilitation, South Australia has consistently performed poorly against the national average in the return to work rate. In the 2008/09 year there was a marked improvement from 75% to 82% (the national average at the time was 83%) but the gap is widening again with the return to work rate for South Australia decreasing to 80% and the national average trending up to 85%. If the return to work rate continues to deteriorate and the 2008 amendments and the Medical Panel do not, together, remove claimants from the Scheme and there is no ability to redeem long term claimants, it can be expected that the unfunded liability will continue to grow and the funding ratio deteriorate.

Despite the improvement in the scheme funding ratio the fact remains that the scheme still compares unfavourably with our

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competitors in the Eastern States which have significantly lower levy rates and are fully funded or in the case of NSW nearly fully funded at 89%.

As the economy recovers from the Global Financial Crisis there is a risk that claim numbers will increase. A recent Australian study has found that worker's compensation "*claims activity*" tends to increase during an economic recovery, and not when times are tough, as is often believed. There are a range of factors said to be responsible. As business confidence rises hiring activity increases and often the average age is lower as experienced and highly paid workers are replaced with younger and less experienced workers. There is a higher risk of injury with less experienced workers. An increase in production can also mean longer hours and overtime which places workers under additional physical and mental stress, both of which have the potential to lead to a claim.

Scheme Review

The review conducted by Bill Cossey comes at an interesting political time for the Government with generational change in the parliamentary party taking a lot of focus and an increasingly

confident and stable Opposition looking to take advantage of disunity in Labor ranks.

Unions SA is understood to have prepared a consolidated submission on behalf of all unions calling for major reforms. Unions SA Secretary Janet Giles, who resigned from the WorkCover Board in protest over the reforms, was quoted as saying that: "*Our submission will show injured workers have been the innocent victims of a failed experiment by Mike Rann and Kevin Foley – the aim to increase the return to work rate and reduce the unfunded liability have not been achieved, yet workers have suffered enormously*".

Whilst the unfunded liability at 30 June 2010 has reduced, the underlying fundamentals raise concerns. The Annual Report showed that its performance worsened in the six months to June 2010 and if that trend has continued it can be expected that currently the "*real* " unfunded liability is back in excess of $1 billion. Coupled with the underwriting loss, the worsening of the performance of the Scheme has the potential to affect the state's AAA rating.

The political pressure will be intense. The government will not be able to satisfy the unions (who will seek fundamental change to restore benefits to injured workers), the ratings agencies or employers, who will be keen to see WorkCover deliver upon its stated intent to reduce the levy rate to within a range of 2.25% to 2.75%.

Legislative Reform

Minister Holloway has flagged his intention to introduce legislation to simplify WorkCover's dispute resolution processes, "*to deliver faster results for injured workers*". He asserts that, "*the proposed changes will create a more equitable process with speedier outcomes for injured workers, without undermining the financial strength of the WorkCover Scheme*". The timing of the announcement towards the end of November 2010 is puzzling, coming as it does as a review of the Scheme is in process. Without going into detail in relation to the proposed changes it is sufficient to say that rather than simplifying the dispute resolution process, taken as a whole, they add a layer of complexity to the process and are heavily reliant upon the ability of Medical Panels SA to deliver opinions upon medical questions referred to the Panel. Current experience suggests that it is unlikely in the extreme that Medical Panels SA will be able to deliver opinions within the timeframe (14 days) proposed. In addition, I have no doubt that jurisdictional issues will need to be dealt with by the Supreme Court.

Once again it appears that the government has elected to introduce complex process by legislation to address a perceived problem which could have been addressed by the simple expedient of introducing an automatic 28 day restoration of income maintenance payments in circumstances where the Compensating Authority seeks to discontinue or reduce weekly payments.

Employer Payment System

Most employers will be familiar with WorkCover's Bonus Penalty Scheme which was first introduced in 1990. That Scheme ceased to operate on 30 June 2010 and now all registered employers pay a levy calculated on the basis of the relevant industry rate multiplied by employer remuneration. It is likely that the new system will require legislative amendments and its expressed aim is to balance "*user pays*" and "*insurance protection*". WorkCover's new CEO, Rob Thompson, returned to South Australia from New South Wales where he was General Manager of the Workers Compensation Division of WorkCover NSW and he is "*keen to have a system that focuses on employers preventing injuries and encourages them to keep their workers at work, or if time off is required, to support their workers to return to work*". It would be reasonable to assume that whatever scheme is introduced will closely resemble that which operates in NSW, where small employers are industry rated, medium and large employers experience rated and large employers given the option of retro paid loss.

WorkCover is currently engaged in a consultation process with stakeholders, whilst no doubt working on the mechanics of its preferred premium payment system. It will require legislative change which is normally a long process and one which will likely be affected by the current review of the Scheme. It would seem optimistic to expect the new system to be agreed upon

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and legislation passed to allow implementation for the 2011/12 financial year, but it will be most interesting to see how the initiative is pursued.

EML & the Legal Panel

The Board's decision to effectively extend EML's claims management contract to 2012 and do the same with their legal panel will at least provide a degree of stability in claims management and it can be expected that EML will work very hard to improve its performance so that it is well placed to continue as the outsourced claims manager for WorkCover beyond December 2012. The performance of EML in managing "*front end* " claims and ensuring effective rehabilitation and care after an injury will be critical in maintaining their position and injured workers will benefit from EML's motivation to improve injury and case management outcomes over the next two years.

Judicial Intervention

The key amendments to the Scheme introduced in 2008 were those that provided:

- The ability to discontinue weekly payments of income maintenance at 130 weeks post-injury for partially incapacitated workers who were not working to their maximum capacity in suitable employment; and
- The introduction of Medical Panels to determine questions that are wide ranging in nature and deal with issues of fact and law.

"The constitutional issue of the binding nature of a Medical Panel decision may also be the subject of consideration by the High Court."

It was intended that many of the functions of the Worker's Compensation Tribunal would be undertaken by the Medical Panel whose decisions would be final and conclusive. Importantly the role of the Medical Panel and the binding nature of its decisions was intended to underpin the "*work capacity reviews*" and ensure the ongoing removal of long term claimants from the Scheme. A recent decision of the Full Bench of the Worker's Compensation Tribunal in the matter of *Davey* reinforces the need for procedural fairness in making work capacity decisions and its effect will impede the ability of EML to carry out work capacity reviews and implement them in a timely fashion.

WorkCover is considering an appeal to the Supreme Court and so uncertainty will remain until a definitive decision is made at that level. Of even more significance is the decision of the Supreme Court in the matter of *Yaghoubi*. The matter proceeded to hearing in the Supreme Court in early December and judgment has been reserved. In that case the rejection of the worker's claim for various disabilities saw medical questions relevant to the subsequent dispute referred to the Medical Panel by EML. The worker in question refused to attend the medical examination with the Panel and the question before the Supreme Court is whether

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EML's referral of the medical question to the Panel was valid in circumstances where the dispute in question had been referred to the Tribunal for judicial determination. The question of law raises a constitutional issue, namely whether a decision of the Medical Panel can bind the Worker's Compensation Tribunal in its determination of a dispute which has been properly referred to the Tribunal.

If the Supreme Court determines that the Medical Panel cannot bind the Tribunal and/or it concludes that a dispute having been referred to the Tribunal for judicial determination, the compensating authority cannot refer a medical question to the Panel of its own motion, it will have significant ramifications and significantly reduce the effectiveness of "*work capacity reviews*" to remove claimants from the Scheme. It necessarily follows from this result that claims costs will increase and the tail will grow, as will outstanding claim liabilities and the unfunded liability. The ability of the government to deliver the reduction in the levy rate promised for the state's employers will be in question.

The constitutional issue of the binding nature of a Medical Panel decision may also be the subject of consideration by the High Court.

A Victorian employer has launched a High Court Appeal against a decision of the Victorian Court of Appeal which ruled that a Medical Panel's finding would bind the jury hearing the case in the County Court. The County Court had made a preliminary ruling prohibiting the employer from leading evidence contrary to the Panel's findings about the former employee's psychiatric state.

Uncertainty

The latest actuarial review is heavily qualified, and properly so. The actuary quite reasonably points out that "*we expect it to be a number of years until the financial impact of the reforms can be confidently determined*" but, "*judicial interpretation of the legislative changes continues to be a source of uncertainty in estimating the Scheme liability* ".

2011 is shaping up to be an interesting year for Self Insurers as well. Although largely unaffected operationally by the 2008 legislative amendments there are some worrying signs that WorkCover is seeking to exercise greater influence directly with individual Self Insurers by restricting consultation with SISA, the organisation which represents this important group of stakeholders.

Quite why WorkCover has chosen this potentially confrontational approach with a group of employers which out performs the Scheme is a mystery.

2011 is the year of the Rabbit in the Chinese Lunar Calendar but so far as WorkCover is concerned it is better termed the Year of Uncertainty.