



Australian Federation of Employers and Industries (AFEI)

**Submission to the State Insurance Regulatory
Authority of NSW (SIRA)**

26 November 2015

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Regulation of legal costs for work capacity decision reviews Discussion Paper

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1. The 2015 *Workers Compensation Amendment Act* gives SIRA regulation making powers to
 - Prescribe the type of review for which legal costs can be recovered
 - Set maximum costs payable for those legal costs.
2. This was introduced as part of the 2015 workers compensation reform package intended to wind back or remove many of the reforms considered necessary in 2012 when the scheme, according to actuarial estimates at that time, confronted unfunded liabilities in excess of \$4 billion.¹
3. As the Government reported publically by late 2013 the significant and much needed 2012 reforms had reversed the deficit.²
4. By mid 2014 the scheme actuary told the Standing Committee on Law and Justice that employers were paying around 20% more in premiums than the scheme required to meet its target funding ratio, despite announced average premium reductions. We have included this lengthy extract to keep the Minister and the Regulator aware of the unnecessarily inflated level of premiums inflicted on NSW employers, two thirds of which surplus is being distributed to NSW workers and now, it appears, also to their lawyers:

Mr PLAYFORD: Over the last six months the assets side of the balance sheet has improved by the order of \$689 million. There are two components to that. One is that the premiums that we are currently charging are higher than what I estimate the underlying cost of the scheme is so additional premium is being collected. That automatically goes to improving the bottom line of the scheme's balance sheet. The second driver of the assets side is that investment returns continued to be very

¹ PriceWaterhouseCoopers, WorkCover NSW: Actuarial valuation of outstanding claims liability for the NSW Workers Compensation Nominal Insurer as at 31 December 2011, 12 March 2012.

² Media Release Premier Barry O'Farrell 30 October 2013; WorkCover NSW Scheme Report 2012-13 October 2013.

good in the last six months of 2013. So those two factors, collecting more premium and the assets getting higher investment returns than the longer term average, contributed to roughly two-thirds of the improvement in the solvency position. Mr DAVID SHOEBRIDGE: When were premiums most recently reduced? Mr PLAYFORD: There was a December 2013 insurance premium order, in which I believe there was a 5 per cent reduction. There had previously been a reduction in premiums at June 2013 as well. Mr DAVID SHOEBRIDGE: Which was substantially bigger than 5 per cent? Mr PLAYFORD: Yes. I think it was 7.5 per cent on average. Mr DAVID SHOEBRIDGE: Even with those reductions in place your actuarial advice is that there is more being received in premiums than is necessary to pay the current package of benefits. Mr PLAYFORD: That is correct. Mr DAVID SHOEBRIDGE: What is the differential? Mr PLAYFORD: It is of the order of 20 per cent currently.

Mr DAVID SHOEBRIDGE: So you could hold premiums at their current level and increase benefits in the order of 20 per cent and you would still have a viable scheme operating close to surplus. Mr PLAYFORD: There are some uncertainties in my calculations but benefit improvements—there are two choices. Well, there are three choices, frankly. If you do not do anything the solvency position of the scheme is likely to continue to improve dramatically, and that is not necessarily an effective use of the capital of society having that locked away in WorkCover's balance sheets. So that is one option. The second option is you could reduce premium rates. The third option is you could improve benefits of the order that you are talking about, yes. Mr DAVID SHOEBRIDGE: So using your best advice, with all your experience, if we hold things as they are for now for another 12 months, what sort of surplus are we looking at in terms of the scheme? Mr PLAYFORD: Again it would depend on a combination of factors, in particular the investment returns. But by June 2015 for example— Mr DAVID SHOEBRIDGE: Using this medium-term assessment. Mr PLAYFORD: You would be looking at the order of about 125 per cent funding ratio. I do not have the numbers to convert that into a dollar figure but basically you have assets in excess of your liabilities of the order of about 25 per cent. Mr SCOT MacDONALD: When you hit that figure of 125 per cent you are well over your 110 per cent which is your preferred level. Mr PLAYFORD: That is correct.³

5. So employers have been paying premiums well above the level required to maintain the scheme's target funding ratio. Not an appropriate policy setting for reducing unemployment and increasing NSW competitiveness.

³ The Standing Committee on Law and Justice Review of the exercise of the functions of the WorkCover Authority (Inquiry) Transcript 12 May 2014 pages 20-21

6. Given that it was awash with employer funds, the Government adopted a policy position that of every dollar above the minimum surplus to keep the scheme sustainable two thirds would be diverted to the benefits of workers compensation recipients and getting them back to work. One third was go to lowering premiums.⁴ WorkCover set about deciding how to best invest the additional solvency funds.
7. Employers, while funding the scheme, have also the right to participate in the distribution of any surplus.⁵ Yet their actual ability to do so, despite so called consultation, is severely curtailed. Firstly, they are effectively excluded from all decision making. The scheme is not accountable to employers whose legitimate concerns about scheme design and operation are not heeded. The recent reforms were entirely instigated by the Government. There is an icare Board member who represents the Union movement but no employer representative with wide experience of employer issues over an expanse of time and industries.
8. Further, despite continued and repeated calls for greater transparency and up to date and meaningful data, none has been forthcoming from SIRA or icare. Apart from the very high level annual report (one year out of date), proper data is not published about current scheme performance. Meaningful information is not provided about claims acceptance rates, work capacity decisions, or work capacity reviews which would give an indication of cost implications.⁶
9. Nor are employers given meaningful or up to date information about return to work rates, presumably a key indicator for a scheme in which **both** workers compensation payments **and** premium formulation are theoretically directed at encouraging the earliest possible safe return to work.
10. The recommendation of the Standing Committee on Law and Justice Inquiry for the scheme (employers) to pay for legal representation in the work capacity decision has been accepted by the Government with alacrity. The decision to invite legal costs back into the scheme is made with no data provided as to the likely cost let alone the need and efficacy of such a measure. Again, there is no data about the work capacity review or decision by which to assess how it is working and how much it costs as it is currently operating, let alone once the lawyers become part of the picture. For this reason it is pointless making any submission on the options raised in the discussion paper, quite apart from our in principle objection to regarding lawyers as equal

⁴ Minister Perrottet Media Release 15 March 2015

⁵ Section 154D(4) Workers Compensation Act 1987

⁶ At best, from the WorkCover Annual Report 2013-14 we can glean that there were 8963 work capacity decisions, 2334 internal reviews and 1136 applications lodged with the Merit Review Service. Of these, 911 applications were finalised, with the vast majority (82 per cent) requiring a full merit review. There would appear to be considerable scope for increased costs when legal fees are added to this administrative mix.

stakeholders in the scheme. We are equally opposed to having any vehicle for legal funding residing within the functions of the WIRO.

11. We know from past experience that disputes which were taken to the Workers Compensation Commission usually cost more in legal fees than the disputed amount in both claims for weekly payments and lump sums.
12. The decision to reintroduce greater litigation into the scheme has continued despite the 2012 reforms and the subsequent regulations, amendments and guidelines to the scheme which have addressed the very features those calling for the presence of lawyers have complained about. There have been major structural reforms, resulting in the formal separation of insurance and regulation. In terms of reducing the regulatory burden for workers and in navigating the system these changes include, according to WorkCover:
 - *Revised work capacity guidance materials for insurers and injured workers.*
 - *Work continues on building capability and establishing robust evidence based decision-making models for work capacity assessments and decisions*
 - *In 2013-14, WorkCover implemented a new Customer Feedback Framework, which adheres to the NSW Ombudsman guidelines, Australian Standard for complaints handling and Australian Securities and Investment Commission's requirements for financial institutions*
 - *The framework also includes dedicated hotlines and a complaints handling team. It places a greater emphasis on Scheme agents and insurers resolving complaints directly with complainants*
 - *If an injured worker cannot resolve an issue directly with their Scheme agent or insurer, WorkCover provides advice about the dispute resolution process, including referral to the WorkCover Merit Review Service, WorkCover Independent Review Office (WIRO) or the Workers Compensation Commission. WorkCover's new complaints handling framework was developed in consultation with the WIRO and provides a greater transparency of the review process that supports the WIRO's statutory functions.⁷*
13. With these in place there can be no argument in favour of introducing a litigious component into this complaints process which has already been specifically structured to assist the worker. In the Discussion Paper, Work Capacity Decisions are listed as having three points of review.⁸ These appear to be based on being undertaken in a practical manner by initially the insurer, then by the Merit Review Service as well as providing the ability for the WIRO to undertake a procedural review.

⁷ WorkCover Annual Report 2013-14.

⁸ Discussion Paper page 3

WIRO undertook procedural reviews of 129 work capacity decisions in 2013-14.⁹ Given the around 9,000 work capacity decisions in 2013-14 this is a minimal proportion and suggests that the vast bulk of matters are resolved at the internal and merit review stages without the involvement of third parties.

14. Before providing open season for lawyers, what has been the experience in these internal and merit reviews from which it is concluded that they are deficient and in need of litigation? What are their current costs to the scheme? They do not appear to be included in its liabilities. This is not even raised as a consideration in the discussion paper, let alone data provided to enable more meaningful assessment of the impact of legal costs on the scheme.
15. Some indication of the potential for litigious growth in this area is given through the WIRO which in 2013-14 had 14,129 ILARS grant applications and appointed 831 Approved Legal Service Providers (up from 656 in the previous year).¹⁰ The number of legal services invoices processed per month by WIRO increased from 80 to more than 1,000 per month, at a value of \$3.9 million per month. The average amount per invoice was \$2,841.¹¹ Since commencing operations in October 2012, the ILARS team has approved funding grants to almost \$95 million.¹² With the current surplus these costs were more than readily absorbed by WorkCover, in fact below budget, which noted in its 2013-14 Report that:

“Total cash flows were \$23.7m favourable to budget mainly due to: favourable operating cash flows of \$29.8m predominately due to lower than expected expenditure in the Independent Legal Assistance and Review Service (ILARS) within the Wo[r]kCover Independent Review Officer (WIRO) in relation to the provision of legal services at no cost, to injured workers in respect to their claims for compensation.”¹³
16. The danger for employers is that the already inflated premium rate will be maintained at an unnecessarily high level to sustain ever increasing legal costs, and whose introduction was unwarranted.
17. Further, if the Work Capacity Decision is so complex (which we do not accept) and in need of lawyers to explain and manage it, why not make the process simpler?
18. It is indeed ironic that, whilst introducing this potentially expensive and damaging legal costs element to the scheme, the 2015 package of reforms also removed features said to necessitate legal support including the cessation of certain benefits

⁹ WIRO Annual Report 2014 page 14

¹⁰ WIRO Annual Report 2014 page 12

¹¹ WIRO Annual Report 2014 page 13

¹² WIRO Annual Report 2014 page 15

¹³ WorkCover Authority of NSW Financial Statements for the Year Ended 30 June 2014 page 82

(work capacity decision stay); PIAWE regulations; increased lump sum and minimum weekly payments; extension of the medical cap and secondary surgery available to all claimants.

19. Importantly, the 2015 reforms also introduced the new premium formula with the return to work incentive, commencing 30 June 2015. Even before any assessment of this initiative could possibly be undertaken, a further element of dispute and litigation is now proposed to be introduced into the scheme in the form of fee paid lawyers. This would appear to be back to the future; with dispute about whether a worker is fit to return to work, whether there is suitable employment available, whether the amount of compensation is correct determined by adversarial processes complete with legal representation, funded by the scheme (ie by employers).
20. The focus of the 2012 reforms was on the ability of the injured worker to return to work. The work capacity assessment and decision process were designed to achieve this outcome, a positive measurement of capacity. Bringing adversarial and litigious legal representation into the process does not accord with that objective; the focus will return to compliance with administrative law and avenues of appeal and further redress.
21. Not for one moment do we accept the fantasy that lawyers will see themselves as educators and facilitators, assisting the efficiency of the scheme. This is about making money. The regulation will be designed *“to provide fair, equitable and appropriate access to professional legal services”*; lawyers will have certain views on what is equitable and fair, particularly since the pricing mechanism is also not to *“compromise the quality or availability of services”*.
22. From the dated and limited amount of information on the scheme which is publicly available it would appear that the reforms have had the intended effect of reducing claim numbers, improving return to work rates and an increased understanding that, in comparison with the old fitness test, most workers will have some capacity for work. From discussions with WorkCover it would appear that the administrative claims process is producing results with fewer claims, earlier return to work and at an earlier stage. There also appears to be a decline in the applications lodged in the Workers Compensation Commission by workers. Why then introduce lawyers and litigation to a scheme which has undergone large scale, system wide change, which has been in transitional mode for much of the first two years and which has already been subject to continual change over the past three years?
23. History has a habit of repeating itself in workers compensation schemes, where there is a bucket of someone else’s money to operate with. And history shows that once the lawyers are embedded in the scheme, the scheme heads for trouble, as does the data.

24. Premier Barry Unsworth in 1986 weeded lawyers out of the scheme. That, together with other changes, reversed the slide into disastrous average premium rates and ushered in a healthy surplus. The next change of government (Greiner) however saw lawyers back in business along with significant increases in worker benefits. The result was to drive the scheme from enormous surplus to deficit by the time of the next successive change of government. Legal fees rocketed from \$40 million in 1992 to \$104 million in 1995.¹⁴
25. The danger before us now seems to be following a similar path of re-embedding lawyers in the scheme and providing significant increases in worker benefits, all attended by a similar determination to keep scheme performance data non transparent. Employers will be compelled to pay premiums well above the target rate in order to support this and further reforms envisaged by the Government, instead of maintaining a focus on a scheme which incentivises behaviour which supports financial sustainability.

¹⁴ Of the \$982 million reversal estimates of future court awards and legal costs accounted for \$613 million. WorkCover figures indicated the increase in legal fees: 1991/92 \$40.8 million; 1992/93 \$67.2 million; 1993/94 \$79.2 million and 1994/95 - \$104.4 million. NSW Parliamentary Research Service Workers Compensation and Motor Accidents Compensation in NSW Briefing Paper No 039/95 Page 28.