Submission to the Joint Parliamentary Select Committee

Submission on the NSW Workers Compensation Scheme

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1. Introduction

There has been what the State Government regards as a significant deterioration in the financial standing of the New South Wales workers compensation scheme since 2008. This has been highlighted by ongoing references in the media and elsewhere to the scheme's unfunded liability which is now estimated to be in the order of $4.08 billion (**PWC 2012: 262**)

In response the Premier suggested, on March 26 2012, that the scheme's unfunded liability is compromising the 'competitiveness' of New South Wales businesses and indicated that "immediate action" (**O'Farrell 2012:5**) on WorkCover was required to secure the State's economic future. In further developments, the Minister for Finance and Services, on behalf of the Government, released an Issues Paper on 23 April 2012 and simultaneously announced the establishment of a Joint Parliamentary Select Committee to review key aspects the scheme (**Pearce 2012: 1-2**) and report back to the NSW Government by 13 June 2012.

The Issues Paper canvasses various options to restore the scheme's financial viability. Most, however, are specifically targeted to strip away the rights of injured workers to compensation. Among the changes put forward are proposals to:

- Remove coverage for injuries while travelling to and from work;
- Cut weekly payments to injured workers after 13 weeks;
- Stop weekly payments for most injured workers after 130 weeks;
- Place limits on medical payments for injured workers;
- Prevent partners of those killed at work being compensated for nervous shock;
- Eliminate access to lump sum payments for pain and suffering due to work injuries; and
- Make it harder for workers to prove employer negligence in common law claims (**NSW 2012: 22-27**).

Inherent in this preoccupation with compensation entitlements is the view that injured workers are somehow to blame for the parlous state of the scheme. The Issues Paper is peppered with references to the need for further financial disincentives as a means

to encourage injured workers to get back to work. The rationale for this appears to be that if workers' entitlements are cut it is more likely they will return to work sooner. This is a simplistic, one dimensional view of the return to work process.

Equally important, it serves to divert attention from the substantive issues which have been responsible for the deterioration in the scheme's performance.

In this respect, the Issues Paper has nothing to say.

It contains no discussion of the WorkCover Board's management of the scheme or any consideration of the performance of WorkCover's claims agents, despite frequent concerns raised by trade unions and more recently the scheme's actuaries. And nor is there any examination of the behaviour of those employers whose negligence has resulted in so many serious, and costly, injuries; or of those who have failed to assist injured workers in their efforts to return to meaningful employment.

Almost invariably, when WorkCover schemes encounter financial difficulties politicians find it expedient to reduce scheme costs by targeting the entitlements of injured workers rather than tackle the underlying causes.

The reluctance of governments to scrutinise the actions of scheme administrators, their claims agents and employers, especially in view of the pivotal roles they play in the functioning and financial performance of workers compensation schemes, is a deep seated, perennial problem and a major obstacle to genuine reform.

In this submission Unions NSW will seek to remedy this state of affairs, as an understanding of the scheme dynamics generated by the behaviour of these players is essential to restoring the social and economic viability of the New South Wales WorkCover scheme. In doing so, it will firstly endeavour to put the scheme's financial position in its proper context. It will then examine a number of issues associated with the management of the scheme which have contributed to WorkCover's current difficulties including underfunding of the scheme, obstacles facing workers seeking to return to work and the outsourcing of the schemes claims management responsibilities. This will be followed by a consideration of the

proposals contained in the Issues Paper. The final section of the submission will outline a series of proposals that provide a foundation for a balanced and viable reform agenda designed to revitalise the operation and performance of scheme.

2. An Overview of WorkCover's Unfunded Liability

Discussion to date on WorkCover's financial performance by politicians, actuaries and the media has been couched in terms of the scheme's 'deficit' and threats to its 'solvency'. The use of these terms in the context of the New South Wales scheme however is both factually inaccurate and highly misleading. The real risk in framing the discussion in this manner is the potential it creates for rash and ill considered policy responses to the scheme's underperformance.

The reality is WorkCover is not about to go broke and its unfunded liability is not a deficit. Nor is it costing New South Wales "more than $9 million a day" (**O'Farrell 2012:5**) as has been suggested by the Premier.

An unfunded liability is the shortfall between a scheme's estimated liabilities and its assets, measured at a given point in time. As workers compensation is a 'long-tail' form of insurance claims, liabilities may extend over several decades since workers who have suffered serious or catastrophic injuries early in their working lives may be in receipt of compensation payments for 40 to 50 years. Consequently, it is often very difficult to accurately predict a scheme's long-term liabilities. In view of what actuaries acknowledge as the 'inherent uncertainty' (**PWC 2012a: 5**) involved, unfunded liability estimates should not be taken as hard and fast numbers.

The next point to note is that an unfunded liability is not a debt but rather an estimate of an amount that a scheme *might* need to pay out over the next 40 to 50 years in relation to existing claims *if* no policy changes, or improvements in the management of the scheme, take place during this period. It is not a sum that needs to be paid out in full at any one time. It is also important to understand that the New South Wales scheme is more than capable of meeting its financial obligations to injured workers and the other day to day expenses associated with its operation.

The use of headline unfunded liability estimates is another issue that can be problematic. This is all the more relevant in view of the fact that this headline figure provides the basis on which the Government is proposing to curtail compensation entitlements to injured workers. It is all very well to say that the New South Wales

scheme has a current unfunded liability estimate of $4.08 billion but what does that actually mean? Does it, for example, mean that its financial performance is worse than that of the South Australian WorkCover scheme, which currently has an unfunded liability estimated at $1.17 billion (**WCSA 2011: 1**)?

To answer this question it is necessary to know the funding ratio of the two schemes. This ratio can be defined as a scheme's total assets expressed as a percentage of its total estimated liabilities. The funding ratio measures the extent to which a scheme is fully funded and provides a far more reliable guide to a scheme's financial performance than any headline unfunded liability number. Thus although the New South Wales scheme has a far higher unfunded liability, its funding ratio of 78% means that it is in considerably better financial shape than its South Australian counterpart which has a funding ratio of only 61.6% (**Ibid.**).

At a more fundamental level workers compensation liability estimates are crucially dependent on the economic assumptions used by scheme actuaries. Even seemingly small variations in these assumptions can result in very substantial changes to the bottom line (**PWC 2012a: 284**).

By way of illustration, Australian workers compensation schemes over the last decade have included a 'risk margin' when determining their outstanding claims liabilities. This inevitably results in a lower funding ratio than might otherwise be the case. The rationale for the use of risk margins is that they provide a buffer in the event actuaries misjudge the full extent of the scheme's liability. The impetus for their introduction was the adoption of new accounting standards and the imposition of more stringent prudential requirements on private insurance companies in the wake of the calamitous financial collapse of HIH in 2001.

It is important to understand that the use of risk margins is not a legal requirement for publicly underwritten workers compensation operators such as the New South Wales WorkCover scheme. Because of the different scheme dynamics involved, the risk profile of publicly underwritten workers compensation schemes is much lower than for private insurance companies and, consequently, so too is the requirement for risk margins.

The inclusion of a risk margin, as already pointed out, can have a significant bearing on a scheme's funding position. According to WorkCover's actuaries the New South Wales scheme's estimated liabilities at December 2011 totaled $18.802 billion, while its total assets were $14.719 billion (**Ibid: 262**). The scheme's liabilities included a risk margin that totaled $1.725 billion (**Ibid: 256**). Its inclusion, however, meant that the scheme's funding ratio was 78.3%. Had this not occurred the funding ratio would have been a much healthier 86.2%.

A further illustration of how actuarial assumptions can influence WorkCover's bottom line is provided by the discount rate. The discount rate is an assumed rate of return on WorkCover's investments which is used to discount the actuarial estimate of the scheme's outstanding liability in order to express it in current dollar terms - its net present value. It is a very sensitive indicator, even to minor changes.

In recent years, the discount rate used by the scheme's actuaries has been the 'risk-free' rate of return based on Commonwealth government bond yields. This risk-free methodology is another measure adopted by corporate regulators to tighten prudential standards designed to deter private insurance companies from pursuing high risk, unsustainable investment strategies that lead to insolvency. There are no compelling grounds, however, why this approach needs be used by publicly underwritten compensation schemes. There are at least two reasons for this. First, unlike private insurance companies, publicly underwritten workers compensation schemes do not go broke. Second, the New South Wales scheme has long taken a balanced, moderate risk approach to its investment responsibilities.

Although precise details are not publicly available, the WorkCover scheme since its inception in 1987 has generally achieved investment returns higher than the risk-free rate. The risk-free approach, however, means that there is no reward for a better investment performance. Since a 1% increase in the discount rate would reduce the scheme's outstanding liabilities by $525.6 million (**Ibid: 284**) this is a significant concern. A more responsive discount rate methodology would ensure that better performance would result in a lower unfunded liability and a correspondingly higher funding ratio than occurs with the current ultra conservative approach.

In view of the defining role of assumptions in shaping actuarial valuations it is not surprising to find that most of the $1.762 billion increase in WorkCover's unfunded liability - some $1.083 billion – was attributable to changes in the underlying assumptions (**PWC 2012b: 2**). This underscores the more general point that actuarial assumptions are major drivers in the construction of the scheme's financial performance.

This is not to suggest that action does not need to be taken to improve the New South Wales WorkCover scheme's performance. It does. What *is* being suggested is that the scheme's unfunded liability is a patently inadequate measure of the scheme's financial performance and it should not be used to manufacture a WorkCover 'crisis' that targets workers entitlements. Even on an ultra conservative basis the scheme is 78% funded. A more realistic assessment would place the funding ratio at 86%, or even higher if WorkCover's investment performance was adequately accounted for.

What is required now is a sober, evidence based review of the causes of the scheme's continuing poor performance and well designed policy responses tailored to get WorkCover back on track and into the black.

3. Underfunding of the Scheme

One of the major issues faced by the New South Wales scheme is that the average premium rate has been set at artificially low levels in recent years. The scheme's reported funding ratio has been in decline since December 2007. By December 2008 it had fallen to 89% and since then has persisted on a downward trend (**PWC 2012a: 263**). During this period WorkCover continued to reduce the average premium rate - to 1.69% in 2009-10 and then to 1.66% in the 2011 financial year (**WCNSW 2011: 1**).

This was bad policy. From a prudential perspective any consideration of reductions in average premium rates should only be undertaken when a scheme is fully funded, and even then only if the underlying claims trend is favourable.

More generally, the temptation to cut premium rates when it is not prudent to do so is fuelled, at least in part, by what can be described as the 'competitive premiums' doctrine. In this view of worker's compensation, state governments claim that unless premium rates in their state are aligned with those where premiums are lower, local businesses will be at a competitive disadvantage and, consequently, the state will face an exodus of investment and employment opportunities. This was the point being made by the Premier in a recent speech to members of the New South Wales employer community (**O'Farrell 2012: 6-7**).

One obvious problem with the Premier's reasoning is that it fails to take account of interstate differences in workplace health and safety outcomes. This can be readily illustrated by a comparison between New South Wales and Victoria. The workers compensation frequency rate for serious work injuries and diseases has been consistently higher in New South Wales than in Victoria. In the five year period to June 2009 the annual New South Wales frequency rate was between 27% and 42% higher than that in Victoria (**WRMC 2010: 7**). This in turn raises the question of why should a State with a much higher risk of serious injury expect that its employers are entitled to the lower premium rates on offer in a State where the risk level has been reduced to a more manageable level? Lower premium rates should be based on performance, not a culture of entitlement.

Notwithstanding this objection, the 'competitive premiums' doctrine has, for over two decades, given rise to periodic bidding wars between the states to create cut-price workers compensation schemes for the benefit of employers (**Purse 2011**). The result is that workers compensation entitlements have become captive to the vagaries of ad hoc industry policies set by state governments.

Despite its influence, no evidence has been produced to support the claim that employers will shift their businesses interstate as a result of interstate differences in workers compensation premium rates. For most employers such premium differentials are quite modest and are hardly likely to prompt them to relocate their businesses. Similarly, at the macro level, while South Australia has for many years had the highest, and Queensland the lowest, average premium rates of all the States, there is no evidence to suggest that there has been a flight of capital and jobs from South Australia to Queensland. Contrary to the competitive premiums' doctrine, relocation decisions by businesses tend to be based on total labour and operating costs along with a range of other strategic factors, such as access to markets or raw materials, rather than workers compensation premium differentials. In this regard, it is also worth noting that the most comprehensive investigation of workers compensation arrangements in the US, by the National Commission on State Workmen's Compensation Laws, reached the same conclusion (**NCSWCL 1972: 124**).

At a more basic level, the public discussion of 'competitiveness' needs to be considered in its proper context. All too often, in workers compensation discourse, references to 'competitiveness' are invoked by political leaders as a pretext to wind back the entitlements of injured workers. One crucial aspect of this discourse is the lack of any acknowledgement that workers compensation claims, and the resultant costs, are primarily the result of failures associated with workplace health and safety management practices. A corollary is that priority is accorded to policy prescriptions that reduce the cost consequences for employers of work related injury and disease rather than their causes. Hence, the focus on interstate premium comparisons and the targeting of workers' entitlements. The ensuing race to the bottom in which states

compete to reduce workers entitlements so as to lower premiums was aptly described by the Industry Commission as a form of 'invidious' competition (**IC 1994:xxxi**).

A proper review of competitiveness needs to place injury prevention at the centre of the public policy debate. Despite improvements, there are still far too many work related injuries and deaths in Australia. In 2009-10 alone there were 640,700 reported injuries across the country (**ABS 2010: 11**). Apart from the human suffering and dislocation to people's lives, this industrial carnage represents a significant drain on the nation's productivity. Workers compensation premiums paid by employers were $6.5 billion in 2009-10 while the total cost of work related injuries and deaths was estimated at $60.6 billion! This represented 4.8% of GDP in terms of a foregone economic activity **(SWA 2012: 3-4**).

These damning statistics highlight the fact that the prevention of work related injuries and deaths is an essential ingredient of any serious agenda to improve productivity and business competitiveness. What is required is 'beneficial' competition between the states, including New South Wales, based on initiatives that deliver improvements in workplace health and safety, claims management and return to work outcomes.

In the short term this is likely to require some upward adjustment in average premium rates to offset the current underfunding. However, as pointed out by the scheme's actuaries this does not necessarily require an immediate, 28% increase in the average premium rate (**PWC 2012b: 2**). It is open to the Government to adopt a more balanced approach.

4. Claims Outsourcing

In New South Wales, as in Victoria and South Australia, responsibility for the scheme's core business – its claims management and return to work functions – has been outsourced to private claims agents.

In 2010-11 remuneration paid to New South Wales WorkCover's seven claims agents was $318 million (**NSWWC 2011: 155**). Compared to the amount paid in 1997, which amounted to $141 million (**NSWWC 1997: 90**), this was an increase of 226%. During the same period, claims for compensation of five days or more declined from 60,109 (**WCNSW 1998: 16**) to 28,056 (**NSWWC 2011: 26**), a reduction of 47%. Even after adjusting for inflation, these statistics suggest that agents were getting paid a lot more for doing a lot less.

The intrinsic downside risk for workers compensation authorities with claims outsourcing is that they are relegated to the role of contract manager, or scheme regulator. In this capacity, they are not necessarily in charge of their own destiny as scheme performance is heavily dependent on the behaviour of the agents.

The adoption of claims outsourcing, which appears nowhere else in the world, was a product of the free market ideology that swept across Australia's political landscape during the 1980s and 1990s. At the time it was argued that outsourcing would result in greater scheme efficiencies. The validity of this claim is, however, rather dubious. As one commentator has pointed out:

> The driver of Agent behaviour is the remuneration arrangements that are in place. These have been subject to almost constant change in the three jurisdictions suggesting that no satisfactory set of measures that will succeed in aligning agent performance with the goals and expectations of the regulator has yet been achieved (**Clayton 2002:246**).

This assessment is supported by a South Australian study; the only published study to date that has evaluated outsourcing.

Claims outsourcing became a feature of the South Australian WorkCover scheme in 1995. Its introduction was accompanied by Government assertions that it would reduce the cost of running the scheme by 10%-15% a year. During the course of the study which covered the period from 1996 to 2008, however, there are no such cost savings. On the contrary, the scheme ended up paying a lot more – in effect, an annual 'outsourcing loading' of 11% (**Purse 2009: 451**). This cost increase occurred despite a 47% decline in claim numbers over the period.

Claims that outsourcing would improve the South Australian WorkCover's funding position and provide better service to injured workers and employers also failed to materialise (**Ibid: 452-455**). In the case of injured workers the failure of claims agents to enforce employer obligations to provide suitable employment was so unsatisfactory that this function had to be in-sourced (**Ibid: 454**).

There have also been problems with outsourcing in Victoria. In 2001, a report by the Victorian Auditor General was highly critical of the Victorian WorkCover Authority's outsourced claims management operations. Among the problems identified were a lack of resources, expertise, and high staff turnover (**AGV 2001: 5**), a failure to follow up employers who failed to comply with their legal requirement to report lost time claims (**Ibid: 9**) and poor return to work outcomes (**Ibid: 31-32**). The report also emphasised the need for more "proactive oversight" (**Ibid: 39)** of claims agents by the Authority.

A more recent investigation by the Victorian Ombudsman also found widespread shortcomings in agent performance. These included delays in payments to injured workers and service providers, privacy breaches in the management of workers' files, a failure to comply with contractual record keeping obligations and outdated IT systems (**VO 2011: 4-8**). In one case financial rorting of the scheme's performance incentive program for agents was also uncovered. The agent in question was subsequently fined $2.8 million and required to make restitution of $2.5 million (**Ibid: 39**).

The New South Wales experience with claims agents has also been problematic. Both the 1997 Grellman inquiry and the 2003 McKinsey report were critical of

WorkCover's claims outsourcing arrangements. Both drew attention to the need to improve the structure of agent remuneration arrangements and for more effective oversight by WorkCover (**Grellman 1997: 37-39, McKinsey 2003: 33, 84**). These issues remain as ongoing concerns.

Claims agents were also the subject of criticism by WorkCover's actuaries in their 2012 report where it was noted that the decline in the scheme's return to work rates were linked to the deteriorating performance of "some of WorkCover's largest Agents" (**PWC 2012b: 29**). This view was echoed, somewhat more forthrightly, by the peer review actuary who stated that WorkCover needs to "take steps to improve the claims management in the scheme especially in relation to the two largest Agents which are making a much larger contribution" (**E&Y 2012: 8**) to the deterioration in the scheme's performance.

The peer review actuary also made the perennial recommendation that a review of agent remuneration be made a scheme priority (**Ibid: 8**). In an implicit but fundamental criticism of WorkCover's handling of this critical function, however, the actuary indicated that "while we recognise that WorkCover" has "recently implemented some changes to Agent Remuneration, we recommend a "back to basics" review of the remuneration" (**Ibid.**) be undertaken.

The concerns raised by the actuaries once again underscore the difficulties that are inherent in outsourcing claims management regarding the alignment of agent behaviour with underlying scheme objectives. In-sourced claims management, as occurs in Queensland and the federal Comcare scheme, provides the only known cure for this problem. However, in view of the status of existing contractual arrangements this is not likely to be a realistic option in the short term. As a result, WorkCover will need to place a much greater emphasis on both the strategic focus and oversight of agent operations.

5. Rethinking Return to Work

Vocational rehabilitation, and the return of injured workers to suitable employment, has been arguably the most important change in workers compensation scheme design in Australia during the last 30 years. It now plays a pivotal role in the social and financial viability of all Australians schemes, although the extent varies between the schemes. It is especially important in long-tail schemes where access to weekly payments and other entitlements may, subject to the seriousness of the injury and its impact on earning capacity, be ongoing.

5.1 Suitable Employment Obligations

In Australian jurisdictions return to work obligations are rightly placed on both workers and employers (**SWA 2011: 259-288**). In New South Wales, for example, workers are obliged to make reasonable efforts to return to work with their pre-injury employer as soon as possible and comply with any obligations imposed under an injury management plan. Failure to do so can result in the suspension or termination of their weekly payments (**Ibid: 271-272**). For New South Wales employers, the most important obligation involves the provision of suitable employment, if it is reasonably practicable, when requested to do so by injured workers (**Ibid: 259**).

It is apparent, however, that WorkCover New South Wales is under performing in this scheme critical function. The main reasons for this are the failure by some employers to provide suitable employment for injured workers, a lack of focus by claims agents in managing the return to work process and WorkCover itself in not providing adequate oversight and strategic direction. This is compounded by the current legislative framework which is confusing, not enforced and, therefore, ineffective.

The confusion arises because of the disjunction between the relevant provisions of the *Workplace Injury Management and Workers Compensation Act 1998* and the *Workers Compensation Act 1987* (**NSWWIM&WCA 1998: s 49, NSWWCA 1987: s 248**). The former sets out the obligations of employers to provide suitable employment. The latter makes it an offence for an employer to dismiss a worker of because of the injury, but *only* if the dismissal occurs within six months of the worker becoming

unfit for employment. This creates an impression among employers and agents that employers are entitled to dismiss injured workers once the six month period expires.

The lack of enforcement of the employer obligation to provide suitable employment simply makes matters a whole lot worse. Apart from the adverse effect on injured workers it also undermines the scheme's return to work results and impacts directly on its bottom line.

New South Wales WorkCover does not provide published data on the number of workers who have their employment terminated while in receipt of compensation payments. Recent figures from the South Australian WorkCover scheme, however, provide a useful insight into this matter. For injured workers who lodged lost time claims in 2008-09, 4.5% had lost their jobs within six months. Within nine months the percentage had more than doubled to 13.5%. By 12 months it had doubled again to 27%. At 18 months after lodgement, 48.5% had had their employment terminated and by 24 months the percentage had climbed to 61.4% (**WCSA 2012: APP. A**).

The relevance of these figures for New South Wales is quite clear given that the average duration of workers' claims is a major cost driver in both schemes. The indiscriminate dismissal of injured workers by employers inevitably increases average claims duration rates and, with it, scheme costs. Protecting injured workers from losing their jobs is not only about workers' rights, important though that is. It is also very much about controlling scheme costs. In this respect, clearly articulated suitable employment obligations for employers and their effective enforcement need to be viewed as essential liability management tools. With fewer injured workers sacked, the scheme's long-tail is reduced and claims liabilities reined in.

As regards legislation, the Victorian and South Australian schemes provide a basis for improvement in the performance of the New South Wales scheme. Of the two, the South Australian provisions are more robust. Sections 58B and 58C of that State's legislation set out the obligations of employers in relation to the provision of suitable employment, along with a requirement to provide WorkCover - and the worker - with at least 28 days notice of intention to dismiss an injured worker (**SAWRACA 1986: ss 58B and 58C**). The 28 days notification period provides WorkCover with the

opportunity to determine whether or not the employer had taken all 'reasonably practicable' steps to provide suitable employment.

Failure to comply with the requirements of section 58B can result in the imposition of a 'supplementary' premium, as provided for under section 67 of the legislation (**Ibid: s 67**). The availability of supplementary premiums as a sanction enables WorkCover to debit the cost of the sacked workers' claims to non-compliant employers until such time as they become compliant or the workers finds alternative employment. The use of this sanction also means that compliant employers are not burdened with the additional costs imposed on the scheme by the minority who seek to avoid their obligations.

The value of these suitable employment provisions, of course, depends on their effective enforcement. This, arguably, can best be achieved through the establishment of a Return to Work Inspectorate, based on the Victorian model, which also seeks to assist employers with providing suitable employment.

5.2 Retraining

The lack of retraining for injured workers is another serious barrier to improved scheme performance. A greater emphasis on the retraining of injured workers has the potential to deliver benefits not only for workers but also employers and WorkCover's financial position. Retraining should be viewed as an integral part of the scheme's return to work philosophy and strategies.

Most injured workers do not require retraining. The overwhelming majority are able to return to their pre-injury employment with their pre-injury employer, albeit with a degree of workplace modification in some cases. Others, however, are not so fortunate. This is especially so for workers unable to resume their pre-injury occupation or related duties as a result of their injuries.

The identification of injured workers who would benefit from retraining should be conducted within an overarching framework that seeks to minimise the prospect of workers whose circumstances indicate that they might otherwise become part of the

scheme's long tail. Among other things this means retraining should generally be used earlier in the claims cycle. Far too often, if used at all, it is used as a last resort rather than as a pro-active intervention.

With low unemployment levels and increasing labour shortages predicted over the next decade and beyond, it is difficult to think of a more favourable economic climate for the introduction of a revitalised retraining program for injured workers.

Safe Return to Work

There is considerable evidence that the initial return to work by injured workers is not always successful. This is particularly so with musculoskeletal conditions, such as back injuries (**Butler, Johnson and Baldwin 1995: 465**). Although further research is required, it is likely that many workers return to unsafe work following recovery from their injuries. Needless to say, the durability of their return to work can be frustrated when this is the case.

A 2010/11 survey of injured workers in New South Wales, 7 to 9 months post injury, reported a durable injury rate of 78% (**CR&C 2011: 2**). Some 35% of the New South Wales workers interviewed also indicated they had lodged a previous lost time workers compensation claim. Although not all of the more recent claims were necessarily attributable to previous injuries associated with an unsafe return to work, some probably were.

The safe return to work of injured workers is a core requirement of any return to work system. In New South Wales, as elsewhere, there are no measures in place to ensure this occurs. The Government should take immediate steps to make sure WorkCover and its claims agents remedy this deficiency.

6. The Issues Paper

As indicated earlier, the Issues Paper is devoid of any consideration of the underlying issues that have given rise to the New South Wales WorkCover scheme's financial and operational shortcomings.

Instead, it has presented a strategy premised on the proposition that workers should pay the price for the scheme's predicament and even suggests, with dissembling arrogance, that this is somehow "fair" to injured workers (**NSW 2012: 29**). In adopting the strategy, it has engaged in a cherry picking exercise that selectively identifies provisions in other schemes consistent with this objective. This cherry picking exemplifies the lowest common denominator approach that underpins the Government's WorkCover 'reform' proposals.

It is also important to note that the Government's proposals are set against a background in which average premium rates in New South Wales have tumbled by 33% since 2005, resulting in annual savings of approximately $1 billion for the State's employers (**Ibid: 13**). Yet despite this, the Government is seeking to quarantine employers from premium increases even though sections of the employer community have contributed significantly to the scheme's poor performance through workplace health and safety negligence and a failure to provide suitable employment for injured workers seeking to get back to work.

This approach contrasts not only with that of the trade union movement but also the position of the scheme's actuaries who have publicly acknowledged that the challenges facing the scheme can also be addressed through changes in the management of the scheme and modest increases in employer premiums (**PWC 2012a: 288**).

The fundamental problem with the Government's diagnosis of WorkCover's difficulties is that it is concerned exclusively with symptoms rather than their causes, as will become clearer following the assessment below of the options for change contained in the Issues Paper.

6.1 Journey Injuries

Coverage for journey injuries, which occur on the way to or from work, differs between the various Australian workers compensation schemes. Workers who incur journey injuries in New South Wales, Queensland, the ACT and the Northern Territory, for example, are covered while those in Victoria, South Australia, Western Australia and Tasmania, generally, are not (**SWA 2011: 37-38**).

In New South Wales, journey injuries accounted for only 2.6% of total compensation claims in 2008-09 (**WCNSW 2010: 7-8**).

Historically, the rationale for the coverage of journey injuries has been based on the fact that journeys to and from work is necessary to give effect to the employment relationship. The everyday reality for millions of New South Wales workers is that their working day begins when they walk out the front door and start the journey to work. These journeys would not otherwise be undertaken. That they are undertaken is of obvious benefit to employers and this underscores their work related nature.

In recent decades the case for coverage has become even stronger. With the advent of new work technology, including laptops, high speed Internet access and ever more sophisticated mobile phones, the distinction between the home and the traditional workplace has become increasingly blurred. More and more workers are working from home and/or are available for work purposes while at home.

Although not spelt out in the Issues Paper it would appear that the Government's position is based on the notion that workers compensation coverage should be limited to issues over which employers have direct control. This would have the effect, however, of undercutting the no fault basis on which workers compensation schemes are based.

Under the Government's proposal, a nurse who had arrived home after having worked an extended shift at a regional hospital could be called on to return to work, as a result of a staff shortage, and if injured in a car crash while on her way back to work would not been eligible for workers compensation. Having put the interests of her employer

and the community first she would be denied compensation for her injury. This might be somewhat more palatable if New South Wales had a comprehensive no fault motor accident scheme as in the case of Victoria. But it doesn't.

This is another reason why coverage for journey injuries should remain as part of the workers compensation safety net.

6.2 Other eligibility issues

In addition to the proposal to abolish journey injuries, the Issues Paper also proposes to prohibit claims for nervous shock suffered by relatives or dependants of workers killed or seriously injured as a result of work related incidents (**NSW 2012: 22**). There is also a proposal to tighten eligibility for strokes and heart attacks (**Ibid: 28**). In the case of the latter, work related stress and shift work, for example, are both known to be associated with these types of injuries. Moreover, the claim that strokes and heart attacks are "arguably inconsistent with the principles of workers compensation legislation" (**Ibid: 28**) is simply asserted without any supporting evidence.

A more appropriate approach is to leave any assessment of the work relatedness of strokes and heart attacks to the Workers compensation Commission and, if required, the higher courts.

Similar objections apply to the assertion that dependants and relatives should be excluded from seeking compensation when their loved ones are killed or seriously injured. Nervous shock is a well recognised condition that needs to be diagnosed by a medical professional. It is much more than grief. It is often so debilitating that it compounds the loss of the deceased worker and, in effect, incapacitates another member of the family

Once again, the adjudication of claims of this nature is best left to the Commission and the courts which have the expertise and independence to make impartial rulings on such issues.

6.3 Definition of Pre-injury Earnings

Unions NSW agrees with the proposition that the disparity between weekly payments made to award and non award workers is anachronistic and should be discontinued. The calculation of pre-injury earnings should be based on a worker's total remuneration including the base wage, penalty rates, overtime and any other relevant allowances.

There seems, however, to be an inconsistency in the Issues Paper's treatment of this issue. At one point in the Paper the impression is given that there is support for the total remuneration approach (**Ibid: 24**), while elsewhere it appears that the preferred approach is based on the Victorian scheme where the calculation of pre-injury earnings is based on the worker's ordinary hours of work (**Ibid: 16**).

The Government should resolve this ambiguity by unequivocally declaring its support for the total remuneration approach outlined above.

6.4 Weekly Payments

A recurrent theme in the treatment of weekly payments, as presented in the Issues Paper, is that they often do not provide a sufficient incentive to 'encourage' injured workers to return to work (**Ibid: 5**). This is accompanied by a proposal that weekly payments be subjected to a step-down equivalent to 95% of their pre-injury average weekly earnings for the first 13 weeks of incapacity and then 80 % for the next 13 weeks (**Ibid: 16**). Implicit in this view is the notion that unless injured workers are subjected to financial disadvantage they will engage in malingering behaviour.

There are at least five major flaws with this line of reasoning.

First, injured workers overwhelmingly want to get back to work following injury. Most workers value work and the satisfaction it brings to their lives. This is reflected in return to work surveys of injured workers. In a 2011 survey, 93% of injured New South Wales workers stated that work is very important to them and 89% said they were satisfied with their work (**CR&C 2011: 19**).

Second, it has long been recognised by workers compensation authorities in Australia that a majority of injured workers are able to return to work within a relatively short period (**HWCA 1996: 91**).

Third, it is assumed that a return to work is the sole responsibility of the injured worker, whereas in reality, as pointed out in the preceding section, it also requires the cooperation of the compensating authority and, most importantly, the worker's employer.

Fourth, it is assumed that return to work rates are correlated with steeper step-downs. On this basis, the Victorian return to work rate should be higher than in New South Wales. The evidence, however, tells a different story. Over the last 11 years, surveys of Victorian and New South Wales workers, conducted between seven and nine months after their injuries, have consistently found that the New South Wales scheme has had a higher return to work rate than its Victorian counterpart. This finding also applies to durable return to work rates (**CR&C 2000-2001 - 2010-2011)**.

More generally, there are also serious doubts in relation to the methodology and interpretation of findings from, mainly US, academic research which purport to provide evidence that lower workers compensation payments are required to get injured workers back to work (**Purse, Meredith and Guthrie 2004: 50-53**).

Fifth, there is no evidence that malingering has been a contributing cause to the deteriorating performance of the New South Wales scheme. This is not surprising. In 2000, a review of some 20 State and Federal Government inquiries found no systemic evidence of workers compensation fraud by injured workers (**Garnett 2000: 11**). More recently, a 2003 National Parliamentary Inquiry concluded that "the level of employee fraud is minimal" (**HRSCEWR 2003: xxix**).

Contrary to conventional wisdom, the main effect of step-downs is that they shift the cost of work related injury from employers to injured workers. This imposes unnecessary hardship on workers, most of who are not particularly well off. Especially for low paid workers, predominantly women, an extended period on

workers compensation means having to contend with a standard of living lower than the minimum wage. The focus on step-downs also results in less emphasis being placed on the necessity to reduce work related injuries and improve rehabilitation and return to work services for injured workers than would otherwise be the case.

Similar comments apply to the use of caps to restrict the amount of weekly payments that can be received. They are an artificial construct designed to limit the liability of employers for work related-injuries. In effect they amount to a 100% step-down. Rather than helping injured workers attain "a certain level of work readiness" (**Ibid: 26**), the introduction of a cap would, in practice, result in most seriously injured workers being shifted from the WorkCover scheme to the Social Security System. As with other step-down arrangements, caps result in cost shifting rather than the return of injured workers to suitable employment. They have no role to play in a modern workers compensation scheme.

6.5 Work Capacity Reviews

As with weekly payment caps, work capacity reviews are a means by which to cease weekly payments to seriously injured workers on the presumption that they can obtain suitable employment. They were introduced in Victoria in 1992 by the then Liberal Government. More recently, work capacity reviews were part of the legislative package enacted by the South Australian Labor Government in 2008.

Work capacity review provisions in both jurisdictions normally come into play after a worker has been incapacitated for a period of 130 weeks or more. Contrary to the unfounded assertion in the Issues Paper they are not used to "assist injured workers on long-term weekly benefits in transitioning from weekly benefits back into paid employment" (**NSW 2012: 25**). The actual purpose of work capacity reviews, as typified by the Victorian and South Australian legislation, is to enable compensating authorities to reduce or terminate weekly payments unless a worker is assessed as having no current work capacity; and likely to continue indefinitely to have no current work capacity (**VACA 1985: s 93CA, SAWRACA 1986: s 35B**). On these criteria, a worker with any residual capacity whatsoever can be presumed capable of obtaining suitable employment, irrespective of whether or not such employment is reasonably available.

One of the perverse consequences of work capacity reviews is that they provide an incentive for claims agents to put off, or wind back, rehabilitation services during the latter part of a workers' claim, secure in the knowledge that he or she can be subjected to a work capacity review after 130 weeks.

Due to the inherent unfairness of work capacity reviews they have been the subject of an increasing number of appeals in the courts. In South Australia, there have been a number of successful challenges to the use of work capacity reviews. These have included the *Campbell, Yaghoubi* (**[2011] SASCFC 58)** and *Martin* **([2012] SASCFC 36**) cases, which have all had the effect of reducing the expected liability reductions that work capacity reviews were intended to generate. Emerging judicial interpretations on the meaning of 'suitable employment' are likely to reduce their effectiveness even further.

6.6 Lump Sum Payments for Permanent Impairment

As with increases in weekly payments and common law claims for work injury damages, there have been increases in lump sum payments for permanent impairment. These increases may reflect the higher incidence of serious injury in New South Wales as well as the 10% increase in the maximum payment for new permanent impairment claims that came into operation in January 2007. Whatever the case, the Government's response in the Issues Paper has been a series of proposals to wind back entitlements in this area.

One of the distinctive features of the New South Wales scheme is that it makes provision for compensation both for permanent impairment and, subject to qualifications, pain and suffering associated with the impairment (**NSWWCA 1987: ss 66-67**).

The inclusion of compensation for pain and suffering is particularly significant as it provides a corrective to the use of the *AMA Guides to the Evaluation of Permanent Impairment*, which is the standard assessment tool used to produce impairment ratings. One of the limitations of the *AMA Guides* though is that they fail to take

account of the effect of impairment on a worker's quality of life (**Burton 2008: 21-29**). The New South Wales legislation addresses this deficiency through the availability of a lump sum payment of up to $50,000 for pain and suffering, although in practice very few workers would be eligible for this maximum amount.

The Issues Paper, however, regards payments for pain and suffering as an 'anomaly' and recommends that this category of compensation should be removed (**NSW 2012: 26**). It also recommends that permanent impairment payments be subject to a 10% Whole Person Impairment (WPI) threshold (**Ibid.**).

Currently, with some exceptions, there is only a 1% threshold in New South Wales. In support of its proposal the Issues Paper notes that other jurisdictions "generally have higher thresholds" (**Ibid: 19**), including Victoria which has a 10% WPI threshold. What is not mentioned is that all the States in Australia with the exception of Western Australia also have higher maximum payments for injuries that result in permanent impairment, and in the case of Victoria the amount is more than twice as high as in New South Wales (**SWA 2011: 43**). This is yet another example of the Issues Paper's selective approach to interstate comparisons.

A 10% WPI threshold may not seem like a major hurdle but rating numbers can be deceptive.

By way of illustration, a worker with bilateral carpal tunnel syndrome in both arms would not be entitled to compensation as the rating for this injury was assessed at 4% WPI. Nor would a worker suffering from a spinal disc bulge and chronic pain - which has prevented him from returning to his previous employment - be eligible for compensation as this type of injury only rates at a 7% WPI. And neither would a worker with multiple fractures of the upper jaw, compound fractures of the lower jaw, with the loss of teeth, and ongoing pain due to the metal plates inserted in his mouth, because the combined rating of these injuries was 10% WPI (**Slater and Gordon 2012: 1**).

A 10% WPI would disqualify thousands of New South Wales workers from receiving permanent impairment payments. Publicly available, South Australian, data on this

issue indicates that approximately 40% of workers who would otherwise be eligible for permanent impairment payments would be denied compensation if a threshold this high was introduced (**WorkCover SA 2006: 30**).

A third cost cutting proposal put forward in the Issues Paper is that workers should be limited to only one claim for a whole person assessment with respect to any given injury (**NSW 2012: 26**). Two reasons are given for this proposal. The first is that it would encourage workers not to lodge a permanent impairment claim until their injury had stabilised.

While this seems not unreasonable, the reality is that with some injuries, and injury types, it is difficult to determine whether they have stabilised. It may appear they have, only for there to be a deterioration in a few months or a year or two, or longer. Also on occasions, unexpected deterioration of an injury will occur. Unfortunately, the determination of injury stability is not an exact science. Consequently, the outcome of this proposal if adopted is that workers would be short changed or alternatively would face even further delays before they applied for a lump sum impairment payment.

The second reason given for this proposal is that it would discourage fraudulent or exaggerated claims. This is a serious accusation. Serious accusations warrant serious evidence, but none has been provided.

In light of these considerations, injured workers should continue to be able to lodge supplementary permanent impairment claim where there is an aggravation or deterioration in their condition.

6.7 Sole WPI Assessments

The Issues Paper contains a proposal that would mandate that there will only be one assessment for the purposes of WPI ratings permanent impairment claims, computations and work injury damages.

No other State, apart from Victoria, imposes a restriction of this nature. Despite claims elsewhere in the Issues Paper (**NSW 2012: 27**) the *AMA Guides* are neither entirely objective nor uniformly implemented.

The most important aspect of any impairment assessment is its accuracy. Medical practitioners and specialists do not always get it right. Mistakes are made which can have an important bearing on a worker's entitlements. Consequently, there should continue to be the opportunity of obtaining further assessment reports where they may be required.

6.8 Work Injury Damages

The scheme's actuaries report that there are likely to be more 'intimations', or claims, by injured workers for work injury damages (**PWC 2012a: 161**), although average settlements are predicted to remain unchanged (**Ibid: 180**). Only workers with a permanent impairment rated at greater than 15% WPI are eligible to seek work injury damages in circumstances where there is employer negligence.

The Government's response, as proposed in the Issues Paper, is to make it more difficult for injured workers to pursue work injury damages for their injuries by incorporating provisions of the *Civil Liability Act 2002* into the State's workers compensation legislation (**NSW 2012: 27**). The civil liability changes, encapsulated in the 2002 legislation, were introduced in response to a concerted lobbying exercise by the insurance industry to boost the industry's profitability by increasing the evidentiary burden required on plaintiffs to prove negligence. None of the other States have sought to utilise this mechanism for deterring workers from taking negligence claims against employers. If implemented, these provisions will have a serious and detrimental impact on injured workers.

Once again, this is an example of the Government dealing with symptoms not causes. The increase in work injury damages intimations is the consequence of employer negligence. And as can be appreciated, from the previous section, to meet a 15% WPI threshold requires a worker to have suffered a serious, debilitating injury; an injury that almost invariably has a damaging impact on a worker's quality of life and their

earning capacity. Instead of seeking to reduce costs by cutting the entitlements of seriously injured workers it would be far more prudent to address the front end of the problem by tackling workplace health and safety negligence by employers. This would be better for workers and their families, the health system, workers compensation premiums and labour productivity.

This does not mean employers need to be demonised. Some do an excellent job and others have shown a demonstrated commitment to improving health and safety in the workplace. Some, however, do not and need to be held accountable.

Regrettably, measures to ensure this accountability have deteriorated markedly in New South Wales during recent years as a result of reduced enforcement of the State's workplace health and safety laws. In the five year period to June 2010, the number of Improvement Notices and Prohibition Notices issued for suspected breaches of the legislation fell by 18% and 29% respectively, while the number of convictions for offences plunged by 78% (**WMRC 2011: 21-22**).

To reiterate, actions by injured workers can only succeed where there has been negligence by their employers. Rather than seeking to quarantine these employers from the financial consequences of their negligent behaviour the Government should take immediate steps to ramp up enforcement of the law.

6.9 Medical Coverage and Health Provider Regulation

One of the great advances in workers compensation policy over many decades has been the transition from a model in which there was only limited coverage for medical costs associated with work injuries to one in which all reasonable expenses are covered.

One of the recommendations in the Issues Paper is that the clock be turned back on this achievement, as has already happened in some states such as Victoria. Most jurisdictions though continue to support the reasonable expenses model.

The most disturbing aspect of the Government's position is that, yet again, there is no analysis of the problem but simply a reflex action that the only way to deal with the issue is to impose a cap on the amount medical expenses, irrespective of the seriousness of a worker's injury.

Medical costs in the New South Wales scheme in recent years have been proportionately higher compared to other schemes. So there is an issue that warrants closer consideration, but cutting access by injured workers to necessary medical services is not an acceptable solution. Unions often find that poor diagnoses at an early stage of a worker's claim, often occasioned by the desire of agents to save money, is not uncommon and subsequently results in higher levels of expenditure being incurred. There also appears to be a lack of best practice protocols for the treatment of some injury types.

What is required is a detailed understanding of the cost drivers that have contributed to the escalation in medical costs in recent years and a well designed strategy to address this important issue.

Similarly, there is scope for improving the regulatory framework governing the scheme's interaction with health providers. The insinuation, however, that worker 'dependency' (**NSW 2012: 28**) is the problem is as offensive as it is unsubstantiated. As indicated earlier, workers overwhelmingly want to return to work. It also has to be recognised that a small proportion of injured workers are unlikely to return to work due to the nature and severity of their injuries, and their medical and health related needs should not be overlooked.

Equally important, it needs to be understood that a bureaucratic 'one size fits all' approach to medical treatments is neither appropriate nor acceptable. What works for some patients does not necessarily work for others. This needs to be factored into any initiatives designed to improve the regulatory framework in this area of the scheme's operations.

6.10 Severely Injured Workers

Unions NSW fully support the proposal to improve entitlements for severely injured workers. However, the 30% WPI (**Ibid: 22**) proposed is far too restrictive as only a relatively small number of workers will benefit from any such improvements. The Government should, therefore, adopt a lower WPI for its definition of severely injured workers.

6.11 Commutations

Commutations are lump sum payments made by compensating authorities to injured workers to finalise liability for their claims. They are often used by compensating authorities as a means to reduce scheme costs. Their use usually occurs in a cyclical fashion. In the initial phase, the policy settings are usually adjusted to make commutations readily available in order to promote their take-up by, mainly seriously, injured workers. In the subsequent phase, as the average cost per commutation increases, their use is eventually restricted; either precipitously or more gradually depending on the prevailing conditions.

Commutations were extensively used in New South Wales during the second half of the 1990s through to the early years of the new century by WorkCover and its agents. During this period, commutation payments increased by over 400%, from $130.7 million in 1997 to $812.5 million in 2002 (**NSWWA 2009: 161**). Despite the fact that the commutations policy was driven by WorkCover itself, it was injured workers and their legal representatives who were subsequently blamed for creating the 'lump sum culture'.

Although commutations can be useful as a short term liability management tool, they are no substitute for best practice, front end injury management measures and well designed return to work programs. Any change in the current policy stance, therefore, needs to be carefully considered in conjunction with other scheme changes.

While not opposed in principle to a more strategic use of commutations, the trade union movement would need to be convinced that their use was part of a broader policy package designed to assist injured workers rather than strip back their entitlements.

7. An Agenda for Reform

It is clear that the diagnosis of the WorkCover scheme's financial and operational difficulties presented in the Government's Issues Paper is seriously flawed. Most of the real problems have been ignored.

The failure of the scheme's claims agents in delivering on their injury management responsibilities, despite receiving $318 million in fees to do precisely that in 2010-11 alone, was not addressed at all. Nor was WorkCover's apparent inability to oversight the operations of its claims agents and align their performance with the scheme's return to work objectives.

The lack of cooperation by sections of the employer community in providing suitable employment for injured workers ready to return to work is another fundamental issue. This is all the more disturbing, not just because of their legal obligations to do so but also because of the direct financial impact on the scheme's bottom line that occurs when they fail to comply with these obligations.

Compounding this has been a massive premium leakage that has contributed materially to the underfunding of the scheme. Since 2005 employer premiums have been reduced by approximately $1 billion a year. Moreover, the drain in premium income was allowed to continue even when the scheme was less than fully funded.

Just as the diagnosis contained in the Issues Paper is flawed, so too are its prescriptions for change. Virtually, the entire set of proposals put forward by the Government are directed at restricting eligibility for compensation and stripping back workers' entitlements. If implemented, the Government's proposals will make one of the most vulnerable groups of people in the community even more vulnerable.

There is a better way forward.

The starting point is a refocusing of WorkCover's injury management strategy. As noted by the scheme's peer review actuary:"In our experience it is possible to arrest deterioration and improve the claims experience by improving claims management"

(**E&Y 2012: 5**). The actuary goes on to recommend that "WorkCover very significantly increase the resources and expertise that they are devoting to investigation of the drivers of the adverse experience and increase the focus of strategies to improve the experience" (**Ibid**.).

The other immediate issue is the need for a greater emphasis on injury prevention. The level of serious injury in New South Wales is higher than in most other States (**WRMC 2010: 42**) and must be addressed. The Government and WorkCover need to make workplace health and safety and the enforcement of the State's health and safety laws a priority.

In line with these objectives, it is recommended that:

7.1 Premiums

The average employer premium rate be increased through a process of modest annual adjustments until the scheme's funding position is restored.

7.2 Claims Agents

WorkCover develop and implement measures to better regulate claims agents so as to promote the efficient management of the scheme and ensure that their focus is on assisting the injured and returning them to work safely, quickly and as easily as possible.

7.3 Employer Obligation to Provide Suitable Employment

The existing New South Wales provisions in this area be reviewed and that legislation, based on the South Australian and Victorian provisions, be enacted regarding employer obligations to provide suitable employment for injured workers. The legislation should include a requirement for employers to provide WorkCover and injured workers with at least 28 days notice of any intention to terminate a worker's employment, as well as provisions to impose supplementary premiums on employers who unreasonably fail to provide suitable employment. Specific provisions

are also necessary to prevent workers from being sacked after six months of incapacity.

7.4 Return to Work Inspectorate

WorkCover establish an adequately staffed Return to Work Inspectorate to promote and ensure compliance by employers and claims agents with the obligation to provide suitable employment.

7.5 Retraining of Injured Workers

A much greater emphasis by WorkCover be placed on retraining injured workers unable to resume employment with their pre-injury employers and that well designed retraining programs be introduced as a matter of priority.

7.6 Workplace Health and Safety

Robust and well resourced enforcement campaigns be undertaken by WorkCover targeting high risk employers that have a track record of poor workplace health and safety performance

7.7 Medical Expenses

WorkCover investigate more thoroughly the drivers of cost increases during recent years and develop proposals, including best treatment protocols, designed to more effectively assist injured workers return to work.

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9. Appendix - Inquiry Terms of Reference

Joint Select Committee on the NSW Workers Compensation Scheme

Terms of reference

1. That the committee inquire into and report on the New South Wales Workers Compensation Scheme, in particular:

(a) the performance of the Scheme in the key objectives of promoting better health outcomes and return to work outcomes for injured workers,

(b) the financial sustainability of the Scheme and its impact on the New South Wales economy, current and future jobs in New South Wales and the State's competitiveness, and

(c) the functions and operations of the WorkCover Authority.

2. That, in conducting the inquiry, the committee note and examine the WorkCover NSW Actuarial valuation of outstanding claims liability for the NSW Workers Compensation Nominal Insurer as at 31 December 2011, and the External peer review of outstanding claims liabilities of the Nominal Insurer as at 31 December 2011.