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Self-insurance: Getting the best out of regulation

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Abstract

This paper takes the form of a meander through the workers' compensation self-insurance landscape. Join us on our journey as we explore the size of the landscape (if it was a State, it'd be the fourth biggest by number of people), who the players are and how they get along (or not!), and hot topics on the landscape, including recent attempts at harmonisation, the move towards a national scheme and other initiatives. We then make an attempt at putting all of this into a nice neat framework of what we consider to be the contemporary financial issues for workers' compensation self-insurers in Australia. We discuss benefit structures, bank guarantees, risk margins and other things actuarial. The adventure wraps up with our opinions on how to 'get the best out of regulation'.

Keywords: self-insurance, workers' compensation, regulation, compliance, monitoring, guidance.

1. Introduction

We've just been taking a stroll through the current workers' compensation self-insurance landscape. Phew, it's hot! We've met a variety of hot people, hot places, hot topics and hot buttons. It's hilly, it's flat and the landscape keeps changing, slowly in some places, more quickly in others. It's time to put down on paper and share some of the tales and our thoughts from our travels…

We've structured our journey in the rest of this paper into a few neat little sections:

2. The size of the landscape;
3. The people;
4. Hot topics in the self-insurance landscape;
5. Framework for 'getting the best out of regulation'; and
6. What next?

Section 2 looks at the size of the landscape, in terms of the proportion of the Australian workforce who are in self-insured arrangements and also the number of self-insurers. We decide it's definitely big enough to merit some serious attention!

Section 3 considers the stakeholders – who are they and how do they all fit into the landscape? We look at their various objectives, needs and desires from the system, and the nature of their relationship with each other, in terms of where their motives may coincide and where conflicts may arise.

Section 4 looks at current hot topics on the landscape, including 'harmonisation' and the 'moves towards a national scheme', as well as some State-based initiatives. What items are being proposed to be harmonised, are we going to see seismic changes to the landscape or just the rearrangement of a few boulders? We can feel many eyes on the Federal Government as employers slowly make their moves towards national self-insurance via the Federal Government's Comcare scheme.

In Section 5, we set out a broad framework of what we consider to be the contemporary financial issues for workers' compensation self-insurers in Australia. We discuss benefit structures, bank guarantees, demonstrations of financial capability, actuarial reporting, prudential monitoring, data collection, risk margins, accounting standards and levy rates.

Section 6 concludes with 'what next'? We wrap up with some thoughts on the perfect environment for "self-insurance: getting the best out of regulation". Is this achievable, or are the practicalities of going from where we are to that ideal an impossible dream? Come on, we challenge you…

2. The size of the landscape

First, let's set down the size of the landscape that we are journeying through. What proportion of the workforce are we talking about? Currently, approximately 15%[i] of employees in Australia work for self-insurers, most in unionised worksites. Compare this to the size of the workers' compensation schemes in the various States/Territories and we'll see that it is a small State in itself! It would slot in at number four by size of workforce in Australia, behind New South Wales, Victoria and Queensland but ahead of Western Australia, South Australia, Tasmania, A.C.T. and the Northern Territories.

Figure 1: "Yoohoo! We're thiiiis big!!!"

*__Footnote__: "But no, we don't all live in the centre of Australia."

In terms of the number of self-insurers, this has grown over the last 10 years from around 180[ii] self-insurance licences to over 250 self-insurance licenses presently across all jurisdictions in Australia. Many of these fall into the top 100 ASX members' list[i]. Some companies have several licences, one for each State in which they are self-insured, so that the 250 licences represent a smaller number of employers. Without attempting to match the names of employers across all States, it is difficult to even count the number of employers who are self-insured Australia-wide – an unfortunate commentary on the degree of interaction between State self-insurance arrangements!

However, unlike a single State, with its single entitlement regime and set of regulations, the collective group of self-insurers will be dealing with a variety of multi-state benefit structures, regulations and reporting frameworks. From an actuarial reporting perspective, compared to one (or possibly a few) actuarial report(s) for a State scheme each year, the self-insurers together will be submitting over 250 separate actuarial reports to nine different WorkCover authorities each year! That's an awful lot of people running around doing a lot of work, and that's not to mention those people who have to read the reports...

3. The people

So who are all these people making up the landscape and how do they all fit in? What are their needs and desires? Do they share the same goals and objectives? Are there any conflicts?

Before going further with forming views on what works or not, we thought it would be important to set the scene with who the various stakeholders are, and their interests, in the system. The main stakeholders in the workers' compensation self-insurance landscape are:

- **Employees**, the beneficiaries in this landscape, sometimes represented by unions – concerns are for a safe workplace, maximum recovery, quality rehabilitation and return to work and adequate compensation in the event of injury, and hence indirectly for their employers to remain successful and financially able to meet these costs.

- **The self-insurers**, mainly larger organisations – these are the employers who have opted out of paying workers' compensation premiums for their employees and instead take on all facets of dealing with workplace injuries themselves including the financing; their ultimate aim would be for a successful, efficient and profitable workplace, and so safety and quick return to work of their employees would therefore be in their interests too.

- **Government,** including the Federal government, representing the wider public interest, as well as the various State WorkCover authorities – responsible for making sure the system is fair, equitable and robust, and the wheels keep turning. Their aim is to maintain the focus on occupational health and safety, accident prevention and efficiency in claims management – another objective might be to encourage a viable self-insurance sector to act as a comparator and competitor for the insured sector.

To a lesser extent, other stakeholders include various providers such as legal advisers, actuaries, health and safety providers, rehabilitation providers, medicos and reinsurers (who would provide the self-insurers with cover for high cost claims or events).

At first sight, it would appear that all of these groups of people share a common set of objectives – safe workplace, optimum care and return-to-work for injured workers, adequate compensation, and a system that is financially sustainable for employers and preserves its competitiveness. So where are the conflicts?

Let's hear a couple of points of view.

National Council of Self Insurers (representing employers)[iii]

"Self-insurers…have far higher incentives to provide safer workplaces and to minimise the impact of injury on injured workers. Preventing injury is a high priority for self insurers. It is evidenced by high level reporting and accountability infrastructures within individual companies to manage both injury prevention and claims."

"There is insufficient monitoring of the performance of self insurers… Union experience of self insurers is that few could be regarded as role models providing a superior service to workers. In a bid to save money self insurers can take a very mercenary approach to their injured employees."

Australian Council of Trade Unions (representing employees)[iv]

Whoa…so we're not one big happy family then? Admittedly, we have deliberately selected two quotes that articulate opposing points of view. However, we feel that the environment is more one of simmering tensions rather than any outright conflicts, as the stakeholders continuously face the challenge of finding the right balance between their competing interests.

Self-insurers, for example, in choosing to take on the risks and costs of their workers' compensable injuries, would have made the decision only after consideration of the advantages of having direct control of claims, with the aim of achieving better return to work and other outcomes. This would have included analysis of the financial viability of self-insurance relative to paying premiums. Any drive for financial savings that result in less than optimal workplace injury preventative measures or care for injured workers would impact negatively on employees. It is generally agreed that to succeed, self-insurance needs to achieve improved workplace injury preventative measures and care for injured workers, with cost savings resulting from these improvements. The WorkCover authorities, being responsible for a stable and effective system, and ensuring that self-insurers do the right thing by their injured workers, would justifiably need to put in place sufficient prudential regulation and security arrangements for the self-insurers. However, the costs of such compliance may not be welcome to self-insurers if they consider the requirements to be overly onerous and especially if they see nothing in return for their effort. The challenge is in achieving the right balance between all these interests.

Probing the landscape further will reveal many initiatives currently going on, all busily attempting to finetune this balance. We had a look to see what the hot topics were, whether they involved just tweaking the balance here and there, or whether wholesale changes to the landscape were being proposed. On the way, we formed some of our own opinions on what works or not, and what could be done better.

4. Hot topics in the self-insurance landscape

So now let's look at some of the hotter rumblings in the landscape. There are a number of current initiatives going on involving the national workers' compensation policy agenda.

Hot topic 1: Current efforts at harmonisation between States

Overheard in boardrooms: "Harmonisation". Overheard in government departments: "Harmonisation". Overheard in the bus: "Harmonisation". Read it in the papers! In fact, everywhere we turned, we heard – "harmonisation, harmonisation, harmonisation"!

It seems moves are afoot by some State workers' compensation authorities to try to achieve harmonisation of their various self-insurer arrangements. This seemed to us unsurprising given the energy, human resources and time expended by so many in administering, understanding, complying with and generally keeping the wheels turning in the many workers' compensation self-insurance structures in the different States.

In 2006, the Heads of Workers Compensation Authorities ("HWCA"), which comprises the workers' compensation regulators in all Australian States/Territories and New Zealand, set up a working group to consider the harmonisation of self-insurance arrangements in Australia. A discussion paper[v] was distributed in September 2006, and workshops held with self-insurers over the following month.

The review considers harmonisation of financial indicators, a multi-state financial applications process, information sharing, bank guarantees and security requirements, and dispute resolution between the States. An important point to note is that the harmonisation of benefit structures and entitlements is *excluded* from this endeavour. This is unsurprising given that any initiative at harmonising of inter-State benefit entitlements would be expected to form part of a wider debate on a national workers' compensation scheme, rather than one just involving self-insurers.

Whilst the objective to redress national inconsistencies has been welcomed by self-insurers, a response[vi] by the National Council of Self Insurers ("NCSI") suggests various shortcomings with the consultation process and proposals. At the time of writing, the consultation process between the HWCA working group and the NCSI is ongoing.

But is all this too little, too late?

Hot topic 2: The moves towards national self-insurance

Given the exclusion of benefit entitlements in the States' harmonisation initiative, and the present considerable differences in benefit entitlements between the States, one might legitimately question whether such a harmonisation initiative is really only "chipping away at administrative adjustments"[vii] and is a long way short of achieving real uniformity between the different self-insurer arrangements in the various States. For all the expended energy, even if all the harmonisation objectives were to be ultimately achieved, and in the most considered and consultative way, a multi-State self-insurer would still be faced with having to administer the disparate benefit entitlements of its workers in the different States.

Or would it? Is there another way?

In March 2004, the Productivity Commission released its report entitled "National Workers' Compensation and Occupational Health and Safety Frameworks" which amongst other recommendations, encouraged "self-insurance applications from employers who meet the current competition test to self-insure under the Comcare scheme". (Comcare is the Federal Government's workers' compensation scheme). The first off the mark was Optus Administration Pty Ltd ("Optus") which obtained a self-insurance licence under Comcare with effect from mid-2005.

With the ability now for companies operating in several jurisdictions to self-insure under Comcare (subject to meeting certain competition criteria with a current or former Commonwealth authority), this removes a major disincentive for many eligible interstate companies to self-insure. These disincentives included the myriad of different compliance criteria by State, and the possibility of inadequate size in some States. The ability to pay a uniform compensation irrespective of which part of Australia their employees get injured in may also be attractive to multi-state employers. Thus far, seven companies (some within the same group) have been granted a licence to self-insure under the Comcare scheme, with a further five having been deemed eligible to apply for a licence.

It is fair to say that these numbers do not indicate a stampede of employers all rushing towards national self-insurance. Nevertheless we do not think that this suggests a lack of interest in national self-insurance. Major impediments to some companies may be the inability to satisfy the competition criteria, disagreement with the Comcare benefit entitlements or legacy tail liabilities within several State schemes that would be difficult or costly to exit. Given there is still a challenge in the High Court by the Victorian WorkCover Authority to Optus' entry to the Comcare scheme, some companies may simply be waiting till all the lights are green before contemplating seeking entry into the Comcare scheme.

So what do workers, or at least the Unions, think of nationalisation of benefits in this way? Here are some snippets of comments[viii] from the ACTU assistant secretary: "…the companies likely to take up licences will undermine unionisation in Australia" and that the Federal Government were "going under the radar" and establishing a national workers' compensation regime "by stealth". Not happy, we think it is fair to say!

And what about the State Authorities? The illustration that various State Ministers and some commentators have evoked of the self-insurance system under Comcare is that of a 'trojan horse'[ix] – a covert means perhaps by the Federal Government to establishing a national workers' compensation scheme eventually available to all interested corporations?

Well, well, it seems like the climate will get a little hotter yet!

Further initiatives taking place in the individual States

Other than harmonisation and ongoing debates on the merits (or otherwise) of a national scheme, there are also various initiatives being undertaken by the various States in relation to their individual self-insurance arrangements.

In Victoria, for instance, the WorkCover Authority there undertook a comprehensive review of self-insurer arrangements commencing in 2003, with a final report[x] presented in August 2005. It contained 23 recommendations intended to provide a framework to guide ongoing consultation on issues relevant to self-insurance in Victoria. Some of these recommendations are currently being implemented. The financial recommendations included development of a process for the scheme actuary to periodically peer review self-insurers' actuarial assessment of outstanding claims liabilities, and provision of actuarial information on scheme trends to actuaries of self-insurers in order to better inform the annual assessment of self-insurers' claim liabilities. The guidelines for actuarial assessment of self-insurers' bank guarantees have been revised and updated (in consultation with those actuaries who advise self-insurers). In addition, in response to one of the review recommendations, the WorkCover Authority has commissioned an independent review of self-insurer contributions to the fund, with the outcomes of this published in a draft report[xi] in May 2006.

In South Australia, the WorkCover Authority there commissioned a review of self-insurer eligibility and assessment criteria in 2003, with a final report[xii] in August 2004. The intent was to develop a model and approaches to the regulation of self-insurers in South Australia that is characterised by conceptual rigour and clarity but which is also operationally robust. Recommendations were made across the self-insurance spectrum, including the role and function of self-insurance, eligibility criteria, financial guarantees, insurances and other protections, scheme levies and of most interest and potential impact, the introduction of a 'natural consequences model' which matches the level of regulation with the performance of the self-insurer. One of the recommendations in the review that has been approved by the WorkCover Board is for the bank guarantee multiplier to increase from 150% to 175% then to 200% in 3 years' time.

Other States also have reviews of different aspects of their self-insurance arrangements, as well as the introduction of different features, from time to time. An example of this is the introduction in NSW of the potential for a self-insurer to take over from WorkCover funding and management of the claims "tail" i.e. liabilities incurred prior to self-insurance.

What strikes us in all of the above is that there is a great deal of thought, hard work and consultation going into reviewing self-insurer arrangements all over Australia. Certainly self-insurers are not an afterthought in the present workers' compensation landscape! What seems to us a pity though is the fact that all this energy, good work and exercising of minds taking place in each State will have a potential impact on fewer people than if the same total effort was expended on a national solution, when some of the analyses could possibly benefit the wider public.

One argument for the State focus is that State rather than national solutions may better reflect local needs and preferences, plus State programs will relate to existing benefits and structures already in place that have been shaped over a long social history.

But just imagine all these great minds and vast expertise instead channelled single-mindedly towards a national solution, and all batting for the same team! Goodness, what might we achieve!

5. Suggested framework for 'getting the best out of regulation'

We have structured the rest of the journey into a broad framework of what we consider to be the contemporary financial issues for workers' compensation self-insurers in Australia. We have had to leave out a number of areas, such as safety audits, claim management and dispute resolution, although some of these are at least as important as the areas we have focussed on. Our rationale is that we have focussed primarily on financial issues, which you might expect at an actuarial conference!

Our framework falls into several headings:

- Benefit structures
- Demonstration of financial capability
- Bank guarantees/security arrangements
- Actuarial reporting
- Financial monitoring
- Levies to the WorkCover Authorities
- Playing on the international stage: accounting standards.

We set out the current situation in relation to each of these components, with discussion in the context of the initiatives mentioned earlier in section 4, and allow ourselves the liberty of expressing some opinions along the way and asking some questions we think need asking. We apologise in advance for dwelling a little longer and indulging in more detail on some of the areas of interest to us as actuaries. You can skip some of the actuarial theory and longer explanations when you see this symbol ☞.

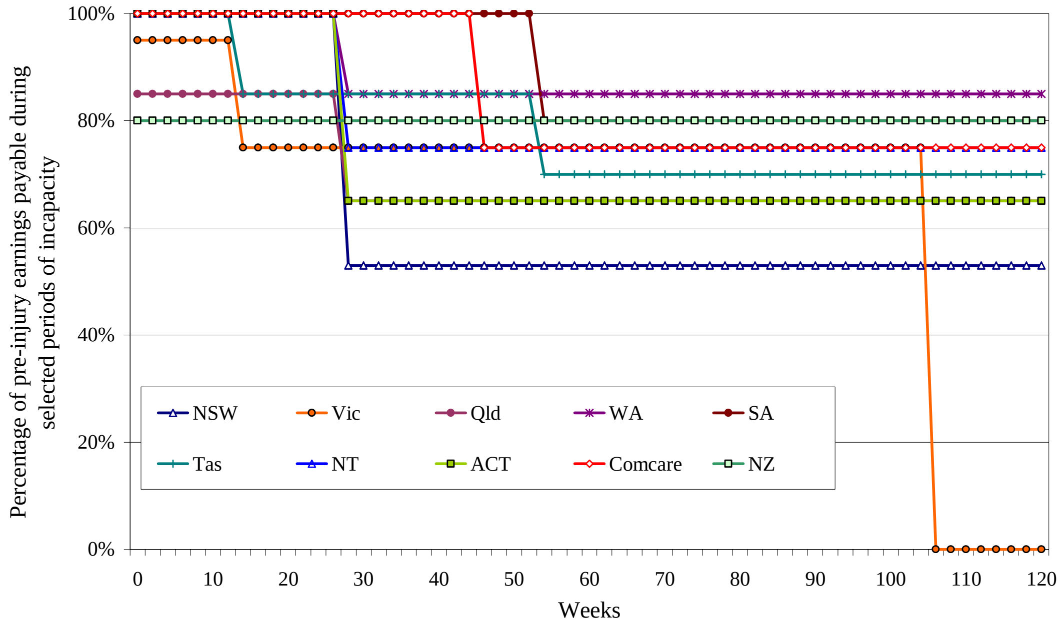
Benefit structures

There is no doubting the fact that the dominant feature of the workers' compensation landscape in Australia is the many different benefit structures and entitlements by State. The United States and Canada are the only two other countries in the world with separate State programmes for workers' compensation.

Differences arise in various facets, including benefits levels under each of the heads of damage, step-downs and caps, whether the scheme is fault or no-fault, availability of common law, coverage including for example recess or journey claims, and so forth.

The following chart[xiii] provides an illustration of the different levels of compensation payable by the various jurisdictions to a middle income injured employee, earning $1,000 per week with a dependent spouse and two young children. The worker is unable to work for 120 weeks, after which he/she returns to full pre-injury duties.

Figure 2: Illustration of relative differences in income replacement entitlements to an injured middle income employee*



***Cautionary note**: The chart only illustrates differences in one element of workers' compensation benefits; that is, the income replacement benefit. Whilst this is an important feature, a complete comparison would need to take account of the wider benefit package.

What key messages do we get from looking at the above diagram?

- Well, for us, pity the poor soul getting injured in NSW, or longer term in Victoria!

- Also, the diagram puts the Union's vocal opposition to nationalised self-insurance under the Comcare scheme into some numerical context; it is interesting to note that the Comcare benefits in this case are generally higher for the middle income employee than most State's apart from South Australia.

Self-insurers have little choice but to operate within this "colourful" landscape, since they are simply administering the workers' compensation legislation of the individual States in which they operate in relation to their own workers. They may be consulted by but are not the policymakers. Even if they desired uniform compensation entitlements for all their workers irrespective of location of work, self-insurers have little choice presently than to pay compensation at the various levels set by the relevant States.

Insured employers can buy "top-up" cover from insurers outside the WorkCover schemes, and so a self-insurer could top-up benefits in each State to the highest level available. This seems difficult to administer and very cumbersome, given that the calculation of the highest level available would need to be done for each benefit type and potentially differ for different claim durations and types. The harmonisation project (hot topic 1 in section 4) does not consider harmonisation of benefit entitlements.

The only route presently available for a multi-State self-insurer to a single workers' compensation benefit structure for all its employees is by opting out into the Comcare scheme (hot topic 2 in section 4). It is not surprising therefore that this is an area that is being watched very closely. However, self-insurance under Comcare is currently available to employers satisfying the eligibility criteria only. Also, another issue to highlight from the considerable differences between benefit levels in the diagram is that moving to the Comcare scheme is not a simple matter of tweaking the benefits a little for current employees. The difference in benefit levels are significant and so there will need to be proper financial feasibility studies as to the cost of moving to the national scheme, as well as proper scrutiny of employment terms in relation to the proposed changes to workers' compensation benefits, and potential negotiations with staff and Unions. There may be issues down the track in relation to recurrence of injuries where the initial claim was covered under a State scheme, but the recurrence occurs when the employer is in the Comcare scheme.

We have heard on several occasions representatives of the various State schemes protest that "Yes, yes, of course, we'd be the first to support a uniform set of benefits for all Australians – so long as they mirror our State benefits which are of course the best"! Gosh, can every State benefit be indeed 'the best', or perhaps 'the best' in being most suited to the local needs of workers in that State? Surely a Queensland Reds supporter is little different from a NSW Waratahs supporter, we ask, and if they got injured at work, should receive the same benefits? Hell, no! They're aliens up north!

Demonstration of financial capability

As with benefit structures, the demonstration of financial capability, in terms of the suite of financial indicators required for a company when submitting a new or renewal application for self-insurance, differs by State. The purpose, however, is common across all States, which is to regulate an entity's financial capability to meet its workers' compensation claim liabilities in the long term.

The harmonisation project (hot topic 1 in section 4) includes consideration of financial indicators. The discussion papers released by the State Authorities' working group provides a set of core and optional indicators for financial analysis recommended by an accounting firm. The core or primary indicators include a balance sheet test, liquidity ratios, interest coverage, return on capital employed, a liabilities to asset ratio and a gearing ratio.

Some of the indicators may be criticised as being not directly relevant for self-insurance. However, whatever the indicators that are finally agreed, the harmonisation of these indicators seems to us a sensible option. However, there is little more for us to comment on presently since the reasoning behind the proposed indicators, the benchmarks and any analyses around these were not released in the discussion papers. The National Council of Self Insurers have supported in principle the primary indicators with some provisions, and with the further suggestions that annual licence renewals be synchronised across States, and further consultation and feedback be sought when the benchmarks are set for each indicator.

Bank guarantees/security arrangements

Self-insurers in the various States are required to take out a bank guarantee. The purpose of the bank guarantee is to ensure that a self-insurer's financial obligations relating to its workers' compensation liabilities are met should it find itself not in a position to do so. Not unexpectedly, the quantum of security required differs by State:

Table 1: Quantum of bank guarantees required across the States

State	Bank Guarantee
NSW	130% of the central estimate
QLD	greater of \$5m or 150% of the central estimate projected forward a year
VIC	greater of \$3m or 150% of the central estimate
SA	150% of the central estimate projected forward a year (to be revised soon; see section 3, 'further initiatives taking place in the individual states')
WA	greater of \$1m or 150% of the central estimate
ACT	greater of \$0.75m or 130% of the central estimate
TAS	central estimate plus the greater of \$0.5m or 30% of the central estimate or the deductible under the self-insurer's catastrophe cover (central estimate is defined as 160% of case estimates plus 10% for expenses)
Comcare	greater of current or projected claims liability in 12 months calculated at the 95th percentile, plus one reinsurance policy retention

Obvious conclusion from above table? Actuaries to NSW and ACT self-insurers must provide more accurate liability assessments than their counterparts in other States!!!

One of the proposals made in the HWCA harmonisation project (refer hot topic 1 in section 4 of this paper) was to standardize the security amounts or bank guarantees between the States at:

- 150% of the central estimate of outstanding claims liabilities, or
- a 90% probability of adequacy,

with an additional amount of the expected cost of new claims less expected claim payments over the next year.

No analysis was provided in the HWCA release in support of the selection of these levels. We therefore thought it would be instructive to attempt to put these numbers in some sort of context. How does a 150% margin compare to one based on 90% adequacy?

☞ Tune off here and skip to the end of the box if you want to avoid some lengthy actuarial theory!

When the Australian Prudential Regulation Authority ("APRA") introduced the requirement for regulated general insurers in Australia to hold risk margins in 2002, it jointly commissioned a report with the Institute of Actuaries of Australia from Tillinghast-Towers Perrin titled "Research and Data Analysis Relevant to the Development of Standards and Guidelines on Liability Valuation for General Insurance" dated 20 November 2001. That research showed derived indicative risk margins which would be required to provide a 75% probability of sufficiency for a range of classes of insurance including "industry average" workers' compensation insurance portfolios.

The Tillinghast-Towers Perrin report contains estimates of variability for different lines of business. Using this information, the estimated coefficient of variation for each line of business can be calculated as:

$$cv_i = \sqrt{a_i^2 + \tfrac{b_i^2}{n_i}},$$

where
cv_i = coefficient of variation for line of business i
n_i = net central estimate of outstanding claims liability for line of business i
$n_i^2 a_i^2$ = systemic variance for direct insurance line of business i
$n_i^2 b_i^2$ = independent variance for direct insurance line of business i

Values for a_i^2 and b_i^2 for workers' compensation portfolios contained in the Tillinghast-Towers Perrin report are 2.8% and 160%, respectively. Using this information, we were able to calculate the implied coefficient of variation. This estimate of variability and the assumption of a log-normal distribution for the outstanding liability were then used to estimate the liabilities with the required implied probabilities of sufficiency.

Using the above parameters, we calculated the indicative risk margins at 75% and 90% probabilities of sufficiency for an "industry average" workers' compensation portfolio with a variety of net central estimates. These are shown in Table 2. The indicative risk margins are expressed as a percentage of the central estimate.

Table 2: Risk margins for various central estimate values for an "industry average" portfolio

Central Estimate	75th percentile	90th percentile
$m		
5	125%	174%
10	121%	156%
13.5	***120%***	***150%***
20	118%	143%
30	116%	138%
40	115%	134%
50	114%	132%
100	113%	128%

So for an "industry average" portfolio with a central estimate of $13.5 million, a 90% probability of sufficiency equates to a risk margin of 150%.

Note that these margins are based on *industry-wide* workers' compensation data, which may have very different characteristics to an individual self-insurer's liabilities. In particular, it may be argued that the systemic variance (ie the variation arising from external factors that are likely to have a similar effect on all claims, such as variation in the judicial environment, claims administrative procedures, etc) would be higher for an individual employer operating in one industry and/or in only one State than for an *industry-wide* portfolio. In that case, the risk margin should be higher for the majority of self-insurers than shown in the above table.

One other aspect of prescribing a 90% probability of sufficiency (or indeed any probability of sufficiency) is the assumption that this value can be determined objectively for any one self-insurer, whatever the size of its liability or length of historical experience. The reality is that the actuarial methods presently used to determine risk margins for large insurers (with hundreds of millions of dollars or more of outstanding claims liabilities) from their own historical experience is a complex exercise, and do not lend themselves easily to smaller portfolios such as the majority of self-insured workers' compensation portfolios. So a risk margin associated with the 90% probability of sufficiency will likely be determined by reference to some external benchmark such as the one from the Tillinghast-Towers Perrin report above.

Given this, we consider that other options for the bank guarantee are worth further discussion. The options might be a simple prescribed percentage of the central estimate that perhaps varies by size of the liability, or perhaps a prescription based on accuracy of past actuarial liabilities. These could be considered in the HWCA's harmonisation project.

Actuarial reporting

Actuarial reporting on outstanding claims liabilities is required by the WorkCover Authorities as a condition of self-insurance, in all States except Tasmania. The purpose of these reports is generally for the self-insurer to determine an appropriate provision for this liability in its accounts, and also to be used as the basis for calculation of the bank guarantee.

As mentioned in Section 2, there will be over 250 separate actuarial reports submitted by self-insurers to the WorkCover Authorities each year. All of these reports must adhere to Professional Standard 300 (PS 300), issued by the Institute of Actuaries of Australia. In some States, the WorkCover Authorities prescribe discount rate assumptions and minimum expense loadings to be used in the liability determinations, and there are also varying disclosures required in the reports under the different State regulations.

PS 300 is currently being substantially redrafted, with greater requirements on actuaries carrying out the valuations and preparing the reports. It may be argued that the PS 300 revisions are made with a focus on Australian Prudential Regulation Authority (APRA) standards for general insurers. Whilst self-insurers are not regulated by APRA, and hence the APRA standards do not apply to them, nevertheless actuarial reporting for self-insurers will be affected by the proposed PS 300 revisions.

What this highlights to us is the wider issue of how the more onerous reporting and regulatory regime for general insurers is having a flow-on effect on self-insurers. The fact is a self-insurer is *not* a general insurer. A general insurer's primary focus is writing insurance business, and it would be expected that the outstanding claims liabilities would be the dominant liability item in its balance sheet. Detailed actuarial assessment of its claims liabilities is therefore extremely important. However, a self-insurer's primary focus is not on writing workers' compensation business but rather managing its own business in its own industry; the outstanding claims liabilities of its injured workers generally only makes up a very small portion of its balance sheet.

Given this fundamental difference, we ask whether it is appropriate that the increasingly onerous and costly requirements on general insurers should impact self-insurers also? Will all the different regulatory requirements for actuarial reports by State accord greater protection to workers?

In Victoria, the WorkCover Authority (VWA) there carried out a self-insurer review, with a final report in August 2005 (see section 4 of this paper, 'further initiatives taking place in the individual states'). A number of good recommendations that were made that provided assistance to self-insurer actuaries included:

- *Release of actuarial information for use by self-insurance actuaries*. Initial criticisms were made in relation to the information divulged, including that the actuarial assumptions were too vague to be useful for comparing final results of a self-insurer's valuation with those from the VWA's valuation, and that a split of liabilities in percentage terms, rather than details of claim frequencies, sizes and assumed patterns of payments, was less useful in enabling actuaries advising self-insurers to compare statistics that are relevant to their self-insurer. However, VWA's scheme actuary has responded to these criticisms by improving the information divulged and we expect that the detail provided will continue to evolve with input from self-insurer actuaries.

- *Peer review by the VWA actuary of some self-insurer valuation reports*. Several of these have already taken place, with feedback provided to self-insurer actuaries.

Prudential/ financial monitoring

Financial regulation is needed to ensure the self-insurer has adequate systems in place to fulfil its workers' compensation obligations, maintains focus on workplace safety and has sufficient financial capability to meet its claims liabilities. All the States have some form of financial regulation of its self-insurers, although the detail in relation to data collected and other requirements may vary.

There are clear benefits in proper monitoring of self-insurers' experience. This is particularly important since workers' compensation is not a self-insurer's core business, but is nevertheless extremely complex (just think of the team of claims managers, lawyers, doctors, rehabilitation providers, occupation health and safety officers, fraud investigators, actuaries, accountants, etc that need to be coordinated!) and needs to be managed well. The focus presently of most States for financial monitoring is to ensure self-insurers are maintaining adequate systems to manage claims and can meet their obligations to pay the claims. No one will argue that this is absolutely necessary.

So why do we hear disgruntled noises from self-insurers? Although varying data and software requirements between States was cited as a large inconvenience, this did not appear to be the main issue of discontentment. Conversations with several self-insurers reveal that the dissatisfaction arises mainly as a result of seeing no apparent return for all the effort of providing data regularly (monthly, quarterly or fortnightly depending on the jurisdiction) and fulfilling faithfully all the reporting, bank guarantee and other compliance conditions for maintenance of a self-insurer's licence. "A big black hole" was quoted more than once… Unfair?

Looking across all the schemes, it is fair to say we found little by way of feedback and guidance from the authorities to each self-insurer, as to how it is tracking, both relative to itself over time or to its peers. Whilst self-insurance operates on the premise of delivering better return to work and other outcomes, there did not appear to be any objective benchmark against which a self-insurer could measure itself and say that this was indeed the case.

One measure presently possible is to track differences between the self-insurer's costs as determined actuarially and the premium rate (in jurisdictions where this measure exists) if insured in relation to its particular industry. The main shortcoming with this is that larger employers if insured would mostly be experience-rated and not in any case be paying the published rates, and published rates do not differentiate by size of employer.

It is fair to say that some States have made moves to address the issue of monitoring for the purposes of providing feedback and guidance to self-insurers. For example, Victoria releases simple indicative performance charts comparing self-insurers against large scheme insured employers (remuneration greater than $20m), the latest in October 2003[xiv]. The comparisons made are of claim frequency, payments per claim, return-to-work rate and injured worker satisfaction. Whilst provision of such feedback is encouraged, caution has to be advised for an individual self-insurer in using these charts for benchmarking since the measures are not distinguished by industry and there would be significant differences expected by industry.

To conclude, it seems clear that an optimum system of monitoring is where both parties gain some benefit for the effort, and that the data collation is not seen purely as a compliance requirement. An ideal framework is one where data is collected routinely, and is useful both for assessing the regular financial health of the self-insurer and for providing guidance to employers. Timely feedback that may assist self-insurers to improve their processes would also encourage more accurate provision of data. Any data to be collected should take into account the limited resources of self-insurers compared to, say, an insurer or a workers' compensation authority. In terms of performance measures, these could track the performance of a self-insurer against the scheme as a whole, against other similar sized (generally large) employers and other self-insurers in the industry, and by highlighting any trends over time.

This section is on financial monitoring and hence we have focussed on objective financial measures. It is worth mentioning that that there will be limitations to such quantitative measures, insofar as the volatility in outcomes to be expected due to the relatively small size of the majority of self-insurers (relative to a general insurer, say, or an entire State scheme). Any evaluation of a self-insurer's performance should not be based solely on quantitative studies alone, but should be considered in the context of the broader environment in which they operate.

Levies to the WorkCover Authorities

Self-insurers in the different States are required to pay levies to the various WorkCover Authorities, as contributions towards the costs of administering the various State schemes. The calculation methodologies and levels of payments required again all vary, sometimes quite significantly, by State. We found this to be an issue of great interest to self-insurers; there seems to be a fine balance between equity (in terms of accurate identification and allocation of the costs to self-insurers) and ease of calculation. Studies have been undertaken in some States to identify appropriate means of determining and allocating these costs.

Playing on the international stage: Accounting standards

One of the purposes of the actuarial valuations for self-insurers is to provide an estimate of the outstanding workers' compensation liability for the annual financial accounts.

We understand that the Australian Accounting Standards Board has determined that the applicable standard for self-insurance liabilities is IASB 137, as indicated in the Australian guidance accompanying AASB 137. There is some ambiguity presently in relation to the interpretation of some elements of this Standard. In particular, the Standard states that:

- *"The discount rate (or rates) shall be a pre-tax rate (or rates) that reflect(s) current market assessments of the time value of money and the risks specific to the liability. The discount rate(s) shall not reflect risks for which future cash flow estimates have been adjusted*". There is debate presently as to whether the discount rate to be used should be the risk-free rate or possibly an estimate of the longer term rates of return on the mix of assets underlying the portfolio. In NSW for example, the benchmark prescribed by NSW WorkCover is based on the yields available on NSW Treasury Corporation 5 Year government bonds, which arguably represents a risk-free rate.

- *"The amount recognised as a provision shall be the best estimate of the expenditure required to settle the present obligation at the reporting date"* and *"The risks and uncertainties that inevitably surround many events and circumstances shall be taken into account in reaching the best estimate of a provision"*. These requirements are somewhat confusing. The former seems to imply that the provision should be a central estimate, while the latter seems to imply that it should include a margin.

The interpretation of accounting standards does not lie within the scope of actuarial expertise and seems to be a matter for the auditors. Accordingly, we will offer no view in this paper as to what may be the correct interpretation of the Standard.

However, looking internationally, it does appear that a margin as well as the use of risk-free rates may soon be prescribed. This is indicated in an exposure draft of revisions to international accounting standard IAS 137, which under current Financial Reporting Council[1] policy will flow through to AASB 137. However, the proposed IAS 137

[1] The Australian Government's Financial Reporting Council is responsible for providing broad oversight of the process for setting accounting and auditing standards in Australia and advising the Minister on these matters.

revisions are presently in exposure draft stage so is only an expression of the direction the IASB is likely to take and not a current accounting requirement.

The interesting thing about all of this is that self-insurers may soon be “harmonised”, at least in accounting terms, internationally. If we find it so hard to agree with our interstate neighbours, hey, just look at our accounting friends who are trying to unite the entire world!

6. What next?

Well, we've come to the end of our journey across the self-insurance landscape, at least in this paper. So let's wrap up with some comments on what we see to be the prominent features of this landscape, and issue a challenge to those of you who are in a position to make a difference.

The feature we most noted in our travels is the level of employer dissatisfaction with the current system of State-based differences in both benefit structures and regulatory requirements. Some of this is evidenced by the interest being shown in national self-insurance under the Federal Government's Comcare scheme.

One response to this is the current attempt at *harmonisation* of the differences between States. A working group set up by the Heads of Workers Compensation Authorities, which comprises the workers' compensation regulators in all Australian States/Territories and New Zealand, is currently undertaking a project considering the harmonisation of self-insurance arrangements in Australia. The harmonisation of benefit structures and entitlements is however excluded from this endeavour.

We fully support the channelling of energies towards harmonisation between States. However, the authorities and people with influence to effect the changes need to be brave. Accepting that benefits cannot, at least presently, be harmonised, there is still an urgent need to harmonise everything else.

We believe that an approach of integrating current practices is unlikely to work. Too many complexities will arise, particularly if the 'most onerous' of regulatory requirements or security arrangements were simply to be adopted without proper investigation and more so if States could opt out of certain elements of the harmonised arrangements.

We consider therefore that it would be better to start with a clean sheet. As opposed to fighting employer moves towards Comcare, we suggest that States should 'accept the challenge' and design such an excellent system with sufficient support to employers that they simply don't want to join Comcare. Such a system should have value-added services for employers such as, for instance, a monitoring facility that not only serves the purpose of compliance but also provides timely feedback to self-insurers on their performance in the wider workers' compensation landscape and assist in their continuous improvement.

The expertise for coming up with the world's best design is right here; just look at all the good research and initiatives taking place in the various States. Comments and input from employers and stakeholders should be sought; we are certain this will be plentiful! All we need now is courage and vision.

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