

WorkCover Authority of NSW

Response to Standing Committee

6 March 2002

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Tillinghast – Towers Perrin

6 March 2002

The Revd the Hon Fred Nile MLC
Committee Chairman
General Purpose Standing Committee No. 1
Legislative Council
Parliament House
Macquarie Street
SYDNEY NSW 2000

Dear Revd Nile

We have pleasure in enclosing this report as part of our evidence to the General Purpose Standing Committee No. 1 on 6 March 2002.

We would draw your attention to the reliances and limitations set out in Section 4 of this report.

Yours sincerely



Dave Finnis



Sally Wijesundera

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1 BACKGROUND AND SCOPE

- 1.1 Tillinghast–Towers Perrin (“Tillinghast”) is presently retained as consulting actuary to the WorkCover Authority of NSW (“WorkCover”) and provides actuarial services to WorkCover in respect of the NSW Workers Compensation Scheme (“the Scheme”). As part of this role, Tillinghast has undertaken various analyses and provided advice to WorkCover, since August of 2000, in connection with the ongoing legislative Scheme reforms (“the reform package”).
- 1.2 Tillinghast has prepared this report in connection with the General Purpose Standing Committee No. 1’s (“the Standing Committee”) third round of hearings, to assist us in giving evidence concisely and in more precise terms than oral testimony alone enables. This report therefore provides the basis upon which our evidence is given to the Standing Committee on 6 March 2002 and forms part of our evidence to the Standing Committee on that date.
- 1.3 In preparing this report, we are mindful that the Standing Committee’s Second Interim Report (dated January 2002), and more specifically Ernst & Young Consultants’ Report, dated 17 January 2002, (“the Ernst & Young report”) which was included as an attachment to the Second Interim report, have raised a number of issues regarding Tillinghast’s work in connection with the reform package. These issues reflect a number of misinterpretations and misunderstandings in relation to our earlier evidence to the Standing Committee (presented on 21 November 2001) and various documents providing advice to WorkCover on the reform package both before and after 21 November 2001. We are keen to correct these areas of misinterpretation and misunderstanding, and believe that this document will be a valuable part of this process.

2 SUMMARY

- 2.1 As will be apparent from Appendix 1 of this report, the reform package comprised a complex set of reforms that evolved over an 18 month period commencing in the middle of 2000.
- 2.2 Tillinghast undertook a range of analyses and provided advice to WorkCover over these 18 months on aspects of the overall reform package as it evolved. Tillinghast's work was therefore undertaken against a backdrop of an evolving reform package. Appendix 2 of this report summarises the nature of the work undertaken by Tillinghast, pursuant to our scope, at different dates over this 18 month period.
- 2.3 Tillinghast has had extensive experience with workers' compensation systems in Australia and around the world, including the evaluation of the effects of reforms to such systems. Dave Finnis has been a key consultant to our Australian investigations in the last 10 years into reform effects in New South Wales as well as Victoria, South Australia, Tasmania and Western Australia.
- 2.4 This report focuses on the following, being those documents to which the Ernst & Young report is principally addressed:
- 21 November 2001 testimony to the Standing Committee.
 - 'Financial Evaluation of the 2001 NSW Workers' Compensation System Reforms for the WorkCover Scheme' (draft report dated 26 November 2001 to WorkCover).
 - 'Actuarial Projections of Funding Scenarios for the NSW Workers Compensation Scheme' (Letter dated 7 January 2002 to WorkCover).
 - 'Review and monitoring of the NSW Workers Compensation Scheme' (Letter dated 7 January 2002 to WorkCover).
 - 'Financial Evaluation of the 2001 NSW Workers' Compensation System Reforms for the WorkCover Scheme' (final report dated 14 January 2002 to WorkCover).

- 2.5 The Ernst & Young report makes a number of specific comments that we have endeavoured to address in some detail within this report. There are a few more general issues raised by the Ernst & Young report which we wish to respond as follows:
- 2.5.1 Section 4.34 of the Ernst & Young report appears to imply that Tillinghast is not an independent firm of consulting actuaries. This implication is incorrect and we confirm to the Standing Committee that Tillinghast is an independent firm of consulting actuaries. We are therefore uncertain as to the merits of the proposal by Ernst & Young that the Standing Committee request WorkCover to engage another actuary to conduct an independent review.
- 2.5.2 We wish to make it clear to the Standing Committee that, as an independent firm of consulting actuaries, we are satisfied that we have performed our work for WorkCover professionally, objectively and in accordance with our scope of work, whilst applying our best endeavours to meet reporting timeframes asked of us by WorkCover.
- 2.5.3 Section 4.33 of the Ernst & Young report appears to imply that relevant parties may not have received appropriate actuarial advice prior to the passage of the reform package. As will be apparent from the explanations contained within this report, and also from Appendix 2 summarising the work we have performed, we do not accept this Ernst & Young criticism.
- 2.5.4 We cannot ascertain from their report how Ernst & Young have formed their overall conclusions, but we appreciate that its author had not considered all relevant material before reaching his conclusions in Section 4.33. We acknowledge that it is a matter for the Standing Committee alone to consider whether or not to seek any explanation from Ernst & Young and we do not reflect on this matter any further within this report.
- 2.5.5 We also note that the author of the Ernst & Young report appears to have misunderstood the impact on our reporting to WorkCover of a number of important aspects of the reform package, and has suggested that aspects of our reporting have been inconsistent. In early January 2002, we held a number of discussions with Ernst & Young where we sought to address their misunderstandings. We note, however, that a number of these

misunderstandings still prevail. We have therefore sought to address these in this report. We do not accept that our advice to WorkCover has been inconsistent and we have provided a summary “audit trail” within this report on certain key aspects of our reporting.

- 2.6 We believe that there is considerable room for legitimate differences in professional opinion in evaluations of the form that we have undertaken for the reform package. We acknowledge that Ernst & Young appear to have a different professional view from us in certain respects. We are somewhat surprised at the apparently definitive nature of certain comments within the Ernst & Young report, which leave us unclear as to whether or not Ernst & Young similarly acknowledge that there is room for legitimate differences in professional opinion regarding many of the issues covered by their report.
- 2.7 In Section 5, we summarise our response to some of the issues raised by the Ernst & Young report and the Second Interim Report. Section 6 of this report provides further details in relation to these matters.
- 2.8 As Ernst and Young themselves have commented, we wish to re-affirm to the Standing Committee that the results of evaluations of the form we have undertaken for the reform package are inherently uncertain. The actual future outcomes will depend upon a range of complex and interacting events and factors and there is considerable actuarial judgement involved in projecting these future uncertain events and factors. Hence the actual outcome may diverge, perhaps markedly, from any of the projections. Typically, there is little or no data on how employers, injured workers and other parties may behave under a set of rules that is yet to be implemented. These behavioural aspects can have a material bearing on the uncertainty inherent in any costing of reforms. The costing process therefore requires the use of informed judgement by experienced practitioners. We refer the Standing Committee to the reliances and limitations that are set out in Section 4.

3 DISTRIBUTION AND USE

This report forms part of Tillinghast's testimony to the Standing Committee on 6 March 2002. It is not intended, nor necessarily suitable for any other purpose.

We understand that the Standing Committee may wish to make this report publicly available as part of the third round of hearings. Permission is hereby granted for such distribution on the condition that the report must be distributed in its entirety.

We cannot be held responsible for conclusions drawn from our reports by third parties. Third parties should place no reliance on this report that would create any duty or liability by Tillinghast to the third party.

Judgements about the conclusions drawn in this report should be made only after considering this report, and our other reports to WorkCover, in their entirety.

Finally, we remain available to answer any questions that may arise regarding this report.

4 RELIANCES AND LIMITATIONS

Much of the content of this report draws upon material contained within our earlier reports to WorkCover and should be read in conjunction with these earlier reports. In preparing our reports, Tillinghast has relied on historical data and other quantitative and qualitative information supplied by WorkCover without audit or independent verification. We have reviewed this information for reasonableness and internal consistency. However, such a review does not constitute a full audit or independent verification.

Our analyses assume that the range and cost of injuries that have occurred historically are indicative of those to appear in the future. It is possible that this may not be the case. For example, due to changes in effectiveness of risk prevention procedures, changes in industry mix, attitude of claimants, other cultural or structural Scheme changes, court settlements/precedents or other external effects, Scheme outcomes may change in an unpredictable manner.

Our reports provide estimates of the savings of reforms to WorkCover's dispute resolution system. We have not estimated start up costs or maintenance costs of implementing the changes. Apart from changes to permanent impairment benefits and access to common law damages we have not estimated the effects (direct or indirect) of reforms on claims costs, apart from a minor allowance in the conversion to accident year analysis. This analysis merely provides a guide to the potential financial effects of changes and does not purport to deliver a firm estimate of the likely costs.

We have not attempted to estimate the long-term or cultural impact of these reforms in our reports since these are dependent on effects beyond the scope of an actuarial analysis. It is important to note that the estimates of the future effects of the Scheme reforms will remain constant over time and not reduce as a result of slippage in effectiveness or efficiency.

Due to limitations, largely caused by the lack of data, and Scheme experience on account of the changes underlying the reform amendments, significant uncertainty surrounds our findings. The financial outcome is also largely dependent on the manner and degree by which reforms are implemented. This increases the uncertainty in our saving estimates. We have attempted to formulate implementation assumptions and scenarios by reviewing reports supplied by WorkCover and through discussions with

WorkCover staff. However, due to the lack of relevant data, many of the assumptions have been formed from what we believe are reasonable projections of outcomes from reforms. In forming these projections, we have, in our judgement, employed assumptions and techniques that are appropriate, and the conclusions presented herein are reasonable given the information currently available.

It should be appreciated that there is inherent uncertainty as regards the future financial effect of the reform package. We caution readers of this report against assuming that the costings of the reform package can be anything other than estimates of uncertain future events.

5 DETAILED COMMENTARY

In this Section, we seek to address the issues raised in the Ernst & Young report, in particular:

- The extent of changes to the reform package as it evolved
- The impact of the reform package on the Scheme deficit
- The scenarios presented in various documents
- The choice of actuarial approach
- The draft status of our 26 November 2001 report
- Other miscellaneous items

Appendix 2 provides further details on aspects of our various reports to assist readers of this section.

We re-emphasise that there is inherent uncertainty as regards the future financial effect of the Scheme reform package. We caution readers of this report against assuming that the costings of the reform package can be anything other than estimates of uncertain future events.

The Extent of Changes to the Reform Package

- 5.1 The evidence we provided to the Standing Committee on 21 November 2001 was based on our understanding of the reform package as it stood on 20 November 2001. There were a number of changes to the reform package between 21 November 2001 and the date on which the final reform package was completed in late December 2001. The changes to the reform package subsequent to 21 November 2001 had a material bearing on the overall potential financial impact of the total reform package. It was for this reason, and this reason alone, that we indicated in our 14 January 2002 report that our 26 November 2001 draft report had been superseded.
- 5.2 It is not clear to us whether Ernst & Young have acknowledged the significance of the changes to the reform package that arose after 21 November 2001, insofar as they relate to our savings estimates or the comparison between our various estimates at different points in time. For example, Section 4.5 of the Ernst &

Young report refers to some 'minor changes to the legislation'.

The Impact of the Reform Package on the Scheme Deficit

- 5.3 Our evidence to the Standing Committee on 21 November 2001 regarding the impact of the reforms on the deficit appears to be a source of some confusion. To understand our position on this, it is necessary to recap on our earlier advice regarding the Scheme deficit.
- 5.4 As part of our 30 June 2001 Scheme valuation, we estimated that the Scheme deficit of \$2.76 billion as at 30 June 2001 would deteriorate to approximately \$3.13 billion as at 31 December 2001, on the assumption that no reforms were implemented. This is a deterioration of \$0.37 billion.
- 5.5 As part of our Scheme valuation report as at 30 June 2001, we concluded that the reforms passed into legislation in July 2001 would have minimal retrospective effect (on the Scheme deficit).
- 5.6 We have estimated that the impact of the reforms as they then stood at 20 November 2001 would have been to reduce the deficit as at 31 December 2001 by approximately \$0.34 billion, using our anticipated 'best estimate' scenario for the 31 December 2001 Scheme valuation. However, this estimated reduction in the deficit would have the effect of merely offsetting our June 2001 valuation projected deterioration in the Scheme deficit over the second half of 2001. It was in this context that we gave evidence to the effect that, based on the reforms proposed as at 20 November 2001, it would be difficult to see how these reforms could have a significant effect on the deficit within a short period of time. In other words, the estimated deficit as at 31 December 2001, after allowing for these proposed reforms, would have been materially the same level as at 30 June 2001.
- 5.7 Using the scenario most closely aligned with our anticipated 31 December 2001 Scheme valuation basis (effectively Tillinghast's 'best estimate' at the time) we have estimated that the additional elements introduced to the reform package subsequent to 21 November 2001 would further reduce the Scheme deficit as at 31 December 2001 by approximately \$0.47 billion. Combined with our estimated \$0.34 billion deficit reduction based on the reform package as it stood

on 20 November 2001, this then reconciles with the \$0.81 billion total estimated impact on the Scheme deficit contained in our 14 January 2002 report.

- 5.8 In our view, it would have been at best extremely difficult, and perhaps almost impossible, to determine a reasonable estimate of the total one-off impact on the deficit prior to the implementation of reforms which introduced lump sum cut-off dates. Our prior experience has shown that the ‘surge’ of applications (a result of claimants and their advisors avoiding the more stringent conditions following implementation of such reforms) is unpredictable for lump sum claims, such as common law and commutations. We believed that the proposed reform package at 26 November 2001 would result in such a surge of applications, resulting in any attempt to assess the retrospective impact of the proposed reforms being highly uncertain and, in our view, of limited value. As a result, the scope of our draft 26 November 2001 report (page 4) expressly stated that we had not assessed the retrospective impact on outstanding claims (ie. the deficit impact), deferring such analysis until our 31 December 2001 Scheme valuation at which time the ‘surge’ effect would become clearer. We also note that the Ernst and Young report comments at some length on the uncertainty of costing reforms (see Section 4.31 of the Ernst & Young report).
- 5.9 Of course, as actual Scheme experience under the reforms emerges, the resulting impact on the deficit may vary significantly from our \$0.81 billion estimate. Whilst we have also provided a higher estimate of \$1.3 billion for the impact on the Scheme deficit as at 31 December 2001, based on the “Targets Mainly Achieved” scenario (that we understood WorkCover intended to adopt internally for performance monitoring and internal goal setting purposes), at the present time, we would not consider it appropriate to adopt this more aggressive future savings outcome for our half yearly Scheme valuations.
- 5.10 In summary, our \$0.81 billion estimate of the effect of the reform package on the Scheme deficit as at 31 December 2001, as set out in our 14 January 2002 report, is consistent with our evidence to the Standing Committee on 21 November 2001, provided that due recognition is given to the effect of the additional elements introduced to the reform package after 21 November 2001. It should also be noted that our \$0.81 billion figure was our preliminary estimate of the impact on the Scheme deficit as at 31 December 2001. Our final estimate will not

be known until the 31 December 2001 valuation is complete.

The Scenarios Presented in Various Documents

- 5.11 Ernst & Young have suggested that our use of only two scenarios in certain of our reports has not presented a balanced view of possible outcomes from the reform package. We do not accept this criticism and believe that their assertions regarding optimistic, central and pessimistic estimates reflect a misunderstanding of our reporting.
- 5.12 During the course of 2001, we provided WorkCover with results on a range of up to five different scenarios. These were also summarised within our 14 January 2002 report.
- 5.13 In certain of our reports, we chose to include two scenarios for the purpose of concise reporting. As we explained in our reports, the scenarios selected were essentially two ‘best estimate’ scenarios, one being Tillinghast’s ‘best estimate’ at respective dates and the other being the scenario that we understood WorkCover intended to adopt internally for performance monitoring and internal goal setting purposes.
- 5.14 Ernst & Young have suggested that “it is the actuary’s responsibility when providing professional recommendations on cost estimates to take responsibility for the scenarios and provide the client with their recommendations of estimates on what the actuary considers to be a reasonable range of scenarios”. We agree with this sentiment and consider that we have done this for WorkCover.
- 5.15 However, Ernst & Young appear to imply that we should maintain this approach in all aspects of our reporting and provide for a range of scenarios in all instances. We hold a different professional view on this matter. We consider that it is reasonable, and indeed expected by the audience, that the actuary will provide advice in a suitably concise form, when appropriate. Having provided different costings to WorkCover on different scenarios at different points in time, we did not consider it unreasonable to narrow these down to our ‘best estimate’ scenario.
- 5.16 However, so as to also convey the effects of WorkCover’s ‘best estimate’, in this instance we considered it appropriate and reasonable to report results on two ‘best estimate’ scenarios. We would again emphasise that we consider we have provided

appropriate explanation of the basis underlying each of these two scenarios. It was then for completeness only that our 14 January 2002 report provided an appendix of results containing the five scenarios from which the two 'best estimate' views had been distilled.

- 5.17 In addition, in the Executive Summary within our 26 November 2001 draft report we have stated that the outcomes are largely dependent on the manner and degree by which reforms are implemented. We also stated that there was a range of possible implementation scenarios and that we have illustrated the outcomes using two scenarios from that range.
- 5.18 Whilst we consider that we have appropriately described and presented the two scenarios as Tillinghast's and WorkCover's 'best estimate' scenarios, in hindsight, we acknowledge that in one of our 7 January 2002 letters (titled "*Actuarial Projections of Funding Scenarios for the NSW Workers Compensation Scheme*") we included a Table 1.4 which labelled the results as "low" and "high" outcomes. Although we did provide some commentary which was intended to convey the same meaning as the description above, with hindsight, we could have used alternative descriptors to "low" and "high". However, we would emphasise that our 26 November 2001 draft report and our 14 January 2002 report provided clear descriptions of the two scenarios, in a manner consistent with our comments above.

The Choice of Actuarial Approach

- 5.19 There is a range of methods that could have been used to cost the reforms. We began our costings using the settlement year approach on the basis that we considered it would provide a reasonable proxy for the accident year approach whilst the reforms remained concentrated on improving the mechanisms for resolving claimants' disputes. In addition, there was more data available with which to model the effects of the dispute resolution reforms using a settlement year basis.
- 5.20 As the reform package evolved, certain reforms were proposed in the second half of 2001 that lead us to reflect upon the continuing suitability of using the settlement year basis for our analysis. We concluded that we could reasonably continue to use the settlement year basis for the purpose of presenting our

estimated cost savings in our 26 November 2001 draft report, but we always considered that we would revert to an accident year basis for the purpose of undertaking our 31 December 2001 Scheme valuation. We communicated our conclusion to WorkCover. We believed that the use of a settlement year basis would provide a reasonable basis for costing the reforms in the short term, albeit with some inherent conservatism for common law claims (all other things being equal) when compared to accident year costings. Given the evolving nature of the reform package and given also that any costings are inherently uncertain, we considered that maintaining an element of conservatism in certain of our estimates was not inappropriate. We commented briefly upon this conservatism for common law claims in our 26 November 2001 draft report.

- 5.21 In forming this conclusion, we had to weigh up two competing factors. On the one hand, we considered it likely that moving immediately to an accident year basis would provide for a better illustration of the effect of estimated cost savings arising from certain of the evolving reforms. On the other hand, we considered that there was merit in maintaining consistency in relation to the manner in which the costings had been undertaken to date so as to provide a consistent basis of reporting during the course of the reforms' evolution.
- 5.22 When using the settlement year basis, our 'best estimate' scenario seeks to provide an estimate of the cost of reforms for a 'steady state' settlement year. We have used the accident year basis to provide estimates of the retrospective and short-term prospective impact consistent with the intended Scheme valuation basis. For the accident year basis, we further refined our best estimate' scenario as part of our initial preparations for the 31 December 2001 Scheme valuation. These refinements to the 'best estimate' scenario mean that the settlement year and accident year 'best estimate' scenarios are not directly comparable. The appendices to our 14 January 2002 report provided further details on the Tillinghast 'best estimate' scenarios adopted for the settlement year and accident year bases respectively.
- 5.23 Using the settlement year basis, together with our corresponding 'best estimate' scenario, the changes to the reform package after 26 November 2001 increased our estimated annual savings from \$88m (in our 26 November 2001 draft report) to \$190m in our 14 January 2002 report.

Using the accident year basis, together with our corresponding 'best estimate' scenario, the prospective annual savings arising from the total reform package were estimated at \$230m in our 7 January 2002 scenario letter and our 14 January 2002 report (note, this estimate also included an additional element for improved 'return to work' outcomes).

5.24 On the basis of the above, we remain comfortable with our use of the settlement year basis for our 26 November 2001 draft report. We consider that the estimates of annual savings produced using this method were a reasonable proxy, albeit somewhat conservative in respect of certain elements, for the accident year basis for the reform package as it stood at the time.

The Draft Status of our 26 November 2001 Report

5.25 Our 26 November 2001 draft report provided estimates in relation to the reform package as at that date. We were informed by WorkCover that our latest draft report was required by WorkCover to meet the request of the Standing Committee.

5.26 As will be apparent from Appendix 1 of this report, the reform package has evolved over a considerable period of time and has continued to evolve beyond 26 November 2001. We have reported to WorkCover throughout the period in which the reforms have evolved, and our 26 November 2001 draft report was merely one part of this overall reporting.

5.27 We consider that we have faithfully represented our 26 November 2001 report as a draft report and that estimates presented therein were draft results against the backdrop of continuing changes to the reform package and refinement of our models and assumptions. Within that draft report, we have signposted a number of important elements, including the following:

- The settlement year approach we had chosen to adopt for the report;
- The package of reforms to which the report related;
- The reliances and limitations applicable to our work, in particular the uncertainty in costing such reforms;

- The element of conservatism arising from the use of the settlement year approach to analyse common law;
- That the retrospective impacts would be addressed in our 31 December 2001 Scheme valuation report.

5.28 In our testimony to the Standing Committee on 21 November 2001, we stated that the reforms were dynamic and that the reform package was still evolving. Our draft report was therefore prepared for WorkCover at an interim stage of our overall reporting. We believe that the interim nature of our report was readily apparent to WorkCover.

5.29 Clearly, in the case of a draft report, there exists the potential for misinterpretation and misunderstanding on the part of readers other than WorkCover, since these readers will not have been engaged (to the same extent) in the process of interaction between WorkCover and Tillinghast up to the 26 November 2001 and beyond.

5.30 Nevertheless, when WorkCover provided a copy of our draft report to the Standing Committee, we understand that WorkCover further qualified our draft report and its interim estimates in recognition of the still evolving nature of the reform package.

Other Miscellaneous Items

5.31 We acknowledge that the pace and complexity of the reforms' evolution has required us to issue a number of documents which assumed a certain amount of prior knowledge on the part of the reader.

- 5.32 We note that it has been a large effort on the part of WorkCover and Tillinghast to ensure that costings were prepared in a timely manner as the reforms evolved and to ensure a reasonable level of reporting to our client during the process. The evolving nature of the reforms meant that our 26 November 2001 draft report did not reflect, and could not have reflected, the changes to the reforms that occurred after that date.
- 5.33 Overall, we remain satisfied with the form and extent of our reporting to WorkCover.
- 5.34 Whilst we remain satisfied with our reporting, we would concede that there are some aspects of our 7 January 2002 letters which, with the benefit of hindsight, we could have worded more precisely so as to emphasise that the results contained within one letter were based on the reform package as it stood at 26 November 2001 whereas the results contained in the second letter were based on the package that was subsequently enacted. However, when read in conjunction with the other documents dated 26 November 2001 and 14 January 2002, we are satisfied that the context of the 7 January 2002 letters is clear.

6 FURTHER DETAILS ON ASPECTS OF OUR REPORTING

Introduction

6.1 Appendix 2 sets out work we have undertaken over the period of the reform package's evolution. We have elected to focus on the following for the purpose of this report;

- Our testimony to the Standing Committee on 21 November 2001.
- 'Financial Evaluation of the 2001 NSW Workers' Compensation System Reforms for the WorkCover Scheme' (draft report dated 26 November 2001 to WorkCover).
- 'Actuarial Projections of Funding Scenarios for the NSW Workers Compensation Scheme' (Letter dated 7 January 2002 to WorkCover).
- 'Review and Monitoring of the NSW Workers Compensation Scheme' (Letter dated 7 January 2002 to WorkCover).
- 'Financial Evaluation of the 2001 NSW Workers' Compensation System Reforms for the WorkCover Scheme' (final report dated 14 January 2002 to WorkCover).

6.2 In the remainder of this Section, in order to clarify certain matters for the Standing Committee, we have provided further explanatory comment on aspects of the above material.

21 November 2001 Testimony to the Standing Committee

6.3 Our testimony to the Standing Committee was based on our understanding of the reforms as at that time. There was much discussion at the 21 November 2001 hearings of the size of the deficit. To assist with some of the issues raised, we summarise aspects of the estimated deficit in Table 6.1 (totals may not add up due to rounding).

TABLE 6.1**Key Financial Measures for the Scheme (\$M)**

	June 2000 ²	June 2001 ³	Projected December 2001 ³
Estimated Total Liabilities	7,906	9,199	10,310
Estimated Total Assets ¹	6,317	6,443	7,177
Estimated Deficit	1,589	2,756	3,132
Estimated Deficit Deterioration ⁴		1,167	376

¹ Includes estimated recoveries

² "Actuarial Review of the Liabilities of the WorkCover Scheme Statutory Fund as at 30 June 2000", dated 19 September 2000. Table 4.2

³ "Actuarial Review of the Outstanding Liabilities of the WorkCover Scheme Statutory Fund as at 30 June 2001" dated 26 September 2001. Table 11.1

⁴ Deterioration since previous financial year end

6.4 Impact on the deficit: We have estimated that the impact of the reforms as they stood at 20 November 2001 would have been to reduce the deficit as at 31 December 2001 by approximately \$0.34 billion, using our anticipated 'best estimate' scenario for the 31 December 2001 Scheme valuation. However, this estimated reduction in the deficit would have broadly offset our June 2001 valuation projected deterioration in the Scheme deficit over the second half of 2001 (see Table 6.1). In other words, the estimated deficit as at 31 December 2001, after allowing for these proposed reforms, would have been approximately \$2.79 billion, materially the same level as at June 2001.

6.5 Excludes key reforms: Our advice did not, and could not, incorporate the effects of restricting the access to commutations or the *Workers Compensation (General) Amendment (Cost of Claims) Regulation 2001*¹. These reforms were proposed after 21 November 2001.

26 November 2001 Draft Report

6.6 This draft report provided details of our estimates for the reform package according to our understanding of how they stood at that time. Our costings in this draft report assumed that all the proposed reforms contained in the Further Amendment Bill 2001 would be passed (see Executive Summary and detailed descriptions of each reform in the body of the 26 November 2001 report).

- 6.7 **Settlement year:** We stated that we had used a settlement year approach to the estimates. We also stated that some conservatism was implied by this approach when compared to an accident year approach. We highlighted to which claim type this conservatism applied and provided an example of the mechanics of the effect.
- 6.8 **Two ‘best estimate’ scenarios:** We stated that we had examined a range of possible scenarios from one in which targets are fully met to a more pessimistic outcome in which the mode of implementation is strongly opposed. We stated that we had illustrated the outcomes from two scenarios within this range in the report, namely:
- **“Targets mainly achieved:** WorkCover’s expected estimate, derived as their compromise between the two extreme scenarios, and based on the most likely outcome if targets were to be mostly achieved.”
 - **“Moderate position:** In broad terms, this scenario is consistent with the actuarial valuation basis, and hence may be described as Tillinghast’s actuarial ‘best estimate’ at the time. This moderate scenario reflects an expectation that all the critical initiatives be implemented with a ‘moderate’ level of effectiveness, while there is no erosion in the crucial ‘building blocks’ of the system (eg rigorous monitoring and corrections for any slippage found).”
- 6.9 Our advice did not, and could not, incorporate the *Workers Compensation (General) Amendment (Cost of Claims) Regulation 2001*. This reform was developed and finalised after 26 November 2001 the final regulation was provided to us on 19 December 2001.

7 January 2002 Review and Monitoring Letter

- 6.10 This letter provided responses to questions on notice from the Standing Committee from our testimony on 21 November 2001.
- 6.11 The figures in Table 3 of this letter were taken directly from our 26 November 2001 draft report estimates.

- 6.12 In response to question 7 we stated that further analysis was being undertaken to assess the impact on the deficit and the expected impact on the 2001/02 Scheme costs (the estimates for which were reported in our other 7 January 2002 letter)
- 6.13 We received the questions on notice and prepared our response to these before focusing on the 7 January 2002 Scenario letter and before we received the *Workers Compensation (General) Amendment (Cost of Claims) Regulation 2001* ("Legal Cost Regulations").

7 January 2002 Scenario Letter

- 6.14 This letter provided details of our savings estimates of the reform package for a range of specified scenarios.
- 6.15 **Accident year estimates.** Using the accident year basis, together with our corresponding 'best estimate' scenario, the retrospective savings arising from the total reform package were estimated to be \$810m and the prospective short-term annual savings were estimated at \$230m (note, these estimates also included an additional element for improved 'return to work' outcomes).
- 6.16 **Restriction of commutations and the introduction of legal cost regulations.** Our advice incorporated the restriction of commutations and the impact of the *Workers Compensation (General) Amendment (Cost of Claims) Regulation 2001*. Our 'best estimate' of the total retrospective savings effects was \$810m, comprising implicitly \$340m in respect of the reform package proposed as at 21 November 2001 plus \$470m in respect of further reforms developed since then.
- 6.17 **Estimate of the 31 December 2001 Scheme valuation:** The results were based on 30 June 2001 data and used approximate methods for estimating the impact the reform package would have on the 31 December 2001 Scheme valuation. It should be noted that the final estimated impact as at 31 December 2001 will not be known until the 31 December 2001 Scheme valuation is complete.

14 January 2002 Report

- 6.18 We provided our final report to update the 26 November 2001 draft estimates for the latest reforms and to reconcile them with those presented on 7 January 2002. Although this coincided with our discussions with Ernst & Young, we did not change our approach or key numbers in response to those discussions. Further, our 14 January 2002 report was not prompted by our discussions with Ernst & Young.
- 6.19 **Changes to reforms:** Changes to reforms had a material impact on our estimates contained in the 26 November 2001 draft report. Due to these changes, this report superseded our 26 November 2001 draft report.
- 6.20 **Update of settlement year estimates:** Using the settlement year basis, together with our corresponding 'best estimate' scenario, the changes to the reform package after 26 November 2001 increased our estimated annual savings from \$88m (in our 26 November 2001 draft report) to \$190m in our 14 January 2002 report.
- 6.21 **Critical initiatives:** We specified the initiatives we saw as crucial to achieving the estimated legal and investigation cost savings of the reform package.

Next Steps – Progress of the Valuation

- 6.22 We are currently undertaking the 31 December 2001 Scheme valuation. Our 14 January 2002 report was based on data as at 30 June 2001 from which the \$810m estimated deficit impact was derived. The 31 December 2001 Scheme valuation outcome will be based on data as at 31 December 2001. The actual estimated impact on the deficit as at 31 December 2001 will not be known until the Scheme valuation is complete.

APPENDIX A

Evolution of the Reforms Package

A summary of key reform package proposals and legislation is provided below. The purpose of this Appendix is to give a broad outline of the manner in which, and the extent to which the reform package evolved over time.

- A.1 WorkCover provided us with a copy of the 8 June 2000 Legislative Council Ministerial Statement in regard to WorkCover Review Principles. In this the Minister, the Hon. J. J. Della Bosca, states his intent to develop a robust and comprehensive reform package. A review of the dispute prevention and resolution system was one element of this package.
- A.2 In August 2000 WorkCover provided us with a summary of the key proposed reforms. At that time it was proposed to amend the Workplace Injury Management and Workers Compensation Act 1998 and related legislation to reform the corporate governance structures for the WorkCover Scheme, simplify commutations, improve dispute resolution procedures, improve compliance with existing provisions, control costs and make other miscellaneous improvements.
- A.3 The Workers Compensation Legislation Amendment Act 2000 was assented in December 2000.
- A.4 In January 2001 WorkCover provided us with an updated summary of the key proposed reforms. At that time it was proposed to improve dispute prevention in the NSW workers compensation Scheme, and to reform the structures and processes used to resolve disputes over statutory and common law entitlements in the Scheme.
- A.5 In March 2001 WorkCover provided us with a copy of the Workers Compensation Legislation Amendment Bill 2001 (Draft), which included:
- Dispute prevention measures, including provisional acceptance of liability.
 - Introduction of a Claims Assessment Service to assess claims through an administrative process, with limited rights of appeal to the court.
 - Introduction of an objective method for assessing impairment through the use of AMA Guidelines.

- Introduction of binding medical assessment for all medical issues.
- Change the common law threshold from 25% under the Current Table to 25% Whole Person Impairment (“WPI”).
- A target of an additional \$50m to improving statutory benefits for workers with a permanent physical loss.

A.6 In May 2001 WorkCover provided us with a summary of the key reforms as they had evolved to that date. This included details on the outcome of negotiations with the Labour Council of NSW in relation to the Workers Compensation Legislation Amendment Bill 2001. Additional proposals included:

- Deferring amendments relating to common law, pending an inquiry.
- Providing access to statutory compensation for workers with a psychological or psychiatric injury, subject to a 10% WPI threshold.
- Lowering the threshold for pain and suffering to 8% WPI.
- Issuing locally developed AMA Guides.
- Further procedural changes:
 - Establishing a quasi-judicial Workers Compensation Commission.
 - Legally qualified arbitrators to preside over arbitration.
 - Introducing the ability to appeal arbitration outcomes.
 - Relaxing the binding provision for non-permanent injury medical assessments.

A.7 In June 2001 WorkCover provided us with a copy of the ‘Workers Compensation Legislation Amendment Bill 2001 (No 2)’ resulting from further consultation since May 2001. Additional proposals included:

- The President will be a judge.
- Removing and later prescribing by regulation:
 - Formulas for compensating permanent impairment.
 - WPI thresholds for psychological injury and pain and suffering.

- A.8 The Workers Compensation Legislation Amendment Act 2001 was assented in July 2001.
- A.9 In July 2001 WorkCover provided us with a copy of PricewaterhouseCoopers' report *'Analysis of trends in NSW workers' compensation common law claims'*.
- A.10 At the end of August 2001 we were provided with a copy of the *'Commission of Inquiry into Workers Compensation Common Law Matters'*. Key recommendations included:
- Reducing the WPI threshold for the recovery of common law damages to 20% WPI.
 - Abolishing the existing entitlement to claim non-economic loss damages under common law and preventing the recovery of any further statutory compensation.
 - Limiting the calculation of future economic loss to age 65.
 - Repealing existing provisions requiring the injured worker to elect to claim either statutory or common law compensation.
 - Introducing a range of new pre-litigation procedures and processes.
- A.11 In October 2001 WorkCover provided us with a copy of PricewaterhouseCoopers' report *'Analysis of trends in NSW workers' compensation commuted claims'*.
- A.12 In October 2001 WorkCover provided us with a summary of the key reforms as they had evolved to that date. The recommendations of the Sheahan Inquiry had been adopted and there was a desire to complete the reforms to dispute prevention and resolution which had been commenced with the recently enacted Workers Compensation Legislation Amendment Act 2001. Additional proposals included:
- Giving effect to the Sheahan Inquiry on damages, thresholds and procedures.
 - Establishing a formula for the determination of permanent loss statutory compensation.
 - Providing a threshold for lump sum statutory compensation for primary psychological or psychiatric injury at 15% WPI.

- Providing a threshold for lump sum statutory compensation for pain and suffering at 10% WPI.
- Introducing a new entitlement for domestic assistance in the statutory Scheme.

A.13 On 22 November 2001 WorkCover (after our testimony to the standing committee) provided us with the proposed amendments to the Workers Compensation Legislation Further Amendment Bill 2001. Additional proposals included:

- Establishing a revised formula for the determination of permanent loss statutory compensation.
- Further reducing the WPI threshold for the recovery of common law damages to 15% WPI.
- Restricting access to commutations.

A.14 On 26 November 2001 WorkCover provided us with a copy of the *Workers Compensation Legislation Further Amendment Bill 2001* that was subsequently assented in December 2001.

A.15 In December 2001 WorkCover provided us with a copy of the *Workers Compensation (General) Amendment (Cost of Claims) Regulation 2001*. This regulation further defined the regulatory fixed scale of applicable fees for legal advice, limits on fees recoverable and mechanisms for the assessment of costs.

APPENDIX B

Scope of Tillinghast Work

- B.1 This Appendix briefly summarises key elements of our work performed in connection with the reform package, in accordance with WorkCover's instructions. The purpose of this Appendix is to give a broad outline of the extent of work we have undertaken for WorkCover on aspects of the reform package as it evolved.

Ad hoc Scheme Reforms

- B.2 Following discussions with WorkCover, we were asked to estimate the impact on the annual ongoing costs to the Scheme of a range of ad hoc Scheme reforms. Our work in this area took place over the period from July 2000 to August 2000.

Dispute and Common Law Legal System Cost Savings

- B.3 In September 2000 we were requested by WorkCover to become involved in costing the effect of a reformed dispute resolution process and we were asked to estimate the impact on legal and investigation costs from proposed dispute prevention and resolution reforms throughout each of the reforms as they evolved (refer to Appendix 1).

Transition to AMA Guides

- B.4 During February and March 2001 we focused on estimating the impact of measuring permanent impairment benefits using AMA Guides.
- B.5 In August 2001 we assisted WorkCover with a stratified sampling project, to estimate the effects of using locally developed AMA Guides on injury impairment percentages.

Exploring Different Permanent Impairment Payment Formulas

B.6 From late February 2001 we were asked to explore the effects of different payment formulae, varying by severity, for permanent impairment lump sum benefits. In September 2001 we further examined the effects of different payment formulae on permanent impairment lump sum benefits.

Varying the Common Law Threshold

B.7 From March 2001 onwards we were asked to comment on, and estimate the savings impact of, different common law WPI thresholds. We continued to develop and refine the underlying assumptions throughout this time, and incorporated the WPI threshold recommendations of the Sheahan Inquiry in September 2001.

New Diseases, Psychological and Psychiatric Injury

B.8 In April 2001 we were asked to estimate the costs of options related to the compensation of Extension of Coverage injuries under the AMA V Guides. Our preliminary work on this aspect of the reforms took place in April 2001 and we finalised our modelling in September 2001.

Varying the Section 67 Threshold

B.9 In May 2001 we were asked to estimate the costs of varying the Section 67 threshold and we further refined our estimates during September 2001.

Costing of Sheahan Recommendations

B.10 In August 2001 and September 2001 we modelled the potential impact of the recommendations of the Sheahan Inquiry. These recommendations impacted a range of areas including common law legal and investigation costs, statutory benefits and permanent impairment numbers, access, take-up rates, and damages awards. Where appropriate, this work was incorporated into all components of our ongoing annual savings estimates from September 2001 onwards.

Commutations

- B.11 During September 2001 we commented on a range of legislative changes to commutation arrangements.
- B.12 In October 2001 we estimated the impact of abolishing commutations as provided in PricewaterhouseCoopers report *Analysis of trends in NSW workers' compensation commuted claims* (dated 8 October 2001).
- B.13 On 22 November 2001 we estimated the impact of final amendments to the Workers Compensation Legislation Further Amendment Bill 2001. These amendments provided that commutations would no longer be abolished completely, but restricted to certain circumstances. We incorporated the estimated impact of this change in our *Financial Evaluation of the 2001 NSW Workers' Compensation System Reforms for the WorkCover Scheme* (draft report dated 26 November 2001 to WorkCover).

Valuation Savings Estimates

- B.14 In October 2001 we commenced our work estimating the effects of the reform package on the 31 December 2001 valuation.

Incorporating the Legal Cost Regulations

- B.15 WorkCover provided us with the *Workers Compensation (General) Amendment (Cost of Claims) Regulation 2001* on 19 December 2001. We incorporated this regulation into the estimated Scheme valuation impact and settlement year annual ongoing cost estimates during December 2001 and January 2002.