SELF INSURERS ASSOCIATION
OF VICTORIA

Self insurers Association of Victoria

Submission to Essential Services Commission - Issues Paper

Ministerial Reference on Contribution Fees payable to the Victorian WorkCover Authority

March 2006

Acknowledgement

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Contents

Executive Summary

1. This submission is made by the Self insurers Association of Victoria (SIAV) in response to the discussion paper issued by the Essential Services Commission (ESC) on 23 December 2005.
2. SIAV welcomes the opportunity for independent appraisal of the methodology and level of charges imposed by the Victorian WorkCover Authority (VWA) on self insurer.
3. SIAV's expectation is for a clear statement of principles and a determination that may span a regulatory period of up to five years. The principles would set the framework for subsequent review and updates.
4. The contributions issue is a major issue with a long history. It is appropriate to carefully develop principles in the full context of the issues and allow time for measured consideration.
5. SIAV notes the review is conducted under Section 10 of the ESC governing legislation rather than 10A or 10B. The implication is that the general principles and processes applicable to the regulation of the prices and charges of any GBE apply. Further the objectives of the *Accident Compensation Act 1985* particularly relating to business efficiency also apply.

SIAV APPROACH

6. SIAV has previously reviewed and proposed revisions to the principles for allocation of the cost pool. This was completed across the 39 self insurers and comprised detailed analysis of the incidence of prices and charges. Members agreed with the revised principles and their application. That review was undertaken in 2004 and the majority of members approached in the last month have since confirmed their support and with various qualifications dependent upon the eventual size of the cost pool have updated their support for those recommendations.
7. SIAV submits that the principles, which align with tariff structural cost allocation can, subject to review by the ESC, be endorsed. If so, the question of allocation can be settled and removed as an active issue in the ESC process.
8. Alternatively, SIAV can assist the ESC to undertake a full evidence study in similar manner to incidence studies undertaken by the Victorian Government and the ESC in other tariff/cost allocation reviews.
9. If this cost allocation/tariff matter can be put aside, then the focus of the ESC review can be confined to the definition and magnitude of the pool of efficient costs attributable to the self insurer.

10. It follows that, in establishing the contribution fee, the first task is therefore to determine what parts of the total pool of costs covering all of VWAs activities are necessary and efficient. The second task is to establish which of these are attributable to self insurer, and the third is to ensure that the pool of costs attributed to self insurance is distributed efficiently and equitably across self insurer.

COST POOL

11. SIAV submits that two overarching principles should apply. These are that:
    - costs should be **necessary and efficien**t; and
    - cost allocations should be based on direct measurers rather than proxies wherever direct information is available.

12. The first principle requires scrutiny of:
    - VWA's expenditures and effort directly focussed on self insurers; and
    - the scope and level of the overhead activity and costs incurred.

13. The ESC has previously reviewed the VWA and noted that :

    > *Under this and the previous review the claims administration expenses and the expenses of the VWA have not been assessed to determine whether the expenses represent efficient costs of operating and managing the scheme. The expenses have only been checked for their reasonableness in terms of the historical cost of the scheme.*[1]

    There are two broad questions that arise from this finding:
    - What are the efficient costs in total and how do these differ from observed costs?
    - What portions of the different components of efficient costs should be attributed to self insurers?

14. SIAV has already addressed the second question and proposed an activity based costing approach which uses direct measures wherever possible.

15. In the longer term, SIAV strongly supports the ESC's previous comments and request for a broader reference from the Minister in order that the efficiency of VWA's costs may be reviewed. When this efficiency review is completed, the pool of efficient costs attributable to self insurers can be adjusted.

16. SIAV notes that this approach is consistent with and advances the Victorian Government regulatory efficiency initiative [Refer par. 5.9 below] and with similar initiatives at the Commonwealth level such as the Banks Review.

17. In the shorter term and in the context of this review by the ESC, SIAV submits that estimates of the size of the total pool of VWA costs should be recognised as being inflated. The practical implication of such recognition is that where the ESC should exercise judgement, that judgement should be conservative in terms of VWA estimates.

[1] Essential Services Commission (2005), *Review of 2005-06 Workcover Average Premium Rate*, p.27.

18. Based on the principles outlined above, SIAV estimates that the pool of costs attributable to self insurers is no more than $7.6 million in 2002-03. This compares with VWA's contention of $15.6 million.

19. SIAV supports an activity-based costing approach. However, SIAV notes that even with direct activity based costing there will always remain the question of how to treat the unallocated common costs. SIAV has sought expert economic advice to articulate the principles that may apply and undertaken appropriate analysis.

20. Practical options exist for distributing the common costs associated with the oversight of both insured employers and self insured employers. It is generally accepted that an efficient allocation of common costs lies within the range of 'incremental' and 'stand alone' costs.

21. At one extreme, the self insured employers could be charged their incremental costs and pay no part of the common costs. At the other extreme they could be asked to pay all of the overhead costs. Where there are competitive suppliers an extreme demand could be immediately rejected by shifting to a competitive supplier. This is not the case here since VWA has a monopoly position as the regulator of the entire industry. Nonetheless it illustrates that for self insurers to pay zero contribution to common costs is extreme and requiring them to pay 100% is equally extreme. The current cap of 60% essentially recognises this position.

22. The ESC should also recognise that efficiency must be met in a dynamic context. Not only should the cost pool attributed to self insurance be efficient in a static sense, it must also meet the incentives requirement for optimal dynamic decisions into the future.

23. It is relevant here, that self insurance directly addresses and resolves the problem of moral hazard. Self insurance's better structure of incentives drives innovation and best practice, with which sub-contractors of self insurance and employers must comply. The better practice employed by self insurers flows through to insured employers. These methods, the VWA may then take as examples. Thus because self insurance provides these positive externalities for the insured, self insurers should, from an efficiency perspective, pay less than their incremental costs of regulatory oversight.

24. SIAV has conducted further analysis of the differences between the VWA 2003 assessment of attributable costs and that of SIAV, with particular attention to the use of proxies. Under the VWA approach, around 70% of the allocation of costs to self insurers reflects the ratio of remuneration of self insurers to all employers.[2] This means that self insurers have limited capacity to reduce their payments by enabling more efficient service delivery by the VWA. In contrast under the SIAV's approach, only 25% of the cost allocation is determined by even 'Notional' allocations and none by

[2] If 'Notional' allocations are included, this proportion increases to over 75%.

remuneration share. As a result, efficiencies obtained in delivering services to self insurers are more likely to be passed on in cost savings to the self insurers.

25. The important point of principle here is that a direct activity based costing approach to determining the cost pool attributable to self insurer is possible. For 2003 the activity based approach undertaken by SIAV's actuary and based on imperfect information provided by the VWA indicated a figure of $7.6 million or for that year 2.33% of VWA's total costs.

26. For the purposes of the ESC's regulatory determination, SIAV submits that these figures need to be confirmed and updated with improved information and that there is a clear basis for doing so. Alternatively, an equitable basis can be negotiated on the existing analysis.

27. Accordingly, in the shorter term, SIAV endorses Option Two of the ESC paper, namely that direct, indirect and non self insured costs be drawn from functional groupings within the VWA and reset from the 2003 incidence study already conducted. A formula to underpin a new regulation based on CPI increases and a projected period for ongoing fees is proposed.

LEGISLATIVE INTENT

28. The legislation requires first that contributions apply to certain administrative costs. The requirement for parity between insured employers and self insurers in the apportionment of administrative costs is conditional on the costs being known. The ESC has previously observed that administrative costs have not been subject to review for efficiency. From SIAV's perspective, the administrative costs are not transparent. SIAV would support a review that delivered recommendations on both issues.

29. SIAV does not consider that it was the intention of the legislation that the costs to business of the administration of the VWA should be obscured through lack of specific information. Or more importantly, that the lesser standards of accountability applied to premium payers could deliver an 'equitable' apportionment of costs. The difficulties arising from VWA using proxies should not translate across to self insurers.

30. Rather, SIAV considers that the ESC should give precedence to the objectives of the legislation in determining the contribution fee for self insurers, i.e. those in the WorkCover legislation and the ESC legislation that seek efficiency– a difficult objective in the absence of accurate information about costs.

31. In applying the legislation, SIAV is advised that:

- Parliament has clear intent that self insurers should contribute to costs;
- it is equally clear that the contribution only relates to services;
- the VWA 'may' determine the fee according to the premium approach – there is no must; and
- in exercising the choice of how this should be done, the VWA must be consistent with the objects of the Act and any other constraints e.g. ESC objects and tax

guidelines and more importantly economic business objectives. In effect the discretion is conditional, fettered and heavily constrained.

RISK

32. Similarly, SIAV considers that the concept of risk is not applicable in determining any aspect of the contribution fee if there is better and direct information. Proxies such as industry rating should only be used in the allocation model in the absence of detailed comparative information. For example, in the SIAV allocation model where risk is used for the assessment of claims liabilities against remuneration and is subject to actuarial assumptions relevant to the individual insurer. The reliability of these assumptions may now be strengthened by new VWA peer actuarial reviews.

ALLOCATION MODEL

33. SIAV endorses the allocation model developed for the SI Review.

34. In the alternative to the allocation method proposed, SIAV prefers a partitioned approach between insured and self insured that allows full use of the considerable and reliable information available about the relatively small group of self insurers, rather than crude industry ratings applicable in large employer populations. SIAV submits that this approach is more efficient and more equitable.

35. SIAV opposes the principle of **proportionality** as little more than a restatement of the current regulatory model which SIAV is advised is seriously flawed. The principle should be disregarded by the ESC.

36. As a regulator, the VWA ought to be subject to the same rigours and disciplines that apply to best practice regulation elsewhere. This includes the gate-keeping framework of Regulatory Impact Statements (RIS) and Business Impact Assessments (BIA). The paramount status of safety and human lives is beyond question but it does not justify spending without explicit justification and accountability.

37. The contributions issue is a major issue with a long history. SIAV believes that the principles will apply for a considerable regulatory period of three to five years – say 2003 to 2011 with some back adjustment. In the future SIAV will table this promoted approach to other associations and at a national level. It is appropriate to carefully develop principles in the full context of the issues and allow time for measured consideration.

1. Expectations & Context

1.1 This submission is made by the Self insurers Association of Victoria (SIAV) in response to the discussion paper issued by the Essential Services Commission (ESC) on 23 December 2005.

1.2 SIAV welcomes the opportunity for independent appraisal of the methodology and level of charges imposed by the Victorian WorkCover Authority (**VWA**) on self insurer.

1.3 The SIAV sees this review as an opportunity to provide a solid foundation for efficient regulation for the near future as well as resolving the current dispute. As an integral part of this process, we expect the ESC to provide a clear statement of principles and outcomes that will be in place for a defined regulatory period of, say, 5 years. These principles will set the framework for the subsequent review and further updates.

1.4 This dispute has a long history, with its origin back to at least 1999.

1.5 An important element defining this review is that the Review is being conducted under section 10 of the *Essential Services Commission Act 2001*, rather regulation than 10A or 10B. Section 10 defines the broad functions of the ESC while section 10A and 10B provide specific guidance for reviews of the insurance industry and statutory insurers, respectively. The implication is that the general principles and processes applicable to the regulation of the prices and charges of any GBE apply.

1.6 In addition, there is a fundamental question that sits above the overall regulatory questions of pricing principles and efficient regulation. SIAV considers that the approach of the VWA to establish appropriate guiding principles does not constitute a user-pays system but a form of taxation and is therefore outside legislative power. SIAV supports an appropriate regulatory framework that incorporates legally supported pricing principles.

THE SIAV SUBMISSION

1.7 SIAV submits that the charges to self insurers should be determined as follows:

A two-step process of:

- determining the size of the pool of efficient costs attributable to self insurers; and
- allocating this cost pool across individual self insurers according to efficient tariff/cost allocation principles.

A cost-pool which is;

- necessary & efficient, and includes
- direct measures not proxies wherever possible.

A tariff/cost allocation that includes

- audit & endorsement of SIAV principles, and

- acceptance of SIAV preferred cost allocation between members

1.8 The majority of SIAV members have agreed with the principles of cost allocation and their application as described below and as previously developed by SIAV advisors.

1.9 Principles of tariff structure/cost allocation adopted can, subject to review by the ESC, be endorsed. If so, the question of allocation can be settled and removed as an active issue in the ESC process.

1.10 <u>Alternatively</u>, SIAV proposes assisting the ESC undertaking a full evidence study similar to incidence studies in other tariff/cost allocation reviews.

PROCESS TO DATE

1.11 SIAV first made submissions on this issue in 1998, following the proposed introduction of a regulation that was to become the *Accident Compensation (Self insurer's Contributions) Regulations 2001*. The effect of that regulation was to change the recognised status of the contribution fee from user-pay to a charge tied to the rises and falls in VWA expenditure since that date. SIAV has consistently argued against the change with various successes in achieving commitments by the Victorian Government and the VWA to review the status and level of the contribution. However, SIAV is of the view that the half decade delay is both inexcusable and unfairly lucrative for the VWA.

1.12 A snapshot of file reasons for delay provided to the Chairman of the VWA in 2002 showed the nature of the types of delay that have mostly continued to the present time. If the regulation is indeed invalid, then significant amounts have been paid over a period of time. Similarly, if VWA can justify its higher rates, the potential for retrospective payments is problematic for SIAV members and the VWA will have been disadvantaged over a period of time. The latter position is difficult to credit given delays to date were mostly of the VWA's making.

1.13 This is a long-standing issue with delays over some 6 years towards resolution. SIAV suggests that the ESC also consider the past costs of delay to self insurers in making their determination.

SELF INSURANCE REVIEW

1.14 In its examination of these issues, a regulator may take account of previous reviews. In the case of the current review, the earlier Self Insurance Review (**SI Review**) was conducted wholly under the auspices of the Victorian WorkCover Authority. SIAV has previously voiced its concern that the VWA was taking on both roles – that of regulator as well as that of insurer. Specifically in the course of the Review, SIAV raised the issue of the VWA making any sort of determination in relation to the contribution fee and on the extent of regulation that might be needed that would directly influence the level of funding required to finance the regulation. The referral to an independent expert third party is well overdue and welcomed by SIAV.

1.15 However, the SI Review should not be considered as authoritative in dealing with this issue. The Review was notable in failing to discuss any economic or legal principles that might guide the setting of the contribution fee.

OTHER REVIEWS

1.16 The issue of SIAV contributions was also raised in the context of the Productivity Commission's 2004 inquiry into *National Workers' Compensation and Occupational Health and Safety Frameworks*. See [2.5] below.

TERMS OF REFERENCE AND THE LEGISLATIVE FRAMEWORK

1.17 The Minister's Terms of Reference to the ESC should also be examined against the legislative framework. They indicate that the 'individual' contributions of self insurers need to be examined. SIAV is of the view that this presupposes the same approach used in the regulation under contention. SIAV's advice indicates that the legislation does not validate this type of approach – in fact the regulatory approach is outside the power given in the legislation to make the regulations. See [8.14]

HOW THE ESC TERMS OF REFERENCE AND RELEVANT LEGISLATION SHOULD BE UNDERSTOOD

1.18 Before turning to specific issues, comments on the Terms of Reference and the appropriate exercise of powers should be made. The Minister's letter indicates that the Terms of Reference are referred under S10 of the ESC legislation. This is a general reference power and our understanding is that it applies to pricing matters. For these references, the ESC is required to consider both its own principles of efficiency and objectives for the reference *together with* (our emphasis) the relevant statutory framework. In this case that is the *Accident Compensation Act 1985,* which specifically sets out objectives for the workers compensation scheme and the operation of the VWA as a regulator. These objectives are not inconsistent with the objectives of the ESC governing legislation. Amongst other matters the VWA must manage;

> *as effectively and efficiently and economically as possible (Para 19(a)).*

1.19 However, regard should also be paid to the relevant sections of the legislation dealing with self insurers and the contribution fee. These are discussed below. See [8.6

HOW TO READ THIS SUBMISSION

1.20 This remainder of the submission is organised as follows. Chapter 2 describes SIAV and gives some background on self insurers in Victoria. Chapter 3 discusses self insurance and in particular dispels myths that have consistently confused policy debates around self insurance. Chapter 4 looks at the role of the VWA as both regulator and insurer and how this impacts on the contribution fee.

1.21 Chapter 5 deals with the derivation of the cost pool. Chapter 6 deals with the tariff and how it should be attributed to the self insurance and should be allocated across individual self insurers and explains that self insurers should only compensate for necessary and efficient costs

1.22 Chapter 7 addresses outstanding questions and assertions raised by the ESC discussion paper including a discussion of the principles raised.

1.23 Chapter 8 reflects legal opinion that the VWA is subject to efficiency objectives and that parity does not mean automatic application of the remuneration as an apportionment mechanism.

1.24 An index shows where in this submission, specific questions and matters arising are discussed. ESC references are given in the order in which they appear in the ESC Issues Paper.

2. About SIAV and its Members

2.1 The Self insurers Association of Victoria (SIAV) represents all self insurers under the Victorian WorkCover Scheme with employees of members comprising approximately 10% of all remuneration in Victoria. While the total remuneration has grown in the past decade, the proportion of self insurance has remained much the same.[3]

2.2 Members estimate that they sub-contract a further 6% of the insured remuneration pool. SIAV members impose their OHS and workplace requirements on their sub-contractors, meaning that the self insurance compliance and safety standards impact at least 16 % of remunerated employees in Victoria.

2.3 Members are drawn mainly from Top 100 companies and approximately, one third are self insured in other Australian jurisdictions with others either insured under other workers compensation schemes or confined to operations in Victoria. A number operate internationally. Self insurers are in the majority of industry sectors, with several managing around one third of the state's major hazard sites.

AN ACTIVE ASSOCIATION

2.4 SIAV has been in place for some 15 years as a registered association. It has a history of working cooperatively with WorkCover, is represented on the Ministerial Advisory Committee and has recently been appointed to a new tri-partite committee established by WorkCover following the Self Insurance Review.[4] Injury Management & Claims and Safety Sub-committees of the SIAV meet monthly with WorkCover staff including staff from the Self Insurance Unit of WorkCover and inspectors from WorkSafe.

2.5 SIAV is active in the National Council of Self insurers (**NCSI**), a body representing self insurers associations in each Australian jurisdiction. NCSI is currently lodging submissions to the newly established Australian Safety and Compensation Council on issues of national consistency – all such initiatives are supported by SIAV.[5] Both organisations lodged submissions on matters including the calculation of contribution fees and levies to the Productivity Commission's Review *of Worker Compensation Frameworks in Australia 2003*.[6]

2.6 A further example of SIAV input to policy issues is the review of performance indicators currently being conducted by the VWA.

[3] Members estimate that they sub-contract a further 6% of the insured remuneration pool. SIAV members impose their OHS and workplace requirements on their sub-contractors.

[4] The WorkCover Advisory Committee is a statutory body established under the *Accident Compensation Act 1985*. The new tri-partite committee includes representatives from WorkCover and unions.

[5] See http://www.ascc.gov.au/NewsAndWhatsNew/Homepage_News/ASCC_Established.asp

[6] See http://www.pc.gov.au/inquiry/workerscomp/subs/sublist.html Submissions 72 & 107 respectively.

2.7 Victorian self insurers invest heavily in safety and claims management practices that have a cascading effect on insured employers in Victoria.[7] A pertinent example is the major retailer that negotiated smaller, easier to handle, box sizes with a ubiquitous soft drink supplier. This had the effect of slowing the rate of back injuries for their own staff and contractors as well as presumably for all corner-shop owners across the state. (Sprains and strains are a major cause of injury for all employers.) [See Attachment B for further examples].

BOX 1 – EXAMPLE OF SELF INSURER INFLUENCE ON STATE-WIDE SAFETY

Large retailer'

'Contractors must meet Safety MAP requirements before we will use them on our sites. We have held Safety Training Courses with our Contractors to ensure they fully understand the Safety MAP requirements. Our aim in doing this is to improve the safety of our contractors and therefore the safety of our staff and customers.'

'We have influenced suppliers to package goods in weights that are in keeping with safe lifting practices. E.g. Dog food and soft drink. We have also influenced suppliers in the glue they used between cartons when stacking stock for transport.'

2.8 In a similar way to VWA preventative programs, self insurance initiatives and behaviour have external benefits beyond the self insurers themselves since the reforms flow-on to insured employers, which lowers injury death and associated costs amongst insured employers.

[7] See SUBMISSION Regulatory Impact Statement - Accident Compensation Regulations 2000 Self insurers Association of Victoria Inc. January 2001 (Available in previous submissions material provided with this submission). January 2001

3. About Self insurance

3.1 By definition, self insurers carry their own risk. They do not shift their risk by entering into contracts with a workers compensation scheme. From an economic perspective, self insurance is the most direct method of dealing with risk.[8]

COMPARISON OF INCENTIVES - SELF INSURERS AND INSURED EMPLOYERS

3.2 For self insurers, incentives to reduce workplace accidents are immediate. First the costs are entirely carried by the company, and second

3.3 The benefits of self insurance include being able to better control workplace practices, injury and death; as well as clear costs to reputation; and to leverage the benefits of 'learning by doing' and economies of scale. While a workers compensation agency may know more about health and safety than small and medium size firms, larger firms will have the benefit of many years of experience often with detailed knowledge for its industry or the capacity to purchase professional assistance and, or international experience. Such firms are also likely to have better insights into return to work strategies and to manage their workplace health and safety issues well.

3.4 Despite the strong fundamental incentives for better outcomes there are a number of myths about self insurance. These are that:

- the incentives in self insurance are not to protect the worker but to withhold funds,
- self insurers are under less scrutiny than comparable large insured employers, and that
- self insurers are poorer performers in terms of workplace safety and compensation and rehabilitation of injured workers.

3.5 None of these statements is correct.

3.6 SIAV considers that clarity on the realities of self insurance incentives, scrutiny and performance, is directly relevant to devising a better rationale for a contribution fee. Each of these and the myths associated with them are discussed below.

DISPELLING MYTHS ABOUT SELF INSURANCE

3.7 **The first myth** is that the move to self insurance is purely a financial decision. However, the decision to move to self insurance is based on powerful drivers evident in Victoria and elsewhere and be made for a variety of reasons. If employers are of

[8] In comparison with self insurance, any other type of insurance offered by an insurer suffers from adverse selection and moral hazard. Insurers overcome these problems through a combination of underwriting, policy terms & conditions, experience based premiums, regulation and changing the culture. The VWA on behalf of the State for example, applies offsets to fetter the moral hazard of the insured employer – industry rates and experience ratings. They are crude approximations of the full impact of the actual risk. In contrast, self insurance avoids these contractual limitations entirely as there is no contract with an insurer and the relevant costs are internalised.

sufficient size, they can spread the risk similarly to a state sanctioned workers compensation insurer. Most importantly, (and particularly in the hybrid workers compensation scheme in Victoria, which out sources claims management to third party administrators), self insurance provides strong and direct control over human resource management, safety and prevention. It also allows participation in other identified benefits.

3.8 Fry and Harris (2002) reviewed the Victorian experience and noted that:

- *Most self insured employers can point to a history of financial savings as a result of their decision to self insure.*
- *Other benefits of self insurance relate to a capacity to have better control and management of claims decision making, resulting in significantly lower claims sizes.*
- *Self insurers are also able to achieve a clearer understanding of their liabilities and avoid some of the volatility that has affected employers in the premium paying system in the past.*
- *Self insurers appreciate the direct impact of claims costs on their financial position, which usually provides a strong incentive for improving systems and performance*[9].

3.9 In summary, self insurance provides a better opportunity to improve the financial performance of the firm, through a variety of measures including optimum human resource management.

3.10 However, it also follows that VWA as a regulator ought to have less to do for self insurers than for insured employers because of the incentives described.

SELF INSURANCE AND SCRUTINY

3.11 **The second myth** about self insurance is that self insurers are under less scrutiny than comparable insured employers. SIAV members currently complete significant numbers of returns and respond to regular requests for information as well as an array of audits SIAV lodged a submission making proposals for more streamlined measures in late January of this year.[10]

3.12 SIAV members also believe that they have been subject at different times to a disproportionate number of WorkSafe inspections.

3.13 Most if not all self insurers are unionised or are the subject of union-based interventions and scrutiny. SIAV estimates that the 39 members account for a large proportion of the

[9] *Comparative Performance of Workers Compensation Self insurers with Insured Scheme Performance* Paper to the Australian Institute of Actuaries' 1Xth Accident Compensation Seminar Fry, M and Harris, P Adelaide 2002

[10] See Attached Materials – SIAV – Performance Indicators Position Paper. Other current self insurer initiatives by WorkCover include the introduction of self insurer actuarial peer review processes. SIAV understands that the VWA Board will consider performance indicator recommendations made by internal staff in April.

unionised work force in Victoria. Individual self insurers are therefore subject to active scrutiny and intervention by union representatives and organisers.

3.14 If the union movement comments on private sector practices then simply by the weight of numbers, there will be a disproportionate focus on self insurers.

SELF INSURANCE SAFETY & CLAIMS PERFORMANCE

3.15 The third myth is perhaps the most contentious and relates to self insurer performance in safety and claims and rehabilitation management. There is little empirical evidence on the performance of self insurers compared with large self insured employers. Members who have moved to self insurance in the past decade or so unanimously report improved claim rates, lower long-term claims results and fewer safety failure events in the time after self insurance.

3.16 **For safety**, SIAV notes that all self insurers must annually perform **SafetyMap** audits for selected sites to Version 4 of **SafetyMap**, which cannot be said of all of the population of large insured employers in Victoria.[11] Members have indicated improved safety outcomes after moving from insured to self insured status.

3.17 In addition, recent commentary at federal level insists that self insurance does produce better outcomes for workers and for employers.[12]

3.18 **For claims**, a VWA study prepared for the draft report of the SI Review asserted poorer results for self insurers than large insured employers, particularly in claims costs and frequency.[13] The data was re-analysed by SIAV's actuary, Julie Evans Consulting, and found to be distorted by growth in the number of self insurers and failed to appropriately consider the longer term outcomes and to make use of samples that were not comparable.[14] The findings from SIAV's actuary, (also provided to the SI Review), were that a more accurate interpretation of the data required segment analysis and analysing results over an appropriate term.

3.19 The sharply different interpretations which emerged are compared below.

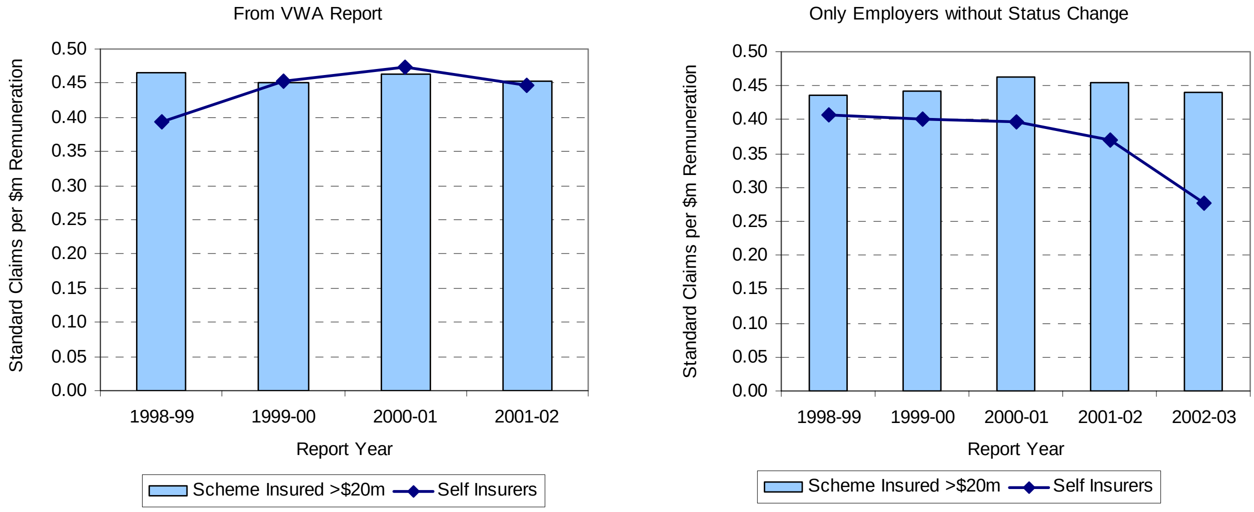
[11] SafetyMap is WorkSafe's safety quality management tool. See http://www.workcover.vic.gov.au/vwa/home.nsf/pages/so_safetymap_intro for the list of Victorian companies certified for SafetyMap. Self insurers must be certified as a condition of their licenses.

[12] Bill Scales, at the SIAV annual dinner – 6 December 2005, Deputy Chair of the newly established Australian Safety and Compensation Council http://www.ascc.gov.au/NewsAndWhatsNew/Homepage_News/ASCC_Established.asp
http://www.ascc.gov.au/NewsAndWhatsNew/Homepage_News/ASCC_Established.asp

[13] See SI Review – www.workcover.vic.gov.au/vwa/home.nsf/pages/SelfInsurers_review/$file/Campbell_Report.pdf

[14] The analysis was undertaken by SIAV actuary, Julie Evans Consulting and submitted as a supplementary paper to the SI Review. The full paper may be found on the VWA website at http://www.workcover.vic.gov.au/vwa/home.nsf/pages/SelfInsurers_review_submissions/$file/siav_draft_response_supplement.pdf

FIGURE 1 – COMPARISON OF VWA & SIAV CLAIM FREQUENCY RATE (EXTRACT)



There are several observations from the comparison of the two charts:

- *the increase in the self insurer claim frequency rate in 1999-00 and 2000-01 (shown in the VWA Report) reflects the addition of new self insurer, rather than deteriorating experience of the existing group from 1999-2000.*
- *the combined claim frequency rate of the 27 self insurers who were self insured throughout the period is superior to the large insured employers, with the gap between the two groups widening during the five year period*
- *the additional year of data shows a marked improvement in the claim frequency rate reported for self insurer, however the accuracy fo this data is still to be confirmed.*[15].

3.20 SIAV's actuary also provided support for the view that a longer term analysis of claims patterns would show a decline in claims frequency for self insurers. Members suggest this is due to an increased focus on safety requirements brought about by the move to self insurance. Various members that have made the move in the past decade attest to this impact.

3.21 **For claims costs**, Fry & Harris (2002), using robust comparisons, found that the payments per $ million of remuneration for self insurers were between 60% and 74% of the corresponding payments for the insured scheme. Gross incurred claims costs showed a difference of 0.3% - between 2.6% for insured employers and 2.3% for self insurers. The results were 'consistent with earlier papers indicating self insurer costs between 66% and 75% of corresponding insured costs.[16] The authors concluded;

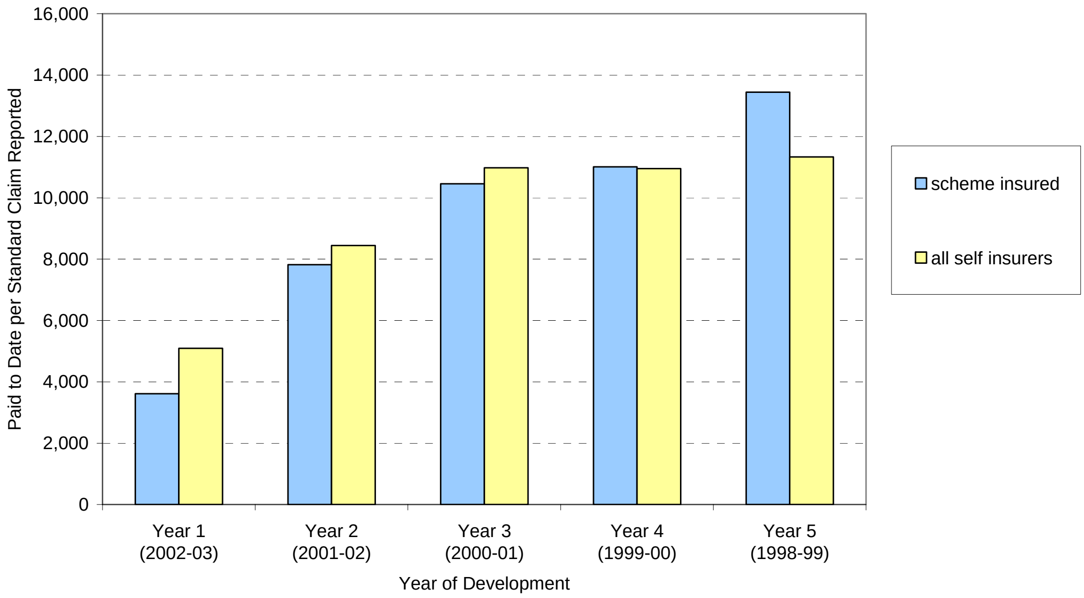
[15] See above p 4. Note the cautions expressed by the author, namely that VWA data for 2002/03 had been provided but had not been verified at the time of production of the comparison; and that the samples were adjusted to provide clearer comparisons.

[16] See above p 5

> *The primary conclusion from this significant difference in claims size is that it demonstrates the tighter claims and injury management activities and superior Return to Work outcomes obtained by self insurers.*[17]

3.22 The analysis described above and undertaken by SIAV's actuary further supported these conclusions. The chart below shows payment patterns extracted from the study data comparing VWA large insured employers, (scheme insured) and self insurer. (Note: Please refer to the source document for an explanation of the assumptions underlying the analysis[18]).

FIGURE 2 – POSSIBLE DIFFERENCES IN PAYMENT PATTERN (EXTRACT)



> *With this interpretation of the data, the chart suggests that self insurers pay more, on average, in the first year of development, but relatively small payments are made beyond year 3 or 4 (the columns for years 3, 4 and 5 are much the same height). For the insured employers, the chart suggests the payments start at a relatively low level, but have a heavier tail.*
>
> *If this interpretation is sound, it implies that re-running the comparison that the VWA uses in its report after another five years (so with all payments to Jun-08) would show the line for the scheme insured sitting noticeably above the line for the self insured. This emphasises the point made earlier about the potential for misleading results from a payments comparison over a relatively short space of time, particularly where there are differences in the pattern of payments over time.*[19]

[17] See above p 3
[18] See above ref 14
[19] Julie Evans Consulting p9 See above. Note: This is a reinterpretation of VWA data used in the SI Review and the cautions expressed in the paper on p 9 should be noted.

3.23 In summary, it can be seen that while self insurers do report fewer claims and may pay less in overall claims costs, they have good reasons to do so. In fact, best practice indicates that the timing of expenditure rather than the extent of expenditure drives results. For instance, members indicate that they will typically spend more on medicals and associated treatment costs at the start of the claim with a focus on early intervention and return to work. Accordingly, members generally have shorter claims and avoid the costs of ‘long tails’ evident in workers compensation schemes.

3.24 Overall these findings show that the predicted economic incentives are largely operating effectively. A sensible discussion of the costs that self insurers may contribute to should now be considered in view not only of the roles and functions of self insurance but also of the VWA. This is discussed in the next section.

4. Relationships and Responsibilities of VWA to Self insurance

FUNCTIONAL ANALYSIS OF VWA &SELF INSURERS

4.1 The VWA combines under one roof the functions of an insurer, a safety regulator, and an insurance regulator. The prime functions are:

a) operating the insurance fund including managing the agents (insurance operations);
b) protecting and enhancing workers safety through inspection, education and awareness and through the regulation of occupational health and safety,(protection & OH&S regulation);
c) regulating the insurance activities of self insurance (insurance regulation); and
d) funding necessary support services such as dispute resolution (administration).[20]

4.2 VWA is both a regulator and an insurer. It is therefore the regulator of its competitors, the self insurers. The failure to separate the two roles means that major disciplines are required to prevent cross contamination. For instance, VWA's input-focussed supervision of its agents, while justified from their role as insurer, should not be transferred to its regulation of the claims management and rehabilitation of self insured employers. Rather as a regulator, VWA should observe best regulatory practices.

4.3 The VWA should not confuse its role as a regulator with that of an insurer; including as a provider of last resort in the event of a failure of a self insurer. The latter consideration is regulated via bank guarantees and regular actuarial and other audit processes. Risk as defined in an insurer context should not be automatically included as a consideration in regulating self insurance. If risk levels are relevant to determining the cost levels of regulation, then these elements must be demonstrated afresh.

4.4 Under clause 4(2) of the Competition Principles Agreement, Victoria and all of the governments in Australia agreed that:

> *Before the party introduces competition to a sector traditionally supplied by the public monopoly it will remove from the public monopoly responsibilities for industry regulation*

and consistent with the principle of competitive neutrality,

> *the party will relocate industry regulations functions so as to prevent the former monopoly enjoying a regulatory advantage over its (existing and potential) rivals*

and under Section 4 (3)(d) review,

> *the most effective means of separating regulatory functions from commercial functions of the public monopoly*

[20] Note; this term is used technically in workers compensation literature to describe dispute resolution costs, levy or premium setting, and governance costs. It generally excludes the costs of managing insurance funds and prevention. See for instance any of the 'administrative inventories' published by the Worker Compensation Research Institute a non-profit body in the US http://www.wcrinet.org/recent_pub.html

4.5 Structural separation of various functions is the most direct and complete method of achieving the separation and may be observed in other sectors subject to National Competition Policy (NCP) agreements including those relating to electricity and water. They require either ownership, legal or accounting separation of monopoly and competitive functions. The most stringent application of the agreement requires varying degrees of legal separation. A weaker but nonetheless useful separation applies to the keeping of financial records. For instance in the case of electricity,

> *the functions should be ring-fenced and separately accounted for*[21]

4.6 There does not seem to be any reason why the VWA is not required to 'ring-fence' accounting for each of its functions – insurance operations and insurance regulation, as has been done in overseas jurisdictions and in Australia in schemes such as Comcare. More recently, Queensland split the regulatory roles and claims management roles into separate organisations, Q-COMP and WorkCover Queensland.[22]

4.7 The extent and nature of costs should be transparent. VWA should be required to use separate and detailed charts of accounts, (or equivalent accounting techniques) to ensure that each function is appropriately costed.

4.8 Self insurance clearly falls within insurance regulation. As recognised by the *Accident Compensation Act 1985,* it does not fall within insurance operations. Furthermore, as with all costs incurred by the VWA, the costs associated with insurance regulation fall within the definitions of economic efficiency also proscribed by the legislation. See [1.18] above.

4.9 <u>It follows that</u>, in establishing the contribution fee, the first task is therefore to determine what parts of the total pool of costs covering all of VWAs activities are **necessary and efficient**. The second task is to establish which of these are attributable to self insurer, and the third is to ensure that the pool of costs attributed to self insurance is distributed efficiently and equitably across self insurer.

4.10 The next section deals how the tasks detailed above might be achieved and the economic framework and principles that should be applied.

[21] Department of Electricity Reform Section 3(iii)
[22] See http://www.workcover.qld.gov.au/AboutWorkCover/Organi644ucture.html

5. Determining the Cost Pool

5.1 SIAV submits that two overarching principles should apply to establish to the charges applicable to self insurer. These are that:

- costs should be necessary and efficient; and
- cost allocations should be based on direct measurers rather than proxies wherever relevant direct information is available.

5.2 Application of the first principle requires scrutiny of both:

- VWA's expenditures and effort directly focussed on self insurer; and
- the scope and level of the overhead activity and costs incurred.

5.3 On the face of it, it is unlikely that all of VWA's costs are necessary and efficient. As noted by the ESC, in its insurance functions VWA is a monopoly and is not subject to competitive pressures.

> *the following matters that may have material implications for future premiums that were not addressed by the current reference: … the efficiency of the VWA's program operations and expenses; and …the implications of any cross-subsidies.*[23]
>
> *Under this and the previous review the claims administration expenses and the expenses of the VWA have not been assessed to determine whether the expenses represent efficient costs of operating and managing the scheme. The expenses have only been checked for their reasonableness in terms of the historical cost of the scheme.*[24]

5.4 Further, as a regulator VWA, in relation to self insurer:

- has not been subject to strong accountability for its regulatory actions or expenditures;
- has not been subject to the degree of scrutiny now envisaged by Premier Bracks and COAG [See below at 5.9] required to demonstrate that its costs are either necessary or efficient.

5.5 There are two broad questions:

- What are the efficient costs in total and how do these differ from observed costs?
- What portions of the different components of efficient costs should be attributed to self insurer?

5.6 SIAV has already addressed the second question and proposed an activity-based costing approach which uses direct measures wherever possible. However the first issue has not been addressed.

5.7 When that efficiency review is completed, the pool of efficient costs attributable to self insurers can be adjusted. However, SIAV strongly supports ESC's previous comments

[23] Essential Services Commission (2005), *Review of 2005-06 WorkCover Average Premium Rate*, p.2.
[24] See above p.27.

and request for a broader reference from the Minister to review the efficiency of VWA's costs.

ENSURING EFFICIENT COSTS

5.8 To ensure that VWA's costs are efficient and remain so, all VWA regulation and associated regulatory effort should be subject of a regulatory plan which sets out:

- purpose & need for regulatory action;
- actions that are envisaged or required;
- Key Performance Indicator measures by which performance & success of actions will be judged; and
- comparisons of benefits and costs to those regulated as well as for the VWA.

5.9 This approach is consistent with and advances the Victorian Premier's regulatory efficiency initiative (The Third Wave) and the February 2006 COAG initiative.[25]

5.10 Since there has been little or no scrutiny of the necessity and efficiency of VWA's costs for either its insurance function or its regulatory functions, the existing costs should be recognised as being inflated. As a result, any attribution of costs across insured and self insured will reflect this inflated base. This is separate from the significant variation in attribution that can and has occurred. The significance of this latter disparity is indicated. For instance, for the 2003 year where VWA has contended that the cost pool attributable to the self insurers is $15.6 million, while SIAV estimates that the appropriate figure is only $7.6 million. However, neither of these cost estimates have any basis of confidence that the expenditures to which they relate are necessary and efficient.

5.11 For now, SIAV submits that estimates of the total pool of VWA costs should be recognised as being inflated, albeit to an unknown degree. Effectively, this is where the ESC should exercise judgement.[26]

SEPARATION OF OVERSIGHT AND EFFICIENT PRICING

5.12 Even with direct activity based costing there will always remain the question of how to treat the unallocated common costs. A useful economic principle here is the principle that efficiency requires that no recipient of services should pay more than if the services were provided to them alone and that they should definitely pay no less than the actual cost of delivery.

[25] SIAV supports this initiative and notes that it follows recent 'regulatory efficiency' initiatives in the UK and canvassed more recently at federal level. (See Australian Financial Review 24 February 2006 *Fewer Regulations but more effectivep*) Based on Dutch reforms, the key aspects are that:the costs to business of any new regulation must first be costed against standardised costing models before implementation, and an independent body audits the proposals and vetos if the costs are presumably not justified.

[26] SIAV notes VWA submission of 14 February on major hazard fees – these should be included in the pool and allocated via the allocation model which includes major hazard recognition.

5.13 This principle was developed by Baumol and separately by Faulhaber.[27] The application to the current situation is as follows.

5.14 The oversight of the safety performance of insured employers and self insured employers involves substantial common costs. The economies of scale involved make it sensible that this oversight be undertaken by the one agency. However as a matter of principle the function of safety performance oversight could be separated and undertaken by different agencies – one for self insurers and one for insured employers. The concept of such a separation illustrates the wide band of cost allocations which are consistent with economic efficiency so long as both self insurers and insured employers meet their respective incremental costs.[28] Then, as noted by Baumol, efficiency would be satisfied:

- if, self insured employers were charged the incremental cost only, leaving the insured employers to pay their incremental costs plus all overheads; or
- if self insured employers were charged their incremental costs plus all overheads that would be necessary to service the self insurer, leaving insured employers to pay their incremental costs only (and any remaining overheads); or
- anywhere in the band between these two extremes.

5.15 The existence of this efficient range would cause problems were regulation provided competitively. If there were competitive regulators an extreme allocation could be immediately rejected by one party shifting to another regulator.

5.16 Examining the proposed allocations, both the cost pool proposed by the VWA and the cost pool proposed by SIAV fit within the efficient range and meet the requirements for static efficiency.

5.17 On the other hand, efficiency must be met in a dynamic context. Not only should the cost pool attributed to self insurance be efficient in a static sense but it must also meet the incentives requirement for optimal dynamic decisions into the future.

5.18 It is relevant here, that self insurance with its better structure of incentives, and that it drives innovation and best practice with which sub-contractors of self insurance and employers must comply. The better practice employed by self insurers flows through to insured employers. The methods may then be taken as examples by the VWA. Thus because self insurance provides these positive externalities for the insured, as noted by Pigou[29], self insurers should, from an efficiency perspective, pay less than their

[27] That is, to promote the efficient allocation of resources (in the absence of externalities), prices should be set no lower than incremental cost of supplying a customer and no more than the cost of supplying that customer alone (by-pass price). See Baumol, WJ and Bradford, DF (1970) "Optimal Departures from Marginal Cost pricing", *American Economic Review*, Vol 60 No 3, pp. 265-283, which promotes the use of Ramsey pricing. Faulhaber GR (1975) "Cross-subsidization: Pricing in Public Enterprises" *American Economic Review*, Vol 65 No 5) pp. 966-977 highlights the standalone or by-pass bound (described as subsidy free).

[28] 'Incremental costs' are simply the increase in common costs arising from inclusion of the self insured employers in the group of employers to which oversight is to apply (that is, the increment in total cost of oversight if costs are already incurred in oversight of the insured group). Stand alone costs are the cost that would apply if an oversight process was set up solely for the group of self insured employers with no possibility of sharing costs with other insured employers.

[29] See Pigou, AC (1946) *The Economics of Welfare*, 4th edition

incremental costs of regulatory oversight. That is, economic efficiency suggests that self insured employers as a group should pay less rather than more of their attributable costs.

COST POOL ATTRIBUTABLE TO SELF INSURERS

5.19 The second over-arching principle for determining the cost pool attributable to self insurers is that direct measures should be applied wherever possible, rather than proxies. SIAV's actuarial advisor has sought to apply this principle comprehensively to estimate the cost pool attributable to self insurer. In contrast, VWA's estimate of the cost pool attributable to self insurers relies overwhelmingly on proxy measures, particularly the remuneration ratio. The resulting differences are substantial:

- when direct measures are used, the resulting cost pool for 2003 is \$7.6 million; and
- when proxy measures are used, the resulting cost pool attributable to self insurers for 2003 is \$15.6 million.

5.20 A detailed comparison of the two approaches is provided below.

COMPARATIVE ANALYSIS OF SIAV AND VWA ESTIMATES OF COST POOL

5.21 Any calculation of the costs to be met by self insurers uses two inputs: the costs for items of administration and the proportion of these costs that will be recovered from self insurer. With regard to the second element, there are three main methods used to determine the proportion allocated:

- **direct cost drivers**: the costs associated with a particular activity can be linked to usage or similar concept that is disaggregated across users. Under the VWA approach, only 17% of all allocated costs are linked to direct cost drivers. In contrast, SIAV's actuary was able to use VWA information to link 47% of allocated costs to direct services;

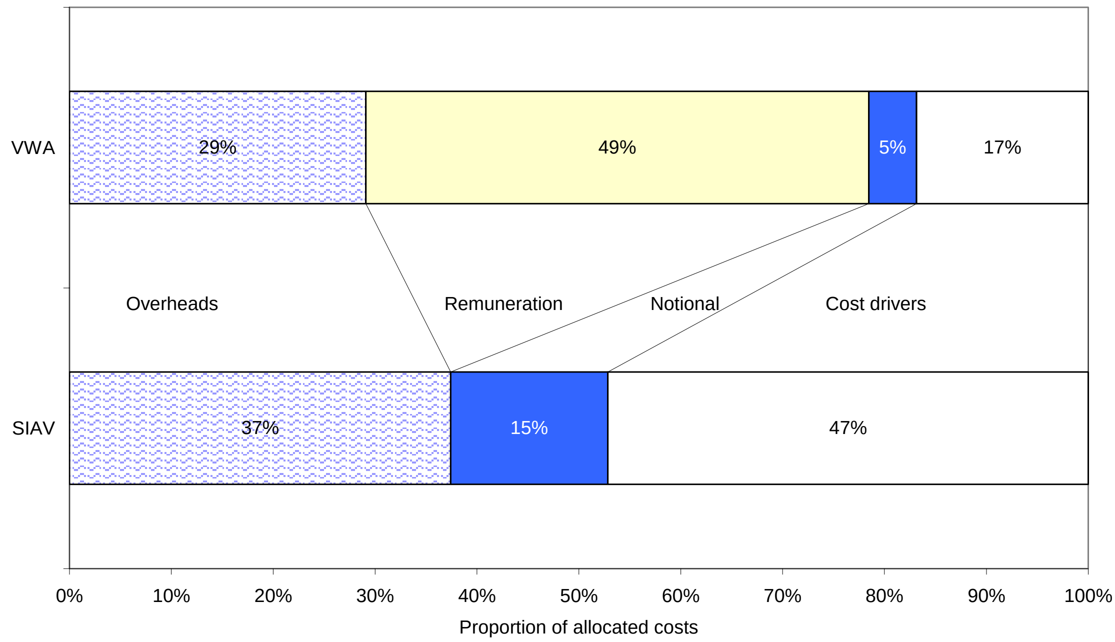
- **notional**: in these cases there is no direct link between a measurable usage figure for users and the costs. The costs are allocated according to judgements of the benefits derived between users. In the VWA case, this is predominantly linked to **remuneration** share; and

- **overheads**: these items are not linked to usage nor can benefits be reasonably split. In these cases, both the SIAV and VWA set the cost allocation based on the weighted average cost allocation for the two methods above.

5.22 As shown in the chart below, the SIAV actuary was able to identify an additional 30% of allocated costs (47% compared with 17%), which could be directly allocated by relevant cost drivers, i.e., an activity based costing system. Overall, the SIAV actuary could see no reason to link any costs with remuneration, and in only one case was a cost allocation partially linked to remuneration. Therefore whereas almost half (49%) of total costs allocated to self insurers by VWA was made on the basis of remuneration share, this proportion was zero for the SIAV.

5.23 In addition, the SIAV actuary considered the benefits from a number of services to be lower than that allocated by VWA, reducing the overall proportion of 'Notional' costs from 15% to 5%.

FIGURE 3 – COMPARISON OF VWA & SIAV ESTIMATES



5.24 As overhead costs are allocated reflecting the allocations based on direct and notional costs, it is important to focus on these two elements. This importance is reflected in the contribution of each to non-overhead costs. For example, while costs allocated by remuneration represents 49% of the total allocated costs under the VWA approach, these represent 70% of non-overhead costs. In the case of the SIAV, while direct costs represent 47% of total allocated costs, they represent 75% of non-overhead costs. That is, the SIAV overall allocation is being predominantly driven by measures of self insurer usage.

5.25 <u>In summary</u> under the VWA approach, around 70% of the allocation of costs to self insurers reflects the ratio of remuneration or self insurers to all employers.[30] This means that self insurers have limited capacity to reduce their payments by enabling more efficient service delivery by the VWA. In contrast under the SIAV's approach, only 25% of the cost allocation is determined by even 'Notional' allocations and none

[30] If 'Notional' allocations are included, this proportion increases to over 75%.

by remuneration share. As a result, efficiencies obtained in delivering services to self insurers are more likely to be passed on in cost savings to the self insurer.

5.26 The important point of principle here is that a direct activity based costing approach to determining the cost pool attributable to self insurer is possible. For 2003 the activity based approach undertaken by SIAV's actuary and based on imperfect information provided by the VWA indicated a figure of $7.6 million or for that year 2.33% of VWA's total costs.

5.27 For the purposes of the ESC's regulatory determination, SIAV submits that these figures need to be confirmed and updated with improved information and that there is a clear basis for doing so. Alternatively, an equitable basis can be negotiated on the existing analysis.

COST POOL – LONGER TERM

5.28 To establish a better base estimate of the efficient and necessary costs of the VWA which can be attributed to self insurer, the VWA should be subject to, and comply with, the same requirements for the imposition of new regulation mooted by the Government and as set out in [5.9]. At a minimum, to ensure VWA accountability these should be:

- Forward Regulatory Plans; and
- justification of any new regulation or program before implementation.

5.29 A feature of the regulatory plan, and a possible difference with the regulatory impact statements, is the external regulatory audits and evaluations performed by an external body with power to veto before and disallow costs later, if it found that costs are not justified.

5.30 These measures should follow and complement the similar comprehensive review of administrative costs along the lines of that already recommended by the ESC for premium payers.

COST POOL – SHORTER TERM

5.31 In the shorter term, SIAV endorses Option Two of the ESC paper, namely that direct, indirect and non self insured costs be drawn from functional groupings within the VWA and with the discipline of an explicit chart of accounts separating the insurance function from the various regulatory functions. Depending upon the period of the ESC's determination, the 2003 based cost pool and the associated ratio (2.33% of VWA's total costs) may be appropriate. If the determination were for one or two years only, then the use of 2002-03 may be appropriate. On the other hand, if the ESC's determination were for, say, 5 years, it would be necessary to update the cost pool estimate and ratio to at least 2004-05.

5.32 In conclusion, SIAV submits that the charges to self insurers should be determined as follows:

A two-step process of:

- determining the size of the pool of efficient costs attributable to self insurers; and
- allocating this cost pool across individual self insurers according to efficient tariff/cost allocation principles.

A cost-pool which is;

- necessary & efficient, and includes
- direct measures not proxies wherever possible.

5.33 The next section discusses tariff/cost allocation.

6. Tariff Structure : Cost allocation between self insurers

ALLOCATION - A TARIFF ISSUE

6.1 VWA's object is to operate as a fully funded entity. As recognised by the Minister's reference to the ESC and the specific use of Section 10 rather than Sections 10A or 10B of the ESC Act, VWA is a Government Business Enterprise (GBE).[31]

6.2 The issues of cost allocation arise because there are very substantial common costs relevant to both insured employers and self insured employers. The allocation of such costs is a frequent problem in the design of tariffs for other infrastructure services and other services.

6.3 Whether conceived as a tariff problem or simply as a cost allocation problem, the issues are the same and apply equally to the division of the cost pool between self insurers. The method of charging should meet the familiar criteria of:

- efficiency;
- equity; and
- simplicity.

6.4 A fourth criteria and discipline is relevant. This is that where possible and appropriate, actuarial concepts and measures may be applied to prevent unnecessary effort in calculation and application.

6.5 On the supply side, efficiency requires that charges cover total costs. On the demand side, efficiency requires that incremental charges reflect incremental costs. This is the familiar marginal cost pricing rule. A reconciliation of these two requirements is a multiple part tariff with incremental charges defined by cost drivers.

6.6 The application of cost drivers is relatively straight forward:

- if costs were driven by the number of inspections then the number of inspections of the sites of each self insurer should be known and a per unit cost charged based on the cost of additional inspections; or
- if the number of inspections for each self insurer were unknowable, but differed systematically between, say, high hazard and other sites, and there were no other charges relating to high hazard sites or self insurer, then high hazard sites could be separated from other sites in terms of deriving an appropriate charge.

6.7 Cost allocation methods and more generally, tariff structures, have the ability to influence behaviour. This ability depends on the size of the price elasticity's and therefore on the materiality of the charges. SIAV acknowledges that the importance of creating a culture more focussed on workplace safety, and therefore supports the use of

[31] VWA status as a GBE is discussed in Attachment B of the SIAV's submission to the SI Review prepared by Marsden Jacob & Associates – *Best Practice Economic & Pricing Principles,* March 2002 See p 2 http://www.workcover.vic.gov.au/vwa/home.nsf/pages/SelfInsurers_review_submissions/$file/Self_Insurers_Association_of_Victoria_Attachment_B.pdf

experience-rating in insurance premiums since the premiums are material for most businesses. For self insurer, however, the materiality of charges levied on them for the regulatory functions of VWA is lower – since the self insurers carry their own claims and claims management costs and implicit premiums. However, risk is relevant where it drives supervisory and inspection costs. As noted above risk should be measured directly unless there are no measures which are direct, readily obtainable and not disputable.

6.8 SIAV proposes that a contribution pool be allocated between individual self insurers, primarily on the basis of VWA's relative oversight effort. The SIAV Allocation Model proposes that:

- self insurers be divided into four groups, each group paying a different proportion of their remuneration, or contribution rate. Group 1 would pay the lowest contribution rate and Group 4 the highest;
- self insurers would be assigned to their respective groups on the basis of whether the self insurer operates a major hazard facility; the ratio of the self insurer's claims liabilities to its remuneration; and level of remuneration.

6.9 SIAV has proposed that the cost pool attributable to self insurers be allocated in the following manner:

- self insurers operating a major hazard facility would automatically pay the highest applicable contributions rate;
- self insurers with a relatively high ratio of claims liabilities to remuneration would pay a higher contribution rate than those with a relatively low ratio of claims liabilities to remuneration; and
- self insurers with a relatively high level of remuneration would pay a lower proportion of remuneration in contribution to the VWA's administrative costs.

6.10 This SIAV allocation model therefore recognises:

- the higher level of inspection and oversight of major hazard facilities compared to other sites;
- the greater level of oversight given to insurers with higher relative levels of claims as indicated by the ratio of their claims liabilities to remuneration. This information is calculated by the actuaries advising the self insurers and therefore is a precise measure of risk for each individual insurer. It avoids the need for - and destroys the relevance of - industry risk classifications; and
- the need for equity between self insurers to ensure that the larger self insurers whose remuneration levels are increased by white collar and executive salaries (for instance in the finance sector), are not unduly penalised.

The use of four categories is an essential simplifying device. It has the further advantage that it promotes fairness, i.e., it avoids the change in method of allocating the cost pool from resulting in big winners and big losers.

6.11 This allocation mechanism differs from that canvassed in the SI Review and that canvassed in the ESC Issues Paper. It differs because it:

- uses Proxies – not direct
- has taken account of hazards
- is not introducing industry rates based on outdated and imperfect concepts

6.12 The concept of industry risk is not applicable in determining any aspect of the contribution fee since there is better and direct information.

6.13 SIAV notes that its approach in developing a tariff structure/cost allocation model is fully consistent with its approach to estimating the cost pool. In both cases the principle is followed that proxies should only be used where there is no direct information relating to cost drivers. In SIAV's approach to cost allocation, risk is acknowledged as a cost driver, albeit a less significant one and is reflected in the ratio of claims costs to remuneration and whilst a relatively 'blunt' measure is established independently and is now subject to actuarial peer review.

6.14 SIAV also notes that the high level principles do not yield precise unique tariff structures or cost allocations. Rather, there is always a range of 'appropriate' options consistent with the principles, and judgements need to be exercised.

6.15 SIAV submits that its actuarial advisor has followed the relevant economic principles for the design of tariff structures and cost allocations. SIAV's actuarial advisor has also examined the incidence of different tariff options across its members.

6.16 SIAV notes that in the event that the ESC can endorse the principles applied by SIAV, then the question of the tariff structure/cost allocation method can be put aside. This would allow the ESC's review to focus on the main issues, i.e., whether VWA's costs are necessary and efficient and the portions of those costs which should be reasonably attributed to the self insurer.

6.17 SIAV does not accept the less rigorous approach taken by the SI Review and suggested as a major option in the ESC Issues Paper. The concerns with these models are discussed in below.

ALTERNATIVES

6.18 In the alternative, the ESC may consider models that provide superior efficiency in terms of workplace safety amongst self insurers. Differences in incentives between small and larger businesses mean that models appropriate for insured employers will not apply for self insurers. The ESC may prefer a partitioned approach between insured and self insured. This:

- allows full use of the considerable and reliable information available about the relatively small group of self insurers (rather than crude industry ratings applicable in large employer populations) and,
- is more efficient and more equitable.

6.19 SIAV prefers a partitioned approach to selecting the model and note that this has not been the approach to date. Again, this is largely a traditional issue. Workers compensation agencies have little choice but to take a non-partitioned approach in allocating costs – they have to try to allocate between all companies with insufficient and imperfect information and therefore must use crude methods. Self insurers have been subsumed into these approaches. However, given the small number of self insurers this approach will overstate the amounts required from individual self insurers and will inevitably be inaccurate.

6.20 SIAV prefers full use of the considerable and reliable information available about self insurers.

6.21 <u>In the alternative and/or in addition</u>, the ESC should conduct further incidence studies and show the 'inefficiency' of the SIAV model. Otherwise, the model should be endorsed.

6.22 In any event, any method should be simple and recognise key drivers and costs imposing on the VWA.

6.23 Importantly, applying the inherent equity in distribution principals in the legislation, there should be no winners and losers. These principles are regularly followed by the ESC.

6.24 The next section provides specific responses to ESC assertions and questions.

7. Specific Responses to ESC Issues Paper

7.1 This chapter is organised to respond to specific assertions and questions in the ESC Issues Paper that have not been covered in the preceding chapters and which are reproduced below. The issues in the order that are addressed are:

- Comparisons of interstate contribution fees [7.3]
- Risk rating as a distribution mechanism compared with remuneration [7.4]
- The appropriate use of risk in the contributions methodology [7.5]
- Problems with risk rating as reliable denominator [7.9]
- ESC review principles [7.21]
- Detailed pool methodology potential and categorisation of costs [7.32]

SI 'RISK RATING' BETTER THAN REMUNERATION

> *In relation to self insurer contributions, the VWA found that the average contribution rate paid by self insurers in Victoria is within the* ***broad range*** *of that paid in other Australian jurisdictions. However, the VWA also noted that its current method of allocating self insurer contributions is based upon a self insurer's share of total remuneration, whereas in other jurisdictions, self insurer contributions are distributed according to their* ***relative risk rating****.*[32]

7.2 Two points need to be clarified here. The first is the correct comparison of the contribution fee for Victoria. SIAV has queried members over the view expressed by the ESC that the contribution fee falls within the

> *broad range of other jurisdictions.*

7.3 The best that can be said is that the range must indeed be broad. Some comments are provided below.

BOX 2 NATIONAL MEMBERS VIEWS OF COMPARATIVE CONTRIBUTION FEES

> National members indicated disparities between contributions paid in different jurisdictions – the overwhelming concern was one of lack of rationale behind the fees.
>
> One of the largest employers in Australia indicated that while fees might be similar between two of the bigger jurisdictions and Victoria; twice as many people were employed in the other state.
>
> Another indicated lower fees in Victoria but no real justification for the higher fees elsewhere.

7.4 The second point is that risk rating need to be considered in context.

[32] Extracted from ESC Issues Paper Section 3.3 Page 10

REFLECTING RISK IN THE CONTRIBUTIONS METHODOLOGY.

7.5 Section 5.3.3 (and others) of the ESC Issues Paper discuss the use of risk in the contributions methodology. SIAV assumes that this is in response to the third principle recommended by the VWA, namely:

> *"the allocation of contributions to individual self insurers should reflect both the risk of each self insurer and the VWA's relative oversight effort in relation to each self insurer."*

7.6 In the opinion of actuarial advisors to SIAV, the case for reflection of risk has not been made. The reasons are as follows:

- The concept of user-pays and risk are confused;
- Risk is not the right incentive or driver for the calculation of contribution fees;
- Applying the expense contribution basis for insured employers to self insurers is problematic; and
- Industry rates are an imperfect measure of risk and are adjusted before being applied to large employers in any event.

CONFUSION BETWEEN USER-PAYS AND RISK

7.7 There is an element of risk in the use of VWA services by self insurers, but probably as important are the internal resources available to self insurer. Each self insurer will concentrate its internal WorkCover resources on the areas where it perceives the greatest value and will use external resources including the VWA, for others.

7.8 As part of the activity-based costing exercise used to determine the total pool, consideration could be given to the extent to which self insurer risk and oversight are likely to affect the "user pays" equation.

RISK IS NOT THE RIGHT INCENTIVE

7.9 The ESC suggests that including risk in the contribution calculation will provide self insurers with incentive to better manage the risks (p26). The self insurer bears the claims cost directly; this provides all of the incentive that is needed for better claims risk and cost management. Any additional incentive from including risk in the contribution calculation is marginal.

7.10 One example is marketing costs. The VWA may conduct a risk-assessment for the scheme and determine that a specific segment requires a marketing campaign. It does not necessarily follow that the relative claim-risk of self insurers should be taken into account in allocating the self insurer share of the costs of those programs. These campaigns are generally not targeted to industries or risks faced by self insurers. For example, they may focus on small businesses, or particular hazards (such as rolling-risk for tractors). If the self insurers are unaffected by those risks, why should the contribution paid by each differ just because one is subject to higher level of other risks?

INDUSTRY RISK RATINGS

PROBLEMS USING THE EXPENSE CONTRIBUTION BASIS OF INSURED EMPLOYERS

7.11 In a number of places the Issues Paper makes reference to the fact that insured employers pay an expense contribution, the amount of which is based on risk. This is true. It does not follow, however, that the expenses incurred are based on risk - simply that this is the allocation method used by the VWA.

7.12 The ESC report into the VWA premiums for 2005-06 reports the following split of the average premium rate into three basic components. (Chart 5, page 22):

- claims costs: 1.26% of remuneration
- expenses: 0.39% of remuneration
- buffer: 0.15% of remuneration

7.13 The total average premium rate is therefore 1.80% of remuneration. In excess of 90% of this average premium is claims-related - including the claims costs themselves, the buffer (a key purpose of which is to accommodate volatility in the claims cost outcome), and the claims-related element of the expense allowance (such as the authorised agents' fees).

7.14 The total expense loading in the premium is often set as a loading to the claims costs. This is generally for reasons of convenience and practicality rather than any philosophical view that it is the most appropriate basis to allocate the non-claims-related expenses. A change to the allocation basis of the non-claims-related costs is likely to have a relatively small impact on the premium paid by any employer. Further, given the uncertainty and volatility in the claims cost outcome for any one employer, it could be considered spurious accuracy to adjust the allocation basis for a relatively small proportion of the total premium.

7.15 In the case of the self insurer contribution, the relevant expenses to which self insurers contribute are only non-claims-related. The premium-payers contribute to these costs in proportion to "risk" for reasons of convenience and practicality. It does not follow that this is necessarily the most appropriate basis for self insurers. Some non-claims-related costs may be more accurately allocated on other bases – such as a user-pays fee, a cost per policy, a cost per employee; a cost per transaction; or as a proportion of remuneration, and so on.

LARGE INSURED EMPLOYERS PAY EXPERIENCE-ADJUSTED RATE, NOT INDUSTRY RATE

7.16 The insured scheme premiums are based on a series of industry rates. Large employers then pay a rate which varies from this rate, depending on their claims performance. In broad terms, the extent of the potential variation from the industry rate increases with the size of the employer.

7.17 In the self insurer environment, an equivalent "industry-based risk rate" would similarly need to allow for variation from the underlying industry rate - particularly as we understand that the data analysis on which the industry rates are based excludes the data of self insurers.

7.18 It is not currently possible to experience-adjust the self insurer rate in the same way as insured employers. A key factor in the experience-adjustment is the 'statistical case estimates' (SCE) that the VWA places on the claims of insured employers. It is SIAV's understanding that the VWA is not in a position to calculate an SCE for a self insurer - and any efforts to do so would be time-consuming and costly for all involved:

- The VWA does not have the highly detailed claim data from self insurers that it would require. SIAV doubts that collecting it is desirable or feasible; the extra volume of data would be massive, and self insurers may record the data differently or in ways which the VWA would find difficult to deal with.
- The SCE model is not parameterised for self insurer data, and additional analysis would be required.

INDUSTRY RATES AN IMPERFECT MEASURE OF RISK

7.19 The ESC should not start with the assumption that industry is an accurate reflection of risk.[33] Whilst industry risk is used as the most practical measure of risk for WorkCover premium purposes, many would argue that occupation-based rating would provide a more accurate reflection of risk. (This is not a criticism of the WorkCover premium system; use of industry rating is a generally-accepted practical response).

7.20 Further, to the extent that there are subsidies within the premium system, they are typically achieved through adjustment of the industry rates. The industry rates should not, therefore, be considered to be an unbiased assessment of risk.

[33] Industry rating is a traditional approach to premium setting. Industry rating with self insurance has been a feature of comprehensive workers' compensation arrangements since its inception at the end of the nineteenth century in Britain. Due to differing economic factors, some variation of arrangements exists across jurisdictions. However, traditional approaches tend to dominate.

ESC REVIEW PRINCIPLES

7.21 This section discusses the principles raised by the ESC in the Issues Paper at Section 5.1, namely;

- proportionality
- competitive neutrality
- reflection of risk and oversight, and
- simplicity and transparency

'PROPORTIONALITY'

7.22 SIAV has no difficulty with the last three principles and these are discussed below and elsewhere in the submission. (See Index). However SIAV opposes the 'principle':

> *Self insurers as a group should meet the proportionate share of costs incurred by the scheme, excluding those costs that relate directly to the VWA's support of its authorised agents.*

7.23 This is little more than a restatement of the current regulatory model described above. The use of the term proportionate relies on no legal basis and on no regulatory principle. If applied at face value, it endorses:

- VWA discretion to 'incur' indeterminate costs;
- self insurer liability for all costs, except those excluded by the VWA at their discretion, and
- a simplified denominator to split the costs between individual self insurers and insured employers. It is simplified because a common factor has to be established between employers and self insurers. This then enables the VWA to undertake a less rigorous apportionment based on percentage or fraction.

7.24 The consequence for members would be a sharp increase in the total costs pool to 100% as envisaged under the original regulation. SIAV has received advice from its legal advisors that this regulation is outside legislative power. See [8.14] below. Accordingly a restatement of a proportionality principle that seeks to become the basis of new regulation would be equally invalid.

7.25 In addition, the principle does not seem to be 'consistent' with Fees and Charges Guidelines referred to in the ESC Issues Paper as "authoritative". The principle would result in 'proportional application' even if there was not benefit derived. The Guidelines require a benefit linked to the contribution.

7.26 The practical difficulties associated with the application by the VWA in the past of the proportionality principle are amply demonstrated in the analysis reproduced below and conducted by Marsden Jacob of the March 2004 '*Derivation of the self insurer fee using the 2003 VWA budget*'. The *Derivation* compared calculations of costs by both the

VWA and SIAV and is the basis for the different results of $15.6m for the VWA and $7.6 for SIAV.[34]

COMPETITIVE NEUTRALITY

7.27 Competitive neutrality refers frequently to the proposition that GBEs such as workers' compensation funds should not be advantaged over private businesses, for instance self insurers, simply as a result of government ownership. SIAV concurs with the good sense of this principle.

7.28 The VWA suggested an altered and very different interpretation that these competitive advantages should be neutralised. SIAV submits that this is a perverse application of the principle. SIAV agrees with the interpretation by the ESC in the Issues Paper that the charging arrangements for self insurance should not affect respective competitive positions of self insurance and insured employers. That is, if the competitive positions are different for whatever reason then the charging arrangements for self insurance should not seek to change competitive positions or relativities.

7.29 A corollary of this interpretation is that the charging arrangements must be cognisant of the costs incurred or attributable to self insurance. Unless this information requirement is satisfied the principle will be violated.

RISK & OVERSIGHT

7.30 Risk and oversight is dealt with in above in [7.5]. SIAV considers that the principle of simplicity should not be translated to enable VWA to discount legislative responsibilities as detailed below in Chapter 8.

TRANSPARENCY

7.31 SIAV supports further transparency and this is also discussed in Chapter 8.

DETAILED POOL METHODOLOGY

> *However, the Commission also notes that while the VWA and the SIAV used the same methodology to assess an appropriate level of total self insurer contributions, they had different opinions on the proportion of costs that could reasonably be applied to self insurers and therefore arrived at markedly different estimates of the costs attributable to self insurers. This suggests that despite the apparent consensus on using a contributions pool in a future methodology, developing such a framework in detail may prove problematic.*

7.32 SIAV suggests that the differences in the proportions are not grounds for dismissing the use of a contributions pool. The differences are differences of fact and may be resolved

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http://www.workcover.vic.gov.au/vwa/home.nsf/pages/SelfInsurers_review_submissions/$file/self_insurers_association_victoria_supplementary.pdf

[34] See p 27 at http://www.workcover.vic.gov.au/vwa/home.nsf/pages/SelfInsurers_review_submissions/$file/self_insurers_association_victoria_supplementary.pdf

using empirical analyses and by applying the economic framework described above. The logical consequence is not to dismiss an approach simply on the basis of a disagreement about how it may apply.

> *The SIAV Supplementary Submission assessed the costs attributable to self insurers for the 2002-03 financial year as being 2.33 per cent of the VWA's total administrative costs, based on the VWA's total administrative budget for 2002-03 of $316.26 million, and suggested that this proportion could be used as the basis for the calculation of a contributions pool in future periods. For example, the contributions pool for the 2005-06 financial year would be calculated by multiplying the VWA's administrative costs for that year by 2.33 per cent.*
>
> *It should be noted that the VWA's administrative costs include several components, such as authorised agents' fees, that are not relevant to self insurers. These components represented over 40 per cent of the VWA's administrative budget in 2002-03, and a significant increase in these costs relative to the VWA's other administrative costs would result in an increase in the contributions pool without any corresponding benefit to self insurers.*

7.33 SIAV agrees with this comment. It then follows on;

> *Similarly, a decrease in the share of costs in the VWA budget would result in self insurers making a lower contribution than would appear appropriate.*

7.34 Essentially, the issue is the possibility that in some years with a stepped set fee, SIAV may pay more and in others less. Some background is provided on the proposal as follows.

7.35 SIAV proposed the 2.33 percentage on the basis that it could provide a fixed price for an agreed future period, regardless of fluctuations in the VWA budget. The proposal was made to avoid an annual analysis of VWA accounts and on the basis that a repeat of the highly detailed analysis of VWA accounts might be conducted after, say, 3 years. SIAV agrees with the ESC Issues Paper observation that the result may not be accurate from year to year and would prefer a more accurate solution. It may be that the VWA operates on a 3 year business plan in any event and that steep fluctuations would not be expected without some similarly timed notification.[35] This proposal should be considered as <u>an alternative</u> to balance complexity and cost concerns associated with accurate analyses and the first option proposed in the ESC Issues Paper.

7.36 SIAV has already undertaken part of the analysis suggested in Option Two based on the work done in 2004. The disadvantage to this approach is that the organisational chart of the VWA appears to change regularly according to the needs of the business. This is entirely defensible from the point of the view of the VWA, however calls these types of analyses into question. There is the empirical issue of the costs that have been allowed to creep into the various branches and the hidden cross-subsidisations that may be present. If these were assessed by an independent group, then such a set of percentages

[35] SIAV notes that SA WorkCover has just changed agent agreements to one agent expecting significant cost reductions. The change followed fixed term contracts and a tender process so changes were expected well in advance. The ideal situation would be to reassess the costs in the year immediately following such changes.

could apply. Similarly they could apply over an agreed period as the alternative suggested above. If this was agreed, SIAV is not certain that quarterly assessments would be necessary.

7.37 It also follows from the analysis of functions beginning above at [4.1], that SIAV does not agree with the ESC analysis of the components of costs and how they may be categorised. Essentially, the distinctions drawn between measurable and non-measurable costs are inappropriate because SIAV considers that a proportion of non-measurable costs are in fact measurable – a distinction shown in [cost analysis section] and undertaken by SIAV's actuary.

7.38 SIAV therefore would characterise the differences between the activity based approach adopted by its actuary and the VWA approach as reflecting fundamental differences in principle, that is, SIAV emphasising and successfully applying the principle that wherever possible direct measures should be used to allocate the costs rather than to rely on proxies.

8. Legislative Framework

PURPOSE OF CONTRIBUTIONS

8.1 The size of all self insurers' remuneration in respect of the states payroll gives the proportion of costs to be shared between self insurers. However, the total costs are limited by a series of user pay services offered by the VWA and listed in the legislation. There is some discretion to include other costs. Section 32(4)(i) of the *Act.*[36]

> any other costs and expenses incurred by the Authority under this Act or any other Act.

8.2 That discretion is limited by the context of the section – in SIAV's view this appears to be that contributions are designed to meet the costs associated with the administration of self insurance. SIAV received legal advice to that effect in 2002.[37]

8.3 The conclusions that can be drawn from this are:

- VWA's contention that parity requires the same method of calculation for self insurers and insured employers is not supported by the legislation
- Even if this was the case, the administrative costs are not yet of a sufficient transparency to provide parity between the calculation of the premium and the calculation of the contribution

8.4 The legislation indicates that costs are to be paid 'as if' self insurers were insured employers. (SIAV notes that the VWA have raised this issue in its response of 14 February 2006).

> *"The Authority may, in accordance with the regulations, determine the amount of contributions payable into the WorkCover Authority Fund having regard to the amount of leviable remuneration or rateable remuneration within the meaning of section 3(1) of the* ***Accident Compensation (WorkCover Insurance) Act 1993*** *paid or payable during the financial year and preceding financial year in respect of that year and preceding year or any quarter of that year or preceding year by each self insurer calculated as if the self insurer were an employer liable to pay the premium…. " Sub-section 33A(1)*

8.5 SIAV has consulted senior counsel and is advised that while the requirement to use remuneration as the basis for the contribution fee is discretionary, the application to services is mandatory.

38. In applying the WorkCover legislation, SIAV is advised that:

- Parliament has clear intent that self insurers should contribute to costs;
- it is equally clear that the contribution only relates to services;
- the VWA 'may' determine the fee according to the premium approach – there is no must; and
- in exercising the choice of how this should be done, the VWA must be consistent with the objects of the Act and any other constraints e.g. ESC objects and tax

[36] S Thomson and R Tracy of Counsel 26 February 2002.

guidelines and more importantly economic business objectives. In effect the discretion is conditional, fettered and heavily constrained.

This is further explained below

8.6 The legislative source of the Governor-in-Council's regulation making power is to be found under paragraphs 253(1)(b) and (k) of the Act in relation to prescribing "fees for the purposes of the Act" or "any matter which is authorised or required to be prescribed for or carrying out or giving effect to this Act." Section 33A of the Act specifically provides for contributions to the WorkCover Authority Fund by self insurers. The Parliament of Victoria, therefore, has unequivocally communicated its intention that self insurers are to "contribute" to the costs of the Scheme, enacting what are fairly prescriptive provisions for determining these contributions. These prescriptive provisions give regulation making power to the Governor-in-Council who may adopt a leviable or rateable remuneration basis for determining these contributions but who must (my italics) ensure that "contributions" be applied towards costs specified under certain categories as outlined in paragraphs 6 and 7 above.

8.7 That the object of the provisions is directed to the application of contributions by self insurers to the Fund that must be related to the services provided to them under the Act, is further supported in the Explanatory Memorandum to the *Accident Compensation (Further Amendments) Bill 1996*. The Explanatory Memorandum explained that the purpose of the changes to that provision was to extend the categories for contribution by self insurers under sub section 33(A): the purpose was "to extend the permissible uses to which contributions by self insurers may be put".

8.8 Although sub-section 33A(1) states that a determination 'may' be made having regard to the rateable remuneration etc., Parliament's intention that there ought to be some parity vis a vis employers', as compared to self insurers' "notional participation in the Scheme", is clearly evidenced by Parliament's use of the words "as if a self insurer were an employer liable to pay the premium". Moreover, the categories of expenditure from which the contributions must be applied under sub-section 33A(7) ought, by necessary implication, be confined to those categories of services provided by the Authority to the self insurers.

8.9 It is implicit that, in the "formulation" of the Proposed Formula, the self insurers are to meet the relevant expenses of the Authority proportional to their relative (notional) remuneration or some other parity basis. On the "parity proposition" discussed above, it would be assumed that the employers within the Scheme should also be subject to the same (relative) contributions based on their "rateable remuneration". Such a parity has not been achieved in past years and, for this reason alone, the regulation is open to criticism.

8.10 SIAV's contention is that in considering these matters the ESC is required to also consider the applicability of equity principles with insured employers in apportioning administrative costs. As noted by Counsel in 2002, the fact that there is no information on the application of administrative costs to the insured employer on which to base parity is still an issue. The premium formula appears to be based on claims costs and there is no overt allocation of administrative costs to individual insured employers.

8.11 SIAV does not consider that it was the intention of the legislation that the costs to business of the administrative costs of the VWA should be obscured through lack of specific information. Or more importantly that the lesser standards in apportioning costs should apply 'equitably'. The difficulties arising from VWA using proxies should not translate across to self insurers.

8.12 The ESC has previously observed that administrative costs have not been subject to review for efficiency. From SIAV's perspective, the administrative costs are not transparent. SIAV would support a review that delivered recommendations on both issues.[38]

8.13 SIAV considers that the ESC should give precedence to the objectives of the legislation that seek efficiency in determining the contribution fee for self insurers.

ISSUES WITH THE DESIGN OF THE REGULATION

8.14 SIAV considers the current regulation a tax and supports the 'no tax in regulation' policy described in the ESC Issues Paper and which is outlined in the *Victorian Guide to Regulation* published by the Department of Treasury and Finance.[14]

8.15 In summary, SIAV considers that the current regulatory design should not be continued. The ESC should consider alternatives.

[38] See above ref. 23 at p 27

Index

ESC Issues Paper Reference	Submission reference
Question 1	
What factors provide the best indicators of the level of the VWA's administrative costs incurred that benefit an individual self-insurer?	Chapters 5 & 8
Question 2	
Which of the VWA's outputs do self-insurers use or derive a benefit from?	Chapters 5 & 8
What activities does the VWA undertake in producing these outputs, and how can they best be costed?	Chapter 5
Where both self-insurers and members of the WorkCover scheme benefit from an output, what cost drivers should be used to determine the level of self-insurer contribution?	Chapter 5
Question 3	
Which costing framework would best identify the costs that should be recovered from self-insurers in a contributions methodology? To what extent do the benefits of adopting this framework outweigh the costs associated with its implementation and ongoing management?	Chapter 4 Chapter 8
Question 4	
Which features of a charging structure would best ensure that the self-insurer's contribution towards the VWA's costs of administering the WorkCover scheme is related to the use of or benefit from those services by that self-insurer?	Chapter 5 Chapter 8
What specific services provided by the VWA could be separately identified in a charging framework to provide incentives for efficient behaviour? Principles (5.3)	Chapter 8
Question 5	
Is it reasonable for a contributions methodology to take into account?	
• The self-insurer's level of remuneration?	Chapter 7
• The risks associated with relevant industries?	Chapters 4,7
• The performance of the individual self-insurer?	Chapters 4,7

ESC Issues Paper Reference	**Submission reference**
Question 6	
What is a reasonable method for calculating the risks associated with a particular industry?	Chapter 7
Question 7	
What is a reasonable method for calculating the performance of an individual self-insurer?	Chapter 4,7
Question 8	
What is a reasonable method for calculating the VWA's relative oversight effort for each self-insurer?	Chapter 5
Question 9	
What factors could reasonably be excluded from a contributions methodology for the sake of simplicity?	Chapter 7
Question 10	
What processes should reasonably apply to a self-insurer contributions methodology to ensure transparency?	Chapter 7