Australian Government

Comcare

Guide to 2005–2006 Premiums

June 2005

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1 Introduction

Comcare sets workers' compensation premiums for Commonwealth authorities and entities.

The aim of this booklet is to help premium paying agencies to understand Comcare's method for setting 2005–2006 premiums.

Comcare's Scheme Funding Group can explain the premium amount for a particular agency.

Scheme Funding Group can also help a premium paying agency that wants to split the premium between parts of the agency.

Agencies can contact Scheme Funding Group on 02 8218 3792.

2 Glossary

In this booklet:

'agency' means a Commonwealth authority or entity that pays a premium to Comcare

'capping' means adjusting each agency's claim costs in premium calculations to spread the premium impact of the highest cost claims

'claim cost' means payments to date on a claim plus an estimated share of future costs

'claim frequency' means the number of accepted claims per million dollars of payroll

'commission' means the Safety, Rehabilitation and Compensation Commission

'customer' means a Commonwealth authority or entity that pays a premium to Comcare

'entity' means:

- an 'agency' for the purposes of the *Public Service Act 1999*, that is, a Department, statutory agency or executive agency
- a Parliamentary Department or
- a prescribed body

'fully funded' means that the total of premiums collected is adequate to meet the estimated benefits and administration costs for as long as Comcare needs to make payments for injuries suffered in the year of coverage

'IBNR' means injuries 'incurred but not reported' at the time of the premium calculation

'injury year' means 1 March in one year to the end of February of the following year

'Minister' means the Minister for Employment and Workplace Relations

'pool' or **'premium pool'** means the overall amount needed to fully fund injuries expected to be suffered in the coming year

'premium' means an amount that an agency will pay to Comcare

'prescribed amount' means a component of the premium

'rate' or **'premium rate'** means the premium amount as a percentage of payroll

'SRC Act' means the Safety, Rehabilitation and Compensation Act 1988

3 Background and framework

The SRC Act

The *Safety, Rehabilitation and Compensation Act 1988* (the SRC Act) introduced the current Commonwealth workers' compensation arrangements.

The Commission

The SRC Act established the Safety, Rehabilitation and Compensation Commission (the commission) to oversee the operation of the SRC Act and provide advice on the scheme to the Minister.

Membership of the commission includes representatives of Commonwealth employers and unions and other members with relevant expertise.

Comcare

Comcare has two business lines:

- one provides secretariat support to the Commission and undertakes regulatory functions under the SRC Act and under the *Occupational Health and Safety (Commonwealth Employment) Act 1991* (OHS(CE) Act);
- the other manages claims for workers' compensation under the SRC Act.

The premium

The SRC Act makes Commonwealth authorities and entities accountable for workers' compensation injuries through the payment of annual premiums that respond to claims.

The premium covers:

- benefit payments (time off work, medical, lump-sum payments)
- rehabilitation and related costs from approved service providers
- legal costs
- Comcare's management of claims.

The SRC Act requires:

- Comcare to set a premium for each Commonwealth authority and entity for each financial year
- each premium to comprise:
  - (a) a **prescribed amount** to cover the cost of claims, and Comcare's management of claims, for injuries that workers may suffer in the next financial year
  - (b) a **bonus or penalty amount** based on the development of claims for past injuries.

In July each year, Comcare notifies each agency of the premium for that financial year.

Appeal processes

Within fourteen days of notice of the premium, the principal officer of a premium paying agency may, by written notice of objection, ask Comcare to review the premium. A notice must set out the grounds of the objection and should be addressed to:

Chief Executive Officer
Comcare
GPO Box 9905
Canberra ACT 2601

Comcare will review the premium and advise the agency if the amount is confirmed or varied.

Within fourteen days of that advice, the principal officer may, by another written notice of objection, request the commission to review the premium.

Payments due

Agencies must pay premiums to Comcare by the later of 31 July or thirty days after Comcare sends the notice. A request for review does not alter the due date. Comcare will charge interest on any amount not paid by the due date. If a review reduces a premium, Comcare will refund the difference with interest.

4 Premium pool

To calculate premiums each year, Comcare first considers advice from a consultant actuary on the total amount that Comcare should collect to fund injuries that workers may suffer in the coming financial year.

The actuary takes into account the development of claims for injuries suffered since the SRC Act commenced on 1 July 1989.

Even with the best analysis and modeling the actuary's estimate of the pool could prove over time to be above or below the amount needed. Under the SRC Act an injured worker may be entitled to benefits for many years. This is a long-tail scheme even by workers' compensation standards. Actual costs will not be final until the last payment, perhaps eighty years after the year of injury. Forecasting the number and particularly the cost of claims for injuries that workers may suffer in the coming year is difficult and always involves a significant degree of uncertainty.

5 The premium model

After setting the pool, Comcare calculates shares of the pool for each agency to pay. These shares are termed prescribed amounts.

Comcare calculates the prescribed amount for an agency as a percentage of that agency's payroll. Comcare sets a different percentage (premium rate) for each agency.

To calculate premium rates Comcare uses the claim frequency and average claim cost of each agency for all injury years. In particular Comcare reassesses the claim frequency and average claim cost of injuries suffered in the last four years for each agency. While Comcare does not reassess each agency's claim frequency and average cost of claims for injuries suffered before the last four years, these parameters for earlier years remain as part of the claim history.

Comcare's premium model is an insurance model. The total of all premiums must fund total costs but an agency's premium for a given year does not necessarily match the cost of that agency's claims for a single year. This is similar to other forms of insurance where claim history has an effect but some 'risk' is shared with other premium payers.

The premium rate for each agency responds to:

- the number of claims from that agency
- the estimated lifetime cost of claims from that agency
- trends in claim frequency and average claim cost for all agencies combined
- the size of the pool.

The premium model includes the following features to dampen premium volatility:

- capping of the highest cost claims
- evolving estimates of claim frequency and average claim size for each agency.

Capping of the highest cost claims

The premium model uses claim capping to spread the impact of the highest cost claims.

The premium model applies a 'cap' to claims for an injury year. The cap is an amount where the sum of the claim costs above the cap is 5% of the sum of the costs of all claims. The premium calculation uses the 'below the cap' cost of each claim plus 5%.

Following are the cap amounts in 2005–2006 premium calculations:

- $698,000 for injury year 2001-2002
- $400,000 for injury year 2002-2003
- $366,000 for injury year 2003-2004
- $245,000 for injury year 2004-2005.

Evolving estimates of claim frequency and average claim size for each agency

Also to dampen volatility in premiums, the premium model uses 'evolving' estimates of claim frequency and average claim cost for each agency for each financial year. The estimates are 'evolving' in the sense that the estimate for one year is a factor in the calculation of the estimate the next year.

For example, the evolving estimate of claim frequency for a year is a weighted average of:

- the agency's claim frequency for the prior year (adjusted by the percentage change in the pool claim frequency)
- the evolving estimate for that agency for the prior year (adjusted by the percentage change in the pool claim frequency).

The balance between these two factors depends on the payroll of the agency. This is because claim frequency for one year is a more reliable indicator of claim frequency for the next year if it is based on more staff (and therefore higher payroll).

In contrast, to calculate the evolving estimate of average claim size for a year the balance between the average claim size in the prior year and the evolving estimate for the prior year depends on the number of claims. This is because average claim size for one year is a more reliable indicator of average claim size for the next year if it is based on more claims.

Appendix A shows the weights.

To calculate premiums, Comcare reassesses the claim frequency and average claim cost of injuries suffered in the last four years for each agency then updates the evolving estimates of claim frequency and average claim size for each agency for each year in chronological order.

IBNR

Comcare continues to accept claims for past injury years after it sets premiums. Therefore the premium model allows for injuries 'Incurred But Not Reported' (IBNR) for each agency. The allowance is based on past delays between occurrence of injuries and acceptance of claims for all agencies. The allowance reduces as an injury year ages.

6 Bonus or penalty

As noted in section 3, each premium comprises:

- a prescribed amount
- a bonus or penalty amount.

Comcare revises the 2004–2005 premium rate for each agency after reassessing each agency's claims for the three injury years ending February 2003.

The bonus or penalty amount in the 2005–2006 premium is the difference between the 2004–2005 prescribed amount and the revised 2004–2005 amount.

7 Managing workers' compensation costs

To reduce its future premiums, an agency must:

- reduce its claims frequency
- reduce its average claim cost.

Agencies need to manage claims for all injuries suffered since 1 July 1989. To estimate the size of the premium pool the actuary analyses the development of claims for injuries suffered in all years. To calculate each agency's share of the pool, Comcare reassesses claims for each injury year several times. For example, for premium calculations, Comcare reassessed claims for injuries suffered in 2001-2002 initially in 2002 then again in 2003, 2004 and 2005.

Payments for time off work are the major driver of claim costs. Management of an injured worker should focus on early, sustainable return to work, even on different duties or reduced hours.

Most claimants have less than one week off work. But the few claimants that will be on benefits for more than one year will create most of the claim costs across the scheme.

Claims for psychological and back injuries, strains and occupational overuse syndrome contribute most to the costs of the scheme. For recent injury years these injury types account for around 80% of the estimated costs. While agencies should aim to manage all injured workers well, these claims have the greatest impact on premiums.

Agencies should contact their Comcare customer liaison officer for help in developing workers' compensation claim management strategies.

8 Estimates of claim costs

Premium calculations use the estimated **lifetime cost** of claims from each agency. Lifetime cost means payments to date plus estimated shares of future costs.

Actuaries forecast future payments for claims for injuries suffered in each past year.

Every month Comcare estimates a share of those future costs for each claim. As far as possible, each estimate takes account of results of other claims with similar characteristics. For example, the estimation software takes account of the latest status of many risk factors that indicate the likely duration and cost of a claim. These include:

- whether the claimant is receiving benefits now and how long that has been the case
- total duration on benefits and how continuous that time was (i.e. Was there a single period of incapacity or were periods at work interspersed with periods of incapacity?)

- gender and age of the claimant
- hours per week at work if on a graduated return to work program
- delay between the date of injury and acceptance of the claim
- recent medical and/or rehabilitation costs
- normal weekly earnings
- nature of injury
- body location of the injury.

No software can estimate perfectly the future costs for each claim. Comcare's estimates are statistically sound but there are limits on their usefulness. For example, there may be two similar claims and past claims show that 50% of claims of this type will recover at 12 months and the other 50% will recover at 24 months. Because it is impossible to know which of the two claims will recover at 12 or 24 months, the software would use for both of these claims the weighted average cost of these two durations. If one does recover at 12 months and the other at 24 months then one would have been over-estimated and the other under-estimated but the sum of the estimates would have been correct.

Another illustration relates to lump-sums. The minimum lump-sum payment for permanent impairment may be around $15,000. There may be two similar claims and past data may show that 50% of claims of this type will receive a minimum lump-sum. Each of these claims would have $7,500 included in their estimated share of future costs even though it is impossible to receive that amount and even though only one is likely to receive any amount. If only one of the claims does receive a $15,000 lump-sum then it would have been under-estimated and the other claim would have been over-estimated but again the sum of the estimates would have been correct.

The software reduces the estimated cost of each claim according to the likelihood of a successful third party recovery for that claim.

Comcare applies the same software to all claims from all agencies and does not negotiate over the estimates.

Comcare is always seeking ways to improve the estimation software and refines the software each year to keep estimates in line with the most recent claim data.

9 Questions and answers

Why are accurate payroll figures important?

The premium rate for an agency would be higher if the agency understated its payroll because the rate responds to claim frequency which is the number of claims per million dollars of payroll.

How does the actual payroll figure influence the bonus or penalty amount?

Revision of the 2004–2005 rate for each agency determines the bonus or penalty amount for each agency.

Comcare revises the 2004–2005 rate after reassessing claims for injury years 2003–2004 and earlier. When calculating original premium rates for 2004–2005 Comcare had to rely on the estimated 2003–2004 payroll for each agency to calculate 2003–2004 claim frequency for each agency. But when calculating revised 2004–2005 rates Comcare could use the actual payroll for 2003–2004 to calculate the 2003–2004 claim frequency for each agency.

Does each agency's premium rate move in line with that agency's claims performance?

The premium rate for each agency responds to the number and cost of that agency's claims. But the premium model does not aim to set a rate that matches claim performance in a single year. The premium model is designed to respond to trends in claim performance, without over-reacting to random fluctuations. Generally the rate will move in the same direction, but to a lesser extent, than the claim performance.

However, the rate is also influenced by the change in the claim frequency and average claim size of the pool overall and these changes may counter the movement toward the agency's claims level.

Without any pool effect the model would set the rate between last year's rate and a rate that matches the claims for the most recent injury year. The new rate would be closer to last year's rate if the recent data has low credibility or closer to the most recent claim performance if the data has high credibility.

Can Comcare predict the premium amount for 2006–2007?

In May each year Comcare aims to tell agencies the expected premium for the next financial year.

Comcare cannot predict premiums reliably before May because:

- the size of the pool affects each agency's prescribed amount and the actuary does not estimate the pool until May
- agency estimates of number of staff and payroll for the next financial year affect the premium pool and each agency's share of the pool. Agencies do not provide these estimates until 31 March
- at the end of the year, each agency's claim frequency and average claim size may differ significantly from mid year
- changes in pool claim frequency and average claim size from year to year affect agency premiums and the actuary does not estimate these until May
- Comcare may not implement any changes to the premium model until May.

Will the premium for an agency reduce if a claimant leaves?

The departure of a claimant from the agency where the injury was suffered does not change the agency's responsibility for the claim. The premium model links each claim to the function where the injury was suffered. To reduce the premium, the agency must reduce the costs associated with a claim by facilitating the return to work of the claimant.

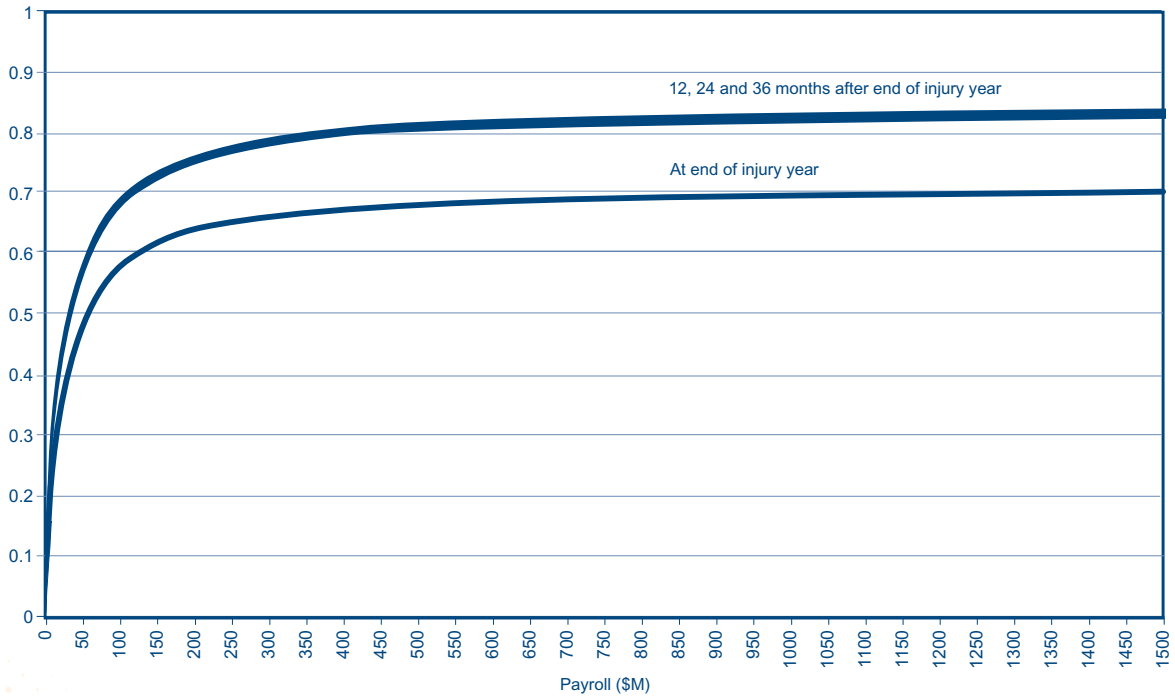
How can the estimated share of future costs for a claim be high if the person has returned to work?

Each month Comcare's computer software allocates to each claim a share of estimated overall liabilities. The software will allocate a share of future costs to a claim even if the claimant has returned to work. The amount will reduce the longer the claimant remains off weekly benefits. Shortly after a claimant returns to work the probability of further time off work is high. The probability of further time off work reduces with each month that the claimant remains off weekly benefits.

Also, the shares of future costs that are available in customer reports reflect the development of each claim to some months before the share is calculated. This allows time for claimants and agencies to provide documentation on time off work and for Comcare to process the claims and pay benefits.

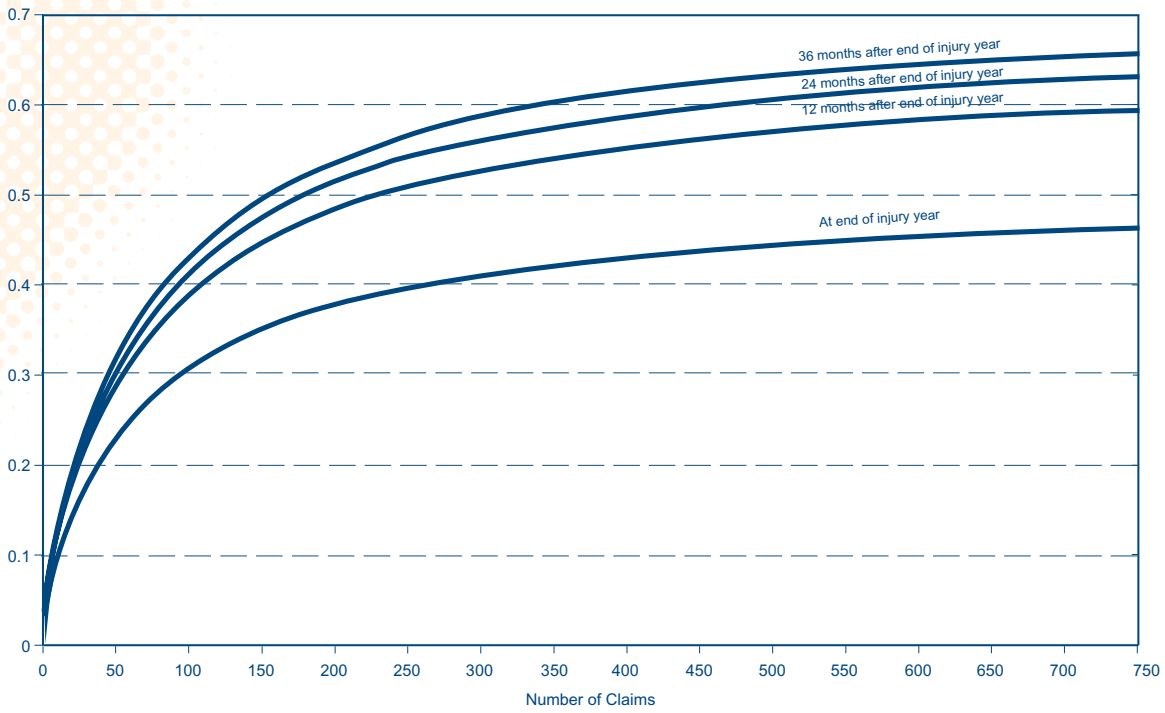
Appendix A: Weights on an agency's claims for each injury year

Weight on average claim size



The pool average claim cost has a weight of 0.05 if the agency has no claims, 0.03 if the agency has one claim or 0.01 if the agency has two claims.

Weight on claim frequency



If an agency's payroll is less than $250,000, pool claim frequency has a weight of (0.05–0.05*payroll/$250,000).