

FRAMEWORK FOR SETTING PREMIUMS

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Australian Government

Comcare

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PURPOSE

This policy outlines the framework for how Comcare's CEO determined the premiums payable by Commonwealth agencies and the ACT Government for each financial year.

BACKGROUND

Comcare must make a determination of the amount of premium to be paid by each Entity and by each Commonwealth authority in respect of each financial year in accordance with the provisions of the *Safety, Rehabilitation and Compensation Act 1988* (SRC Act).

These determinations must be made in accordance with the written guidelines, which the Safety, Rehabilitation and Compensation Commission (the Commission) has prepared and issued to the CEO in relation to the determination of premiums by Comcare under section 97E of the SRC Act.

Section 73 of the SRC Act provides that the Minister for Employment and Workplace Relations (the Minister) may give a direction to Comcare with respect to the performance of its functions or the exercise of its powers under the SRC Act. Comcare is not aware that any Ministerial direction has been given in relation to the setting of premiums.

The *Commonwealth Authorities and Companies Act 1997* (CAC Act) applies to Comcare as if the CEO were a director of Comcare. For reference, extracts from the CAC Act relating to civil obligations of care and diligence, the business judgement rule and good faith are included at Attachment A to this policy.

There is no specific legislative requirement for Comcare to put in place a policy for premium setting or prudential management of compensation liabilities. This policy documents the prudential framework in which the premium determinations are made.

The framework in this policy is intended to be consistent with best practice for a workers' compensation scheme such as Comcare, having taken into consideration the practices of other Australasian compensation schemes and government insurers, Australian insurance industry prudential standards and consultation with representatives of the Australian Government Actuary's Office in the Treasury, the Department of Finance and Deregulation, the Victorian Department of Treasury and Finance, NSW Treasury and the Australian Prudential Regulation Authority (APRA).

SCOPE

For the purposes of setting premiums, Comcare's claims liabilities are its liabilities for outstanding compensation and non-economic loss claims under the SRC Act for claims arising from injuries or disease sustained on or after 1 July 1989 ('premium business').

Separate from the premium business, Comcare also has claims liabilities for:

- > 'pre-premium business'—liabilities for SRC Act claims arising from injuries or disease sustained on or before 30 June 1989, including latent disease claims incurred because of an event or process which happened or commenced before 1 December 1988, and
- > certain claims for compensation arising from asbestos-related diseases under the *Asbestos-related Claims (Management of Commonwealth Liabilities) Act 2005* (ARC Act).

As the pre-premium business and ARC Act claims liabilities are funded by appropriation from the Consolidated Revenue Fund (CRF), the framework for setting premiums does not apply to them.

ISSUES

The matters addressed in this policy are:

1. The basis for reserving for claims liabilities
2. Catastrophe risk and reinsurance
3. The funding ratio
4. Setting the premium pool
5. Determining premiums for individual Entities and Commonwealth authorities
6. Actuarial advice

1. RESERVING FOR CLAIMS LIABILITIES

- 1.1. In keeping with Comcare's current practice and with accounting and actuarial standards, Comcare's claims liabilities should be:
 - > established based on independent actuarial advice,
 - > inclusive of claims management costs, and
 - > discounted to allow for the time value of money using Commonwealth Government bond yields matched to the duration of the liabilities.
- 1.2. For the purposes of determining the funding ratio, claims liabilities should be set at a level which provides for an intended 75 per cent probability of sufficiency. This basis:
 - > recognises the inherent uncertainty in placing a value on long-tail workers compensation liabilities,
 - > recognises that Comcare's access to financial support from the CRF is limited (refer to 3.1 below),
 - > is consistent with the minimum standard for the valuation of insurance liabilities for insurers authorised under the *Insurance Act 1973* as prescribed in APRA's prudential standard GPS310, and
 - > is consistent with the practice of most other Australasian government insurers and compensation authorities.

- 1.3. Comcare's accounting policy for recognising claims liabilities in the annual financial statements has varied in the past. Current policy is to recognise the claims liability at a central estimate value, i.e. without a margin to achieve an intended 75 per cent probability of sufficiency. This means there is currently a difference between the accounting basis (net equity position reported on the balance sheet) and the prudential basis (the funding position measured by the funding ratio).

2. CATASTROPHE RISK AND REINSURANCE

- 2.1. The compensation scheme is exposed to the potential of significant claims costs arising from a single event, including potential events such as an incident at a major hazard facility, a natural catastrophe or war or acts of terrorism in Australia and/or overseas.
- 2.2. Comcare does not currently purchase any commercial reinsurance or hold any separate reserve for catastrophe risk. In the event of such an occurrence, the extent of Comcare's retained funds and access to the CRF (refer to 3.1 below) is expected to be sufficient to meet short-term cash-flow requirements. The impact of such an event occurring would be to reduce the funding ratio for the premium business. Measures for restoring the funding ratio are addressed in the funding ratio and premium setting sections of this policy.
- 2.3. Accordingly, Comcare's premiums should not include any charge or loading for catastrophe risk.

3. FUNDING RATIO FOR PREMIUM BUSINESS

- 3.1. The SRC Act specifies Comcare's sources of funding for premium business. Comcare must pay the cost of all compensation liabilities, damages and expenses from Comcare-retained funds (section 90C(1)). If there are insufficient Comcare-retained funds, costs can be met by appropriation from the CRF up to a prescribed maximum amount which represents the balance of premiums previously paid to the CRF before 1 July 2002 and notional interest thereon (sections 90C(2), 90C(3) and 90D). Comcare has no subscribed capital and there is no provision or requirement under the SRC Act for Comcare to pay a dividend to the Commonwealth.
- 3.2. Consistent with the approach commonly taken by statutory compensation schemes, the adequacy of Comcare's financial position should be measured and managed with reference to a 'funding ratio'.
- 3.3. Continuing Comcare's past practice, the funding ratio for premium business should be calculated as $A \div L$ where:

A = the value of the assets available to meet premium business liabilities, being the total of Comcare-retained funds relating to premium business and the maximum amount available to Comcare under section 90C of the SRC Act

L = the value of Comcare's claims liabilities for premium business, net of third party recoveries, determined in accordance with this framework and including a margin which provides for an intended 75 per cent probability of sufficiency.

3.4. With consideration of:

- > Comcare’s source of Commonwealth funding under section 90C of the SRC Act,
- > the current investment policy for Comcare-retained funds,
- > community expectations of trust and confidence that compensation schemes have the resources to support injured workers in the long term,
- > Comcare’s risk tolerance for reporting a funding ratio below 100 per cent, and
- > the potential variability of the funding ratio over a one-year period,

the target funding ratio for premium business should be in the range from 100 per cent to 110 per cent.

3.5. Variation of the funding ratio within the target range is to be expected, because of the variability which is inherent in the claims experience, the liability valuation and asset values.

3.6. The reporting of a funding ratio outside the target range is not of itself a significant matter. If the reported year-end funding ratio is outside the range, a plan should be developed to move the funding ratio back to the target range consistent with the policy for setting premiums (see 4.11 below).

4. PREMIUM SETTING

4.1. This section establishes a framework for determining:

- > the ‘central estimate premium pool’ for premium business, and
- > the final premium pool, including any margin above or below the central estimate.

4.2. Separate premium pools are determined for:

- > Commonwealth agencies (in total), and
- > the ACT Government (in total).

4.3. Premiums must be set consistently with the requirements of the SRC Act and the guidelines issued by the Commission under section 97E of the SRC Act.

Central estimate premium pool

4.4. The central estimate premium pool is the estimate of the amount required to fully fund the estimated cost of claims arising from injuries and diseases sustained in the premium year, including related claims management costs.

4.5. For consistency with best practice, the central estimate premium pool should be determined:

- > based on independent actuarial advice,
- > allowing for the time value of money by discounting at the target return on investments consistent with Comcare’s source of Commonwealth funding and investment policy, and
- > with no margin above or below the central estimate of the estimated cost.

4.6. The actuarial advice should include a hindsight reassessment of the central estimate premium pool for previous premium years, which is an important part of the ‘control cycle’ of the actuarial advice.

Final premium pool

4.7. As information which allows the premium determination to be made in this prudential framework, a financial projection should be prepared which:

- > is for a period of 10 future financial years,
- > is based on the independent actuarial advice on claims liabilities and premium pools, but may consider alternative scenarios in addition to the actuarial central estimate, and
- > projects the funding ratio for premium business at each future year-end.

4.8. The setting of the final premium pool is a decision of the CEO.

4.9. In setting the premium pool the CEO (or Delegate) should take into account:

- > obligations under the CAC Act, including those to exercise care and diligence, the business judgement rule and good faith (refer to Attachment A)
- > trends in claim performance and the ‘price signal’ which the premium sends to premium payers to reduce compensation costs by effective rehabilitation and work health and safety measures¹

- > the current and projected funding ratio, relative to the target, from the 10 year financial projection
- > a preference by premium payers for stability and predictability in premium rates from year to year
- > relevant legislative requirements including any guidelines issued by the Commission.

4.10. These factors may conflict and it should be recognised that some judgement may need to be exercised by the CEO (or Delegate) to balance these considerations.

4.11. If the funding ratio is—or is projected to be—outside the target range, the premium pool should include a margin above or below the central estimate pool consistent with a strategy to return the projected funding ratio to the target range based on the following table:

Funding ratio	Margin over central estimate
>110%	Down to -10%
100%-110%	0%
90%-100%	Up to 15%
80%-90%	Up to 20%
70%-80%	Up to 25%
<70%	Up to 30%

¹ From the Second Reading Speech of the then Minister introducing the SRC act 1988: ‘Under the existing Act, the Commissioner determines the liability of the Commonwealth to pay compensation. This legislation will impose that liability to pay compensation on the Commission or self-administrator. In order to fund the system, the Commission will be required to calculate, on the basis of the each organisation’s claims record, the contributions to be made by departments and statutory authorities to the Consolidated Revenue Fund. These contributions will act as a direct financial inducement to each department and statutory authority to reduce workers’ compensation costs by effective rehabilitation and occupational health and safety measures.’



5. AGENCY PREMIUMS

- 5.1. The determination of premiums for individual Commonwealth premium payers must be made in accordance with the SRC Act and the section 97E guidelines issued by the Commission. The total of these premiums must equal the total premium pool for Commonwealth agencies.
- 5.2. The section 97E guidelines currently in force require agency premiums to be set using the model agreed by the Commission. The Commission's guidelines also cover a number of other factors relevant to individual agency premiums which must be complied with.
- 5.3. A guide for premium payers which includes a description of the methodology should be provided to premium payers each year.
- 5.4. The SRC Act requires a notice of premium determination to be given to the principal officer of each Entity and Commonwealth authority. In keeping with current practice, this should be provided in the form of a letter to each premium payer from the CEO (or Delegate).
- 5.5. In any year a specific determination may need to be made for the effect of any changes which affect only some premium payers.
- 5.6. The determination of premiums for individual entities within the ACT Government is determined by the ACT Government from the total ACT Government pool which Comcare determines.

6. ACTUARIAL ADVICE

- 6.1. Independent actuarial advice is an important element of the prudential management of a long-tail compensation scheme. The following elements are based on best practice with reference to APRA's prudential standards for licensed insurers.
- 6.2. Comcare should engage an external, independent actuarial advisor to provide advice on:
 - > the claims liabilities at year-end, and at interim dates if required
 - > the central estimate premium pool
 - > the cost and premium effect of significant changes to entitlements, whether by legislative amendment, legal precedent or other source, and
 - > other matters where it is appropriate.
- 6.3. The requirement for independence should preclude the actuarial advisor for Comcare's year-end liabilities from being associated with Comcare's external auditor including any firm subcontracted to provide actuarial services to the auditor.
- 6.4. The actuarial advisor should be allowed direct and confidential access to Comcare's CEO, as the sole Director of Comcare.
- 6.5. Comcare may appoint more than one actuarial firm to provide this advice. Firms should be engaged under contracts for at least three years, subject to satisfactory performance.

- 6.6. The actuarial advisor, or principal nominated by the actuarial firm, should be a Fellow of the Institute of Actuaries of Australia with at least five years of relevant post-qualification experience who meets such fit and proper tests as Comcare requires.
- 6.7. Comcare must provide access to all relevant data, information, reports and staff which the actuarial advisor reasonably believes is necessary to fulfil their responsibility.
- 6.8. The actuarial advice must be prepared in accordance with the *Code of Professional Conduct* and relevant *Professional Standards* and *Practice Guidance* issued by the Institute of Actuaries of Australia. The advice on the year-end valuation of claims liabilities must be prepared in accordance with the Professional Standard for the valuation of general insurance claims.
- 6.9. Comcare should consider the need for peer review of the actuarial advice and the frequency and scope of any such reviews. As a minimum, the year-end valuation of claims liabilities should be subject to actuarial peer review at least every three years.

7. FRAMEWORK REVIEW

- 7.1. This framework should be reviewed at least every 3 years or when there is a material change in the interest rate environment.



ATTACHMENT A

Extracts from the Commonwealth Authorities and Companies Act 1997 (CAC Act)

DIVISION 4—CONDUCT OF OFFICERS

21 Background to duties of directors, other officers and employees

- (1) This Part sets out some of the most significant duties of officers and employees of Commonwealth authorities. Other duties are imposed by other provisions of this Act and other laws (including the general law).
- (2) Section 5 defines both *director* and *officer*.

SUBDIVISION A—GENERAL DUTIES

22 Care and diligence—civil obligation only

Care and diligence—officers

- (1) An officer of a Commonwealth authority must exercise his or her powers and discharge his or her duties with the degree of care and diligence that a reasonable person would exercise if he or she:
 - (a) were an officer of a Commonwealth authority in the Commonwealth authority's circumstances; and
 - (b) occupied the office held by, and had the same responsibilities within the Commonwealth authority as, the officer.

Note: This subsection is a civil penalty provision (see Schedule 2).

Business judgment rule

- (2) An officer of a Commonwealth authority who makes a business judgment is taken to meet the requirements of subsection (1), and their equivalent duties under the general law, in respect of the judgment if he or she:
- (a) makes the judgment in good faith for a proper purpose; and
 - (b) does not have a material personal interest in the subject matter of the judgment; and
 - (c) informs himself or herself about the subject matter of the judgment to the extent he or she reasonably believes to be appropriate; and
 - (d) rationally believes that the judgment is in the best interests of the Commonwealth authority.

The officer's belief that the judgment is in the best interests of the Commonwealth authority is a rational one unless the belief is one that no reasonable person in his or her position would hold.

Note: This subsection only operates in relation to duties under this section and their equivalents under the general law (including the duty of care that arises under the common law principles governing liability for negligence)—it does not operate in relation to duties under any other provision of this Act or under any other laws.

- (3) In this section:

business judgment means any decision to take or not take action in respect of a matter relevant to the operations of the Commonwealth authority.

23 Good faith—civil obligations

Good faith—officers

- (1) An officer of a Commonwealth authority must exercise his or her powers and discharge his or her duties:
- (a) in good faith in the best interests of the Commonwealth authority; and
 - (b) for a proper purpose.

Note 1: This subsection is a civil penalty provision (see Schedule 2).

Note 2: Section 187 of the Corporations Act 2001 deals with the position of directors of wholly owned subsidiaries of Commonwealth authorities.

Note 3: Section 27A makes provision for persons who are also APS employees or Agency Heads.

- (2) A person who is involved in a contravention of subsection (1) contravenes this subsection.

Note 1: Section 5 defines involved.

Note 2: This subsection is a civil penalty provision (see Schedule 2).

Note 3: Section 27A makes provision for persons who are also APS employees or Agency Heads.



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