



**Australian Government**  

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**Comcare**

# FRAMEWORK FOR SETTING PREMIUMS

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# PURPOSE

This document outlines the framework within which Comcare's Chief Executive Officer (CEO) determines the premiums payable under the *Safety, Rehabilitation and Compensation Act 1988* (SRC Act) by Commonwealth premium payers.

# BACKGROUND

In accordance with the provisions of the SRC Act, Comcare must determine the amount of premium each Entity and each Commonwealth authority ('premium payer') must pay in respect of each financial year. Entities and Commonwealth authorities are defined in the SRC Act to mean *Public Service Act 1999* agencies, parliamentary departments, prescribed entities and body corporates.

Under section 97E of the SRC Act, determinations must be made in accordance with the Safety, Rehabilitation and Compensation Commission's (the Commission's) written guidelines that are issued to Comcare's CEO.

Section 73 of the SRC Act provides that the Minister for Employment and Workplace Relations (the Minister) may give direction to Comcare about the performance of its functions or the exercise of its powers. The Minister has not given any directions in relation to the setting of premiums.

The *Public Governance, Performance and Accountability Act 2013* (PGPA Act) applies to Comcare, the CEO being the Accountable Authority. For reference, extracts from the PGPA Act relating to the general duties of accountable authorities and officials are included at Attachment A to this policy.

While there is no specific legislative requirement for Comcare to put a policy in place for premium setting or prudential management of compensation liabilities, the CEO has endorsed a framework for setting premiums since the 2012–13 financial year. This framework documents the prudential process and principles used for premium determinations.

The framework is intended to be consistent with best practice for Comcare's workers' compensation schemes. It is the result of extensive consultation with representatives of the Australian Government Actuary, the Department of Finance, the Victorian Department of Treasury and Finance, NSW Treasury and the Australian Prudential Regulation Authority (APRA) and consideration of the practices of other Australasian compensation schemes, government insurers and Australian insurance industry prudential standards.

# SCOPE

When setting premiums, Comcare defines claims liabilities as liabilities for outstanding compensation and non-economic loss claims under the SRC Act from injuries or disease sustained on or after 1 July 1989 ('premium scheme').

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

- > 'pre-premium scheme' – 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.
- > 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 scheme and ARC Act claims liabilities are funded by appropriations from the Consolidated Revenue Fund (CRF), the framework for setting premiums does not apply to them.

# PROCESS FOR SETTING PREMIUMS

The process for setting premiums under this framework is as follows:

1. Comcare receives independent actuarial advice on:
  - > claims liabilities for the premium payers, which are used to determine the current funding ratio;
  - > 'central estimate premium pool' for the premium payers;
  - > 'uncertainty margin' required for a 75 per cent probability of sufficiency in the premiums, and
  - > projection of the funding ratio for the next ten years under various scenarios.
2. CEO determines the 'final premium pool' for the premium payers, which is the sum of:
  - > adopted 'central estimate premium pool', and
  - > adopted 'total margin' (which is the adopted 'uncertainty margin' plus any adjustment required to reflect Comcare's forecast funding ratio).
3. CEO determines premiums for each premium payer, using the adopted model to allocate the 'final premium pool' for premium payers between the individual agencies.

Definitions of the above terms and additional details are provided in the Issues section below.

## ISSUES

This section provides additional details on the following issues relevant to setting premiums:

1. Reserving for claims liabilities
2. Funding ratio for the premium scheme
3. Setting the premium pool
4. Entity premiums
5. Catastrophe risk and reinsurance
6. Actuarial advice
7. Framework review

# 1. RESERVING FOR CLAIMS LIABILITIES

- 1.1. The value of Comcare's claims liabilities is used to determine the funding ratio. Management of the funding ratio is integral to the financial sustainability of the compensation scheme and hence the premium setting process.
- 1.2. 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.
- 1.3. 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 2.1);
  - > 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 CPS320, and
  - > is consistent with the practice of most other Australasian government insurers and compensation authorities.
- 1.4. Comcare's accounting policy for recognising claims liabilities includes a margin to achieve an intended 75 per cent probability of sufficiency and is consistent with the basis used to determine the funding ratio.

# 2. FUNDING RATIO FOR THE PREMIUM SCHEME

- 2.1. The SRC Act specifies where Comcare can source funding for the premium scheme. 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. This maximum amount must represent 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.
- 2.2. 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'.
- 2.3. The funding ratio for the premium scheme is calculated as A divided by L where:

A is the value of the assets available to meet the premium scheme's liabilities, being the total of Comcare-retained funds relating to the premium scheme and the maximum appropriation from the CRF available to Comcare under section 90C of the SRC Act.

L is the value of Comcare's claims liabilities for the premium scheme, 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.
- 2.4. The target funding ratio for the premium scheme is a minimum of 110 per cent. There is variation expected in the funding ratio due to the inherent variability in the claims experience, the liability valuation and asset values.
- 2.5. It is still possible for Comcare to remain solvent and continue to pay benefits when the funding ratio is below the minimum or below 100 per cent. However, 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 3.13).

## 3. SETTING THE PREMIUM POOL

- 3.1. This section establishes a framework for determining:
- > the 'central estimate premium pool' for the premium scheme, and
  - > the 'final premium pool', including any margin above or below the central estimate.
- 3.2. 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

- 3.3. The 'central estimate premium pool' for the financial year is the central estimate of the amount required to fully fund the:
- > estimated cost of claims arising from injuries and diseases sustained in the financial year ('estimated liability component' in section 97A(3)), and
  - > related claims management costs ('estimated management component' in section 97A(3)).
- 3.4. 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.
- 3.5. The actuarial advice should include a hindsight reassessment of the 'central estimate premium pool' for previous financial years, which is an important part of the 'control cycle' of the actuarial advice.

### Uncertainty Margin

- 3.6. The long-term nature of claims in the Comcare scheme means that any estimate of the premium pool is inherently uncertain. To safeguard against this uncertainty when setting the 'final premium pool', Comcare may allow for an 'uncertainty margin' to be added to the 'central estimate premium pool'.
- 3.7. The 'uncertainty margin' should be determined:
- > based on independent actuarial advice, and
  - > at a level that provides a 75 per cent probability of sufficiency, consistent with Comcare's claims liabilities.
- 3.8. Any portion of the 'uncertainty margin' that is not used to fund claim costs or liabilities will improve Comcare's funding ratio. Depending on the level of actual or projected funding ratio, Comcare may use a higher or lower 'uncertainty margin' than originally determined as per 3.7 above (see 3.13).

### Projection of the funding ratio

- 3.9. As information assisting the premium determination to be made under this framework, a financial projection should be prepared that:
- > 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 the premium scheme at the end of each year.

## Final premium pool

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

3.11. In setting the premium pool the CEO (or Delegate) should consider:

- > obligations under the PGPA Act, including those to exercise care and diligence, and act in good faith and for a proper purpose (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 measures<sup>1</sup>;
- > the current and projected funding ratio, relative to the target, throughout the 10-year financial projection;
- > a preference by premium payers for stability and predictability in premium rates from year to year, and
- > relevant legislative requirements including any guidelines issued by the Commission.

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

3.13. If the funding ratio is – or is projected to be – outside the target range at a future year-end, the uncertainty margin should be adjusted above or below the value originally determined as per 3.7 above. The adjusted uncertainty margin should be 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
>125%	Down to -10%
111%-125%	0%
91%-110%	Up to 15%
81%-90%	Up to 20%
71%-80%	Up to 25%
<70%	Up to 30%

## 4. ENTITY PREMIUMS

4.1. 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 individual entity premiums must equal the total 'final premium pool' for Commonwealth premium payers.

4.2. The section 97E guidelines require compliance with a number of other factors relevant to individual entity premiums.

4.3. A guide for premium payers, including a description of the methodology should be provided to premium payers each year.

4.4. The SRC Act requires a notice of premium determination to be given to the principal officer of each premium payer. In keeping with current practice, this should be provided in the form of a letter to each premium payer from the CEO (or Delegate).

4.5. In any year a specific determination may be required to consider a change that affects limited premium payers.

<sup>1</sup> 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. CATASTROPHE RISK AND REINSURANCE

- 5.1. The compensation scheme is exposed to potential significant claims costs arising from a single event, such as an incident at a major hazard facility, a natural catastrophe or war or acts of terrorism in Australia and/or overseas.
- 5.2. 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 2.1) is anticipated to be sufficient to meet short-term cash-flow requirements.
- 5.3. The impact of such an event occurring would be to reduce the funding ratio for the premium scheme. Measures for restoring the funding ratio are addressed in the Funding ratio and premium setting sections of this policy.
- 5.4. Accordingly, Comcare's premiums do not include any charge or loading for catastrophe risk.

## 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 and 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 another 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 Accountable Authority of Comcare.
- 6.5. Comcare may appoint more than one actuarial firm to provide 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 and meet such fit and proper tests as Comcare requires.
- 6.7. Comcare must provide the actuarial advisor with access to all relevant data, information, reports and staff as reasonably required 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. The year-end valuation of claims liabilities should be subject to actuarial peer review once every five years or after significant changes to methodology.

## 7. FRAMEWORK REVIEW

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

# **EXTRACTS FROM THE PUBLIC GOVERNANCE, PERFORMANCE AND ACCOUNTABILITY ACT 2013 (PGPA ACT)**

## **SUBDIVISION A – GENERAL DUTIES OF ACCOUNTABLE AUTHORITIES**

### **15 Duty to govern the Commonwealth entity**

- (1) The accountable authority of a Commonwealth entity must govern the entity in a way that:
- (a) promotes the proper use and management of public resources for which the authority is responsible; and
  - (b) promotes the achievement of the purposes of the entity; and
  - (c) promotes the financial sustainability of the entity.
- Note: Section 21 (which is about the application of government policy) affects how this duty applies to accountable authorities of non corporate Commonwealth entities.
- (2) In making decisions for the purposes of subsection (1), the accountable authority must take into account the effect of those decisions on public resources generally.

### **16 Duty to establish and maintain systems relating to risk and control**

The accountable authority of a Commonwealth entity must establish and maintain:

- (a) an appropriate system of risk oversight and management for the entity; and
- (b) an appropriate system of internal control for the entity;

including by implementing measures directed at ensuring officials of the entity comply with the finance law.

Note 1: An example of a measure directed at ensuring officials of the entity comply with the finance law is a measure:

- (a) requiring, as a condition of employment of an official of the entity, that the official complies with the finance law; and
- (b) specifying sanctions (such as termination) that apply to the official for contravening that condition.

Such a measure would not be needed for officials to whom the *Public Service Act 1999* or *Parliamentary Service Act 1999* applies because, under that Act, sanctions may be imposed on those officials for contravening the finance law: see section 32 of this Act.

Note 2: This duty includes managing consultants and independent contractors who work for the entity, even if they are not officials of the entity.

### **17 Duty to encourage cooperation with others**

The accountable authority of a Commonwealth entity must encourage officials of the entity to cooperate with others to achieve common objectives, where practicable.

### **18 Duty in relation to requirements imposed on others**

When imposing requirements on others in relation to the use or management of public resources for which the accountable authority of a Commonwealth entity is responsible, the accountable authority must take into account:

- (a) the risks associated with that use or management; and
- (b) the effects of imposing those requirements.

## **19 Duty to keep responsible Minister and Finance Minister informed**

- (1) The accountable authority of a Commonwealth entity must do the following:
  - (a) keep the responsible Minister informed of the activities of the entity and any subsidiaries of the entity;
  - (b) give the responsible Minister or the Finance Minister any reports, documents and information in relation to those activities as that Minister requires;
  - (c) notify the responsible Minister as soon as practicable after the accountable authority makes a significant decision in relation to the entity or any of its subsidiaries;
  - (d) give the responsible Minister reasonable notice if the accountable authority becomes aware of any significant issue that may affect the entity or any of its subsidiaries;
  - (e) notify the responsible Minister as soon as practicable after the accountable authority becomes aware of any significant issue that has affected the entity or any of its subsidiaries.
- (2) However, for a Commonwealth entity that is related to a court or tribunal, subsection (1) applies only to activities, reports, documents, information or notifications about matters of an administrative nature.
- (3) Without limiting subsection (1), the rules may prescribe matters to be taken into account in deciding whether a decision or issue is significant.
- (4) The accountable authority must comply with a requirement under paragraph (1)(b) within the time limits set by the Minister concerned.

### **Relationship with other laws and powers**

- (4A) If a Commonwealth entity has enabling legislation, then subsection (1) applies only to the extent that compliance with that subsection is not inconsistent with compliance with that legislation.
- (4B) This section is subject to any Commonwealth law that prohibits disclosure of particular information.
- (5) This section does not limit any other power that a Minister has to require information from a Commonwealth entity.

## **SUBDIVISION A – GENERAL DUTIES OF OFFICIALS**

### **25 Duty of care and diligence**

- (1) An official of a Commonwealth entity must exercise his or her powers, perform his or her functions and discharge his or her duties with the degree of care and diligence that a reasonable person would exercise if the person:
  - (a) were an official of a Commonwealth entity in the Commonwealth entity's circumstances; and
  - (b) occupied the position held by, and had the same responsibilities within the Commonwealth entity as, the official.
- (2) The rules may prescribe circumstances in which the requirements of subsection (1) are taken to be met.

### **26 Duty to act honestly, in good faith and for a proper purpose**

An official of a Commonwealth entity must exercise his or her powers, perform his or her functions and discharge his or her duties honestly, in good faith and for a proper purpose.

## 27 Duty in relation to use of position

An official of a Commonwealth entity must not improperly use his or her position:

- (a) to gain, or seek to gain, a benefit or an advantage for himself or herself or any other person; or
- (b) to cause, or seek to cause, detriment to the entity, the Commonwealth or any other person.

## 28 Duty in relation to use of information

A person who obtains information because they are an official of a Commonwealth entity must not improperly use the information:

- (a) to gain, or seek to gain, a benefit or an advantage for himself or herself or any other person; or
- (b) to cause, or seek to cause, detriment to the Commonwealth entity, the Commonwealth or any other person.

## 29 Duty to disclose interests

- (1) An official of a Commonwealth entity who has a material personal interest that relates to the affairs of the entity must disclose details of the interest.
- (2) The rules may do the following:
  - (a) prescribe circumstances in which subsection (1) does not apply;
  - (b) prescribe how and when an interest must be disclosed;
  - (c) prescribe the consequences of disclosing an interest (for example, that the official must not participate at a meeting about a matter or vote on the matter).

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