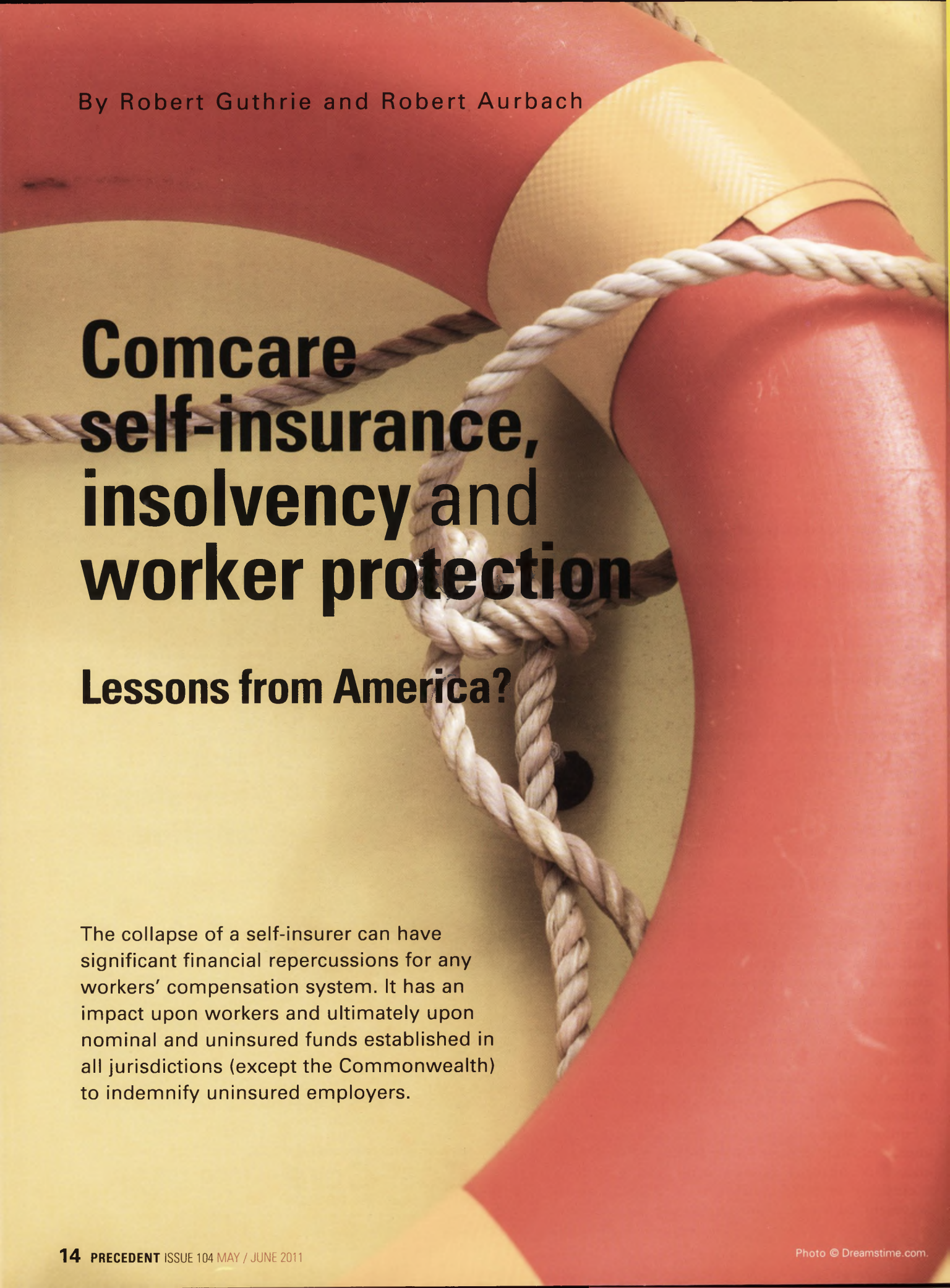
By Robert Guthrie and Robert Aurbach

Comcare self-insurance, insolvency and worker protection

Lessons from America?



The collapse of a self-insurer can have significant financial repercussions for any workers' compensation system. It has an impact upon workers and ultimately upon nominal and uninsured funds established in all jurisdictions (except the Commonwealth) to indemnify uninsured employers.

With the exception of the Commonwealth, under the *Safety Rehabilitation and Compensation Act* 1988 (Cth) (Comcare), the legislative requirements for self-insurance have considerable commonality in all Australian states and territories, typically requiring bank guarantees and/or forms of re-insurance as a safety net against insolvency.

Other operational requirements set out in the regulations of the respective jurisdictions – in particular, the variations in reporting arrangements – may create additional administrative burdens. These matters provide some incentive for a select group of employers to move to the Comcare system in order to reduce compliance costs. It follows that the issue of insolvency of a self-insurer under Comcare is worthy of some attention.

THE PREVALENCE OF SELF-INSURANCE IN AUSTRALIA

All Australian jurisdictions provide that employers who fulfil certain, strict prudential requirements are able to apply for a licence to self-insure in relation to workers' compensation matters. However, each jurisdiction has particular requirements in relation to workers' compensation self-insurance although, again, there are common themes. The protection provided to injured workers in receipt of workers' compensation in the event of corporate insolvency are particularly relevant when corporate collapses have stripped shareholders and investors of their assets; this circumstance often leaves workers without access to income support.

In its 2004 report, *National Workers' Compensation and Occupational Health and Safety Frameworks*, the Productivity Commission recorded that, as at 2004, there were 165 employers who held a self-insurance licence in at least one state or territory, of which 32 were self-insured in more than one jurisdiction.[1] South Australia has a particularly high rate of self-insurance, although it is only the fifth largest jurisdiction in terms of number of workers and employers in Australia.

WorkCover Western Australia noted during 2008 that:

> 'Several self-insured employers in Western Australia are also self-insurers in other Australian states and territories. Based on available data from all states and territories, only four Australian companies are self-insurers in all eight jurisdictions; these are the major retailers, Woolworths and the Coles Group, and Commonwealth and Westpac banks. The ANZ Bank self-insures in seven jurisdictions...
>
> Companies self-insured across five states include BHP, CSR, Ingham Enterprises and Rinker, while Bluescope, One Steel and Symbion Health are self-insured in four. Brambles self-insurers in three states and Alcoa, BP Australia, and Smiths Snackfoods self-insure in only one other state apart from Western Australia.'[2]

The Commonwealth Bank has since obtained a licence under Comcare, as has the National Australia Bank, which suggests that the Westpac and ANZ Banks will follow suit in the future. By moving into the Comcare system, employers are able to relinquish liability under the sub-national schemes and operate under and comply with the requirements of a single scheme. Woolworths and Coles have yet to make application for a licence under Comcare.

Some employers who are not self-insured, but who are conducting multi-jurisdictional business, may also migrate to Comcare if they can satisfy the eligibility criteria. Examples of this form of migration are the transport companies TNT Australia, Linfox and K & S Freighters, and construction company, John Holland.

Self-insurers do not generally pay a premium as such; logically, this is because they are not insured. However, all systems require self-insurers to contribute to variously described nominal or uninsured or general funds, and the contribution that is levied on self-insurers is most often referred to as a 'notional premium'. It appears from the limited data available[3] that self-insurers contribute about 10 per cent to the overall premium pool, although it is likely that in South Australia this may be higher. A move from the sub-national systems into Comcare by large self-insurers and employers, such as John Holland, could conceivably affect the premium pool for those remaining. In South Australia, a migration of self-insurers may have a more significant effect, although on current form it would appear that only the banks and large retailers are likely to make this move.

THE COMCARE REQUIREMENTS

Under the *Safety Rehabilitation and Compensation Act* 1988 (Cth), a single public insurer is established to insure all Commonwealth authorities[4] required to insure under this Act. The scheme is administered by Comcare.[5] Under Part VIII of the same Act, employers who satisfy the prudential requirements set out in ss98A and 108 are able to self-insure under Comcare's unified benefits scheme. The effect of self-insurance is that the employer effectively administers its own claims and is directly liable for payments and any obligations that arise under the Act.[6] As at 30 June 2007, there were 17 self-insurers under this Act. At the time of writing, there are 28 licensees,[7] the increase in licensees arising due to Howard Coalition government policy changes in 2006.[8] The prudential requirements[9] under the *Safety Rehabilitation and Compensation Act* 1988 (Cth) require a licensee to obtain (on a yearly basis):

- an actuarial assessment of current and projected outstanding workers' compensation liabilities;
- a bank guarantee based on the 95th percentile of outstanding workers' compensation liabilities, subject to a minimum of $2.5 million;
- a reinsurance policy with a reinsurance retention amount as approved by the Safety Rehabilitation and Compensation Commission; and
- certification by the principal officer of the licensee that the actuarial assessment has been made in accordance with the licence conditions, provision has been made in the accounts for meeting the >>

The advent of 'mega-bankruptcies' has created unanticipated regulatory problems for self-insurance that remain unresolved.

> estimated liabilities, and the licensee has the capacity to meet any single claim up to the reinsurance retention amount.[10]

An annual base license fee of $30,000 is payable by a self-insurer, with variations to this fee depending upon contributions to regulatory management under this Act. There are no provisions under the *Safety Rehabilitation and Compensation Act* 1988 (Cth) that address the issue of insolvency of a self-insurer. However, s90C of the Act provides that Comcare will in the first instance manage a central fund out of which all liabilities under the Act for Commonwealth authorities will be paid by Comcare. In the event that insufficient funds are available, then the Commonwealth shall pay to Comcare such amount as is necessary to meet its liabilities. This provision appears to deal with the (unlikely) insolvency of a Commonwealth authority which is not self-insured; however, whether s90C in fact provides a form of indemnity for self-insurers is a moot point. This is because s108 provides that a self-insurer is authorised to accept liability for all claims made against it and s108A appears to shift any liability under the Act from Comcare to the licensee. In particular, sub-paragraph (c) provides that the licensee is liable to pay compensation and other amounts under the Act in respect of a claim for injury, loss, damage or death; and sub-paragraph (d) provides that Comcare is not liable to pay compensation or other amounts under the Act in respect of that injury, loss, damage or death. These provisions suggest that the effect of self-insurance is to shift liability from Comcare to the self-insurer so that the safety net provided under s90C does not apply to self-insurers: that section relates to the Commonwealth obligation to meet any outstanding liabilities 'in relation to compensation that Comcare incurs' under the Act. If this is correct, there would appear to be nothing under this Act that provides direct protection for a worker employed by a self-insurer which becomes insolvent. A worker in such a situation would have to rely upon the prudential safeguards in place – namely, the bank guarantees and re-insurance required – in order to recover. Relying on these mechanisms may prove adequate in terms of providing sufficient assets to pay all the claims, although there is more than likely to be a considerable delay in satisfying workers' compensation claims because the administrator would have to activate these resources. The Productivity Commission Report commented upon this circumstance, noting that under Comcare the bank guarantee required of a self-insurer referred to above is set at 100 per cent of claims liability calculated to the 95th percentile. This means that, according to actuarial assumptions, there is only a 5 per cent probability of the bank guarantee not being able to cover claims. In effect, this means that Comcare's exposure is only the difference between the bank guarantee and the actual claims liability.[11] The Commonwealth is the only jurisdiction that does not provide a form of dual protection for workers in the form of both bank guarantees and nominal funds.

THE AMERICAN EXPERIENCE WITH SELF-INSURER COLLAPSES

The recent, so-called 'global financial crisis' focused some attention on self-insured employers in the US, where some spectacular collapses highlighted some short-comings with the system in the multiple jurisdictions in America. The US also has a system for resolving the liabilities of an insolvent entity.[12] The 'Bankruptcy Code' provides a system for collecting the assets of an insolvent company and distributing those assets under the supervision of a specialised court, under a specified priority system. Self-insured employers who are insolvent very often resort to this system of resolving their financial situation. When that occurs, the liabilities owed to injured workers for wage replacement and for medical and other services under the state workers' compensation schemes are subject to the administration of the Bankruptcy Court.

Unfortunately, the priority system for distributing the assets of the insolvent employer favours commercial liabilities, and the rights of injured workers are not well protected.[13] American regulators confronting a bankruptcy frequently find that the security on hand to pay the liabilities is inadequate. It is typical of the American experience with the bankruptcy of self-insurers that the regulator finds, after the fact, that the stated liabilities for workers' compensation, on which the security is based, are almost universally lower than the actual liabilities experienced.[14] (Incidentally, this is also a concern noted in Australia by the Productivity Commission.[15]) There are several reasons for this phenomenon. First, lodging security is costly. Not only do banks charge fees based upon the size of the security lodged, but it is common for such financial institutions to require complete (or at least partial) collateralisation of the security deposit. This collateralisation represents a diversion of working capital for the company and there is an observed tendency for businesses to consistently under-report their liabilities.[16] Second, many American self-insurers use agents to administer their claims, and such agents typically tend to be overly optimistic about their ability to settle the liabilities at the lowest possible sum. This tendency is presumably motivated by the desire to appear to be providing excellent service in ad environment where competition between agents for the business of self-insurers can be intensive. Finally,

there simply is a delay between the lodging of security and the periodic re-examination of the amount of security that the regulatory authority will require. During this period, if liabilities do increase – due to new accidents or the surfacing of claims that have been incurred but not yet reported – the security will diminish relative to the whole liability exposure, even without any wrongdoing. Since the appearance of a 'spike' in claims frequency following layoffs or a business closing is frequently observed, the importance of the lag time between the posting of security and a re-examination of its adequacy can be significant.[17]

The relative adequacy or inadequacy of security should not be an issue, if there is an adequate safety net fund to provide an alternative source of payments for injured workers. Unfortunately, when the self-insurer is large, the existing safety nets have sometimes proved inadequate for the job. Kmart, a retailer in the US with stated assets of over $6 billion USD, declared bankruptcy in 2003. With operations in most of the state jurisdictions, the sheer size of the company was thought to insulate it from insolvency. When it defaulted on its workers' compensation obligations, claims were made to the safety net funds in those states that had them. Unfortunately, in several states the size of the claims against the safety net fund decimated the fund corpus, resulting in delays in payments to injured workers and, in some instances, defaults on obligations to them.[18]

In 2008-2009, both General Motors and Chrysler declared bankruptcy. Although their bankruptcy cases were administered in a remarkably short time, a pattern emerged that has not yet been resolved.[19] Both companies utilised the bankruptcy as an opportunity to close operations that they considered unprofitable. In both instances, the withdrawal of all operations from one or more states occurred. Where the companies withdrew from a state, each of them abandoned their liabilities to injured workers to their (inadequate) security and to state safety net funds. In more than one state, there are concerns that the corpus of the safety net fund may be entirely consumed without fully funding liabilities to injured workers, resulting in delays of benefit provision or, in some cases, unfulfilled obligations.[20] The decimated safety net funds will also not be available to cover the liabilities of other employers, including the parts suppliers of those manufacturing giants, who also closed their doors as a result of the global financial crisis. The advent of these 'mega-bankruptcies', with the potential for creating liability exposures never anticipated when safety net funds were created, has created regulatory problems for self-insurance that have not yet been resolved.

COLLAPSES IN AUSTRALIA

It is important to note that the mega-bankruptcy phenomenon is not replicated in Australia, where strategic bankruptcies undertaken to divest liabilities are not available in the same way that they are in the US. However, the experience in the US is still valuable. Prudential requirements set at 100 per cent of liabilities may not be sufficient if liabilities have been understated and/or a spike in claiming due to layoffs limits the security, making it no longer reliable. The cost of administering the claims presents an additional demand on security posted for the employer, which raises questions about the adequacy of security set only at the level of stated liabilities. Delays in claims payment while the financial institution that placed the guarantee seeks to protect its own interests must be also be considered.

In Australia, the closure of Mitsubishi in South Australia in 2008 demonstrates the possibility of a large corporate entity terminating operations abruptly, with substantial financial consequences. Mitsubishi closed its Tonsley Park production facility in South Australia at the end of March 2008, making approximately 930 workers redundant and affecting the job prospects of thousands of additional workers who were engaged in parts manufacturing and other related enterprises.[21] The impact upon injured workers was presumably affected by the fact that Mitsubishi had an outstanding debt of AUD$35 million for repayment of a grant received from the South Australian government in 2002. Nonetheless, even in the context of an orderly termination of operations, the Australian government posted a >>

Sole reliance on prudential requirements to cover liabilities to injured workers may be an inadequate strategy.

AUD$50 million package of benefits to ease the transition for the affected workers.[22] It is easy to imagine that a company of similar or larger size, with no outstanding obligations to enforce good corporate citizenship, might be tempted to allow its bank guarantees to be left as the sole source of funding for the claims of injured workers, leaving government to 'pick up the pieces' should the bank guarantees prove to be insufficient.

Thus, the American experience suggests that sole reliance upon prudential requirements to ensure that liabilities to injured workers will be fulfilled may be an inadequate strategy. The presence of a nominal fund as a backup to prudential security requirements also has a mixed history in the US. As the economic environment has changed, and with it the drain on such funds, they have proven to be inadequate in some cases. However, the nominal funds have been quite good at providing continuing benefits for the injured during the course of legal proceedings surrounding the insolvency, in many instances, even when they have proven to be ultimately inadequate for the full payment of the claims. The structure of nominal funds and the level of funding needed to truly provide a safety net is a matter of significant regulatory attention in the US at present.

This experience may have implications, particularly for Comcare, since it apparently has no direct liability to the injured workers of its self-insurers, leaving those workers without any safety net fund (such as a nominal or uninsured funds) in the event of the insolvency of a self-insurer, where the existing prudential security is inadequate to fund the liabilities.

CONCLUSIONS

All jurisdictions, save for the Commonwealth, have employed a 'belts and braces' approach by insisting upon strict prudential thresholds for self-insurers and, in addition, nominal or uninsured funds upon which workers can claim in the event of corporate insolvency. WorkCover Western Australia observed, in relation to the self-insurers in that jurisdiction, that it encouraged only large and medium-sized companies to self-insure and numbered several companies in the ASX top 50 companies within this group. This is probably typical of the pattern of self-insurers in Australia, and most certainly typical of those who are licensed under Comcare. The Productivity Commission recorded that only two Australian self-insurers had become insolvent; one was Blue Ribbon Meats – a Tasmanian company leaving liabilities of $575,379, which had a bank guarantee of 150 per cent of claims liabilities estimated at the 50th percentile amounting to $438,238. In South Australia, T O'Connor & Sons Pty Ltd became insolvent in 1991, with claims liabilities of $2.1 million, with a bank guarantee of 150 per cent of claims liabilities estimated at the 50th percentile, resulting ultimately in $797,000 being provided. In other words, despite these bank guarantees there was a shortfall in securities to cover worker claims. In both cases, the respective jurisdictions strengthened their prudential requirements following these collapses.[23] Importantly, several licensed insurers such as Palmdale/AGCI Insurance, National Employers Mutual General Insurance Company, Bishopsgate Insurance Company and HIH Insurance have also collapsed in the past.[24] Comcare does not adopt the belts and braces requirements of the other Australians schemes insofar as it relies on the stringent prudential requirements of 100 per cent of claims liability estimated at the 95th percentile. The Productivity Commission implicitly acknowledged the strength of these requirements but also noted that the Australian government actuary had observed the potential for unforeseen claims to emerge upon insolvency, rendering bank guarantees insufficient in some cases.[25] One weakness in the Comcare system in relation to worker protection is the apparent inability of workers employed by self-insurers to gain easy and timely access to a safety net fund, as in other jurisdictions. In effect, if insolvency occurs, a worker in the Comcare system would, if funds were insufficient to cover claims, have to await the outcome of the insolvency administration. While there has been no history of self-insurer insolvency within Comcare, the migration of employers to that system in recent times (which is likely to accelerate if the current Gillard Labor government moratorium on granting licences is lifted) raises the matter for consideration. The legislative creation of a nominal fund as, for example, in South Australia, or the ability to apply post-event levies upon self-insurers as in Western Australia, could be applied to Comcare to prevent risks to employees governed by that scheme that are not present in the state systems. Even in the state systems, the adequacy of funding for the nominal insurer fund should periodically be examined to ensure its adequacy to prevent any drain on funds in the event of a major self-insurer collapse. ■

This article is an abridged and updated version of a paper that first appeared in the *Insurance Law Journal* (2010) July, Vol. 21, No.1, p24.

Notes: **1** Australian Government Productivity Commission (2004) *National Workers' Compensation and Occupational Health and Safety Frameworks*, Productivity Commission Inquiry Report, 27 March 2004, p345. **2** *Self-Insurance in Western Australia: A Historic and Current Overview*, WorkCover, WA, 2008, p7 at http://www.workcover.wa.gov.au/NR/rdonlyres/798914B5-4E64-4365-9D9A-5C347E49D026/0/HistoricOverviewApril2008_Final__2_.pdf 3rd April 2009. **3** *Review of self-insurance arrangement in Victoria:* Report of the Self-Insurance Review Team, August 2005, for the period 1994-2003 at http://www.worksafe.vic.gov.au/wps/wcm/resources/file/ebdd024df0405d3/self_

insurance_report_final.pdf 3rd April 2009 p9 (8-10%); and *Self-Insurance in Western Australia*; A Historic and Current Overview WorkCover, WA, 2008. p11, for the period 1997-2007 at http://www.workcover.wa.gov.au/NR/rdonlyres/798914B5-4E64-4365-9D9A-5C347E49D026/0/HistoricOverviewApril2008_Final__2_.pdf 3rd April 2009, (9-12%). **4** As defined in s4 of *Safety Rehabilitation and Compensation Act* 1988 (Cth). The obligation to insure is set out in Division 4A of the Act , ss96-97P. **5** Part VII of the *Safety Rehabilitation and Compensation Act 1988* (Cth); in particular, s 66. **6** Section 108 of the *Safety Rehabilitation and Compensation Act* 1988 (Cth). **7** Safety Rehabilitation and Compensation Commission current licenses <http://www.srcc.gov.au/self_insurance/current_licensees > at 13th March 2009. **8** K Purse, R Guthrie and F Meredith, 'Faulty Frameworks: The Productivity Commission and Workers' Compensation', *Australian Journal of Labour Law* (2004) 17(3) 306; and K Purse, F Meredith and R Guthrie, 'Neoliberalism, Workers' Compensation and the Productivity Commission', *Journal of Australian Political Economy* (2004) 54, 45. **9** Which arise out of the powers conferred under s108D, although the conditions appear to be a matter of administrative policy rather than legislative regulation. **10** Safety Rehabilitation and Compensation Commission, *Prudential and Financial Conditions of A Licence* <http://www.srcc.gov.au/self_insurance/licence_conditions_and_performance_standards/prudential_and_financial_conditions_of_a_licence > at 13 March 2009. **11** Australian Government Productivity Commission (2004), *National Workers' Compensation and Occupational Health and Safety Frameworks,* Productivity Commission Inquiry Report, 27 March 2004 p350. **12** 11 USC ss100, *et. seq.*. **13** See, generally, R Aurbach, 'Bankruptcy and Workers' Compensation: Broken Promises, Broken Lives', *WorkCompInsider*, 12, 13 and 14 January, 2009, www.workerscompinsider.com. **14** This is true even in the presence of virtually universal requirements for producing audited financial reports, and independent audits of the adequacy of claims reserves conducted by, or under contract to, the regulatory authority. When the discrepancy between stated and actual reserves is first noted, it has often been the case that the company cannot post additional security to cover the under-reported liabilities without creating a substantial danger that the additional security requirement will be the 'straw that breaks the camel's back' and forces the company into bankruptcy. **15** Australian Government Productivity Commission (2004), *National Workers' Compensation and Occupational Health and Safety Frameworks,* Productivity Commission Inquiry Report, 27 March 2004, p351, referring to the experience in the NSW coal industry. **16** In the state of New Mexico, for instance, the observed under-reporting of liabilities over eight separate bankruptcy episodes had a mean of approximately 25 per cent and a maximum of over 33 per cent. **17** See, for example, F Schmid, 'Workplace Injuries and Job Flows', http://papers.ssrn.com/sol3/papers.cfm?abstract_id=1377704; and J Gardner et. al, *Cost Drivers in New Jersey*, Workers' Compensation Research Institute, 1994, pp55 *et.seq.* The magnitude of the business closing 'spike' in claims has been estimated as high as a 30 per cent increase in claims frequency in some cases. **18** Notably, the state of Michigan. **19** Each of those cases lasted a matter of weeks from the filing of the initial petition for bankruptcy protection to an order distributing assets, as compared to the Kmart bankruptcy, which lasted more than 18 months before it was resolved. **20** Alabama, Georgia, New Jersey and Oklahoma were excluded from continued payments from the 'new company' in the General Motors bankruptcy, and may be in danger of significant impact on their safety net funds. **21** A Fallah, 'Mitsubishi Goes Full Import', 5 February 2008, *CARADVISE.COM.AU* available at http://www.caradvice.com.au/10035/mitsubishi-australia-goes-full-import/ last viewed 15 October 2009. **22** N Haxton, ' Fears Mitsubishi will shut SA plant', 5 February 2008, ABC National Radio AM, available at http://www.abc.net.au/am/content/2008/s2154423.htm last viewed 15 October 2009; and Joint Media Release with Minister for Industry and Premier of South Australia, 5 February 2008, 'New fund to boost innovation and investment in southern Adelaide', available at http://parlinfo.aph.gov.au/parlInfo/search/display/display.w3p;adv=;db=;group=;holdingType=;id=;orderBy=;page=;query=Source%3A%22PRIME%20MINISTER%22%20Author_Phrase%3A%22carr,%20sen%20kim%22;querytype=;rec=3;resCount= last viewed 15 October 2009. **23** It is often wrongly presumed that when Ansett Airlines collapsed in 2001 it was self-insured, but it was in fact insured by Alliance insurance. **24** Chamber of Commerce and Industry Western Australia (2003*), Submission to Productivity Commision Inquiry into Workers' Compensation and Occupational Health and Safety Frameworks*, available at http://www.pc.gov.au/__data/assets/pdf_file/0018/19206/sub055.pdf, last viewed 15 October 2009, p25. **25** Australian Government Productivity Commission (2004), *National Workers' Compensation and Occupational Health and Safety Frameworks,* Productivity Commission Inquiry Report, 27 March 2004, pp351 and 353.

Rob Guthrie *is Adjunct Professor of Workers' Compensation and Workplace Law at Curtin University.* **PHONE** *(08) 9425 3264* **EMAIL** *Robert.Guthrie@justice.wa.gov.au.*
Robert Aurbach *is CEO of Uncommon Approach Inc, a consulting firm specialising in design and evaluation of workers' compensation programs, and editor of the Journal of the International Association of Industrial Accident Boards and Commissions.* **EMAIL** *bob@uncommonapproach.com.*