

Frequently Asked Questions

Claims Estimates

June 2008

Introduction to the Model

As part of a broader package of reforms introduced in 2004/05, WorkSafe Victoria changed the way the future costs of claims are estimated for premium purposes. The new model uses claims data to determine a Statistical Case Estimate (SCE / estimate), providing for a more consistent and objective approach to the estimation process.

Estimates are used to provide a means of measuring the severity of injuries through the full cost of a claim. They allow for claims in each year to be weighted equally and for claims to be removed from the calculation after they have been used three times. If no estimate is used older claims would have a greater weighting as they have more actual payments and all other factors being equal every dollar paid would have a greater impact on premium.

The SCE model is a particular type of predictive claims model which provides individual estimates of future claim costs arising from existing claims. These estimates are predicted via a statistical model using the individual characteristics of each claim.

Predictive claims models are useful because they implicitly link underlying drivers to outcomes of interest at the individual claim level. The models themselves help to perform three key tasks:

- Provide a stronger link between changes in the claims processes and reserving;
- Provide estimates of future claims costs arising from existing claims; and
- Provide an understanding and quantification of the drivers of a claim.

Past payment levels is also generally a good predictor of the likelihood of future payments, and form one of the key model drivers. They form the basis for determining whether a claim is currently receiving weekly benefits ("on" benefits), or not ("off" benefits). Moving from "on" benefits to another month of being "on" benefits gives rise to a higher probability that benefits will continue.

Benefits of the Model

There are many benefits from using predictive claims models in a number of applications:

- Better usage of individual claims data for forecasting and reporting;
- Updating estimates for changes to legislation;
- Better understanding of the claims drivers, enabling implementation of more appropriate claims management initiatives;
- Improved quantification of benefits from/monitoring of claims management initiatives; and
- Identification of high risk claims¹.

To assist with an understanding of the estimating process, answers to the following frequently asked questions have been prepared:

¹ Prevett, Mitchell & Gifford, David (2007) "Statistical Case Estimation for Long Term Claimants - Uncovering Drivers of Long Term Claims Cost in Accident Compensation, paper prepared for the XIth Accident Compensation Seminar 1-4 April 2007

Questions

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1. What this means for my premium?

Although the value of the estimates may appear higher under the estimation model, this does not necessarily imply a dramatic effect on an employer's premium. This is because the claims costs are used to determine an employer's relative performance – that is, how an employer's claims costs compare to their peers. An employer's estimates are also used in the claims experience of their industry – it is the ratio that is important.

This means that an employer's claims estimates are compared with the estimates for all other employers in their industry (or industries) with all estimates made using the same consistent and objective method. Accordingly, the chance of an employer being disadvantaged by the use of modelled estimates is significantly reduced.

2. Why are there step changes in estimates (typically 31 March and 31 October)?

WorkSafe estimates the cost of each claim using an estimation model which provides for an objective, consistent and relative measure aligned to scheme experience. To ensure that the model reflects scheme experience and scheme trends it is recalibrated and adjusted twice a year following actuarial valuations of the Scheme.

Past recalibrations have occurred on the following estimate valuations:

- ◆ 31 October 2007; and
- ◆ 31 March 2008.

Recent scheme experience may suggest that claims with certain characteristics have a higher probability of incurring further payments, whilst others have a lower probability. The model is recalibrated and adjusted to reflect these trends, looking at the interaction of all the characteristics in determining the estimated future costs for each claim, which will change from month to month as the claim develops.

Not all claim variances are due to model recalibrations. Monthly variations to the claim estimates will typically reflect changes in claim characteristics, such as coding and payment status.

Reductions to estimates generally occur when sustainable return to work has been achieved. The effect is not immediate hence return to work outcomes need to be sustained.

It is important that employers are made aware of how claims costs are used to determine their performance, essentially how their claims costs compare to their peers. The estimates for a particular claim are also used in the claims experience of the industry and it is the relativity between the employer and the industry as a whole that is important. This means that for employers, claims estimates are compared with the estimates for all other employers in that industry with all those estimates made using a consistent objective method. This means that the chance of an employer being disadvantaged by the use of modelled estimates is significantly reduced.

3. Why do inactive claims continue to have estimates calculated?

While a claim may be inactive now – that is, no payments have been made recently - history tells us that a significant percentage (approximately 30% over a three year period) of claims re-open and incur further costs. There is no way of knowing exactly which ones will be re-opened, so an estimate continues to be calculated on inactive claims in the scheme to reflect this possibility by applying a probability that the inactive claim will reopen. However, this estimate is lower than it would be if the claim was still active because the probability of the claim reopening is comparatively small and will reduce further the longer the claim stays inactive. If a claim does come back on benefits the estimate on the claim is likely to increase. Counterbalancing the probability applied to inactive claims that they will reopen, is a probability applied to active claims that they will close.

4. Why is there still an estimate calculated for a worker who has left?

A worker's legal entitlement to compensation for an injury is not extinguished if they leave or change their employment. If a worker with a claim has resigned or is no longer employed by the injury employer, the claim may still have an estimate of future costs. This reflects the possibility that the claim may be reopened through appeal, or deterioration of the worker's condition.

5. How are rejected and terminated claims treated by the model?

If a claim has been rejected and no compensation has been paid then it will not have an estimate used in the calculation of an employer's premium for 2008/09.

In past years the practice was to include rejected claims with any payment made (i.e. liability has been denied by the employer and the Agent has rejected the claim) because of the potential for the claim to reopen and incur future costs. It was recognised that this only occurs for a minority of claims. Employer feedback indicated that very few claims are reopened.

In 2008/09, claims will only have estimates applied for premium purposes where compensation has been paid. Claims with only investigation costs (i.e. the costs associated with determining liability including investigation and claim management) will only have actual payments incurred so an estimate of future costs will not be included in the premium calculation.

In the case of claims where there has been a payment of benefits, an estimate will be calculated and applied. Where a worker's benefits have been terminated, the worker is still entitled to appeal such a decision. Most terminations are for weekly benefits only (for example 130 weeks) and therefore the worker may still be entitled to medical and like benefits and other entitlements (impairment, common law etc) Also, a worker may exercise their appeal rights under the *Accident Compensation Act 1985*. and therefore an estimate will be in place.

If a claim has ceased to have compensation paid on it and remains inactive, the lower the probability of future payments, and the lower the estimate of future costs will generally be over time.

6. The claim has been settled but an estimate continues to be calculated?

If a worker has formally withdrawn their claim, or it has been settled, an estimate will still be calculated. This relates to both settlements (under sections 115, 116 and 117 of the *Accident Compensation Act 1985*) and common law settlements, where the estimate for compensation and common law is set to zero. However, these claims may still attract an estimate for future medical or legal expenses as these settlements do not preclude the worker from claiming for these future costs.

Historically, a certain proportion of claims that are rejected, terminated or withdrawn will attract future payments, particularly medical, legal and common law payments. In some instances the claims may be reactivated by legal action or a determination. Therefore, as some of these claims are likely to incur a future cost, and there is no way to predict which claims these will be, a proportion of the expected costs are allocated to each of the claims.

7. Why do estimates continue to be calculated once retirement age is reached?

Retirement age (based on the worker's date of birth) is one of the variables taken into account by the model, and factored in throughout the estimating process for a claim. It is therefore not expected that an estimate would drop significantly when retirement age is reached and weekly payments cease.

Payments may still be incurred after a worker retires and an estimate of future costs is calculated taking these payments (e.g. medical services) into account.

8. The worker has died but an estimate has still been calculated?

If a worker dies, an estimate of future costs will not be applied, however the date of death needs to be recorded. Where this has not occurred, an estimate will continue to be calculated and applied.

9. Are non-negligent third party TAC claims excluded for premium purposes?

Generally, when WorkSafe Victoria recovers funds from a third party, an employer's claims costs for premium purposes are reduced by the amount of the recovery. When recovering from the TAC the situation is somewhat different.

From 2007/08 onwards, any claim with TAC recoveries under section 137(5A) of the Act that was recorded as involving a negligent third party prior to the claim costs extract date in early July, will not be used in the employer's premium calculation.

Where there is no negligent third party associated with a claim any recoveries made from TAC are not taken into account.

Rationale

Where a worker is involved in a car accident, the cost of the claim is removed from an employer's premium calculation where a negligent third party was involved. If the cost of the claim was offset in all cases, there would be a reduced premium incentive to ensure the safety of workers and maintain emphasis on return to work.

For example, if a worker is using a piece of equipment in a workplace and the worker is injured, the compensation costs of that injury are included in the employer's premium calculation. If the injury was due to a failure of the machinery due to the negligence of the manufacturer then a recovery may be possible and any amount recovered would offset claim costs included in the premium calculation at the time the recovery is made. However, if the injury was caused for any other reason and the machine manufacturer was not negligent, there would be no recovery and none of the costs of the claim would be reduced.

Work related motor vehicle accidents are treated in the same way with an offset of the recovery only applied if the injury is caused by the negligence of a third party.

In instances where the TAC makes a payment to WorkSafe Victoria for non-negligent third party claims, the benefit of these payments is applied across all employers through the industry rate calculation. This is reflected in the industry rates and overall scheme premium rates but not individual employer premiums, maintaining safety incentives and ensuring that they are not reduced.

10. Why are there different estimates assigned to the same injury for two different claims?

Two claims with identical characteristics will always have the same estimate calculated; however the chances of all characteristics being identical are small. It is possible for two claims to be lodged for the same individual with the same or similar injury type, however if the characteristics are not identical for each claim the estimates will not be identical.

If different payment types are made on each of the claims this will mean that they are not identical. The level and types of payments may differ, along with the timing of the benefits being delivered, which can also impact the size of the estimate.