Reducing the cost of the compensation culture – an opportunity missed

We live in a world where there is a plethora of statistics and surveys, crashing onto the beachhead of our collective consciences, but which are mostly washed back out of mind by the ebb tide of evening. But there is one statistic which makes even the hard men of UK business visibly wilt and despair.

It was brought back to my mind, never being far away, by Lord Levene's speech as Chairman of Lloyd's the other week **(Note 1)**. As he spoke of the broader economic and political implications of the compensation culture, he reminded his audience that the average cost of an employers' liability claim had increased by over 100% over the last five years. But even this fact, dismaying though it is, is not the statistic of which I speak.

It is that 40% of compensation costs are accounted for by lawyers' fees **(Note 2)**. And it sticks in the craw because it is waste for which employers are compelled to pay.

All employers are required by law to buy Employers Liability (EL) insurance up to a statutory minimum of £5 million, on pain of a fine of up to £2,500 per day - even if such insurance is not available in the marketplace. (Just to make it really interesting, no-one is actually obliged to make EL insurance available.). Indeed, concerns are now being raised by the British Insurance Brokers Association whether a significant number of policies sourced from offshore companies are valid **(Note 3)**

In simple terms, EL insurance covers claims arising from a business's liability for the injury, disease or death of employees through the *fault* of the employer. This in turn depends on fault being established under England's adversarial system of justice, with prosecution and defence parties being free to present their case as they see fit.

This form of insurance can be contrasted with Workers' Compensation (WC) insurance. WC insurance typically pays for medical care and physical rehabilitation of injured workers, and helps to replace lost wages while they are unable to work. The amount of benefits paid and other compensation provisions is governed by legislation. WC laws have been on the books in the United States since the early part of the twentieth century.

The WC system is premised on a trade-off between employees and employers - employees promptly receive the limited statutory workers' compensation benefits for on-the-job injuries and, in return, the limited workers' compensation benefits are the exclusive remedy for injured employees against their employer, even when the employer negligently caused the injury.

It is a no-fault system, meaning that injured employees need not prove the injury was someone else's fault in order to receive workers' compensation benefits for an on-the-job injury. The no-fault structure eliminates litigation, and therefore significant legal costs, over whether employers are negligent in causing workers' injuries.

Faced with the steep rise in premiums over the last two years, the insurance industry sometimes tells us employers how lucky they are. That premiums have been under-priced for years, and that costs are much less than in Europe, etc. But at the same time I am amazed by the frequency with which the word "crisis" is used by insurance professionals in the context of EL insurance. Not particularly because of the rapid rate of premium increases to date, but what might follow in the light of emerging social and legal factors. The industry is effectively saying that it can make no forecast about future levels of EL insurance premiums

In last week's speech Lord Levene, referring to the effects of spiralling litigation, exhorted " by plugging away at the problem at all levels we can step up the momentum for legislative change." I agree. However, and notwithstanding that the ABI has indeed been plugging away, one of the opportunities for change has already left the Department for Work and Pensions (DWP) station.

The DWP Review of Employers' Liability Compulsory Insurance was published in June 2003 **(Note 4)** and was followed by a Second Stage report in December 2003 **(Note 5)**. The June report contained a lot of useful practice and process improvements but stayed within the box of the existing EL system. Deep in the woods of detail (the report runs to over 80 pages) it happened across the notion of a no-fault system.

Rather lazily for such an otherwise detailed report, and more importantly, unconvincingly, it effectively dismissed the no-fault system under two unanswered challenges. An economic challenge, whether reduced legal costs might be offset by an increased propensity to claim; and curtailment of the right of the individual to recourse to the courts. There is no further discussion. I would have thought that there would be ample evidence from other countries as to whether the said challenges were fatal or not in transitioning to a no-fault system.

We have an acknowledged crisis in the EL system but WC seems to be an option which has not been exhaustively tested. Further, it might even be feasible to develop a hybrid of a compulsory EL system and a no-fault system, which provides appropriate rehabilitation for both "routine" and catastrophic workplace incidents / illnesses. The DWP's rather too eager to please December 2003 follow up report ("So – as this report demonstrates – the Government is acting….To deliver significant, sustained improvements we must tackle the underlying problems together. And we are") busies itself with lots of things which are going to help a little, but are unlikely to make a lot of difference.

This is in one sense a political issue for, as the ABI has argued, it is for society to decide who should be compensated, and for how much. However, increased compensation is not cost-free. It means, under the current system, that EL premiums will inevitably increase to fund the compensation. And these premiums are, of course, paid by businesses and ultimately by consumers.

The government, by the way, is a massive beneficiary of the general rise in insurance premiums. Receipts from Insurance Premium Tax (IPT) have more than doubled

from £1.0 billion in 1997-98 to £2.1 billion in 2002 – 03 **(Note 6)**. IPT, in most cases at a rate of 5% of premiums payable, now raises more for the Exchequer than each of betting and gaming duties, and wine duties.

There is an old management "two by two" matrix of explaining the difference between efficiency, being *how well things are done*; and effectiveness, which is about *doing the right thing*. If you are effective, but inefficient, you will not thrive but you may eventually survive. If you are ineffective but efficient, you will not survive; moreover, your demise will be quick, not slow! The government's breathless efficiency in tackling the problems of the EL system, rather than the effectiveness of the EL system itself, does not augur well.

I sense that deference to our adversarial system of justice may have precluded a proper consideration of fundamental reform of compulsory EL insurance. It needs to be recognised that, while the problems of EL insurance are essentially an economic issue, their ultimate resolution may require bolder political intervention.

It would perhaps be a good place to start in facing up to Lord Levene's compensation culture issue.

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Notes

(1) http://www.lloyds.com/index.asp?ItemId=6935
(2) Commonly quoted by many insurance industry companies
(3) http://www.telegraph.co.uk/money/main.jhtml?xml=%2Fmoney%2F2004%2F02%2F16%2Fcnins16.xml&secureRefresh=true&_requestid=64120
(4) http://www.dwp.gov.uk/publications/dwp/2003/elci/dw2583_employers_review.pdf
(5) http://www.dwp.gov.uk/publications/dwp/2003/elci/dwp_employers_review04-12-2003.pdf
(6) http://www.hm-treasury.gov.uk/media//E3CCB/PublicFinancesDatabank280104.XLS