Nominal Insurer Liability Valuation as at 30 June 2016

Background

Insurance & Care NSW (icare) commissioned PricewaterhouseCoopers Actuarial Pty Ltd (PwC) to estimate the insurance liabilities of the NSW Workers Compensation Nominal Insurer (NI) as at 30 June 2016. This document summarises the results of PwC's independent assessment of the NI insurance liabilities.

The PwC valuation has been prepared with the intention of complying with the Actuaries Institute Professional Standard 300 'Valuations of General Insurance Claims' and producing results that comply with Australian Accounting Standard AASB 1023 'General Insurance Claims'.

Results

As at 30 June 2016 PwC have estimated the discounted net outstanding claims liability of the NI to be $13,015m. This figure includes a 15.6% risk margin over and above the central estimate which has been adopted to provide an estimated 80% probability that the combined liability estimate will prove to be sufficient. The components of the outstanding claims liability as at 30 June 2016 are set out in the following table.

Table 1: Outstanding claims liability

Items	Undiscounted Liability Estimate ($m's)	Discounted Liability Estimate ($m's)
Weekly compensation	4,150	3,417
Medical benefits	4,617	3,119
Work injury damages	2,391	2,192
Section 66 and 67	654	576
Investigation costs	254	224
Legal costs	275	248
Rehabilitation benefits	289	265
Commutations	149	115
Other	201	178
Asbestos	183	113
Uninsured employers	150	107
Gross outstanding claims liability	**13,314**	**10,554**
Excess recoveries	2	2
Tax recoveries	93	84
Other recoveries	236	222
Uninsured employer recoveries	11	8
Net outstanding claims liability (excl. CHE)	**12,973**	**10,238**

Items	Undiscounted Liability Estimate ($m's)	Discounted Liability Estimate ($m's)
Claims handling expenses (CHE)	1,266	1,021
Net outstanding claims liability (incl. CHE)	**14,239**	**11,259**
Risk margin (15.6%)	2,221	1,756
Total outstanding claims liability	**16,460**	**13,015**

The risk margin percentage of 15.6% remains unchanged since the 31 December 2015 valuation.

The above liability estimates include an allowance for the anticipated impact of the 2015 benefit reforms.

The discount rates used by PwC in the assessment of the outstanding claims liability were taken from the yields on Commonwealth Government Bonds as at 30 June 2016 for the first 15 projection years. Beyond the 15 year point a fixed discount rate was adopted. Future inflation rates were based on a number of economic forecasts. After the first 10 projection years a fixed gap between the discount and inflation rates was adopted. Blending to the fixed gap occurred between years 5 and 10 of the projection.

The mean term of the outstanding claims liability was estimated to be 11.5 years on an inflated and undiscounted basis and 8.3 years on an inflated and discounted basis.

PwC estimated the premium liability of the NI to be $553m as at 30 June 2016. This figure includes a risk margin of 17.3% on the unexpired risk component, again with the intention of providing an estimated 80% probability that the unexpired risk liability estimate will prove to be sufficient. The components of the premium liability as at 30 June 2016 are set out in the following table.

Table 2: Premium liability

Items	Liability Estimate ($m's)
Unearned premium reserve	395
Unearned premium related to future adjustments	27
Total unearned premium reserve	**422**
Unexpired risk reserve	471
Risk margin (17.3%)	82
Total unexpired risk reserve	**553**
Required premium deficiency reserve	131
Premium liability	**553**

No risk margin is included in the pricing basis for the NI which will, in general, lead to a premium deficiency when comparing the unearned premium to the expected future claim costs including a risk margin. The 2015 reforms were not factored into the 2016/17 pricing and as such will have contributed to the deficiency. Premium under-collection can also impact the premium liabilities.

The premium liability at 30 June 2016 is lower than the comparable figure at 31 December 2015 as a direct result of the non-uniform pattern in which premium is written over the year.

The following table shows the estimated financial position of the NI as at 30 June 2016.

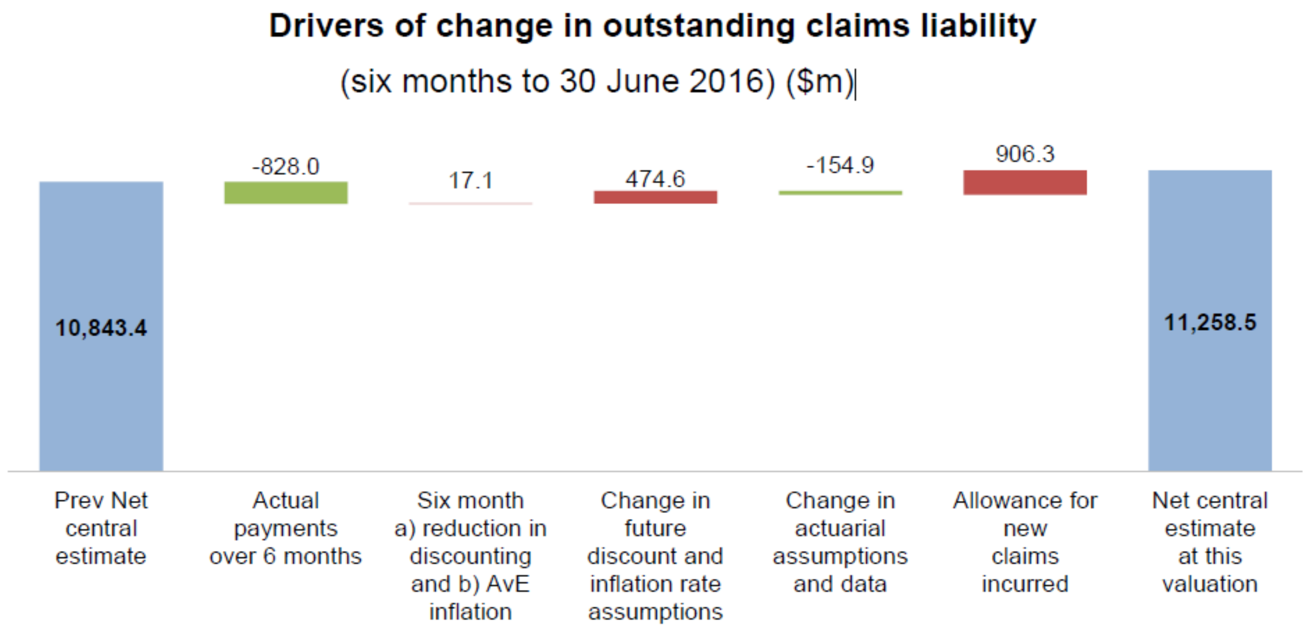
Table 3: Financial position

Items	$m's
Investments	15,943
Outstanding claims recoveries	365
Other assets	1,599
Total assets	**17,907**
Gross outstanding claims liability (incl. CHE)	13,380
Unearned premium reserve	395
Unexpired risk reserve	131
Other liabilities	649
Total liabilities	**14,554**
Funding ratio	**123%**

Movement in results

The following figure shows the movement in the discounted net central estimate (i.e. excluding the risk margin) of the outstanding claims liability between December 2015 and June 2016 split by the key components of the change. Relative to expectations at 30 December 2015 the liability estimate has increased by approximately $480m, or 3.8%, including the risk margin.

Figure 1: Change in the outstanding claims liability



The key drivers of the change were:

- A reduction in the yields on Commonwealth Government Bonds lead to an increase in the liability estimate for pre 31 December 2015 claims of $475m.
- Experience within the portfolio was favourable leading to changes in the assumptions underlying the valuation. This led to a reduction in the liability estimate for pre 31 December 2015 claims of $155m. The primary drivers of this reduction were:
  - A reduction in the number of claimants remaining on weekly compensation benefits was partially offset by an increase in the average weekly compensation cost. Overall the weekly compensation experience and modelling changes led to a $98m reduction in the estimated liability.
  - The numbers of claimants in receipt of medical benefits had also fallen. Combined with the recalibration of the allowance made for reactivations post the 2015 reforms due to the low number of reactivations observed to date this has led to a reduction in the liability estimate of $54m.
  - There were small increases in work injury damages intimation numbers relative to expectations. This led to a $24m increase in the liability estimate.
  - Higher than expected death reports and payments led to an increase in the liability estimate of $22m
  - Reduced average investigation payment assumptions and lower experience led to a decrease in the liability estimate of $17m.
  - Increased average rehabilitation payment assumptions and higher experience led to an increase in the liability estimate of $10m.
  - Other modelling and assumption changes reduced the liability estimate by $20m.
- The impact of the new incurred claims arising from the six month period to 30 June 2016 was 9%, or $78m, higher than the actual payments over the past six months.

Uncertainties

Any estimate of insurance liabilities will contain elements of uncertainty. In the case of the NI these uncertainties are compounded by past benefit reforms, including but not limited to, the 2012 and 2015 reforms. The key uncertainties identified in the PwC valuation were:

- The impact of the Worker Assistance Program and the application of the Section 39a benefit caps are still uncertain. As injured workers are assessed a better picture of the whole person impairment distribution and the likely outcome of the capping will emerge.
- The 2015 reforms allow for the payment of legal costs for the review of work capacity decisions. Regulations around this change are still being drafted so it is difficult to estimate what the impact may be. Increased legal activity will have a direct cost impact. It may also lead to behavioural changes that further impact costs.
- The limited data available on whole person impairment and the reliance of post 2012 benefits on this information has led to approximations of the whole person impairment distribution being used. This adds to the uncertainty in the valuation estimates.
- The 2012 and 2015 reforms have changed the way claims develop. Benefit utilisation and continuance could both be impacted and the post reform patterns may

not be clear for a number of years. Estimates of the impact of the 2012 and 2015 reforms will be refined as experience emerges but the later development years are more uncertain as a result of the reforms.

- A number of precedents have already occurred following the 2012 reforms. The indexation of transitional weekly compensation benefits and decisions impacting section 66 and 67 benefits has provided some clarification around the application of aspects of the reforms. As decisions were made, and in some cases overturned, certainty increased but the changes further destabilised the emerging post reform experience. Potential future decisions could alter the experience again increasing the uncertainty.
- Work injury damages were being accessed more frequently leading up to 2012. The nature of this benefit type is such that it is subject to significant volatility and may escalate rapidly. The cost impact of changes to work injury damages experience can be significant and as such this is viewed as a key risk area for the NI.
- The long tailed nature of the NI's liabilities mean that it is highly leveraged to risk free discount rates and the actual investment returns achieved. In the current volatile market environment this can lead to significant instability in both the liability estimates and the funding ratio.

The above list is not exhaustive but does illustrate the uncertainty in the NI portfolio and the liability assessment process. Maintaining a sound funding ratio position is essential to ensuring the ongoing ability of the NI to deliver on its commitments to the workers and employers of NSW.