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Nominal Insurer Liability Valuation as at 30 June 2019

Background

Insurance & Care NSW (icare) commissioned Finity Consulting Pty Ltd (Finity) to estimate the insurance liabilities of the NSW Workers Compensation Nominal Insurer (NI) as at 30 June 2019. This document summarises the results of Finity's independent actuarial assessment of the NI insurance liabilities.

The insurance liabilities of the NI include the future claim payments, which continue for the life of the injured worker in some cases, for all claims arising from accidents on or before 30 June 2019 as well as the expenses associated with administering the claims. They also include the expected claim costs that may arise from the exposures written before the valuation date.

The purpose of an insurance liability valuation is to estimate the reserves required for balance sheet reporting. The estimates are reflective of the information available at a specific point in time, the valuation date, and the actuary's expectations across future experience, environmental drivers and economic conditions.

Liability estimates are inherently uncertain and can change as new information becomes available.

The Finity valuation has been prepared with the intention of complying with the Actuaries Institute Professional Standard 302 'Valuations of General Insurance Claims' and producing results that comply with Australian Accounting Standard AASB 1023 'General Insurance Claims'.

Results

As at 30 June 2019 Finity have estimated the discounted net outstanding claims liability of the NI to be $16,192m. This figure includes a 15.1% 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 2019 are set out in the following table.

Table 1: Nominal Insurer outstanding claims liability as at 30 June 2019

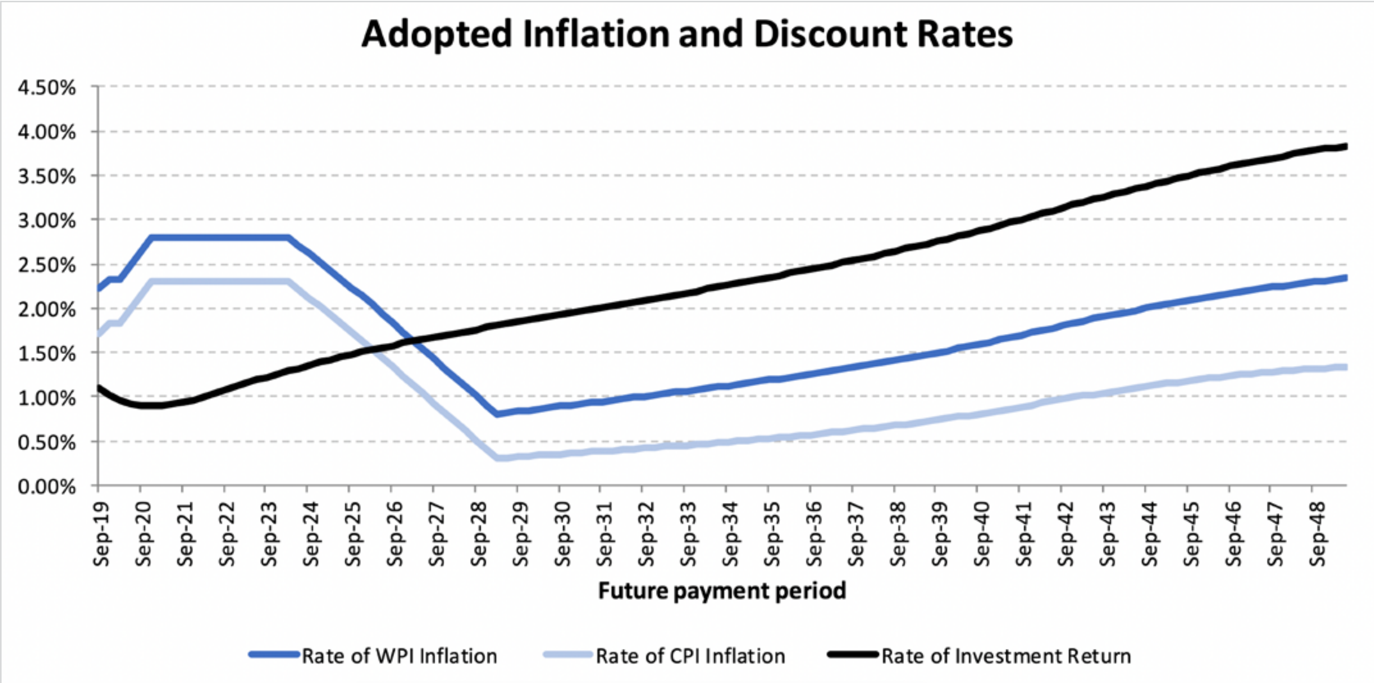
Outstanding claims liability	Undiscounted Liability Estimate ($m's)	Discounted Liability Estimate ($m's)
Weekly compensation	4,502	3,966
Medical benefits	6,656	4,719
Work injury damages	2,664	2,504
Section 66 and 67	761	711
Investigation costs	221	202
Legal costs	227	210
Rehabilitation benefits	220	211
Commutations	137	112
Death	177	166
Other	235	181
Asbestos	217	155
Uninsured employers	158	120
Gross outstanding claims liability	**16,175**	**13,258**
Tax recoveries	78	73
Other recoveries	186	179
Uninsured employer recoveries	24	18
Net outstanding claims liability (excl. CHE)	**15,887**	**12,988**
Claims handling expenses (CHE)	1,224	1,080
Net outstanding claims liability (incl. CHE)	**17,111**	**14,067**
Risk margin (15.1%)	2,584	2,124
Total outstanding claims liability	**19,695**	**16,192**

The risk margin percentage of 15.1% remains unchanged since the 31 December 2017 valuation.

The discount rates used by Finity in the assessment of the outstanding claims liability were taken from the yields on Commonwealth Government Bonds as at 30 June 2019 for the first 30 projection years. Beyond the 30 year point a fixed discount rate of 4.50% was adopted. Future inflation rates were based on short-term economic forecasts (0 to 5 years), long-term assumptions on the gap between the discount rates and inflation rates (10 years and beyond), and blending between the above approaches for the mid-term (5 to 10 years).

The adopted rates for the June 2019 valuation are shown in the following figure.

Figure 1: Economic assumptions as at 30 June 2019



The mean term of the outstanding claims liability was estimated to be 12.5 years on an inflated and undiscounted basis and 8.9 years on an inflated and discounted basis.

Finity estimated the premium liability of the NI to be $743m as at 30 June 2019. This figure includes a risk margin of 13.7% 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 2019 are set out in the following table.

Table 2: Nominal Insurer premium liability as at 30 June 2019

Premium liability	Liability Estimate ($m's)
Total unearned premium reserve	556
Unexpired risk reserve	653
Risk margin (13.7%)	90
Total unexpired risk reserve	743
Required premium deficiency reserve	187
Premium liability	743

No uncertainty 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. Premium under-collection can also adversely impact the premium liabilities.

The premium liability at 30 June 2019 is lower than the comparable figure at 31 December 2018 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 2019 where the liabilities are provisioned at the 80% probability of adequacy.

Table 3: Financial Position	($m's)
Investments	17,658
Outstanding claims recoveries	311
Other assets	1,234
Total assets	19,203
Gross outstanding claims liability (incl. CHE)	16,503
Unearned premium reserve	556
Unexpired risk reserve	187
Other liabilities	377
Total liabilities	17,623
Funding ratio	109%

The published results for the Nominal Insurer include liabilities expressed at the 80% probability of adequacy. Consistent with this accounting approach the NI capital management policy adopts a target funding ratio operating range of between 110% and 130%. This range is based on the estimated minimum capital requirement that would exist for the NI under APRA regulation. It does not include the additional capital an APRA regulated insurer would be required to hold to ensure it did not breach statutory minimums.

The funding ratio for the NI at 80% probability of adequacy has increased from 108% as at 31 December 2018 to 109% as at 30 June 2019. This is largely driven by:

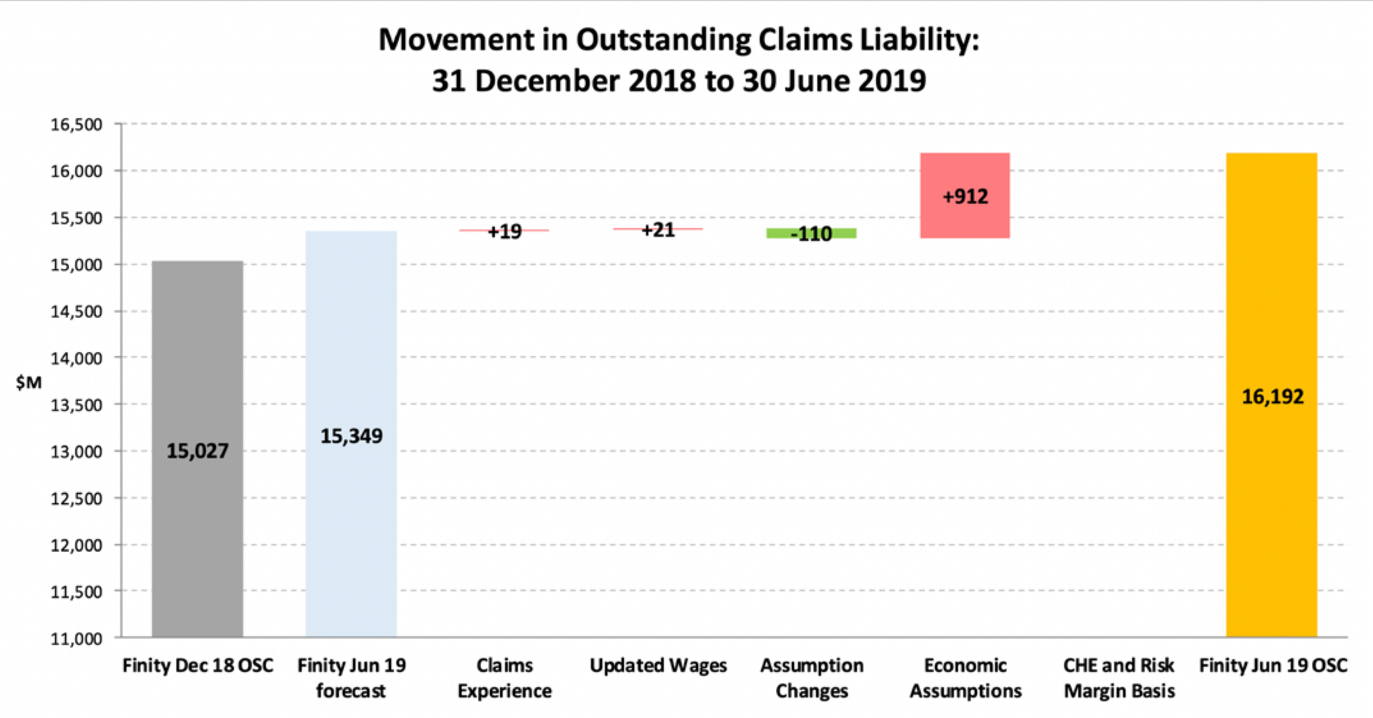
- Releases in outstanding claims liability due to valuation basis changes described further below,
- Positive investment returns in the second half of FY2018/19, and
- Offset by a significant strengthening in outstanding claims liability due to the drop in the risk-free yield curve.

This is outside the target operating range by 1%. The capital management policy requires a management action review and/or plan to return the funding ratio to the target range within five years. icare is actively working on claim management strategies, with a focus on return to work and medical spend to achieve claim savings. Claims experience will continue to be closely monitored so that icare management decisions can appropriately reflect emerging information.

Movement in results

The following figure shows the movement in the total outstanding claims liability between 31 December 2018 and 30 June 2019 split by the key components of the change. The figures are inclusive of risk margins intended to deliver an 80% probability of adequacy.

Figure 2: Change in the outstanding claims liability (incl. risk margin)



Relative to Finity's expectations at December 2018, the outstanding claims liability estimate at 30 June 2019 has increased by approximately $842m, or 5.5%. The key drivers of the change were:

- A $912m increase from revised economic assumptions around inflation and discount rates. These changes are driven by a sharp drop in Commonwealth Government Bond yields from 31 December 2018 to 30 June 2019.
- Actual claims experience over the six months to 31 March 2019, which increased the liability estimate by $19m due to more claims remaining on benefits than expected, particularly at early durations.
- A $21m increase due to growth, as wages were higher than originally forecasted.
- A $110m decrease from changes to the valuation basis. The primary drivers of this decrease were:
  - A $192m decrease from lower than assumed weekly average claim sizes to reflect emerging claim experience.
  - A $182m increase from higher assumed weekly and medical active claim number at early durations.
  - A $135m decrease from lower assumed settlement size for Work Injury Damages (WID), where icare's strategy to fast track WID settlement has led to higher finalisations and lower settlement size.
  - A $132m increase due to higher average size assumptions for catastrophic medical claims. This is in response to higher attendant care, home modification, and allied health payments for catastrophic medical claims.
  - A $108m decrease in Rehabilitation, Investigation and Legal benefits in response to the continued favourable claims experience for these payment types.
  - Other modelling and assumption changes totalling a net increase of $12m.
- No change to claims handling expense and risk margin assumptions.

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, 2014 and 2015 reforms. The key uncertainties identified in the Finity valuation were:

- 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. The recent downward shift in the yield curve has been a key driver for higher than expected reserve as at 30 June 2019. Further volatility in the current market environment can lead to continuing instability in both the liability estimates and the funding ratio outcomes.
- 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. This has been compounded by delays in injured workers seeking these assessments because of the use of a single assessment to determine some lump sum benefit payments.
- The *Workers Compensation Legislation Amendment Act 2018* changes the way disputes for Work Capacity Decisions and medical assessments of WPI are decided. This may influence the effectiveness of these processes and make future experience difficult to interpret.
- The increasing medical payments, which is driven by procedures such as surgery and inpatient services becoming more expensive and complex for the NI.
- The transition of claims between Scheme Agents and the implementation of the new claims service model from 1 January 2018 has made the experience at early durations more complicated to interpret.
- There is a long-term trend for more eligible claimants pursuing Work Injury Damages (WID). The more recent accident years have very little experience so far, and future levels of WID lodgement are uncertain.
- Residual uncertainty relating to the impact of the Section 39 benefit caps (the limitation of Weekly Compensation benefits to 260 weeks for injured workers with whole person impairment less than 21%). The assessments of whole person impairment through the icare initiated Workers Assistance Program are complete, but there is still uncertainty around the number of claims that will successfully dispute their whole person impairment assessment.
- The 2012, 2014 and 2015 reforms have changed the claim reporting and development patterns. 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, 2014 and 2015 reforms will be refined as experience emerges, but the more recent accident years are more uncertain as a result of the reforms.

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 ensure the ongoing ability of the NI to deliver on its commitments to the workers and employers of NSW. That means managing and mitigating the uncertainty in the estimates where possible and holding sufficient funds to protect against potential fluctuations where it is not possible.