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Nominal Insurer Liability Valuation as at 30 June 2021

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 2021. This document has been prepared by icare and 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 2021 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 in accordance with the Actuaries Institute Professional Standard 302 'Valuations of General Insurance Claims' and Australian Accounting Standard AASB 1023 'General Insurance Claims'.

Results

As at 30 June 2021 Finity have estimated the discounted net outstanding claims liability of the NI to be $18,308m. This figure includes a 11.7% risk margin on top of the central estimate, which has been adopted to provide an estimated 75% probability that the combined liability estimate will prove to be sufficient. The components of the outstanding claims liability as at 30 June 2021 are set out in the following table.

Table 1: Nominal Insurer outstanding claims liability as at 30 June 2021

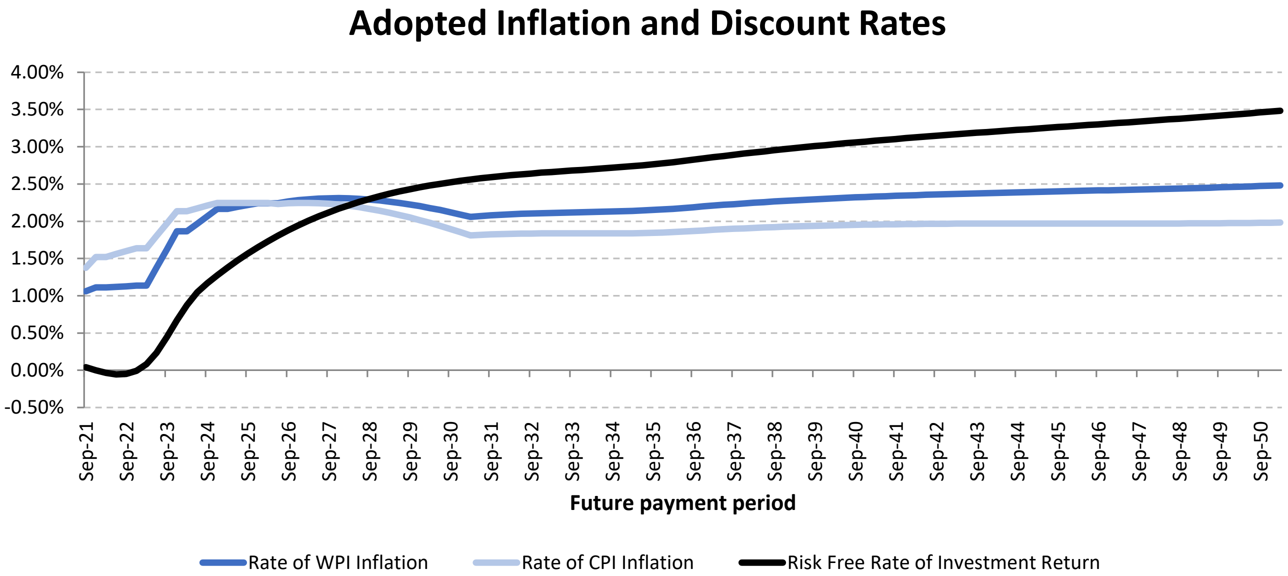
Table 1: Outstanding claims liability	Undiscounted Liability Estimate ($m's)	Discounted Liability Estimate ($m's)
Weekly compensation	5,384	4,809
Medical benefits	7,967	5,399
Work injury damages	3,028	2,896
Section 66 and 67	864	816
Investigation costs	292	269
Legal costs	234	218
Rehabilitation benefits	263	256
Commutations	161	128
Death	175	163
Other	275	210
Asbestos	266	186
Uninsured employers	237	174
Gross outstanding claims liability	**19,149**	**15,526**
Tax recoveries	78	73
Other recoveries	184	178
Uninsured employer recoveries	40	30
Net outstanding claims liability (excl. CHE)	**18,847**	**15,246**
Claims handling expenses (CHE)	1,412	1,146
Net outstanding claims liability (incl. CHE)	**20,259**	**16,392**
Risk margin (11.7%)	2,369	1,916
Total outstanding claims liability (75% PoA)	**22,628**	**18,308**

The risk margin percentage of 11.7% brings the central estimate to a 75% Probability of Adequacy (PoA). This remains unchanged since the 31 December 2020 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 2021 as per accounting standard AASB 1023. 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 2021 valuation are shown in the following figure.

Figure 1: Economic assumptions as at 30 June 2021



The mean term of the outstanding claims liability was estimated to be 12.5 years on an inflated and undiscounted basis and 8.4 years on an inflated and discounted basis.

Finity estimated the premium liability of the NI to be $947m as at 30 June 2021. This figure includes a risk margin of 12.1% on the unexpired risk component, again with the intention of providing an estimated 75% probability that the unexpired risk liability estimate will prove to be sufficient.

The components of the premium liability as at 30 June 2021are set out in the following table.

Table 2: Nominal Insurer premium liability as at 30 June 2021

Table 2: Premium liability	Liability Estimate ($m's)
Total unearned premium reserve	**618**
Unexpired risk reserve	845
Risk margin (12.1%)	102
Total unexpired risk reserve	**947**
Required premium deficiency reserve	330
Premium liability (75% PoA)	**947**

The premium liability includes a risk margin and is discounted using yields from Commonwealth Government Bonds as at 30 June 2021 as per the accounting standard AASB 1023. This is a different basis to the NI pricing basis which includes no margin and allows for investment income that is reflective of the NI's invested assets. This difference in basis means by accounting standards, the NI will always have a premium deficiency reserve.

The premium liability at 30 June 2021 is lower than the comparable figure at 31 December 2020 as a direct result of the seasonality effects of when NI policies are underwritten.

The following table shows the estimated financial position of the NI as at 30 June 2021 where the liabilities are provisioned at the 75% probability of adequacy.

Table 3: Financial Position ($m's)	Accounting basis	Insurance basis
Investments	17,528	17,528
Outstanding claims recoveries (incl. RM on recoveries)	314	271
Other assets	1,982	1,982
Total assets	**19,824**	**19,781**
Gross outstanding claims liability (incl. CHE and RM)	18,622	14,908
Unearned premium reserve	618	618
Unexpired risk reserve	330	191
Other liabilities	497	497
Total liabilities	**20,066**	**16,213**
Funding ratio	**99%**	
Insurance ratio		**122%**

The published results for the Nominal Insurer include liabilities expressed at the 75% probability of adequacy.

The NI capital management policy has been updated to align with recommendation 42 from the McDougall review. The capital position of the Scheme is now assessed via a composite of the insurance ratio (McDougall's 'economic funding ratio') and its outlook as a primary measure, and the funding ratio, operational cashflows and their outlook as additional considerations.

The funding ratio is the ratio of Scheme assets to liabilities on basis consistent with accounting standard AASB 1023, where liabilities are calculated using risk-free discount and inflation assumptions. This ratio is subject to volatility from the movements in risk-free Government bond yields that do not change the underlying financial position of the Scheme.

The insurance ratio is the ratio of Scheme assets to liabilities, where liabilities are calculated using discount and inflation assumptions that reflect the expected long-term investment return for the Scheme. This ratio reflects the need to manage financial risks across a longer time horizon, the expected return on investment assets and the different level of capital required compared to the private sector.

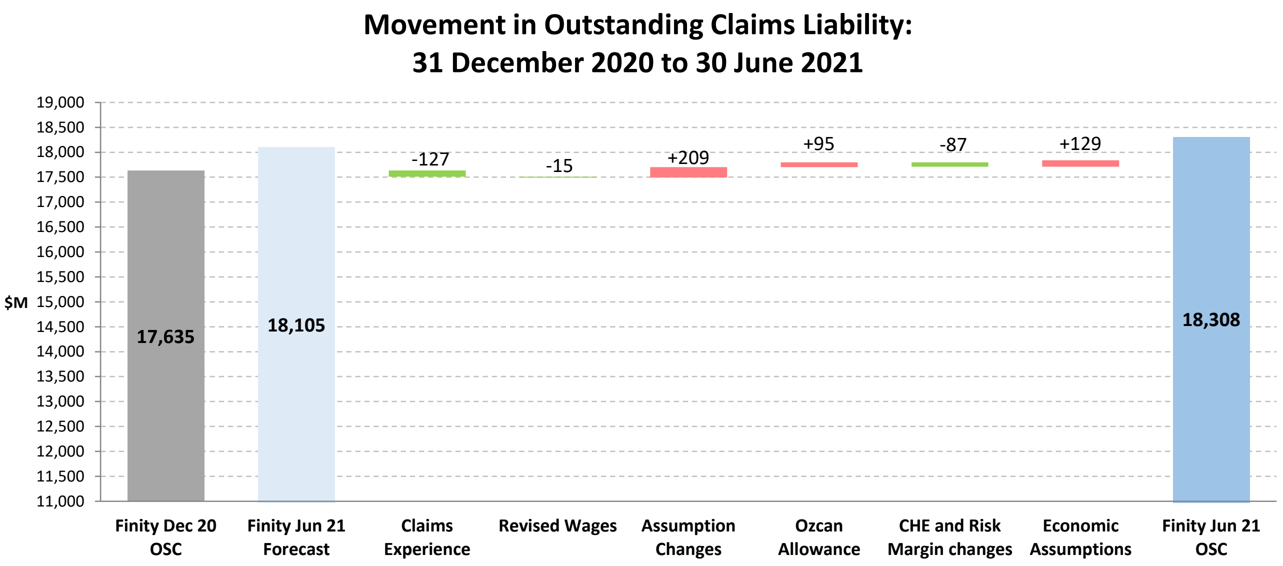
The NI capital management policy has adopted a Target Operating Zone, Zone A, of Insurance Ratio greater than 130%. This range is based on icare's Board's risk appetite. The insurance ratio for NI is 122% as at 30 June 2021.

icare is actively working on its key financial levers of claim cost savings via return to work improvements and medical cost containment, premium changes and expense 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 2020 and 30 June 2021 split by the key components of the change. The figures are inclusive of risk margins intended to deliver an 75% probability of adequacy.

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



Relative to Finity's expectations at 31 December 2020, the outstanding claims liability estimate at 30 June 2021 has increased by approximately $203m, or 1.1%. The key drivers of the change were:

- Actual claims experience over the six months to 31 March 2021 decreased the liability by $127m, mainly due to a lower number of catastrophic medical claims. The impact of lower than expected weekly and medical active claims with low Whole Person Impairment (WPI) was mostly offset by higher than expected weekly and medical active claims with high WPI.
- A $15m decrease due to lower than expected wages. This would have an offsetting impact from less premium collected.
- A $209m increase from changes to the valuation basis. The main movements were:
  - A $102m decrease due to lower than average medical spend per claim assumptions.
  - A $90m increase due to a higher number of psychological claims expected to reach higher WPI bands, which are gateways to Work Injury Damages (WID) or longer weekly and medical benefits. This relates to the 2018 to 2021 calendar accident years.
  - A $105m increase in response to higher average WID settlement sizes for tail claims.
  - A $74m increase due to higher numbers of assumed deafness claims.
  - Other modelling and assumption changes totalling a net increase of $42m.
- A $95m increase due to Ozcan vs Macarthur Disability Services ruling, where aggregation of WPI may be permitted if injuries sustained in the first incident caused or contributed to the second or subsequent incident(s). Noting that this is an early estimate and has a high degree of uncertainty.
- A $87m decrease due to reduced claims handling expense assumptions.
- A $129m increase from revised economic assumptions around inflation and discount rates. These changes are driven by higher inflation and partially offset by an uplift in the yield curve across most maturities as forecasted at 30 June 2021.

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 Finity valuation were:

- The COVID-19 pandemic continues to create uncertainty, particularly in light of the increase in community transmission since June 2021. The valuation assumes the recent return to work experience over 2020 (which was impacted by COVID) continues. The impact of the current outbreak and economic restriction could, however, lead to different outcomes than those observed over 2020. The reopening of the NSW economy may also lead to additional compensable direct COVID claims.
- The long-tailed nature of the NI's liabilities mean that it is highly leveraged to risk free discount rates, the actual investment returns achieved and future inflation. Volatility in the current market environment, especially amid the COVID-19 pandemic can lead to continuing instability in both the liability estimates and the funding ratio outcomes.
- There has been an increase in psychological injury claims (stress claims) over the past few years, although numbers have recently stabilised. These claims have significantly longer durations and higher costs associated. The extent to which psychological claims remain steady or grow in future remains uncertain. There is also uncertainty over how many psychological claims will have a WPI over 15%, and this proportion has been increasing of late.
- Claim costs have been higher in recent accident years following lower return to work rates. The valuation assumes the recent experience continues into the future but actual return to work rates could be better or worse than currently assumed in the valuation.
- The ultimate number of claims with a WPI over 20% are anticipated to be similar to historical levels for the five most recent accident years. This is currently supported by the post reform experience. However, the increase in number of weekly claims remaining active at five year duration could also put pressure on the 15% and 21% threshold levels as more claims will reach higher WPI bands and receive longer weekly and medical benefits. There is pressure from pschological claims for which the valuation has allowed.
- The increasing medical payments, which is driven by procedures such as surgery and inpatient services becoming more expensive and complex for the NI. The increase in average medical payment amounts has moderated over the past two years, which followed a number of years of significant increases. The valuation assumes medical payments remain at their recent levels, but actual medical payments could be higher or lower.
- 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.

The above list is not exhaustive but does illustrate the uncertainty in the NI portfolio and the liability assessment process. Maintaining a sound capital 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.