GPO Box 4052,
Sydney, NSW 2001
T 13 44 22

icare.nsw.gov.au

Nominal Insurer Liability Valuation as at 31 December 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 31 December 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 31 December 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 31 December 2019 Finity have estimated the discounted net outstanding claims liability of the NI to be $17,057m. 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 31 December 2019 are set out in the following table.

Table 1: Nominal Insurer outstanding claims liability as at 31 December 2019

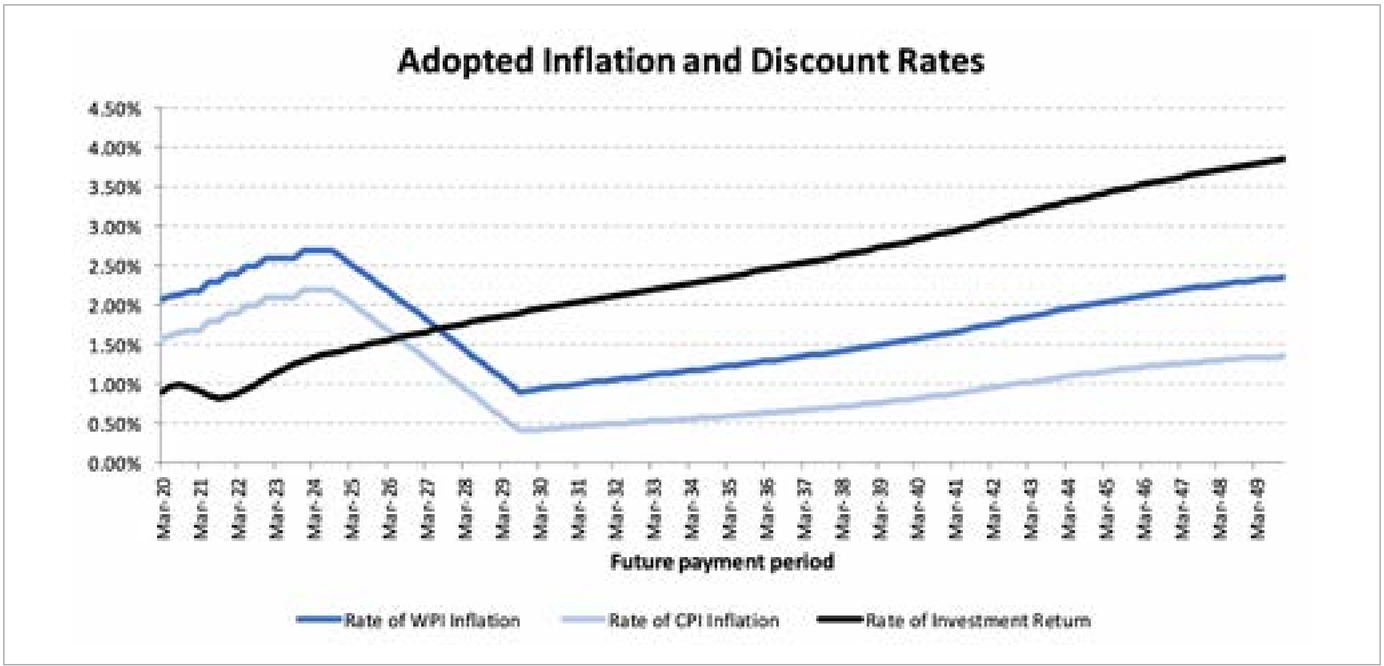
Outstanding claims liability	Undiscounted Liability Estimate ($m's)	Discounted Liability Estimate ($m's)
Weekly compensation	4,671	4,151
Medical benefits	7,237	5,059
Work injury damages	2,760	2,593
Section 66 and 67	780	730
Investigation costs	268	244
Legal costs	218	201
Rehabilitation benefits	226	218
Commutations	138	112
Death	187	174
Other	271	208
Asbestos	211	150
Uninsured employers	167	128
Gross outstanding claims liability	**17,134**	**13,968**
Tax recoveries	75	70
Other recoveries	196	189
Uninsured employer recoveries	25	19
Net outstanding claims liability (excl. CHE)	**16,837**	**13,690**
Claims handling expenses (CHE)	1,270	1,130
Net outstanding claims liability (incl. CHE)	**18,107**	**14,820**
Risk margin (15.1%)	2,734	2,238
Total outstanding claims liability	**20,842**	**17,057**

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 31 December 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 December 2019 valuation are shown in the following figure.

Figure 1: Economic assumptions as at 31 December 2019



The mean term of the outstanding claims liability was estimated to be 12.5 years on an inflated and undiscounted basis and 8.7 years on an inflated and discounted basis.

Finity estimated the premium liability of the NI to be $1,684m as at 31 December 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 31 December 2019 are set out in the following table.

Table 2: Nominal Insurer premium liability as at 31 December 2019

Premium liability	Liability Estimate ($m's)
Total unearned premium reserve	**1,380**
Unexpired risk reserve	1,481
Risk margin (13.7%)	203
Total unexpired risk reserve	**1,684**
Required premium deficiency reserve	304
Premium liability	**1,684**

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 31 December 2019 is higher than the comparable figure at 30 June 2019 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 31 December 2019 where the liabilities are provisioned at the 80% probability of adequacy.

Table 3: Financial Position	($m's)
Investments	17,697
Outstanding claims recoveries	320
Other assets	2,029
Total assets	**20,045**
Gross outstanding claims liability (incl. CHE)	17,377
Unearned premium reserve	1,380
Unexpired risk reserve	304
Other liabilities	260
Total liabilities	**19,322**
Funding ratio	**104%**

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 APRA prudential 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.

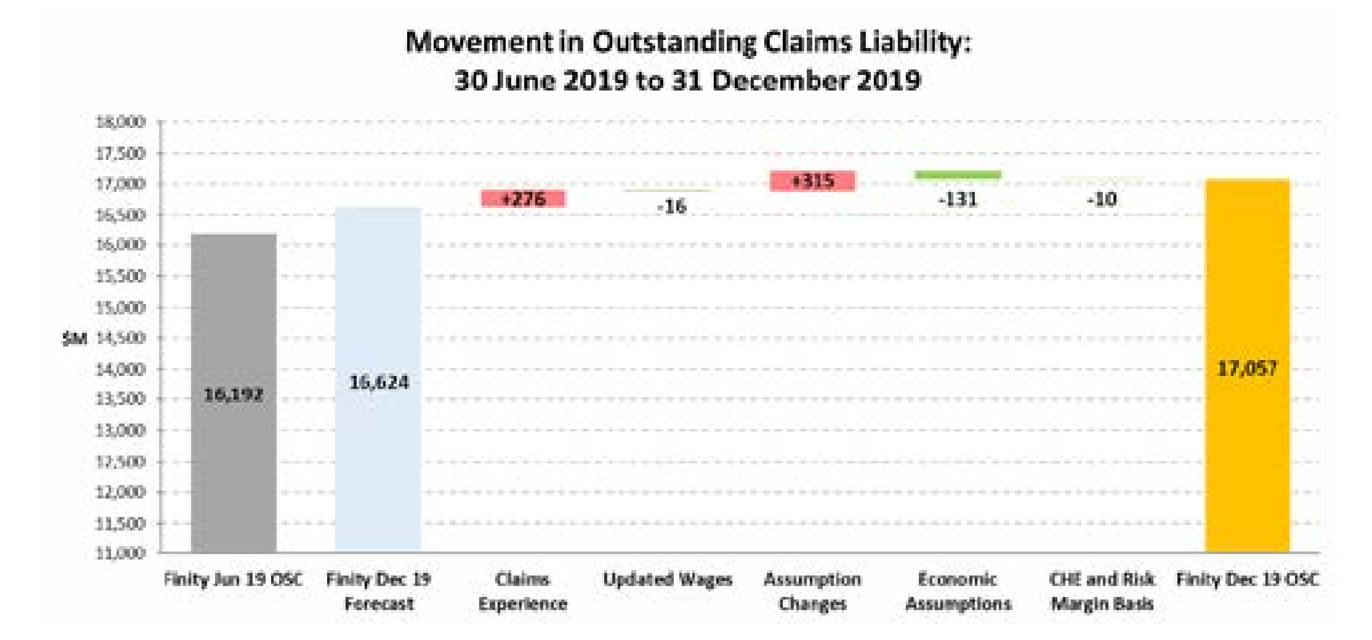
The funding ratio for the NI at 80% probability of adequacy has decreased from 109% as at 30 June 2019 to 104% as at 31 December 2019. This is largely driven by strengthening in outstanding claims liability due to recent claim experience and valuation basis changes described further below. At the 75% probability of adequacy, the funding ratio for NI would be 107%.

This is outside the target operating range by 6%. 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 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 30 June 2019 and 31 December 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 30 June 2019, the outstanding claims liability estimate at 31 December 2019 has increased by approximately $434m, or 2.6%. The key drivers of the change were:

- Actual claims experience over the six months to 30 September 2019, which increased the liability estimate by $276m due to more claims remaining on benefits than expected, particularly at early durations.
- A $16m decrease from updated wage projection which was lower than the previous projection.
- A $315m increase from changes to the valuation basis. The primary drivers of this increase were:
  - A $338m increase from higher assumed weekly and medical active claim number at early durations.
  - A $155m increase due to higher medical claim costs relating to increases in attendant care rates driven by market pressures including the recent NDIS attendant care rate increases.
  - A $55m increase from assumption changes in response to higher investigation and miscellaneous payments.
  - A $128m decrease from lower weekly average payment assumptions to reflect emerging claim experience.
  - A $91m decrease due to a greater proportion of claims with a high WPI opting to pursue a WID
  - Other modelling and assumption changes totalling a net decrease of $14m.
- A $131m decrease from revised economic assumptions around inflation and discount rates. These changes are driven by a small reduction in short term inflation assumptions at 31 December 2019.
- A $10m decrease from revised claims handling expense assumptions, with no material changes to 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 impact of COVID-19 is not considered in December 2019 valuation, however its disruption will manifest in a number of ways for Nominal Insurer, such as direct COVID-19 claim eligibility, slowdown of economic activity in certain industries, changing ways of working, prolonged economic uncertainty and implications on assets and investment returns. COVID-19 is a post December 2019 balance date event and at this stage it is too early to estimate the duration of the pandemic and severity of its impact.
- 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 can lead to continuing instability in both the liability estimates and the funding ratio outcomes.
- The increasing payments in catastrophic medical claims, which is driven by increasing attendant care rates due to pressure from NDIS. The potential for additional future rate changes is difficult to forecast.
- 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.