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Nominal Insurer Liability Valuation as at 31 December 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 31 December 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 31 December 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 31 December 2021 Finity have estimated the discounted net outstanding claims liability of the NI to be $19,253m. 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 31 December 2021 are set out in the following table.

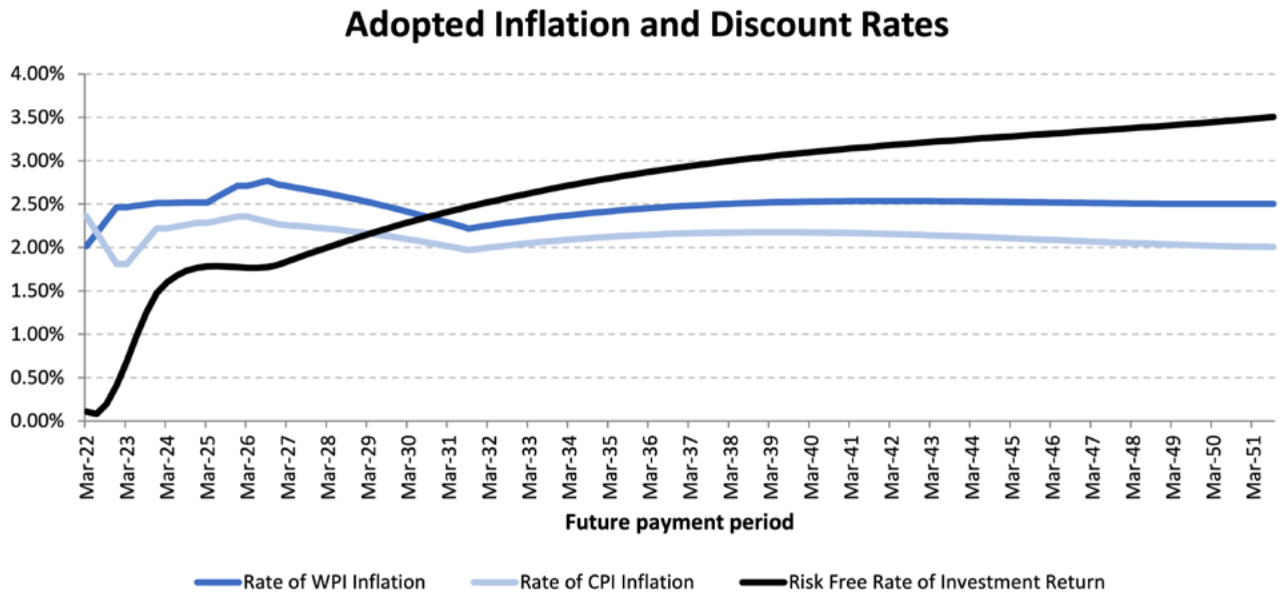
Table 1: Nominal Insurer outstanding claims liability as at 31 December 2021

Table 1: Outstanding claims liability	Undiscounted Liability Estimate ($m's)	Discounted Liability Estimate ($m's)
Weekly compensation	5,816	5,100
Medical benefits	8,491	5,608
Work injury damages	3,343	3,154
Section 66 and 67	920	852
Investigation costs	301	272
Legal costs	284	262
Rehabilitation benefits	273	264
Commutations	187	144
Death	172	157
Other	332	256
Asbestos	309	215
Uninsured employers	244	178
Gross outstanding claims liability	**20,672**	**16,463**
Tax recoveries	85	78
Other recoveries	207	198
Uninsured employer recoveries	45	33
Net outstanding claims liability (excl. CHE)	**20,335**	**16,154**
Claims handling expenses (CHE)	1,367	1,089
Net outstanding claims liability (incl. CHE)	**21,702**	**17,243**
Risk margin (11.7%)	2,532	2,010
Total outstanding claims liability (75% PoA)	**24,233**	**19,253**

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 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 December 2021 valuation are shown in the following figure.

Figure 1: Economic assumptions as at 31 December 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 $2,356m as at 31 December 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 31 December 2021are set out in the following table.

Table 2: Nominal Insurer premium liability as at 31 December 2021

Table 2: Premium liability	Liability Estimate ($m's)
Unexpired risk reserve	2,102
Risk margin (12.1%)	254
Premium liability (75% PoA)	2,356

The premium liability is discounted using the same assumptions as the outstanding claims liability. 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 31 December 2021 is higher than the comparable figure at 30 June 2021 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 31 December 2021 where the liabilities are provisioned at the 75% probability of adequacy.

Table 3: Financial Position ($m's)	Accounting basis	Insurance basis
Investments	17,854	17,854
Outstanding claims recoveries (incl. RM on recoveries)	345	301
Other assets	2,541	2,541
Total assets	**20,740**	**20,696**
Gross outstanding claims liability (incl. CHE and RM)	19,598	15,785
Unearned premium reserve	1,524	1,524
Unexpired risk reserve	832	480
Other liabilities	272	272
Total liabilities	**22,226**	**18,061**
Funding ratio	**93%**	
Insurance ratio		**115%**

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 with the insurance ratio (McDougall's 'economic funding ratio') and its outlook as the 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.

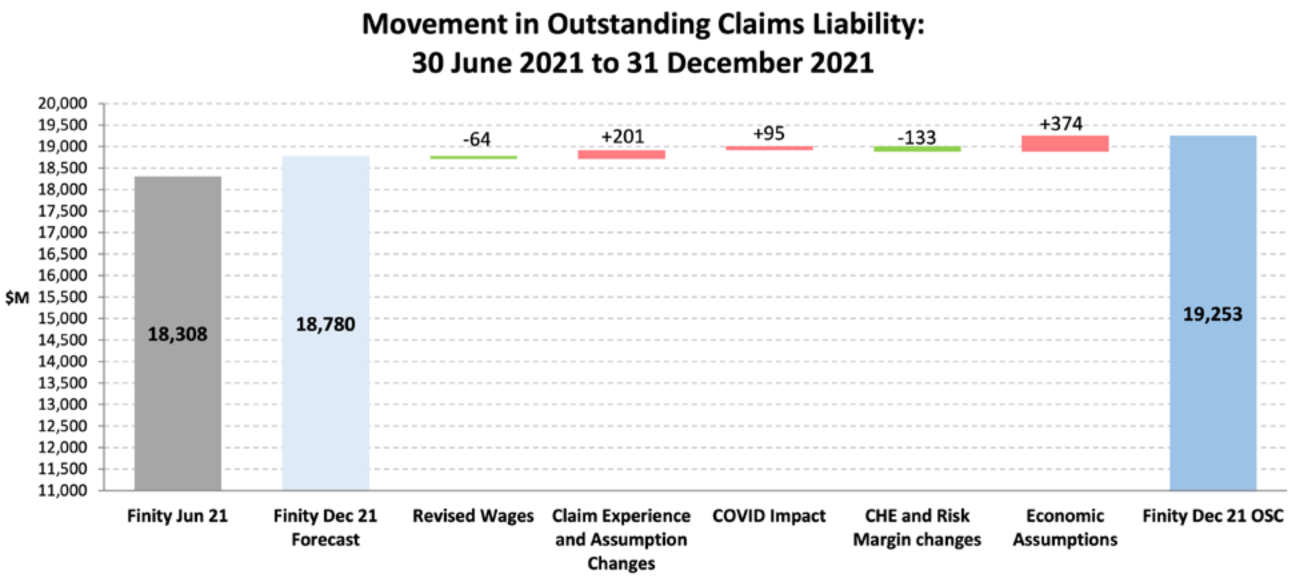
The NI capital management policy has adopted a Target Operating Zone, Zone A, of Insurance Ratio greater than 130%. This range is based on icare's Board's risk appetite. The insurance ratio for NI is 115% as at 31 December 2021.

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 30 June 2021 and 31 December 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 30 June 2021, the outstanding claims liability estimate at 31 December 2021 has increased by approximately $473m, or 2.5%. The key drivers of the change were:

- A $64m decrease due to lower than expected wages as a result of COVID lockdown leading to less economic activities and hours worked. This would have an offsetting impact from less premium collected.
- A $201m increase from actual claim experience over six months to 30 September 2021 and changes to the valuation basis. The main movements were:
  - A $120m decrease due to a lower number of catastrophic medical claims.
  - A $75m decrease due to the anticipated removal of surgery fee loading from July 2022
  - A $66m decrease due to lower than average medical spend per claim assumptions.
  - A $134m increase due to a higher Work Injury Damages (WID) average sizes for psychological claims.
  - A $50m increase due to a higher number of psychological claims expected to reach WPI band 15%+, which are gateways to Work Injury Damages (WID) or longer weekly and medical benefits.
  - A $84m increase due to higher numbers of assumed deafness claims.
  - A $48m increase due to actual inflation in the six months to 31 December 2021 being higher than expected.
  - Other modelling and assumption changes totalling a net increase of $147m.
- A $95m increase due to COVID-19 related fatality claims and adverse impact on return to work experience following the second NSW lockdown in September 2021 quarter. Noting that this is an early estimate and has a high degree of uncertainty.
- A $133m decrease due to reduced claims handling expense assumptions.
- A $374m 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 31 December 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 in many aspects of the scheme, including claim numbers, return to work activity, medical and care related payments, as well as compensable direct COVID claims. As NSW emerges from the second lockdown, there is continuing uncertainty around what "post-COVID" experience will look like.
- 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 increase in average medical payment amounts has moderated over the past three 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. Removal of sugical fee loadings will have a favourable impact, but there may be subsequent behavioural changes.
- 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.