icare™ | Workers Insurance

GPO Box 4052,
Sydney, NSW 2001

T 13 44 22

**icare.nsw.gov.au**

## Nominal Insurer Liability Valuation as at 30 June 2022

## 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 2022. 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 2022 as well as the expenses associated with administering the claims. They also include the expected claim costs that may arise from the policies written before the valuation date.

The purpose of an insurance liability valuation is to estimate the reserves required for balance sheet reporting. The estimates reflect 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 Contracts'.

## Results

As at 30 June 2022, Finity have estimated the discounted net outstanding claims liability of the NI to be $17,851m. This figure includes a 11.2% 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 2022 are set out in the following table.

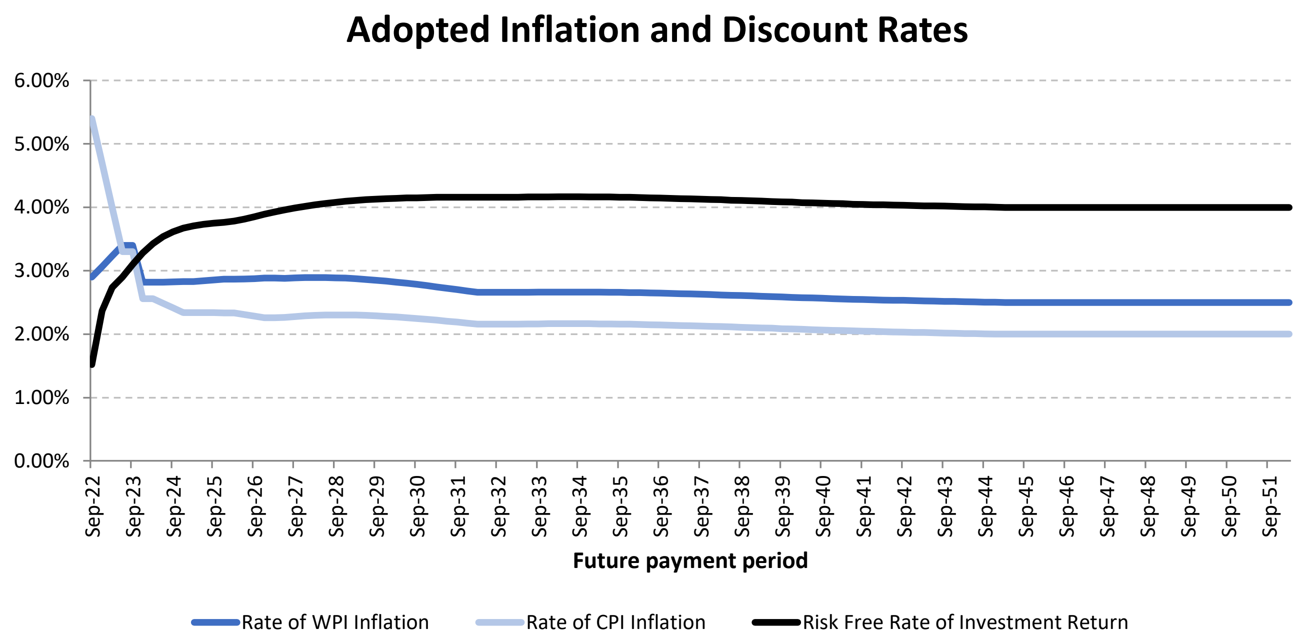
**Table 1: Nominal Insurer outstanding claims liability as at 30 June 2022**

| Table 1: Outstanding claims liability | Undiscounted Liability Estimate ($m's) | Discounted Liability Estimate ($m's) |
|---|---|---|
| Weekly compensation | 6,112 | 4,794 |
| Medical benefits | 9,110 | 4,944 |
| Work injury damages | 3,635 | 3,165 |
| Section 66 and 67 | 952 | 822 |
| Investigation costs | 307 | 252 |
| Legal costs | 293 | 247 |
| Rehabilitation benefits | 265 | 244 |
| Commutations | 201 | 129 |
| Death | 159 | 132 |
| Other | 288 | 184 |
| Asbestos | 336 | 197 |
| Uninsured employers | 289 | 178 |
| Direct COVID-19 | 86 | 83 |
| **Gross outstanding claims liability** | **22,033** | **15,372** |
| Tax recoveries | 92 | 80 |
| Other recoveries | 215 | 193 |
| Uninsured employer recoveries | 58 | 36 |
| **Net outstanding claims liability (excl. CHE)** | **21,667** | **15,063** |
| Claims handling expenses (CHE) | 1,421 | 992 |
| **Net outstanding claims liability (incl. CHE)** | **23,088** | **16,055** |
| Risk margin (11.2%) | 2,584 | 1,796 |
| **Total outstanding claims liability** | **25,672** | **17,851** |

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 2022 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 rate at 10 years, very-long-term assumptions on the gap between the discount rates and inflation rates (30 years and beyond), and blending between the above approaches for the mid-term (5 to 10 years) and long-term (10 to 30 years).

The adopted rates for the June 2021 valuation are shown in the following figure.

**Figure 1: Economic assumptions as at 30 June 2022**




The mean term of the outstanding claims liability was estimated to be 12.7 years on an inflated and undiscounted basis and 7.5 years on an inflated and discounted basis.

Finity estimated the premium liability of the NI to be $992m as at 30 June 2022. This figure includes a risk margin of 11.6% 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 2022 are set out in the following table.

**Table 2: Nominal Insurer premium liability as at 30 June 2022**

| Table 2: Premium liability | Liability Estimate ($m's) |
|---|---|
| Central estimate of premium liability | 889 |
| Risk margin (11.6%) | 103 |
| **Premium liability (75% PoA)** | **992** |

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 reflects the NI's invested assets. This difference in basis means that by accounting standards, the NI will always have a premium deficiency reserve.

The premium liability at 30 June 2022 is lower than the comparable figure at 31 December 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 30 June 2022 where the liabilities are provisioned at the 75% probability of adequacy.

**Table 2: Nominal Insurer financial position as at 30 June 2022**

| Table 3: Financial Position ($m's) | Accounting basis | Insurance basis |
|---|---|---|
| Investments | 16,280 | 16,280 |
| Outstanding claims recoveries | 343 | 322 |
| Other assets | 1,930 | 1,930 |
| **Total assets** | **18,553** | **18,532** |
| Gross outstanding claims liability (incl. CHE) | 18,194 | 16,549 |
| Unearned premium reserve | 669 | 669 |
| Unexpired risk liability | 323 | 258 |
| Other liabilities | 612 | 612 |
| **Total liabilities** | **19,798** | **18,088** |
| **Funding ratio** | **94%** | |
| **Insurance ratio** | | **102%** |

The NI capital management policy uses the insurance ratio and its outlook as the primary measure of the Scheme's capital position, as recommended by the McDougall Review. The funding ratio and operational cashflows are also considered.

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 102% as at 30 June 2022.

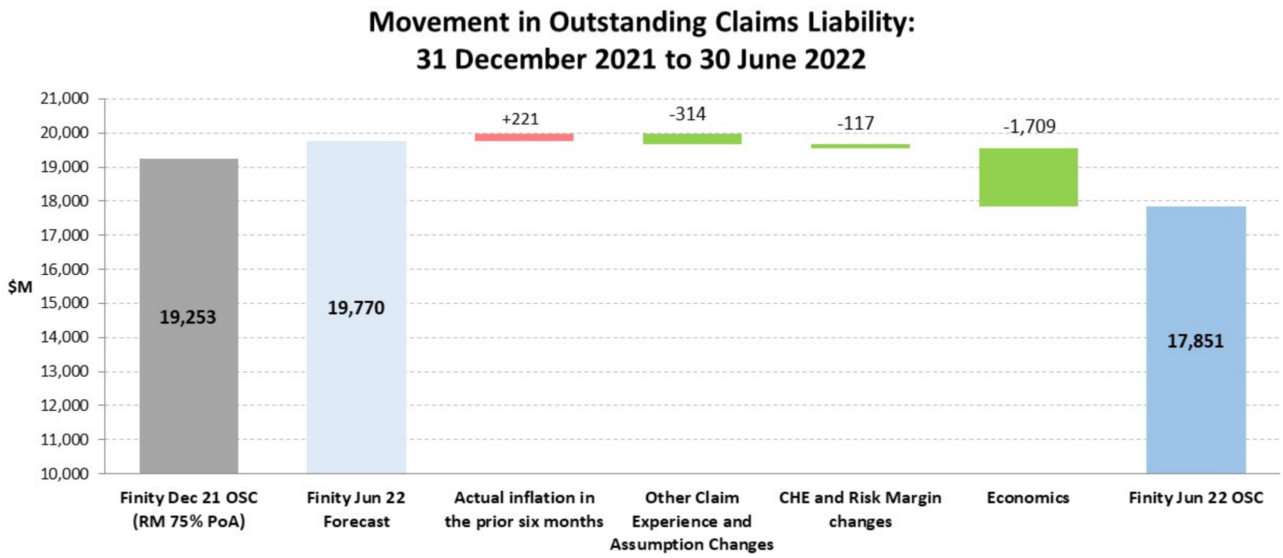
The funding ratio is the ratio of Scheme assets to liabilities on a basis consistent with accounting standard AASB 1023, where liabilities are calculated using risk-free discount and inflation assumptions. This ratio is subject to volatility from the movements in risk-free Government bond yields that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

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 2021 and 30 June 2022 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 2021, the outstanding claims liability estimate at 30 June 2022 has reduced by approximately -$1,919m, or -10%. The key drivers of the change were:

- A $221m increase due to actual inflation in the six months to 30 June 2022 being higher than expected.
- A $314m decrease from actual claim experience over six months to 31 March 2022 and changes to the valuation basis. The main movements were:
  - A $400m decrease due to fewer front end weekly and medical active claims due to improved return to work, which has been partly reflected in future projections.
  - A $73m decrease for medical claims with high WPI bands, reflecting lower average medical spend per claim assumptions.
  - A $71m decrease due to fewer open catastrophic medical claims that was mostly offset by a $57m increase due to higher assumed attendant care rates for these claims.
  - A $169m increase due to a more claims being expected to reach high WPI bands (particularly the 2017/18 accident year).
  - Other modelling and assumption changes totalling a net increase of $4m.
- A $29m decrease due to reduced claims handling expense assumptions.
- A $88m decrease due to the release of additional risk margin held for COVID-19 due to reduced uncertainty of COVID-19 impacts on the scheme's claims.
- A $1,709m decrease from revised economic assumptions for inflation and discount rates. A significant uplift in the risk-free yield curve was partly offset by higher future inflation rate 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 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, the actual investment returns achieved and future inflation. Volatility in the current market environment, especially amid global inflationary pressures and 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 largely continues into the future, with allowance for increase in Work Capacity decisions activities. 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, there is pressure from psychological claims for which the valuation has allowed. The increase in number of weekly claims remaining active at five years 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.
- 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.
- 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 COVID-19 pandemic has impacted many aspects of the scheme environment, including claim numbers, return to work activity, medical and care related payments, as well as compensable direct COVID claims. As the NSW economy reopens, there is uncertainty around what "post-COVID" experience will look like.

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.