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 2023

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 2023. 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 2023 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 2023, Finity has estimated the discounted net outstanding claims liability of the NI to be $19,220m. This figure includes a 11% 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 2023 are set out in the following table.

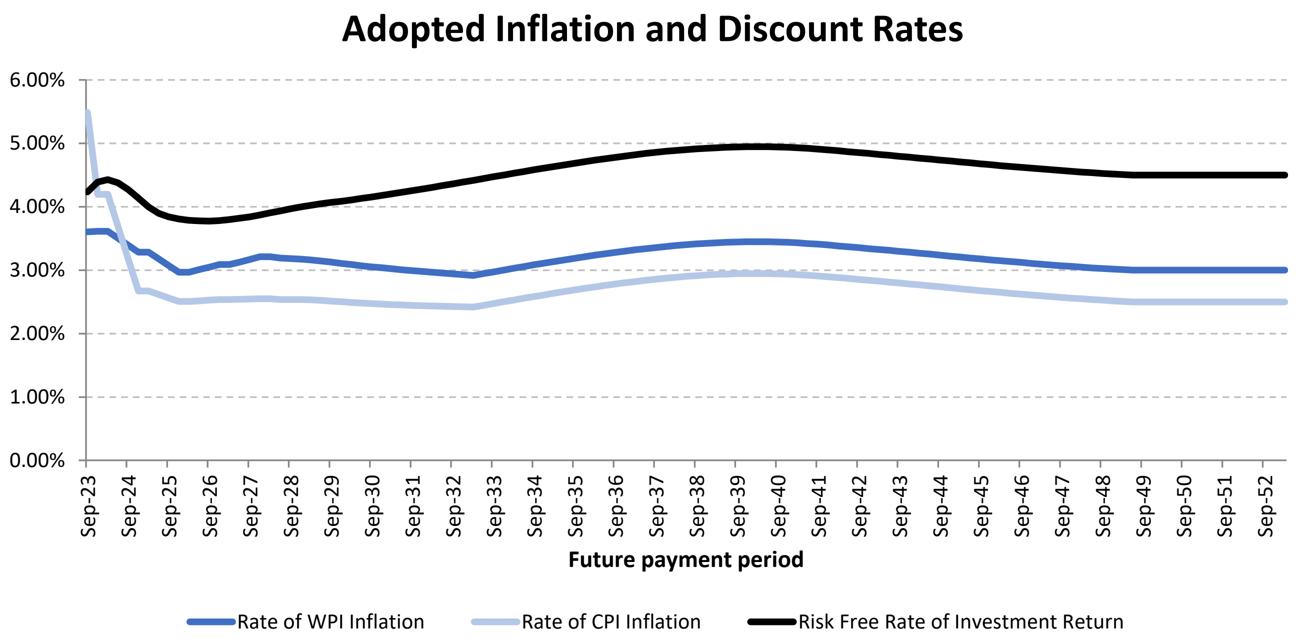
Table 1: Nominal Insurer outstanding claims liability as at 30 June 2023

Table 1: Outstanding claims liability	Undiscounted Liability Estimate ($m’s)	Discounted Liability Estimate ($m’s)
Weekly compensation	7,084	5,284
Medical benefits	10,740	5,327
Work injury damages	3,999	3,393
Section 66 and 67	1,004	847
Investigation costs	354	281
Legal costs	308	253
Rehabilitation benefits	286	260
Commutations	234	140
Death	186	151
Other	361	208
Asbestos	380	209
Uninsured employers	307	179
Direct COVID-19	29	26
Gross outstanding claims liability	**25,270**	**16,558**
Tax recoveries	106	89
Other recoveries	257	225
Uninsured employer recoveries	61	36
Net outstanding claims liability (excl. CHE)	**24,845**	**16,208**
Claims handling expenses (CHE)	1,695	1,111
Net outstanding claims liability (incl. CHE)	**26,540**	**17,319**
Risk margin (11.0%)	2,916	1,902
Total outstanding claims liability	**29,456**	**19,220**

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 2023 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 10 to 30 years.

The adopted rates for the June 2023 valuation are shown in the following figure.

Figure 1: Economic assumptions as at 30 June 2023



The mean term of the outstanding claims liability was estimated to be 13.5 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 $1,015m as at 30 June 2023. This figure includes a risk margin of 12.3% 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 2023 are set out in the following table.

Table 2: Nominal Insurer premium liability as at 30 June 2023

Table 2: Premium liability	Liability Estimate ($m's)
Central estimate of premium liability	904
Risk margin (12.3%)	111
Premium liability (75% PoA)	**1,015**

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 2023 is lower than the comparable figure at 31 December 2022 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 2023 where the liabilities are provisioned at the 75% probability of adequacy.

Table 3: Nominal Insurer financial position as at 30 June 2023

Table 3: Financial Position ($m's)	Accounting Basis	Insurance Basis
Investments	17,564	17,564
Outstanding claims recoveries	389	370
Other assets	2,343	2,343
Total assets	**20,296**	**20,277**
Gross outstanding claims liability (incl. CHE)	19,609	17,959
Unearned premium reserve	777	777
Unexpired risk reserve	238	179
Other liabilities	1,457	1,457
Total liabilities	**22,081**	**20,372**
Funding ratio	**92%**	
Insurance ratio		**100%**

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 rates 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 NI capital management policy has adopted a Target Operating Zone of Insurance Ratio greater than 130%. This range is based on icare's Board's risk appetite. The insurance ratio for NI is 100% as at 30 June 2023.

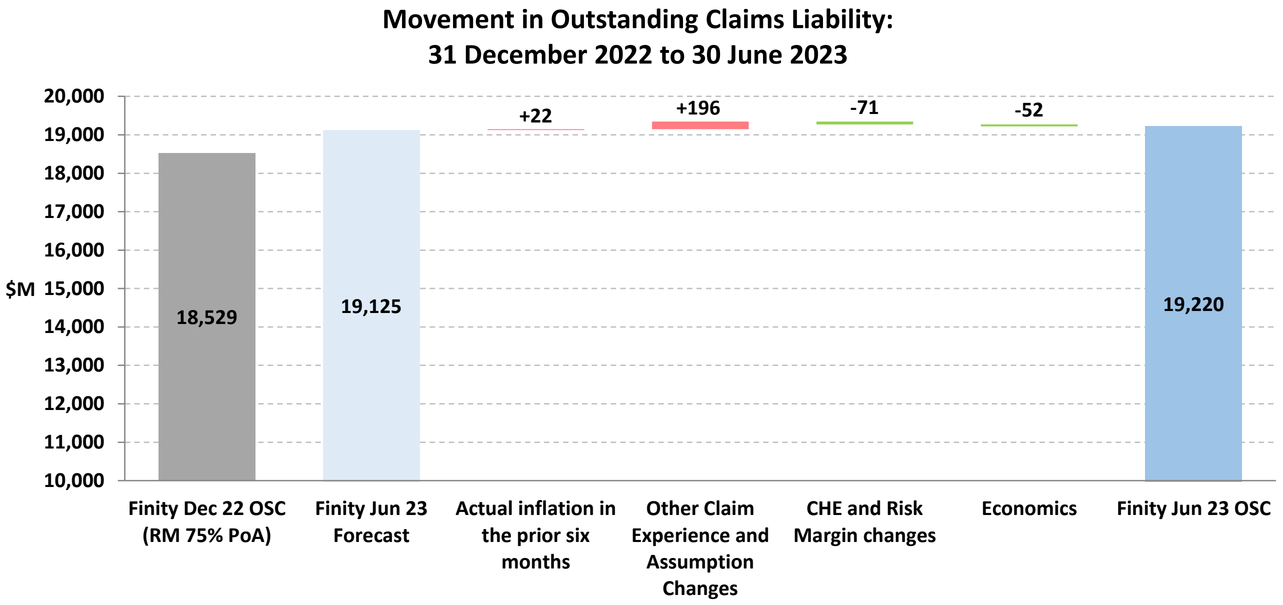
The funding ratio is the ratio of Scheme assets to liabilities on a basis consistent with accounting standard AASB 1023, where liabilities are calculated using risk-free discount rate. This ratio is subject to volatility from the movements in risk-free Government bond yields that do not change the underlying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

icare is actively working on its key financial levers of claim cost savings via new Claims Service Providers (CSPs) arrangement designed to improve claim outcomes (such as better return to work rates), 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 2022 and 30 June 2023 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 2022, the outstanding claims liability estimate at 30 June 2023 has increased by approximately $95m, or 0.5%. The key drivers of the change were:

- A $22m increase due to actual inflation in the six months to 30 June 2023 being higher than expected.
- A $196m increase from actual claim experience over six months to 31 March 2023 and changes to the valuation basis. The main movements were:
  - A $163m increase due to more physical injury claims being expected to reach high Whole Person Impairment (WPI) bands, which are gateways to Work Injury Damages (WID) or longer weekly and medical benefits
  - A $86 million decrease due to lower weekly and medical active claims for lower WPI bands due to improved return to work
  - A $91m increase due to higher average medical cost for hearing loss claims (assessments, hearing aids, and batteries) reflecting an increased number of services per claim
  - Other modelling and assumption changes totalling a net increase of $29m.
- A $37m decrease from claims handling expenses to reflect a lower number of front-end active claims.
- A $35m decrease due reducing risk margin, reflecting reduced uncertainty around the development of older accident years, partly offset by increased inflation uncertainty.
- A $52m decrease from revised economic assumptions, mostly due to lower 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 tail nature of many of the benefits payable means that changes in future inflation and discount rate assumptions can have a significant effect on the liability. Volatility in the current market environment, especially amid global inflationary pressures, can lead to continuing volatility in both the liability estimates and the insurance ratio.
- The number of physical injury claims reaching a higher whole person impairment (WPI) over 15% has recently increased. These claims have significantly longer durations and higher cost associated with them. There is uncertainty over how many physical claims will have higher whole person impairment and therefore higher claims cost.
- The number of claims with a primary psychological injury has increased over the past few years, although the numbers have recently stabilised. These claims have significantly longer durations and higher cost associated with them. There is also uncertainty over how many psychological claims will have a WPI over 15% and therefore higher claims cost.
- The claims cost of the recent accident years had been higher due to lower return to work rates, although has improved over the last year. The valuation assumes the recent experience continues, reflecting the increase in Work Capacity Decision activity. Changes to the claims service providers managing claims could lead to disruption, although the gradual transition planned should partly mitigate this risk. Actual return to work rates could be better or worse than currently assumed in the valuation.
- Above economic inflation rises in attendant care costs has driven strong growth in average medical payments for the most severe claims. The growth in average medical payments for other claims has moderated over the past four years. 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 eligible claimants pursing Work Inury Damages (WID). The more recent accident years have little experience to date and actual WID settlements could be higher or lower.

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 NI's ongoing delivery 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.