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Mr Darren Parker  
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2 August 2020

## Key risks associated with the 31 December 2019 Nominal Insurer Valuation

Dear Darren

Please find attached a summary of the key risks identified with the Nominal Insurer valuation as at 31 December 2019.

Should you have any questions or require any further information, please do not hesitate to contact me.

Yours sincerely

Phillip Halverson  
Partner

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## 1. Executive Summary

### 1.1 Introduction and scope

We have reviewed the Finity Consulting ("Finity") report titled "Insurance Liabilities as at 31 December 2019 - NSW Nominal Insurer" ("the Valuation Report"), for the purposes outlined in the scope below.

We have conducted this review in accordance with the scope agreed with SIRA. This scope and the purpose of this report is to identify and comment on:

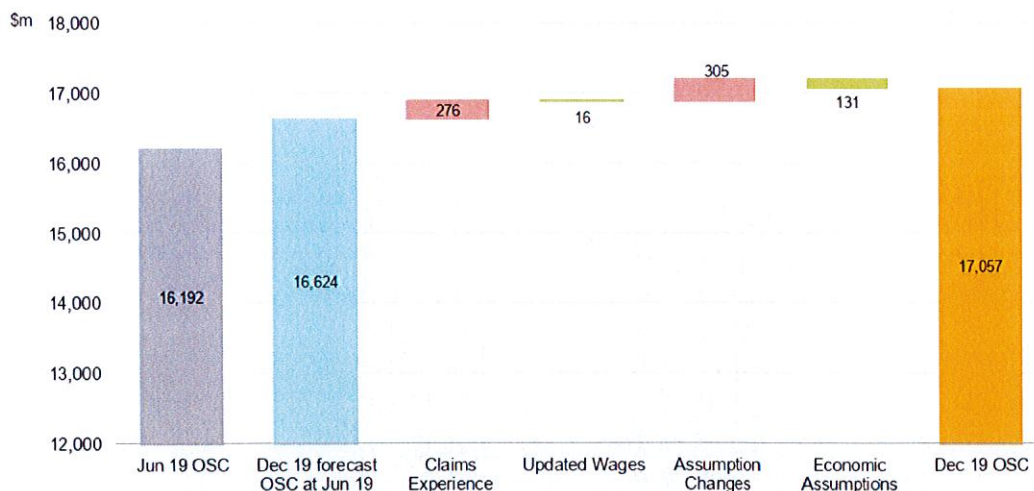
- ▶ the key risks to the valuation of the outstanding claims liabilities
- ▶ aspects of the Nominal Insurer's (NI) performance where SIRA may consider further investigation and analysis.

This scope does not constitute an External Peer Review ("EPR") under APRA CPS320 or an audit review. An EPR or an audit would require a review of the valuation data, underlying models and all assumptions, including relevant discussions with the valuation actuary. This was not the purpose of this review.

### 1.2 Summary of results

By way of background, the movement in outstanding claims liability between 30 June 2019 and 31 December 2019 is summarised in the following graph. The valuation utilises data as at 30 September 2019 to estimate the outstanding claims liability as at 31 December 2019.

#### Movement in liability



The outstanding claims liability has increased by \$276m due to deterioration in claims experience and changes in assumptions have led to a further increase of \$305m.

The main experience features noted in the Valuation Report during the period include:

#### Weekly benefits

- ▶ A decrease in the "Fit for Work Rate" at development quarter 4. That is, the proportion of claims that did not receive weekly payments in development quarter 4 (primarily because they have returned to work). This rate has reduced from greater than 86% for accident quarters up to March



2017 to 76% for the last accident quarter measured (December 2018) (refer to Figure 3 of the Valuation Report)

- ▶ A decrease in the number of weekly exits between 104 to 260 weeks duration. Historically, there have been approximately 400 exits per calendar quarter. This has reduced to approximately 150 claims per accident quarter (refer to Figure 4 of the Valuation Report)
- ▶ A trend that has been previously identified is the increase in number of claims exceeding 13 weeks incapacity. Historically, this has been an average of approximately 1,500 claims per accident quarter. This number has been increasing since the September 2017 accident quarter and is now more than 2,000 claims per quarter (refer Figure 5.6 of the Valuation Report)

#### Medical benefits

- ▶ There has been an increasing trend in payments for catastrophic medical claims. This is driven by both a higher number of claims than expected and an increasing cost of care rate (refer to Figure 7.4 of the Valuation Report)
- ▶ A reduction in the observed rate of superimposed inflation of medical payments

#### Statutory Lump Sum (S66) and Work Injury Damages (WID) claims

- ▶ Increasing numbers of s66 claims indicating greater numbers of claims in WPI bands 11-20% and +21%. (refer to Figures 4.7 and 4.8 of the Valuation Report)
- ▶ Consistent with the above point, there appears to be an increase in claims that will be eligible for a WID claim (refer to Figure 8.4 of the Valuation Report)

Refer to Section 3 of this report for more detail on the key experience items.

### 1.3 Key risks identified

Section 3 of this report shows there has been an overall strengthening of the valuation basis as a result of both the claims experience and changes to the assumptions. In many cases the changes made to the assumptions are in line with the emerging experience.

The risks identified primarily arise from where assumptions have been selected that do not follow directly from the current claim experience i.e. where there has been other information used, anticipated improvements due to management initiatives and judgement applied in selecting the assumptions, etc. In these instances, should the future experience emerge similarly to the recent claims experience then this could result in future strengthening of the actuarial valuation basis (liability increases).

The EY review (this Report) has concentrated on these selected assumptions and their sensitivities to highlight key risks to the valuation should the experience not emerge in line with assumptions. Our detailed findings in regard to the key risks are included in Section 4 of this Report.

The major risk identified relates to the findings of the Dore Report in regard to claims management.

The Dore Report concluded that improved claims management was required to improve return to work outcomes in addition to the implementation issues being resolved. SIRA's first quarterly claims file review of the 2019 claims cohort has been completed. The review identified some areas of improvement, however, there were also a number of key areas that had not improved.



If the technical case management issues identified in the Dore Report such as lack of claims strategy, lack of injury and medical management planning and lack of communication with stakeholders do not continue to improve then there will be no commensurate improvement in return to work rates. This will likely have flow on impacts to many aspects of the scheme. This is a key risk associated with the Nominal Insurer's performance and hence the actuarial valuation.

The following table summarises the key risks and possible further investigations that SIRA may consider undertaking.

Risk	Comments	SIRA considerations
<p>Valuation of weekly benefits</p> <p>(Weekly benefits are 30% of the total liability)</p>	<p>Early duration continuance rates have continued to deteriorate and the number of exits from the scheme between 2 to 5 years continue to fall.</p> <p>In response to this experience, Finity has made some allowance for this deterioration, however not to the full extent and assumes this trend will reverse during 2020.</p> <p>For the early duration continuance rates, Finity have assumed early indications of improving return to work rates and the successful resolution of the implementation issues identified by the Dore report will result in improved continuance rates.</p> <p>The adopted continuance rates imply that the low observed exit rate for weekly benefit claims at 2 to 5 years after the accident will return to the near long-term average during 2020.</p> <p>There have been significant delays in conducting work capacity decisions. This could be one of the drivers of the number of low scheme exits between 104 and 260 weeks. The valuation assumes an increase in the number of work capacity decisions and the efficacy of these decisions to drive increased numbers of scheme exits. Experience to March 2020 appears to support this assumption.</p>	<ul style="list-style-type: none"> <li>SIRA should continue with its quarterly performance reviews of Nominal Insurer claims to ensure that the claims management issues identified by the Dore report continue to improve</li> <li>SIRA may wish to monitor the number and the mix of work capacity decisions. These decisions are a key part of the legislation</li> </ul>
<p>Valuation of medical benefits</p> <p>(excluding catastrophic medical)</p> <p>(medical benefits are 22% of the total liability)</p>	<p>Medical inflation has averaged greater than 10% per annum in the three years to September 2018 with an improvement experienced in the year to September 2019.</p> <p>The valuation basis has an additional allowance for superimposed inflation of 4% that extends to September 2021. Post this date the assumed level of inflation reverts back to the level of normal medical inflation.</p>	<ul style="list-style-type: none"> <li>SIRA should continue to monitor medical payment inflation</li> <li>A focus on medical payments in the quarterly claims performance reviews should continue</li> </ul>
<p>Catastrophic claims</p> <p>(14% of total liability)</p>	<p>Due the unpredictable nature and low number of catastrophic injury claims, the data available is both scarce and volatile.</p> <p>The liability for these claims can be very large (&gt;\$10m).</p>	<ul style="list-style-type: none"> <li>Monitor volumes</li> <li>SIRA may also consider investigating rates of care as this is a key driver of cost</li> </ul>

Risk	Comments	SIRA considerations
<p>Work Injury Damages (WID) claims</p> <p>(WID benefits are 19% of the total liability)</p>	<p>There is a high level of uncertainty in the estimation of the WID liability.</p> <p>It is both the level of WID claims and the mix of WID claims (between different whole person impairment "WPI" levels) that represent a risk to the scheme.</p> <p>The uncertainty is primarily due to limited recent experience and the unclear impact of the Section 39 process (and other WPI thresholds) on claimant behaviour and the proportion of eligible claims that will pursue a WID outcome.</p> <p>The valuation models WID claims separately for the cohort of claims with WPI between 15% and 20% and the cohort with WPI of 21%+ as these two cohorts impact the liability in different ways.</p>	<ul style="list-style-type: none"> <li>SIRA may consider investigating the behaviour of claimants with WPI &gt;15% to understand the likelihood of future WID lodgements</li> <li>SIRA may consider investigating possible bracket creep within the scheme potentially leading to increased eligibility to WID claims and other benefits</li> </ul>

#### 1.4 Reliance and limitations

In accordance with normal professional practice, neither EY, nor any member or employee thereof undertakes responsibility in any way whatsoever to any person other than SIRA in respect of this report. Neither the whole of this report, or any part thereof, or any reference thereto may be published in any document, statement or circular nor in any communication with other third parties without prior EY written approval of the form and context in which it will appear.

Further reliances and limitations are outlined in Section 7 of this report.



## 2. Introduction and scope

We have reviewed the Finity Consulting (“Finity”) report titled “Insurance Liabilities as at 31 December 2019 - NSW Nominal Insurer” (“the Valuation Report”) and subsequent information provided by Finity, with the purposes outlined in the scope below.

We have conducted this review in accordance with the scope agreed with SIRA. This scope and the purpose of this Report is to identify and comment on:

- ▶ the key risks to the valuation of the outstanding claims liabilities
- ▶ aspects of the Nominal Insurer’s (NI) performance where SIRA may consider further investigation and analysis.

This scope does not constitute an External Peer Review (“EPR”) under APRA CPS320 or an audit review. An EPR or an audit would require a review of the valuation data, underlying models and all assumptions, including relevant discussions with the valuation actuary. This is not the purpose of this review.

We have not formed a view as to the overall reasonableness of the valuation assumptions or valuation results. This review had the purpose of highlighting to SIRA the risks inherent in the liability valuation, to inform SIRA’s focus for ongoing monitoring of the sustainability of the NI. The sustainability of the NI can be impacted by material increases in the estimate of the outstanding claims liability. As such this report has concentrated on areas where, in our judgement, there is more upward pressure on the liabilities than downward.

The risks identified primarily arise from where assumptions have been selected that do not follow directly from the current claim experience i.e. where there has been other information used, anticipated improvements due to management initiatives and judgement applied in selecting the assumptions, etc. In these instances, should the future experience emerge similarly to the recent claims experience then this could result in future strengthening of the actuarial valuation basis (liability increases). There may also be instances where experience will emerge better than expected, which equally may lead to reductions in the valuation basis, but discussion of risks that may lead to this was not the purpose of this Report.

The Valuation Report contains a significant amount of analysis of the scheme experience and the experience of the drivers of the key valuation assumptions. We note that a number of risks that we have identified have also been identified by Finity in the “Uncertainty and sensitivity analysis” section of the Valuation Report. The uncertainty has been demonstrated in the Valuation Report by a combination of sensitivity analysis (shows the sensitivity of the liability estimate to different nominal assumption changes) and scenario analysis (which in the case of the Valuation Report shows the sensitivity of the liability estimate to selected assumptions should certain assumed improvements not materialise). Given the changes to the scheme legislation (2012 and 2015), changes to the claims management model, changes to the IT infrastructure and the recent deterioration in the claims experience, there is heightened uncertainty surrounding much of the claims experience and hence assumptions.

All figures referenced in this Report are sourced from Finity’s Reports.

## 3. Summary of valuation results and experience

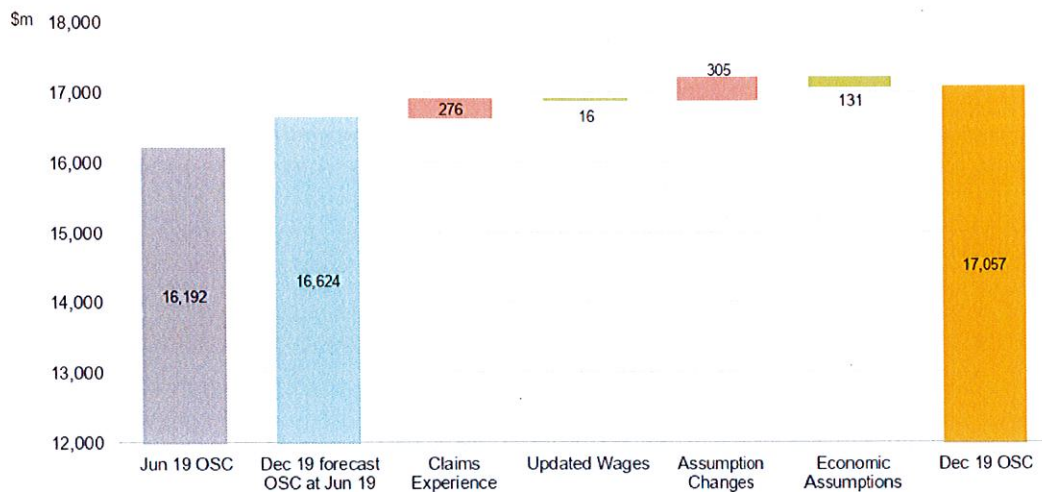
The net outstanding claims liability (excluding claims handling expenses) as at 31 December 2019 is \$13,690m. After the addition of claims handling expenses and a risk margin to provide an 80% probability of adequacy (“PoA”), the provision is \$17,057m. The funding ratio at 80% PoA has



reduced from 109.0% at 30 June 2019 to 103.7% at 31 December 2019, with net assets reducing by \$0.9bn.

The movement in outstanding claims liability between 30 June 2019 and 31 December 2019 is summarised in the following graph.

#### Movement in liability



The outstanding claims liability has increased by \$276m due to deterioration in claims experience, mainly driven by the following:

- ▶ A \$160m increase due to a higher number than expected of new catastrophic medical claims reported and an increase in the average payment on catastrophic medical claims to reflect higher actual medical costs
- ▶ An \$89m increase due to higher than expected weekly and medical active claims, particularly as a result of increasing claim duration and low numbers of Work Capacity Decisions made in recent accident years
- ▶ A \$27m increase due to higher investigation and rehabilitation costs as a result of higher than expected weekly active claims.

Changes in valuation assumptions have increased the outstanding claims liability further by \$305m. This increase was a result of a number of movements, namely:

- ▶ A \$338m increase due to an increase in projected weekly and medical active claim numbers in response to higher continuance rates observed in early durations
- ▶ A \$115m increase to reflect higher actual medical costs, including a substantial increase for attendant care rates for claims with catastrophic injuries.

This was partially offset by:

- ▶ A \$128m decrease due to lower weekly payments per active claim ("PPAC") assumptions across all Whole Person Impairment ("WPI") segments
- ▶ A \$91m decrease due to a higher assumed proportion of claims with WPI 15%+ pursuing a work injury damages ("WID") claim and hence, if successful, ceasing weekly and medical payments (for the cohort of claims with a WPI of 21%+, the estimated cost of future weekly and medical benefits is greater estimated cost in the valuation model than an average WID claim).

### 3.1 Main experience features

The valuation utilises data as at 30 September 2019 to estimate the outstanding claims liability as at 31 December 2019. The main experience features noted in the Report during the period include:

#### Weekly benefits

- ▶ A decrease in the "Fit for Work Rate" at development quarter 4. That is, the proportion of claims that did not receive weekly payments in development quarter 4 (primarily because they have returned to work). This rate has reduced from greater than 86% for accident quarters up to March 2017 to 76% for the last accident quarter measured (December 2018) (refer to Figure 3 of the Valuation Report)
- ▶ A decrease in the number of weekly exits between 104 to 260 weeks duration. Historically, there have been approximately 400 claim exits per calendar quarter. This has reduced to approximately 150 claims per accident quarter (refer to Figure 4 of the Valuation Report)
- ▶ A trend that has been previously identified is the increase in number of claims exceeding 13 weeks incapacity. Historically, this has been an average of approximately 1,500 claims per accident quarter. This number has been increasing since the September 2017 accident quarter and is now more than 2,000 claims per quarter (refer Figure 5.6 of the Valuation Report)

#### Medical benefits

- ▶ There has been an increasing trend in payments for aids and modifications, primarily driven by an increase in the number of hearing loss claims (refer to Figure 6.23 of the Valuation Report)
- ▶ There has been an increasing trend in payments for catastrophic medical claims. This is driven by both a higher number of claims than expected and an increasing cost of care rate (refer to Figure 7.4 of the Valuation Report)

#### Section 66 (s66) and WID claims

- ▶ Increasing numbers of s66 claims indicating greater numbers of claims in WPI bands 11-20% and +21%. Following the 2012 workers compensation reforms there was a slow down in s66 payments. This trend now appears to have reversed throughout 2018 and 2019 (refer to Figures 4.7 and 4.8 of the Valuation Report)
- ▶ Consistent with the above point, there appears to be an increase in claims that will be eligible for a WID claim (refer to Figure 8.4 of the Valuation Report)
- ▶ There has been a spike in the number of s66 payments as a result of deafness claims (refer to Figure 9.13 of the Valuation Report).

## 4. Key risks identified

### 4.1 Weekly benefits

#### 4.1.1 Summary of liability movements

The valuation of weekly benefits is a significant part of the liabilities and has some assumptions that do not fully follow the current experience. Rather, weight has also been given to emerging lead indicator data, certain management initiatives and application of areas of judgement.



Table 5.16 from the Valuation Report highlights the movements in the liability valuation of the weekly benefits between June 2019 and December 2019.

**Table 5.16 – Analysis of Change: Weekly Payments (Inflated, Discounted, Excluding CHE and RM)**

		\$m
OSC Estimate at Jun19		3,966
<b>Expected OSC at Dec19</b>		<b>4,084</b>
Movements due to:		
Experience	Actual inflation	(6)
	Active claim numbers to September 2019	79
	Updated Wages	(5)
	Subtotal	68
Basis Changes	Revised ultimate numbers for WPI 11%+	26
	Front-end continuance (DQ 1-8)	58
	2-5 year continuance	141
	Higher WID claim numbers	(100)
	PPAC changes	(102)
	All other number assumptions	9
	Subtotal	31
<b>OSC at Dec19 (Jun19 economics)</b>		<b>4,183</b>
Change in Economic Assumptions		(32)
<b>Actual OSC at Dec19</b>		<b>4,151</b>

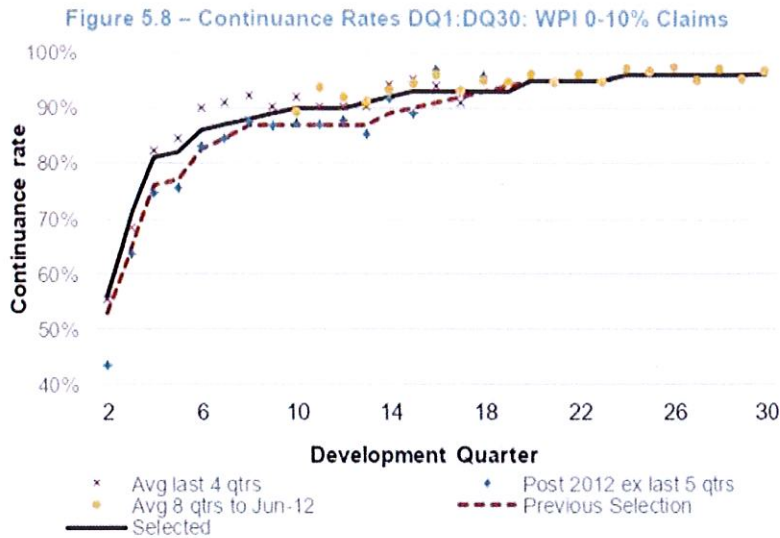
The table shows that overall there has been a strengthening of the valuation basis of approximately \$65m. Experience has been \$68m worse than expected over the six-month period. Some of the experience deterioration has been offset by assumption changes, in particular to WID (Common law) assumptions (refer to section 4.3) and lower average claim size assumptions (PPACs).

#### 4.1.2 Short term continuance rates

In the six months to December 2019, active claims and payments have been higher than expected for claims with less than 5 years duration on benefit. Recent continuance rate experience for WPI 0-10% claims is higher than the selections adopted at the previous valuation, as shown in the graph below (Figure 5.8 of the Valuation Report). Finity has responded by increasing the adopted short-term (development years 0-2) and mid-term (development years 2-5) continuance rates.

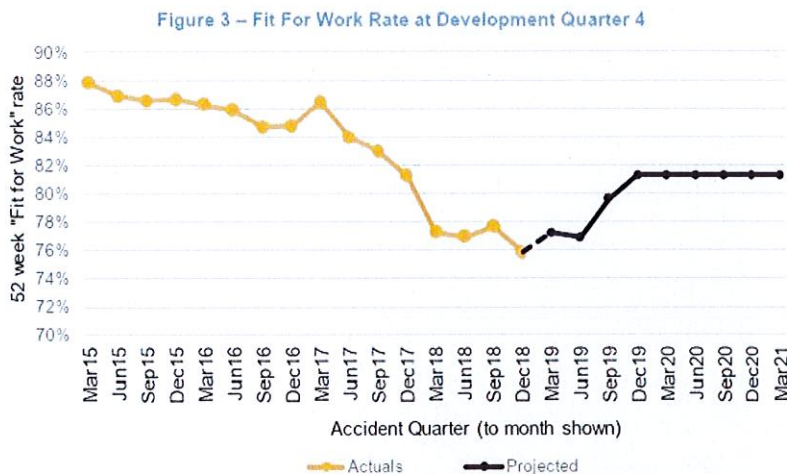
The crosses and dots in the figure show the latest experience. The black line is the assumed rates and is sitting below the experience (we note that the assumptions have been increased from previous assumptions but not to be equivalent to the recent experience).





The following figures from the Valuation Report, show selected assumptions and related projections that assist in identifying key risks.

Figure 3, from the Valuation Report shows the trajectory of the “fit for work” rate at development quarter 4 and the assumed rate in the valuation. The experience trend through 2017 and 2018 shows a rapid deterioration. The valuation assumes a recovery in the December 2019 and following accident quarters.



We have summarised below the two primary evidence points provided to support the view that the recent experience is temporary and improvements in short term continuance rates are likely:

► **The Dore Report**

The Valuation Report refers to conclusions of the Dore Report in conjunction with other information, in forming some of those judgements.

In particular, page 8 of the Valuation Report states:

Based on recent return to work data provided by icare, combined with the SIRA review of the Nominal Insurer finding that at least some degree of the reduction was due to *implementation* of the new claims management model (and therefore temporary), the valuation assumes a degree of improvement in return to work will occur in the near future.

And page 55 of the Valuation Report states:

SIRA's review of icare (which focused on the 2018 accident year, prior to the implementation of Guidewire) also supports the view that higher continuance rates are to some extent temporary in nature. The review noted two key implementation issues relating to the new claims model first introduced in 2018:

- a lack of capacity, due to too few claims managers, and
- a lack of capability, due to claims managers not being sufficiently experienced.

Table 5.10 details the two key issues, along with three secondary issues raised in SIRA's review that related to the new claims operating model and icare's responses or actions to these issues.

Finity state that the two key issues identified by the Dore Report and icare's response to each are shown in the table below.

Key issue identified by SIRA/EY	icare's response to the issue
Under resourcing - actual caseloads above target	<ul style="list-style-type: none"> <li>▶ icare has shown that caseloads for staff have reduced</li> <li>▶ Budgeted agent remuneration fees have increased for 2019/20</li> </ul>
Inexperienced case managers appear to be impacting claimant outcomes	<ul style="list-style-type: none"> <li>▶ icare expanded training to EML staff in 2019</li> <li>▶ EML staff will have an additional year of experience compared to the review</li> </ul>

The Dore Report concluded that improved claims management was required to improve return to work outcomes in addition to the implementation issues being resolved. SIRA's first quarterly claims file review of the 2019 claims cohort has been completed. The review identified some areas of improvement, however, there were also a number of key areas that had not improved.

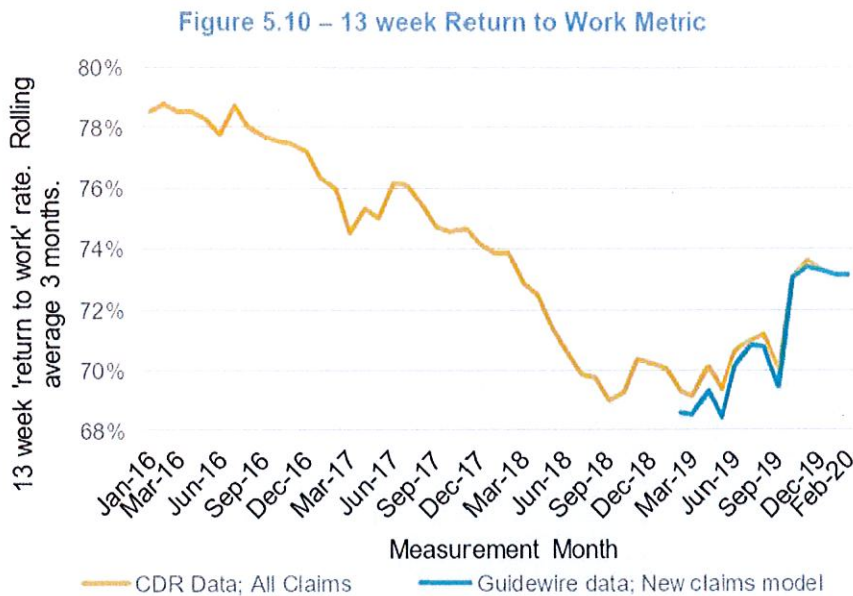
If the technical case management issues identified in the Dore Report such as lack of claims strategy, lack of injury and medical management planning and lack of communication with stakeholders do not continue to improve then there will be no commensurate improvement in return to work rates. This will likely have flow on impacts to many aspects of the scheme. This is a key risk associated with the Nominal Insurer's performance and hence the actuarial valuation.

The assumptions appear to have been selected indicating, at least to some degree, that icare's response to these issues will sustain the improvements in return to work rates seen in the Guidewire data (see next bullet). Given this, the future outcomes are relying on the success of these management initiatives.

- ▶ Improvement in the 13 week return to work rate based on the cessation of weekly payments methodology as shown in Figure 5.10 from the Valuation Report (below).

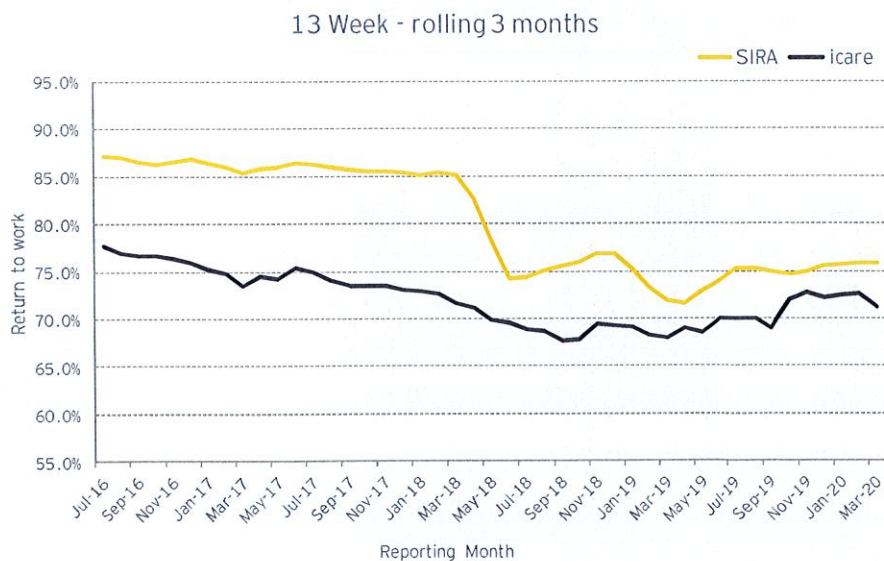


The assumed improvement in experience shown in Figure 3 of the Valuation Report is based to a degree on Figure 5.10 of Valuation Report which shows an improvement in the 13 week return to work metric. This metric is based on a cessation of weekly payments methodology.



In other work that EY have completed for SIRA (refer to our return to work presentation to SIRA of 8 May 2020) we have compared the return to work metric based on cessation of weekly payments with the SIRA measure based on work status code. This comparison is shown in the graphic below which shows:

- ▶ The icare measure illustrating the improvement indicated by Finity in the second half of calendar year 2019
- ▶ The SIRA measure, which does not show the same improvement
- ▶ Both measures exhibiting some degree of volatility, making judgements more challenging.

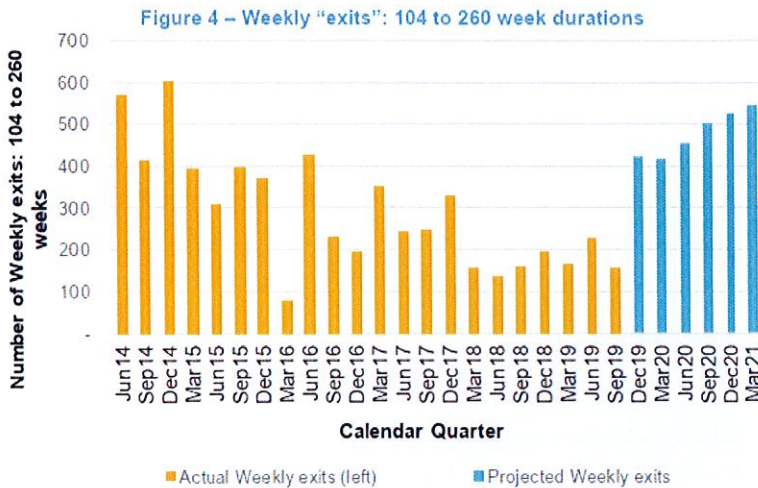




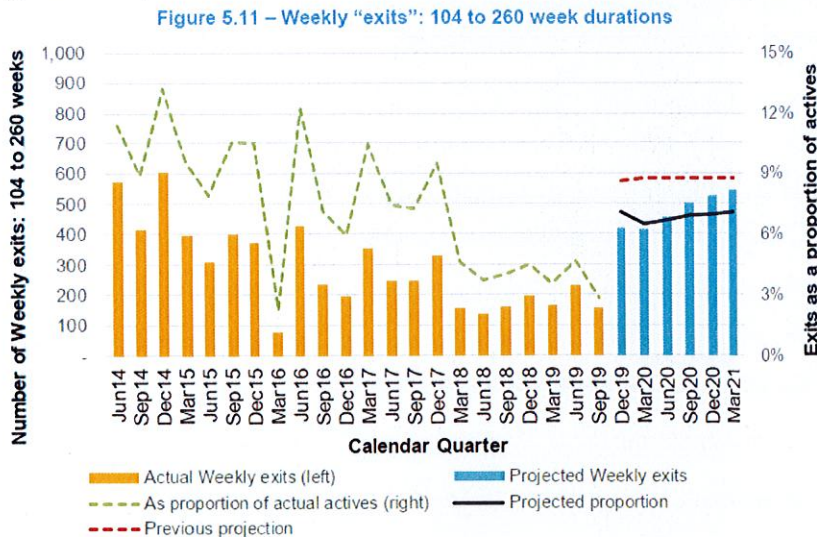
There are a number of reasons for this divergence which are articulated in the EY return to work presentation. Given the uncertainty surrounding improvements in the return to work rates, there is a significant level of uncertainty surrounding the early duration continuance rates and this is one of the key risks identified for this report.

#### 4.1.3 Mid-term continuance rates (development years 2-5)

Figure 4 in the Valuation Report shows the weekly exits between 104 and 260 weeks. The actual experience and the projected experience (i.e. based on the underlying selected assumptions) are shown. The projection shows the reversal of a general downward trend and more recent flat trend. The projections illustrate a step change in expected outcomes from December 2019.



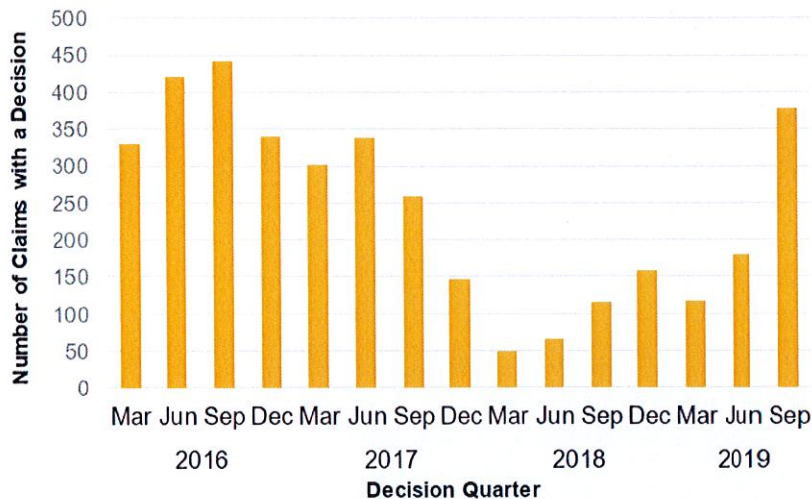
For weekly active claims with duration between 2 and 5 years, a key factor that influences the number of weekly exits is the impact of Work Capacity Decisions. Claims that receive an adverse outcome from a Work Capacity Decision are expected to cease receiving (or have a reduction in) weekly payments i.e. an “exit” from the scheme. The number of Work Capacity Decisions has reduced significantly since 2017 and the rate of weekly exits (as a proportion of total active claims) has also reduced, from approximately 9% in 2017 to 4% since 2018 as shown in Figure 5.11 from the Valuation Report.



The Valuation Report implies that the weekly exit rate will increase to around 7% as shown in Figure 5.11 of the Valuation Report (black line in graph). This is lower than the 9% assumed at the previous valuation (June 2019), but still higher than the actual weekly exit rate that has occurred in the most recent two years. The basis for this improvement is information from scheme agents which shows that in the 6 months to September 2019, there has been a substantial increase in the number of Work Capacity Decisions (including adverse outcomes) as shown in Figure 5.4 from the Valuation Report.

A downward trend in work capacity decisions is evident since late 2016. The last quarter of 2019 shows the number of work capacity decisions increasing to prior levels. The implication of the work capacity decisions is that you would expect a proportion of them to receive an “adverse” work capacity decision, resulting in either a reduction or cessation of weekly benefits. So as the volume picks up, you may reasonably expect the return to work to improve. This will take some time to emerge.

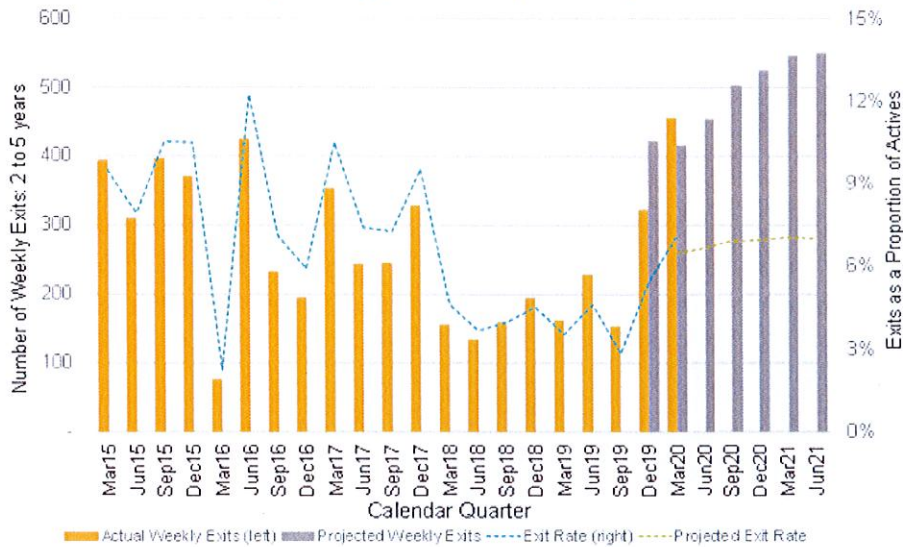
**Figure 5.4 – Number of Work Capacity Decisions Made**



Finity provided an update of the number of weekly exits between 104 and 260 weeks taking into account the most recent six months to March 2020. The figure below shows the number of exits in the December 2019 and March 2020 quarters has been close to expected.

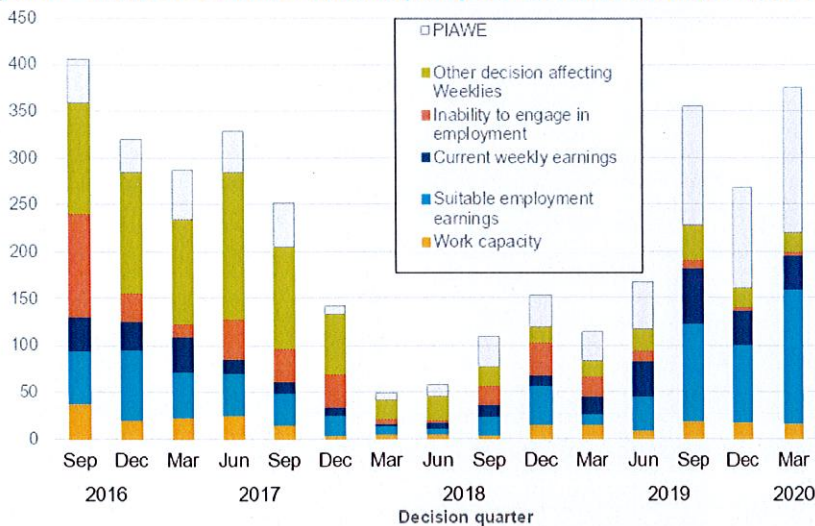


**Figure 1 – Number of Weekly claim exits at 2-5 years duration, showing data to Mar-20 (including previous expectations)**



Further work capacity decision experience for the most recent two quarters has been provided by Finity (up to March 2020). This shows a continuing high number of work capacity decisions (similar to the September 2019 quarter). Overall, this is shown in Figure 2 below. It also shows the mix of recent adverse work capacity decisions has changed with a higher proportion relating to weekly earnings (PIAWE).

**Figure 2 – Number of Adverse Work Capacity Decisions as Recorded in the CDR**



While there is very recent experience that suggests a step change improvement in activity is occurring, there is a risk that the level of exits emerging will not be maintained at the assumed level. In monitoring this, SIRA should also monitor the mix of those adverse work capacity decisions occurring as to their likely impact on payments i.e. the consistency of the characteristics of exits from the earlier periods to most recent periods.



## 4.2 Medical benefits

### Summary of liability movements

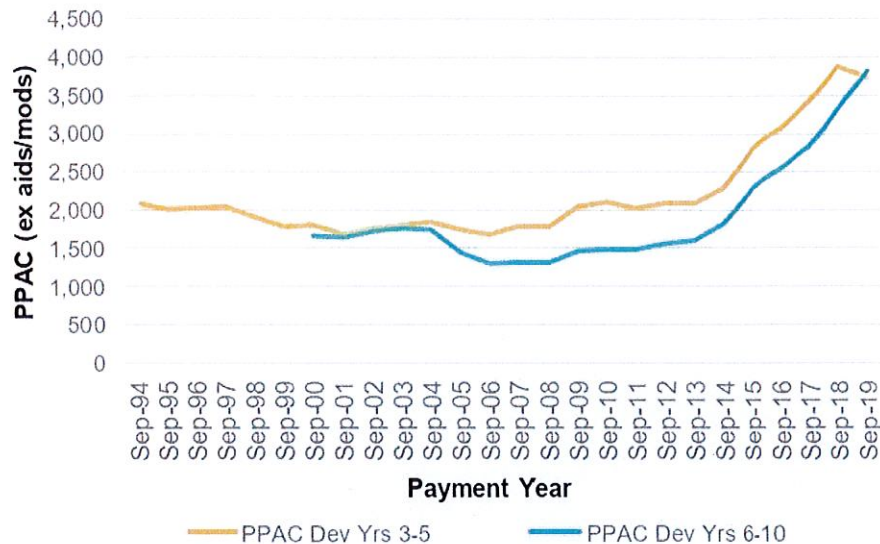
Table 6.11 from the Valuation Report (below) shows the movements in the valuation of the medical benefits between June 2019 and December 2019.

**Table 6.11 – Analysis of Change: Medical Payments (Inflated, Discounted, Excl CHE and RM)**

		\$m
OSC Estimate at Jun19		2,974
<b>Expected OSC at Dec19</b>		<b>3,051</b>
Movements due to:		
Experience	Actual inflation	(9)
	Active claim numbers to September 2019	10
	Updated Wages	(2)
	Subtotal	(1)
Basis Changes	Revised ultimate numbers for WPI 11%+	4
	Front-end continuance (DQ 1-8)	18
	2-5 year continuance	28
	Higher WID claim numbers	(38)
	Revised mortality assumptions	10
	All other number and continuance rate assumptions	7
	PPAC changes	21
	Hearing aids PPCI strengthening	24
	Subtotal	71
<b>OSC at Dec19 (Jun19 economics)</b>		<b>3,121</b>
Change in Economic Assumptions		(23)
<b>Actual OSC at Dec19</b>		<b>3,097</b>

Overall, the medical benefit valuation basis has remained relatively neutral. The main feature of the medical benefits over the last few years has been superimposed inflation of approximately 10% per annum as can be seen in Figure 6.21 from the Valuation Report (below).

Figure 6.21 – Analysis of Superimposed Inflation – Past 25 Years



The assumptions allow for this trend which is why the medical valuation basis has not required strengthening. The assumptions contained in the valuation basis are shown in Table 6.9 from the Valuation Report (below).

Table 6.9 – Applied Superimposed Inflation by Payment Year

Model Segment	Actual Superimposed				Adopted Superimposed Inflation			
	Sep-16	Sep-17	Sep-18	Sep-19	Sep-20	Sep-21	Sep-22	Later
Medical 0-20% WPI					6%	4%	-	-
Medical 21-100% WPI	7%	10%	10%	(1%)	3%	1%	-	-

There is an allowance for superimposed inflation up until payment periods September 2021. Should the trend of the last few years continue past this point then a further strengthening of the valuation basis would be required. The experience to September 2019 shows effectively no superimposed inflation.

As a sensitivity, Finity has indicated that if superimposed inflation were increased by 1% per annum, then the outstanding claims liability would increase by \$940m.

### 4.3 Catastrophic injury medical costs

The key movements in the liability for catastrophic injury medical costs are summarised below:

- ▶ An increase in the adopted average annual payment on reported claims reflecting higher attendant care and hospital costs in the recent experience. This has increased the liability by \$97m
- ▶ 29 new claims identified as catastrophic injuries contributed \$63m to the liability, however this has been partially offset by a \$40m reduction on closure of existing claims
- ▶ icare increased fees payable to attendant care providers on its panel effective 1 July 2019. A 10% increase has been applied to the projected average annual payment for reported Workers Care claims that use icare panel providers, as well as all IBNR Workers Care claims. This has increased the liability by \$59m. No further allowance for any future attendant care cost inflation has been included in the projections.



Due to the unpredictable nature and low number of catastrophic injury claims, the data available is both scarce and volatile. Therefore, a number of simplifying assumptions were required to be made in the modelling process. The assumptions with a high degree of uncertainty include:

- ▶ No further increases to attendant care costs are allowed for in the projections. Any further increases will increase liability as care costs are awarded for life
- ▶ The mix of injury type and severity of IBNR claims has been assumed to follow the current portfolio of reported claims. The medical costs and degree of mortality impairment can vary significantly between different types and severity of injury
- ▶ The average age at injury of IBNR claims is assumed to be consistent with that of the current portfolio of reported claims. Depending on the actual age of IBNR claims as they are reported, the duration and level of attendant care required, and thus the total cost, may differ greatly
- ▶ The number and size of IBNR claims. The IBNR claim number assumptions have increased in the current valuation to reflect the higher number of Workers Care claims identified in recent years. There is also the potential for catastrophic injury claims to emerge with care needs significantly higher than average. In the 6 months to September 2019, 3 such claims were identified with severe injuries that require 24/7 care and these 3 claims alone contributed \$53m to the liability.

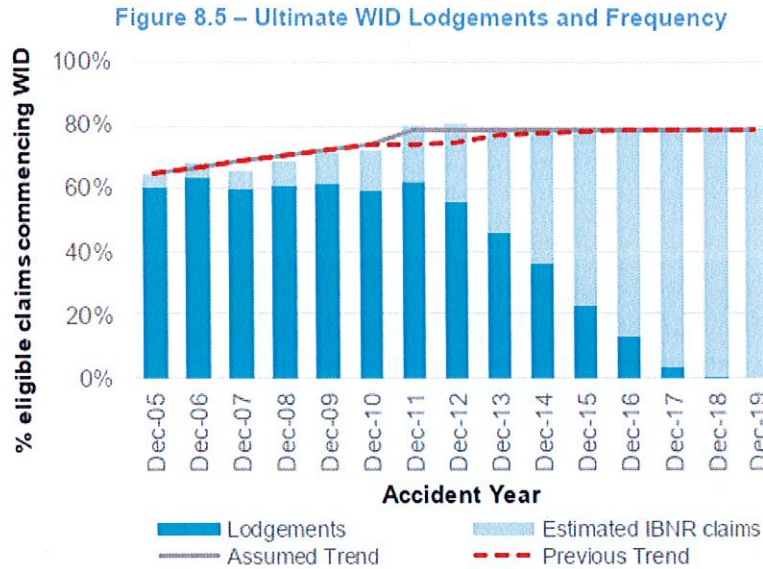
While we believe these simplifying assumptions are necessary and reasonable given the data available, we note that for these particular assumptions, deviations in actual experience may have a material impact on the outstanding claims liability for catastrophic medical claims. These outcomes should be monitored closely.

#### 4.4 Work Injury Damages (WID) claims

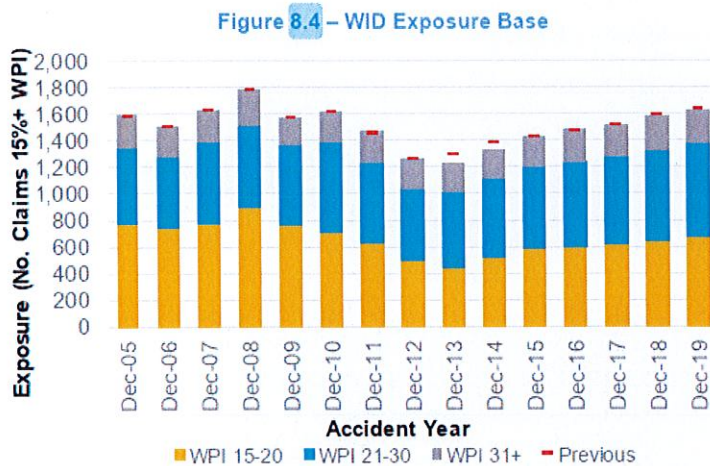
Across all accident years, both the number of WID lodgements and finalisations have been higher than expected in the 6 months since the previous valuation:

- ▶ For accident years 2012 to 2016, this is suggested to be due to an increase in the number of WPI assessments as claimants attempt to achieve a WPI assessment over 20%. This will allow the injured worker to avoid a Work Capacity Decision which may reduce their weekly benefits after 130 weeks. In response, the projection has been increased for the ultimate number of WID lodgements for this period, increasing the liability by \$36m
- ▶ For accident years prior to 2012, this is believed to be due to WPI assessments conducted as part of the s39 process. This has increased the number of later than expected lodgements, made more than 5 years since accident. In response, the lodgement pattern has been adjusted to reflect later lodgements for earlier accident years, increasing the liability by \$33m.

Figure 8.5 from the Valuation Report shows the number of assumed WID lodgements as a percentage of the number of claims projected to be eligible for a WID claim. The long-term assumption is that 80% of WID eligible claims will ultimately lodge a WID claim. This assumption combines experience for both claims with a WPI between 15% and 20% and claims with a WPI > 21%. WID claims with a WPI greater than 21% are assumed to result in a net reduction to the liability (as it is assumed that the cost of a WID claim is less than the present value of future weekly and medical payments).



For reference, Figure 8.4 from the Valuation Report shows increasing WID exposure over the most recent six years.



The valuation of common law claims is complex and is based on data that takes considerable time (years) to develop to ultimate numbers and cost. The current valuation basis makes the following assumptions:

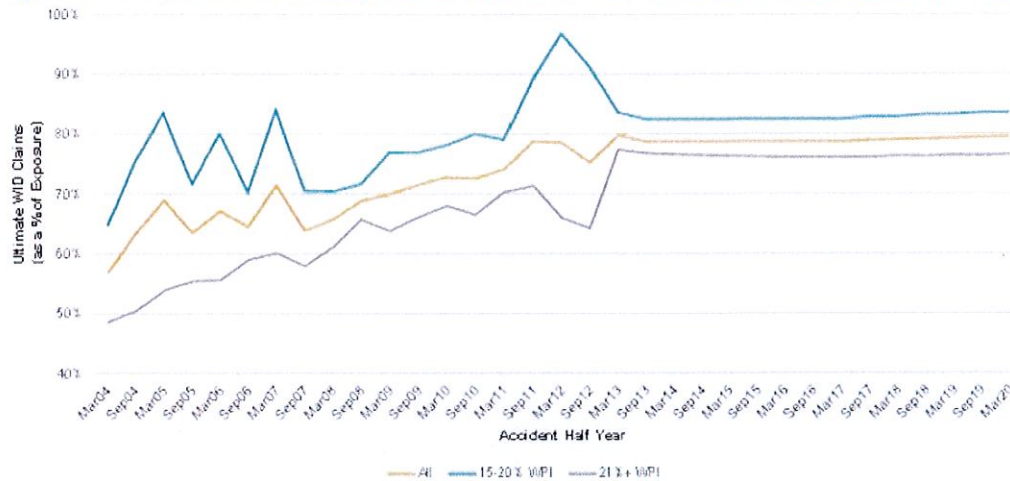
- ▶ There is an increasing base of claims with a WPI >15% that will be eligible to lodge a WID claim
- ▶ It is assumed that an increasing number of claimants (up to 80% of eligible claims) will lodge a WID claim.

Claimants with a WPI greater than 21% and claimants with a WPI between 15% and 20% impact the liability estimate in different directions.

Figure 3 (below) was included in Finity’s December 2018 valuation. This shows the actual and assumed behaviour of the two WPI cohorts.



**Figure 3 – Proportion of Weekly Claims with a WPI over 15% Expected to Lodge a WID Claim**



Given the WPI thresholds contained in the legislation, upward pressure on WPI assessments is a risk to the cost of the scheme. The Valuation Report’s sensitivity analysis shows that a 25% increase in the number of claims with a WPI assessment of 11% or more will increase the liability by \$1,411m. This is a net effect including the assumed statutory benefits savings as a result of a WID exit.

The savings come about as it is assumed that a WID exit for an injured worker in the 20%+ cohort will decrease the liability. This is because WID lodgements for WPI 20%+ claims are linked to exits from weekly and medical benefits. As such an increase in WID lodgement experience for this cohort will result in higher WID payments but also a greater and opposite impact on the liabilities for weekly and medical benefits, as the foregone benefits are generally greater than the cost of a WID payment.

As an example of the possible impact on the liability of WID exits for the 20%+ cohort, the Report shows that a 5% increase in the utilisation of WID claims above WPI of 21% results in:

- ▶ A \$163m increase in WID liability
- ▶ A \$293m reduction in weekly benefits
- ▶ A \$185m reduction in medical benefits
- ▶ A \$31m reduction in other benefits

The implication is that an injured worker will forego approximately \$3 in future benefits for every \$1 they receive in common law (lump sum) benefits.

Given there is limited data available, since the 2012 legislative reforms, upon which to base these assumptions, there is a higher level of judgement applied in setting the assumptions. Common law liability represents approximately 20% of the total liability and as such represents a key risk to the valuation.

## 5. Sensitivity Analysis

The Valuation Report contains a sensitivity analysis and the table below provides a subset of this sensitivity analysis highlighting assumptions related to the key risks identified. This gives an indication of the sensitivity of the estimated liability should the experience not emerge as assumed, and so assist SIRA in directing its monitoring and further analysis.

Scenario	Impact	Comment
Continuance rates 0 - 2 year duration	+ \$330m	This scenario assumes the short term continuance rates align to the recent experience
Continuance rates 2 - 5 year duration	+ \$382m	This scenario assumes the medium term continuance rates align to the recent experience. That is, exits from durations 2 to 5 years are lower than assumed in the valuation
Superimposed inflation equivalent to adding 1% to Medical Inflation	+ \$940m	The current additional medical superimposed inflation assumption is assumed to cease during 2021. This scenario assumes an ongoing additional superimposed inflation rate of 1%, effectively adding 1% to the assumed medical inflation rate
WPI bracket creep (assuming a 25% increase in the number of injured workers with a WPI of 11% or more)	+ \$1,411m	This is a scenario only. It does show the risk of bracket creep under the thresholds that are now part of the legislation
5% increase in WID utilisation for those with WPI between 15% and 20%	+ \$136m	Approximately 85% of this cohort is assumed ultimately receive a WID settlement



## 6. Other matters to note

### 6.1 Hearing loss claims

While not material to the actuarial valuation, increasing levels of hearing loss claims are an issue that SIRA is currently investigating across the NSW system.

Figure 6.23 from the Valuation Report (below) shows an increasing trend in payments related to deafness claims since 2016, with a particular change over the last year. This is also seen in the s66 experience related to deafness claims.

Figure 6.23 – Actual and Projected Payments (excluding expected Baldacchino Payments) (\$m)

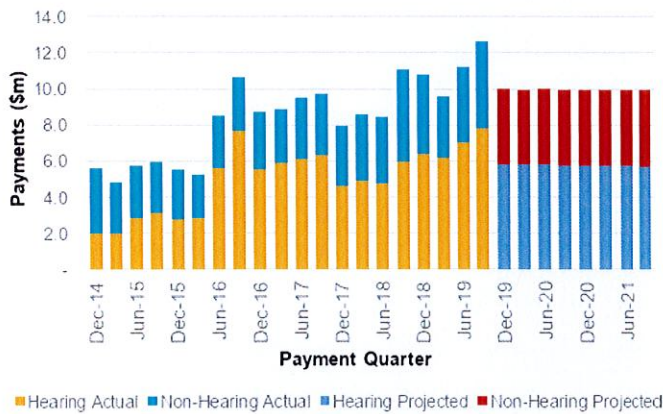
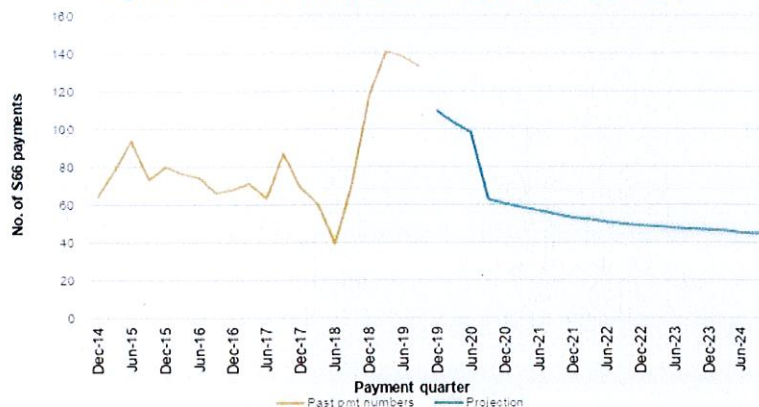


Figure 9.15 from the Valuation Report (below) shows the associated s66 experience and the selected valuation assumptions. The valuation assumptions show the number of s66 payments returning to at or below long-term levels. The basis for the assumption is not clear from the Valuation Report, however given the lack of materiality we have not investigated this any further. There is considerable uncertainty around the drivers of the s66 hearing loss experience both within the NI and the rest of the workers compensation system.

Figure 9.15 – No. of s 66 Payments: AY 2002 and Later (Deafness)



The hearing loss payments are not material to the valuation, however they often also lead to a s66 statutory lump sum and are also leading to increased ILARS payments. The increase in hearing loss claims is evident across the NSW system and SIRA are investigating this issue.

## 6.2 Impact of COVID-19 pandemic

The impact of the COVID-19 pandemic in early 2020 and the policies implemented by the Australian government in response will introduce significant uncertainty to the June 2020 valuation results. At this early stage, Finity has identified the possible impact on outstanding claims liability to be increased difficulties for injured workers to return to work and disruptions to icare's claims management operations. However, as these are considered post-valuation date events (for December 2019), the current outstanding claims liability valuation makes no allowance for any additional claims due to the COVID-19 pandemic.

In addition, the Australian economic environment has also changed significantly since 31 December 2019, reducing the risk free yield curve. As such, we expect future discount rate assumptions will be lower than the current valuation, leading to an expected increase in the outstanding claims. In a well matched portfolio, this interest rate movement may not impact the net position between assets and liabilities, although in practice this can be challenging.

## 6.3 Operational breakeven premium

icare introduced a new definition of the operational breakeven premium rate in December 2018. The operational breakeven premium has increased slightly from 1.48% to 1.50% over the last 6 months. This is driven by an increase in weekly benefits and a material reduction in investment income, partially offset by a small reduction in expenses.

## 6.4 Nominal Insurer funding position

The funding position of the NI has deteriorated in the 6 months to 31 December 2019. At 80% probability of adequacy, the funding ratio is 103.7%, compared to 109.0% as at 30 June 2019. This deterioration is caused by a \$0.9bn increase in outstanding claims liability (driven by portfolio growth, poor experience and assumption changes) and a \$0.8bn increase in unearned premium liability (as most policies incept on 1 July), which were only partially offset by a \$0.8bn increase in assets.



## 7. Reliances and limitations

In undertaking this review, we have performed our work in accordance with the scope agreed with SIRA. This scope did not constitute an actuarial external peer review nor have we conducted any audit procedures.

It is normal for professional judgement to be used in forming assumptions regarding future experience after considering a range of information sources. Different actuaries will form different views or place different weight on matters in forming a judgement.

In general, reliance was placed on but not limited to the information provided. Except where indicated, the information has been used without independent verification.

In accordance with normal professional practice, neither EY, nor any member or employee thereof undertakes responsibility in any way whatsoever to any person other than SIRA in respect of this Report. Neither the whole of this Report, or any part thereof, or any reference thereto may be published in any document, statement or circular nor in any communication with other third parties without prior EY written approval of the form and context in which it will appear.

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The work that we have performed does not constitute an audit in accordance with Australian Auditing Standards or a review made in accordance with Australian Auditing Standards applicable to review engagements and, consequently, no assurance is expressed in the nature and content of any advice provided.

In preparing this Report we have assumed that only those persons who are technically competent in the areas addressed will use it. The Report is designed to be read in its entirety. We are available to answer any queries and the reader should seek that advice before drawing conclusions on any matter in question.

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