

Tendered by
Mr Peter Achterstraat
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Workers Compensation Nominal Insurer (trading as the NSW WorkCover Scheme)

Audit Opinion

The audit of the NSW WorkCover Scheme's (the Scheme) financial statements for the year ended 30 June 2011 resulted in an unmodified audit opinion within the Independent Auditor's Report.

Operational Snapshot

The Scheme collects premiums for workers compensation insurance policies and pays benefits to injured workers.

The Scheme's investments balance at 30 June 2011 was \$11.4 billion to meet long-term claims. The outstanding liability for benefit payments to injured workers was \$14.7 billion.

Key Issues

Financial Position of the Scheme

The Scheme's net asset deficiency increased by \$780 million to \$2.4 billion at 30 June 2011. The majority of the deficiency was incurred during the global financial crisis.

The Scheme aims to maintain an asset to liability ratio between 90 and 110 per cent. This ratio decreased to 85 per cent at 30 June 2011 from 107 per cent in 2007. If the deterioration continues, the Scheme may need to increase premium rates. The movements in the Scheme's funding ratio for the last five years were:

At 30 June	2011	2010	2009	2008	2007
(Surplus)/deficit (\$m)	780	101	2,107	187	(727)
Net assets/(liabilities) (\$m)	(2,363)	(1,583)	(1,482)	625	812
Funding ratio (%)	85	89	89	104	107

In the June 2011 valuation, the Scheme's actuary estimated the Scheme will not return to surplus until sometime after 2020, a significant change from last year's estimate of 30 June 2018.

The Scheme's actuary attributed the decrease in the projected solvency of the Scheme to:

- the deterioration in the outstanding claims valuation due to changes in actuarial assumptions, an increase in assumed inflation rates and the lower discount rate
- the collected premium rate (1.68 per cent of wages) is now below the Scheme's break-even rate (1.73 per cent) based on the risk-free investment return. As a result, the Scheme needs to earn greater investment returns to address the continuing deterioration.

The government does not own the net liability of the Scheme. The net liability can be reduced by:

- improved claims management
- improved returns on investments
- reduced benefits to injured workers
- increased premiums paid by employers.

The Scheme's financial position deficiency continued to deteriorate and was \$2.4 billion at 30 June 2011

The estimated premium collection for 2011-12 is below requirements

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Statutory Non-Economic Benefits – Maximising Claims

Under the *Workers Compensation Act 1987* injured workers are entitled to compensation for permanent impairment (section 66) and pain and suffering (section 67). These types of benefits are known as statutory non-economic loss benefits.

In recent years there has been deterioration in several parts of the permanent impairment experience. There is increased concern about the extent of second, third and fourth claims for permanent impairment benefits. These additional claims indicate that injured workers are attempting to reach particular thresholds of impairment to establish entitlement to other benefits. The proportion of permanent impairment claims now resulting in 'pain and suffering' claims have dramatically increased. Scheme liabilities have increased significantly as a result.

The change indicates that workers and their advisors are becoming more familiar with the rules for particular benefit entitlements, and are behaving so as to maximise their claims. According to the Scheme's actuary, after any significant reform process it takes a few years for entitlements to become clear and for workers to establish the optimal claiming procedure and pattern. This process of optimisation may increase Scheme costs.

Workplace Injury Damages Claims

Workplace Injury Damages (WID) claims are made when an injured worker takes legal action against their employer. Damages are paid as one lump sum and only cover the economic loss of past and future earnings. These types of claims emerge slowly over time, and are finalised even more slowly.

The Scheme's actuary significantly increased the projection of WID claims this year from about 400 WID per half year to about 490.

If the 'lump sum culture' re-emerges on the Scheme, then WID may be considerably higher in future, with dramatically increased Scheme costs.

There is an increase in the liability for WID payments based on emerging experience which may continue to deteriorate in the short to medium-term and a higher WID liability. The actuary advised that this is an area where WorkCover Authority of New South Wales' management can potentially influence outcomes by proactive management of these claims in coming periods.

Performance Information

Number of Claims Incurred

The Scheme is responsible for claims incurred from 1986-87. The Scheme's actuary estimated the total number of claims incurred over the life of the Scheme was 2,600,316.

The trend in claims incurred over the last five years is:

At 30 June	2011	2010	2009	2008	2007
Claims incurred	76,343	79,891	82,714 *	88,637	88,194
Claims not yet reported	6,211	2,237	1,642	1,170	839
Total Claims	82,554	82,128	84,356	89,807	89,033

In recent years the number of claims reported has decreased, which is attributed to the general downturn in the economy resulting from company closures and downsizing following the global financial crisis and improved occupational health and safety practices by employers.

Changes in workers compensation claimants' behaviour indicates attempt to maximise claims resulting in increased Scheme costs

Lump sum claims may be re emerging resulting in dramatic increased workers compensation costs. Proactive management is required

Investment Performance of the Scheme

The following table shows the Scheme's actual and benchmark investment return percentages for the last three years:

Year ended 30 June	Investment Performance per annum		
	2011 %	2010 %	2009 %
Investment return/(loss)	8.0	11.0	(7.9)
Benchmark return/(loss)	7.6	11.3	(8.7)

Source: WorkCover New South Wales Annual Report (unaudited).

Since the Scheme's commencement, its investments have returned 5.2 per cent per annum and outperformed the benchmark by 0.6 per cent. Investment losses incurred in previous years were consistent with the poor performance in global financial markets.

5

Credit worthiness of the Scheme's Investments

Indexed and interest bearing investments comprise 67 per cent of the Scheme's investments. An investment's credit rating is a key measure of its credit worthiness (or likelihood of default). Credit ratings of the Scheme's cash and interest bearing investments at 30 June were:

At 30 June	2011 %	2010 %
Rating:		
AAA/aaa	83	74
AA/Aa	9	8
A/A	5	15
BBB	3	3
Total	100	100

Source: WorkCover New South Wales Annual Report.

Investments rated BBB and above are considered investment grade. The Scheme increased its AAA rated securities by increasing its holdings of Australian fixed interest bonds, most of which are high quality AAA rated bonds.

Lower rated investments are more susceptible to adverse changes in issuer circumstances and economic conditions, which may impact the value of the investment.

Other Information

Retro Paid Loss Scheme

Since 30 June 2009, employers who met certain criteria could apply to have their workers compensation insurance premium calculated using an alternative method, the Retro Paid Loss Scheme. Under this process, employers pay a deposit premium covering the period of insurance, with subsequent premium adjustments to reflect the actual costs of claims incurred.

As the insurance premium for these employers is not finalised for five years from the commencement of the insurance, each employer is required to lodge security with the Scheme. The amount of the security represents the difference between the premium paid to date and the maximum amount of premium the employer may need to pay. Acceptable forms of security include cash or bank guarantees.

At 30 June 2011, there were 200 (125 in 2010) employers participating in the Retro Paid Loss Scheme and the Scheme held security deposits comprising cash and bank guarantees of \$494 million (\$260 million).

Financial Information

Abridged Statement of Comprehensive Income

Year ended 30 June	2011 \$m	2010 \$m
Net earned premiums	2,495	2,395
Investment income	922	1,080
Other income	13	26
Total Revenue	→ 3,430	3,501
Net claims incurred	3,518	2,978
Management fees	333	328
Statutory levies	233	228
Other expenses	126	68
Total Expenses	→ 4,210	3,602
Deficit	780	101
Other Comprehensive Income	—	—
Total Comprehensive Expense	780	101

The Scheme had realised and unrealised investment gains of \$393 million in 2011 (\$842 million in 2010). Investment gains in the prior year benefited from the recovery in the financial markets following the global financial crisis in 2008.

The increase in net claims of \$540 million was due to the increase in the outstanding claims liability in 2011. This reflects changes in the assumptions used by the Scheme's actuary, including assumed discount and inflation rates.

Abridged Statement of Financial Position

At 30 June	2011 \$m	2010 \$m
Investments	11,381	10,719
Other	1,946	1,745
Total Assets	13,327	12,464
Outstanding claims	14,737	13,152
Other	953	895
Total Liabilities	15,690	14,047
Net Liabilities	2,363	1,583

Investments increased by \$662 million due to increases in the value of the Scheme's investments as financial markets recovered from the global financial crisis.

Outstanding claims increased by \$1.6 billion largely due to changes in discount and inflation rates of \$521 million and other assumptions used by the Scheme's actuary, \$829 million. New claims incurred in 2011 were \$2.3 billion (\$2.1 billion in 2010), while claims payments were \$2.0 billion (\$2.0 billion).

4,083 -
2,363

1,720

3



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14,268 + 469 =

Investments

At 30 June	2011 \$m	2010 \$m
Indexed and interest bearing securities	7,597	7,037
Australian equities	702	487
International equities	1,473	1,465
Unit trusts	1,465	1,479
Derivative assets	144	251
Total Investments	11,381	10,719
Derivative liabilities	125	286
Net Investments	11,256	10,433

The Scheme's strategic asset allocation changed during the year. The Scheme increased growth asset holdings such as equities by two per cent, with the corresponding decrease in defensive assets such as bonds.

Scheme Activities

The Scheme was established under the *Workers Compensation Act 1987*. It comprises two entities, the Workers Compensation Nominal Insurer and the Workers Compensation Insurance Fund. The Nominal Insurer manages the Insurance Fund.

The Nominal Insurer operates as a licensed workers compensation insurer. The Insurance Fund holds premiums, investment funds and all other funds received. Effective operation of the Nominal Insurer and Insurance Fund commenced on 1 July 2005 when the assets and liabilities of the former WorkCover Scheme Statutory Funds were transferred to the Insurance Fund and the Nominal Insurer.

The WorkCover Authority does not control, but does act, for the Nominal Insurer.

The *Workplace Injury Management and Workers Compensation Act 1998* established the Workers Compensation Insurance Fund Investment Board to determine investment policies for Insurance Fund assets. The Investment Board reports to the minister on the investment performance of the Insurance Fund.

For further information on the Scheme, refer to www.workcover.nsw.gov.au.

4