



Supplementary Questions For Mr Michael Playford

To: Joint Select Committee on the NSW Workers Compensation Scheme

Date: 25 May 2012

Subject: Supplementary Question

From the Hon Adam Searle MLC

- 1. There are two graphs on page 17 of the PWC Executive Summary showing intimation and finalisation of WID claims. They suggest that finalisations since December 2010 and for some periods beforehand were higher than intimations for the same period. How can that be the case?***

An intimation refers to the first time a case estimate is raised by a Scheme Agent (see my response to your question 4 below). However, there is typically then a delay until a WID matter is then finalised, It is not unusual for the delay between the date of intimation and the date of finalisation to exceed six months. The number of finalisations in a half year does not necessarily match the number of intimations in the same half year due to these differences.

For example in the December 2010 half year the number of intimations was lower than both June 2010 and June 2011. The increased number of intimations in the June 2011 half year is believed to be in part due to the clearing of a backlog of matters needing to have case estimates raised by several Scheme Agents.

There has been some evidence of a speeding up in the rate of finalisation over the last 2 years (ie a shortening in the delay between intimation and finalisation). Increased numbers of finalisations relative to intimations in more recent periods is at least partly explained by this change in processing delay.

Since WorkCover changed its WID case estimation guidelines in 2005 it has been our observation that approximately 90% of WID intimations are eventually finalised for a WID settlement in excess of \$20,000 (on average the settlement amount is approximately \$320,000). As a result it is considered that WID intimations are a good lead indicator of the emerging WID claim experience.

- 2. Were actual figures available for WID finalisations in June and December 2011? If so, what were they?***

The graphs on page 17 of the Executive Summary represent actual figures. They are not actuarial assumptions. The following table provides the relevant numbers of intimations and finalisations



	All Intimations	All Finalisations
Jun-07	254	306
Dec-07	302	318
Jun-08	335	338
Dec-08	370	347
Jun-09	358	376
Dec-09	368	346
Jun-10	426	412
Dec-10	393	440
Jun-11	566	502
Dec-11	541	463

3. Are there any figures to prove the number of intimations and finalisations for any of these periods?

a. If so what are they?

See response to Answer 2.

4. Is a WID claim intimated at the time an insurer is first given particulars of a claim for WID?

An intimation represents the date at which an insurer/Scheme Agent raises a WID case estimate for the first time. This may differ from the date at which the insurer/Scheme Agent first became aware of or was given particulars of a claim for WID.

5. When you prepared your report did you understand that a Statement of Claim is not filed until after all of the pre-litigation procedures of the legislation had been compiled with, including giving notice of the claim, service of a pre-filing statement and a mediation so that a claim must be intimated at an early stage, and may not result in a claim for WID being brought at all?

I am aware of all of the above. Unfortunately the WorkCover Central Data Repository does not capture this information. The date at which a Scheme Agent raises a case estimate is the first lead indicator available data that a particular claim is being considered for a WID settlement.

Our analysis does consider what proportion of WID intimations do not proceed (settle for zero), close with only a small amount of legal costs (settlements less than \$20,000) or proceed to settlement (settlements greater than \$20,000), so your point that “a claim must be intimated at an early stage, and may not result in a claim for WID being brought at all” is considered in our analysis.

Since WorkCover changed its WID case estimation guidelines in 2005 it has been our observation that approximately 90% of WID intimations are eventually finalised for a WID settlement in excess of



\$20,000 (on average the settlement amount is approximately \$320,000). As a result it is considered that WID intimations are a good lead indicator of the emerging WID claim experience.

We note (Page 163 of the valuation report) that WorkCover conducts regular file reviews to WID matters, the results of which are considered as part of our valuation.

6. *Has any modelling been done to assess the effect of implementing the suggested changes on page 16 in relation to WID claims?*

The Costing Report I have just prepared and provided separately for the Inquiry considers the effect of legislative strengthening of the three year statute of limitations.

The suggestions on P16 were all non-legislative areas where applied effort might assist in stabilising WID claims experience. None of the suggestions have been costed and it would be extremely difficult to do so. In isolation I would hesitate to assume that they would be effective in reducing WID/Scheme cost. The effectiveness of non-legislative efforts to stabilise the current deteriorating WID utilisation trend would depend on how well they are implemented. I would not have any confidence that they would be successful until there is a clear change in the emerging experience of this payment type.

7. *Do you agree that it would be necessary to assess the effect of those changes before considering legislative change?*

No

8. *What would be the effect on the scheme valuation and peer review if the WorkCover scheme was approached/assessed in the same way as the motor accident long-term care model?*

The WorkCover and LTCS schemes are completely different schemes with completely different claimant profiles, benefit structures and service delivery models. Very different approaches to valuing liabilities are necessary given these differences.

We do use a similar approach to valuing the liability of a small number of very high cost medical claims, which have a significant continuing care requirement, using an approach similar to the approach used by the LTCS Scheme (see Section 9 of the valuation report).

From an accounting perspective the LTCS Scheme is not treated as insurance (as no policies are issued). Rather it is funded via a levy. As a result the LTCS Scheme is accounted under a different accounting standard (AASB137). The WorkCover Scheme is accounted for under accounting standard AASB1023.

Key differences with respect of the accounting treatment of AASB137 include:

- No requirement to maintain a risk margin
- The liabilities can be discounted based on an assumption as to the expected long term rate of investment return rather than a risk free rate of return (based on yields from Commonwealth Government Securities)



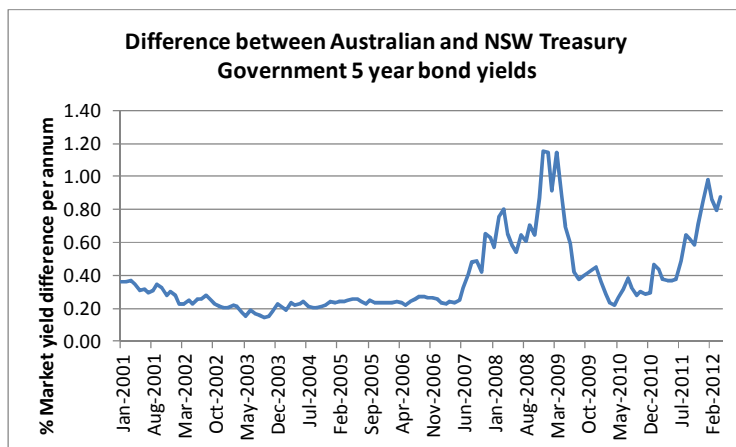
- No requirement to maintain an unearned premium reserve or premium deficiency reserve.

Given WorkCover issues policies to employers it is difficult to see how the WorkCover Scheme could be reclassified under an alternative accounting standard.

Setting accounting treatment aside an alternative assessment of the outstanding claims liabilities assuming a long term expected investment return and no risk margin would still show a \$2 billion deterioration in the liability assessment since June 2008 based on deterioration in the claim management performance of the scheme, merely with the start and end points both being lower.

9. What would be the effect on the scheme valuation and peer review if the WorkCover scheme used the NSW Treasury Bond rate rather than the Commonwealth in connection with Scheme liabilities?

NSW Treasury Bonds have market yields higher than those on Commonwealth Government Bonds. The following graph illustrates the difference in market yields for 5 year bonds as an example:



The graph shows the significant increase in yield spreads and volatility in yield spreads between Australian and NSW Treasury Bonds since the start of the GFC.

At 31 December 2011 the difference in yield spreads on 5 year bonds was 0.86%. Without a full recalculation of the valuation result an approximate impact can be estimated by multiplying the the mean duration of the outstanding claims liability (approximately 8 years) by this difference. Increasing the discount rate assumed by 0.86% pa would have the effect of reducing the outstanding claims liability by almost 7%.

I note that using NSW Treasury Bond yields would not meet the requirements of the Accounting and Actuarial standards as representing “risk free”.

Setting the discounting rate aside, the valuation result would still show a \$2 billion deterioration in the liability assessment since June 2008 based on deterioration in the claim management performance of the scheme, merely with the start and end points both being lower.





From Mr Mark Speakman MP

10. Looking at the table on page 174 of the full actuarial valuation at 31 December 2011 by PWC dated 12 March 2012:

a. What is the conceptual difference between “Modelled Ultimate Intimations” and “Current Ultimate Intimations”?

“Modelled ultimate Intimations” shows the results of using the chain ladder method for estimating the ultimate number of intimations. The results of the Modelled Ultimate Intimates column are not adopted for the more recent accident years where the results produce unrealistic results (see answer to b).

“Current ultimate intimations” shows the ultimate number of intimations adopted on which the valuation result is based.

b. How have each been calculated?

One of the valuation approaches to extrapolating the intimations reported to date (see column titled “Intimated to date”) to estimate the expected ultimate number of intimations for each accident year is termed the “chain ladder method”. The chain ladder method essentially looks at ratios in the number of intimations reported at various durations since accident, in order to extrapolate to the expected ultimate number of intimations.

Looking at the column “Intimated to date” you can observe that very small numbers of claims are intimated for WID until several years have occurred since the injury. It is not, for example, until you go back to the December 2008 accident half year that the cumulative number of intimations for an accident half year reaches triple figures.

The column titled “Modelled Ultimate intimations” is the result of applying the “chain ladder method”. The chain ladder method produces unrealistic results for the more recent accident periods where the cumulative number of intimations reported to date are very low (ie December 2008 accident half years and later). There is also believed to be a speeding up in the timing of intimation reporting. That is, claims are being intimated earlier in the life cycle of a claim than previously was the case. Although the numbers reported to date for the most recent accident years are very low (30 for June 09, 11 for Dec 09, 3 for June 10) these are actually relatively high compared with what would have been expected to be reported for these years (based on the numbers prior accident years had had reported at the same time intervals since accident). The numbers reported to date are the “starting seed” for the chain ladder method projection. Because the most recent accident years have relatively high numbers reported to date the chain ladder method extrapolates this out to an unrealistic high modelled ultimate number. That is, the chain ladder method does not make any allowance for speeding up in the rate at which intimations are being raised. We do not adopt the “chain ladder” model results for the more recent accident years when determining the valuation result.

We also employ various other approaches to better understand the likely ultimate number of intimations. One important approach discussed in the report considers the projected number of future Section 66 Permanent Impairment payments (see section 14 of the valuation report), what proportion of future Section 66 payments can be expected to be assessed with a Whole Person Impairment greater



than 15%, and what conversion rate has been observed of this sub-pool of Section 66 claims proceeding to access Workplace Injury Damages.

The column “Current ultimate Intimations” is our adopted ultimate intimations on which the valuation results are based. For the most recent accident years (December 2008 and later where the reported experience to date is so immature) we have adopted an expected number of ultimate intimations (generally 507 per half year) in line with the immediately preceding accident half years. You can see that the numbers in this column also appear in the table on Page 175 in Section 15.7.1.3 “Summary of Intimations”.

The column in the table on Page 174 titled “Previous Ultimate Intimations” is the adopted ultimate number of intimations from our previous valuation. The increase in adopted intimations between the previous and current valuation is a direct response to the increasing trends in the number of intimations and number of WID settlements observed.

c. What is the explanation for the increases in “Modelled Ultimate Intimations” from June 2009 to December 2009, June 2010 and June 2011 (the “spike”)?

The column titled “Modelled Ultimate intimations” is the result of applying the “chain ladder method”. The chain ladder method produces unrealistic results for the more recent accident periods where the cumulative number of intimations reported to date are very low (ie December 2008 accident half years and later). There is also believed to be a speeding up in the timing of intimation reporting. That is, claims are being intimated earlier in the life cycle of a claim than previously was the case. Although the numbers reported to date for the most recent accident years are very low (30 for June 09, 11 for Dec 09, 3 for June 10) these are actually relatively high compared with what would have been expected to be reported for these years (based on the numbers prior accident years had had reported at the same time intervals since accident). The numbers reported to date are the “starting seed” for the chain ladder method projection. Because the most recent accident years have relatively high numbers reported to date the chain ladder method extrapolates this out to an unrealistic high modelled ultimate number. That is, the chain ladder method does not make any allowance for speeding up in the rate at which intimations are being raised. We do not adopt the “chain ladder” model results for the more recent accident years when determining the valuation result.

d. Why did “Modelled Ultimate Intimations” increase in that period but “Current Ultimate Intimations” were fairly stable?

See response to 10b

e. How, if at all, have the figures in the “Modelled Ultimate Intimations” column in that table been used in arriving at the “estimate of discounted outstanding liability” at 31 December 2011 for workplace injury damages?

The modelled intimations are one input into the adopted number of ultimate intimations. For the more recent accident half years (December 2008 and later) the modelled chain ladder numbers (those shown in column “Modelled Ultimate Intimations”) produce unrealistic results as discussed in (a) and are not used in determining the outstanding claims liability at 31 December 2011.



The valuation results are based on the adopted ultimate number of intimations shown in the column on page 174 titled “Current ultimate intimations”.

f. How, if at all, have other figures in that table been used in arriving at the “estimate of discounted outstanding liability” at 31 December 2011 for workplace injury damages?

See response to 10b

g. By what amount and how (if at all) does the “spike” affect the “estimate of discounted outstanding liability” at 31 December 2011 for workplace injury damages?

The spike in the chain ladder “modelled ultimate intimations is not adopted for the valuation results. As a result the valuation results are not affected by the spike feature observed in the column “Modelled Ultimate Intimations”.

h. What is your response to the critique of work injury damages calculations given orally to the committee by Law Society witnesses on 21 May 2012?

I am always willing to respond to questions concerning my work and welcome the opportunity to do so, in response to the matters raised by several of the legal groups. Had these matters been raised with me by those groups prior to their submissions and testimony I am certain I could have satisfied their concerns, so that the Joint Select Committee’s time (which is limited) did not need to be taken up by them.

I have set out below my comments first in relation to the questions raised by Law Society and then in relation to the issues raised by Australian Lawyers Alliance, concerning my report.

Law Society

The Law Society submission Page 2 “The Committee has concluded, from its analysis of the material provided, that the actuarial advice and recommendations are flawed. The methodologies adopted (whilst in accordance with accounting standards) contain inaccurate assumptions, apply artificially high discount rates and base the recommendations on unsubstantiated opinion regarding such matters as claimant behaviour. There is no accounting, forensic, statistical or psychosocial survey, report, data or the like to support the opinion”.

There is no basis for the Law Society’s assertion. PwC has not carried out the 31 December 2011 valuation in isolation. Its analysis and calculations are based on the claims and payments database of the WorkCover Authority and the valuation has been carried out in compliance with the Actuaries Institute Code of Conduct and relevant Professional Standard – PS300 Valuation of General Insurance Claims. It is one in a series of six monthly valuations going back to June 2002 which have been critically reviewed by two other separate independent actuaries on a regular basis (being EY on behalf of the WorkCover Authority each six months and Cumpston Sarjeant for the NSW Audit Office every 30 June).



Between valuations the actual claim and payment experience is monitored in comparison with the expected numbers and cash flows projected from the valuation to ensure consistencies and to provide a benchmark to consider whether emerging experience is better or worse than expected.

The Law Society has also submitted on page 2 of their submission that PwC has used an “*artificially high discount rate*” in relation to its work. The discount rate used is based on the requirements of the Accounting and Actuarial Standards to use a ‘risk-free’ rate based on the returns observed in the market place on Commonwealth Government Securities. The risk free discount rate used is actually lower than the targeted long term investment return targeted by WorkCover (based on advice from WorkCover’s Investment Division). Setting the discounting rate aside, the valuation result would still show a \$2 billion deterioration in the liability assessment since June 2008 based on deterioration in the claim management performance of the scheme, merely with the start and end points both being lower.

The Law Society submission on page 3 says “*The [EY] report does not support the actuarial analysis of PwC*”.

This is not correct. I refer the Inquiry to the EY report which concludes “*having carried out the review as described in this report, nothing has come to our attention that would lead us to believe that estimates from the Scheme Actuary’s Insurance Liability calculation are unreasonable.*”

The Law Society submission page 4 “*There is no verifiable evidence to support the existence of a lump sum culture and to the extent to which PwC (and others) proffer an opinion that it exists, they opine well outside their areas of expertise and should table evidence to support their opinions*”.

My response is that I see the evidence of what I (and others) term a lump sum culture in how it manifests itself in the claim and payment trends of the Scheme. Currently the Scheme has the following trends –creep in Whole Person Assessment scores leading to an increased number of claimants being assessed over key threshold levels required to access lump sum benefits, increasing utilisation of lump sum benefits, coupled with a deterioration in return to work experience leading to increases in weekly and medical benefits also being paid.

Australian Lawyers Alliance

Mr McManamey (Australian Lawyers Alliance) in his testimony refers to mistreatment in the classification of Commutation and Workplace Injury Damages Liabilities, with the potential for double counting of liability with the Weekly and Medical liabilities.

There is no basis for this assertion and it is not factually correct. There is no ‘double counting’ of liability. The Weekly and Medical liabilities have been assessed only including an allowance for weekly and medical benefits up until the expected timing of commutation and WID lump sum payments. The actual commutation and WID lump sum payments are modelled separately both to improve the quality of the analysis and because it is critically important for the governance of the Scheme to be able to monitor and identify trends in lump sum payment patterns.

The Australian Lawyers Alliance submission says on page 5 “*WorkCover or others on its behalf provided the actuaries with assumptions upon which to base their report*”. Mr McManamey (Australian Lawyers Alliance) makes a similar assertion in his testimony.



This is factually incorrect and shows a lack of understanding as to how PwC has performed the valuation of the outstanding claims liabilities. PwC has undertaken an independent and impartial review in compliance with the Actuaries Institute Code of Conduct and the relevant Professional Standard. PwC selects its all of its own assumptions based on its interpretation of the emerging trends in the claims and payment experience. The exception is the discount rate which is selected based on the accounting and actuarial standard requirements. PwC has in no way been influenced by WorkCover in any aspect of the valuation, the selection of assumptions or received any direction as to the valuation results.

The Australian Lawyers Alliance submission says on page 4 *“The PwC Report identifies half the deficit as due to poor investment strategies, partly due to the GFC”*. The submission refers to P288 of the PwC valuation report.

The statement is not correct; there is no view expressed anywhere in the PwC report as to the effectiveness or otherwise of WorkCover’s investment strategy. On Page 288 of the PwC report it is written *“The Scheme deficit is now in excess of \$4 billion. Approximately half of this deficit is due to deterioration in claims management experience since June 2008. Further deterioration in claim management experience would add to this deficit. The remainder half is due to external influences impacting investment returns achieved and particularly the “risk free” discount rate used to discount the outstanding claims liability. Given the current global economic uncertainty is it plausible that investment returns achieved and risk free discount rates continue to remain below longer term average levels for a lengthy period. Scenarios of solvency trajectory illustrate that a large deficit is likely to continue for many years unless a strategy is implemented.”*.

Mr McManamey in his testimony says *“the peer review is very careful to say that it says nothing about the assumptions, it just says on the processes they have adopted from the outside without questioning the assumptions, that is ok”* and later *“Ernst and Young do not examine the accuracy of the assumptions. The Auditor General does not examine the accuracy of the assumptions”*.

This is not correct. A reading of the Ernst and Young review report makes it clear that they have considered the reasonableness of the assumptions and make a clear statement to that affect. This is also a clear requirement the Actuaries Institute Professional Standard for undertaking an external review (PS315 External Peer Review of General Insurance Liability Valuations) which Ernst and Young have undertaken their review in accordance with. The NSW Audit Office also has a separate actuarial firm, Cumpston Sarjeant, carry out an external review of our valuations every 30 June. Cumpston Sarjeant’s scope of work also includes considering the reasonableness of the valuation assumptions and makes a statement to that affect. Their review is also performed in compliance with the Actuaries Institute Professional Standard for undertaking an external review.