Private & Confidential
Hon. David Clarke MLC
Chair
Legislative Council Standing Committee on Law and Justice
NSW Parliament
Parliament House
Macquarie St
Sydney NSW 2000

28 November 2014

Dear Mr Clarke,

Correction of previously provided response to question from the Law and Justice Committee Review of the exercise of the functions of the WorkCover Authority

During the course of the 2014 Law and Justice Committee Review of the exercise of the functions of the WorkCover Authority I appeared as a witness on two occasions. I take my responsibility as a witness to provide accurate factual information to the Parliamentary Committee very seriously.

I took responsibility to reply to some questions on notice and provided answers in the form of letters. After the hearing on the 21 March 2014 the Committee asked a number of supplementary questions including the following question:

"Can the Independent Actuary provide an estimate of the Scheme's performance if there had been no legislation in 2012, using the historical external factors (Discount rates, yields, etc)?"

The response was a letter which was forwarded to the Law and Justice Committee and was titled "*Impact of investment returns on Workcover Solvency position – December 2011 to December 2013*" and dated 1 April 2014. It was published by the Committee on the NSW Parliament website as "*WorkCover Authority - Attachment F*"

Last week, as part of some analysis following the most recent Scheme valuation as at June 2014, I revisited the balance sheet projection modelling spreadsheet which formed the basis for the above letter. In doing so, on 18 November 2014, I identified a technical error in the calculations. In essence the projected investment return for the 2012/13 financial year was double counted which materially changes the projection scenario results.

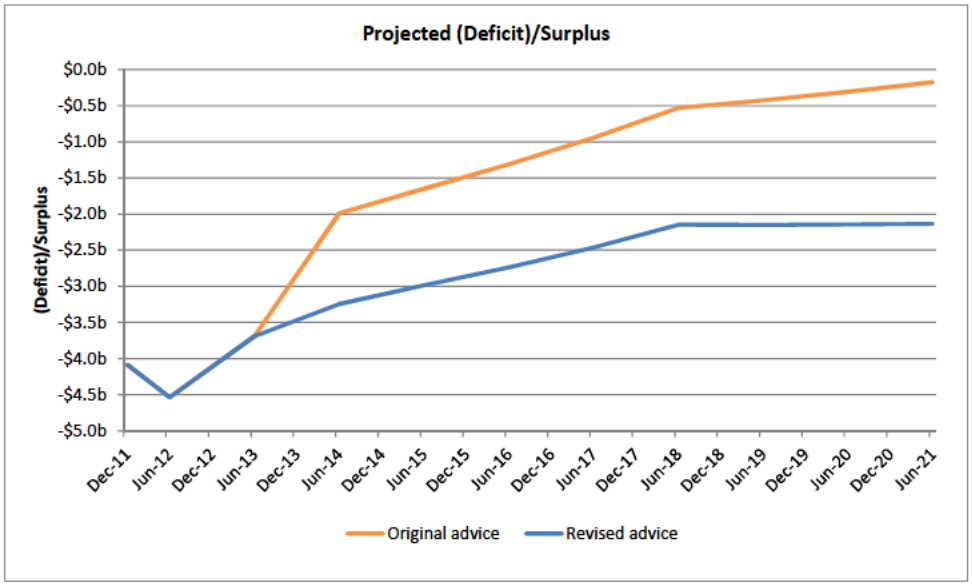
I appreciate the serious implications of incorrect information having been provided to the Law and Justice Review and I have endeavoured to review and revise the calculations in order to provide a correction as soon as possible. The purpose of this current letter is to provide corrected results. I have also advised WorkCover of the error in the original letter and I understand WorkCover has arranged for the estimates in the current letter to be subject to peer review so the Law and Justice Committee can be confident the estimates in the current letter are reliable and valid.

The six monthly outstanding claims valuations performed by PwC as the independent Scheme actuary for the Workers Compensation Nominal Insurer Scheme, the results of which are included in the Nominal Insurer Scheme's financial accounts, are subject to peer review by Taylor Fry, the independent review actuary for the Workers Compensation Nominal Insurer Scheme. Valuations are also subject to review by the Auditor General and the independent actuary engaged by the Auditor General.

As noted in the original letter the projections assume:

- The 2012 reforms did not occur
  - Premium rates remained unchanged from what they were at June 2012
  - Claims experience emerges as per the December 2011 valuation assumptions (i.e. based on the pre-reform benefit structure and consistent with the recent experience to December 2011, without any allowance for any potential future deterioration or improvement. It is worth noting that claims experience had been deteriorating in the lead up to December 2011)
- Investment returns:
  - Actual investment returns for the 2012 (10.2%pa) and 2013 (11.2%pa) calendar years applied to assets held at December 2011
  - Expected investment returns (of 6.58%pa) for all subsequent projection years
- Risk free discount rates:
  - Actual discount rates at projection dates to 30 June 2013 have been used.
  - Subsequent to this, we have transitioned over the following 5 years to a longer term equilibrium yield curve (provided by Mercer in their role as WorkCover's investment advisor). That is, we have assumed that discount rates will revert back to a higher equilibrium level over the medium term.

The following graph summarises the projection contained in my original letter compared with the corrected projection.



In summary the differences in the projections are:

- At June 2014:
  - The original letter estimated a deficit position of $2.0bn
  - The current letter estimates a deficit position of $3.2bn
- By June 2018:
  - The main reason both projections continue to improve to June 2018 is due to the assumed reversion of risk free discount rates to the higher historic pre-GFC average level (when discount rates increase the present value of the outstanding claims liability goes down and so the funding ratio increases)
  - The original letter estimated the deficit position reducing to $0.5bn
  - The current letter estimates an deficit position of $2.1bn
- Beyond June 2018:
  - The original letter estimated that full funding may have been approached by 2021
  - The current letter estimates that fully funding may not eventuate for many years.

I sincerely apologise for the difficulty caused by this issue and can assure you that we have conducted a full technical review to ensure there are no other errors in the work.

Yours sincerely

Michael Playford FIAA
Partner

Cc Mr Vivek Bhatia, CEO Safety, return to Work and Support