

## Of ICNSW Annual Reports and other dangerous ideas.

The world needs agents' provocateur. Agents' provocateur (agitators) shine bright lights into the dark crevasses of spin. They expose festering corruption. Agitators mock pretension and challenge assumptions. They do not tolerate hypocrisy. Agitators drive change, more often for the better. Effective agitators must be contemporaneous or risk losing relevance. That history is littered with their carcasses is a tribute to their effectiveness.

Speaking of which;

The ICNSW Annual report was quietly tabled in the NSW Parliament on Thursday 23 November 2017<sup>1</sup>, it is also available on Icare's website. It makes very interesting reading.

At first glance, the reader will probably be convinced that the author was a Gilbertian<sup>2</sup> scholar. The Report is packed with paragraphs of hubris occasionally offset by Uriah Heep-like references to "umbleness". On second glance, the reader will realise that there is little in the way of what exactly will be done, rather, vague references to ambition and journeys.

These are some of the key points which otherwise are buried in the fine print of the report:

- The Nominal Insurer (NI, Managed by ICNSW) expense ratio has increased by more than two and a half times in the last 20 years from less than 12% in 1997 to 31% in 2017
- The NI expense ratio in 2017 of 31% is almost double the three-year average expense ratio (to 2016) of the privately underwritten workers compensation scheme in Western Australia of 13.7%.
- There are statements which do not appear to correlate with the facts, for example the Report notes (page 129) that a number of transformational objectives have been successfully delivered across icare including a new claims operating model. The full model does not come into effect until 1.1.18. and is neither tried nor tested (something as significant as this should surely have been extensively field tested prior to implementation?); its successful implementation will not be confirmed for years.
- Missing is any commentary on metrics which are used to indicate the health of a compensation system. For example, there is no reference to scheme RTW performance rates at key claims milestones; work injury damages experience or the effects of Section 39.
- Under "Transformation – key deliverables" (page 13), the CEO notes that "Operating model simplification for underwriting – bringing in-house the underwriting, policy and billing of Workers Insurance policies to ensure consistent delivery for over 296,000 businesses in NSW." There is no commentary about the numbers of policies which have still to be processed which were renewed on 30 June 2017, numbers estimated to be in the hundreds.
- Page 61 of the report sets out how ICNSW measures its customers satisfaction using the Net Promoter Score (NPS) system. Currently, ICNSW's NPS is 19 and according to the anecdotal evidence, this illustrates how poor their services are. As noted above, there are still many hundreds of employers who are yet to receive premium adjustments from policy year end 30 June 2017.

<sup>1</sup> Can be accessed from <https://www.parliament.nsw.gov.au/la/papers/pages/house-papers.aspx?filterHouse=LA&paperType=TabledPapers&view=TabledPapersViewByDate&browseHouse=LA&type=TabledPapers&s=1>

<sup>2</sup> WS Gilbert wrote the lyrics for Gilbert and Sullivan's comic operas.

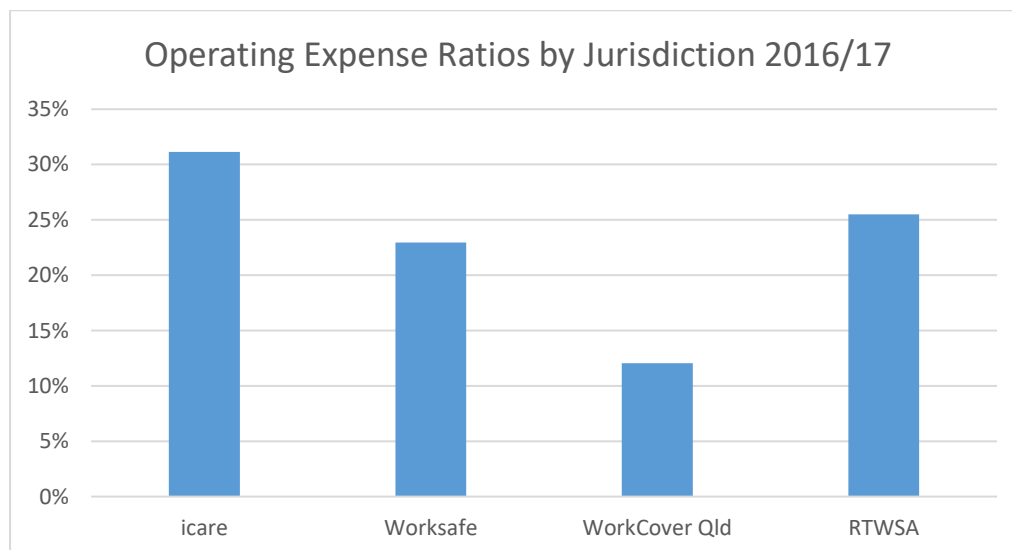
In 1997 there were 12 licenced Agents who all competed for market share on service delivery. In those days an Agent was required to have at least a 3% market share of premiums written, or risk losing their licence. In 1997 the net earned premium of the NSW WorkCover Scheme Statutory Funds<sup>3</sup> was \$1,415,487,000. Statutory levies were \$121,283,000; net claims incurred were \$2,368,485,000. The underwriting result was a loss of \$952,998,000.

Fast forward 20 years and nothing much seems to have changed even though we are constantly being reminded about the major advances made in the ways that claims and policy services are, or will be, delivered.

Instead of 12 Agents and a competitive marketplace for the NI scheme, we now have a monopoly (as at 1.1.18 all new claims will be managed by EML<sup>4</sup>) and are at risk of experiencing all of the inefficiencies typical of bureaucratic monopolies. The monopolistic approach has been tried in another Australian jurisdiction (SA) and abandoned because of the inefficiencies it created.

20 years ago, scheme management expenses (insurers management fees, consultants, actuarial etc) amounted to \$166,016,000. The expense ratio (earned premiums/expenses) 20 years ago was 11.72%.

According to the ICNSW 2017 Annual Report, net earned premiums (i.e. excluding statutory levies = \$313,160,000) were \$1,905,208,000. Expenses (service fees, other expenses) were \$593,583,000. The expense ratio under ICNSW is a massive 31%<sup>5</sup>, just under three times that of 20 years ago.



In Western Australia, a privately underwritten workers compensation scheme is in place. This scheme provides competition on both price and service. According to the WorkCover WA 2017/18 Recommended Premium Rates Report<sup>6</sup>, the adopted 3-year average expense ratio is 13.7%, less than half that of ICNSW.

<sup>3</sup> WorkCover Annual Report 18 November 1997.

<sup>4</sup> What changes on 1 January 2018 <https://www.icare.nsw.gov.au/news-and-stories/a-new-claims-process-for-injured-workers>

<sup>5</sup> BTW the expense ratio for 2015/16 was 28.3%, 2014/15 was 28.2%.

<sup>6</sup> Can be accessed from <https://www.workcover.wa.gov.au/content/uploads/2014/04/3-Actuarial-Assessment-of-201718-Recommended-Premium-Rates-RPR-Repor....pdf>

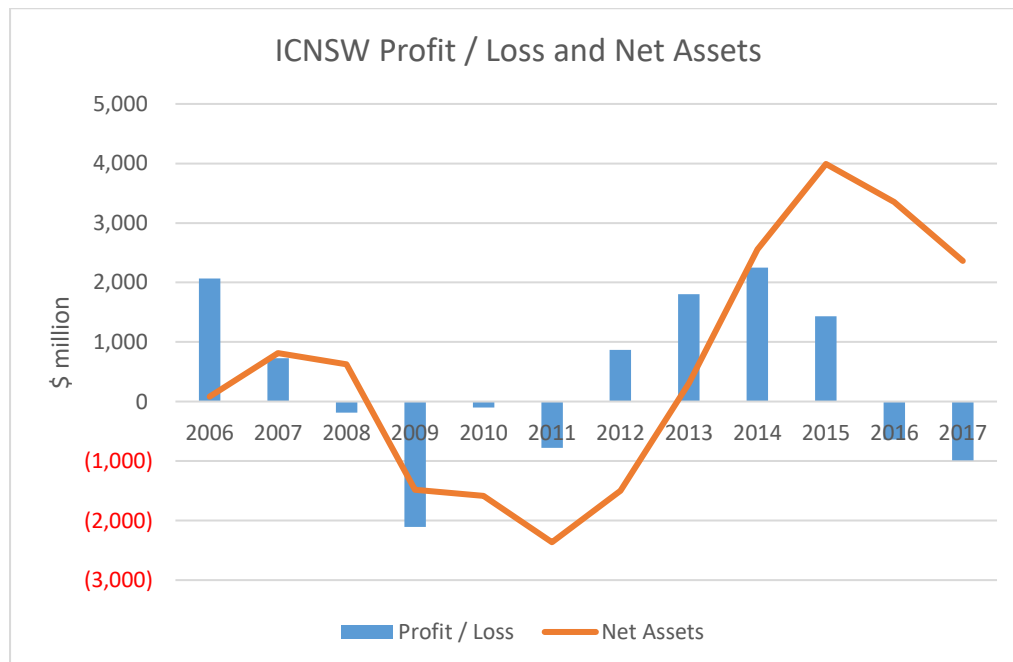
The fact that ICNSW’s expenses are so high in comparison with other jurisdictions<sup>7</sup> and the organisation so inefficient (comparatively) must be of significant concern to both the employer and injured workers’ communities.

These inefficiencies are costing in excess of \$300m of employers’ premiums, money which otherwise ought to be used as payments to injured workers. In all other circumstances inefficiencies of this magnitude ought to be the subject of an Auditor General’s review. Certainly, SIRA ought to be raising its regulatory hackles.

When it comes to expenses, ICNSW should be cashing in on the economies of scale that a scheme of NSW’s size can generate. Perhaps this is an area where the current Board and management lack the requisite skills to achieve success, as according to their profiles, no independent directors have an insurance background?

Workers compensation has a long history of boom-bust cycles, with periods of poor performance leading to major legislative reforms. This is often followed by massive improvements in financial results as the actuaries credit the reforms over time. Typically, this then leads to a turn-around in performance as the reforms are partially unwound or legal involvement and precedence undermines the reforms’ impact. The cycle is continuing.

The Annual Report reveals an underwriting loss of \$988,234,000, slightly worse than 20 years ago. This is on top of the underwriting loss from 2015/16 year of \$638,469,000. These losses have strongly contributed to the erosion of the workers compensation scheme’s surplus which as at 30 June 2015 was \$3,991,697,000 and now stands (as at 30 June 2017) at \$2,364,994,000, a drop of \$1,546,703,000. Interestingly there is minimal reference to any of this in the Annual Report.

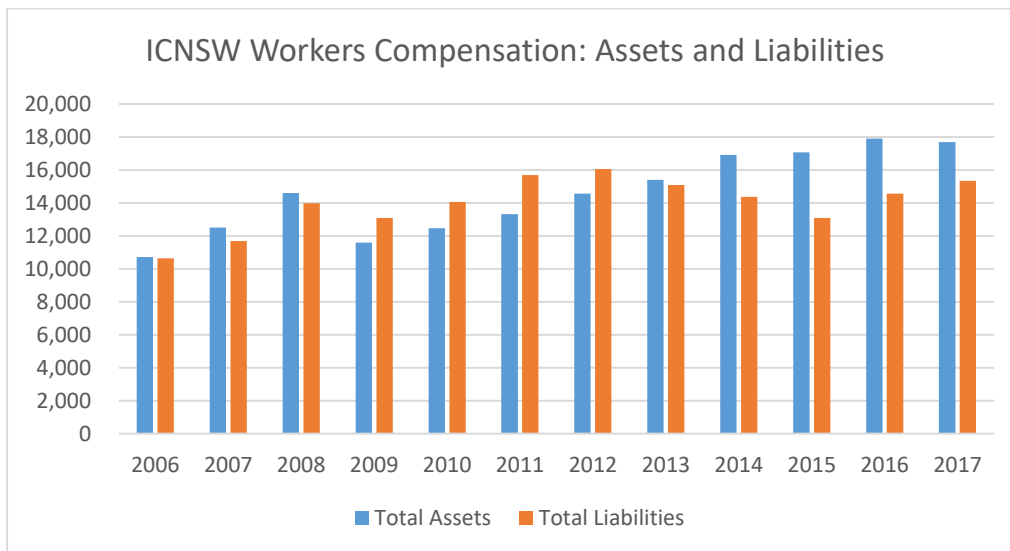


<sup>7</sup> The expense ratios for Worksafe Victoria and RTWSA also include costs of regulation and levies which are not part of the ratio for ICNSW

The Report comments that “the net losses of \$639m in 2016 and \$988m in 2017 were primarily driven by the impact of the 2015 workers compensation reforms and the incorporation of new information relating to the 2012 workers compensation reforms (section 39) respectively.

Had these changes not been experienced, the net result for the scheme would have been positive \$421m in 2016 and \$52m in 2017”.

Regardless of these excuses for the losses, a loss is a loss and most Boards of management of private insurers would, after two years of negative results, be suffering the ire of their stakeholders. There is no commentary in the report on what the plans are to address the leakage and prevent it from accelerating, nor is there any commentary about just who it was who advised the NSW Government that the reforms which returned a billion dollars to injured workers and employers were affordable.



Experienced observers<sup>8</sup> say that you can only fund recurring benefit increases or for that matter premium reductions where the breakeven premium (BEP) rate is below the average premium rate (APR) charged. If the BEP is not below the APR then the surplus would very quickly become a deficit.

According to the then NSW Minister for Finance and Services, Dominic Perrottet<sup>9</sup> the findings of a statutory review of the 2012 amendments to workers compensation in NSW show that sound financial management is needed for the Scheme to remain sustainable. This begs the question; “Does sound financial management include running at a loss with expenses at least twice what ought to be expected?”

ICNSW Annual Report contains a message from the Chairman of the Board “A key component of our strategy has been the creation and stand up of a new technology platform which is changing the way we interact with our customers.” Interestingly, this new technology platform was supposed to be fully operational by September 2017 but according to market reports is still a further 12 months from full delivery. This begs the question “How can this new technology platform be changing the way that ICNSW interacts with its customer when it is still to be implemented?” There is also the question of delivery costs overruns which could run into tens of \$millions.

<sup>8</sup> Greg McCarthy Past CEO of RTWSA refer: <https://actuaries.asn.au/Library/Events/%20InjuryDisabilitySchemesSeminar/2017/5bGregMcCarthy.pdf>

<sup>9</sup> Ministerial Media Release | 30/06/2014

The CEO has a message in the Report. “Employers can now buy workers compensation either digitally or over the phone, with approximately 80% choosing to self-serve and purchase their policies online.” Whilst this may well be true, what has been left unsaid is anything about the huge backlog of policy processing which is still outstanding from 30 June 2017 and what is being done to reduce this. Perhaps this is an early symptom of monopolistic malaise.

According to the CEO, a claimed efficiency benefit of \$44 million in service fees (we assume payments to Agents) was achieved in 2016/17 which represents a saving of 6.36% over last year. It should not be lost on the working community that the one of the costs of ICNSW’s changes resulted in the loss of over 400 jobs<sup>10</sup>. 20 years ago, real savings of 7% were made in salaries and employee payments<sup>11</sup>.

Contractors’ fees paid by ICNSW in 2016/17 for workers compensation related services were \$55 million (this figure excludes amounts paid to consultants i.e. actuaries). If we assume (for the sake of the argument) that each contractor is paid an average of \$150,000 per annum, this adds a further 360 persons to the ICNSW head count pushing the total persons employed to over 1,000.

There has been a major change in investment returns with investment income falling by more than 50% from the previous year with only a minor downward shift in assets. In 2014, investment income was \$1,461,695,000 on an asset base of \$16,917,624,000; in 2015 investment income was \$1,416,081,000 on assets of \$17,069,080,000; in 2016 investment income was \$933,258,000 on assets of \$17,907,166,000; in 2017 investment income was \$438,862,000 on assets of \$17,695,273,000.

The benchmark return (based on asset allocation) for 2016/17 was 3.74%, the achieved return was 2.46%.

The Annual report explains the drop in returns as “Investment revenue was down on the previous year. The long-term nature of the portfolio structure and the movements in the market combined to result in a variance against the asset-weighted benchmark.” Further commentary in the “Investments Overview” section of the report does not explain in any depth why there has been such a massive (60%) turnaround in 3 years.

This is insufficient explanation for stakeholders to maintain any confidence in the prudential management expertise of ICNSW. This is another issue which ought to be of significant interest to the Auditor General and SIRA.

Overall, the Annual Report is characterised by its good news stories and whilst this maybe a great way of selling itself, ICNSW does not have to sell anything; it is a Government Agency operating in a compulsory, statutory insurance market. What is missing is an informed commentary on the health of the NSW workers compensation scheme, on its failures and the plans developed to ensure its viability.

As a Government Agency, ICNSW needs to act consistently with the reasons by which it was constituted but since there is scant reference in the Annual Report to ICNSW’s statutory roles, it is difficult to conclude that it is meeting its objectives or that the objectives it has set itself are within its purview.

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<sup>10</sup> <http://insurancenews.com.au/local/icare-changes-hit-more-than-400-jobs-union>

<sup>11</sup> WorkCover Annual Report 18 November 1997.

For instance, the ICNSW Strategic plan 2017/18 contains the KPI “Reduction in Workplace Incidence Rate.” Measurement Metric is the number of Injury Incidences divided by the wage roll during a specified time period. A Baseline (17/18) metric has not been determined nor has a target. It is now nearly mid-year and still no metrics have been determined.

Then there is the matter of Performance and Reward and Remuneration Governance. According to the Report, ICNSW has implemented a balanced scorecard approach to measuring performance. This scorecard directly links performance to the delivery of the ICNSW strategic plan and informs any possible performance payments.

There is a table of the ICNSW scorecard which under the topic of “Transformation” lists a number of successfully delivered transformational objectives, one of which is the new claims operating model. A major component of the new operating model is a brand-new claims management model (it also includes transitioning existing claims from one agent to another and selecting a single agent to manage all new claims post 1.1.18). The brand-new claims management model can only be described as conceptual; it will not be implemented until 1.1.18, it is untried and untested and its success or otherwise will not be known for many years to come.

ICNSW uses the Net Promoter Score as a measurement of its customer satisfaction. Subtracting the percentage of Detractors from the percentage of Promoters yields the Net Promoter Score<sup>12</sup>, which can range from a low of minus 100 (if every customer is a Detractor) to a high of 100 (if every customer is a Promoter). Since ICNSW began using the NPS results have improved from – 12 to 19 which is a turnaround of 31 points.

Each year Satmetrix, the co-developer of Net Promoter, benchmarks leading brands in the USA according to their Net Promoter Score. These benchmarks can be used to compare a company's NPS to the scores of its competitors<sup>13</sup>.

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<sup>12</sup> <https://www.netpromoter.com/know/>

<sup>13</sup> <https://info.satmetrix.com/hubfs/Infographic/satmetrix-infographic-2017-b2c-nps-benchmarks-glance-061217.pdf?t=1513101681776>

This is a table of the USA 2017 NPS Consumer benchmarks.

Industry Sector	Average NPS	
Department/Specialty Stores	60	79
Online Shopping	56	73
Tablet Computers	53	66
Brokerage/Investments	50	60
Online Entertainment	46	62
Auto Insurance	43	76
Hotels	41	78
Home/Contents Insurance	40	73
Laptop Computers	39	62
Shipping Services	39	40
Airlines	38	62
Credit Cards	37	55
Grocery/Supermarkets	37	66
Smartphones	36	60
Banking	35	75
Cell Phone Service	35	52
Life Insurance	34	48
Software & Apps	31	55
Drug Stores/Pharmacies	29	33
Travel Websites	22	41
Health Insurance	12	28
Cable/Satellite TV	3	27
Internet Service	2	21

The point of publishing the chart above is to illustrate how low Icare's NPS is (19) and to establish that an awful lot of work must be done to raise it to a level which is acceptable. Certainly, the anecdotal evidence is that simple transactional events will need to be promptly responded to if any positive changes to the NPS are to be made. Emails which disappear into ICNSW's ether are symptoms of a greater malaise, lost or delayed documents are early signs of constitutional apathy and forgetting statutory purpose is careless behaviour.

In relation to the effect of Section 39 changes to injured workers benefits the Report notes that the changes were made through amendments to the section and that the changes will start to affect the income replacement benefits of workers from late in 2017.

An estimated 1,600 workers will be given the very unwanted Christmas present of losing benefits on 26 December 2017. Other than vague references to establishing an Advisory Assistance Service to help people understand the impacts of the changes to section 39 (they are losing their benefits); creating a Community Support Service with St Vincent de Paul Society, Uniting Care and Interact (linking in with Charities); and working with Centrelink, there is almost no detail on exactly what will happen to the injured workers affected and exactly how ICNSW has assisted them in planning their futures.

The ICNSW Annual Report appears to satisfy the requirements of the Annual Reports (Statutory Bodies) Act 1984.

Whether it satisfies the informational and other needs of an astute observer lies (like beauty) in the eye of the beholder.