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ICNSW Annual Report 2019 and a stroll among the paragraphs of spin.

A year ago, I published a commentary on the ICNSW's 2016/2017 Annual Report. Anyone interested can read it here[1]. That report was snuck into Parliament with minimal fanfare as befits its annual results, a thumping loss of $988 million, a loss for the second time in a row since ICNSW took over NSW workers compensation in 2015.

This year, ICNSW "is proud to share our 2017-18 annual report," and on a first reading they have a right to be, it reveals a surplus.

Like most Annual Reports, ICNSW's seeks to put the most positive spin it can on the past year's achievements but hidden within all the beautiful words, are facts which the writers would probably prefer to be kept under wraps.

Having just survived hiking through the Patagonian wilderness, coming face to face with Pumas and Guanacos (and all other wonderous things) I feel fit enough to wander through the ICNSW 2019 Annual Report and see what can be uncovered.

It perplexes me to read that "icare is a social insurer whose purpose is to protect, insure and care for the people, businesses and assets that make NSW great." To begin with, icare is not a legal entity, it is not an insurer, it is a Trade Mark. The legal entity is Insurance and Care NSW (ICNSW). ICNSW is not an insurer, it is a Government Agency.

Section 154D (4) of the 1987 Act, provides that employers are entitled to participate in the distribution of any surplus in the Insurance Fund, and are responsible for meeting any deficit in the Insurance Fund, by means of the fixing of premiums, levies and contributions as provided by the Act.

Funny enough, is that fact that there are no employer representatives on the ICNSW Board, even though it is the employers who are the major stakeholders in the Insurance Fund.

I am then even more perplexed when I read this statement: "icare is a social insurer that places its customers at the centre of everything it does. Key to this strategy are financially sustainable schemes. Operating on a breakeven basis, icare passes on savings accrued through prudent financial management as reduced service fees to the schemes it provides services to and reinvests to deliver better customer outcomes."

[1] https://www.risknet.com.au/wp-content/uploads/ICNSW-Annual-Report-Commentary.pdf

Let's have a closer look at the facts around passing on savings accrued through prudent financial management as reduced service fees to the schemes ICNSW provides services to, in particular the NI.

If all nonoperational expenses are stripped out of the expenses (statutory levies, interest, investment management) and the last four years' data is used[2] this picture emerges.

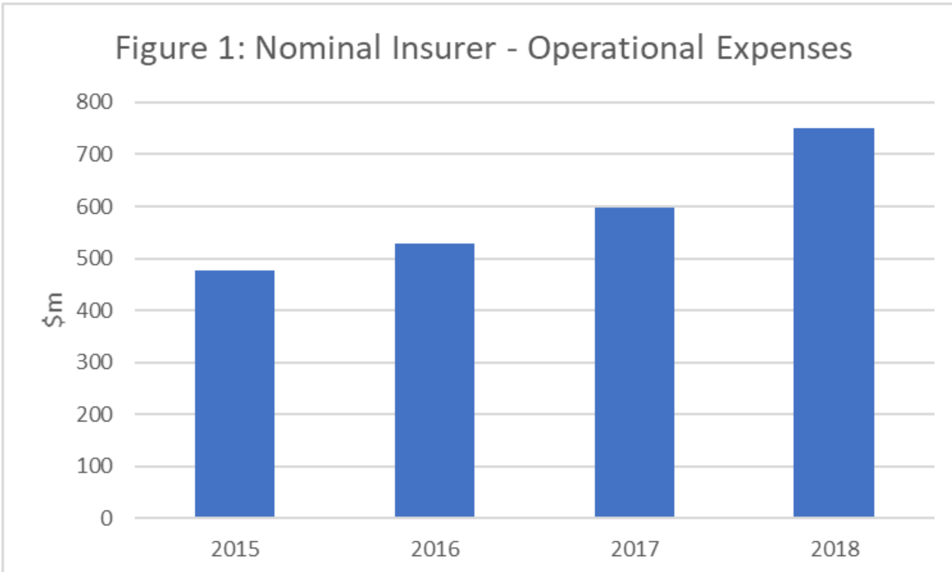

Figure 1 shows that operational expenses have increased by 58% over the three years since 2015 from \$475.6m to \$750.4m – that is an average of over 16 percent per annum. Admittedly there was a "transformational" expense in 2018 of \$129,835,000, up from \$49,246,000 in 2017, but this doesn't explain the close to, 60% increase since ICNSW took the reins.

If the cumulative increases in the expenses incurred by the Dust Diseases Board and Lifetime Care Services are added to the NI increase, a massive \$518,168,000 is the result.

I guess then the broader question remains, "What savings are there to pass on?"

Another indicator of sound prudential management is how well an organisation manages credit.
In Note 2.5 of the Notes to the Financial Statements accompanying the ICNSW Annual Report (Notes) the term "Impairment[3] of trade and other receivables" is used to describe an amount of \$52,102,000.

As at 31 July 2017, there is a carryover allowance in the NI accounts for impairment of \$35,117,000, meaning that as at 31 July 2018 the total allowance for impairment stands at \$87,291,000.

[2] 2015 data is used as this was the last year under the WorkCover regime. It is a useful benchmark to demonstrate just how much expenses have increased since ICNSW took over.
[3] Definition of Impairment can be found here: https://www.investopedia.com/terms/i/impairment.asp

In Note 2.6 (page 274) of the Notes, a table is provided to describe the ageing of the receivables. If that table is used as the basis for comparisons over the past four years, this is the result.

Table 1: Nominal Insurer - Overdue and Impaired Premium

	2015 $m	2016 $m	2017 $m	2018 $m
Premium Recievable	306	360	424	653
Overdue Premium	67	87	125	313
Allowance for Impairment	29	37	35	87

Table 1 demonstrates that ICNSW has a major debtor's problem in its Nominal Insurer operations with a ballooning premium receivable, overdue premium and premium impairment figures. Since ICNSW took over the management of the NI in 2015, there has been a 364% increase in overdue premiums. Since ICNSW brought in-house the management of premium processing and collection in June 2017, the deterioration in overdue premiums has increased by 150% during 2017/18 alone. This has started to translate to increasing levels of impaired premiums which have risen to $87m during 2017/18.

The broader question is, "How on earth did this situation develop in the first place? And why has the Auditor General not picked up on this in her Audit?"

ICNSW has the power to enforce the collection of premiums, directors of corporations are personally liable for unpaid premiums, so how did ICNSW allow this ballooning debtors problem to arise?

It is a serious matter and needs to be addressed as it is likely to have an effect on all premiums paid by NSW employers. If the premiums were collected as they ought to be, premiums could be lower by an average of 0.1% of all NSW wages.

In June 2018, ICNSW posted an article about funding ratios on its website[4], this is an excerpt:
"As at 31 December 2017, icare's Nominal Insurer funding ratio was 114 per cent. Even at this level, there is still a risk that funds may fall short if future events turn out to be significantly different to the estimates and assumptions made in the calculations, which is why icare has established a funding target of 120% - 140%. However, given market variabilities the funding ratio can be targeted over a 5 year period so we do not cause significant and unnecessary swings in premium or changes in services."

The 2017 capital management plan already adopted the 120% - 140% range as well as providing that:

- An appropriate Target Capital Ratio was 127%.
- An appropriate Minimum Capital Requirement was 100%.
- The Target Operating Zone should be 120 – 140%, such that the Target Capital Ratio dissects the zone with approximately one third below and two thirds above.
- All capital ratio calculations and projections should use liabilities which include a risk margin to a 75% Probability of Adequacy (PoA).

[4] Can be accessed here: https://www.icare.nsw.gov.au/news-and-stories/icares-funding-ratio/

There is no need to worry about the market variabilities over a five year period since the ICNSW draft capital management policy put out in November 2018, concludes that:

- An appropriate Target Capital Ratio be lowered to 123%.
- An appropriate Minimum Capital Requirement was 100%.
- The Target Operating Zone should be lowered to at 115% – 135%, such that the Target Capital Ratio dissects the zone with approximately one third below and two thirds above.
- All capital ratio calculations and projections should use liabilities which include insurance claims liabilities at 75% PoA.

With the tanking of many of the equities markets and other market uncertainties over the past 6 months, taking a less than robust approach to capital ratios may be problematic for the future of the NI.

According to the NI actuaries "Maintaining a sound funding ratio position is essential to ensuring the ongoing ability of the NI to deliver on its commitments to the workers and employers of NSW. That means managing and mitigating the uncertainty in the estimates where possible and holding sufficient funds to protect against potential fluctuations where it is not possible."

Perhaps the relaxation of the capital requirements has something to do with anticipated difficulties in achieving those originally determined.

Of course, this then introduces an elephant into the centre of the ICNSW prudent financial management rooms. Perhaps the dear reader can name the elephant.