Capital Management Policy

Lifetime Care and Support Scheme

V.6.0 June 2023

Contents

1. Purpose

Capital is core to the financial strength and long-term sustainability of the Lifetime Care and Support Scheme (the Scheme). Capital management is an integral part of icare's risk management framework. One of the key objectives of the Scheme is to have sufficient capital to meet its obligations to its participants, even under adverse conditions.

The objectives of the Capital Management Policy (CMP) are to:

- Outline clearly the lines of responsibility in respect of the Scheme's capital management
- Summarise the Scheme's risk appetite with regards to capital
- Outline the Target Operating Zones for levels of capital
- Outline the triggers and subsequent actions at different levels of capital

2. Scope

This policy applies to the Scheme and its financial management.

3. Key concepts

The **accounting discounting and inflation assumptions** are the discount rate and inflation rate assumptions used in calculating the insurance liability of the Scheme in accordance with statutory financial reporting requirements. The discount rates are based on risk-free Government bond yields. The long term inflation rates are set with consideration to the long term bond rates, i.e. "a gap" approach, assuming that there are economic linkages between the two.

The **economic discount and inflation assumptions** are the discount rate and inflation rate assumptions used in calculating the insurance liability of the Scheme where the discount rates reflect the expected long-term investment return for the Scheme. The long term inflation rates are set without regard to the risk free discount rates.

The **accounting funding ratio** for the Scheme is calculated as total assets divided by total liabilities as per the financial reporting. The insurance liability (which makes up the majority of the Scheme's liabilities) is calculated using the accounting discount and inflation assumptions and does not include a risk margin. This is consistent with account standard AASB 137 and is the same basis as statutory financial reporting.

The **insurance ratio** for the Scheme is calculated as total assets divided by total liabilities. The insurance liability is calculated using the economic discount and inflation assumptions and do not include a risk margin. This differs from the statutory financial reporting basis. It provides a better perspective of the long term solvency of the scheme.

The **Target Operating Zone** is defined as the preferred range for Scheme's insurance ratio to operate within.

The **capital position** for the Scheme is measured by the insurance ratio, accounting funding ratio and the probability of meeting operating cashflows.

Probability of coverage is the likelihood that the Scheme will meet its financial obligations as they fall due if the scheme entered run-off, i.e. no longer accepting new policies. This is a hypothetical scenario for the purpose of measuring financial condition of the scheme.

4. Policy principles

4.1 General principles

There are certain aspects of the Scheme that creates key differences in capital management between the Scheme and private sector insurers, the most notable being:

- The Scheme is the default insurer for a compulsory insurance product. Therefore, the future premium income for the Scheme is more predictable than the private sector.
- The Scheme's claims payment profile tends to be much longer tailed than the private sector. This longer time horizon gives arise to more opportunity to invest in growth assets to enhance the investment returns for the Scheme.

As such the Scheme needs to manage financial risks across a much longer time horizon compared to the private sector. This needs to be reflected in the capital management policy specifically:

- the utilisation of insurance ratio to reflect the expected returns of the investment assets,
- longer time horizon to manage the financial position,
- different level of capital required compared to the private sector.

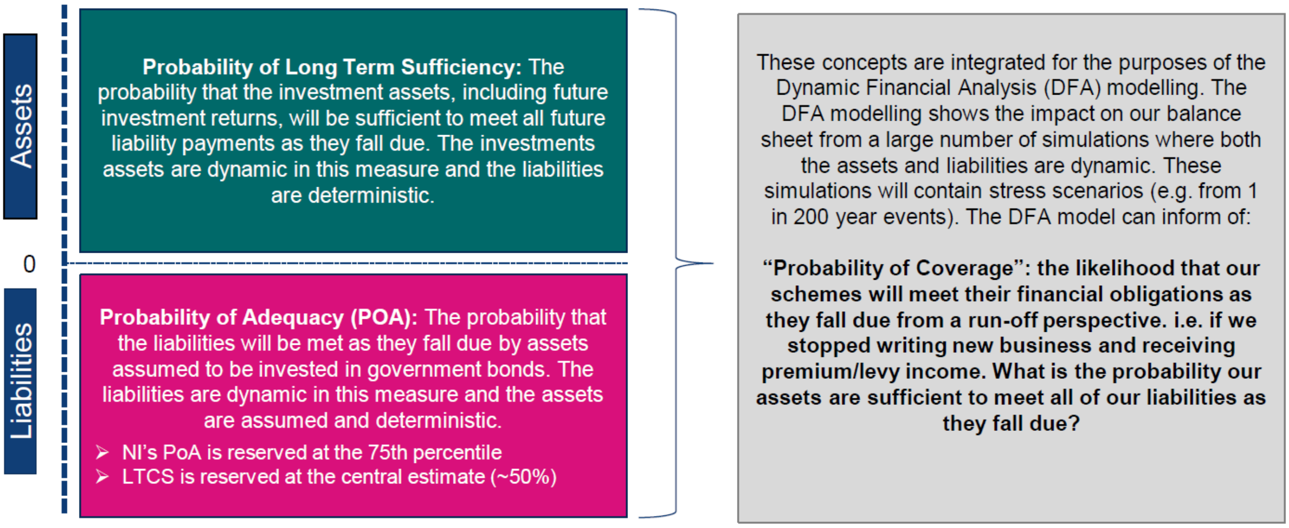
Taking the above into consideration and the unique nature of the Scheme the Target Operating Zone has been established using insurance ratio and the respective probability of coverage. The capital position of the Scheme will be assessed via a composite measure comprising:

- Primary metrics: insurance ratio and the outlook of the insurance ratio
- Additional considerations: accounting funding ratio and the Scheme's operational cashflow and its projection

The insurance ratio is preferred as the primary metric and the accounting funding ratio as an additional metric. This is because the accounting funding ratio is subject to the volatility from the movements in risk-free Government bond yields, that do not change the underlying financial position of the Scheme.

Capital adequacy measures for the Scheme need to recognise both asset and liability risks. The Probability of Coverage, as outlined in Figure 1, integrates asset and liability risks and is used to select the Target Operating Zone.

Figure 1: Probability of Coverage



Prudential standards for capital management set by the Australian Prudential Regulatory Authority (APRA) may not be appropriate for the Scheme as they are intended for private sector general insurers. A more detailed comparison of public schemes to private schemes are shown in Appendix A.

4.2 Target Operating Zone, Triggers and Actions

The Target Operating Zone, Zone A, has been set to achieve a **96.7% Probability of Coverage or higher** in a hypothetical runoff scenario. The top of the Target Operating Zone has been set in excess of 99.5% Probability of Coverage. Similarly, Zone C has been set to be 90% Probability of Coverage or lower.

If there are significant changes to the risk profile of the Scheme, a review of the zones below is required to ensure the zones still meet the same Probability of Coverage.

Table 1 outlines the Capital zones, triggers, and subsequent actions required by icare.

Table 1: Capital zones, triggers, and actions

Insurance Ratio	Positive Outlook (insurance ratio improves in the projection)	Stable Outlook (no significant change of insurance ratio in the projection)	Negative Outlook (insurance ratio deteriorates in the projection)
Zone A: Between 140% to 170%	**Monitor:** Continuously Monitor the insurance ratio, accounting funding ratio, the trajectory of both ratios and cashflow projections.	**Monitor:** Continuously Monitor the insurance ratio, accounting funding ratio, the trajectory of both ratios and cashflow projections.	**Review:** Review the trajectory of the insurance ratio. If the insurance ratio is projected to stay above 140% in the next ten years, closely monitor the insurance ratio including a comparison to the projection. If the insurance ratio is projected to fall below 140%, consider actions to improve the insurance ratio. Monitor the accounting funding ratio, its trajectory and cashflow projections.

Insurance Ratio	Positive Outlook (insurance ratio improves in the projection)	Stable Outlook (no significant change of insurance ratio in the projection)	Negative Outlook (insurance ratio deteriorates in the projection)
Zone B: Between 140% to 115%	**Review:** Management to engage the CEO and Board upon the insurance ratio falling into this zone as part of regular reporting. Review the trajectory of the insurance ratio. If the insurance ratio is projected to improve to greater than 140% within the next ten years, closely monitor the insurance ratio improvements including a comparison to the projection. Consider the timeframe of the recovery and whether additional actions are required. Monitor the accounting funding ratio, its trajectory and cashflow projections. If the accounting funding ratio falls under 100%, management is to engage the Board.	**Act:** Management to engage the CEO and Board upon the insurance ratio falling into this zone as part of regular reporting. Analysis to understand the underlying drivers of the current financial results and position to decide whether an action plan is required. If required, an action plan will be developed to improve the insurance ratio to above 140% within the next ten years. Monitor the accounting funding ratio, its trajectory and cashflow projections. If the accounting funding ratio falls under 100%, management is to engage the Board.	**Act:** Management to engage the CEO and Board upon the insurance ratio falling into this zone as part of regular reporting. Management to develop an action plan to improve the insurance ratio to above 140% within the next ten years. Monitor the accounting funding ratio, its trajectory and cashflow projections. If the accounting funding ratio falls under 100%, management is to engage the Board.

Insurance Ratio	Positive Outlook (insurance ratio improves in the projection)	Stable Outlook (no significant change of insurance ratio in the projection)	Negative Outlook (insurance ratio deteriorates in the projection)
Zone C: Below 115%	**Review:** Management to engage the Board upon the insurance ratio falling into this zone. Review the trajectory of the insurance ratio. If the insurance ratio is projected to improve to greater than 140% within the next ten years, closely monitor the insurance ratio improvements including a comparison to the projection. Consider the timeframe of the recovery and whether additional actions are required. Otherwise, management to develop an action plan to improve the insurance ratio to above 140% within the next ten years. Monitor the accounting funding ratio, its trajectory and cashflow projections. If the accounting funding ratio falls under 100%, management is to engage the Board.	**Act:** Management to engage the Board upon the insurance ratio falling into this zone. Management to develop an action plan to improve the insurance ratio to above 140% within the next ten years. Monitor the accounting funding ratio, its trajectory and cashflow projections. If the accounting funding ratio falls under 100%, management is to engage the Board.	**Act:** Management to engage the Board upon the insurance ratio falling into this zone. Management to develop an action plan to improve the insurance ratio iabove 140% within the next ten years. Monitor the accounting funding ratio, its trajectory and cashflow projections. If the accounting funding ratio falls under 100%, management is to engage the Board.

The development of a management action plan should consider all four financial levers available to management:

- Levy Setting: such as adjusting the LTCS levies
- Initiatives to reduce the cost of claims: such as via cost control agreements with service providers
- Investment strategy: such as changes Strategic Asset Allocation
- Reducing operating costs, which may have flow on implications e.g. claims liabilities, which will need to be managed and monitored

In the case of the insurance ratio operating above the target operating zone, appropriate management action such as premium discounts and de-risking the investment portfolio should be considered to return to the target operating zone within five years.

In particularly strenuous circumstances where the management actions return the insurance ratio to Zone A in more than ten years, explicit approval from the icare Board is required.

4.3 Monitoring and reporting

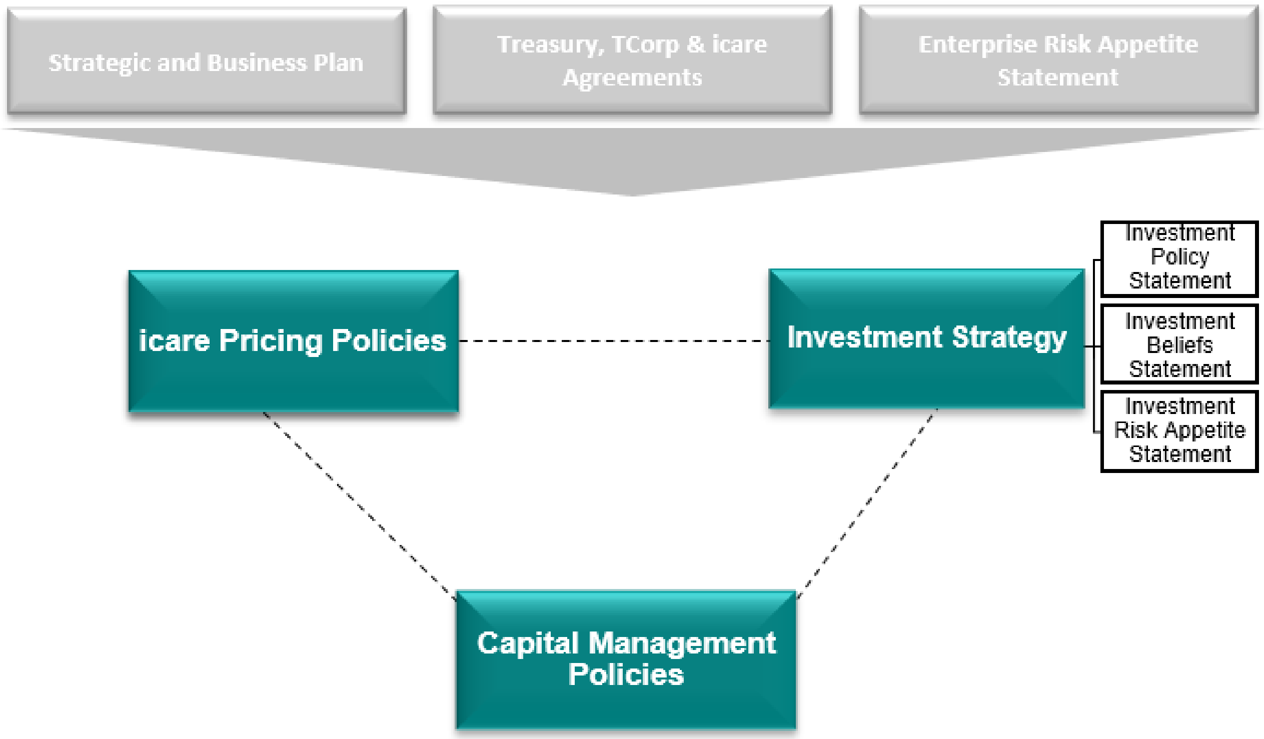
The Scheme's current capital position will form part of the regular reporting to the Board and Board Risk Committee. The Scheme's forecast capital position will form part of reporting to and discussions at the Board as well as actuarial monitoring, risk and performance monitoring and finance reporting.

The Financial Condition Report (FCR), prepared annually by the Chief Actuary, will assess the Scheme's capital position in the year against its forecast and against the objectives of the CMP. The FCR will also include an assessment of the Scheme's capital projections at future reporting periods. The FCR is provided to the Board.

5. Related Policies and Procedures

icare's governance framework for the Scheme is formed, collectively, by a number of components as shown in Figure 2.

Figure 2: icare's governance framework



LTCS Investment Strategy: the insurance ratio utilises the TCorp investment return target from the LTCS Investment strategy as the discount rate. In addition, the probability of coverage is calibrated using the investment strategy at the time of reviewing the Capital Management Policy. If there are material changes in the volatility or expected long term return of the investment strategy. The Capital Management Policy will need to be reviewed.

The Capital Management Policy also notes the investment strategy as one of the four financial levers that may form the management action plan.

The Pricing Policy: will be aligned with the capital management policy in terms of the discount rate used. The Pricing Policy also notes levy setting should take into consideration of the Capital Management Policy as it is one of the four financial levers.

6. Roles and responsibilities

<table>
<tr><th>Role</th><th>Responsibilities</th></tr>
<tr><td>Board</td><td>Ultimate responsibility for prudent capital management of the Scheme rests with icare's Board of Directors. As such, the Board owns and approves the Scheme's CMP. The Board should:
• Approve a CMP for the Scheme annually
• Receive any escalation of material matters from the Board Risk Committee and take appropriate action.</td></tr>
<tr><td>Audit & Risk Committee (ARC)</td><td>icare's BRC oversees the implementation of the Scheme's CMP and supporting framework and methodology. The BRC should:
• Receive reporting on the effectiveness of the CMP for the Scheme, as well as any matters escalated from the Chief Actuary or Group Executive Organisational Performance
• Review and endorse a CMP for the Scheme for approval by the Board annually
• Provide oversight of icare's control framework for managing capital and take appropriate action in relation to non-compliance or breaches of the framework
• Escalate material matters relating to capital management to the Board as necessary</td></tr>
<tr><td>Chief Financial Officer (CFO)</td><td>The Board and BRC delegate responsibility to the CFO for operational aspects of providing ongoing monitoring of actual capital position, and forecast of the capital position.

The CMP is reviewed annually by the CFO to ensure its continuing relevance to the Scheme. The scope of the review will include consideration of:
○ whether the underlying risk profile of Scheme has changed materially since the previous review
○ whether the risk appetite of the Scheme has changed materially since the previous review

Changes to the CMP are prepared by the CFO, endorsed by the BRC and approved by the Board.

The CFO is accountable to the BRC for continuous adherence to the CMP.</td></tr>
<tr><td>Chief Actuary</td><td>The Chief Actuary owns the technical modelling used to assess and determine the appropriate Capital Zones.</td></tr>
<tr><td>Chief Risk Officer (CRO)</td><td>The CRO is responsible for second line review, challenge and assurance for compliance with the CMP and escalation to the BRC as appropriate. The CRO is also responsible for raising any material risks which may impact the CMP.</td></tr>
</table>

Group Executive Lifetime Schemes	The Group Executive Lifetime Schemes is responsible for the business plan and action to return the scheme back to the target operating zone.

7. Version Control and Document History

Key document information	
Document owner (Policy Owner)	Chief Actuary and group Executive Organisational Performance
Approving Authority	Board
Last Approval Date	29 May 2023
Review Frequency	Annual

Version	Author	Change Summary	Approved by and approval date
1.0	Dai Liu, Chief Actuary	Initial draft	Chief Actuary, 13 May 2021
2.0	Dai Liu, Chief Actuary	Feedback received from CFO on Version 1.0 and incorporated into the CMP	CFO on 14 May 2021
3.0	Dai Liu, Chief Actuary	Feedback received from the Asset and Liability Committee (ALCO) on Version 2.0 and incorporated into the CMP	ALCO on 17 May 2021
4.0	Dai Liu, Chief Actuary	Feedback received from Audit Risk Committee (ARC) on Version 3.0 and incorporated into the CMP	Endorsed by the ARC on 27 May 2021 and approved by the Board on 4 June 2021
5.0	Dai Liu, Chief Actuary	Removed explicit reference to 6% p.a. discount rate. Incorporated feedback from BRC to explicitly reference investment return targets for discount rate. Simplified timeframes to ten years to recover to target operating zone.	Endorsed by the BRC on 26 May 2022 and approved by the Board on 30 May 2022
6.0	Dai Liu, Chief Actuary	Added the top of the range for the target operating zone.	Endorsed by the BRC on 25 May 2023 and approved by the Board on 29 May 2023

A. Comparison of public schemes to private insurers

Characteristic	Public Scheme	Private Sector
Often the default insurer of a compulsory insurance	Reasonably predictable cash inflows Have significant volumes of long term cash outflows and high average claim durations Higher levels of growth investment assets that provide better long term returns This allows public schemes to take a longer time horizon and incremental steps in managing its financial sustainability Less pricing volatility compared to the private sector	Cash inflows are less predictable due to competitive market Pricing limitations based on market conditions. Ability to risk select Must meet the APRA capital requirements, and hence must manage solvency over a shorter time horizon (essentially continuously)
Regulatory Regime - Key liability side considerations	The financial reporting results are usually the basis of funding calculations Funding ratios below 100% would risk regulatory actions, public scrutiny and legislative action (e.g. benefit reform)	Solvency calculations are prepared according to APRA's regulations – this would include a buffer above the PCR. If capital sufficiency is in question, immediate action is required or risk severe regulatory action