Lifetime Care (LTC)

Capital Management Policy

November 2018

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Chief Policy Originator:	Chief Risk Officer (CRO)
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Summary of Lifetime Care Scheme Capital Management Policy

Why is this Policy required?	▪ Capital is core to the financial strength and long term sustainability of the Lifetime Care Scheme. Capital management is an integral part of icare's risk management framework. One of the key objectives of the Lifetime Care Scheme is to have sufficient capital to meet its obligations to its participants, even under adverse conditions.
Whom & what does this Policy apply to?	▪ This policy applies to the Lifetime Care Scheme (the Scheme) and its current and future capital position.
Ownership	▪ Ultimate responsibility for prudent capital management of icare rests with its Board of Directors. As such, the Board owns and approves the Scheme's Capital Management Policy. ▪ The Board's Audit & Risk Committee (ARC) oversees the implementation of the Scheme's Capital Management Policy and the supporting framework and methodology. ▪ The Board and ARC delegate responsibility to the Chief Financial Officer (CFO) and Chief Actuary for operational aspects of providing Actual, Modelled and Projected Capital Ratios, and the ongoing monitoring, reporting, and implementation of any related management action. ▪ The Chief Risk Officer (CRO) is accountable to the ARC for continuous adherence to this Policy.
Policy Key Points	The Scheme will be managed towards holding capital above the Minimum Capital Requirement within a defined range as set out in the "Target Capital Ratio Policy" (Appendix A).

CAPITAL MANAGEMENT POLICY

1 Introduction

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

This policy documents icare's strategies to maintain adequate capital to achieve these outcomes.

2 Definitions

Accounting Capital Ratio

The ratio of the value of the Scheme's assets to liabilities on an accounting basis. That is, as reported in icare's financial statements.

Audit & Risk Committee (ARC)

The Board's Committee having oversight of risk, compliance and audit matters, including capital management.

Capital Adequacy Requirements

The capital adequacy requirements which apply to the Scheme as set out in Section 3 of this policy.

Capital Management Framework

The totality of systems, structures, policies, processes and people used to monitor, report, and control or manage capital.

Minimum Capital Requirement (MCR)

The minimum Policy Capital Ratio that the Board requires the Scheme to hold.

Prudential Capital Requirement (PCR)

The minimum amount of assets in excess of liabilities that an APRA regulated general insurer must hold, on a continuous basis, as defined in APRA's Professional Standard GPS110.

Policy Capital Ratio

The ratio of the value of the Scheme's assets to liabilities calculated in accordance with the Target Capital Ratio Policy (Appendix A).

Relevant Law

All laws covering conduct relating to the provision of financial services that apply to icare, including regulations, rulings, circulars, guidelines and licence conditions in relation to icare.

Target Capital Ratio

The Target Capital Ratio is the desired level of the Policy Capital Ratio, determined by considering the risks held in the company to its Balance Sheet.

Target Operating Zone

The Target Operating Zone is the range of acceptable Policy Capital Ratio values. If the actual Capital Ratio falls within the Target Operating Zone no immediate action is required.

3 Capital adequacy requirements

There are two basic elements to the Scheme's requirements in relation to how it maintains capital adequacy:

i. The Minimum Capital Requirement (MCR) set by the Board.

ii. The additional requirements, as decided by the Board, to provide the Scheme with a reasonable "buffer" above the MCR to address the possibility that the MCR may be breached at any time. The manner in which this "buffer" is maintained is through the application of the Target Capital Ratio Policy which is attached as **Appendix A**.

In this policy these various requirements are collectively referred to as our "Capital Adequacy Requirements".

4 Capital forecasting

This policy requires that the CFO and Chief Actuary facilitate a quarterly capital forecast. Reporting is provided as part of the management reporting for the forthcoming ARC meeting, where, at a minimum, the following matters must be addressed:

- There must be a calculation of the Policy Capital Ratio, a comparison to Target Capital Ratio and a forecast of projected Policy Capital Ratios, including a forecast of the position for each remaining quarter of the current year, and the three year ends thereafter
- The main assumptions in the forecast
- Any major or unusual risks to that forecast

5 Capital reporting

A fundamental component of a capital adequacy strategy and framework is systematic and robust reporting against ones Capital Adequacy Requirements.

This policy requires that capital reporting to the Board is via management reporting and the quarterly ARC meeting minutes. Capital reporting to the ARC is prepared quarterly and presented to the ARC meeting, addressing at a minimum the following matters:

- Statement of the MCR and actual Capital Ratios (Accounting and Policy) and latest modelled capital buffer
- Presentation of the Policy Capital Ratio against the Target Capital Ratio, as set out under the Target Capital Ratio Policy
- The main assumptions in the forecast
- Any major or unusual risks to that forecast
- A description of the potential impact of risk to capital, using analyses such as stress testing, reverse stress testing and scenario testing
- Other such matters as the Board may require, including, but not limited to, reporting in relation to current and future capital positions

6 Review of the Capital Management Framework

The Capital Management Framework is reviewed annually by Management, with the intent of providing continuous improvement. Any recommendations for change are made to the ARC for endorsement, before approval by the Board.

If requested by either the ARC or Board, Management will undertake a comprehensive review of the capital management framework in a manner and with timing as directed by either the ARC or Board.

7 Policy access and contact

A copy of this Capital Management Policy will be available to employees through the Office of the CRO and via the website once approved by the Board.

The CRO is the point of contact for matters arising from this Policy.

APPENDIX A: Target Capital Ratio Policy

1 Introduction

The Target Capital Ratio Policy forms a key component of the Scheme's Capital Management Policy. This document serves as a reference point for the process, general methodologies and assumptions used by the Board to select the Target Capital Ratio and Target Operating Zone.

2 Purpose

The purpose of this document is to state the Board's Policy in relation to the setting of the Target Capital Ratio, having regard to icare's Beliefs and appetite for risk.

The ongoing review and evaluation of the Policy Capital Ratio against the Target Capital Ratio is an important control device. A series of management actions based on trigger points (a 'Traffic Lights' approach) is set out in Section 5 below.

3 icare's Beliefs

The key principles underlying the Board's approach to managing the capital and solvency requirements of its schemes are reflected in icare's Beliefs (see Appendix B).

4 Selection of Target Capital Ratio & Target Operating Zone

To select the Scheme's initial Target Capital Ratio and Target Operating Zone in late 2017, the Board considered an appropriate capital level for icare with respect to its risk appetite, with consideration of the following:

- the unique nature of the business from both various perspectives – internal (financial and operational) and external (economic, political)
- the liabilities of the Scheme are included in the NSW Government's Balance Sheet but there is no explicit Government guarantee to cover any funding shortfall
- its strategic objectives and the risks of not achieving them
- APRA's regulatory requirements as they pertain to the insurance industry

Material discussion points provided to the Board for consideration during the November 2018 review included:

- The Lifetime Care Scheme is not treated as an insurance arrangement for the purposes of financial reporting. The Scheme's accounts are constructed under AASB 137 (Provisions, Contingent Liabilities and Contingent Assets) rather than AASB 1023 (General Insurance Contracts). This means the liabilities of the Scheme are reported in icare's financial statements at the net central estimate exclusive of any risk margin.
- Having said that, if the APRA guidelines were applied, the Scheme's PCR is 42% of liabilities and the risk margin at a 75% probability of adequacy is 22%.
- Including a risk margin in the calculation of the Policy Capital Ratio is not warranted because:
  - The Scheme is not treated as an insurance arrangement from a financial reporting perspective.
  - The benefit structure of the Scheme is less likely to change materially when compared to the NSW Workers' Compensation Scheme.

- The future funding stream, via a levy included in NSW motorists' CTP premium, is reasonably certain.
- The Scheme is still growing, is cash flow positive and will not reach a "steady state" for many years.
- If a risk margin was included in the levy calculations for future years this would put upward pressure on the required levy amount. Conversely, if the risk margin was not funded the funding ratio would fall below the "green zone".

- Considering the Scheme's estimated PCR as a stake in the ground, it was agreed:
  - It is prudent to aim to hold capital at a similar level.
  - Whilst an APRA regulated insurer cannot continue trading freely if its capital falls below its PCR, we can take a longer term view. Therefore, holding a multiple of PCR (as regulated insurers do) is not necessary.
  - Our investment strategy is informed by the characteristics of our claim liabilities, including their long duration and sensitivity to inflation and interest rates. In this context, holding growth assets is prudent. The Scheme needs to have sufficient assets to pay its claim liabilities. This overrides any potential PCR benefits from a lower Asset Risk Charge were growth assets to be reduced.
- The Capital Management Policy will be reviewed at least annually and the traffic lights structure will not be a "set and forget".
- The Target Operating Zone within which an acceptable capital ratio could fall should be wide enough to absorb reasonable fluctuations in the Policy Capital Ratio without the need to take action (e.g. without the need to adjust the required levy).
- The Lifetime Care Scheme as at 30 June 2018 has adopted risk free discount rates for its liability valuation. As such the funding ratio is subject to additional volatility without changes in the underlying expected future cash flow or the risks attached to the cashflows.
- As at 30 June 2018, the Lifetime Care Scheme's funding ratio is 124% but if the past 6 valuation's economic assumptions were used it would have ranged from 131% to 122%. As such consideration for expanding the Target Operating Zone should be considered.

It was concluded that:

- An appropriate Target Capital Ratio was 140%.
- An appropriate Minimum Capital Requirement was 100%.
- The Target Operating Zone should be 125% – 155%, such that the Target Capital Ratio sits in the middle of the zone.
- This is a change from the previous Lifetime Care Scheme's Target Operating Zone of 130% – 150% to reflect the increased volatility of the funding ratio due to the adoption of the risk-free discount rate. This increase in volatility is entirely arbitrary with no change in the level of risk in the future cashflows.
- All capital ratio calculations and projections should use liabilities which do not include a risk margin.

5 Responsibilities, Monitoring and Reporting

5.1 Responsibilities

- The Target Capital Ratio Policy is determined by the Board.
- Management is responsible for implementing the CMP and the CFO has responsibility for the operational aspects of calculating the actual and projected Capital Ratios, and the ongoing monitoring, reporting and co-ordination of any related management actions required.

5.2 Monitoring and Reporting

- It is the responsibility of the CFO and the Chief Actuary to assess the level of actual and projected Capital Ratios at least on a quarterly basis. Should significant events occur which impact the capital position of the Scheme, a more frequent assessment and monitoring will be performed.
- The Board, via the ARC, receives advice from management on the level of actual and projected Capital Ratios at least quarterly.
- The Chief Actuary reports to the Board each year in the Financial Condition Report a detailed summary of the actual and projected Capital Ratios.
- Any other advice to the Board on actions which could significantly impact the capital position of the Scheme should include advice on the impact of the action on the actual Capital Ratio.

The results are reported to management and used to determine a series of management actions as follows:

Policy Capital Ratio **Assets/Liabilities**	**Response Level**	**Action Required**
> 155%	Blue	Next regular Board meeting to consider whether any actions are warranted. An Action Plan* will be developed if required.
125% - 155%	Green (Target Operating Zone)	No action required.
100% - 125%	Orange	• CEO or CRO to engage the Board. • Management to formulate an Action Plan* to return to Green within five years.
< 100%	Red	• CEO or CRO to engage the Board. • Convene a Board meeting within five working days to determine an appropriate Action Plan* to return to Orange within three years. Once back in Orange, a further Action Plan* will be developed to return to Green.

* The development of an Action Plan will include:

- Analysis of the events leading to the Capital Ratio being where it is.
- An assessment of where the projected Capital Ratio will trend over the next 5 years assuming no Management intervention.
- Consideration of the actions that can and should be taken to achieve the desired outcome (i.e. moving back to Green or Orange) within the required timeframe, including:
    - Actions to address any deterioration in claims experience (i.e. changes to claim management practices),
    - Adjustments to premium rates,
    - The application of premium discounts,
    - Alternative capital arrangements (e.g. the use of reinsurance), and/or
    - Changes to the Scheme's investment strategy.
- A review of the projected Capital Ratio over the next 5 years based on an agreed set of Management actions.

APPENDIX B: icare's Beliefs

icare's Risk Appetite

Customer Outcomes

Customer outcomes should be optimised for injured people and care participants

- Customer outcomes and satisfaction should be a significant factor in all decision making
- Services should be delivered in a fair and equitable manner to optimise the meeting of customer needs
- The cost of delivering services should be minimised, subject to not compromising outcomes
- Claims and care decisions will be made with icare's risk appetite in mind

Pricing

Premiums and levies should be minimised subject to not compromising treatment and care outcomes

- Premiums and levies should be optimised to provide the lowest possible cost to customers
- Pricing should reflect the relative risk of the customer
- Cross subsidisation should be minimised
- Price volatility should be minimised
- Pricing decisions will be made with icare's risk appetite in mind

Capital Management

Solvency should be actively managed to remain within agreed tolerances

- Solvency should be actively managed through pricing and investment decisions
- Solvency should be managed with both a short term and long term view in mind
- Reinsurance decisions should be made with solvency in mind
- Capital management decisions will be made with icare's risk appetite and capital management policy in mind

Investment Management

Investment decisions will be made with icare's investment strategy and risk appetite in mind

- Investments should be, where appropriate, liability aware (duration, inflation and interest rate aware)
- Excess investment returns should be used to reduce premiums or improve outcomes
- Investment assets should be used to meet financial obligations as they fall due
- Investment incomes should be maximised subject to risk tolerances

All interrelated with dependencies