

Motor Accidents Insurance Board Pricing Investigation 2017

Office of the Tasmanian Economic
Regulator

April 2017

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Tasmanian Economic Regulator
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Dear Mr Dimasi

Motor Accidents Insurance Board Pricing Investigation 2017

We are pleased to present our report on a number of aspects of the pricing review for the Motor Accidents Insurance Board pricing investigation.

We look forward to discussing this report with you.

Yours sincerely

A handwritten signature in black ink, appearing to read "G Harrex".

Gillian Harrex

A handwritten signature in black ink, appearing to read "D McNab".

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Motor Accidents Insurance Board Pricing Investigation 2017

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Part I Executive Summary

1 Introduction

The Treasurer has requested that the Tasmanian Economic Regulator (the Regulator) conduct an investigation into the Motor Accidents Insurance Board's (MAIB's) pricing policies. The pricing investigation covers the four year period from 1 December 2017 to 30 November 2021 and will be the seventh investigation carried out by the relevant Tasmanian Regulator. The previous investigation was conducted in 2013 by the Regulator and covered the four year period from 1 December 2013 to 30 November 2017.

To assist with the pricing investigation, the Regulator has commissioned Finity Consulting Pty Limited (Finity) to prepare this report. This is the second such review commissioned by the Regulator. We understand that this report may be made publicly available.

The scope of work required in this report is to include a review of MAIB's financial targets (such as solvency and risk margins), MAIB's insurance profit margin and also the superimposed inflation and investment return assumptions in MAIB's premium pricing.

2 MAIB's recommended increases

MAIB have recommended unchanged premiums for 2017/18 (other than a few small changes to a number of classes, reflective of emerging experience) and then premium increases to a maximum of AWOTE across the remaining three years of the review period.

3 Summary of Findings

Overall we are satisfied that MAIB's financial targets, profit margins, approach to superimposed inflation and investment returns are not unreasonable. While there may be some room for further refinement, our observations do not reflect any fundamental concerns.

At a high level, the key findings from our investigations include:

- The financial position of MAIB is very strong
- This strength of the financial position provides significant protection for motorists against future premium increases
- The current recommendations for premium increases of 0%, followed by a maximum of AWOTE are not unreasonable
- While the current profit margin targets are comparable with other CTP insurers, lower profit margin targets may be supportable given the overall financial strength of the balance sheet.

Considerations for Solvency and Profit

The level of solvency and profit for MAIB to target are a function of MAIB's and Government's risk tolerances and preferred average dividend. Capital in excess of a minimum defined solvency outcome (and, to a much lesser extent, profit) provides a financial buffer against adverse outcomes.

In our view it is not possible to determine a single 'correct' solvency framework and profit for MAIB. However, it is possible to determine acceptable settings that balance the needs of Government, Tasmanian motorists and claimants.

Setting solvency and profit targets generally considers the following:

- Measurement of capital and definition of a 'poor' solvency position
- 'Risk tolerances' associated with capital level
- Preferred level of dividend or return on capital
- Risk tolerance to premium increases (or other remedial actions such as expenditure cuts or benefit changes)
- Acceptable time horizon to recover from a 'poor' solvency position.

In general, lower solvency and lower profit margins equate to higher risk. One of the risks associated with lower solvency and profit is that premiums may need to increase, potentially significantly, in future to remediate an unfavourable financial position.

On the other hand, higher solvency and profit lead to higher premiums and potentially an "inefficient" use of financial resources. A higher solvency margin ties up capital that might be better deployed elsewhere for the state.

Solvency

MAIB's overall financial framework reflects the relatively conservative nature of the MAIB. The key elements of the financial framework include:

- target funding range of 120% - 145%
- a small (less than 15%) chance of falling from the bottom of the current range to 100% accounting solvency over a 5 year period
- payment of dividends of 50% of the rolling average of 5 years' profits, including implicitly reserving for future dividends within the current funding position calculation
- a claims liability risk margin intended to secure at least a 75% Probability of Sufficiency
- long term asset allocation of around 65% allocation to growth assets
- discounting of liabilities at risk free rates (in accordance with the accounting standard), while investments are expected to earn interest at a higher level.

While not unreasonable, MAIB's solvency target of 120%-145% (with a mid-point of 132.5%), along with other elements of the capital framework, results in a financial position which is toward the upper end of those typically adopted by government owned CTP schemes. This reflects the relatively small size of the MAIB; the strong desire to maintain funding above 100%, the desire to continue to provide dividends to the Government and the relatively limited impact that any premium rate response to adverse experience would have on the overall funding position (noting that annual premiums are only around 15% of outstanding claims).

The dividend policy of 50% (currently 60%) of the rolling average of the last 5 years' profits provides a further layer of conservatism. As the dividends are not paid immediately if, between when the profits emerge and the dividend is paid, the solvency of the scheme were to deteriorate materially, there may be an opportunity for MAIB and the Government to revise any required dividends and thereby allow MAIB to maintain solvency in its target range. While we understand that this would not be desirable from either MAIB's or the Government's perspective, it is a potential protective mechanism if claims or investments were to deteriorate in a catastrophic manner.

On the whole, the strength of MAIB's financial position significantly protects motorists from the risk of a future material increase in premiums. In making this observation we note that assets are currently around \$500 million higher than the balance sheet value of the liabilities, and even further in excess of the expected future cost of claims when discounted at the expected future rate of investment earnings.

Profit Margin

MAIB's projected profit margin of 10% to 13.5% generates a return on capital of between 7% and 8% after tax which appears reasonable for a Government insurer. This return on capital is materially lower than in the private sector where insurers would typically target a return on capital in the order of 10% to 15% (after tax). In this context MAIB's return on capital appears reasonable for a Government insurer.

In our experience Government CTP insurers typically target profit margins in the range 6% to 12%.

While the target profit is reasonable, we note that it is not explicitly linked to the financial position of the Scheme. In some other schemes, the Board has the ability to vary the profit margin to reflect factors outside the immediate break-even premium consideration, such as the desire to build or release capital, or to take account of some external event. This may be a policy that MAIB could consider in the future.

As noted above, MAIB is in a strong position, with a conservative financial framework. Given this framework (and assets more than \$500 million in excess of liabilities), it would be possible to adopt a lower target profit while still maintaining a suitable level of solvency.

Regardless of this issue, we are comfortable that the premium increases recommended by MAIB are not unreasonable.

Superimposed Inflation

The rate of superimposed inflation adopted in MAIB's break-even premium is:

- Future care claims 0.00% p.a.
- Common law claims 1.50% p.a.
- Scheduled benefits 1.50% p.a.

These assumptions are consistent with MAIB's claims experience and in line with ranges we have observed in other jurisdictions (aside from Future Care). While the Future Care rate is lower than we have observed in other jurisdictions, it is consistent with MAIB's own experience. We note that a separate allowance has been made for the ongoing impacts of the FWA decision in 2012. We are satisfied that the superimposed inflation rate assumptions are reasonable.

Investment Return Margin

In our opinion, the discount rates adopted by MAIB for setting premiums and for valuing outstanding claims are appropriate. MAIB incorporate an anticipated investment return to set premiums. The anticipated investment return is consistent with the expected long run future average return associated with their strategic asset allocation. For outstanding claims, a 'risk free' discount rate to value outstanding claims.

The 'real rate of return' is the difference between claim cost inflation and the investment return. In the context of MAIB the real rate of return has historically been considered as the assumed rate of return above Average Weekly Ordinary Times Earnings (AWOTE).

The assumed real rate of return in the MAIB Submission is 3% pa which is unchanged from the previous Pricing Investigation. We are satisfied that the selection of a 3% p.a. real rate of return is not unreasonable for MAIB.

Other Observations

In addition to its overall submission on premium rates, MAIB have made a number of recommendations in relation to premium relativities. We consider these changes to be sensible and reflective of experience.

4 Reliances and Limitations

Our reliances and limitations are an important part of this report and are shown in Section 8.

Part II Detailed Findings

1 Introduction

The Treasurer has requested that the Tasmanian Economic Regulator (the Regulator) conduct an investigation into the Motor Accidents Insurance Board's (MAIB's) pricing policies. The pricing investigation covers the four year period from 1 December 2017 to 30 November 2021 and will be the seventh investigation carried out by the relevant Tasmanian Regulator. The previous investigation was conducted in 2013 by the Regulator and covered the four year period from 1 December 2013 to 30 November 2017. The former Government Prices Oversight Commission (GPOC) conducted five investigations prior to that.

To assist with the pricing investigation, the Regulator has commissioned Finity Consulting Pty Limited (Finity) to prepare this report. This is the second such review commissioned by the Regulator and completed by Finity. We understand that this report may be made publicly available.

1.1 Background to MAIB

The MAIB scheme provides funding for payments to all persons injured in motor vehicle accidents involving Tasmanian-registered vehicles or accidents in Tasmania involving interstate motor vehicles. It is a state government run enterprise and the scheme provides benefits on a no fault basis with common law access.

The liabilities of MAIB are very long term in nature, with benefits potentially paid for the life of catastrophically injured claimants. This presents particular challenges as changes in experience can potentially affect many past accident years. The leveraged effect of changes in underlying economic conditions can also cause financial results to be volatile from year to year.

Since the previous pricing investigation, MAIB's Funding Ratio has increased to around 128% (compared to 118% at June 2012), which is comfortably within the target funding range. This reflects favourable claims experience and strong investment returns over the past four years.

For the pricing investigation, the Regulator has received a Submission from MAIB which provides an overview of the MAIB operating environment and also provides an analysis of premium.

Appendix B of this report includes further information about the financial performance and portfolio experience of MAIB.

1.2 Scope

Our advice to the regulator is required to address the following matters:

- *Financial Targets:* Targets including items such as solvency rates, prudential risk margin on outstanding liabilities and liability adequacy test level. While not explicitly mentioned in the scope, we have also included an examination of dividend policy in our analysis
- *Insurance Profit Margin:* The appropriate insurance profit to determine the average premium for a government owned compulsory third party (CTP) insurer.
- *Superimposed Inflation:* The rates of superimposed inflation above Australian Average Weekly Ordinary Time Earnings (AWOTE) for claims inflation.
- *Investment Return Margin:* Investment return margin methodology and level.

While each individual matter is important, they are by their nature intertwined. For example, higher profit margins help to build or maintain solvency, as well as the scheme's ability to pay dividends.

We have therefore taken a holistic view when considering these matters.

1.3 Information

The sources of information we relied upon for this review are documented in Appendix A.

1.4 Financial Objective of MAIB

MAIB aims to ensure that a balance exists between premium income, claim costs and achieving a sustainable commercial rate of return that maximises value for the State.

There are no 'optimal' financial settings to achieve this objective, as different settings will tend to favour one group of stakeholders over another. However, an 'acceptable' set will strike an appropriate balance between the needs of MAIB, motorists, claimants and the Tasmanian Government.

This objective should also be considered in the context of the governance structure under which it operates. The key pieces of legislation that govern MAIB include:

- The Motor Accidents (Liabilities and Compensation) Act 1973
- The Government Business Enterprises Act 1995
- The Economic Regulator Act 2009.

In addition to the legislation outlined above, MAIB are subject to accounting standards and comply with AASB 1023. Details of the framework can be found in Appendix B.

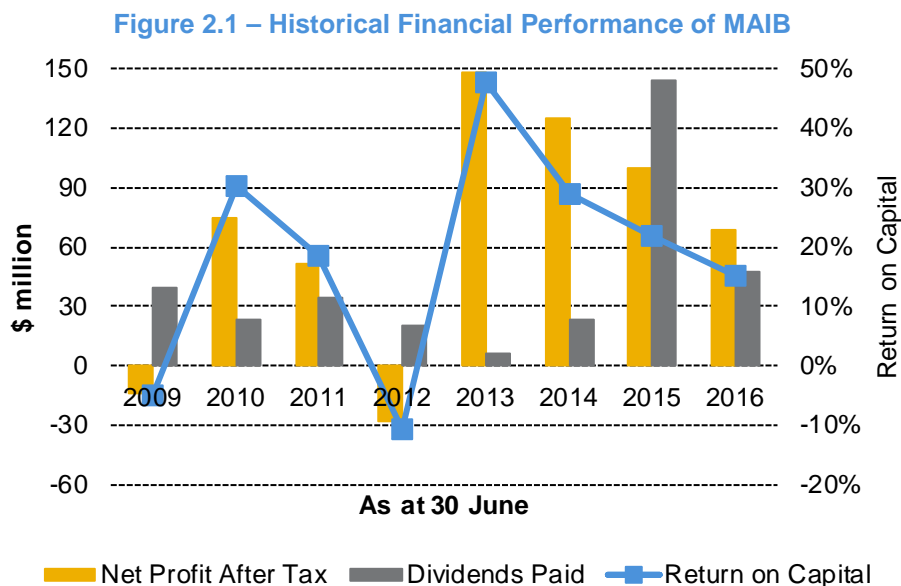
2 MAIB's Historical Financial Performance

This section provides a short summary of the recent historical financial performance of the MAIB and a comparison to interstate premiums. It is included to assist the reader in understanding our conclusions regarding MAIB's Pricing Submission.

2.1 Financial Performance

In the four years since the previous pricing investigation, MAIB delivered outcomes consistent with its financial strategy settings. Its strong financial performance has been driven by reductions in claim related liabilities and above-target investment returns (with the exception of 2015/16). Key financial results (shown in Figure 2.1) are as follows:

- Investment returns have averaged 10.3% p.a., which is 4.6% above target.
- NPAT has averaged \$111 million (ranging from \$69 million to \$148 million)
- Dividends to the Government have averaged \$30 million (with a range of \$6 to \$48 million). A one-off Special Dividend of \$100 million was paid to the Government in 2014/15 reflecting MAIB's strong financial performance.
- Return on capital (ROC) over the period has averaged 28.3%, above the guidance issued by Treasury for Government Business Enterprises (GBEs).



The key features of MAIB's claims and financial experience include:

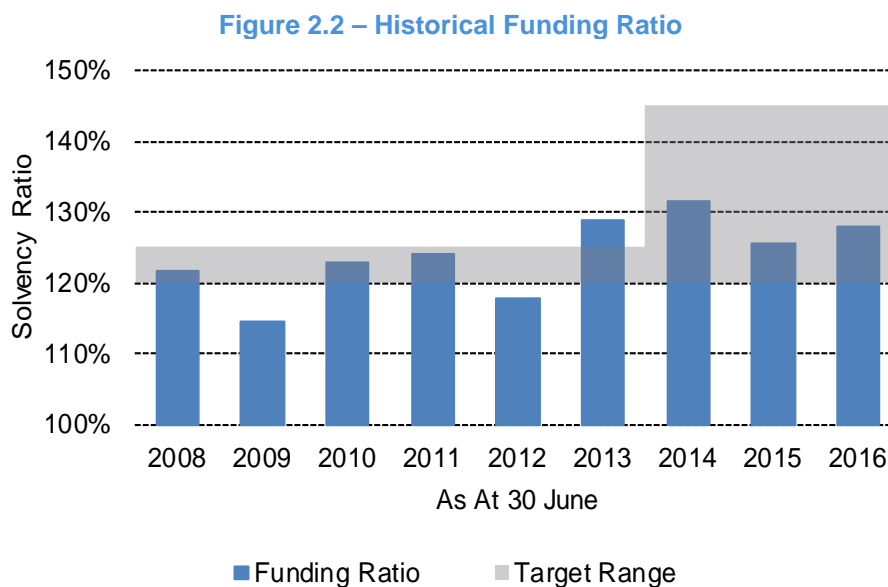
- Continued reductions in the claim frequency, with a record low in 2016, despite steady growth in the number of registered vehicles in Tasmania.
 - ▶ Fewer new Future Care claims.
 - ▶ Closures on existing Future Care claims due to higher than expected mortality.
 - ▶ Reduction in Common Law claim numbers.

- A recent resolution of the long standing discussions regarding the hospital bed day rate, which will result in substantial increases in the coming few years. This has been fully reflected in both the outstanding claims and the premium projections. In our view, this is a positive development, as it has removed a level of uncertainty previously included in the MAIB forecasts.
- Lower bond yields, which have resulted in increases in claim liabilities.

2.2 Solvency

The Funding Ratio¹ is a key measure of MAIB's financial performance and is defined as

Funding Ratio: the ratio of assets (less non claim related liabilities, deferred dividends and net deferred tax assets) to outstanding claims and premium liabilities. The historical Funding Ratios are shown below.



Section 3.1.3 discusses the change in the target Funding Ratio that has occurred since the previous investigation.

Over the past nine years, the Funding Ratio has fluctuated between 115% and 132%, and averaged 124%. It has only been below the target range twice (in 2008/09 and 2011/12) due to a poor investment return environment (including the impact of the GFC) and low discount rates increasing the value of claims liabilities.

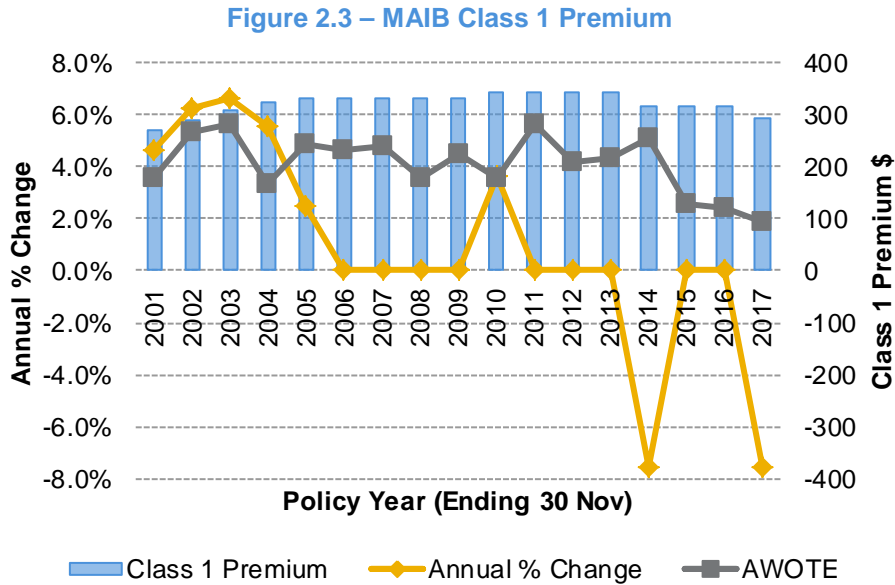
The strong financial performance over the past four years resulted in a Funding Ratio higher than historically observed, although comfortably within the target range. The small reduction in 2014/15 was due to the payment of a one-off Special Dividend of \$100 million to the Government.

The Funding Ratio at 30 June 2016 was 128% and is forecast to increase to around 136% for the next four years as a result of forecast investment returns and higher discount rates.

¹ MAIB's measure of capital adequacy has changed over time. A similar Solvency Ratio measure was used prior to 2013/14, which was the ratio of net assets (less deferred dividends and tax) to outstanding claims. The current Funding Ratio definition is more consistent with practices in other jurisdictions and will be adopted for the remainder of this report.

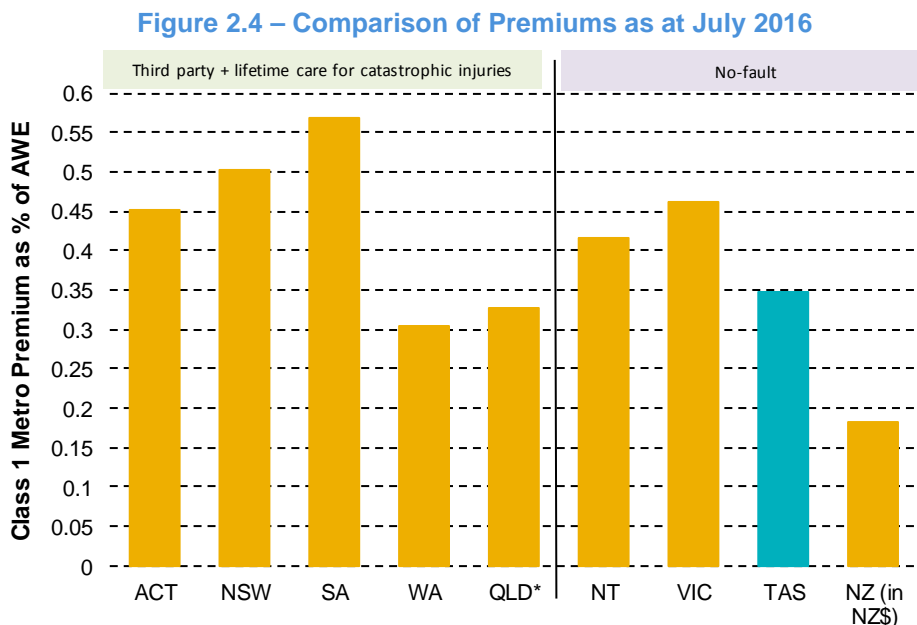
2.3 Class 1 Premiums

Premiums vary in response to the particular circumstances in each year. The historical Class 1 premiums are shown in Figure 2.3 (source: MAIB submission: Appendix 1)



Improving claims experience has meant that premium increases have been kept to well below AWOTE increases. The chart above shows that since the 2005 policy year, there has only been one premium increase (equal to the maximum allowable amount of AWOTE inflation), with other years experiencing no change or decreases in response to reducing claim frequency. In other words, premiums have decreased in real as well as absolute terms. The current Class 1 premium (\$294) is the lowest since the 2001/02 policy year.

The chart below compares Tasmania’s premium to other CTP schemes around Australia as at July 2016. Care should be taken in comparing premiums, due to the different benefits offered in each state.



The chart above shows that the current MAIB Class 1 premium is around 35% of AWE: a competitive position relative to other jurisdictions around Australia. It is considerably lower than the other two no fault schemes in Australia (NT and Vic), reflecting in part the nature of the Scheduled Benefits offered.

3 Financial Targets

Capital in excess of a minimum solvency level provides a financial buffer against adverse outcomes and funding for strategic investments. Higher solvency provides a greater degree of financial sustainability, although it may be seen as an inefficient use of financial resources.

This section considers:

- The appropriate target Funding Ratio for MAIB, giving consideration to both the framework around the minimum level of assets to hold
- The dividend policy currently in place for MAIB
- The appropriate risk margin and its associated probability of sufficiency.

We have included, where appropriate, comparisons to other jurisdictions around Australia and New Zealand.

3.1 Solvency

3.1.1 Solvency Considerations

Setting solvency and profit targets should generally consider the following:

- Measurement of capital and definition of a 'poor' solvency position.
- Risk tolerances associated with capital levels and solvency volatility.
- The variability of the business, including claim costs and investment returns.
- Risk tolerance to remedial actions such as expenditure cuts, premium increases, benefit changes, dividend holidays and legislative reforms.
- Acceptable time horizon to recover from a 'poor' solvency position.
- Preferred level of dividend or return on capital.

Trade-offs exist between these aspects, and holding these in tension is a key consideration.

3.1.2 Solvency for Government Insurers

The Australian Prudential Regulation Authority (APRA) sets minimum prudential capital requirements for authorised private insurers. While the APRA framework provides a useful comparison point, there are a number of reasons why Government insurers are able to operate at a lower level of capitalisation than required by an APRA authorised insurer underwriting the same risks. These reasons include:

- Government insurers are not subject to APRA regulation. They are permitted to continue in business whilst technically insolvent and fund the deficit "post-event".
- The Government is (generally) able to contribute additional capital to the insurer if necessary.
- Liquidity is not generally an issue. Government insurers' liabilities tend to be long-tailed and are not going to be paid in the short term, so there is time to recover from any poor performance.
- A captive client base means that they can increase premiums without fear of losing business.

- Most stakeholders may see an over-capitalised Government insurer as an inefficient use of financial resources. For example, policyholders (motorists) would prefer to have excess capital returned to them by way of lower premiums. The Government may prefer to direct funding elsewhere, such as state infrastructure.

MAIB's solvency target does not have reference to APRA's capital standards. In our view, this is appropriate, reflecting the government owned status of the MAIB. The solvency target and range seeks to strike a balance between the desire for financial stability, whilst not overcapitalising a state owned entity.

Government owned schemes generally do not follow the APRA capital framework when determining the target level of capital, although it may provide guidance about the upper and lower bounds of the framework, as well as different factors to consider when building up the framework.

Benchmarking to APRA Standards

While APRA standards are a useful comparison point, given the different nature of Government schemes, including the potential for the Government to provide additional capital, we are of the view that other solvency benchmarks may be more appropriate.

3.1.3 MAIB's Solvency Framework

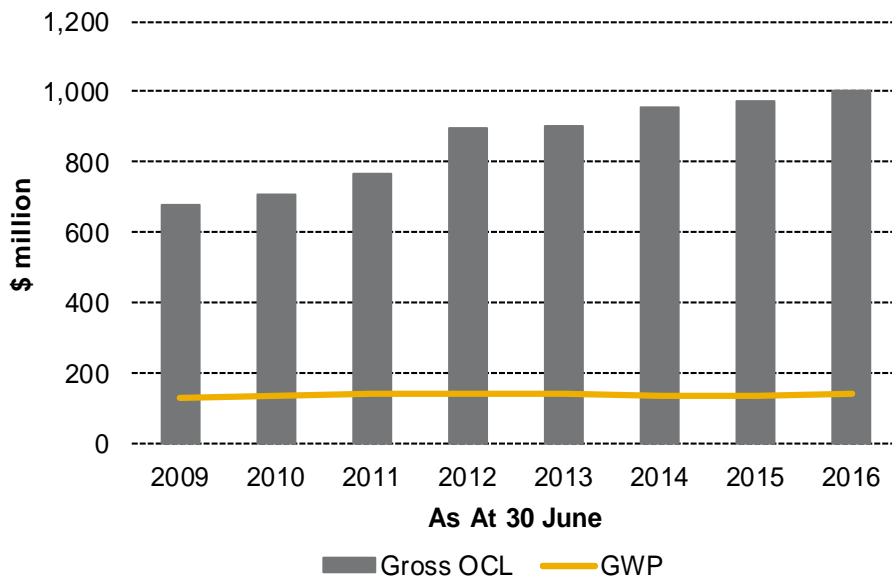
The Funding Ratio is a key measure of MAIB's financial performance and is defined as

Funding ratio: the ratio of assets (less non claim related liabilities, deferred dividends and tax) to outstanding claims and premium liabilities.

A ratio greater than 100% implies that assets available to meet claims exceed the outstanding claim and premium liabilities.

While falling below 100% at a point in time is not disastrous, it is a level at which a reasonable stakeholder would identify financial and reputational risk (particularly as a government entity). MAIB also has a significant aversion to falling below 100% due to its limited ability to remediate a poor financial position. Reasons for this include:

- The scheme's long-tail nature means that the annual premium pool is only a small proportion (around 15%) of the outstanding claim liabilities, as illustrated in Figure 3.1. Any premium increases or movements in profit margin would have little impact on the Funding Ratio. The balance sheet is much more sensitive to movements in discount rates and investment returns.
- Annual premium increases are restricted by the Regulator.
- Dividend reductions below the 'standard formula' are subject to Government agreement.
- Legislative changes and benefit reductions may be difficult to achieve in a short period of time.

Figure 3.1 – Gross Written Premium versus Outstanding Claim Liabilities

Since the previous pricing investigation, MAIB has conducted a detailed review of its funding range and target solvency utilising Dynamic Financial Analysis (DFA). This work was completed in 2014 by MAIB's actuary, Taylor Fry, and specifically considered the potential volatility in MAIB's financial settings. This DFA review was in line with our recommendation from the previous investigation.

As a result of this analysis, MAIB's target funding range was broadened from 120%-125% to 120%-145%. The target funding ratio is therefore 132.5% (the midpoint).

The Board accepted a Funding Ratio of 120% as the bottom of the target range as it provided an appropriate degree of confidence (defined as greater than 85% probability) that MAIB would not fall below a ratio of 100% after five years. This lower funding bound is relatively high but not unreasonable in the context of MAIB's aversion to falling below 100%.

The Board determined the width of the target funding range based on the probability of remaining within the range. A broader range better reflects the potential variability in investment returns and discount rates, as well as movements in the Funding Ratio under normal operating conditions. By widening the range to 120%-145%, there is a 67% probability that the funding ratio would remain within range after five years (having commenced at the midpoint of 132.5%). The midpoint or upper end of the range was not explicitly chosen with reference to the probability of falling below 100.

We understand from discussions with MAIB that if the Funding Ratio were to breach the bottom of the target range (i.e. fall below 120%), MAIB would review the reasons for the breach and then decide if corrective action were necessary. To date, no formal policy has been developed on actions to be taken if the Funding Ratio were to fall outside the target range.

We note that there is no documented risk tolerance, but we understand that further work on the risk appetite/tolerance will be taken in the next 12 months and we support this. This work will help MAIB and the government to better understand the appropriate policy framework for MAIB in the long term, and the implications on their financial targets.

3.1.4 Other Jurisdictions

The solvency frameworks and targets for other Government insurance entities are shown in Table 3.1 below. It is important to bear in mind that a number of these schemes (SA MAC, and ICWA) have liabilities that are much 'shorter tail' in nature than MAIB.

Table 3.1 – Solvency Frameworks and Targets

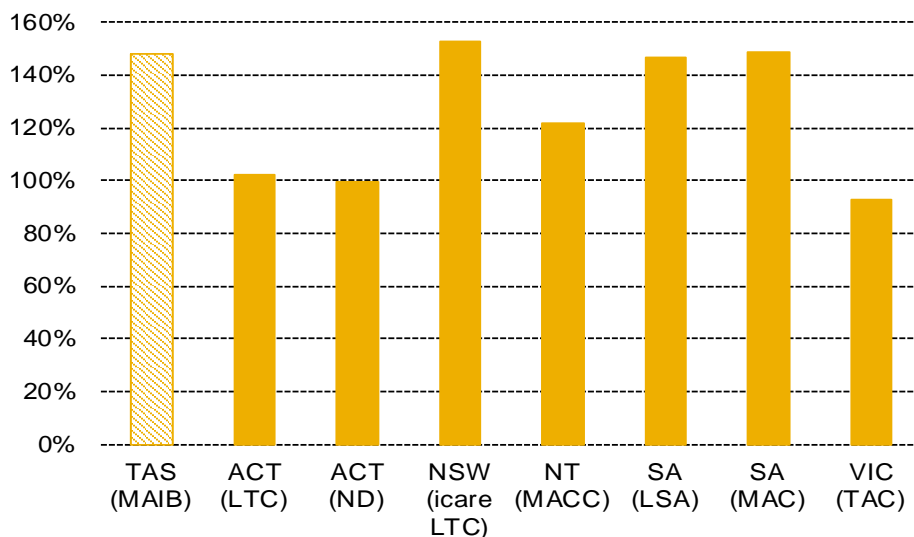
Entity	Funding Ratio Measure	Target Funding Range
TAS (MAIB)	Assets (less non claims liabilities, tax, deferred dividend) to Net OSC and PL	120% to 145% (Target 132.5%)
NSW (icare LTC)		>120%
NT (MACC)	Retained Earnings to Net OSC	
NZ (ACC MV)	Assets to Net OSC	100% to 110%
SA (LSA)	Investment Assets to Net OSC	>65% PoS (i.e. approx. 135%)
SA (MAC)	Assets to Liabilities plus 10% of Net Claims Liabilities and Equity/Property Investments	>100%
VIC (TAC)	Net Funding Assets to Net OSC	80% to 100% (Target 100%)
WA (ICWA)	Assets to Liabilities	>125% (Target 135%)

The TAC in Victoria is the most similar scheme to MAIB in terms of benefit structure and liability profile. It provides no-fault coverage, Common Law lump sums and long term care for the catastrophically injured. It also invests primarily in growth assets. While it targets a Funding Ratio of 100%, it has a broader funding range (40%) that allows it to be effectively underfunded.

MAIB's target Funding Ratio is broadly comparable to other Schemes, although overall is at the conservative end of the spectrum. Given the relatively smaller scale of MAIB, and the high proportion of liabilities associated with Future Care claims, this is not unreasonable.

Figure 3.2 shows the ratio of **total assets to the net outstanding claims liability and unearned premiums** for other Government entities as at 30 June 2016. We use this ratio as a proxy for solvency rather than adjusting for the definitional differences in funding ratios outlined above. This highlights the relatively conservative financial position of MAIB.

Figure 3.2 – Ratio of Total Assets to the Net Outstanding Claims Liability



Solvency Targets

The current target funding range of 120% - 145% represents a reasonable range for an entity such as MAIB, with significant exposures to both liability and asset risk. It reflects an aversion to falling below a Funding Ratio of 100% and a desire to remain within the target range.

3.2 Dividend Policy

Dividends paid to the Government increase solvency risk and it is possible for payments to drive solvency below preferred levels. However, we see this as low risk compared to underlying scheme volatility outcomes.

For MAIB, the long term dividend is calculated as 50% of average annual after tax profits and losses over the current and four preceding years. The dividend payout was temporarily increased to 60% from 2013/14 to 2015/16. As the dividends are not paid immediately if, between when the profits emerge and the dividend is paid, the solvency of the scheme were to deteriorate materially, there may be an opportunity for MAIB and the Government to revise any required dividends and thereby allow MAIB to maintain solvency in its target range. While we understand that this would not be desirable from either MAIB's or the Government's perspective, it is a potential protective mechanism if claims or investments were to deteriorate in a catastrophic manner.

This dividend policy results in lower volatility dividends compared to a payout ratio linked solely to a single year's profit result. The largest drivers of profit (and therefore dividend) volatility are investment return and the impact of changing discount rates on claim liabilities, but the averaging approach smooths dividends through market cycles and results in a less volatile solvency outcome. However, we note that this policy does allow payment in a loss making year, increasing solvency risk.

In our view, there is a sensible compromise between the requirement of the Government for dividends and the need to recognise short term volatility impacts in the balance sheet due to external forces (predominantly investment market conditions).

3.2.1 Other Jurisdictions

Dividend policy for government insurers varies around the country, with some states not requiring a dividend, while others require a dividend at the Minister's discretion or based on Profit from Insurance Operations (i.e. excluding investment fluctuations). This is summarised in Table 3.2 below. In addition to dividends some schemes (but not all) also pay tax equivalents to the relevant state government.

In the case of TAC in Victoria, the dividend may be adjusted upwards or downwards to ensure that the scheme's funding ratio remains within the target funding range. No such mechanism currently exists for MAIB, but is a possibility if the Board desires an additional lever to remediate a poor financial position and a greater probability of remaining within the target range.

Table 3.2 – Dividend Policy in Other Jurisdictions

State	Scheme	Income Tax/Tax Equivalents	Dividends or Dividend Policy
TAS	MAIB	Yes	Dividends calculated as 50% (currently 60%) of the average of after tax profits and losses over the current and preceding four years, i.e. average over 5 years.
	TRMF	No	No dividends paid in recent years (policy not available)
VIC	TAC	Yes	TAC and Worksafe pay a dividend and make capital repayments as determined by the Treasurer having regard to funding levels and profitability (50% of 'performance from insurance operations').
	WorkSafe	Yes	TAC also contributes significant capital to road safety infrastructure. In years where WorkSafe has had very large surpluses, these have been returned to employers through reduced premiums.
	VMIA	No	Dividend of \$72.5 million paid in 2015/16 (policy not publicly available).
NSW	TMF	No	TMF operates within the Department of Treasury with net assets in excess of the required level paid to the Crown and net assets in deficit covered through payments from the Crown.
	WorkCover	No	In recent years, scheme reforms have material reduced claims costs, with these savings being returned to employers through lower premiums.
QLD	QGIF	No	QGIF operates within the Department of Treasury and funds held at a whole of government level so no dividends.
	WorkCover	Yes	No dividends paid in recent years (policy not publicly available).
SA	Return to Work SA	Yes, if FR > 100%	No dividends paid in recent years (policy not publicly available).
	MAC	No	Dividends in excess of \$1.2 billion announced over last 2 years (policy not publicly available).
	SAFA	Yes	No dividends paid in recent years (policy not available publically).
WA	ICWA CTP	Yes	Dividends calculated as 4% of net equity.
	RiskCover	No	RiskCover operates with the Department of Treasury (policy not publicly available).

Dividend Policy

The current dividend policy for MAIB represents a sensible compromise between the Government's requirement for dividends and the need to recognise short term volatility impacts in the balance sheet (predominantly investment market conditions).

3.3 Risk Margins

Both the outstanding claim and premium liabilities in MAIB's Funding Ratio calculation include a risk margin in addition to the central estimate of future claim costs and claims handling expenses. The additional margin increases the probability that the liability will be sufficient to cover future payments that fall due.

At the previous pricing investigation, we recommended that MAIB undertake a risk margin review to clarify the probability of sufficiency (PoS) associated with MAIB's risk margin allowance. In May 2016, Taylor Fry completed this review based on analysis of MAIB's risk profile and historical claims variability. The current risk margin of 20% on the outstanding claims liability provides a PoS in excess of 75% (although not materially so). In our view, this PoS is relatively high but is not an unreasonable target.

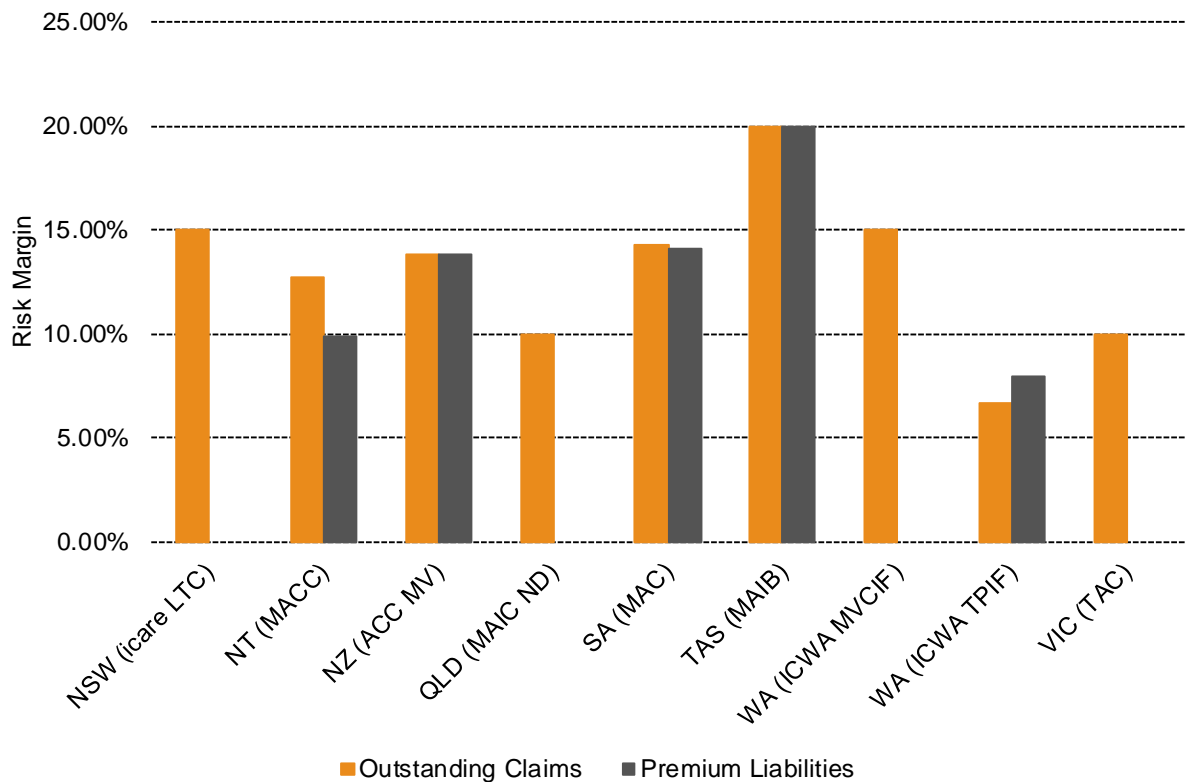
As discussed above, MAIB holds additional capital above the risk margins to act as a further buffer against adverse claim outcomes.

3.3.1 Other Jurisdictions

APRA authorised insurers are required to hold risk margins at a minimum of 75% PoS. Government schemes are not subject to this requirement but most adopt a 75% PoS, with the exception of MAC in SA (80% PoS). Lifetime Care in NSW do not hold a risk margin but provide an indicative risk margin at a 75% PoS of 15%.

The risk margins of other relevant entities are shown in Figure 3.3.

Figure 3.3 – Risk Margins of other relevant entities



MAIB's risk margin for its outstanding claims liability is higher than that of similar schemes in other jurisdictions. This reflects both a higher adopted PoS (in excess of 75%) and the fact that a smaller scheme such as MAIB will have fewer claims and tend to experience more claims variability, resulting in a higher risk margin at a given PoS.

The risk margin associated with an insurer's premium liabilities is generally higher than that of the outstanding claims for the same probability of sufficiency. The reason for this is the greater uncertainty of events surrounding future claims that have not yet occurred. MAIB currently adopt the same risk margin for premium liabilities, implying a lower probability of sufficiency on the premium liabilities, as compared to the outstanding claims liabilities. We are aware of other (private) insurers who adopt a similar approach and do not consider it be unreasonable.

Risk Margin

The 20% risk margin adopted by MAIB provides a level of sufficiency in excess of 75%. While this is ultimately a question for the Board of MAIB, we note that many other equivalent schemes adopt a probability of sufficiency of 75%.

3.4 Liability Adequacy Test (LAT)

The LAT is required under the Australian Accounting Standard AASB 1023 and compares:

- The present value of the expected future claims costs net of reinsurance, plus an allowance for claims handling expenses and a risk margin, that will be incurred after the balance date arising from policies issued prior to the balance date; and
- The unearned premium liability less deferred acquisition costs.

The approach used to the estimation of the LAT by MAIB is consistent with good practice and appropriate to the nature of MAIB's risks.

3.5 Summary of Findings

As discussed earlier in this section, capital in excess of a minimum solvency level provides a financial buffer against adverse outcomes and funding for strategic investments.

MAIB's overall financial framework reflects the relatively conservative nature of the MAIB. The key elements of the financial framework include:

- target funding range of 120% - 145%
- a small (less than 15%) chance of falling from the bottom of the current range to 100% accounting solvency over a 5 year period
- payment of dividends of 50% of the rolling average of 5 years' profits, including implicitly reserving for future dividends within the current funding position calculation
- a claims liability risk margin intended to secure at least a 75% Probability of Sufficiency
- long term asset allocation of around 65% allocation to growth assets
- discounting of liabilities at risk free rates (in accordance with the accounting standard), while investments are expected to earn interest at a higher level.

This financial conservatism is not unreasonable given the desire for the Board (and Government) to have only a low probability of falling below a Funding Ratio of 100%, and the requirement to pay dividends of 50% of after tax profits, as well as tax equivalents. It does however provide significant buffers against adverse future experience (investment or claims related) and the likelihood that a significant premium correction (i.e. an increase above AWOTE) would ever be needed is therefore very low (probably more so than other comparable entities).

4 Insurance Profit Margin

According to industry best practice, the total required premium should be built up using the central estimate of each premium component. There should be no conscious bias in the claim, expense or investment return assumptions, and any margin above the central estimate is shown explicitly. MAIB adopt this approach to premium settings.

The actual premium charged includes:

- **Break-even premium** – Expected claim costs inflated and then discounted to allow for future investment earnings on the premium, plus expenses related to administering insurance operations.
- **Profit margin** – This should cover the risks associated with providing insurance and provide for an appropriate rate of return to be earned on the capital supporting the business (as required by the GBE Act).

4.1 Profit Considerations

The considerations underlying the choice of profit margin are similar to those for solvency. The profit margin should balance pressure to keep motorists' premiums low, with solvency and dividend requirements. Lower profit margins (and therefore premiums) are favourable from a motorist's perspective but are associated with higher risk.

The choice of margin impacts a scheme's ability to sustain the preferred level of dividends, and should therefore make reference to dividend policy. This is easiest when dividend policy is framed in terms of a proportion of premium or a return on capital.

Profits can, to a degree, support a scheme's ability to absorb solvency volatility and recover from a poor financial result. While future premium increases are possible, they are not immediate and tend to be an insensitive lever.

Profitability is highly sensitive to variations in investment returns. If returns are 1% p.a. lower than expectations, this will reduce the implied profit margin in the coming year from 10.5% to 5.0%.

Both APRA and accounting standards stipulate how to measure assets, liabilities and therefore the level of profit in annual accounts. This version of profit relies on the use of discount rates at a point in time, rather than the expected long term returns on assets. We note that in some jurisdictions (particularly Victoria) an alternative measure of profit and solvency is used, which utilises long term economic returns, rather than results presented in the accounts (often called the economic funding position). We do not propose that MAIB adopt an alternative approach to measuring profit that departs from generally accepted principles.

4.2 MAIB's Profit Margin

MAIB targets a profit margin of 10% of premiums, which is projected to generate a 6% return on capital (defined as the profit divided by capital). This is unchanged from the previous pricing investigation. We understand that this return on capital objective is broadly consistent with the expectations of Government.

Because premium stability is a key requirement for MAIB, its profit margin is implied by the premium charged rather than an explicit loading on the break-even premium or a particular return on capital objective. Premiums are generally indexed with inflation or remain unchanged unless the implied margin deviates excessively from target or additional income is required to remediate a poor financial position. The MAIB Submission provides two scenarios for future premiums from 1 December 2017 to 1 November 2021:

- **Scenario 1** – No premium indexation in 2017/18, with indexation (not exceeding AWOTE) thereafter. Implied profit margins are projected to increase from 10.5% to 12.5% over four years, mainly due to expected reductions in claim frequency.
- **Scenario 2** – Premium indexation (not exceeding AWOTE) from 2017/18 onwards. Implied profit margins are projected to increase from 13.1% to 15.0% over four years, well above the target.

The MAIB Submission has recommended Scenario 1. This produces profit margins close to target and allows flexibility to increase future premiums in line with claims inflation, noting the following potential risks to future premiums:

- Claim frequency improvements are uncertain
- Uncertainty around the NIS roll out, which is expected to increase care costs
- Future Care claim experience is uncertain
- Volatility in investment markets and bond yields

Adopting Scenario 1 may not necessarily result in actual increases if experience is better than or as expected.

The return on capital generated by the annual premiums in Scenario 1 is expected to increase from 6.2% to 6.7% over four years, assuming a target funding ratio of 132.5% (the midpoint of the current target range). This is lower than the projected return on capital in the previous Submission due to a lower profit margin, higher target funding ratio and lower valuation discount rate.

4.3 Relationship between profit margin and financial position

While the target profit is reasonable, we note that it is not explicitly linked to the financial position of the Scheme. In some other schemes, the Board has the ability to vary the profit margin to reflect factors outside the immediate break-even premium consideration, such as the desire to build or release capital, or to take account of some external event. This may be a policy that MAIB could consider in the future.

As noted above, MAIB is in a strong position, with a conservative financial framework. Given this framework it would be possible to adopt a lower target profit while still maintaining a suitable level of solvency.

4.4 Other Jurisdictions

Government CTP insurers are generally long tail (longer than private sector CTP insurers who do not cover a Future Care component) and consider the investment return on assets backing the business. In our experience Government CTP insurers in Australia typically target a profit margin between 6% and 12%, although publicly available information is limited.

Private sector CTP insurers also target profit margins in that order, and even though they hold more capital to back the business we estimate these insurance margins generate a return on capital in the order of 10% to 15% after tax.

Although MAIB's target profit margin of 10% (and return of capital of around 6%) is comparatively lower than what a commercial insurer may seek, it is reasonable based on experience for other government CTP insurers and the strength of MAIB's financial position. Similarly, its projected profit margin generates a return on capital of between 6.2% and 6.7% after tax which sits below the lower end of our estimated range targeted by the private sector.

The November 2012 paper "Profit Margins in Regulated General Insurance Markets" by the Actuaries Institute profit margins working party presents a framework for establishing profit margins in regulated markets. The paper describes a "fair price" of a regulated product as "one that provides a sufficient, but not excessive, return to the capital provider". The principle of the discussion is that an entity's return on capital should be comparable with an entity with similar risks while maintaining sufficiency to attract capital. MAIB having a target return on capital lower than private sector CTP insurers would be consistent with this principle.

Profit Margin

The current target level of profit in premiums is intended to achieve a return on capital of around 7% after tax. This is materially lower than in the private sector, where insurers would typically target a return on capital in the order of 10% to 15% (after tax). In our view, the target profit of around 10% is reasonable, although lower profit margins would also be reasonable given the strength of MAIB's financial position

5 Superimposed Inflation

Superimposed inflation is:

- The tendency for benefits for a given injury to increase faster than a suitable standard measure of claims inflation (such as Australian AWOTE in the context of MAIB) or
- The increase in the total cost of compensation that has not been explicitly provided by the actuarial model(s).

Superimposed inflation often occurs in 'fits and spurts', with periods of benign claims inflation followed by shorter periods of more dramatic increase. It is important to not just consider what has occurred in the past, but also, importantly, what the outlook is.

The overall claims environment in Tasmania appears to have been benign for many years, with some modest increases over inflation over time.

5.1 MAIB Superimposed Inflation

MAIB's actuaries Taylor Fry have provided their most recent superimposed inflation investigation (based on data to June 2016) to support the assumptions outlined in the Submission.

Superimposed inflation is evident in MAIB's historical claim experience, and the current assumptions are:

- | | |
|----------------------|------------|
| • Future care claims | 0.00% p.a. |
| • Common law claims | 1.50% p.a. |
| • Scheduled benefits | 1.50% p.a. |

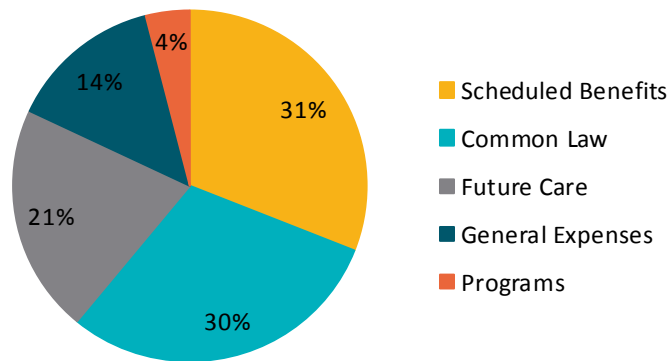
While the assumed rate for Future Care is 0%, additional allowance has also been made for the ongoing outworkings of the FWA changes from 2012. MAIB have negotiated rate increases with its providers which typically amount to increases of around \$0.98 per hour over and above CPI. These allowances are included in the assessment of future required breakeven premiums and are reasonable.

The assumed rate for Common Law was increased in 2014 from 0.75% p.a. to 1.50% p.a. following the decision in *Mercer v Allianz Australia Insurance Limited* in July 2013. The other rates have remained unchanged since the previous pricing investigation.

5.2 Benefit Types

The claim cost components of MAIB's break-even premium are shown in Figure 5.1 below.

Figure 5.1 –Cost Components



While the benefit types (excluding expenses and programs) make up similar proportions of the break-even premium, their mean terms are quite different. The discounted mean term of Scheduled Benefits is 5.2 years, Common Law 3.1 years and Future Care 20.9 years.

The nature of benefits paid, including likely duration and the ability to control claims costs are key elements in determining appropriate superimposed inflation assumptions. The observations made in the Taylor Fry investigation are summarised by benefit type below.

5.2.1 Scheduled Benefits

For Scheduled Benefits, trends in average claim sizes are analysed on a payment year basis and an accident year basis for comparison. This assumes that superimposed inflation is linked to when services are provided (i.e. when the payments occur) or when the accident occurred.

On a payment year basis, superimposed inflation over 1994 to 2016 has been around 0.2% p.a. on average. This analysis was based on payments within five years of accident, which represents the majority of Scheduled Benefit payment experience. While historical experience alone does not suggest a significant amount of superimposed inflation, increases in hospital bed day rates (discussed in Section 2.1) are expected to produce superimposed inflation of 1.6% p.a. by 2020. Analysis on an accident year basis is not inconsistent with these conclusions.

The assumed superimposed inflation rate for Scheduled Benefits has remained unchanged at 1.5% p.a. This reflects both historical experience and also that the immediate future will see significant increases in hospital bed day rates. The allowance for superimposed inflation therefore appears appropriate.

5.2.2 Common Law

Sources of superimposed inflation in Common Law settlement sizes include legal precedents and changes in rates used to discount loss of future earnings amounts. In 2014, the superimposed inflation assumption was increased from 0.75% p.a. to 1.50% p.a. due to the *Mercer v Allianz Australia Insurance Limited* decision in July 2013 and the *Civil Liability Amendment Bill 2013* were expected to result in cost increases. While higher settlement amounts have not yet materialised, it remains a risk in coming years and we consider this increase to be appropriate. This should continue to be monitored prior to the next investigation.

The approach to determining superimposed inflation for Common Law is similar to Scheduled Benefits. On a payment year basis, experience from 1994 to 2016 suggests superimposed inflation of 1.1% p.a. for finalisations within five years of accident (which form the majority of Common Law claims) and 1.9% p.a. for later finalisations.

Given the experience and the risk of higher costs following the *Mercer* decision, an allowance of 1.5% p.a. is not unreasonable. However, important considerations going forward include the impact (or lack thereof) of *Mercer* and the ongoing reduction in Common Law claim numbers. If experience continues to emerge favourably in the next few years, then a reduction in this assumption may be warranted. This would have a modest impact on the premium as a whole, given Common Law makes up only around 30% of overall break-even premiums.

5.2.3 Future Care

Superimposed inflation in Future Care may arise from increases in care needs or higher attendant care rates. The number of individual Future Care claims is very low (6 per annum) and therefore analysis of superimposed inflation is difficult to assess for this benefit type. In addition, Future Care claims have a considerably longer mean term than Scheduled Benefits or Common Law claims. This means that an examination of historical average claim sizes includes a considerable amount of estimation.

Care costs have exhibited superimposed inflation over the long term, ranging from around 0.5% to 1.0% p.a. However, this observation has been offset by the following:

- Superimposed inflation in care costs have been close to nil in recent years, suggesting improvements in MAIB's management strategies.
- Non-care costs have been reducing in real terms over time.
- Mortality experience has been heavier than expected, resulting in claim closures and lower ultimate claim costs. However, there have not yet been adjustments to mortality assumptions.
- The long term downwards trend in terms of claim numbers.

While the case could be made for more explicit modelling of a number of these elements which may result in the inclusion of an allowance for superimposed inflation, on balance Taylor Fry have adopted a rate of 0%, reflecting their expectation that these factors will be broadly offsetting. In our view, this is not unreasonable, although we would suggest that consideration be given to some additional granularity in modelling, particularly around mortality.

The FWA decision (discussed above) is considered a specific 'burst' of superimposed inflation which Taylor Fry has explicitly allowed for in projections and we consider this to be a reasonable response.

5.3 Other Jurisdictions

No two schemes exhibit exactly the same timing, quantum, duration and drivers of bouts of superimposed inflation. It is also worth noting that greater granularity in the modelling of benefits can sometimes result in lower assumed levels of superimposed inflation, as more elements of the claims process are captured, i.e. in some schemes superimposed inflation is used as something of a 'catch-all' for factors not specifically modelled. For this reason, care should be exercised when comparing the assumed rates of superimposed inflation in different schemes.

Several schemes indicate the level of superimposed inflation in annual reports and other public documents, which is summarised below.

Table 5.1 – Reported Superimposed Inflation

Government CTP Scheme	SI assumption at June 2016
TAS (MAIB)	1.5% p.a. for Scheduled Benefits 1.5% p.a. for Common Law 0% p.a. for Future Care
NZ (ACC MV)	Ranges from 1.0% p.a. to 5.9% p.a. based on benefit type and payment term
SA (LSA)	0.75% p.a. for Attendant Care 0.75% p.a. for Medical 1.25% p.a. for Brain Injury Medical
SA (MAC)	2.0% p.a.

In addition to the publicly available information, we are aware of the rates used in a number of other jurisdictions, which are broadly comparable to those shown above. We note that in recent years a superimposed inflation rate of around 3% pa has been used by NSW CTP insurers, despite the recent rapid increase in the number of small low value claims.

In our experience, typical ranges for superimposed inflation in Government schemes are:

- 0.75% to 1.5% per annum for Future Care (noting that specific 'life event' increases in care packages are factored in to the liability before SI is added on in many instances)
- 0.75-1.25% per annum for medical related services.

While it is unusual to have 0% p.a. for Future Care liabilities, the claims inflation experience of MAIB supports this assumption and, as noted above, may actually be offsetting some other modelled experience.

Superimposed Inflation

The rate of superimposed inflation adopted in MAIB's break-even premium is consistent with their claims experience, in line with ranges we have observed in other jurisdictions (aside from Future Care) and therefore does not appear unreasonable.

6 Investment Return Margin

Insurers are required to use expected future rates of return in the estimation of both outstanding claims and premiums.

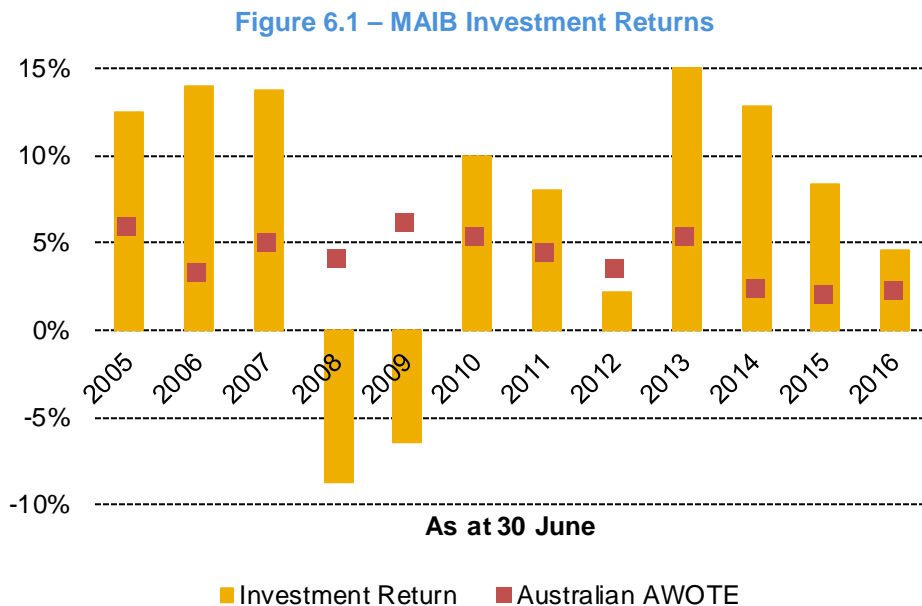
Accounting standards stipulate that outstanding claims should be valued using a 'risk free' discount rate based on Commonwealth Government bond yields.

There is more flexibility in the choice of investment return when setting premiums. The risk free rate does not recognise that MAIB expects to earn a higher rate of return on collected premiums over the life of the claims. Using the expected long term investment return to discount future claims costs passes the higher returns back to the motorists in the form of lower premiums.

6.1 Discount Rate used for Premium Rates

MAIB's break-even premium is the expected future payments discounted back to present time using an assumption of investment earnings on the premium collected. The discount rate is equivalent to the expected long term real return (i.e. the return above AWOTE) earned on its strategic asset allocation. Because a real return is targeted, investments are structured to minimise the net impact of changes in claims cost inflation on premiums or projected financial positions. This approach is appropriate.

The historical investment returns for MAIB compared to Australian AWOTE are shown in Figure 6.1 below.



The annualised real return since 2000 has been 2.9% pa, including the negative impact of the GFC during this period. Returns have been higher over the four years since the previous pricing investigation, averaging 10.3% per annum (7.6% above Australian AWOTE over this period and therefore 4.6% above target). The poor investment returns following the GFC and then during the economic downturn over 2011/12 resulted from MAIB's high exposure to the equity market and its volatility.

Current future expected AWOTE is 3.0% p.a. based on independent economic forecasts (forecasts for Australian AWOTE are used, as forecasts for Tasmania are less reliable). MAIB has adopted a long term “real” return of 3.0% pa to calculate its break-even premium (i.e. 3% over AWOTE), based on advice from its investment consultant Willis Towers Watson (WTW). This is unchanged from the previous pricing investigation in 2013 and reflects the profile of claim payments, capital policy, the current funding level and economic conditions. To achieve this return, MAIB has an investment strategy comprising 65% growth assets and 35% defensive assets.

In our view, the current selection of a 3.0% pa real rate of return is not unreasonable for MAIB, however WTW has indicated that there may be downwards pressure on this assumption in the future. We also note that in the short term there is uncertainty regarding the economic outlook over the next four years, particularly around the potential impact of Brexit and the recently elected Trump administration on investment markets and economic growth. Given the long mean term of the liabilities of MAIB this would not be expected, on its own, to have a material impact on the assumed rate of investment returns.

6.2 Discount Rate used for Outstanding Claims

In line with accounting standard requirements, outstanding claim liabilities are inflated and then discounted back to present value using ‘risk free’ discount rates as at the valuation date. Australian Government Bond yields are typically used to set risk free rates for up to 30 years. However, long term payments (such as Future Care) may fall due after the end of observable bond yields. A widely accepted approach is to adopt a discount rate at a fixed ‘gap’ above the assumed inflation rates beyond 30 years.

The MAIB Submission has projected a long term AWOTE assumption of 4.0% p.a. and a gap of 2.0% p.a., which suggests a long term discount rate of 6.0% p.a. We note that this risk free gap is not the same as the long-term expected investment return as per the pricing basis and potentially introduces a further layer of conservatism in MAIB’s balance sheet.

6.3 Benchmarks

It is difficult to compare long term expected returns in isolation from the allocation of the exposure to growth assets. The investment return assumptions available for other relevant schemes are shown in Table 6.1 below.

Table 6.1 – Investment Return Assumptions of Other Relevant Schemes

Scheme	Asset Allocation		Stated Long Term Investment Rate Assumption	Assumed Equivalent Long Term Investment Rate ^{1,2}
	Growth	Defensive		
TAS (MAIB)	65%	35%	Aus AWOTE + 3.0%	7.0%
VIC (TAC)	74%	26%	CPI over rolling 10 year periods + 5%	7.5%
WA (ICWA)	68%	32%	CPI over rolling 7 year periods + 3.5%	6.0%

¹ investment return expected over the term of the liabilities

² Assuming MAIB's forecast of 4% for AWOTE and 2.5% for CPI

Other CTP schemes in Australia and New Zealand are currently assuming similar real rates of return. In particular, TAC and ICWA each have growth allocations above 60% and assume rates of return of 7.5% and 6.0% p.a. respectively. MAIB's assumption of 6.0% is in line with these jurisdictions (and their respective strategic asset allocations).

Investment Return

The sources of information used by MAIB to set investment return assumptions are appropriate. The methodology adopted for discounting the claims-related components of the break-even premium and the outstanding claim liabilities is appropriate.

The rate of investment return used in setting premiums appears reasonable and based on external advice. It is reflective of the long term asset mix adopted by MAIB and is, in effect, allowing the benefit of the higher expected returns to flow to the motorist by way of lower premiums.

7 Other observations

In addition to our designated scope of works, as part of our discussions with MAIB, the Regulator, and State Growth, the question of changes to premium relativities for various vehicle types was raised.

In our view, the proposed changes to premium relativities reflect a pragmatic response to emerging experience. Table 7.1 summarises the proposed changes

Table 7.1: Proposed Premium Relativities

Class	Proposed relativity *	Proposed change in relativity
Motorcycles (Classes 4, 5 and 20)	1.70	Increase of 0.19
Taxi or Chauffeured Hire Cars (Class 6)	3.50	Increase of 0.10
Motor Trade Plate (Class 14)	1.00	Decrease of 0.06
Farm Tractor (Class 15)	0.30	Decrease of 0.08
Medium Passenger Vehicles (Class 16)	1.25	Decrease of 0.09
Small Motorcycle (Class 17)	0.60	Increase of 0.10
Off Road and Recreational Vehicle (Class 18)	1.00	Increase of 0.24
Special interest vehicles (Class 22)	0.25	Decrease of 0.07

One area of potential concern is the premium relativity for Taxis. The current experience suggests that premiums could increase materially. However premiums are already materially higher than for Class 1. MAIB have recommended a small increase in the relativity.

In other jurisdictions, the impact of Ride Sourcing (e.g. Uber) is currently the subject of discussion and consideration. There is currently little, if any, publicly available information in relation to the claims experience of Ride Sourcing vehicles. In its submission, MAIB have recommended that Ride Sourcing vehicles continue to be included in their current class (most likely Class 1) at the current time. In our view, this is another reason to exhibit a level of caution in relation to the premium charged for Taxis over the next projection period.

In addition, MAIB have suggested that it may be prudent to allow for an element of flexibility in relation to ride sourcing vehicles, so that if additional data were to become available across the premium outlook period, there would be an opportunity to review the premiums for these vehicles. Given the relatively small size of the current ride sourcing market in Tasmania, and the ongoing work in other jurisdictions we think this reflects a pragmatic approach to an emerging change in the market place.

8 Reliances and Limitations

8.1 This Report

This report is provided for the sole use of the Office of The Tasmanian Economic Regulator for the purposes stated in Section 1 of this report.

It is not intended, or necessarily suitable, for any other purpose. This report should only be relied on by the Regulator for the purpose for which it is intended.

We acknowledge that this report is being made publicly available, and should be provided in full. Inclusion of the report in any financial statement, prospectus, proxy statement, offering circular or other similar document, in full text or otherwise, or any oral report issued by the Regulator or by members of the Regulator is not allowed, unless we give our approval in writing.

Any third party receiving this report should not rely on it, and this report is not a substitute for their own due diligence. We accept no liability to third parties relying on our advice.

Please read the report in full. If you only read part of the report, you may miss something important. If anything in the report is unclear, please contact us. We are always pleased to answer your questions.

8.2 Uncertainty

Many things may change in the future. We have formed our views based on the current environment and what we know today. If future circumstances change, it is possible that our findings may not prove to be correct.

The financial position of the MAIB is dependent on a number of individual financial estimates, each containing uncertainty as to their ultimate outcome. These include, but are not necessarily limited to, estimates of future claims liabilities, premium volumes, loss ratios and investment returns.

As well as difficulties caused by limitations on the historical information, outcomes remain dependent on future events, including legislative, social and economic forces. We note the projections have not anticipated any extraordinary changes to the legal, social or economic environment (or to the interpretation of policy language) that might affect future premium volumes, the extent of coverage given by policies issued, the cost, frequency or future reporting of claims or the future course of investment markets. It is quite possible that one or more changes to the environment could produce a financial outcome materially different from estimates.

There is additional uncertainty associated with projecting financial outcomes into the future, not just as at the most recent balance date. For example, estimates of loss outcomes in respect of policies which have not yet been written and in respect of claims which have not yet occurred.

8.3 Data and Other Information

In developing this report Finity has relied extensively on historical data and other quantitative and qualitative information provided by, or on behalf of the Regulator.

We relied on the completeness and accuracy of the information we received. If the information provided to us is inaccurate or incomplete, please let us know as we may need to change our advice.

We did not audit or verify the information provided to us, but have reviewed it for general reasonableness and consistence.

This report and the results, opinions and conclusions herein contained are presented as at the date of the report set out in the covering letter and are based on information supplied in the MAIB Submission as at 20 February 2017. They may be rendered inaccurate by developments after these dates.

Part III Appendices

A Sources of Information

- MAIB Submission to the Regulator dated 20 February 2017
- Discussions with representatives of the following organisations:
 - ▶ The Regulator
 - ▶ MAIB
 - ▶ MAIB Actuary Taylor Fry Consulting
 - ▶ Department of State Growth
 - ▶ Department of Treasury and Finance
- MAIB Corporate Plan 2016
- Taylor Fry report “Dynamic Financial Analysis of Solvency Requirements” dated 13 February 2014
- Taylor Fry letter “Review of MAIB’s risk margin” dated 11 May 2016
- Taylor Fry letter “Superimposed inflation investigation” dated 7 October 2016

B Measurement of Capital and Solvency

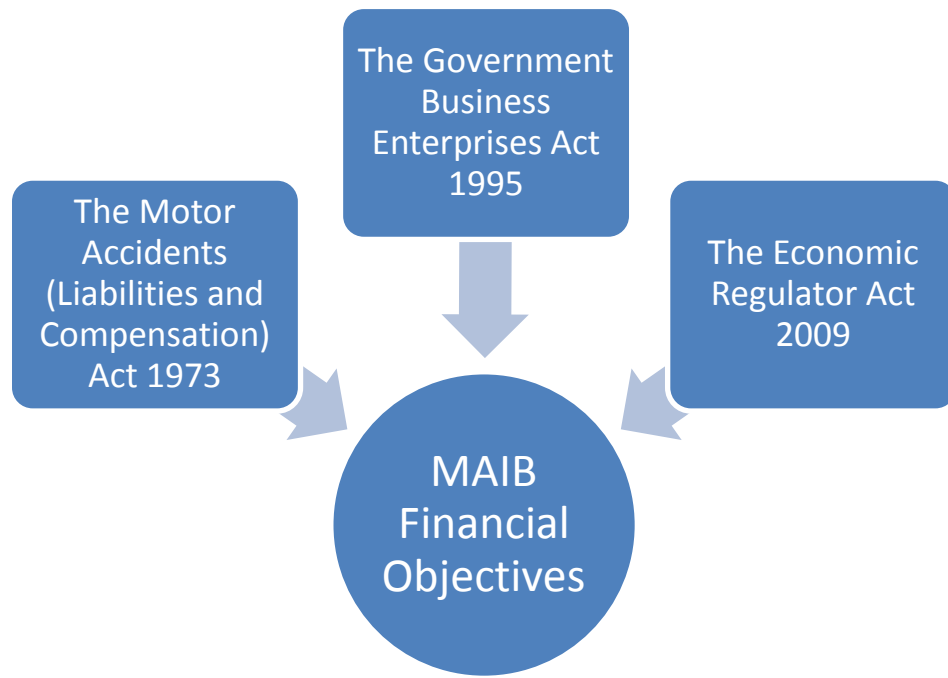
'Accounting' solvency calculates claims liabilities using a 'risk free' discount rate and includes a risk margin to increase the probability of meeting payments that fall due. This is consistent with accounting standards and is MAIB's current approach to measuring solvency.

'Economic' solvency uses the expected long-term investment return to discount liabilities, recognising that MAIB expects to earn significantly more than the risk free rate on its asset portfolio over time. It also excludes a risk margin allowance. This better reflects MAIB's expected long-term economic position and financial health.

C MAIB Governance Framework

The governance of MAIB is illustrated in Figure C.1

Figure C.1 - Governance of MAIB



C.1 The Motor Accidents (Liabilities and Compensation) Act 1973

The MAIB was established by the Motor Accidents (Liabilities and Compensation) Act 1973 (“MA Act”) and this Act outlines that its objectives are to:

- provide for the payment of compensation in respect of personal injury resulting from a motor accident; and
- allow the contribution of funds to programs designed to reduce the incidence of motor accidents in Tasmania and to enable better care and treatment for persons injured as a result of motor accident.

C.2 Government Business Enterprises (GBE) Act 1995

Part 2, Section 7 of the GBE Act states that two principle objectives of a Government Business Enterprise (e.g. MAIB) are to:

- Operate in accordance with sound commercial practice and as efficiently as possible
- Achieve a sustainable commercial rate of return that maximises value for the State in accordance with its corporate plan and having regard to the economic and social objectives of the State.

C.2.1 MAIB Corporate Plan

In accordance with the GBE Act MAIB must prepare a corporate plan each financial year. The financial performance objectives are made in consultation with the Portfolio Minister and Treasurer and must be consistent with the ministerial charter for government business enterprises.

The Financial Management Objective stated in the MAIB Corporate Plan in 2016 is to maintain a balance between premium income, the cost of claims and the requirement to achieve a sustainable commercial rate of return that maximises value for the State.

Other objectives include maintaining the funding ratio within the target range of 120%-145% to ensure financial viability and monitoring premium requirements and affordability.

C.3 The Economic Regulator (ER) Act 2009

The ER Act established the Regulator as an independent body to oversee the pricing policies of monopoly government bodies such as MAIB.

The ER Act Section 25 specifies the Terms of Reference under which the Regulator investigates MAIB's pricing policies. Section 31 includes the following matters:

- any interstate or international benchmarks for prices, costs, revenues and return on assets in bodies supplying a service similar to the monopoly service;
- the need to protect consumers from the adverse effects of the exercise of monopoly power by a monopoly provider in relation to prices, pricing policies and standards of service in respect of the supply of the monopoly service;
- if appropriate, the need for a reasonable return (including the payment of dividends) on the assets of a monopoly provider;
- the need for efficiency in the supply of the monopoly service for the purpose of benefiting the public interest through a reduction in the cost of supplying the monopoly service;
- the effects of inflation;
- the need for the monopoly provider to be financially viable;
- the impact on pricing policies of any borrowing, capital, dividend and tax equivalent obligations of the monopoly provider, including obligations to renew or increase assets;
- any ministerial charter that applies to the monopoly provider.