

**general
insurance
seminar**

Tides of Change

12-13 November 2012
Sofitel Sydney Wentworth



Profit Margins in Regulated General Insurance Markets

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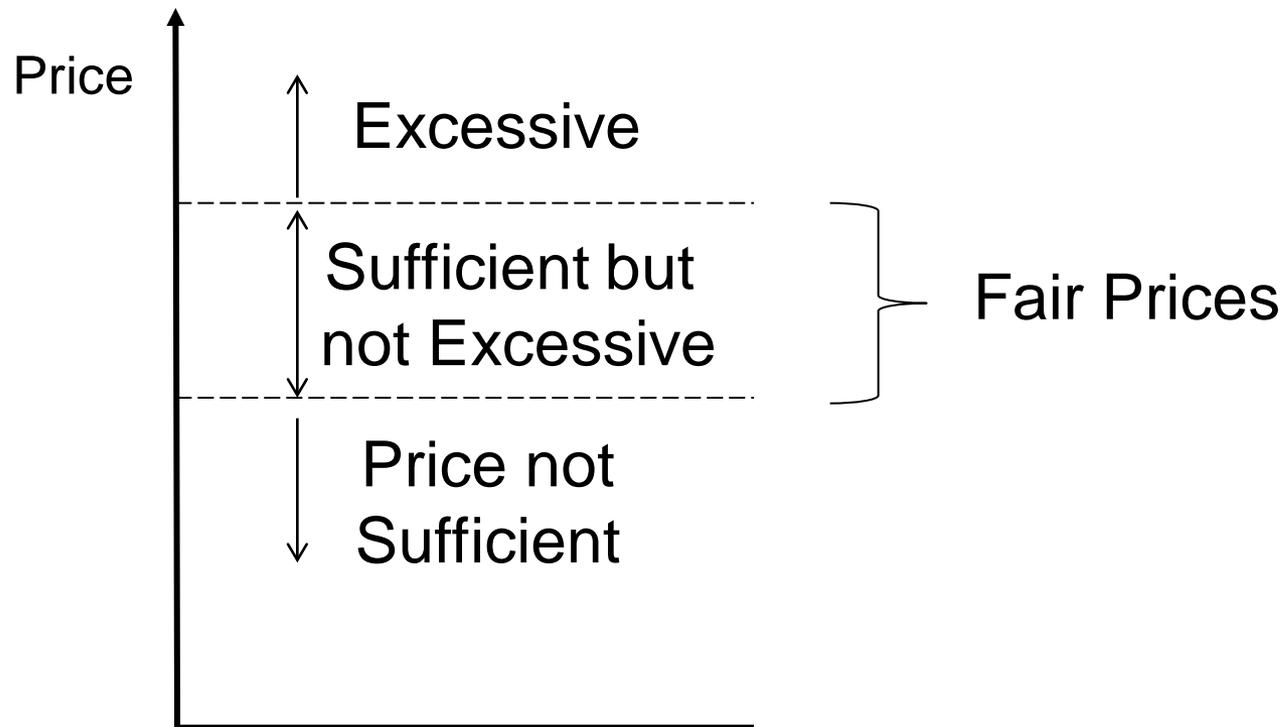
Pricing Regulation

- Fair prices



Pricing Regulation

- Fair prices





Range of Fair Prices

- Lower bound:

Competitive price for incumbent players

- Upper bound:

Price sufficient to attract new players

- Difference between the two is 'sunk costs' – i.e. assets with no alternative productive use



Competitive Price for Insurance

- That which would arise in a freely competitive market
- Opportunity cost of all inputs
 - Expenses
 - Expected claim payments
 - Investment income (an offset)
 - Opportunity cost of allocated financial capital
 - Opportunity cost of economic capital



Allocated Financial Capital

- Assets held to support a portfolio of insurance policies already sold, or projected to be sold
 1. risk margins on outstanding claims and premium liabilities
 2. capital held to meet regulatory standards
 3. capital held to provide a target capital adequacy ratio or to maintain a target credit rating



Economic Capital

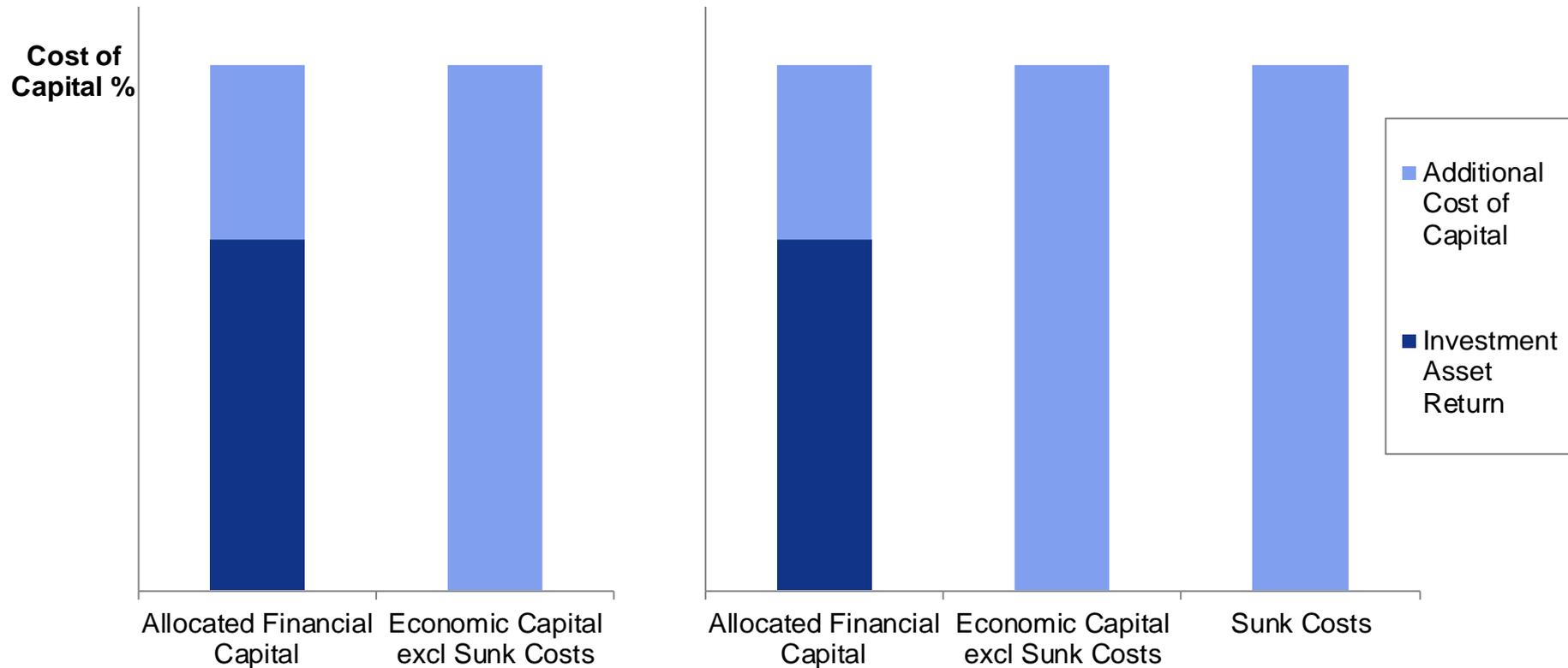
- Assets held that allow future sales of goods or services. An input to production that largely remains intact to be used again
 1. Physical assets
 2. Intangible assets
 3. Inventory



Fair Return on Capital

Lower Bound

Upper Bound



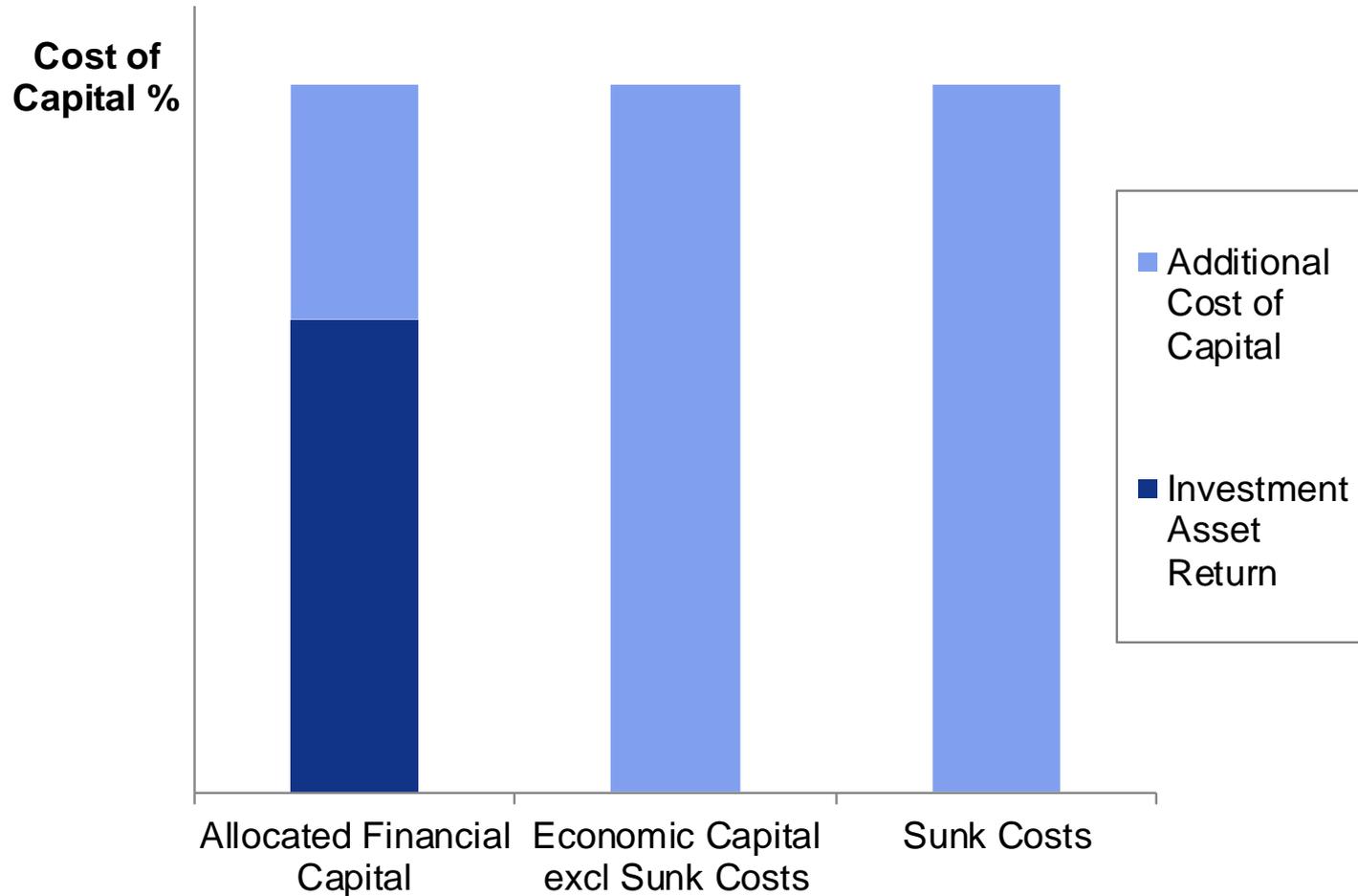


Alternative Methods

- Alternative methods used in both Australia and USA have included
 - Myers-Cohn
 - Internal Rate of Return (IRR)

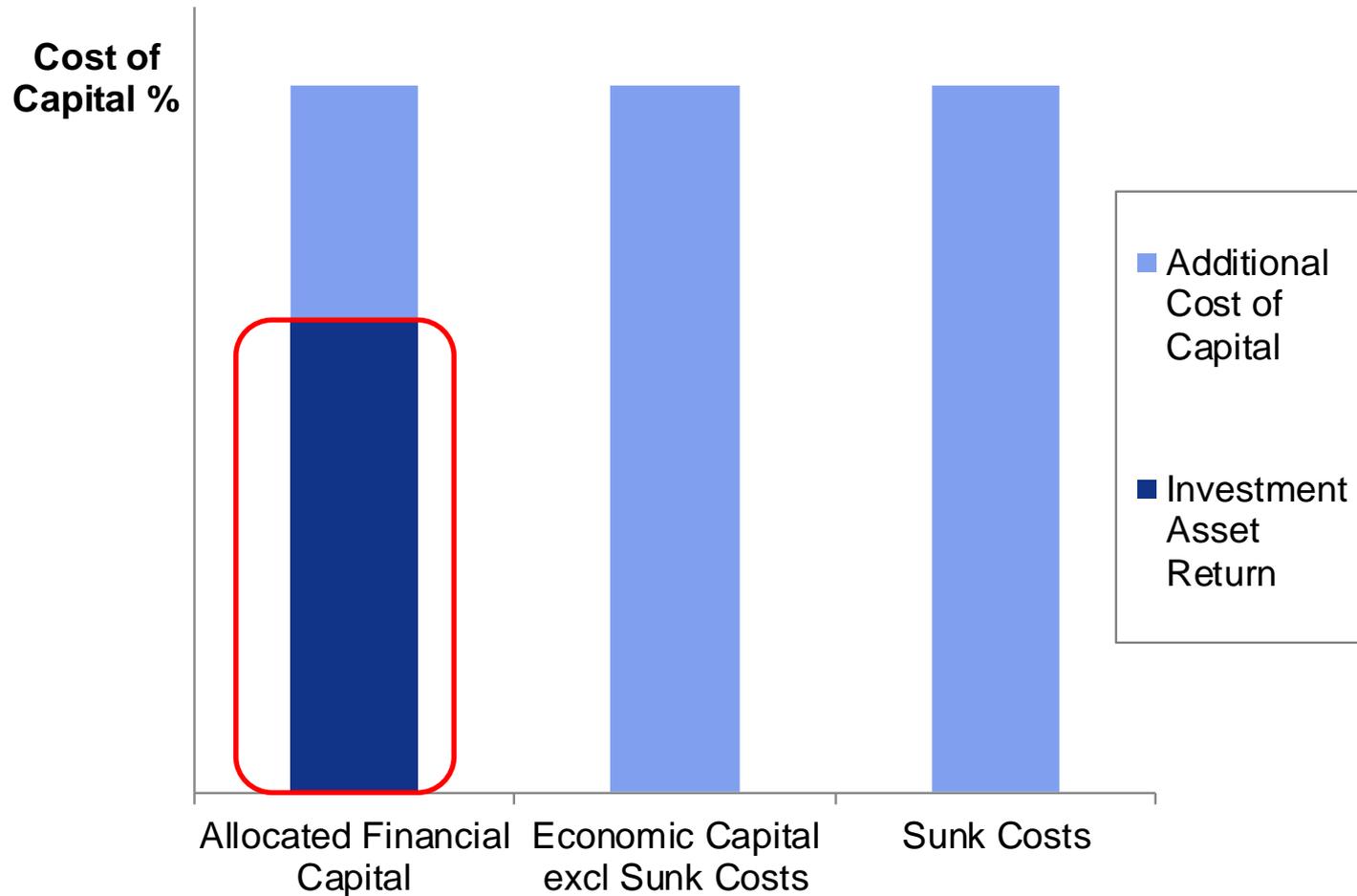


Myers-Cohn Method



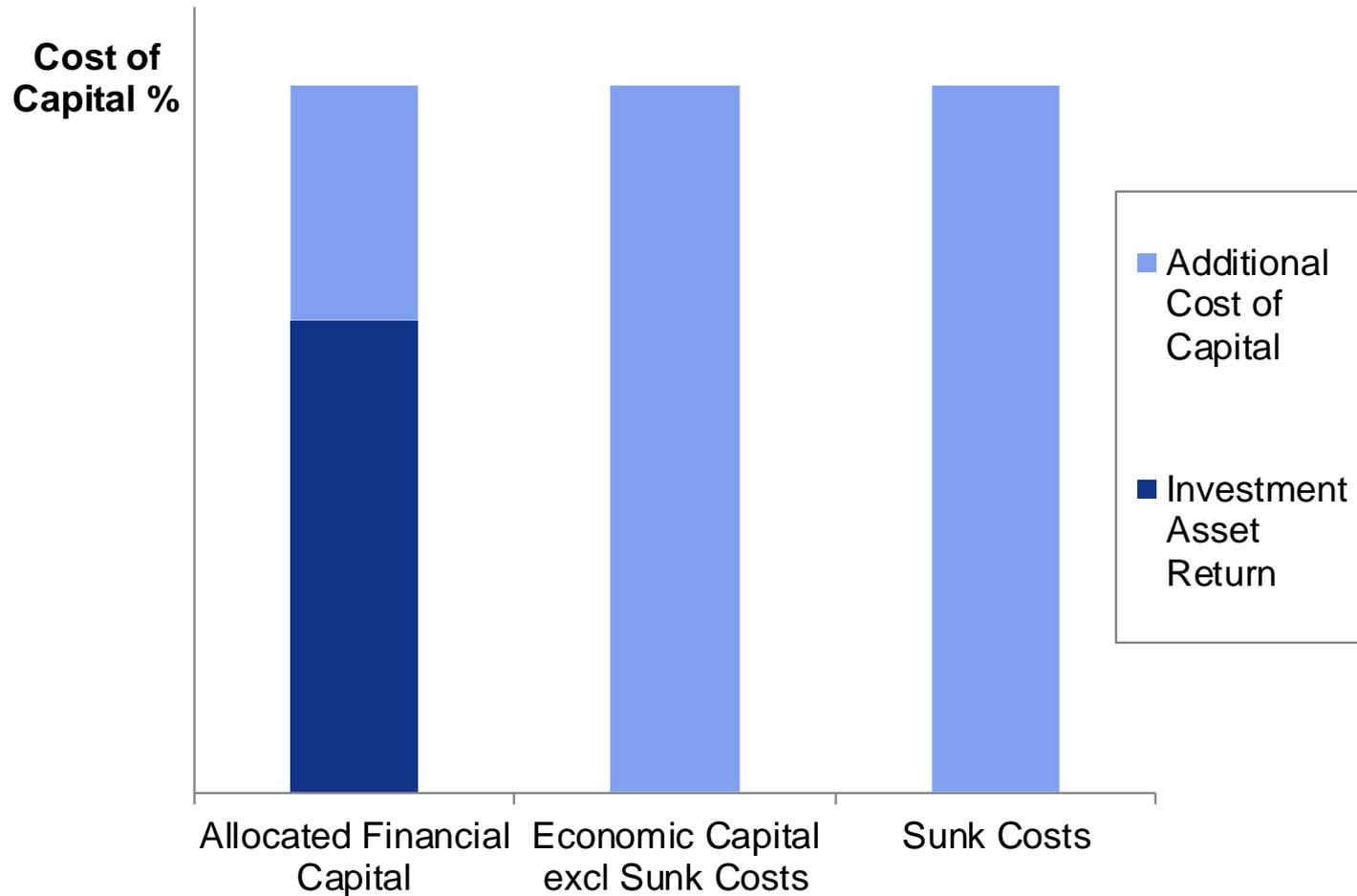


Myers-Cohn Method



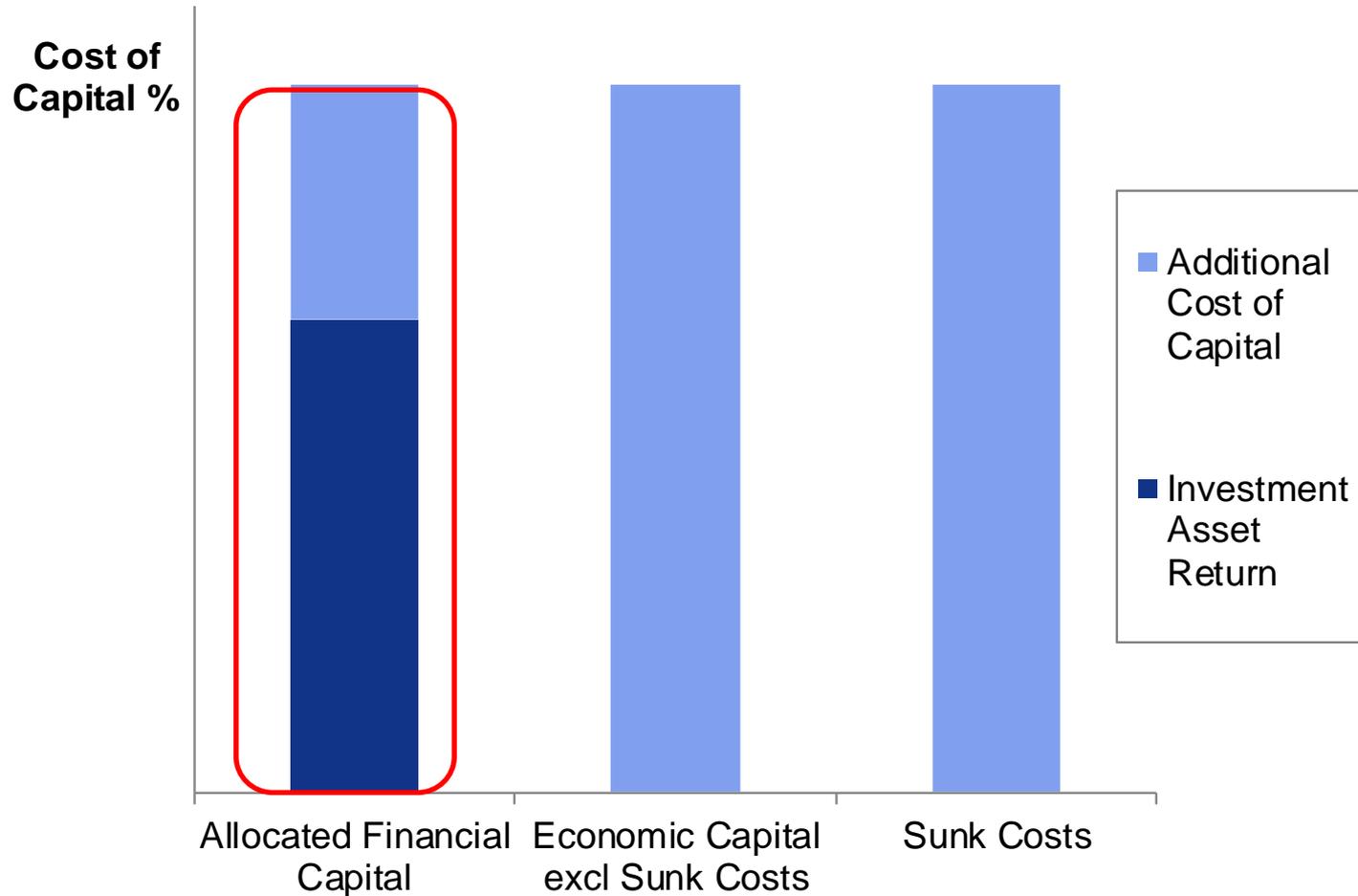


IRR Method



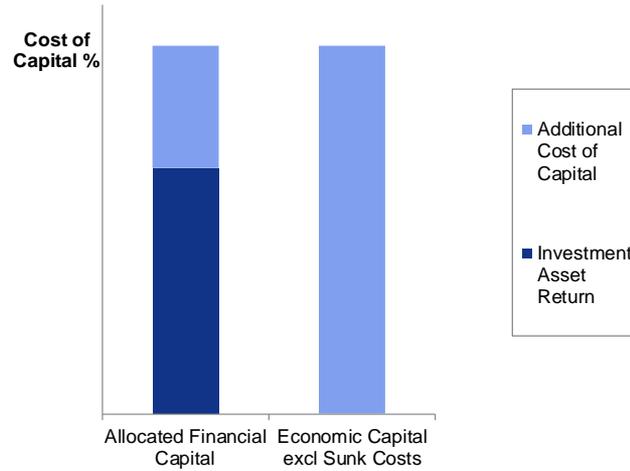


IRR Method

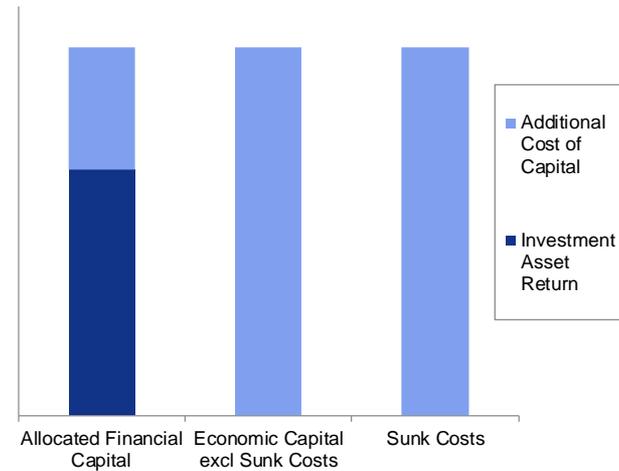




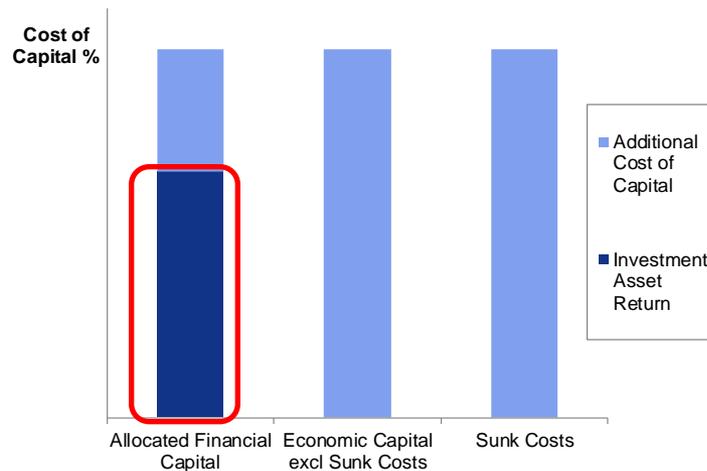
Lower Bound



Upper Bound



Myers-Cohn



IRR

