The areas of Greatest Subjectivity and Interest within the IFRS Financial Statements of Large Insurance Groups as at 31 December 2010
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Introduction

Many insurance groups have a calendar financial year. In 2010, this financial close coincided with the continuing financial crisis, and as such was heavily impacted by unfavourable business environment conditions, such as:

- Stagnation within the main developed countries;
- Low interest rates;
- Increased credit risk on government bonds;
- Prolonged decline in the stock markets;
- High market volatility; and
- Solvency II framework early stage implications.

Since 2008 and the financial crisis, both analysts and investors have faced increased difficulty in assessing insurance groups’ performance not least because of the points listed above.

We have performed an analysis of the financial statement disclosures based on the 2010 year-end IFRS financial statements of several of the largest insurance and reinsurance groups looking at issues:

- from an accounting perspective, considering compliance with IFRS especially regarding topics that we consider to be particularly sensitive; and
- from a financial and regulatory perspective, as we focus on the insurers’ and reinsurers’ financial disclosures regarding key indicators and capital management.
This year, the survey has focused on the following topics:

- Goodwill and associated tests regarding recoverability;
- Financial instruments and associated risks;
- Key performance indicators (EEV, MCEV); and
- Information related to capital management.

Throughout our study we have focused on the objectives of comparability, understandability and relevance that are included in the IFRS framework and form the objective of other regulatory requirements.
Scope of study

Mazars have analysed the 31 December 2010 published annual reports of 13 European insurance and reinsurance groups (the ‘sample’ group):

<table>
<thead>
<tr>
<th>Country</th>
<th>Insurance and Reinsurance groups</th>
</tr>
</thead>
<tbody>
<tr>
<td>France</td>
<td>AXA, SCOR, CNP, Groupama(1)</td>
</tr>
<tr>
<td>Germany</td>
<td>Allianz, Munich RE</td>
</tr>
<tr>
<td>United Kingdom</td>
<td>Aviva, Old Mutual</td>
</tr>
<tr>
<td>Switzerland</td>
<td>Swiss Life, Zurich</td>
</tr>
<tr>
<td>The Netherlands</td>
<td>Aegon</td>
</tr>
<tr>
<td>Italy</td>
<td>Generali</td>
</tr>
<tr>
<td>Spain</td>
<td>MAPFRE</td>
</tr>
</tbody>
</table>

(1) Unlisted

The sample group has been enlarged to include bank insurance groups on some topics, particularly regarding financial instrument impairment methodologies.

This year, we have also included some non-European sample entities publishing their Financial Statements under IFRS: AIA (Hong Kong), Great Eastern (Singapore) and QBE (Australia). These are presented in dedicated red boxes.

Where relevant, extracts from these financial reports have been used to illustrate our findings. We disclosed some technical or regulatory insights in the blue boxes.
Given the context of the continuing financial crisis, we dedicated the first part of our survey to goodwill and more specifically the information disclosed regarding its recoverability.

**A. CONSEQUENCES OF THE FINANCIAL CRISIS**

Before the financial crisis, a significant rise in the volume of mergers and acquisitions occurred in the European insurance market (+137% between 2005 and 2007). These transactions had an impact on insurers’ and reinsurers’ goodwill.

These increased by 50%, + € 21 Bn between 2005 and 2010 as the equity value increased by 20% in the same period:
Even if the effects of the 2008 financial crisis are still evident, we noted some improvements:

- Goodwill increased by 11% from 2008 to 2010 for the sample group; and
- Equity values are again reaching the level of 2007 as these were impacted by the slight recovery in the financial markets at the 2010 year-end.

The goodwill to net equity ratio, as disclosed below, is a relevant indicator of past experience. After the 2008 peak at 27%, the ratio decreased to 23% in 2010. However, some insurers have a goodwill to net equity ratio close to 37%.

This ratio is a sensitive indicator in the context of an unstable economic and financial environment. The TNAV (Tangible Net Asset Value) is a related indicator often scrutinised by analysts. It consists of the net equity less the intangible assets, corresponding to value of the group in the event of a forced sale. The TNAV per share is a very harsh measure of the absolute bottom level that any share in a profitable business should trade, as it assumes that all intangible assets are worthless.
The economic context remains challenging for insurers. Given the financial markets uncertainties and the pessimistic view on potential growth of European insurance and reinsurance markets, their forecasted future margins are still impacted by the prolonged effects of the financial crisis.

Therefore, the main assumptions used for goodwill impairment testing have deteriorated compared to those that prevailed at the time of the acquisitions. The graph below highlights this trend by representing the change in impairment charges since 2006. As can be seen, goodwill has been further impaired and the impairment amounts to 5%. The total amount of impairment recorded as at 31 December 2010 on entities included in our scope was 680 M€, compared to 645 M€ in 2009.

Even if this amount is not considered material, it emphasises the fact that these groups face the risk associated with a decrease in the amount of headroom when looking to support the recoverability of goodwill.
The main consequences of this situation are:

- Goodwill impairment testing is becoming a sensitive financial information issue for large insurance groups; and
- Investors’ and analysts’ expectations are growing regarding the acquisition information disclosed.

Very few insurers disclosed information regarding the headroom when looking to support the recoverability of goodwill. Only one insurer commented on the surplus after impairment test for its main CGU and compared it to the previous year.

**B. THE GOODWILL IMPAIRMENT TEST PROCESS**

The requirement to perform impairment tests on goodwill, and the disclosures required to be included in the annual report are included in IAS 36 ‘Impairment of assets’. Set out below is a synopsis of the requirement of IAS 36 in the context of the major areas reviewed in the annual financial reports of the sample group.

- The way goodwill is allocated is critical. The standard states that goodwill should be allocated to Cash Generating Units (CGU) or groups of CGUs. According to the standard, a Cash Generating Unit is the smallest identifiable group of assets that generates cash inflows, separately to any other cash inflows from any other assets or asset group.
- Impairment testing is required to be conducted annually and additionally whenever an unfavourable event occurs between the two annual tests. The impairment test compares the carrying value of the CGU or the group of CGUs (including the carrying amount of the goodwill) to its recoverable amount. Its recoverable amount is the higher of its fair value less costs to sell and its value in use.
- Fair value less costs to sell is the amount obtainable from the sale of an asset or cash-generating unit in an arm’s length transaction between knowledgeable, willing parties, less the cost of disposal. The value in use is the present value of the future cash flows expected to be derived from an asset or cash-generating unit.
The purpose of this part of our survey was to check the compliance with IAS36 requirements, but also to analyse the information disclosed by the insurers regarding the goodwill impairment test process. This is particularly relevant as the standard requires interpretation and judgment.

The survey focuses on the following points:
- Goodwill allocation to CGUs;
- Valuation method and approach to determine the key assumptions;
- Information produced on key assumptions and recoverable amount;
- Focus on discount rate; and
- Impairment test sensitivity analysis.

### GOODWILL ALLOCATION TO CGUs

The standard requires that goodwill allocated to each CGU be disclosed in the notes to the financial statements. In the case of groups of CGUs, it is critical to evidence that the goodwill has been tested at the lowest level (cf. IAS 36.80).

Most of the groups in our sample are compliant with this requirement. In cases where goodwill is disclosed per acquisition, additional information is provided to understand the connection between the entities acquired and the corresponding CGUs or segments (one exception noted).

<table>
<thead>
<tr>
<th>Breakdown per CGU</th>
<th>Breakdown per groups of CGU</th>
<th>Breakdown per acquisition</th>
</tr>
</thead>
<tbody>
<tr>
<td>6</td>
<td>5</td>
<td>4</td>
</tr>
</tbody>
</table>
The survey also pointed out that most groups in our sample gave the generic definition of the CGU by quoting IAS 36. On the other hand, we noted that granularity used to disclose the CGUs and groups of CGUs is not homogeneous. As a consequence, the mutualisation impact can change significantly from one insurer to another.

<table>
<thead>
<tr>
<th></th>
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</thead>
<tbody>
<tr>
<td>Global</td>
<td>34,4</td>
<td>0,0</td>
<td>0,0</td>
</tr>
<tr>
<td>Global Vida</td>
<td>17,8</td>
<td>0,0</td>
<td>0,0</td>
</tr>
<tr>
<td>La Banque Postale Prevoyance</td>
<td>45,8</td>
<td>22,9</td>
<td>22,9</td>
</tr>
<tr>
<td>Groupe CAIXA</td>
<td>360,6</td>
<td>270,9</td>
<td>239,8</td>
</tr>
<tr>
<td>CNP UniCredit</td>
<td>366,5</td>
<td>247,0</td>
<td>262,5</td>
</tr>
<tr>
<td>Martin</td>
<td>81,6</td>
<td>81,6</td>
<td>85,9</td>
</tr>
<tr>
<td>Barclays</td>
<td>60,0</td>
<td>60,0</td>
<td>164,5</td>
</tr>
<tr>
<td><strong>Total</strong></td>
<td><strong>966,7</strong></td>
<td><strong>682,5</strong></td>
<td><strong>775,6</strong></td>
</tr>
</tbody>
</table>

For the purpose of the impairment test, the Goodwill is allocated to cash-generating units (CGU) likely to benefit from synergies. A CGU is the smallest assets which generate some cash flow independently from other groups of assets. The group retains an entity or an homogeneous entity approach.

*Source: reference document CNP 2010*
The Goodwill is allocated to cash-generating units (CGU) that take advantage of the combination. A CGU is an identifiable asset which can produce cash flow independently from other groups of assets. In case of unit management, management tools, geographic area or large branch of activity, a CGU constitutes the grouping of homogeneous entity.

The value in use calculation is the approach that is most frequently used which itself results in even more judgemental assumptions within the valuation process. Nevertheless the survey showed that the information disclosed regarding the value in use approach most of the time is more detailed than the one regarding the fair value less costs to sell approach.

### VALUATION METHOD AND APPROACH TAKEN TO DETERMINE THE KEY ASSUMPTIONS

The key assumptions for determining the Goodwill are based on the value in use. This approach involves estimating the cash flows that the CGU is expected to generate in the future. The cash flows are discounted to their present value using a discount rate that reflects the risk of the CGU.

**In millions of Euros**

<table>
<thead>
<tr>
<th></th>
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</tr>
</thead>
<tbody>
<tr>
<td><strong>VALUE AT THE BEGINNING OF THE YEAR</strong></td>
<td>3524</td>
<td>(121)</td>
<td>(186)</td>
<td>3128</td>
<td>3497</td>
</tr>
<tr>
<td>Newly consolidated</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Deconsolidated</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>France</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Central and east Europe</td>
<td>(4)</td>
<td>(79)</td>
<td>(8)</td>
<td>(161)</td>
<td></td>
</tr>
<tr>
<td>Turkey</td>
<td></td>
<td></td>
<td>10</td>
<td>10</td>
<td>(11)</td>
</tr>
<tr>
<td>United Kingdom</td>
<td>0</td>
<td>4</td>
<td>4</td>
<td>4</td>
<td></td>
</tr>
<tr>
<td>Greece</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td>(5)</td>
</tr>
<tr>
<td>Spain</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td>(41)</td>
</tr>
<tr>
<td>Tunisia</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td>(33)</td>
</tr>
<tr>
<td><strong>Other movements during the year</strong></td>
<td>(4)</td>
<td>(79)</td>
<td>6</td>
<td>(77)</td>
<td>(279)</td>
</tr>
<tr>
<td><strong>Value at year end</strong></td>
<td>3520</td>
<td>(199)</td>
<td>(180)</td>
<td>3141</td>
<td>3218</td>
</tr>
</tbody>
</table>

*Source: reference document Groupama SA 2010*
For each Cash generating unit the carrying amount is compared to the recoverable amount, which is the higher of the fair value less costs to sell of the cash-generating unit and its the value in use.

The value in use represents the net assets and future profits expected from existing portfolios and new business written taking into account expected future cash flows generated by each CGUs.

The expected futures profits are estimated by using the embedded value of life insurance and investments contracts as published by AXA or similar estimation for other business lines. The fair values less costs to sell are estimated based on various valuation multiples.

Source: reference document: 2010 annual reporting - AXA

The purpose of the impairment test on goodwill is to identify the existence of any impairment losses on the carrying amount recognised as intangible asset. In this context, cash-generating units to which the goodwill is allocated are identified and tested for impairment. Cash-generating units (CGU) units usually represent the consolidated units within the same primary segment in each country. The impairment is equal to the difference, if negative, between the carrying amount and the recoverable amount, which is the higher of the fair value of the cash-generating unit and its value in use, i.e. the present value of the future cash flows expected to be derived from the cash-generating units. The fair value of the CGU is determined on the basis of current market quotation or usually adopted valuation techniques (mainly DDM or appraisal value based on EBS). The Dividend Discount Model is an alternative of the Cash flow method. In particular the Dividend Discount Model, in the excess capital methodology, states that the economic value of a financial entity is equal to the discounted dividends flow calculated considering the minimum capital requirements. Such models are based on projections on budgets/forecasts approved by management and covering a maximum period of five years. Cash flow projections for a period longer than five years are extrapolated using estimated growth rate. The discount rates reflect the free risk rate, adjusted to take account for specific risks.

Source: reference document: 2010 annual reporting – AXA

For each CGU the standard requires the following information:

- A description of the key assumptions used for the forecasts or the fair value;
- A description of management’s approach to determine these key assumptions;
- The period of projected cash flows and justification if it exceeds five years;
- The growth rate to extrapolate the flows; and
- The discount rate.
The required information has been disclosed by most of the sample entities. However, the description of the key assumptions used to assess the projections or the fair value is rarely disclosed.

We also noticed that the insurers are more and more referring to their embedded value model regarding their life business. This means that the consistency between the goodwill impairment tests and the business valuation is increasing.

The following observations were noted from our analysis of the financial statements of the sample group:

- The key assumptions are often disclosed before the CGUs analysis. Only two groups in the sample disclosed the key assumptions for each CGU;
- A description of the approach used to assign values to the key assumptions was generally not disclosed. It was therefore often difficult to assess whether these key assumptions were derived from historical internal data or from external sources;
- The period over which the management has projected cash flows is not always disclosed. The sample group often only referred to management approved budgets;
- The growth rate used to extrapolate cash flows beyond the period covered by the most recent budget was not disclosed for each CGU. As a consequence this information is less relevant to the user; and
- The discount rate was also often not disclosed for each CGU. A rate for each geographical area should at least be disclosed, especially when the number of CGUs is significant.

In order to allow the comparability of the financial statements, there is a clear need for improvement regarding the description of the approach to impairment testing and how the impairment test key assumptions were determined.

Therefore, it appears that, even if the annual reports reviewed are mostly compliant with the requirements of the standard, users may still have difficulties when assessing the headroom margin in the impairment tests.
■ DISCOUNT RATE

The discount rate is the most critical assumption with regard to goodwill impairment. The standard states that the discount rate must reflect the market assessment of the specific risks related to the cash flows derived from the asset considered. Therefore the Weighted Average Cost of Capital (‘WACC’) is a relevant approach that has been frequently used.

However, the implementation of the WACC approach varies from one insurer to another. The discount rates must be adjusted to reflect the market data and not the insurance company’s internal data. Thus, the rate should be independent of the way the entity financed the purchase of its assets.

The survey evidenced that a significant part of the sample group uses methods other than the WACC approach (4 different approaches noted). These alternative approaches make it difficult to compare the impairment results.

Even if more and more insurers disclose the previous year discount rate, this information remains rare:
Given the sensitivity of the impairment tests to the discount rate, the inclusion of the previous year discount rate should be considered as critical for a proper understanding of the financial statements.

**DISCLOSURES OF IMPAIRMENT TEST SENSITIVITIES**

Disclosure of impairment test sensitivities is required by the standard when a reasonable change in a key assumption on which management has based its determination of the unit’s (group of units’) recoverable amount would cause the unit’s (group of units’) carrying amount to exceed its recoverable amount.

Almost half of the sample group concluded in one sentence that the sensitivity analysis did not lead to the need to perform an additional impairment test. Four of the group sampled disclosed the changes made to the key assumptions (growth rate and discount rate), when it was only strictly required by the standard for two of them.
IAS36.134f requires that additional information about impairment test sensitivity be disclosed when a reasonably possible change in a key assumption on which management has based its determination of the unit’s (group of units’) recoverable amount would cause the unit’s (group of units’) carrying amount to exceed its recoverable amount.

When IAS36.134f applies (two sampled groups identified), the insurer has to disclose the following information:

- The amount by which the unit’s (group of units’) recoverable amount exceeds its carrying amount;
- The value assigned to the key assumption; and
- The amount by which the value assigned to the key assumption must change, after incorporating any consequential effects of that change on the other variables used to measure recoverable amount, in order for the unit’s (group of units’) recoverable amount to be equal to its carrying amount.

For the two of the groups sampled that are required to disclose this information, we noticed that:

- One complies with the requirements with the exception of the amount by which the recoverable amount exceeds the carrying amount; and
- The other complies with the standard and discloses the impact related to the changes in the key assumptions (additional impairment or surplus).
CONCLUSION

The information disclosed by the sample group of companies complies with most of IAS36 requirements even if there is room for improvement to fully address all requirements. However, the quality and the accuracy of the information disclosed varies, impeding the comparison of the financial statements regarding goodwill impairment tests. Particular attention on these disclosures will continue to be relevant for the 2011 financial year.
Financial assets impairment

This year again, the year-end close took place within the context of continuing, disrupted financial markets. As a consequence, available-for-sale (‘AFS’) assets impairment remained an issue. The information disclosed in the financial statements on this area is important to the understanding and the comparison of the income of the large insurance and reinsurance groups.

Users’ expectations regarding the transparency of disclosures in this area are considered high. We focused our survey on the two following topics:

- AFS equity instruments impairment methods; and
- Debt securities impairment methods including government bonds.

A. IAS39 ‘FINANCIAL INSTRUMENTS’

IAS 39 defines impairment testing as:

An entity shall assess at the end of each reporting period whether there is any objective evidence that a financial asset or group of financial assets is impaired. A financial asset or group of financial assets is impaired and impairment losses are incurred if, and only if, there is objective evidence of impairment as a result of one or more events that occurred after the initial recognition of the asset and that loss event has an impact on the estimated future cash flows of the financial asset or group of financial assets that can be reliably estimated.

The standard gives examples of loss events that are considered to be objective evidence of impairment. These include:

- Significant financial difficulty of the issuer or obligor; and
- Breach of contract such as a default or delinquency in interest or principal payments.
The standard also specifies additional events that on their own are not necessarily considered as objective evidence, but should none-the-less be considered:

- The disappearance of an active market because an entity’s financial instruments are no longer publicly traded;
- A downgrade of an entity’s credit rating; and
- The decline in the fair value of a financial asset below its cost or amortised cost.

However, with regards to the equity instruments, a significant or prolonged decline in the fair value of an investment in an equity instrument below its cost is considered objective evidence of impairment.

Nevertheless, judgement is required to determine if the fall in market value is deemed temporary or more permanent in nature. The preparers of financial statements have seized this opportunity, which has led to divergence in the application of impairments in practice.

B. IMPAIRMENT OF AFS EQUITY INSTRUMENTS

IAS 39 standard requires that an AFS equity instrument must be impaired in case of significant or prolonged decline in the fair value. The determination of the threshold evidencing the significant or prolonged decline is left to the discretion of the management. As a consequence, the criteria used by the sample group varies:
In some cases, the groups use additional criteria in order to mitigate the impact of the automatic threshold on significant or prolonged decline in fair value.
In 2010, two groups changed their criteria regarding the prolonged decline in fair value. These changes are referred to in the notes to the financial statements and the impacts are disclosed (net of deferred tax and net of deferred participation rights). These two groups justified those changes by the market conditions and the prolonged impact of the financial crisis.

**C. IMPAIRMENT OF DEBT SECURITIES**

Most of the time, the sample group considered the general principles of the standard, especially the notion of objective evidence of impairment. However, the identification process of the objective evidence for the securities is not always clearly disclosed, although some of the sample group disclosed the nature of the evidence used quoting the standard:

- Issuer credit incident;
- Default;
- Evidenced credit risk;
- Credit rating downgrade; and
- Disappearance of an active market, etc.

The information disclosed in the notes to the financial statements does not allow a clear understanding of the nature of the analysis performed by the companies regarding government bonds, notably the practical impairment thresholds are not disclosed.

This kind of information is nevertheless critical in the context of the sovereign debt crisis, given the difficulties some countries are facing on the markets.

Sovereign debt is a hot topic that has been highlighted strongly by the insurance and reinsurance groups at year-end 2010. Some of the sample group even considered it as a significant event of the year.

Without any credit event, the position of the market was not to impair any European sovereign debt securities as at 31 December 2010.

Among the thirteen sampled groups, eight insurers disclosed their gross exposure to government bonds. Two of them disclosed the unrealised...
losses (net of policyholder profit-sharing and net of deferred tax) regarding the most at risk countries (Greece and Ireland). However, the information disclosed is left to management discretion and as a consequence, these varied in relation to the following matters:

- Scope of the countries: PIGS (‘Portugal, Ireland, Greece and Spain’) or Euro-zone;
- How the exposure has been assessed and the type of assets covered (government bonds, public institution debts, etc); and
- Presentation format (total amount or breakdown by country, etc.).

Therefore the information provided by the sample group does not allow any meaningful comparison of government bonds exposure. This topic will be considered in greater detail in our next survey considering the ongoing disturbance within the debt market in the first half of 2011. The regulators’ expectations regarding the information to be provided will certainly be increased including disclosures on:

- Gross and net exposure per maturity, per country, etc.;
- Derivatives instruments exposure (CDS);
- Justification of the existence or not of an objective evidence of impairment;
- Unrealised losses recorded in the financial statements; and
- Valuation methods used (market value vs. valuation techniques using observable or non-observable market data).
A. THE CLASSIFICATION CRITERIA

IFRS 7 amended, published in March 2009, brought in a three level hierarchy regarding the information to be disclosed in fair value measurement, which reflected the nature of the underlying data used to calculate these amounts.

The investments that are categorised as Level 1 are those for which the fair value is based on active market quotations, without adjustment. The concept of active market is not defined in the standard. However, the following criteria can be used:
   ▶ Existence of several sources providing consistent prices;
   ▶ Prices regularly updated;
   ▶ Bid and Ask prices lower than a certain level;
   ▶ Issue size higher than a certain level; and
   ▶ Investment grade rating, etc

The investments that are categorised as Level 2 are those for which the fair value is based on standard valuation techniques, using observable market data. The following are examples of level 2 observations:
   ▶ Price directly observable on an inactive market available from pricing providers, brokers, etc;
   ▶ Directly observable parameter (such as swap rates, foreign exchange rates, etc.) used in a standard valuation technique;
   ▶ Indirectly observable parameter (such as implicit volatility derived from prices and options, comparative valuation, etc.) used in a standard valuation technique; and
   ▶ Use of a standard valuation technique containing little unobservable data that has no significant impact on the valuation.

Follow up on the application of IFRS 7 amended
The investments that are categorised as Level 3 are those for which the fair value is based on a standard valuation technique using unobservable market data. The following are examples of inputs that would cause the investment to be categorised as **level 3**:

- Unobservable data, i.e. not based upon market transactions;
- Internal or specific assumptions;
- Exotic derivatives based upon non standard valuation techniques; and
- Valuation which is partially modelled.

**B. DISCLOSURES**

Our survey indicated stability in the sampled insurance groups’ disclosures regarding the classification of fair value investments:

- Information required by the standard is disclosed including the Level 3 reconciliation; and
- The split between the three levels is stable from 2009 to 2010: the average percentage of level 1 investments remains at 72% and the level 3 element is negligible.

Nevertheless, the survey shows that the description of the classification process is often limited to a reminder of requirements of the standard. Only 8 entities sampled described how the classification of the investments has been performed, with the level of information disclosed varying significantly. The analysis highlighted that for two sample entities, no relevant disclosures were provided to explain why the percentage of level 1 was significantly below the average at 40%.
Six of the sampled entities took the initiative of disclosing specific information regarding the IFRS 7 classification of certain government bonds (Portugal, Italy, Greece and Spain). Among the six samples, four decided to classify these as level 1 investments and the remaining two classified these as level 2 investments.
Given the difficult economic situation, the sampled insurance and reinsurance groups are struggling to illustrate the profitability of their businesses in their IFRS financial statements. As a consequence, they often use other key indicators that we identified and analysed in our survey.

The more frequently used key indicators are the embedded value and capital adequacy which are themselves at the heart of analysts' expectations in the context of Solvency II implementation.

A. EMBEDDED VALUE: METHOD HARMONISATION PROCESS SPED UP BY THE SOLVENCY II PROJECT

a) Still a relevant indicator

The comparison of insurers’ practices regarding Embedded Value is still relevant as:

- It remains a basic indicator to measure the profitability of Life business;
- The closest indicator to the Solvency II economic balance sheet; and
- Most of the insurers use it for the purpose of IFRS 7 requirements regarding market risk sensitivity analysis (IFRS 7 §40 and §41).
Embedded value is now used globally: among the 3 samples we selected out of Europe (AIA, QBE, Great Eastern), 2 of them disclose detailed information regarding the computation of a standard EV using a deterministic approach.

Our survey focuses on the following issues:

- The changes in the regulatory framework and the application among the sample group (EEV vs. MCEV);
- The comparability of the information disclosed:
  - Towards the homogenisation of the computation parameters (liquidity premium, cost of capital, implicit volatility);
  - Discrepancies noted regarding the concept of Group EEV/MCEV.
- The increasing convergence with Solvency II; and
- The identification of other related indicators used by most of the sample group.

b) Definition and recent changes in the regulatory framework

EEV (European Embedded Value) and MCEV (Market Consistency Embedded Value) are key financial performance indicators, which are generally presented to complement analyses and disclosures made in the financial statements.

These indicators contain information showing value creation for the shareholder and include:

- The discounted value of future cash flows attributable to the shareholder;
- The new business value; and
- The growth of available capital.
The European Embedded value (EEV) principles were released by the CFO Forum in 2006 and amended in June 2008 to introduce the principles of the Market Consistent Embedded Value (MCEV): 

The main changes brought by the MCEV framework are:

- The use of a market consistent approach for the assessment of the time value of options and guarantees embedded in insurance portfolios, which is a similar approach to the valuation of financial instruments that have comparable cash flows; and

- The valuation of the non covered residual risks costs (such as insurance risks) using economic capital models.
More than a half of the sample group applies the MCEV framework. Most of the ones that still apply the EEV framework use a market consistent approach to assess the time value of options and guarantees. The main discrepancy between MCEV and EEV approach relates to the assessment of the cost of capital.

The implementation of the MCEV and other market consistent approaches coincides with an unstable financial environment:

- Fall in stocks markets values and of the risk free rate combined with an increasing volatility of stocks and rates; and
- Increase in corporate and sovereign spreads.

In order to mitigate some of the impact of the financial environment since 2008, many insurance and reinsurance groups adapted their approach introducing the illiquidity premium concept (which is added to the risk free rate in order to reflect the illiquidity of certain liabilities) or adjustments on the stocks and rates volatility. The suitability of these adjustments was confirmed through the amendment of the MCEV principles in October 2009.

The purpose of the following analysis is to assess the impact of these adjustments on the comparability of the MCEV figures.
c) Assumptions and parameters comparability

- Illiquidity premium

At year-end 2009, the CFO Forum allowed the use of an illiquidity premium in the computation of the MCEV. This premium impacts the discount rate used for the cash flows projections by adding a margin to the risk free rate.

Most of the sample group adjusted the risk free rate in 2009 and 2010, complicating the comparability of the results:

- Between the insurers as the information regarding the premium are different; and
- from one financial year to another for the same insurer.

However, we noticed that comparability issues have been mitigated by the extensive use of the Solvency II QIS5 approach by the market players. Below an example of the alignment to the QIS 5 approach:
The liquidity premium allowance is based on a two step approach. The first step consists in measuring the liquidity premium available in the markets by economy. In line with the industry research and QIS5, the liquidity premium is calibrated using the so called 50/40 formula corresponding to a liquidity premium equal to Maximum (0; 50%*(corporate spread – 40bps)) where the corporate spread is measured with appropriate market indices for each economy.

As a second step, a ratio is applied to the measure obtained in the first step to reflect the nature of the liabilities and, consequently, AXA’s ability to capture the liquidity premium.

In line with market converging practices, AXA considers four buckets:
- 100% liquidity premium for Immediate Annuities in payment
- 75% liquidity premium for all General Account business with participating features or with guaranteed rates higher than current 10 year rate
- 50% liquidity premium for all other General Account business and will mainly capture Pure Protection business with annually renewal premia
- 0% liquidity premium for all Unit-Linked business including Variable Annuities

For each bucket the liquidity premium is added to the forward rate until the last liquid forward rate observable in the market.

Source: Assicurazioni Generali 2010 Life EV Supplementary Information

As at 31st December 2010, we noticed that illiquidity premiums used are almost the same from one insurer to another. Below is an example of the illiquidity premiums of two insurers using the QIS 5 approach:

<table>
<thead>
<tr>
<th>Currency</th>
<th>2010</th>
<th>2009</th>
</tr>
</thead>
<tbody>
<tr>
<td>EUR</td>
<td>36 bps</td>
<td>43 bps</td>
</tr>
<tr>
<td>CHF</td>
<td>8 bps</td>
<td>5 bps</td>
</tr>
<tr>
<td>USD</td>
<td>56 bps</td>
<td>61 bps</td>
</tr>
<tr>
<td>GBP</td>
<td>79 bps</td>
<td>72 bps</td>
</tr>
</tbody>
</table>

Source: Assicurazioni Generali 2010 Life EV Supplementary Information

<table>
<thead>
<tr>
<th>Currency</th>
<th>Liquidity premium (Bucket 100%) 31/12/09 adjusted (*)</th>
<th>Liquidity premium (Bucket 100%) 31/12/10</th>
<th>UFR (%)</th>
<th>Extrapolation entry point</th>
</tr>
</thead>
<tbody>
<tr>
<td>EUR</td>
<td>43 bps</td>
<td>36 bps</td>
<td>4.2%</td>
<td>30</td>
</tr>
<tr>
<td>GBP</td>
<td>72 bps</td>
<td>79 bps</td>
<td>4.2%</td>
<td>50</td>
</tr>
<tr>
<td>USD</td>
<td>61 bps</td>
<td>56 bps</td>
<td>4.2%</td>
<td>30</td>
</tr>
<tr>
<td>JPY</td>
<td>0 bps</td>
<td>0 bps</td>
<td>3.2%</td>
<td>20</td>
</tr>
<tr>
<td>CHF</td>
<td>5 bps</td>
<td>8 bps</td>
<td>3.2%</td>
<td>15</td>
</tr>
<tr>
<td>AUD</td>
<td>65 bps</td>
<td>65 bps</td>
<td>4.2%</td>
<td>15</td>
</tr>
</tbody>
</table>

(*) 2009 adjusted liquidity premium as in QIS5

Source: AXA – Embedded Value 2010 Report
Implicit volatility

At year-end 2009, the CFO Forum made it not possible to use the year-end volatility but an average volatility, in the case of illiquid options market. This amendment confirmed the market practice noted in the previous year.

Implicit volatility is a critical parameter in the assessment of the time value of options and guarantees. The market consistent approach states that the volatility to be used is the one reflected in the market value of listed derivatives at year-end (swaption for rate volatility and options for the stock volatility)

<table>
<thead>
<tr>
<th></th>
<th></th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td>A</td>
<td>31 Dec</td>
<td>31 Dec</td>
</tr>
<tr>
<td>B</td>
<td>31 Dec</td>
<td>31 Dec</td>
</tr>
<tr>
<td>C</td>
<td>31 Dec</td>
<td>31 Dec</td>
</tr>
<tr>
<td>D</td>
<td>No information</td>
<td>No information</td>
</tr>
<tr>
<td>E</td>
<td>31 Dec</td>
<td>31 Dec</td>
</tr>
<tr>
<td>F</td>
<td>Extrapolation of swaption and equity option implied volatility data beyond terms of 2 years and 3 years respectively</td>
<td>Extrapolation of swaption and equity option implied volatility data beyond terms of 2 years and 3 years respectively</td>
</tr>
<tr>
<td>G</td>
<td>Reference date not mentioned</td>
<td>Reference date not mentioned</td>
</tr>
<tr>
<td>H</td>
<td>31 Dec</td>
<td>31 Dec</td>
</tr>
<tr>
<td>I</td>
<td>31 Dec</td>
<td>31 Dec</td>
</tr>
<tr>
<td>J</td>
<td>31 Dec</td>
<td>31 Dec</td>
</tr>
<tr>
<td>K</td>
<td>31 Dec</td>
<td>31 Dec</td>
</tr>
<tr>
<td>L</td>
<td>31 Dec</td>
<td>31 Dec</td>
</tr>
<tr>
<td>M</td>
<td>No information</td>
<td>No information</td>
</tr>
</tbody>
</table>

At year-end 2010, all the sample group are now compliant with the initial guidelines, i.e. the use of year-end volatility. This results in an improvement in comparability.

Government bonds spreads

For the purpose of the MCEV/EEV computation, the group sampled did not make any adjustments related to the disruption on government bonds spread. Nevertheless, some of them disclosed the impact of the disruption:
The poor economic variances refer almost entirely to the VIF, and are mainly due to the extraordinary widening of the spreads between government bonds and swap rates in many European Countries where the Group operates (such as Italy, Spain and Belgium), coupled with higher corporate bond spreads, lower swap interest rates (net of variations in the liquidity premium) and higher interest rate volatilities.

In particular, the disruptions on government bond spreads have a significant impact on the valuation of VIF which, according to the current methodology based on swap rates, does not benefit on the liability side from the higher returns offered by government bonds, but on the contrary is depressed on the asset side by the lower value of existing government bonds.

Had the government spreads remained at the same level as at the end of 2009, the VIF at the end of 2010 would have been 2.5bln higher. Neutralising also the drop of the Italian equity market (linked to the same extraordinary pressure on local government bonds), the overall benefit for the VIF at the end of 2010 would have been 3.0bln.

Source: Assicurazioni Generali 2010 Life EV Supplementary Information

Key indicators

Cost of Capital

MCEV principles state that a cost must be allocated regarding the non hedgeable financial and non financial risks. The MCEV principles do not recommend using any specific approach but require communicating the cost of capital necessary to reduce the ruin probability to one in 200 years. This requirement guarantees the comparability between the insurers.

Among the 6 sampled groups analysed on this issue, the approach and assumptions vary:

<table>
<thead>
<tr>
<th>Methodology</th>
<th>2010 equivalent to the average cost calculated at approximately 99.5%</th>
<th>2009 equivalent to the average cost calculated at approximately 99.5%</th>
<th>2008 equivalent to the average cost calculated at approximately 99.5%</th>
</tr>
</thead>
<tbody>
<tr>
<td>A</td>
<td>3.25% applies of the capital requirement of the group at 99.3% (after diversification)</td>
<td>4.0%</td>
<td>6.5%</td>
</tr>
<tr>
<td>B</td>
<td>Alignment with the methodology Solvency II</td>
<td>4.0%</td>
<td>4.0%</td>
</tr>
<tr>
<td>C</td>
<td>2.0% has been applied to residual symmetric and asymmetric non-hedgeable capital at a business unit level over the life of the contracts</td>
<td>2.9%</td>
<td>2.6%</td>
</tr>
<tr>
<td>D</td>
<td>A 2.5 percent cost of capital charge has been applied to the diversified present value of non-hedgeable RBC based capital for 2010 and 2009</td>
<td>no information</td>
<td>no information</td>
</tr>
<tr>
<td>E</td>
<td>1.5% capital applied to unit-level capital at 99.5% percentile</td>
<td>5.5%</td>
<td>2.5%</td>
</tr>
<tr>
<td>F</td>
<td>5% capital applied to unit-level capital at 99.5% percentile</td>
<td>2.7%</td>
<td>2.6%</td>
</tr>
</tbody>
</table>

However, we noted a tendency to align the approach with the Solvency II framework which uses a cost of capital approach with 99.5% confidence level. As an example, below is the information disclosed by one of the sampled group:
The poor economic variances refer almost entirely to the VIF, and are mainly due to the extraordinary widening of the spreads between government bonds and swap rates in many European Countries where the Group operates (such as Italy, Spain and Belgium), coupled with higher corporate bond spreads, lower swap interest rates (net of variations in the liquidity premium) and higher interest rate volatilities. In particular, the disruptions on government bond spreads have a significant impact on the valuation of VIF which, according to the current methodology based on swap rates, does not benefit on the liability side from the higher returns offered by government bonds, but on the contrary is depressed on the asset side by the lower value of existing government bonds. Had the government spreads remained at the same level as at the end of 2009, the VIF at the end of 2010 would have been 2.5bln higher. Neutralising also the drop of the Italian equity market (linked to the same extraordinary pressure on local government bonds), the overall benefit for the VIF at the end of 2010 would have been 3.0bln.

Source: Assicurazioni Generali 2010 Life EV Supplementary Information

In conclusion, it is fair to consider that the approaches are getting more and more consistent and that the information disclosed is compliant with the CFO Forum requirements.

Only AIA discloses the method elected for the computation of the cost of capital.

d) Out of scope business

MCEV principles do not only deal with life insurance business, they also provide guidelines for the general insurance business. Group MCEV guidelines allow comparison of the entire business of insurance groups.
As a minimum standard, a Group MCEV should be presented in a suitable format including the covered business under the MCEVM and the non-covered business valued as the unadjusted IFRS net asset value. A mark to market adjustment should therefore not be performed for external borrowings and other items not on a mark to market basis under IFRS relating to non covered business. However adjustments may be required to ensure consistency between the value allocated to covered and non covered business for example:

- Where the IFRS treatment of pension scheme deficits does not bring in the full mark to market value;
- Where IFRS earnings are before tax; or
- Where IFRS is gross of minority interests.

We noted that the application of CFO Forum guidelines regarding the Group MCEV presentation varies from one insurer to another.

Firstly, not all the groups sampled disclosed a group MCEV.

As for the cost of the capital, only AIA discloses the Group Embedded Value.
Secondly, for the ones disclosing it, we identified several divergences in the application of the CFO Forum principle:

- **Group EEV/MCEV**
  - Yes
  - No
  - Is the asset management included?
    - Yes
    - No
    - How are the other businesses assessed?
      - Adjusted IFRS net assets
      - IFRS net assets
      - IFRS net assets + unrecognised unrealised gains

Some insurers deliberately exclude this business from the portfolio value.

MCEV principles recommend using the IFRS net assets. However, many insurers adjust net assets. These adjustments are justified by the fact that they bring more consistency between the businesses in the scope of the MCEV and the others. The issue is that it also brings more sources of divergence in the assumptions and as a consequence impedes comparability. This is increased by the low transparency noted for these adjustments.
e) Consequences of the ongoing convergence of MCEV with Solvency II

Our survey of the Group MCEV computation parameters and presentations still highlights some sources of divergence. However, we noted promising changes in the information provided by the insurers for the 2010 year-end:

- Some key assumptions are converging to the principles in Solvency II (illiquidity premium and cost of capital assessment). Areas of improvement can be found regarding policyholder and management behaviours; and

- The insurers are now more experienced in the MCEV/EEV computation as evidenced by the absence of material impacts from change in methods.

The first consequence of these findings is that such an indicator is likely to be volatile as Solvency II is expected to be. Recent experience on change in MCEV highlights the volatility risk.
This is confirmed by the sensitivity analysis disclosed by the sampled group. As an example, one insurer assessed that a change of 100 bps in the swap rate curve can impact the MCEV by 15%:

<table>
<thead>
<tr>
<th>Central Assumptions</th>
<th>Inforce MCEV</th>
<th>New Business VNB</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>EUR mn %</td>
<td>EUR mn %</td>
</tr>
<tr>
<td>Required Capital equal to local solvency capital</td>
<td>635 2</td>
<td>52 5</td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th>EV change by economic factors</th>
<th></th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td>Risk Free Rate – 100bp</td>
<td>–4,065 – 15</td>
<td>–299 – 27</td>
</tr>
<tr>
<td>Risk Free Rate +100bp</td>
<td>2,089 8</td>
<td>162 17</td>
</tr>
<tr>
<td>Risk Free Rate – 50bp</td>
<td>–1,726 – 7</td>
<td>–119 – 13</td>
</tr>
<tr>
<td>Risk Free Rate +50bp</td>
<td>1,176 4</td>
<td>99 10</td>
</tr>
<tr>
<td>Charge for CNHR +100bp</td>
<td>–445 – 2</td>
<td>–33 – 3</td>
</tr>
<tr>
<td>Equity and property values – 10%</td>
<td>–986 – 4</td>
<td>–42 – 4</td>
</tr>
<tr>
<td>Swap option volatilities +25%</td>
<td>–633 – 2</td>
<td>–61 – 6</td>
</tr>
<tr>
<td>Equity option volatilities +25%</td>
<td>–914 – 3</td>
<td>–21 – 2</td>
</tr>
<tr>
<td>delta to CFO Forum peers</td>
<td>4 –</td>
<td>27 3</td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th>EV change by non-economic factors</th>
<th></th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td>Lapse Rates – 10%</td>
<td>224 1</td>
<td>53 6</td>
</tr>
<tr>
<td>Maintenance Expenses – 10%</td>
<td>750 3</td>
<td>64 7</td>
</tr>
<tr>
<td>Mortality – 5% for products with death risk</td>
<td>205 1</td>
<td>23 2</td>
</tr>
<tr>
<td>Mortality – 5% for products with longevity risk</td>
<td>–350 – 1</td>
<td>–23 – 2</td>
</tr>
</tbody>
</table>

Source: Allianz Group Market Consistent Embedded Value Report 2010

This pro-cyclicality is likely to be highlighted by the extension of the risks modelled that so far are not included in the IFRS net assets used in the Group MCEV.

The second consequence is linked to increasing experience shown by the market in the MCEV production process. Some of the sampled group are now able to disclose change in MCEV analysis that is similar to the Solvency II change in best estimate analysis.
As an example, one of the groups sampled makes a distinction between the impact from experience variance and the change in assumptions at the year end:

Source: Zurich Financial Services Group Annual Report 2010

f) Other MCEV related indicators

New MCEV related indicators have been used by the insurance groups for the 2010 year-end. These are not really new by nature, but it is the first year that they are used as part of the financial disclosure by insurance groups.

The IRR (‘Internal Rate of Return’) is one illustration of indicators introduced recently. It corresponds to the rate of return generated by new business cash flows. IRR is defined in the CFO Forum principles and is often considered as a similar financial analysis ratio.

Another indicator recently introduced is the payback period, being the time needed for the available cash flows to equal the fixed capital.
These indicators do not as yet make the sampled groups’ performance easier to understand. They make the information more complicated and increase the volume of data to analyse. In addition to that, these indicators are volatile and difficult to compare from one insurer to another.
These key indicators are considered to be challenging for insurers as well as analysts: the information is plentiful, complicated, volatile and not easy to compare.

In that context, insurers were called upon to provide more tangible information. This is the reason why they disclosed more classic indicators, such as capital profitability.

This “back to basics” movement toward capital management is the subject of the last section of our analysis.
A. INTRODUCTION

Since the beginning of the financial crisis, investors and analysts have put the capital of large insurance groups under scrutiny. In the context of deep-rooted changes in the regulatory framework and disruption of the debt markets, there are considerable concerns regarding both the adequacy and management of capital.

The financial crisis highlighted the limitations of the solvency margin ratio under the Solvency I framework. This ratio does not capture all the risks borne by the insurance companies such as financial risks.

The Solvency II framework brings complexity into capital management and solvency margin assessment. The Solvency II approach is based on the quantitative assessment of risk by using prospective models.

At the same time, classic indicators such as capital profitability have been introduced into insurers’ financial disclosures. These indicators are indeed not specific to insurance business, but they are much more accessible to the investor community.

Therefore, capital management is now at the heart of insurers’ financial disclosure and is extensively developed in their annual reports.

Our survey focused on the following aspects of the capital management:

- The transition to Solvency II and the various capital models;
- The nature of the figures disclosed; and
- The indicators selected to measure the efficiency of capital management and the introduction of classic financial analysis indicators.
B. THE INFORMATION DISCLOSED REGARDING THE TRANSITION TO SOLVENCY II AND CAPITAL MODELS.

FRAGMENTED INFORMATION

One of the first findings of our survey is that information regarding the transition to Solvency II and capital models is spread among many financial disclosure documents: annual report, presentation of annual results to the analysts, papers distributed during investors' seminars etc.

Qualitative information is mostly contained in the annual report which discloses the issues related to the Solvency II transition and the operational impacts, such as:

- Status of the level 2 implementation measures;
- Description of the internal process to perform the transition and governance monitoring the project; and
- Status of the discussion with the regulator regarding the pre-approval process of the internal capital model, if any.

The quantitative information related to pillar 1 of the Solvency II directive is disclosed in the documentation for the analysts and the investors.

Where is the Pillar 1 information?

In the near future, all the Solvency II information will be found in one document, as required by Solvency II Pillar 3.
QUANTITATIVE INFORMATION ANALYSIS

The level of information provided varies significantly from one insurer to another.

We noted that it is difficult to identify the groups that have chosen to use an internal model, a partial internal model or the standard formula for the purpose of transition to the Solvency II framework. Based on our understanding, most of the large insurers and reinsurers tend to use an internal model.

Besides any issues related to current change in regulations, we analysed the nature of information provided by insurers using an internal capital model for the purpose of capital management. We noted that most of the sampled groups disclose global information for each main risk or line of business regarding their internal model. However, very few are disclosing:

- Quantitative data per risks, geographical areas, etc;
- Methods used and computation assumptions per risk; and
- Sensitivity analysis.
The information disclosed regarding the models varies significantly from one insurer to another. The Swiss, English and German insurance groups appear to be the most transparent in that regard.

Those variations can be found also among the Asian sampled group. The information disclosed by AIA and Great Eastern is limited to the local solvency margin requirements. QBE emphasises the capital model developed internally in order to monitor its risks and capital needs. QBE also shares its analysis of the possible impacts of Solvency II on its European partners involved in its reinsurance program.
Based on our analysis, the graph below presents the first findings regarding the quantitative information:

Over the last two years, the change in economic solvency ratio is significantly different from the solvency I ratio. The solvency I ratio is increasing slightly in 2010 while the economic solvency ratio is decreasing by 15%.

Little information was available to understand this divergence. The insurers rarely disclose an analytical review of their economic capital.

Insurers’ communication regarding their financial strength is still mainly driven by the Solvency framework, as is required by laws and regulations.

The sampled groups provide more and more information regarding the nature of the capital, disclosing for instance the portion of hybrid capital. This kind of information is relevant given the current debates about the treatment of hybrid capital in the Level 2 implementing measures.
Economic capital computation

At the 2010 year-end, seven of the sampled group provide a solvency ratio different from the Solvency I ratio. We analysed the related quantitative information provided by these seven insurers. It appears that many discrepancies have been reported in the confidence level used to measure the economic capital needs, as evidenced by the graph below:

These discrepancies impede comparability between the insurers, even if some of them disclose the outcome of their capital model with different confidence levels. This situation is emphasised by:

- the poor level of information regarding assumptions used and the nature of the business and assets modelled; and
- sensitivity of the models to the key assumptions, as evidenced by the graph below extracted from the financial disclosure of one of the group sampled:
As of today, the objectives of comparability and consistency are far from being achieved.

Only three among the seven that disclose an economic capital solvency ratio mentioned that it is compliant with the Solvency II framework. This situation is understandable as the Solvency II framework is not finalised so far. Many issues are pending such as future premiums, tax, strategic investment valuation and tier classification (value in force, subordinated debts, etc). The insurers did not disclose the options elected regarding the Level 2 implementing measures.

So far, it is still a challenge to anticipate how investors and analysts will consider the solvency margin under Solvency II as a relevant financial disclosure indicator.

**MAIN FINDINGS**

Within the implementation of the Solvency II framework, we noticed that the economic capital ratio disclosed by the sampled groups is so far satisfactory (150% in average). However, it is too early to conclude on their capital adequacy under Solvency II as most of the assumptions used may differ from the final ones applied.
Despite the lack of outlook, we can still find in the most accomplished annual reports information regarding the economic capital (sensitivity analysis, weighting per type of risks, diversification effect, etc). This information is particularly relevant for the investors and analysts for the purpose of the assessment of the insurers' financial strengths.

Source: Analysts’ Conference 2011 Munich RE

**Allocated internal risk capital by risk category**
*(total portfolio before non-controlling interests)*
*as of December 31, 2010 (December 31, 2009)*

Pre-diversified before tax, in € mn

- Total Group internal risk capital: 45,149 (43,809)
  - Business risks: 7,254 (6,993)
  - Underwriting risks: 12,028 (10,944)
  - Market risks: 18,997 (19,720)
  - Credit risks: 6,871 (6,152)

*Source: Allianz Group Annual Report 2010*
The general trend observed within the sampled groups is a significant increase of the Solvency II related information in all the financial disclosure documents. Nevertheless, some insurers are not able to provide such information at this juncture. The potential postponement of the Solvency II implementation will enable them to continue improving their annual reports in this regard.

C. CAPITAL MANAGEMENT EFFICIENCY INDICATORS

As already highlighted, capital management is now at the heart of the insurers’ financial disclosure. This trend implies the use of classic indicators such as the ROE (Return on Equity).
Asian sampled groups present and also insist on the ROE.

Some of the sampled groups already make a connection between the measure of this efficiency and the economic capital by using new indicators such as the ROEC (Return on Economic Capital) or the Operating Free Cash Flow Generation:

Even if the purpose of this trend is to address the investors and analysts’ concerns, the increase in the number of indicators impedes the analysis and the comparison of the information.
Conclusion

Insurance groups’ disclosure regarding profitability and economic capital is challenging not least because IFRS is currently unable to adequately address these requirements and other frameworks are not yet finalised.

Our survey demonstrates that insurance and reinsurance groups sampled significantly improved their disclosure around these matters. Nevertheless these efforts did not go as far as mitigating rising investors’ and analysts’ concerns regarding the future impact of ongoing regulatory changes.
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