

THE FINANCIAL COMMUNICATION OF INSURANCE GROUPS: FOCUS ON THE INTRODUCTION OF SOLVENCY II

AS OF 31 DECEMBER 2015



CONTENTS

INTRODUCTION	4
SCOPE OF THE SURVEY AND COMPOSITION OF THE SAMPLE	6
1. COMMUNICATION ON SOLVENCY II	7
1.1 What information has been communicated about Solvency II?	8
1.2 Evolution of Solvency I and Solvency II ratios	11
1.3 Regulatory capital requirement and breakdown of risks	13
1.4 Models used	16
1.5 Methodologies	19
1.6 Eligible own funds	27
1.7 Volatility of Solvency II ratios: sensitivity analyses results	28
1.8 Impact on capital management and future prospects	30
1.9 Performance indicators: the end of embedded value?	34
2. OTHER MATTERS OF ATTENTION AT THE 2015 YEAR-END	38
2.1 Impact of persistent low rates	39
2.2 IFRS 9: Financial instruments	41
CONCLUSION	43

INTRODUCTION

Over the years, financial communication has become an essential aspect of promoting the activities of large groups, especially for insurers, with their particular business model.

The exercise has particular salience this year with the arrival of the European Solvency II Directive, introducing far-reaching changes in the matter of capital requirements and risk management.

2015 stood out as the year of preparation for the introduction of Solvency II, which became mandatory on 1 January 2016, and this was reflected in a significant increase in the volume of disclosures published by insurance entities on the application of the Directive, in particular on their financial soundness in this new environment and hence on their current and future ability to distribute dividends.

Against this background, we have taken a closer look at the information available on Solvency II, the major issue in financial communication in 2015, than in previous years when our analyses focused more particularly on performance indicators and some accounting topics.

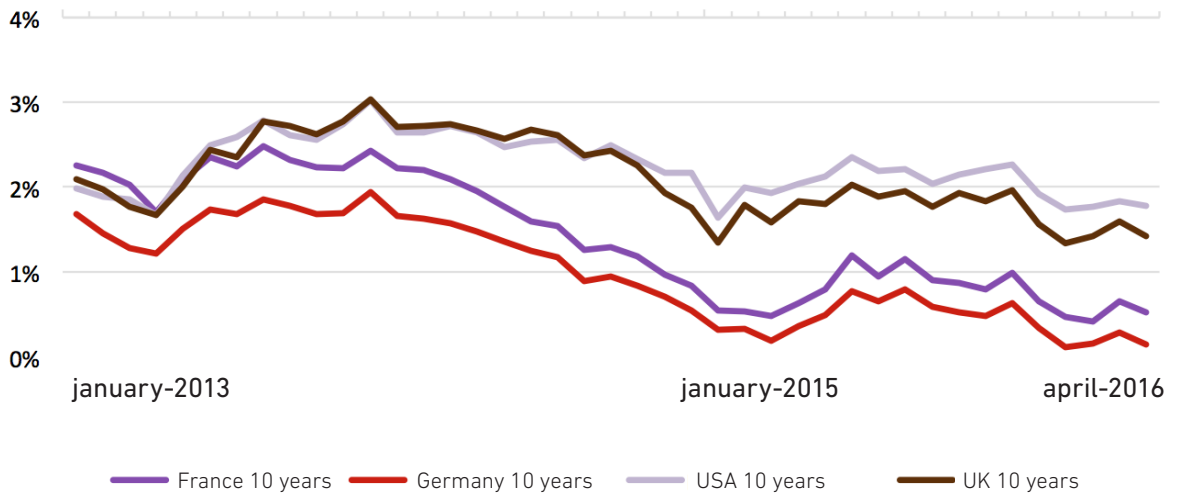
Our analysis mainly addresses the following areas:

- What disclosures were made on solvency indicators, and with what level of detail?
- Who uses an internal model and what information is provided on the details of the methodologies applied? What are the uncertainties?
- What disclosures are made on capital requirements? Who has published a breakdown by risk of the Solvency Capital Requirement (SCR)? What are the trends?
- Is volatility under control? How did the Solvency I and Solvency II ratios change between 2014 and 2015? How many entities have published sensitivity analyses?
- What disclosures are published on capital management? Are there any visible impacts of the introduction of Solvency II?
- Are there multi-standard reconciliations, and what are their impacts on embedded value?

We have also analysed the accounting information provided by entities on the rate risk in the unprecedented context of interest rates stuck at a historically low level.

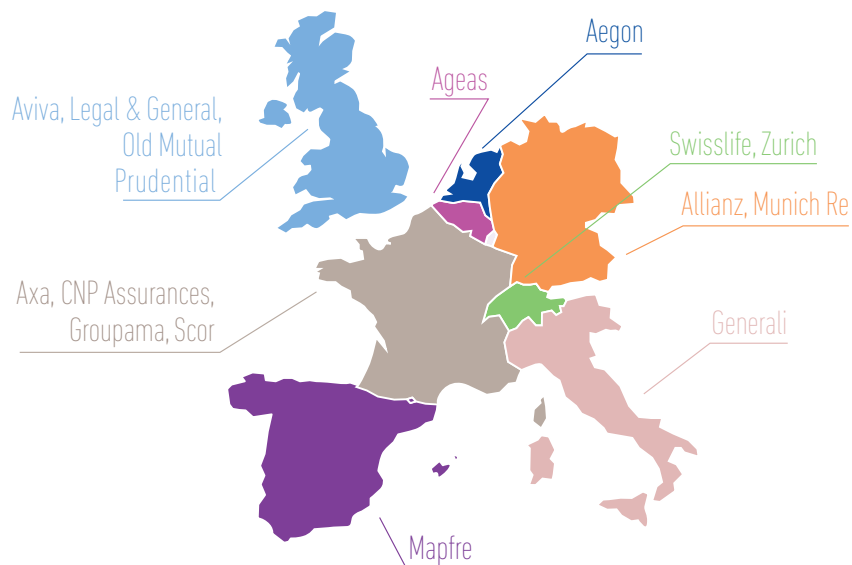
Finally, we have also covered disclosures on the progress towards and expected impact of the introduction of IFRS 9 – Financial instruments, which has still not been endorsed at the European level.

Changing interest rates



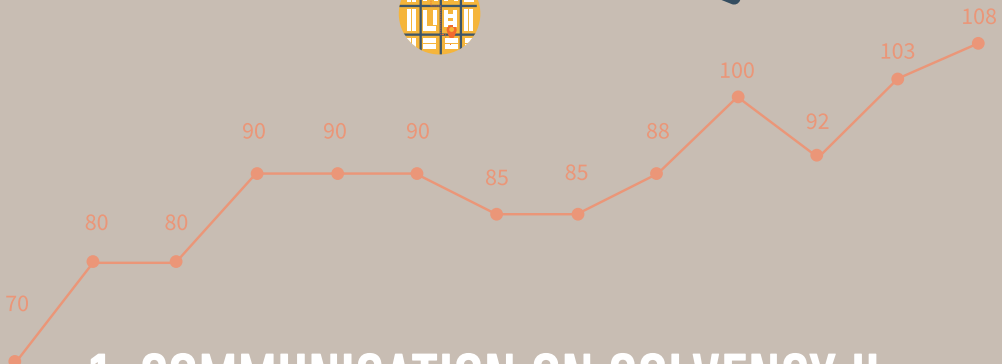
SCOPE OF THE SURVEY AND COMPOSITION OF THE SAMPLE

Our sample consists of the following 16 European insurance and reinsurance groups, including two Swiss companies that publish their accounts using IFRS:



However, the financial publications of Swiss insurers have not been taken into account in our analysis of Solvency II communication, since these insurers are not subject to the Directive.

We illustrate our analysis of these topics using extracts from communications to financial analysts and annual reports issued by the sample entities.

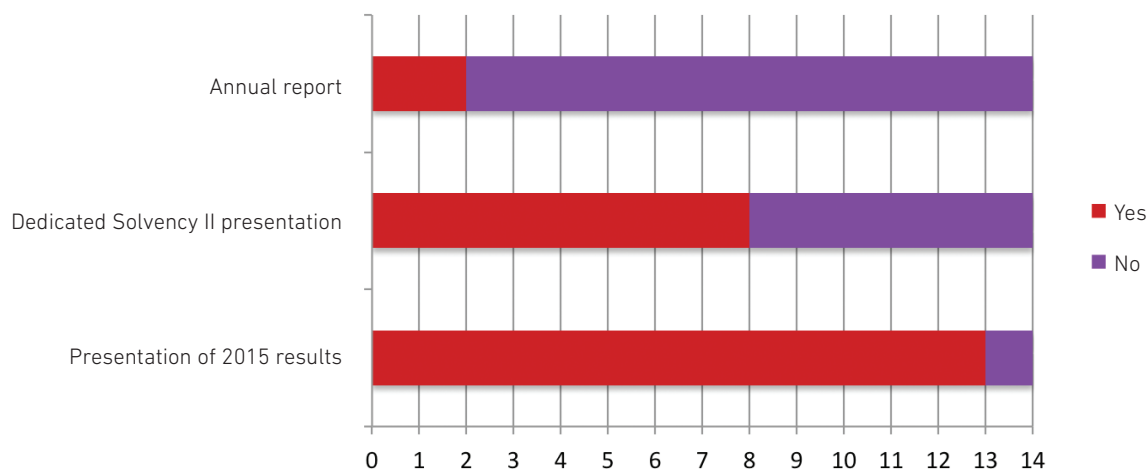


1. COMMUNICATION ON SOLVENCY II

1.1 What information has been communicated about Solvency II?

Where can you find the information?

The information provided by the players in our sample is particularly revealing this year in comparison with the 2014 financial period. The entry into force of the Solvency II Directive has been accompanied by numerous presentations from insurance groups. The format is fairly varied, as the graph below shows.



Of the companies surveyed only one failed to provide information on Solvency II in 2015. The thirteen players who published disclosures on Solvency II did so in the presentation of their 2015 results to analysts. Of these thirteen players, eight published a presentation dedicated to Solvency II ahead of the reporting date. They have generally taken advantage of the approval of their internal models by the regulators to transmit information to the market and to provide specific presentations on the subject. Approval of the model has removed many of the uncertainties as to the methodology chosen and hence as to their ratio. The presentations made on this occasion were therefore more detailed than those made when presenting the results to analysts.

Finally, two players included qualitative and quantitative information on Solvency II in their annual reports. These appear to us to be the most mature players in this respect. The level of disclosures provided is more detailed in terms of the calculation methods, results and sensitivities. Ultimately we believe that this method of communication should become a standard, and would potentially allow insurers to incorporate the Solvency and Financial Condition Report (SFCR, the regulatory report intended for the public) in their annual report.

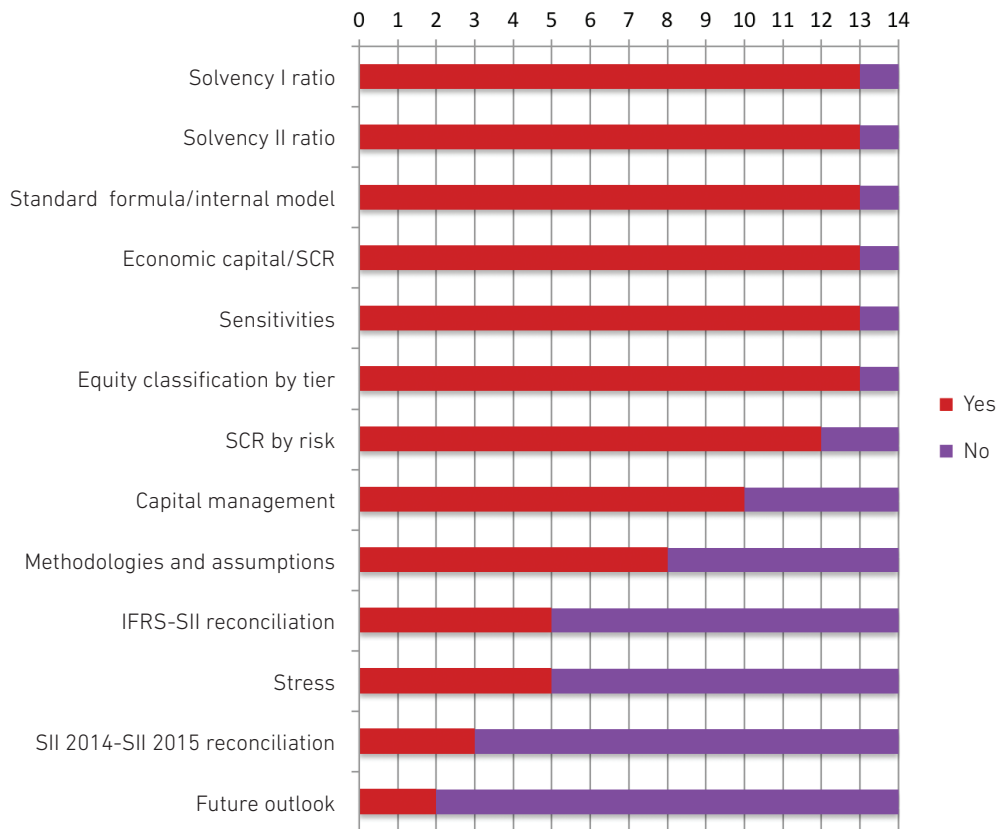
We have found an overall consistency in the content of these messages, with a desire to reassure investors that groups remain financially sound with this new framework.

What kinds of disclosures are published?

The insurers in our sample have communicated information of several kinds:

- Solvency ratios (Solvency I and Solvency II)
- Economic/eligible own funds
- Regulatory capital required (Solvency Capital Requirement - SCR)
- Sensitivity analysis of the Solvency II ratio
- Capital management
- Use of the standard formula or an internal model.

The table below indicates the number of players who provided disclosures on these different aspects:

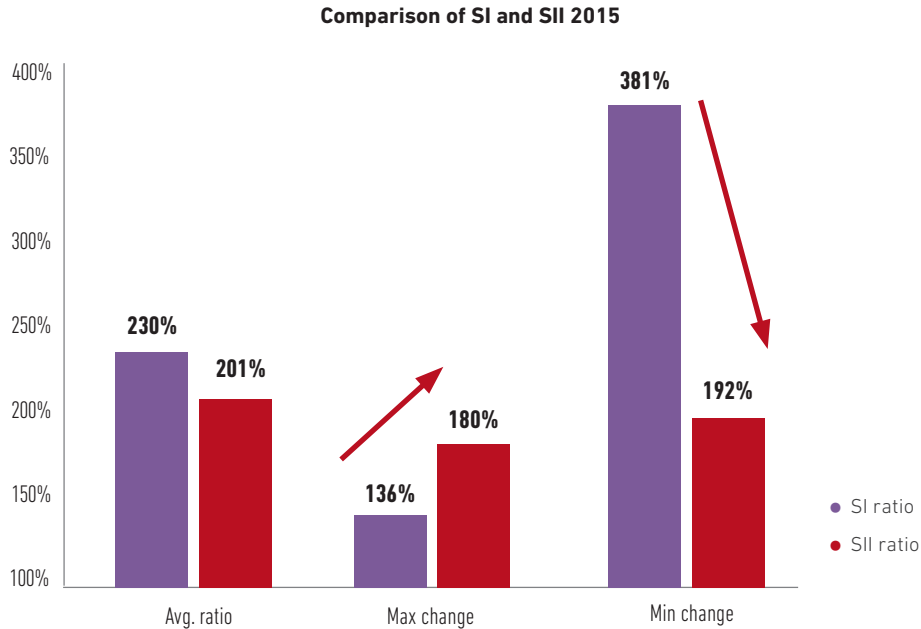


WHAT ARE THE MAIN LESSONS?

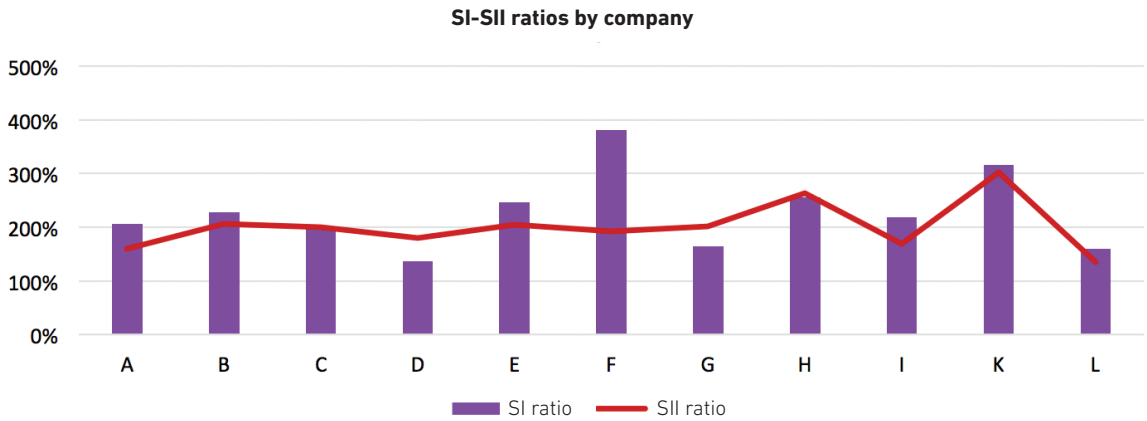
- Of the fourteen insurers in our sample subject to Solvency II regulations, only one player gave no information about its Solvency ratio. The remaining insurers provided both the Solvency II ratio and the Solvency I ratio that was still in force at 31/12/2015.
- Disclosures on the use of the standard formula or the partial or full use of an internal model were provided by all the companies publishing their Solvency II ratio.
- We also consistently found interesting results regarding analyses of the sensitivity of Solvency II ratio to certain parameters, financial in particular, although these parameters were not consistently applied by all the players.
- Twelve insurers disclosed the breakdown of their SCR (Solvency Capital Requirement) by risk (financial risks, underwriting risks, etc.).
- However, disclosures on capital management in the Solvency II framework are less systematic.
- Methodologies and assumptions are hardly described at all by the insurers in our sample - these topics which were the subject of controversial discussions within the industry are given little detailed explanation. We shall return to this later in our study.
- Little information is given on the future outlook. Few players report on the future development of their ratio. It would have been particularly interesting to see a forward-looking vision under the current interest rate scenario. This type of information will surely be more widespread in 2016 communication.

1.2 Evolution of Solvency I and Solvency II ratios

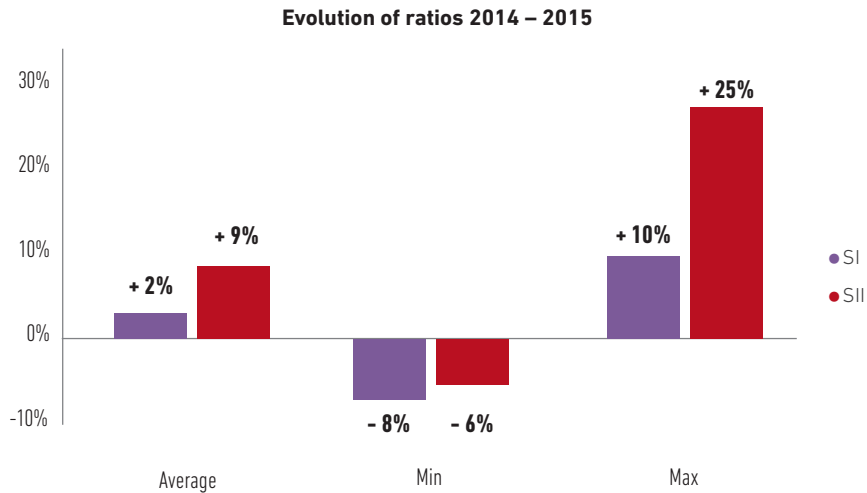
We have analysed the evolution of Solvency I and Solvency II ratios. The players publishing their ratio report an average Solvency I ratio of 230% against 201% for the Solvency II ratio at the end of 2015. This reduction associated with the introduction of Solvency II was expected, given the more restrictive nature of this new framework.



The case presented on the right of the graphic above relates to a player who also disclosed a Solvency I ratio including unrealised gains. At the end of 2015, the Solvency II ratio of the sample was within a range of 135% and 302%. The majority of players had a ratio close to 200%. For the players towards the bottom of the scale, management clarified that the capitalisation level appears to be reasonable to them. This is a reassuring initial snapshot at 31.12.2015, without prejudice to future changes in Solvency II ratios, which are extremely sensitive to financial parameters.



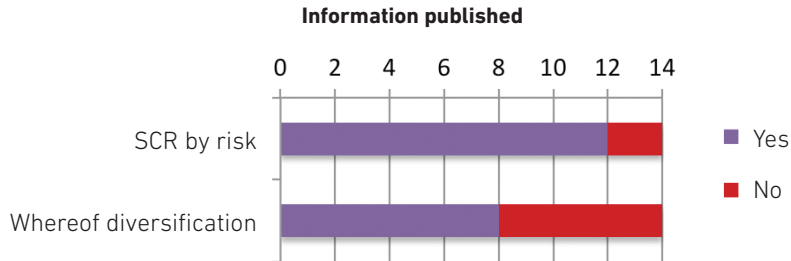
We have also compared the change in Solvency I and Solvency II ratios between 2014 and 2015. As expected, and as illustrated in the graphic below, the Solvency II ratio is more sensitive. By nature, Solvency II capital based on a fair value balance sheet and the SCR calculation are more sensitive to financial parameters.



We found that the average change in Solvency I ratios was +2% between 2014 and 2015 while the change in the Solvency II ratios was +9% over the same period. Nonetheless, these changes are based on a single year of observation, which is insufficient to reach a conclusion.

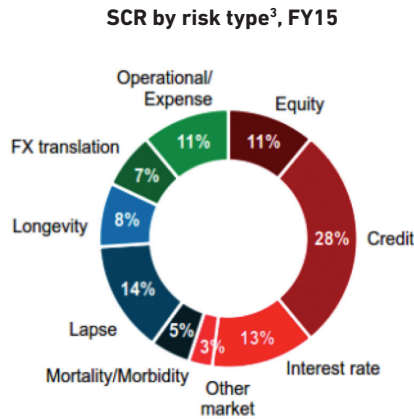
1.3 Regulatory capital requirement and breakdown of risks

Twelve players in our sample gave the details of their SCR by risk. We analyse the risk profile expressed by the breakdown of the SCR before diversification into financial risks, underwriting risks, etc.



The level of information provided is varied. Some players provided very granular detail of the SCR by sub-risk, for example distinguishing the risks of longevity, redemption and mortality within Life risks, whereas others give a much more aggregated picture, simply dividing their SCR into five categories. This wide variety of presentation does not make it easy to compare the players.

Example of an insurer detailing the sub-risks:

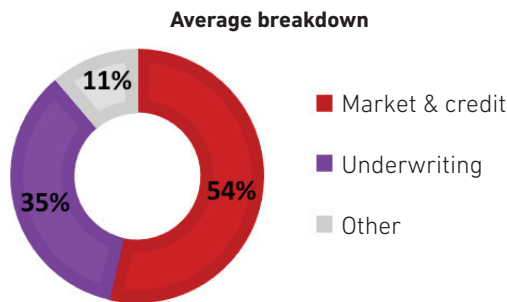


Source: Prudential - Results 2015 presentation

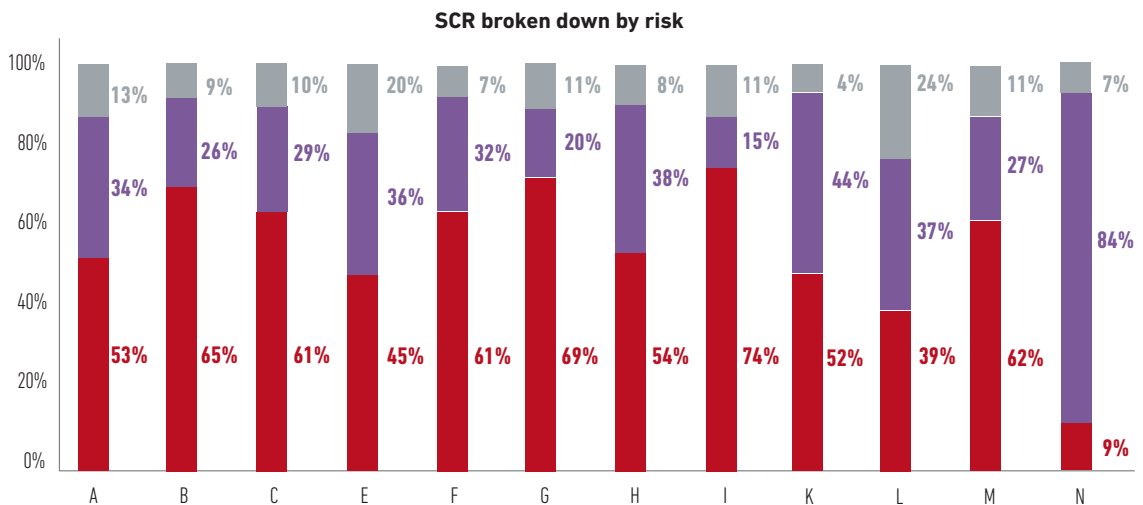
The classification of the spread risk varies from one player to another. For example, one player includes the spread risk in the credit risk, whereas in general it tends to be classified in the market risk.

To present the quantitative analyses of the breakdown of the SCR by risk, we have excluded the effects of diversification and have aggregated:

- market risk with credit risk;
- underwriting risks in Life, Non-Life and Health;
- operational and other risks.



Our analysis shows that on average, market and credit risks represent more than half of the SCR. The market and credit risk weighting in the SCR varies from 9% to 74% depending on the players. This disparity can be explained by the activities of these entities. The player with a significant underwriting SCR is a reinsurer and more focused than traditional insurers on insurance of risk (non-life, protection).



It will be interesting to analyse how this breakdown changes over time, in particular how changing risk profiles reflect management measures for capital management and “derisking”.

One player provided disclosures on the changes in its risk profile in conjunction with derisking measures taken by the management (in particular for credit risk).

Risk management – Risk disclosure

Breakdown of Solvency Capital Requirement (SCR) by risk category for Munich Re according to internal model¹



Solvency capital requirement – Breakdown by risk category and segment							€bn
Risk category	Group			RI	ERGO	MH	Remarks
	2014 ²	2015	Delta	2015	2015	2015	
Prop.-Casualty	5.7	6.3	0.6	6.2	0.4		P-C: Increase driven by reinsurance – FX and growth in special risks
Life/Health	4.8	4.7	–0.1	3.8	1.3	0.3	
Market	8.8	8.7	–0.1	5.8	4.3		Credit: De-risking of investment portfolio and full implementation of SII methodology
Credit	4.6	4.2	–0.5	2.7	1.6		
Operational risk	1.0	1.0	–	0.8	0.4	0.1	
Other ³	0.2	0.1	–0.1				
Simple sum	25.1	25.1	–	19.3	8.0	0.4	
Diversification	–9.1	–9.3	–0.1	–7.4	–2.1	0.0	Diversification benefit: 37%
Tax	–2.2	–2.3	–0.2	–2.0	–0.7	–0.1	Loss-absorbing capacity of deferred taxes
Total SCR	13.8	13.5	–0.3	9.9	5.2	0.3	

No major movement in SCR reflects unchanged risk profile of Munich Re (Group)

¹ Munich Re uses a full internal model, which was approved by BaFin and core college in 2015.

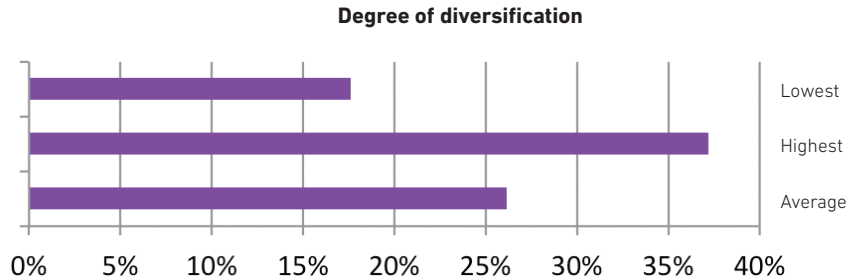
² After reconciliation into SII metric.

³ Capital requirements for other financial sectors, e.g. institutions for occupational retirement provisions.

We can expect this type of presentation to become more widespread.

We also looked at the degree of diversification reported by players in our sample.

For the eight players who published this information, the degree of diversification lies within a range of 18% to 37% of the SCR.



On average, diversification reduces the group SCR by a quarter. Unsurprisingly, large insurance companies active across multiple geographic areas and/or in multiple business lines and large reinsurers show the highest degree of diversification.

No information on the method of calculating diversification was reported by insurers in our sample.

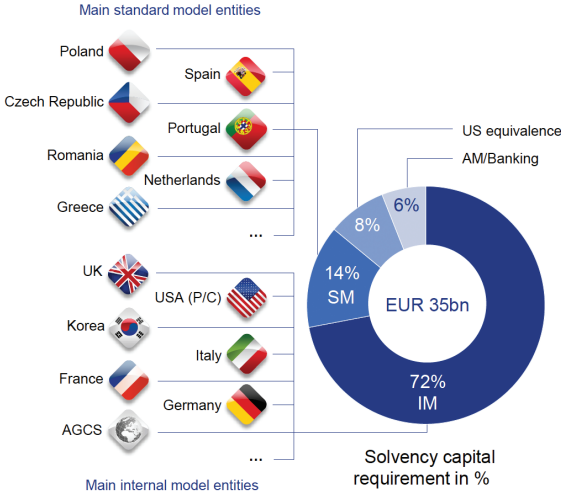
1.4 Models used

The thirteen groups in our sample which provided information on Solvency II reported whether they had used either a partial or full internal model or the standard formula and, where appropriate, whether the regulator had approved the internal model.

Our analysis highlights a number of points:

- Two players use the standard formula; unsurprisingly, they are the smallest companies in our sample;
- Only four companies used a “full” internal model (covering all the risks and with sufficient geographic reach). This is not very many at the European level and reflects the expense of introducing a full internal model, in particular the difficulties of justifying all the assumptions, documenting them and completing the regulatory approval process;
- Of the players who indicated that they used a partial or full internal model, all reported that their model had been approved by the regulator. Only two of these players reported the absence of conditions precedent in conjunction with the approval of their internal model. In the other cases, we assume that the model was approved subject to conditions, potentially sources of risk in terms of capital add-on. This is a point to follow-up on when reviewing the publications next year.

We identified an example of good practice in terms of geographic and business line cover in an internal model which breaks down the SCR between the scope of the internal model and the scope of the standard formula, the US equivalence part (the US regulatory regime has obtained equivalence for use in Solvency II), but also the regulatory capital allocated to banking and asset management.

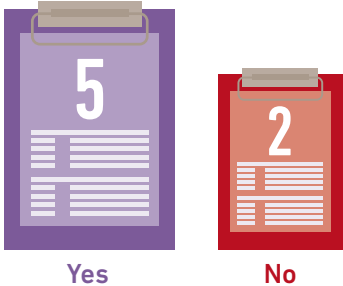


Source: Allianz - Presentation of 2015 results

We have also considered the seven players using a partial internal model, and more particularly the risks covered by the model. Only five of them gave any detail of the risks covered.

Information on the risks modelled

The risks covered by these five players are summarised in the table below:



Partial internal model	B	C	D	G	H
Market & credit	●	●	●	●	●
Life underwriting	●	●	●	●	●
Non-Life underwriting	●	●	●	●	●
Operational	●	●	●	●	●
Other	●	●	●	●	●

● Internal model ● Standard formula

We found that:

- Market risk and credit risk are modelled by a majority of groups;
- the Life underwriting risk is not consistently modelled: the interaction of assets and liabilities makes this modelling very complex, which explains why only three of these five players have opted for an internal model;
- the Non-Life underwriting risk is consistently modelled: these risks are more easily calibrated and modelled;
- the operational risk is seldom modelled (only two of these five players), probably because of data availability issues.

One player includes all the risks – its internal model is partial because of incomplete geographical cover.

Internal model vs. standard formula:

There is no current obligation for players using an internal model to publish the ratio calculated using the standard formula.

Nonetheless, one of the insurers in our sample using an internal model presented a comparison of the internal model and the standard formula based on data for the first half of 2015. This information was published as part of the disclosures on Solvency II ahead of the 2015 reporting date.

This comparison is interesting, because it highlights the reduced capital requirement resulting from the use of an internal model. In the case of the player concerned, the increase of the SII ratio due to using the internal model is insignificant at 31 December 2015: its solvency ratio is 210% applying the standard formula compared to 221% using the internal model for the first half of 2015. This finding

does not allow for a general conclusion. Nonetheless, we believe that this information is useful to shareholders, who could use it in assessing the return on investment associated with the introduction of an internal model.

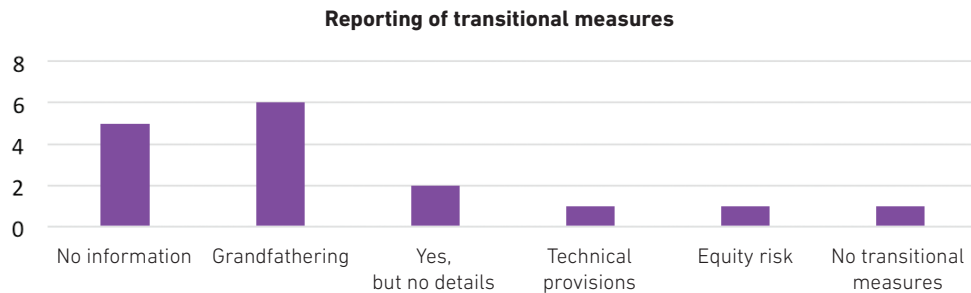
1.5 Methodologies

Our survey found that few players give details of the specific methodologies used in their model, despite their diversity.

In this part, we have identified areas that were discussed during the introduction of the Solvency II Directive where there could be divergences between the companies, and for which we could expect a certain level of information from insurance groups.

Transitional measures

The first aspect analysed is the transitional measures permitted in Solvency II. This is because the Directive offers entities the option to use transitional measures to spread the impact of the transition from Solvency I to Solvency II. These measures can be applied to the technical provisions and to equity risks.



One player explicitly reported that it was applying transitional measures to technical provisions and to equity risks, disclosing the impact of these measures on the Solvency II ratio.

Note that this communication is required by the regulatory texts. Another entity reported that it was not using any transitional measures, but the great majority of our sample made no reference to the use of these measures, or only mentioned their use of the Grandfathering¹ of subordinated debts among the transitional measures allowed.

1: Transitional measure allowing entities to maintain, for a ten-year period, the Tier 1 or Tier 2 classification of perpetual debt issued under Solvency I rules and no longer meeting the criteria of the new Directive.

We therefore deduce that these entities are not using any other transitional measures. However, more explicit information in this respect could be expected.

Below is the example of a player providing explicit details of the use of transitional measures.

Appendices

MEASURES FOR ADAPTATION TO SOLVENCY 2

- The new Solvency 2 framework leads to large increases in technical reserves and regulatory capital requirements. Consequently, Omnibus 2 was drafted, incorporating specific measures – measures of the long-term guarantees package – adapted to long-term life insurance products.

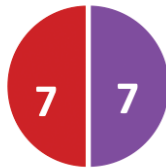
Long-term guarantee measures		Needs a request for approval	Application
Permanent measure	Volatility adjustment (art.77d)	×	✓
Permanent measure	Matching Adjustment (recital 17f, art.77b&c)	×	×
Transitional measure	On technical reserves (art.308D)	✓	✓
Transitional measure	On rates (art.308C)	✓	×
Other measures			
Transitional measure	Reduced equity shock	×	✓

Source: Groupama - Presentation of 2015 results

Fungibility

Fungibility reflects the ability to use the capital of entities within the group. Of the thirteen players surveyed, seven describe the extent to which they take account of fungibility. In general, the information provided is brief and fairly diverse across the players. As a minimum, non-controlling interests in subsidiaries are disclosed within capital not considered fungible.

Fungibility of capital



■ No information

■ Details of constraints

Some players reported stricter constraints on fungibility. Some said that they took account of constraints on the surpluses of foreign subsidiaries outside the European Union, others of restrictions on surplus ceilings which could not be used at group level.

We found a wide diversity of practices in the manner of considering capital as fungible. However, no precise information enabled us to measure materiality at group level. This is an interesting topic which should be reported in more depth in the future communication of insurance groups.

Tax absorption in the calculation of the SCR

The Solvency II Directive and its Delegated Acts offer insurance groups the option of calculating tax absorption in the SCR, that is, of recognising the carryforward tax effects of the 1-in-200 shock. It would be useful to identify the extent to which insurance groups recognise these tax losses, but little information was published on this topic.

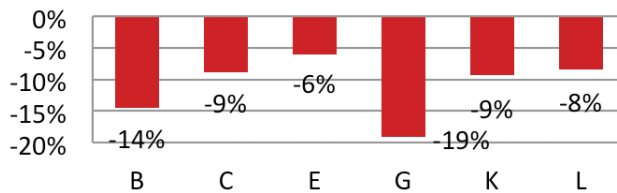
Four of the thirteen players simply gave an amount, with no explanation of the calculation method. Two provided details of the amount and of methodological aspects, in this instance capping the tax absorption at the amount of the net deferred liability recognised in the Solvency II balance sheet.

Absorption capacity of deferred tax



Nonetheless, the regulations provide for the possibility of going beyond the net liability position of the Solvency II balance sheet when a recoverability test is conducted. So far, we have no information suggesting that any of the players used this option by conducting such a test. More detailed communication on the subject would be helpful, given the amount potentially concerned.

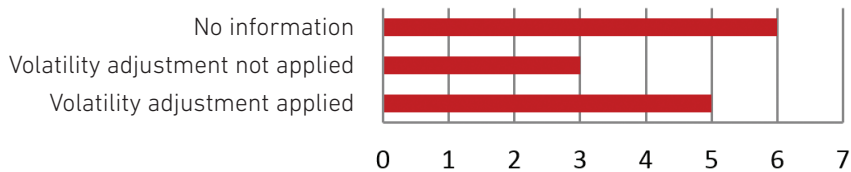
Absorption capacity/SCR



Volatility Adjuster - VA

The approach to determining the volatility adjuster applied to the discount rate is seldom the subject of accurate communication. This is because some groups adapt the volatility adjuster when calculating the SCR (taking into account the impact of widening bond spreads), while others fix this parameter. In our sample, one player gave clear information on the chosen methodology. It may be appropriate to develop the disclosures on this topic.

Use of the Volatility Adjuster



Example of disclosures on the volatility adjuster:

Volatility Adjuster (VA)

- The Volatility Adjuster has been applied according to EIOPA rules
- The market value of assets in the AFR reduces when spreads widen.
- The Volatility Adjuster applies a corresponding adjustment to the liabilities
- This reflects our **ability to bear illiquidity risk** on assets backing long term liabilities

-13pts impact on our Solvency II ratio in case of +75bps widening corporate spreads and **stable VA**

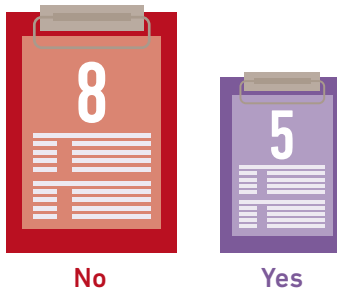
- The VA is calculated using the weighting of corporate and sovereign bonds in a reference portfolio of the assets of European insurers
- EIOPA VA = 65% [$w_{gov} * S_{gov} + w_{corp} * S_{corp}$]
with $w_{gov} = 38.7\%$ and $w_{corp} = 48.2\%$

A reduction by 5% in the weighting of corporate bonds in the reference portfolio would reduce our Solvency II ratio by **5pts**

Source: AXA – Investors' day presentation

In terms of the balance sheet, we found that the use of the volatility adjuster varied significantly from one player to another. This diversity may be linked to the companies activities. For reinsurers, for example, who have little asset-liability interaction, the volatility adjuster is generally not material.

Use of the Volatility Adjuster



IFRS – Solvency II reconciliation

Communication on the reconciliation of IFRS equity to Solvency II own funds is another good practice which we found. Most of the time, this is communicated in the form of a bridge. These reconciliations are very valuable for recalling the methodological differences between the two frameworks.

The example below represents all the aspects of the IFRS-Solvency II reconciliation:

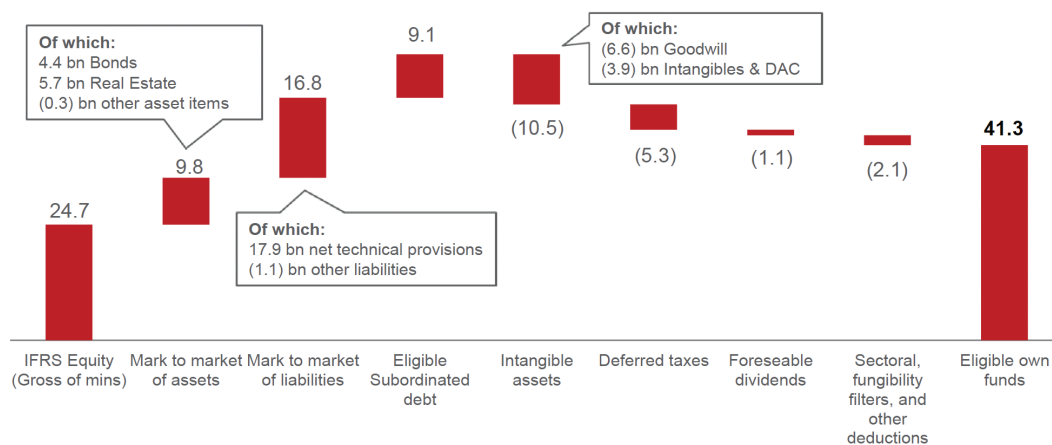
- Cancellation of intangible assets (goodwill, DAC, etc.);
- Assets at fair value if they are not already accounted for at FV in IFRS;
- Remeasurement of liabilities at Best Estimate;
- Reclassification of eligible subordinated debts;
- Deferred taxes on Solvency II adjustments.

An example of reconciliation is presented below:

Reconciliation of IFRS equity to Solvency II Eligible Own Funds

Solvency II Eligible own funds

(FY15, Euro bn, Internal model view)



© Generali

March 18, 2016 Results 2015



Source: Generali - Presentation of 2015 results

Reconciliation of Solvency II 2014 ratio to Solvency II 2015 ratio

Some players disclose the variances in their Solvency II ratio between 2014 and 2015. This enables users to understand and analyse the changing ratio in terms of capital generation, but also in terms of the evolution of risks.

The level of analysis is highly aggregated, with few details of the evolution of the underlying risks in the calculation of the SCR.

Example of reconciliation:

	Excess Own Funds ⁽¹⁾ (Euro bn)	Solvency II ratio (%)
FY 2014	17.7	186%
Perimeter & FX	0.5	+2%pts.
Normalised capital generation	3.1	+16%pts.
Variances and other movements	0.6	+3%pts.
Dividends (proposed for FY15)	(1.1)	-5%pts.
FY 2015	20.9	202%

⁽¹⁾ Eligible Own Funds in excess of Solvency Capital Requirement (full internal model view)

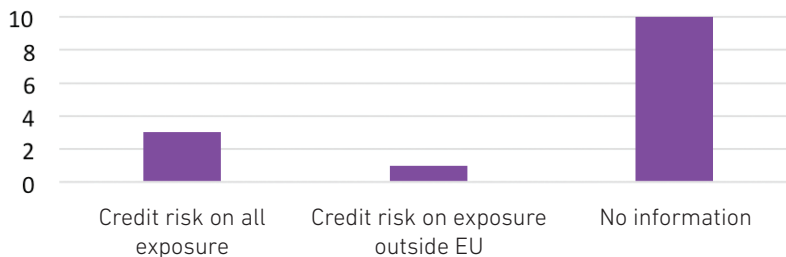
Source: Generali – Presentation of 2015 results

Modelling sovereign risk

The methodology for modelling sovereign risk has been the subject of much discussion. Of the thirteen players providing Solvency II data, ten made no mention of the way in which sovereign risk is treated in their solvency calculation.

Of the three players who did make disclosures on their way of assessing sovereign risk, two had taken account of all of their credit exposure, and just one took account of the credit risk on sovereign bonds outside the European Union. The difference between the two may turn out to be material.

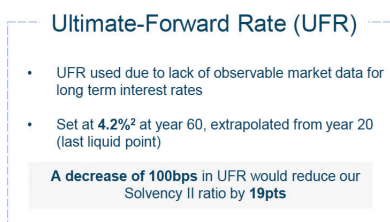
Sovereign risk methodology



Ultimate Forward Rate - UFR

The Ultimate Forward Rate corresponds to the ultimate discount rate used in calculating the best estimate, at year 60 and beyond, in the absence of observable market data. This regulatory rate is a parameter which insurance groups do not control. Given the current economic environment, the level of the UFR (4.2%) has been much discussed, and a downward review by the regulator is likely.

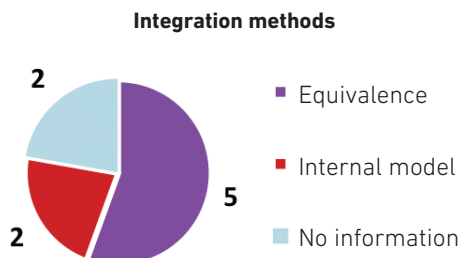
Some players have calculated the sensitivity of the Solvency II ratio to a reduction in the UFR. We have taken the example given by one member of our sample: a fall of 100 pts in the UFR would lead to a substantial 19% fall in the SCR.



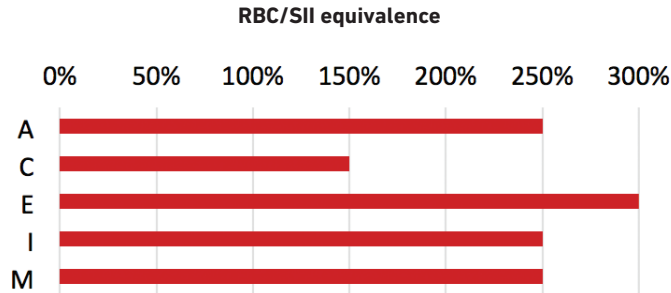
Source: AXA – Investors' day presentation

Integration of American subsidiaries (Risk-Based Capital regime - RBC)

This is the final methodological aspect analysed in this study. Given the regulatory equivalence of the US framework, groups with American subsidiaries can integrate local regulatory capital requirements directly in their Solvency II ratio. All the players concerned (nine of the thirteen surveyed) indicated the way they integrate their subsidiaries in the ratio, with some interesting disparities. While the majority use the equivalence as authorised by the regulator (five of the nine), two chose a Solvency II internal model.



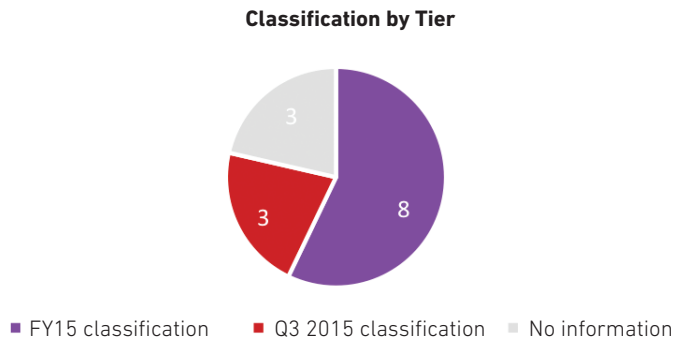
RBC levels also varied greatly, from 150% to 300%, as shown in the graph below. Little information is available to explain the level chosen or the sensitivity of the ratio to this choice.



We believe it would be appropriate to provide an explanation of the way in which the RBC levels were set, along with sensitivity analyses to changes in the RBC for insurance groups.

1.6 Eligible own funds

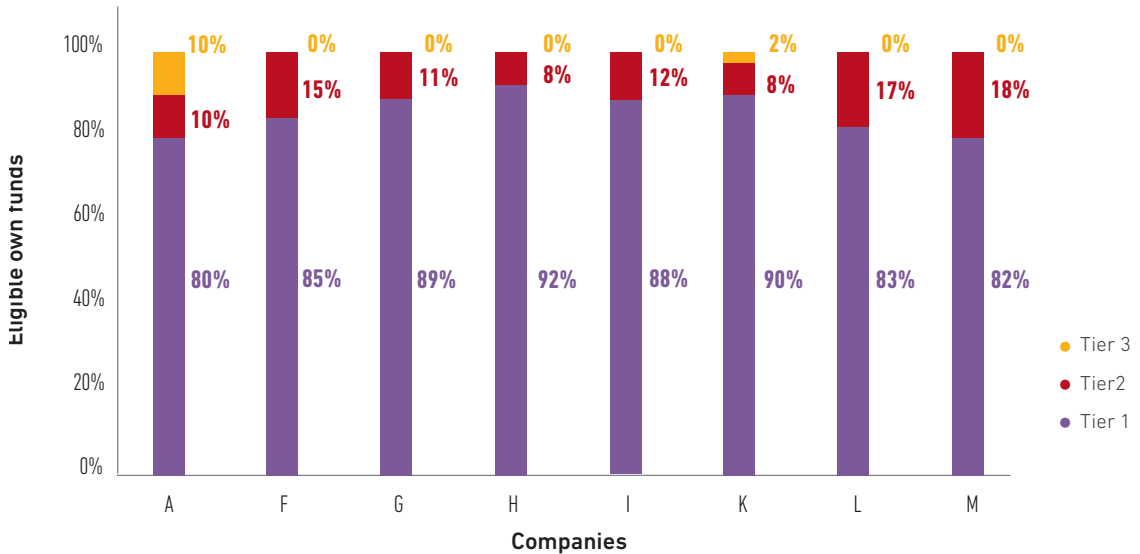
All the European insurance groups communicated their level of eligible own funds under the Solvency II framework.



The information published on the breakdown of own funds by tier revealed a predominant proportion of Tier 1 (86% on average), reflecting the quality and solidity of the insurers' own funds and their capacity to absorb losses.

It should be noted that the current breakdown incorporates the benefits of grandfathering subordinated debts, as described above (see 1.5. *Transitional measures*).

Breakdown of eligible own funds

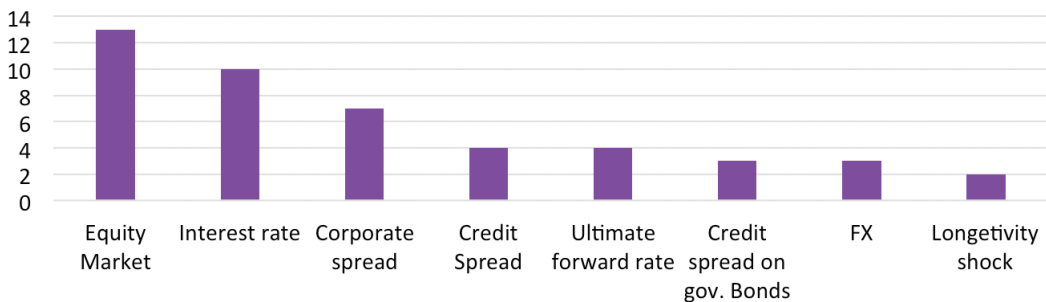


1.7 Volatility of Solvency II ratios: sensitivity analysis results

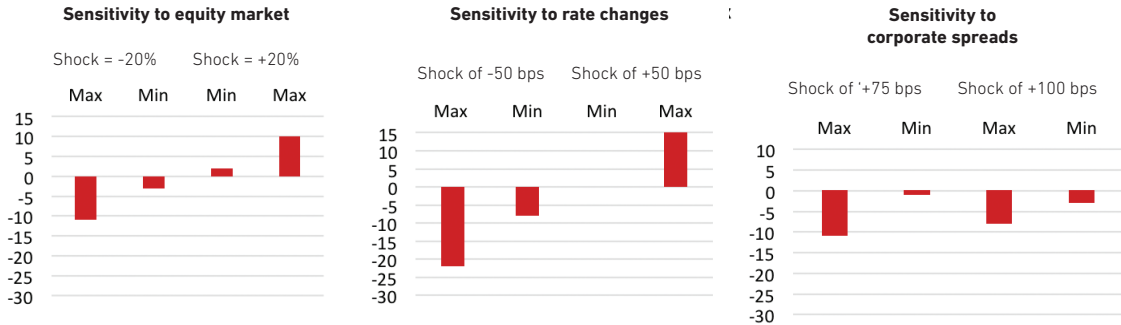
Given the intrinsic sensitivity of the Solvency II ratio, in particular to market parameters, many players included a sensitivity analysis.

The effects of interest rate variations, equity markets and corporate spreads represent the most frequently tested parameters.

Sensitivity tests: the indicators analysed



Of these three parameters, it comes as no surprise to find that the Solvency II ratio is the most sensitive to interest rate variations.



This situation can be explained:

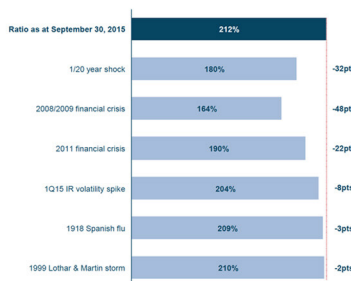
- Firstly, by the steady and sustained reduction in exposure to equities, which became too costly in capital under the Solvency II framework, and whose impacts on the solvency ratio are therefore under control;
- Secondly, by the low interest rate environment, which in some downward scenarios would produce performance levels that would not cover the guaranteed rates in some Life insurance contracts.

One way of improving existing communication would be to supplement the information on sensitivity tests with explanations of the indicators and assumptions on which they are based. Today's circumstances could also justify additional rate analyses (in particular, the potential impact of convexity).

Note that some players have supplemented their sensitivity analyses with more extreme scenario simulations, modelling shocks similar to those of past events, including the financial crises of 2008 and 2011. The results of these shocks give an indication of the soundness of the insurers' model in the event of major systemic shocks, and of the impact that such events would have on the evolution of the Solvency II ratio.

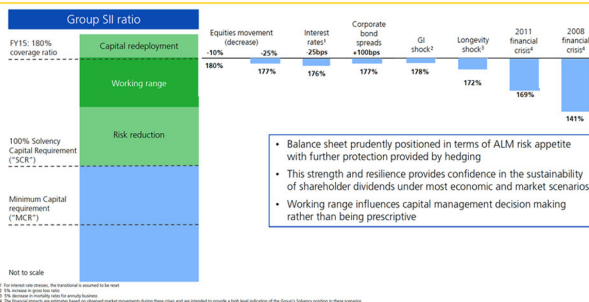
It appears that the 2008 financial crisis represents the most material shock in terms of impact on the solvency ratio, with generally similar orders of magnitude for all the insurers providing this information.

OUR SOLVENCY II RATIO IS RESILIENT TO A WIDE RANGE OF SHOCKS



Source: AXA – Investors day presentation

Capital resilient to stresses



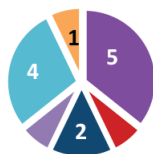
Source : AVIVA – Presentation of 2015 results

1.8 Impact on capital management and future prospects

The entry into force of the Solvency II Directive has significant consequences for capital management policies in insurance groups. This topic was addressed by most of the players in our sample, although some gave no quantitative information on their capitalisation targets.

Quantitative information was generally presented in the form of a range of ratios within which the capitalisation level was regarded as adequate. This range was consistent across the groups, generally lying between 160% and 220%.

Capital management targets - Method of communication

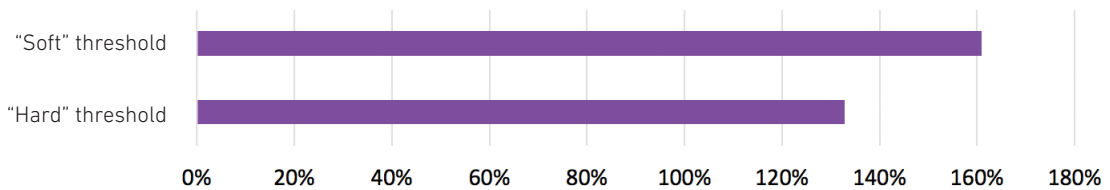


- No information
- "Hard" threshold only
- Range only
- Precise target + "hard" threshold
- Range + "hard" and "soft" thresholds
- "Soft" and "hard" thresholds

Some players distinguished between “soft” and “hard” thresholds, the first representing the thresholds from which measures to improve solvency are taken, while the second represents critical solvency levels, below which more radical interventions are required (discontinuation of activity, derisking, stopping dividend payments, etc.).

On average, “soft” thresholds are fixed at 160% and “hard” thresholds at 130%.

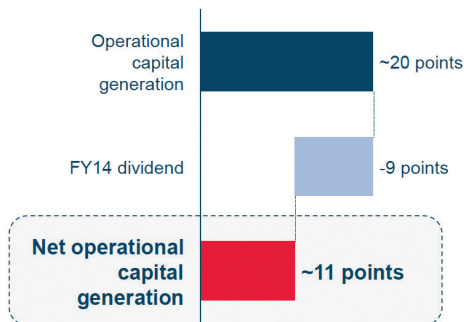
Average thresholds triggering management action



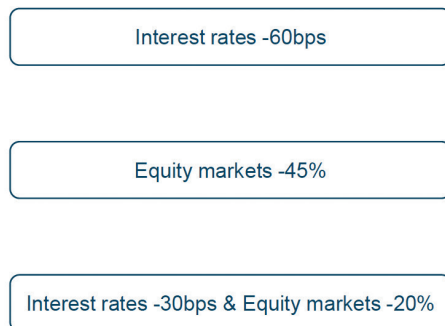
The information available and the broad ranges published this year by European insurers reflect a degree of caution as to possible movements in the solvency ratio, and an approach to management which is still a work in progress at this stage. We may expect greater control over the volatility of this indicator to lead to the publication of narrower ranges in the future.

One example of good practice is to disclose the annual expected change in the solvency ratio reflecting forecasts in terms of capital generation and of dividend distribution, along with examples of the shocks that these changes would make it possible to sustain:

Illustrative net capital generation per year...



... is enough to sustain individual shocks on



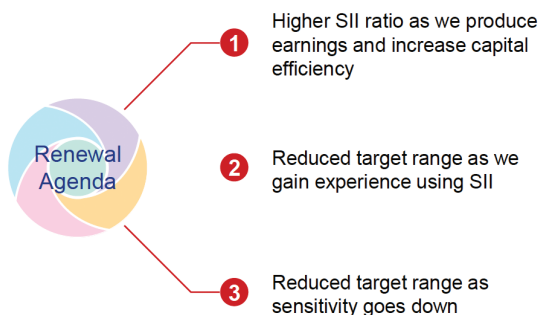
Source: AXA – Investors’ day presentation

Information on management measures

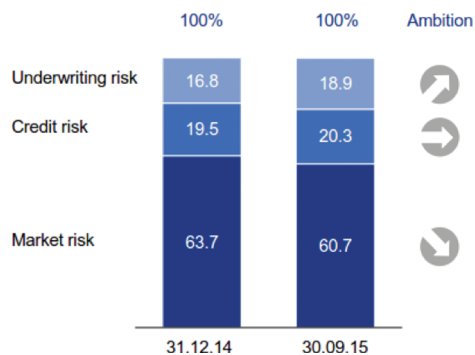
Although the financial communication around Solvency II in 2015 is not yet exhaustive or harmonised, it is interesting to identify the management measures that are being taken against the background of this new regulatory framework.

Some players have indicated the approaches that would enable them to optimise their solvency levels. In particular, this provides information on the capacity of insurance groups to steer their ratios over time and to distribute dividends.

One player disclosed exact targets in terms of risk management, reflecting an ambition to reduce the target range for capital and reduce uncertainties as to the level of dividends payable to shareholders.



Risk capital by risk categories



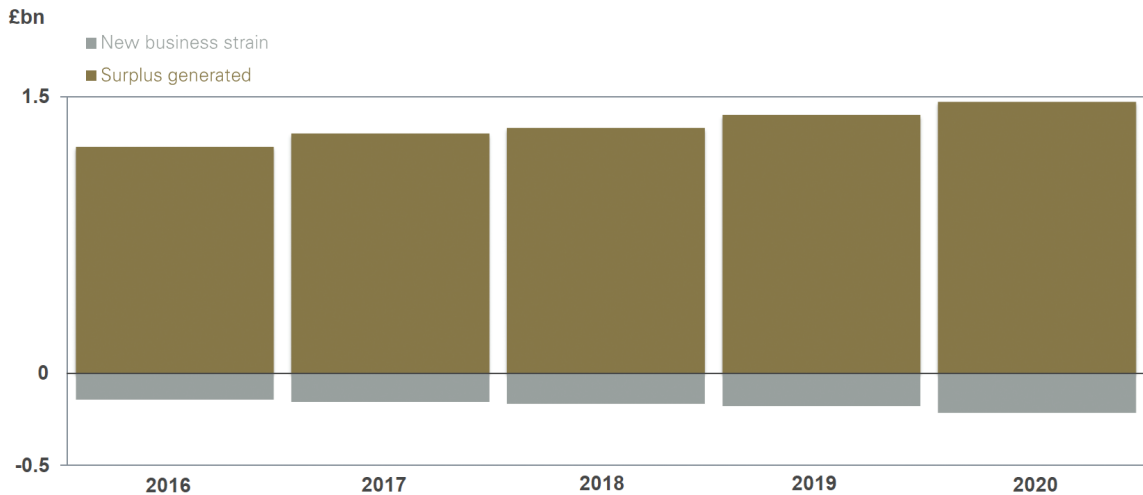
Source: Allianz – Solvency II Presentation

Future strategies and prospects

Few of the groups in our sample provided forecasts and information on the future prospects of their Solvency II ratio.

Only one presented a projection of the Solvency II surplus expected over the next five years, without clarifying the methodology applied for doing so (market environment adopted).

Group Solvency II surplus emergence



- Projection shown subject to market and other sensitivities, new business and other management actions
- Figures projected allow for transitional run-off on a linear basis
- Surplus from back book closely monitored throughout the year and the level of new business strain adjusted if necessary
- Pre-dividends in each discrete year

Source: Legal & General – Presentation of 2015 results

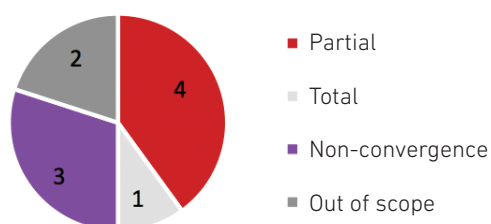
The Solvency and Financial Conditions Report, the first edition of which is expected to cover 2016, should enable us to supplement and expand the information provided by insurers on future prospects and on the expected changes in their Solvency II ratio.

1.9 Performance indicators: the end of Embedded Value?

The final part of this survey looks at the impact of Solvency II on communication around Embedded Value, the key indicator for assessing the economic value of Life Insurance activities.

In methodological terms, Embedded Value is calculated using an approach similar to that applied to the Solvency II balance sheet. Nonetheless, some of the calculation parameters differ, in particular discount rates, cost of capital and projected future premiums.

EV -SII alignment methodology



The following developments were found in 2015 among insurers in our sample:

- two players published no report on Embedded Value, without officially giving notice that they had dropped this indicator;
- five players changed their methodology, with partial alignment with the Solvency II model, in particular for discount rates and the cost of capital.

Partial alignment parameters



- Finally, one insurer opted for total convergence of the two frameworks, completely aligning the parameters and assumptions of embedded value with those of the Solvency II Life model:

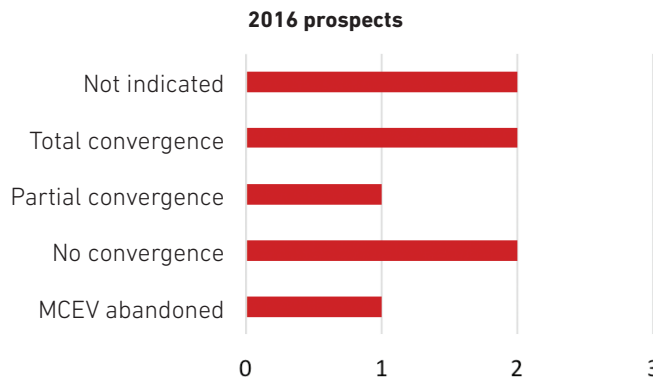
The new methodology and further alignment to the Solvency II requirements and guidance comprises:

- Reference rates used for the calculation of the best estimate liabilities follow EIOPA specifications;
- Implementation of Solvency II contract boundary definition;
- Removal of cost of Required Capital (“CReC”) and replacement of Cost of Non-Hedgeable Risk (“CNHR”) by Risk Margin, as Solvency II requires an allowance for the cost of holding non-hedgeable risk capital but not for hedgeable financial risks as these may be removed through the capital markets;
- Reflecting the full bottom-up tax calculations incorporated in the MVBS;
- Removal of explicit allocation of holding expenses to Life and Health segment.

The calculation of VNB has been kept under distributable earnings approach on an after-tax basis, but was also aligned to Solvency II: Full EIOPA specifications, contract boundaries definition and application of risk margin, which allows to use the value as contribution of VNB in the development of MCEV on MVBS. The corresponding reconciliation performed over the 12M 2014 VNB revealed a difference of 6.5%. Look-through profits are not included.

Source: Allianz– MCEV report 2015

The trend noted in 2015 is likely to persist in 2016. This is because some players have already announced total convergence with Solvency II or the abandonment of Embedded Value.



Although some groups have as yet adopted no stance on the matter, we expect that the Embedded Value indicator will be eclipsed by the information published under Solvency II, largely because of the operational costs of maintaining both frameworks. It remains possible that the New Business Value will continue to be published to highlight new wealth creation.

Note that one player explicitly published a reconciliation between the IFRS balance sheet, the Solvency II balance sheet and Embedded Value:

The following table shows the reconciliation between IFRS shareholders' equity, IFRS tangible net asset value (IFRS TNAV), group Embedded Value (EV), and group available financial resources (AFR).

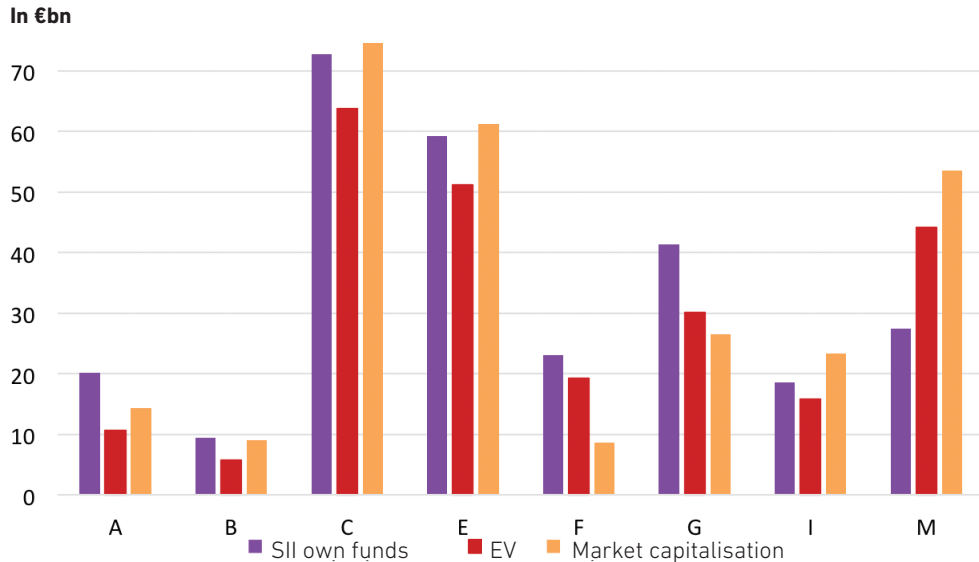
RECONCILIATIONS <i>Euro billion</i>	Life & Savings	Other Segments	Group 2015	Group 2014
IFRS SHAREHOLDERS' EQUITY¹	54.2	14.3	68.5	65.2
Net URRCG not included in SHE	1.8	3.5	5.3	4.2
Excluded TSS/TSDI	-	(9.5)	(9.5)	(9.1)
Excluded Intangibles	(21.3)	(10.6)	(31.9)	(28.8)
<i>Goodwill</i>	(6.7)	(9.1)	(15.8)	(14.9)
<i>DAC</i>	(12.1)	0.0	(12.1)	(10.0)
<i>VBI</i>	(1.9)	-	(1.9)	(1.8)
<i>others</i>	(0.6)	(1.5)	(2.2)	(2.0)
IFRS TANGIBLE NET ASSET VALUE¹	34.7	(2.4)	32.3	31.5
Life & Savings VIF	28.0	-	28.0	25.3
Elimination of UCG projected in VIF	(6.9)	-	(6.9)	(8.6)
Mark to market debts & others	(1.6)	(0.5)	(2.1)	(1.0)
GROUP EV¹	54.2	(2.9)	51.2	47.2
Dividends to be paid			(2.7)	(2.3)
TSS/TSDI & subordinated debts			16.4	15.6
Technical provision adjustments			(5.9)	(4.3)
Other valuation discrepancies			0.0	(1.9)
GROUP AFR²			59.2	54.2

¹ Group share; ² Including minority interest

Source: AXA – report EEV 2015

To conclude our review of Embedded Value we compared Solvency II economic capital with market capitalisation and group Embedded Value2 of players in our sample, where possible.

SII own funds, EV and market capitalisation



Our analysis does not suggest that the value of a business can be extrapolated from these indicators alone. Nevertheless, it is interesting to observe that the market capitalisation of two large players in the sector is close to their Solvency II economic equity.



2. OTHER MATTERS OF ATTENTION AT THE 2015 YEAR-END

This year, we identified two subjects of interest in the financial information published by the insurers in our sample at the 2015 year-end.

The first relates to the accounting impacts and the disclosures provided on the rate environment; the second concerns IFRS 9 - Financial instruments, which is intended to replace the existing IAS 39. The timetable for application of IFRS 9 was still uncertain for insurance groups at 31 December 2015.

2.1 The impact of persistently low interest rates

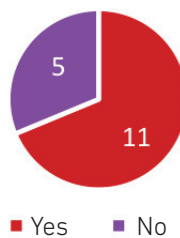
The low interest rate environment has been a point of attention for several years. Its continuation into 2015 made it a real source of concern to insurers with significant Life business.

During our survey we analysed the available information to assess the impacts of these persistently low rates on the financial situation and performance of European insurers. Maintaining profitability under these circumstances is becoming a real challenge.

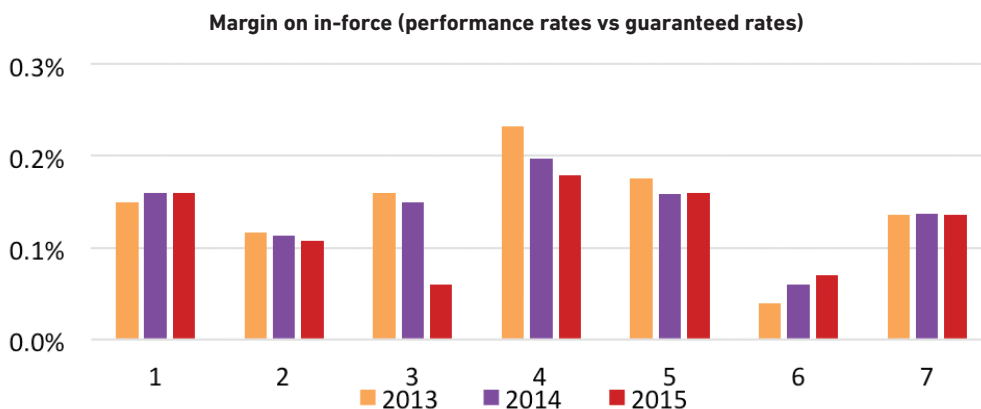
A first observation is the absence of new disclosures by comparison with the financial communication of insurance groups in 2014. Insurers continue to put out a positive message, insisting on their ability to maintain performance despite the current environment.

Some players have reported on their strategies for adapting to the current economic situation: adjustments to investment policies, moving from Life insurance products to provident activities, reallocating savings products to unit-linked policies, etc.

Reallocation to unit-linked policies

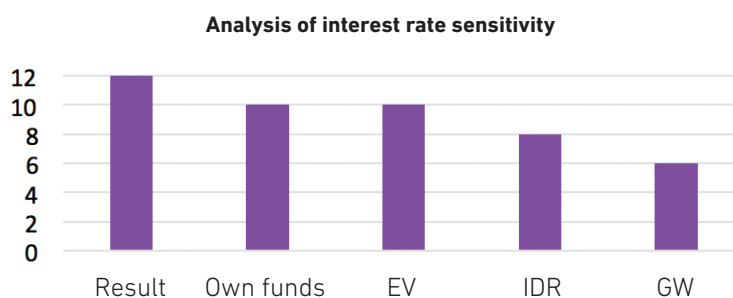


Analysis of the quantitative information published suggests that, for insurers who disclosed this information, the net margin between portfolio performance rates and guaranteed contract rates was weak but under control over the last three years, reflecting the margins of manoeuvre that insurance groups still have to sustain their profitability.



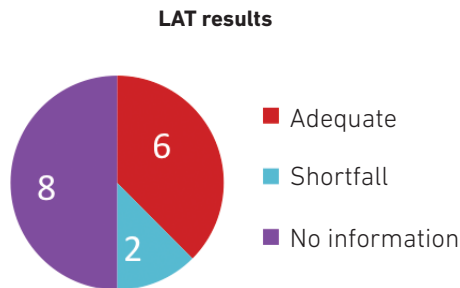
Another useful indicator for assessing the impact of the current situation on European insurers is the result of tests for interest rate sensitivity published with respect to the requirements of IFRS 7, IAS 19 (employee pensions) or IAS 36 (goodwill impairment testing).

All the groups in our sample reported sensitivity test results. However, it is not easy to compare this information, because of the different variation ranges applied to the scenarios tested. Further, the aggregates analysed are not always uniform: results, own funds, embedded value, etc.



Finally, the liability adequacy test required by IFRS 4 is a useful indicator for anticipating the future impacts of the continuing low interest rate environment. Nonetheless, IFRS 4 has no particular requirements for disclosures on this test, and therefore few players publish information: the principle of the test was explained in general terms without describing the method adopted, and the conclusion on insurance liability adequacy did not clarify the level of surplus that the test revealed.

Two players whose tests revealed a shortfall published quantitative information about the additional provisions constituted in the IFRS accounts.



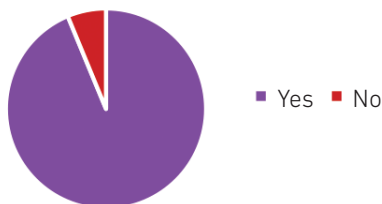
2.2 IFRS 9: Financial instruments

Following the recommendations from ESMA (European Securities and Markets Authority) and the AMF (Autorité des marchés financiers, French regulator), we analysed the information published on the expected impacts of the entry into force of IFRS 9 and the state of advancement of preparatory work ahead of its implementation.

Several players mentioned the IFRS 4 amendment exposure draft published in December 2015 and the options it puts forward, in particular the temporary exemption from applying IFRS 9 for insurers satisfying certain criteria.

Against a background of uncertainty as to when IFRS 9 will come into force for insurers, the groups in our sample simply presented a brief qualitative assessment of its expected impact. No quantitative information was given. Nine insurers mentioned that the project is in progress, with no details as to its state of advancement.

Communication on IFRS 9



Advancement of IFRS 9 project



The main impact expected from the introduction of IFRS 9 is increased volatility, due to the reclassification of non-SPPI (solely payment of principal and interest) assets to fair value through profit or loss and to the expected loss impairment model for debt instruments.

In terms of the draft amendment to IFRS 4, some players explicitly indicated a preference for the deferral option, which would enable them to postpone the application of IFRS 9 until the effective date of the future IFRS 4 Phase II, or 2121 at the latest:

The Group considers the Deferral approach as most appropriate to solve the problems resulting from the application of IFRS 9 before the new accounting standard on insurance liabilities. The overlay approach implementation would create incremental costs compared to those of the first implementation of IFRS 9. In particular, the Group has identified critical points related to the alignment and reconciliation of data arising from the simultaneous application of IAS 39 and IFRS 9.

Source: Generali – DDR 2015

Note that even if the temporary exemption option were confirmed (the definitive text of the amendment is expected in September 2016), insurers would have to present the following information in the notes to the financial statements from 2018:

- the nature and the characteristics of financial assets, with an adequate level of granularity;
- the fair value of assets not meeting the SPPI test, separately from other financial assets;
- the fair value and the amortised cost before impairment of SPPI financial assets which do not have a low credit risk;
- reference to any IFRS 9 information which would be presented in the financial statements of subsidiaries.

Furthermore, the confirmation that the predominance of insurance activities will be assessed at reporting entity level should lead to the exclusion of Bancassurers and groups with significant non-insurance activities from the scope of entities eligible for the temporary exemption.

CONCLUSION

The introduction of Solvency II has enhanced the financial communication of insurers, both qualitatively and quantitatively, in particular with regards risk indicators. The information is consequently more complex.

Our first finding is that several groups have adapted well to the demands of the new regulatory environment, no doubt due to earlier work to develop their internal models.

Unsurprisingly, a comparison of the information published is difficult, partly because most players use internal models that reflect their own risk management and business model and partly because of a lack of exact information as to the particular methodologies used.

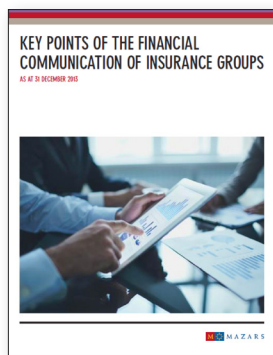
Further, the information on future prospects, capital management and the distribution of dividends could all be improved - and here again, some players are at the forefront of this development.

Financial communication will doubtless be enriched in 2016 with the effective date of the Solvency II Directive, the first SFCR publications, and the full maturity of Own Risk Solvency Assessments (ORSA).

The future of Embedded Value reporting is something to keep an eye on in the years to come: will convergence with Solvency II be complete, leading to the disappearance of this indicator?

Finally, it will be interesting to see how the constraints of the Solvency II framework will be integrated into the strategic planning of European insurance groups, and what communication will be provided about management action in the matter.

PREVIOUS STUDIES



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