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How to evaluate the shareholder's
value of insurance company under IFRS17?

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How to evaluate the shareholder's value under IFRS17 and K-ICS?

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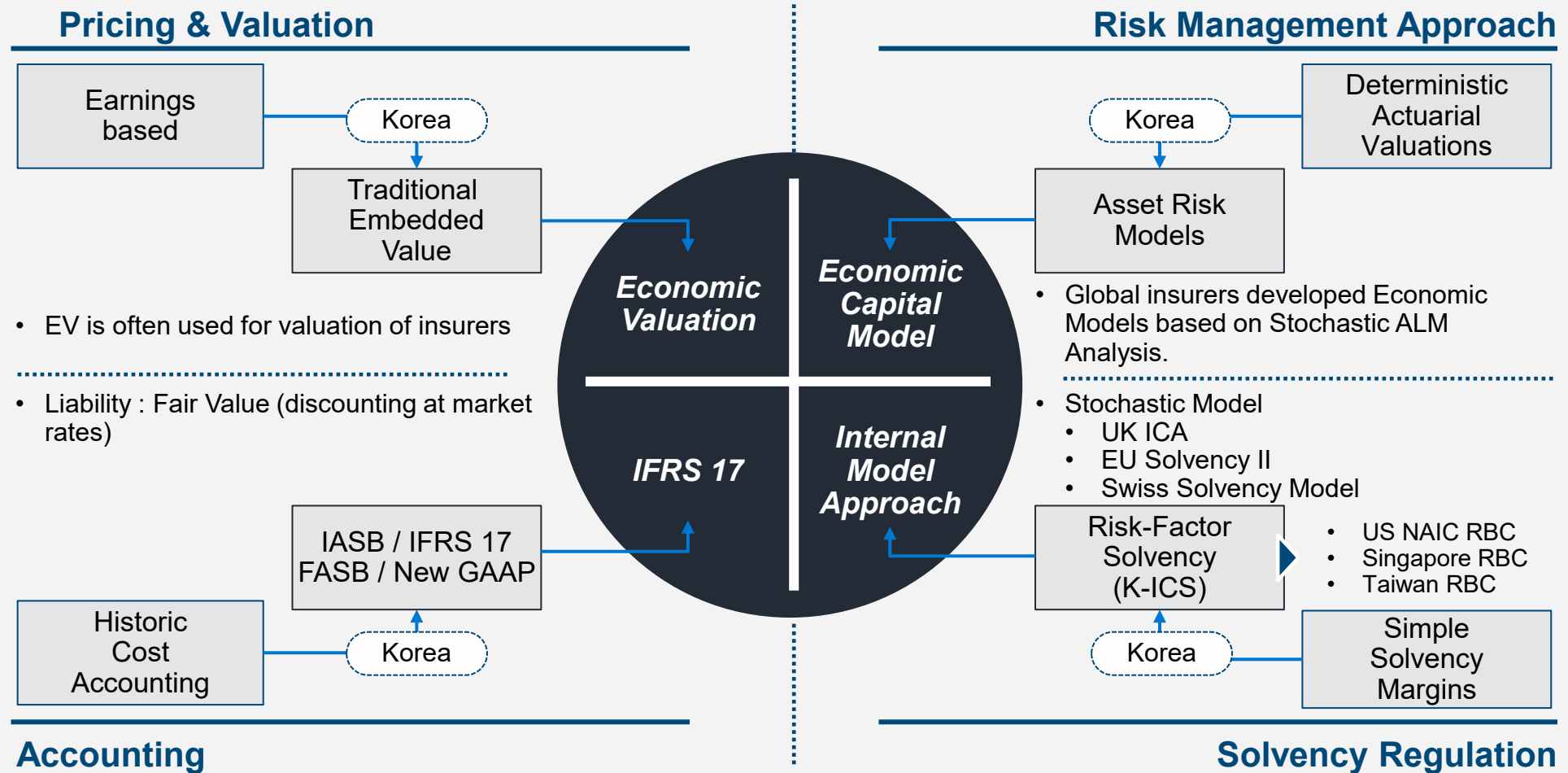
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Global Trend of Financial Management of Insurers

Strong tendency toward for “fair value” approaches – “New Paradigm”



Discussions about “Fair Value” regime

“Fair Value” will tell us everything

- Company value
- Performance measurement of management (KPI)
- Risk level of operation
- Profitability of products
- Financial planning of business



Expectations from the market

Accounting information with “CSM” and “IFRS Equity” will be a key item for the operation of insurance companies.



CSM + IFRS Equity

- 
- Company value
 - Performance measurement of management (KPI)
 - Risk level of operation
 - Profitability of products
 - Financial planning of business

Insights

Can CSM Replace EV?

or

Can CSM represent the
shareholder's value?

CSM provides insight into “future profits.” However, the question remains: Does it truly encapsulate the “shareholder value” of insurers?



1

Comparability

Can we really assert that a company with a higher CSM holds greater "shareholder value" compared to other companies with lower CSM?

2

Realization into Profit

Can a company's reported CSM on the book really be realized into profits in the future?

3

Dividend

Once the insurers' reported CSM on the book gets amortized into profit, will investors be able to get that as dividend?

1. [Comparability] IFRS17 Balance Sheets of insurers may tell a different story, depending on the choice of transitional approach and accounting policy

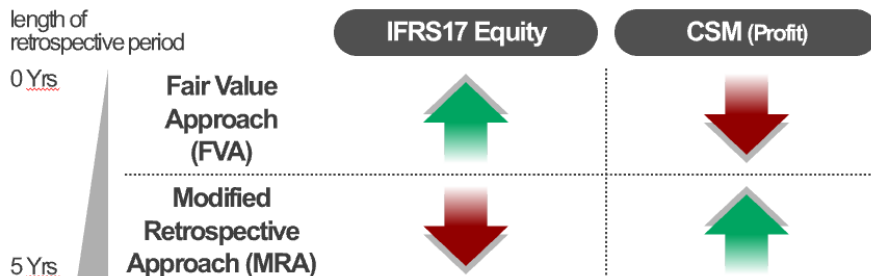
A Transitional Approach

Most insurers have applied a mix of the MRA and the FVA at transition. Differences between insurers have largely been from the selection of the retrospective period (0 to 5 years)

(Unit: # of Insurers, %)

Type	Retrospective Period for MRA					FVA Only	Total
	5yrs	4yrs	3yrs	2yrs	1yr		
Life	1 (5%)	3 (14%)	10 (45%)	1 (5%)	3 (14%)	4 (18%)	22 (100%)
Non-Life	5 (42%)	2 (17%)	3 (25%)	0 (0%)	0 (0%)	2 (17%)	12 (100%)

Depending on the mix of approach, as well as the length of the retrospective period, insurers will report different balance of IFRS17 equity and CSM

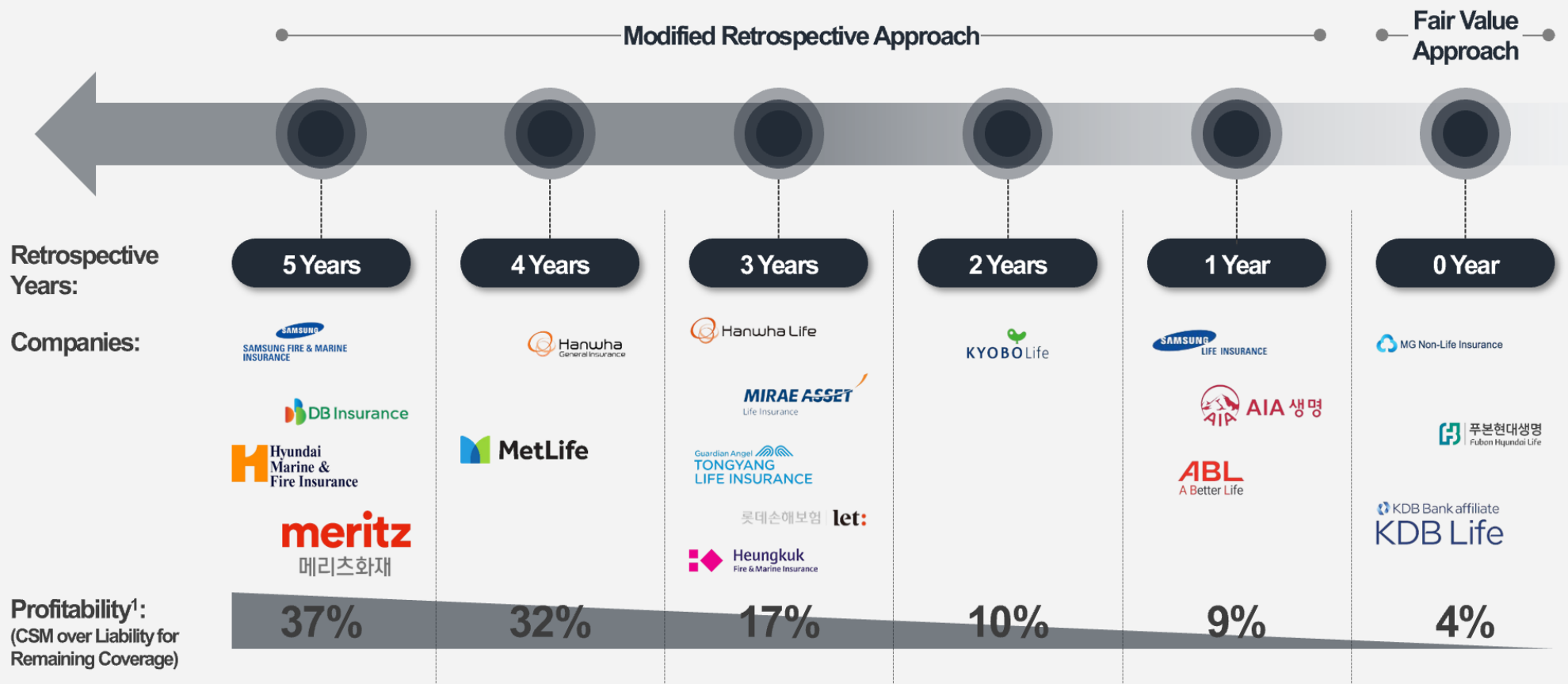


B Accounting Policy

Insurers have different accounting policies in determining the level of indirect expenses, different interpretations about IFRS17 rules, and different actuarial approaches widely exist.

- Level of Prudence**
 - Some insurers are using “best estimate” assumptions, whereas others are adding some “prudence margin” on their assumptions to avoid adverse experience variance
- Claim**
 - Insurers have different outlooks, especially on 1) future loss ratio development for medical reimbursement products, and 2) lapse rate on no/low-CSV products
- Expense**
 - Insurers have different definitions of “indirect expense,” which would result in different levels of CSM

1A. (Backup) Insurers made various choices regarding the length of the retrospective period, compromising the comparability of CSM

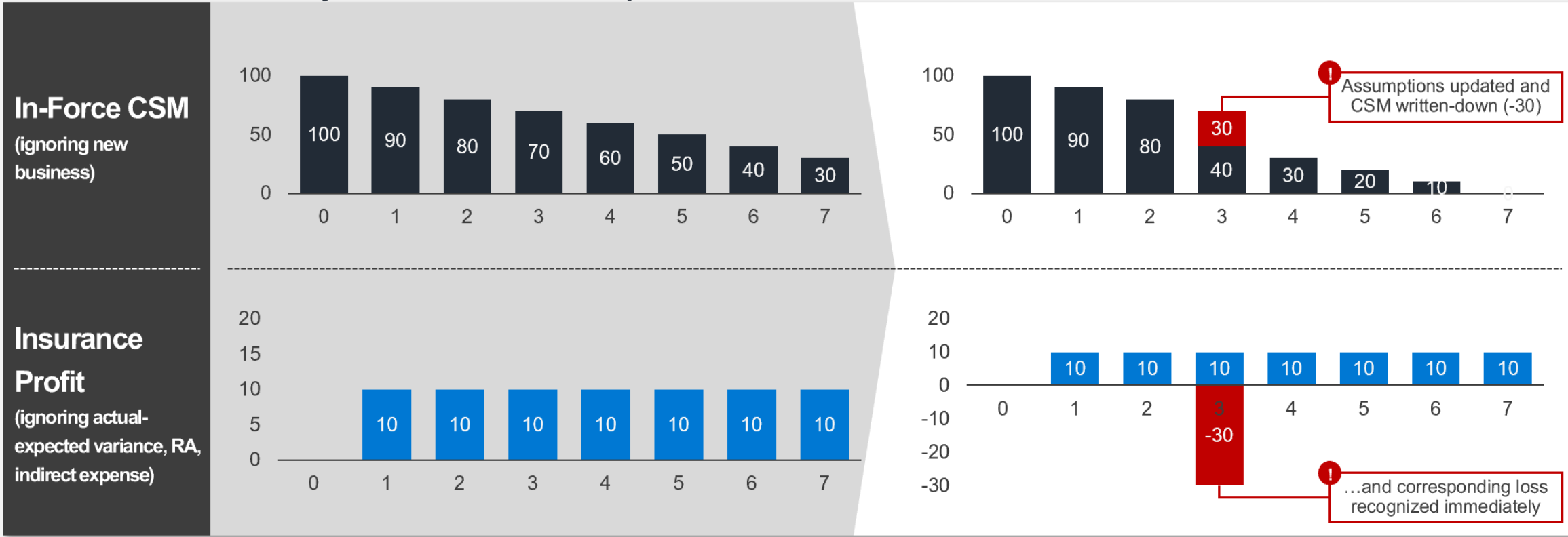


Source: KLJA, KNIA Statistics; 2. Contractual Service Margin as a ratio over Liability for Remaining Coverage, as of 2023.3Q;

2. [Profit Realization] CSM represents the firm's estimation of its future profits. However, with negative experience, unexpected losses can occur

In an ideal situation, CSM would be amortized into profit smoothly over time as services are provided.

If there is persistent variance in claims and/or expenses, CSM needs to be revalued.







3. [Dividend] A large CSM and IFRS17 Equity do not necessarily indicate an insurer's high dividend-paying capacity

Why IFRS17 Fails as a Value Measure

- Some IR managers and analysts contend that IFRS17 Equity captures the 'current value' of insurers, with Post-Tax CSM representing their 'future value', thereby making 'IFRS17 Equity + Post-Tax CSM' a solid metric for company valuation.
- However, this measure fails to account for the capital that insurers must set aside, which is not available for dividends or reinvestment. In fact, this measure can significantly inflate the company value with the sale of new business.
- Therefore, IR managers and investors should recognize that 'free surplus'—the excess of available over required capital—and 'VNB' provide more precise indicators of potential dividends. Embedded Value aims to measure these exact factors.

Relationship Between Free Surplus and 'IFRS17 Equity + Post-Tax CSM' from New Business Sales

Measure	Point of Sale	Post Sale
IFRS17 Equity plus Post-Tax CSM	 Increase <ul style="list-style-type: none"> CSM from new business sales is immediately recognized on the Balance Sheet Most of acquisition expenses are deferred over the policy benefit term under IFRS17, meaning they are not recognized as expense immediately. 	 Neutral <ul style="list-style-type: none"> 'Expected Profit' from the CSM amortization flows into IFRS17 equity, resulting in no net change. 'Unexpected Profit' from experience variances and the recovery of loss components would increase IFRS17 equity, though these are typically assumed to be zero.
Free Surplus plus Distributable Earnings	 Decrease <ul style="list-style-type: none"> Under K-ICS, CSM is considered available capital. Concurrently, new business sales incur additional required capital. Free surplus typically declines since the increase in required capital often surpasses the rise in available capital. 	 Unknown <ul style="list-style-type: none"> Impact on free surplus depends on the relative pattern of 1) CSM amortization and 2) release of required capital. This depends on the firm's product mix, channel mix, and underwriting/claim capability.



This is what investors should focus on,
and this is what Embedded Value tries to measure

Conclusions

CSM may not be the one we expected before.

- Fair value?
- Representing the shareholder's value?

Also, the market appears hesitant to accept insurers' reported financials under the new regulatory standards (IFRS17/K-ICS)

The market is only acknowledging ~30% of the insurers' stated "value of the company (IFRS17 Equity + After-Tax CSM)"

Market Capitalization of insurers listed on the KOSPI

(Insurers' View) Total IFRS17 Equity + After-Tax CSM:

144 Trillion¹ KRW

(Market's View) Maximum Market Cap:

44.1 Trillion KRW

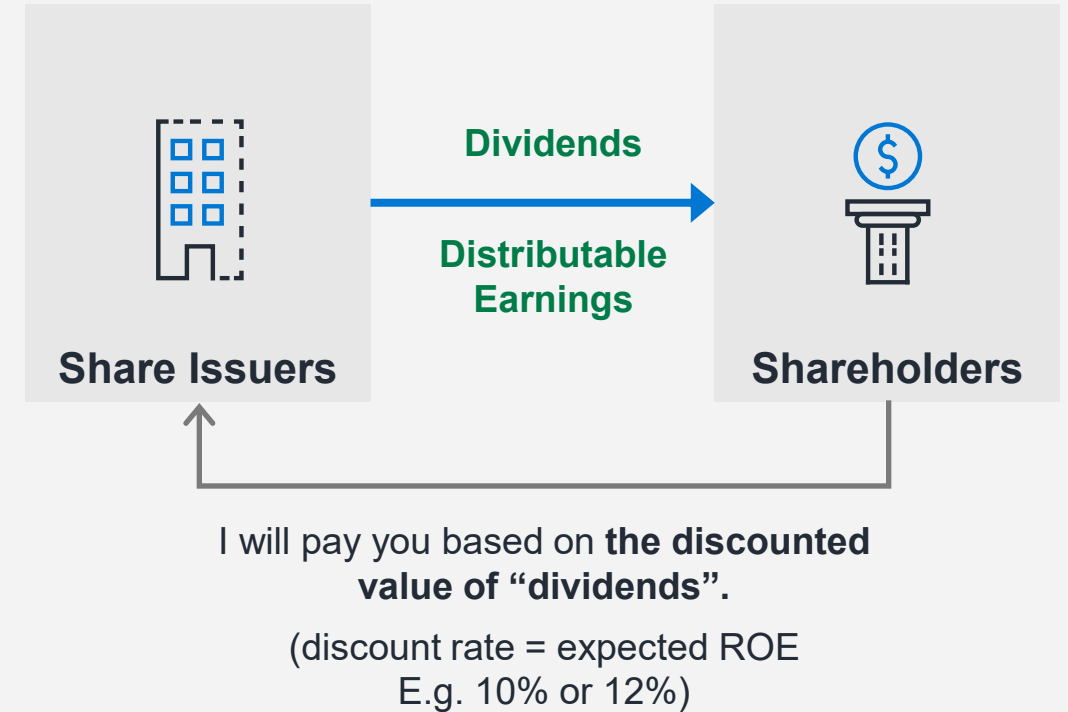
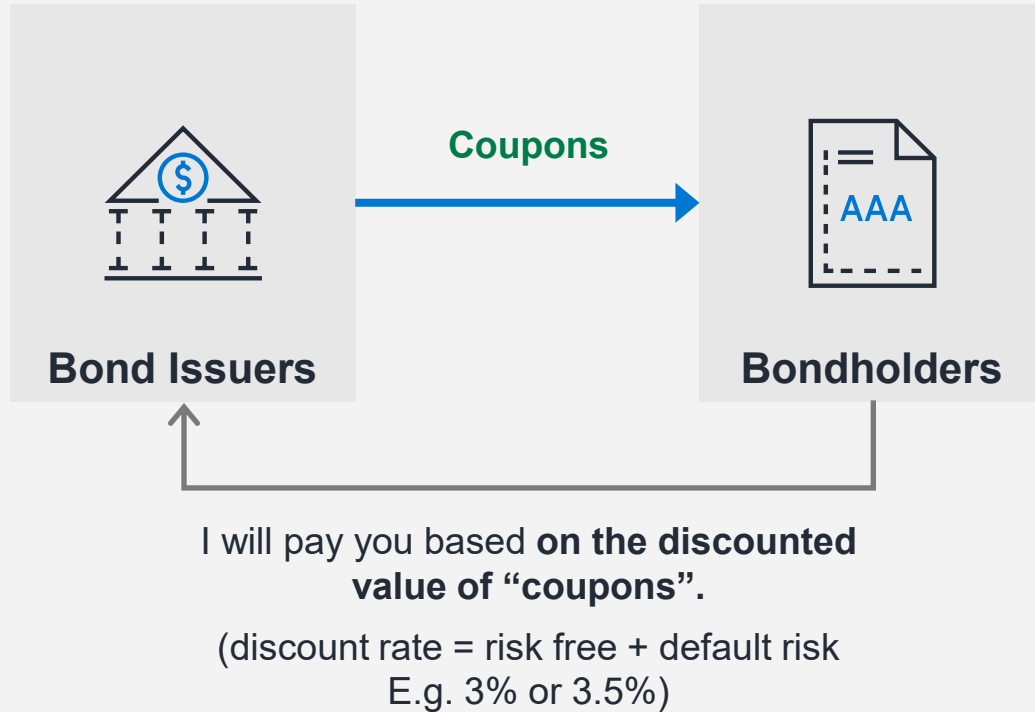


1. As of 2023.1H; Source: Company Reports, KRX Market Data System

All of major M&A deals based on IFRS accounting information have been failed.

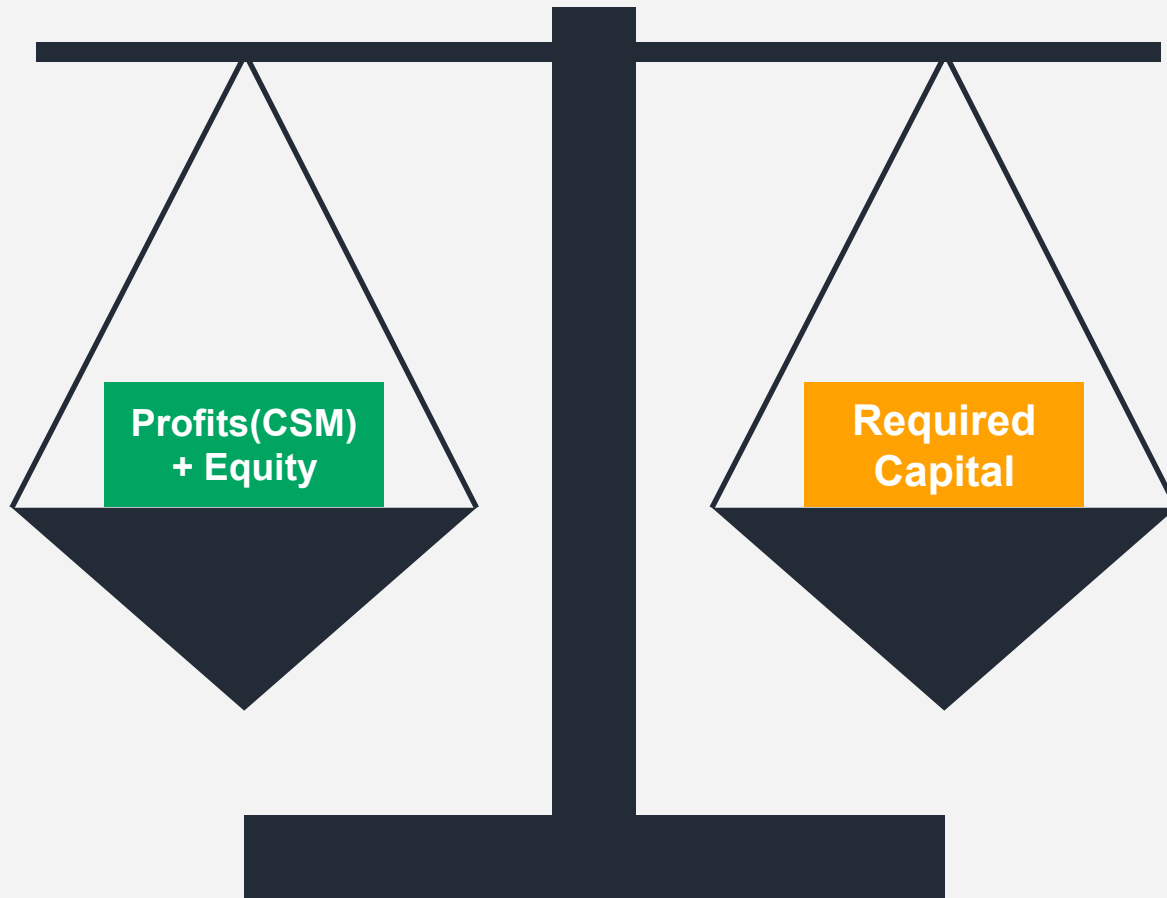
Market doesn't want to recognize CSM and IFRS equity as a shareholder's value.

What is the shareholder's values?



Accounting information about CSM and IFRS Equity are not enough to derive "distributable earnings" for shareholders.

What is the value for the shareholders?



Shareholder's value based on the balance between equity + CSM and required capital.

CSM + IFRS Equity may not be enough to represent the shareholder's value!

1

It means that CSM is not what shareholders want from the company.

2

What the shareholders want is “dividend” from the company.

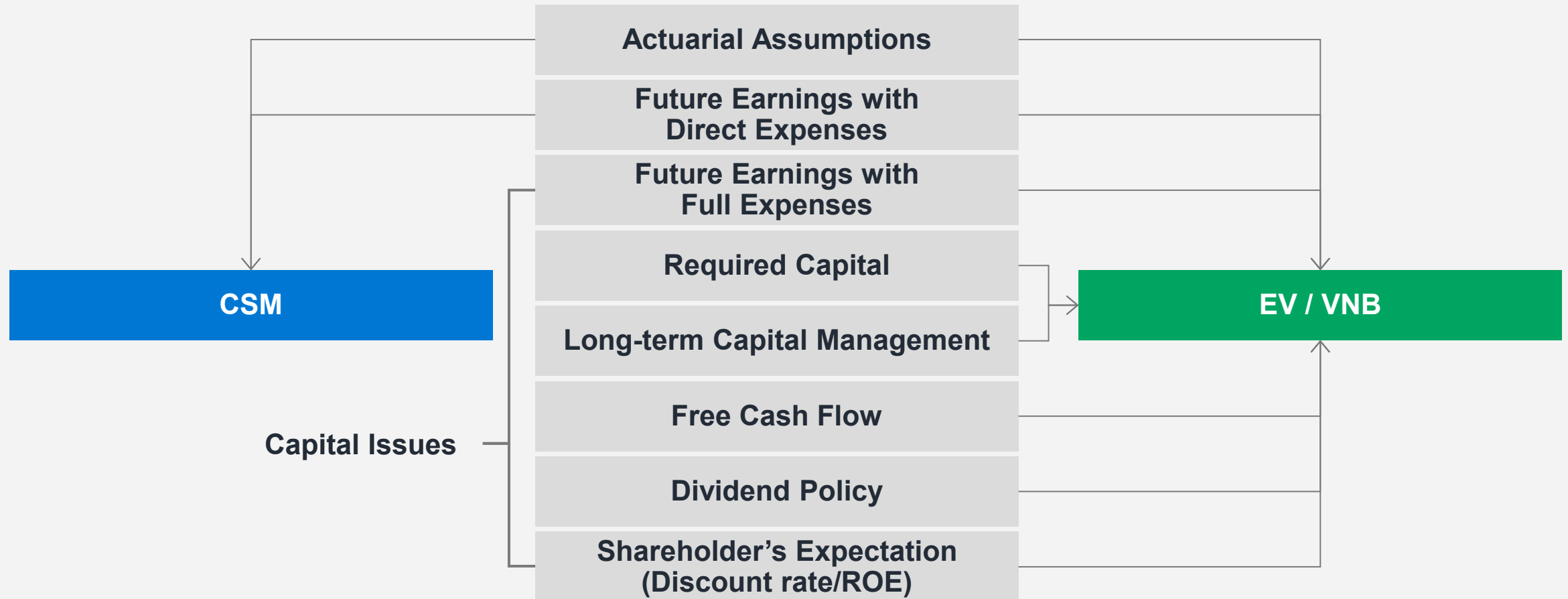
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The Dividend amount will be driven by “distributable earnings” from the company.

4

So, if the shareholder is not able to receive dividends, then the value of the company would be “zero”.

[Observation] EV Approach still remain as superior to CSM as it is a mechanism to reflect “key value factors” for the value of insurance companies

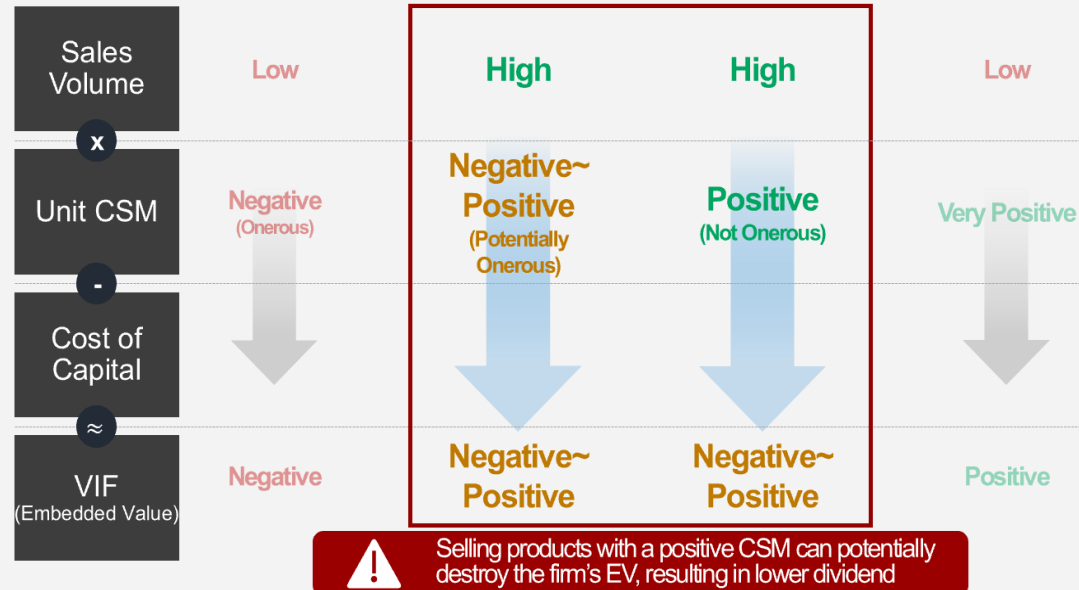


Comparison between CSM (under IFRS17) and VIF (under EV) in detail

Category	CSM (under IFRS17)	> VIF (under EV)
Objective	Measure Unearned (Insurance) Profit	Measure Shareholder Value
Calculation basis	Future Insurance Profits	Future Distributable Earnings
Expenses	Direct Expenses only (directly attributable to insurance contracts)	All Expenses (including direct and indirect expenses)
Taxes	Pre-Tax basis	Post-Tax basis
Capital charges	Insurance Risk only	All Risks (insurance, market, operation, etc.)
Discount Rate	Close to risk-free rate (risk free + illiquidity premium of ~1%)	Shareholders' risk discount rate (risk free + risk premium; typically, in 10~12% range)
Reporting classification	Fixed within accounting principles	Flexible depending on needs
Return from invested assets	Not reflected	Reflected
Capital situations	Not reflected	Reflected
Usage	Financial Reporting	M&A, Transfer of closed-book, etc.
Other	Contracts with negative CSM ("onerous contracts") are not included on the reported CSM	Includes both profitable and onerous ("loss-making") products
	Measure of future "unearned profits"	Measure of future "distributable earnings"

Bigger Issues when CSM is being used as “KPI”!

Products that require a significant amount of capital can hinder the firm’s ability to pay dividends, despite having a positive CSM

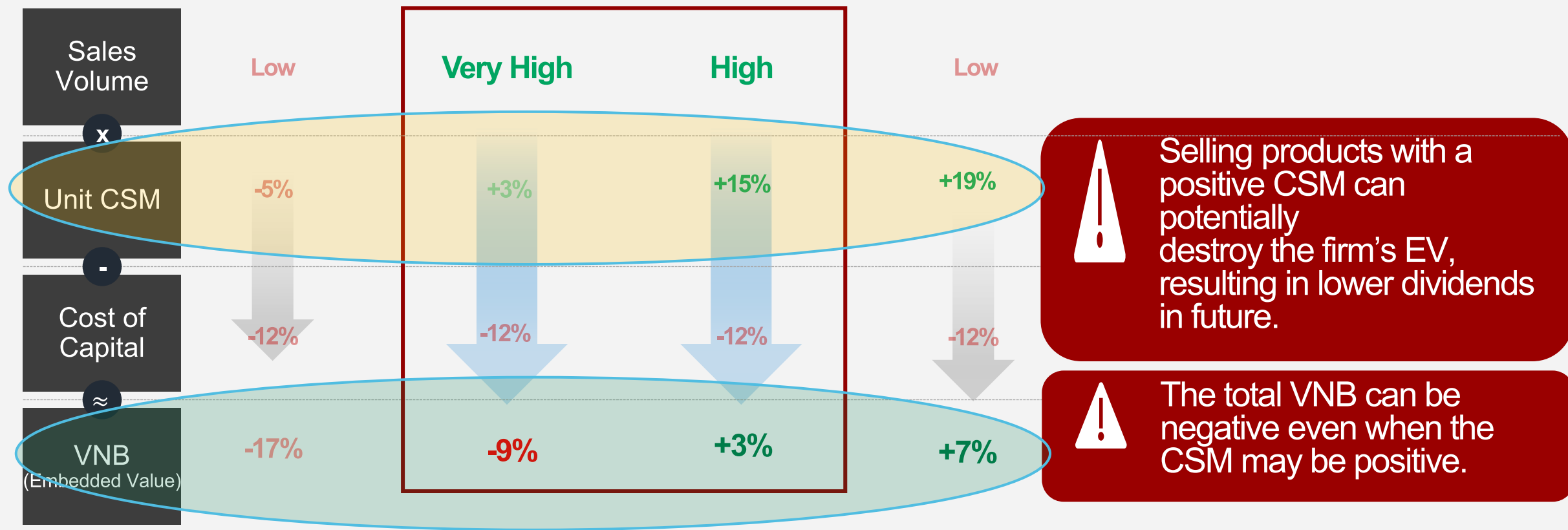


- Much of the competition revolves around products offering extensive coverage and longer benefit terms (i.e., those with positive CSM, but with high amount of required capital)
- When a product is sold, the expected future profits from that sale is booked on the financial statement as “CSM”
- Simultaneously, the insurer must allocate additional required capital, which is not directly disclosed in the financial statement.
- Despite positive CSM, the insurer might be unable to distribute dividends if the capital burden surpasses the increase in CSM (i.e. increase in required capital exceeds the corresponding increase in available capital)

Note: In reality, EV is calculated based on cashflow basis (i.e., net cashflow), not on accounting profit basis (i.e., amortization of CSM). But here, we are assuming CSM is proxy for profit for illustration purpose

Insurance, as a long-term business, entails a **significant amount of “cost of capital (i.e. business risk)”**
This distinction underscores why **investors should not solely focus on profitability (i.e., CSM)**, unlike in many other industries

[Case Study] Even a positive CSM can lead to “negative VNB(EV values)”.



Note: In reality, EV is calculated based on cashflow basis (i.e. net cashflow), not on accounting profit basis (i.e. amortization of CSM). But here, we are assuming CSM is proxy for profit for illustration purpose

How about others?

(Backup) Despite the early implementation of IFRS17 in Europe, leading insurers continue to base their dividend policies on the Solvency II ratio, rather than IFRS17 measures

	Allianz Group	AXA Group	AVIVA Group
Target Dividend	<ul style="list-style-type: none">▪ Maintain dividend payout ratio¹ greater than 50%▪ Annual growth rate of 5% on DPS²	<ul style="list-style-type: none">▪ Maintain dividend payout ratio of 55~65%	<ul style="list-style-type: none">▪ Annual growth rate of 5% on DPS
Condition for Target	Solvency II ratio ³ stays within the range of 150% to 180%	Maintain Solvency II ratio of at least 190%	Maintain Solvency II ratio of at least 180%

1. Dividend Payout Ratio—total amount of dividend over net income; 2. DPS—dividend per share; 3. Available Capital / Required Capital on S-II basis



All of them are talking about how to maximize the dividends (=distributable earnings) within company for the shareholders.

How about others?

1H 2023 Very Strong Financial Performance



Growth	Earnings	Capital & Dividends	
VONB \$2,029m +37%	OPAT \$3,272m +4% per share	UFSG \$3,288m +10% per share	Free Surplus \$16.3b After \$3.6b shareholder returns
EV Equity \$70.6b Operating ROEV 13.3%	Operating ROE 14.2% vs 13.0% in FY22	Interim Dividend Per Share 42.29 HK cents +5%	Share Buy-Back \$2.0b Cumulative \$5.5b

What's happening in PCA?

Key takeaways

- 1 IFRS17 is a new accounting framework. No change to the economics or attractive fundamentals of our business
- 2 CSM release is the main driver of adjusted operating profit, which remains a KPI
- 3 Compounding growth from new business CSM will support growth in IFRS17 adjusted operating profit over time
- 4 Embedded Value is linked to regulatory capital and future capital generation and is more representative of shareholder value

HY23 Results: 30 August 2023

PCA recently announced that they will stop reporting MCEV and start reporting TEV (free surplus basis) from 2025.

How about others(2)?

Capital Management Policy Returning \$4.0b to Shareholders

- 1

Payout Ratio Target:
75% of Annual Net Free Surplus Generation

➤ **\$3.0b** payout as follows:

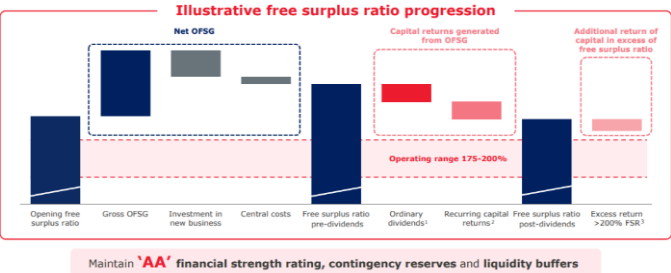
 - **\$2.4b** total dividends following 10% increase in final dividend per share
 - **\$0.6b** remainder through share buy-back
- 2

Ongoing Regular Review and Return of Excess Capital

➤ **\$1.0b** additional share buy-back

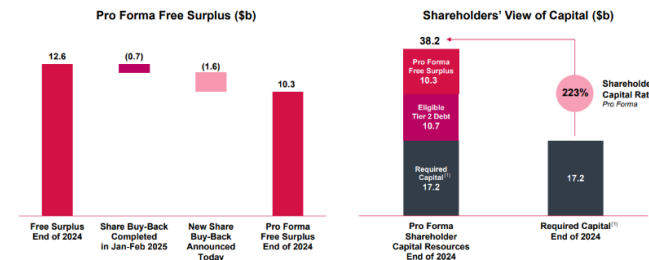


Free surplus generation drives capital return¹



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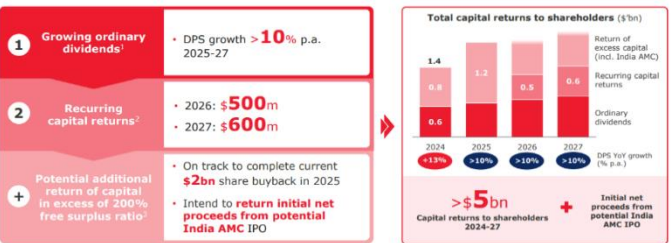
Shareholders' View of Group Capital



Note: (1) Required capital as used in our embedded value calculations

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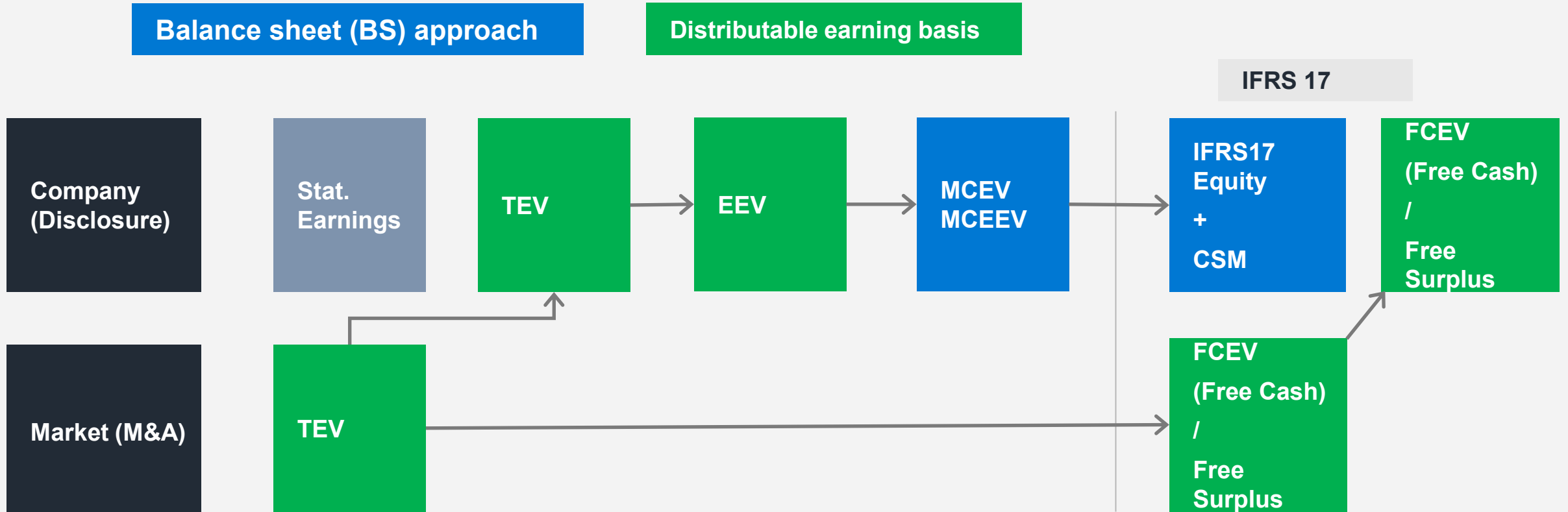
Enhanced and sustainable capital allocation framework¹



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History of EV reporting?



- CSM is very close to MCEV in definition, so MCEV could be replaced by CSM under IFRS 17
- FCEV (Free Cash EV) or Free Surplus is simply an update version of TEV under IFRS 17 still looking for “distributable earnings” for shareholder values
- The calculation of “distributable earnings” for shareholders has been a consistent way in M&A market.

So, do we need EV calculations for shareholder's value?

- Yes! Yes!, but we should modify TEV a little bit for IFRS17 and capital regime to make it as “FCEV” or “Free Surplus”.
- Before we make the decision, we should look at the methodologies and assumptions of EV to make sure that it can represent “the value of shareholders”.



[Proposal] New EV Approach [Free Cash Embedded Value (FCEV)] is needed by reflecting “key value factors” for the value of insurance companies



1

Direct Linkage to “Free Cash Flow”

New EV Approach should be able to explain how the “Free Cash Flow” are being generated within the company.

2

Full reflection of the dividend policy

How the company would like to pay dividend to shareholders and to manage their capital position for long-term

3

Prudent reflection of market expectation

Risk discount rate should be based on “long-term market observations” after reflecting reality in market.



Thank you

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