

IASB Insurance Working Group meeting



A user's view on the Insurance Contracts Exposure Draft

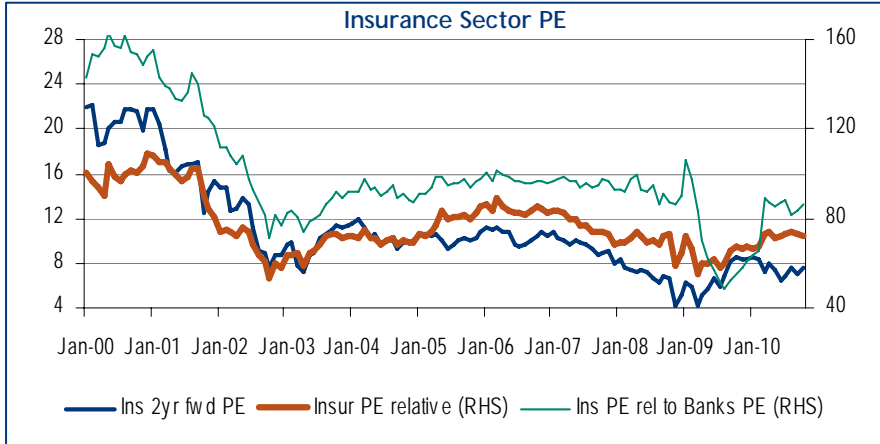
Brian Shea >> +44 20 7996 4154
Managing Director
Head of European Insurance Equity Research
MLPF&S (UK)
brian.shea@baml.com

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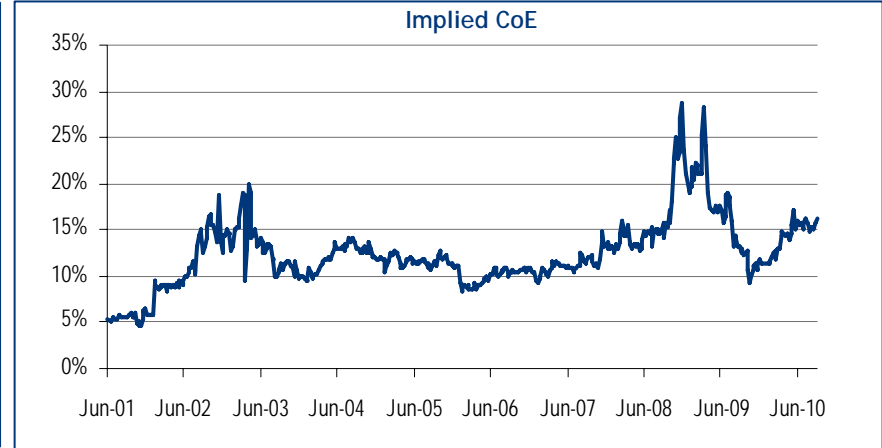
The complexity discount thrives!

Sector has a low valuation . . .



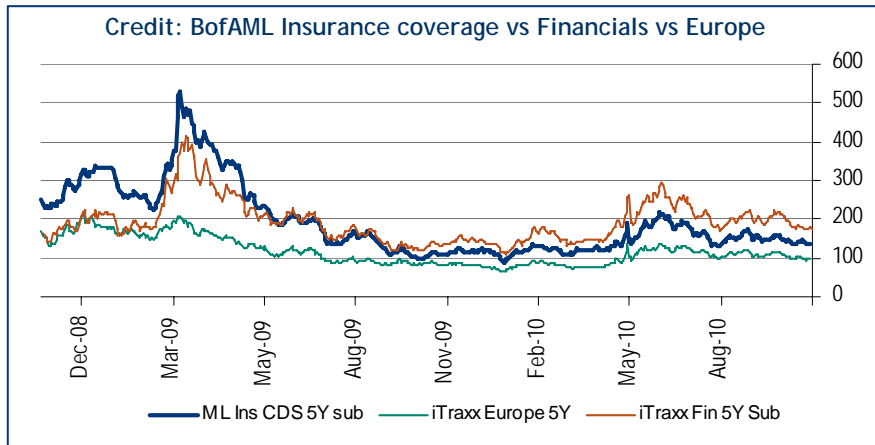
Source: Datastream

. . . And a very high implied CoE



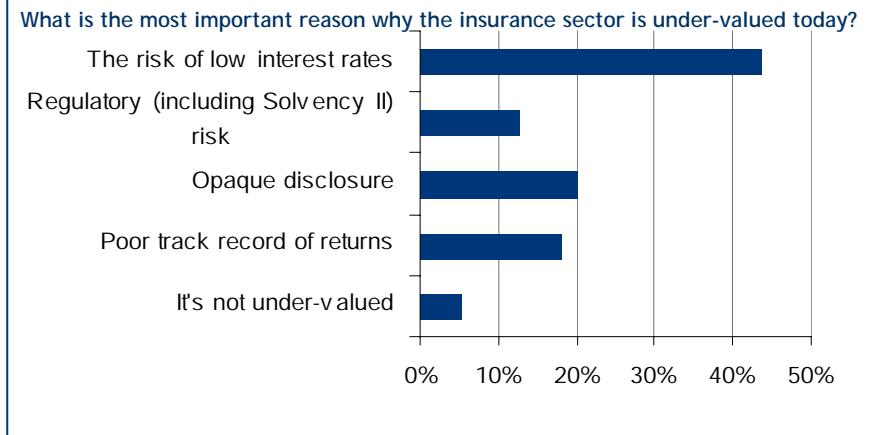
Source: BofA Merrill Lynch Global Research

Higher risk perception in credit too



Source: Datastream

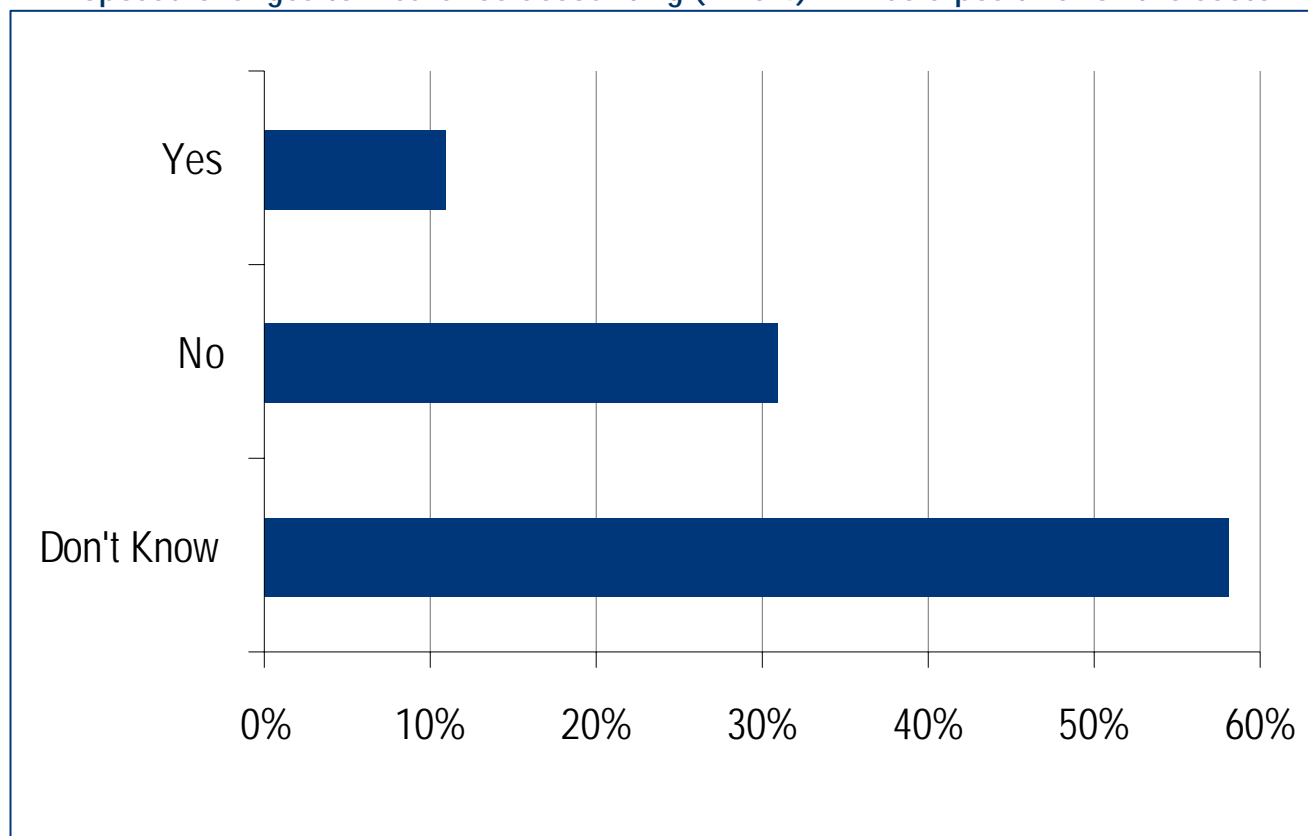
Poor disclosure remains an important driver of the under-valuation



Note: investor survey conducted Sep 2010. Source: BofA Merrill Lynch Global Research

In crafting a new standard, more user involvement is needed

Proposed changes to insurance accounting (IFRS 4) will be a positive for the sector

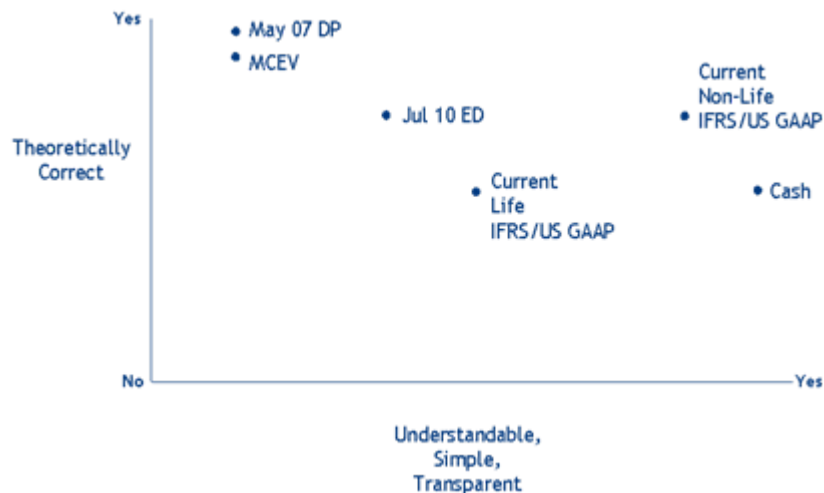


Note: investor survey conducted Sep 2010. Source: BofA Merrill Lynch Global Research

- More practical examples are needed
- Companies need to force-feed analysts and investors

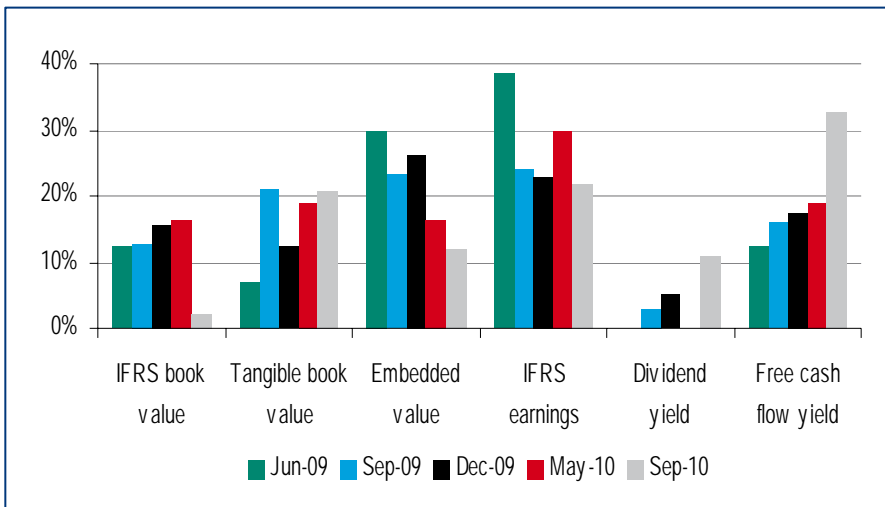
Main issue: problems of complexity and distance from cash haven't been solved

Accounting needs to balance theoretically correct vs understandable



Source: BofA Merrill Lynch Global Research

Which valuation approach will gain the most in popularity over the coming 12m?

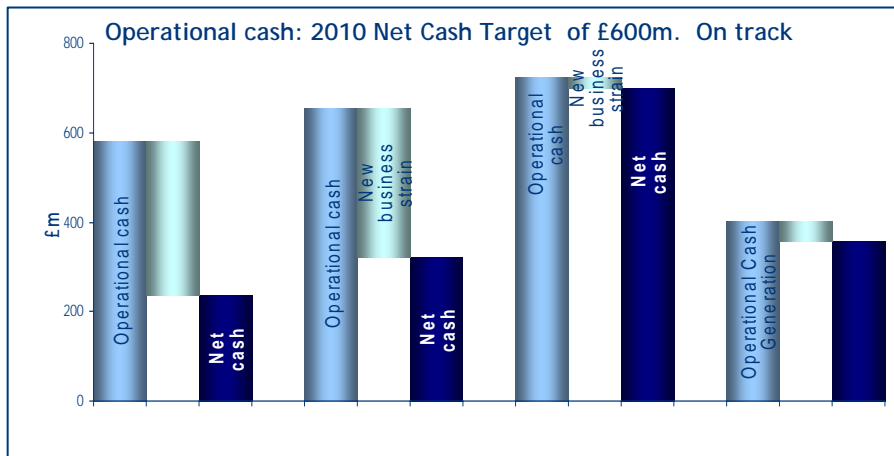


Source: BofA Merrill Lynch Global Research

- This EV-like standard is not what investors want
- Complexity and distance from cash permits manipulation and a lack of comparability
- A company using more aggressive accounting *may* fool investors
- For life operations, an AUM x margin approach continues to resonate much better with investors
- Proposal to disaggregate life margin into different drivers *is* useful
- The impact on non-life (short-duration contracts) appears largely sensible

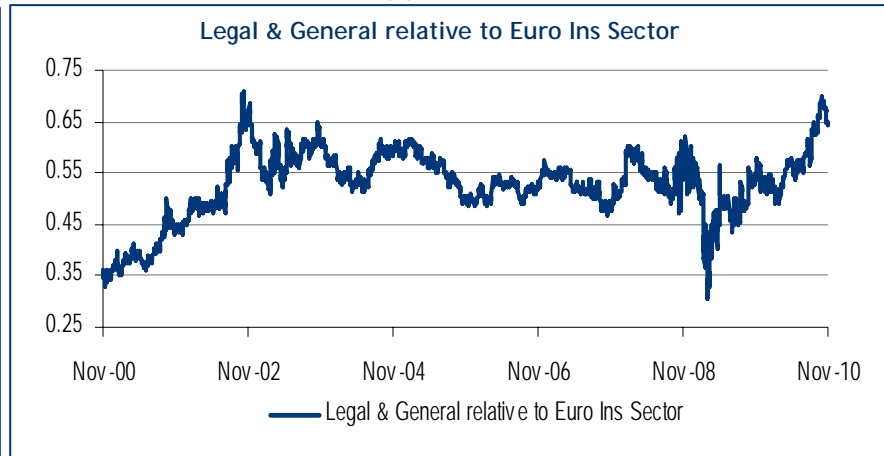
Cashflow statement needs to be beefed-up in tandem

Legal & General did this . . .



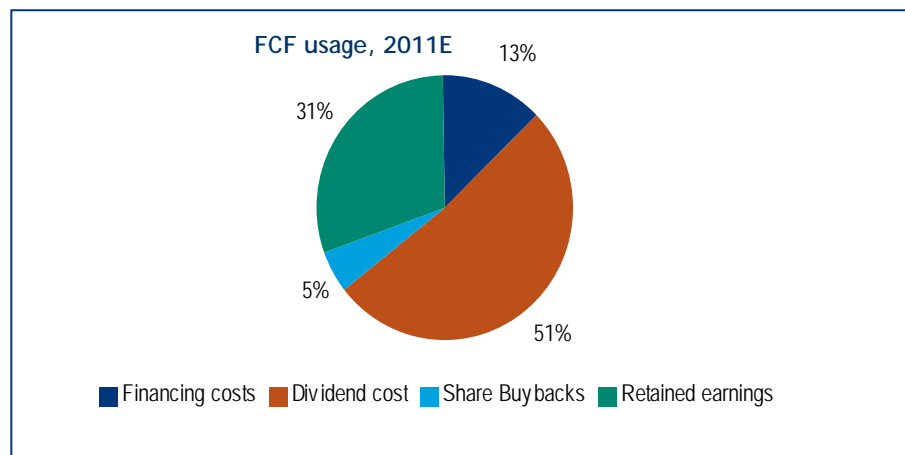
Sources: Company reports (Aug 10 presentation).

. . . and this is what happened



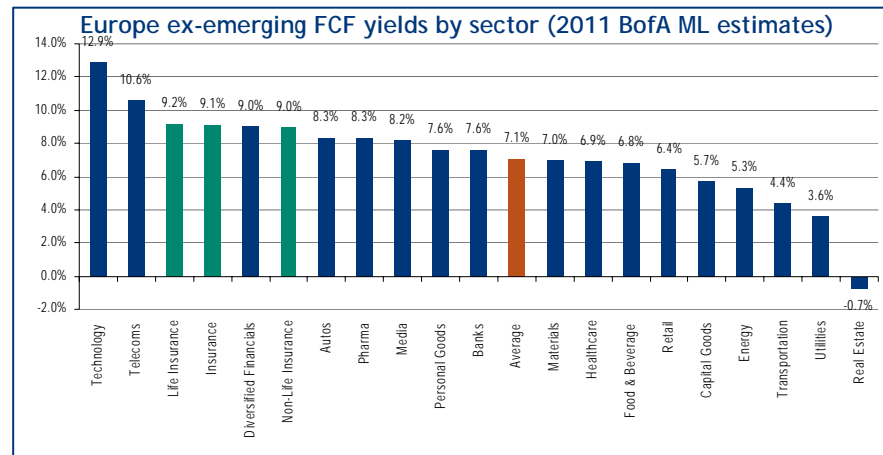
Sources: BofA Merrill Lynch Global Research.

Sector has a good FCF generation story . . .



Sources: BofA Merrill Lynch Global Research.

. . . which deserves more attention



Sources: BofA Merrill Lynch Global Research.

A few items of detailed feedback

One or two margins?

- *Slight preference for a single composite margin*

Which discount rate?

- *The middle ground of not tying to asset side but allowing an illiquidity premium is probably the least bad approach*
- *Accounting alone shouldn't have the consequence of making products extinct*

How to treat acquisition costs?

- *The current proposal is a sensible compromise*

Is it necessary to sync with Solvency II?

- *100% sync is not possible, so minimise the potential for conflicts*
- *We do need a bridge between the two*

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Investment rating	Total return expectation (within 12-month period of date of initial rating)	Ratings dispersion guidelines for coverage cluster*
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Neutral	≥ 0%	≤ 30%
Underperform	N/A	≥ 20%

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