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Layout & Distribution: Valéria Kozakova

Measuring and Assessing Insurance Company Performance

Stefan Schürmann

Summary – Insurance Company Performance Measurement

- 1. Information base**
- 2. Soft factors**
- 3. Hard Factors**
 - ◆ P/E
 - ◆ RoE
 - ◆ EV/EEV
 - ◆ SOTP
- 4. Conclusion**

Measuring and Assessing Insurance Company Performance

- ◆ Company view (**Allianz**, Burkhard Keese)
- ◆ **Institutional investor's view → CA Cheuvreux**
- ◆ Shareholder view → **UKSA**, Martin White (other than institutional angle)
- ◆ Debt holder/Rating agency view (**Moody's**, Simon Harris)
- ◆ Policyholder's view
- ◆ Employee's view
- ◆ Regulator's view

Measuring & Assessing Insurance Companies "Analyst View"

Information base:	Usefulness:
◆ Annual reports (usually IFRS)	Main source
◆ Embedded value reporting (EV, EEV)	Improving
◆ Regulatory statutory filings (where available), „Back-testing“	
◆ Management Meetings	Yes, but can we trust them – do they tell us enough?
◆ Industry Market Reports (consultants, RA)	Not allways „fresh“ data, cost factor

“Soft” Factors in Company Assessment

<p>Issue:</p> <ul style="list-style-type: none"> ◆ Company/Management meetings ◆ Industry/broker/employee contacts ◆ Investor discussions <p>➔ Challenge: includes findings in valuation model and earnings forecast</p>	<p>Impact</p> <p>„Gut feeling“</p> <p>„Bottom-up mirror“: do findings match top management message?</p> <p>„Trend mapping“: „In“ and „Out“ companies/sectors, „Hot stories“</p>
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“Hard” Factors for Performance Measurement

KEY „RATIO“	BASIS/DETAILS	ACCOUNTING		
	Examples	IFRS(4)/ ..GAAP	EV/ EEV	STATU- TORY
PRICE/EARNINGS	Net reported earnings	X		
	Normalised or adjusted earnings	X, adj		
	Operating profits	X		
„RoE“	Return on IFRS equity	X		
	Return on economic capital	(X) Adj		
	Return on embedded value		X	
PRICE/EV / EEV	Price to embedded value multiple		X	
NB multiple	New business multiple		X	
SUM-OF-THE-PARTS VALUE	Appraisal value (NAV + life in-force + added value non-life + life NB value)		X	
	ROE/CoC multiple by segment	X		
SOLVENCY	Regulator solvency ratio			X
	Rating agency solvency ratios	X		
	Solvency II (FSA, FTK, SST, etc)	?		

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Price / earnings multiple

Valuation table

In local currency 26/10/2005	Price	Mkt Cap.	Float (bn)	P/E				
				05	06	07	08	
Germany								
Allianz	ALVG.DE	EUR 116.3	44.8	41.2	11.0	10.7	10.9	11.1
AMB Generali	AMBG.DE	EUR 73.1	3.9	1.4	12.8	11.9	11.6	11.4
AWD	AWDG.DE	EUR 23.1	0.9	0.6	27.6	17.9	15.2	13.0
Hannover Re	HNRGn.DE	EUR 30.2	3.6	1.8	12.3	8.2	8.6	9.2
MLP	MLPG.DE	EUR 15.5	1.7	1.0	29.4	24.6	20.4	18.0
Munich Re	MUVGn.DE	EUR 97.9	22.5	15.4	11.9	9.3	10.2	11.4
Switzerland								
Baloise	BALN.VX	CHF 63.8	3.5	3.5	8.2	8.2	7.9	7.9
Conventum	CHRN.S	CHF 12.4	1.8	1.8	12.7	7.0	6.1	6.4
Helvetia Patria	HEPN.S	CHF 235.2	2.0	0.8	12.5	11.4	10.8	11.1
Swiss Life	SLHN.VX	CHF 198.3	6.6	6.6	7.6	6.7	5.9	5.4
Swiss Re	RUKN.VX	CHF 86.3	27.8	25.8	9.2	9.0	8.2	8.1
ZFS	ZURN.VX	CHF 218.2	31.6	31.6	7.2	6.5	6.8	7.1
UK **								
AVIVA	AV.L	GBP 648.0	15.2	15.2	9.4	9.4	8.9	8.3
Brit Insurance	BRE.L	GBP 80.3	0.8	0.8	8.3	8.0	13.1	22.5
Resolution	RSL.L	GBP 589.5	1.2	1.2	16.4	15.7	14.7	13.7
Friends Provident	FP.L	GBP 173.5	3.6	3.6	11.3	10.5	10.6	10.6
Legal & General	LGEN.L	GBP 105.8	7.2	7.2	10.0	9.2	8.4	7.8
Prudential	PRU.L	GBP 485.5	10.3	10.3	12.1	10.8	9.8	8.9
Royal & Sun Alliance	RSAL	GBP 94.8	2.8	2.8	7.9	9.4	12.4	13.2
France								
AGF	AGFP.PA	EUR 76.0	14.4	4.6	10.7	10.5	10.7	10.5

- ➔ Definition of „earnings“ as a challenge
- ➔ IFRS4 volatility lowers reliability of earnings forecasts (especially Life)
- ➔ Is P/E really useful? General investors still use it, specialists less so

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Measuring Insurance Companies : IFRS4

Factor	Our appreciation	Fin. Impact
◆ Insurance contract classification	No real help	None
◆ Assets at market, liabilities at cost	No help	Volatility
◆ Financial asset classification	Accounting driving strategy?	+ / -
◆ Segment reporting	Useful	None
◆ Goodwill treatment	Helps comparability	+
◆ Equalisation reserves	A detail	+
◆ Employee benefits	A one-off mostly	-
◆ Conclusion: IFRS4 no help for use of P/E multiples		

Performance Measurement, "Hard" Factors

KEY „RATIO“	BASIS/DETAILS	ACCOUNTING		
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SUM-OF-THE-PARTS VALUE	Appraisal value (NAV + life in-force + added value non-life + life NB value)		X	
	ROE/CoC multiple by segment	X		
SOLVENCY	Regulator solvency ratio			X
	Rating agency solvency ratios	X		
	Solvency II (FSA, FTK, SST, etc)	?		

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"RoE"

04/11/2005	Mkt Cap. (bn)	P/E				Avg gr. 2005-08	P/gr 2006-08	P/EV	Cheuvreux		ROE 2005
		05	06	07	08				Yield 2005	Upside	
Reinsurance	25.2	13.8	8.4	8.2	8.0	14%	-6.6	1.16	3.0%	5.7%	9.6%
Non life & Composites	232.3	11.9	11.1	11.3	11.3	1%	17.6	1.31	3.1%	5.8%	13.5%
Life	102.7	11.0	10.9	10.2	9.7	3%	-1.9	1.32	3.7%	2.4%	20.0%
Asset Gatherers	8.4	20.3	19.2	18.0	17.3	4%	-4.1	1.74	3.4%	6.8%	29.2%
Bank insurers	84.0	9.3	9.4	8.7	8.0	4%	-1.2	1.45	4.5%	3.9%	19.7%
Germany	80	12.1	10.7	11.1	11.9	1%	2.3	1.40	2.6%	5%	12.6%
Switzerland	50	9.6	7.6	7.6	7.6	6%	109.0	1.05	2.8%	11%	12.5%
UK	64	10.7	10.3	9.9	9.3	3%	-2.4	1.32	4.0%	5%	30.9%
France	71	12.4	11.6	11.0	10.2	5%	-2.1	1.21	3.5%	5%	12.3%
Italy	74	15.4	15.0	14.9	14.2	2%	-5.9	1.49	3.6%	5%	14.9%
Benelux	105	9.3	9.7	9.1	8.4	3%	-1.3	1.44	4.3%	2%	18.2%
Nordic Countries	6	20.9	20.2	29.9	28.9	-8%	1.1	1.53	0.0%	-22%	17.3%
Spain	4	12.7	11.2	10.1	9.3	8%	-1.4	1.27	2.0%	4%	13.3%
Insurance sector	452.7	11.28	10.61	10.36	9.99	3%	-3.8	1.33	3.5%	4.7%	15.6%


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- ➔ Definition of **return**: same problem
- ➔ Definition of **equity** challenging, but more choice of base: RoEV, RoEC, RoE(IFRS)
- ➔ IFRS4 increases volatility on „R“ as well as on „E“
- ➔ RoE more often used than P/E (RoE often external target definition)

European Embedded Value – A Step Forward


Issue	Our appreciation
1. EEV vs EV	A step forward
2. Transparency	Better, not great yet
3. Consistency	Not really achieved yet
4. Comparability	EEV not widespread yet

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Performance Measurement, “Hard” Factors

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Sum-of-the-parts-valuation (SOTP)

- ◆ ROE approach or embedded value approach
- ◆ Example for ROE approach:

X	Capital allocation per segment	SOTP valuation (\$m)	Allocated equity	ROE	CoC	Multiple	Valuation	CHF ps
	(Normalised) return on allocated equity							
=	Cost of Capital							
	SOTP							

SOTP valuation (\$m)	Allocated equity	ROE	CoC	Multiple	Valuation	CHF ps
Non-life insurance	10 206	15.0%	9.0%	1.7	17 010	147
Life insurance	5 573	9.0%	9.0%	1.0	5 573	48
Farmers (DCF)	3 331			2.1	7 012	61
Other Business	1 939	5.0%	9.0%	0.6	1 077	9
Excess Capital	1 132				1 132	10
HQ costs & PF deficit					-2 818	-24
Total	22 181			1.3	28 986	250

- ➔ ◆ Analyst appreciation of company value
- ◆ CoC (or RdR) as biggest challenge
- ◆ SOTP useful for price target setting

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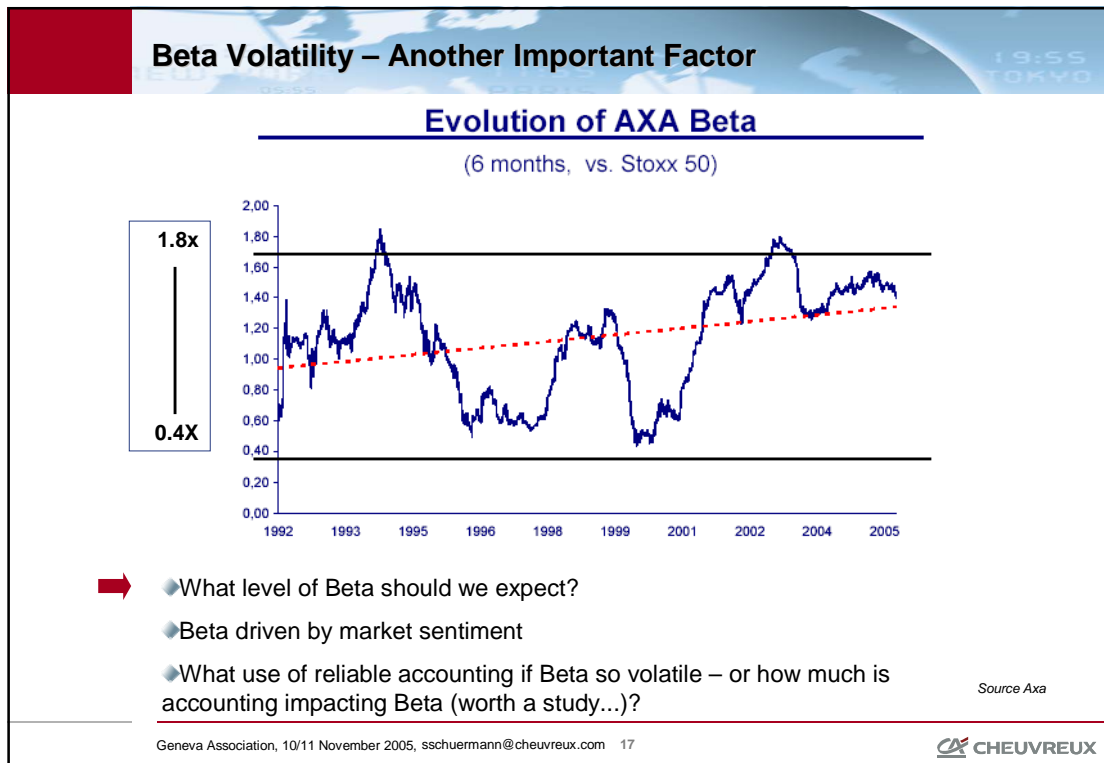
Cheuvreux Approach for Cost of Capital Assessment

$$\begin{array}{rcl}
 \text{Risk free rate} & + & \text{adj. Beta (our appreciation)} & \times & \text{risk premium} & = & \text{CoC} \\
 3.5\% & & (1.4 & & \times & 4.0\%) & = & 9.1\%
 \end{array}$$

from 1: excellent to 5: poor	Strategy / Management	Market maturity	Compet. position	Prospects	Market life	etc	...	Note	Note for relative risk	Cost of Capital implied %
Weighting	2	1	2	2	1	2		3.23	18	3.23
Aegon	3	5	2	4	2	5		3.56		10.50
ACE	4	4	3	3	3	1		2.83		9.21
Allianz	2	3	4	4	3	3		3.11		8.99
Allianz	3	3	2	3	1	4		2.83		9.30
Aviva	1	3	2	3	1	4		2.56		8.36
AWD	3	3	2	3	3	3		2.83		8.51
AXA	1	4	3	2	5	5		2.67		8.40
Baloise	4	5	3	4	3	2		3.39		8.70
.....
.....
.....
RAS	3	3	2	5	3	5		3.11		8.80
Royal & Sun Alliance	4	4	4	4	3	2		3.72		10.38
SCOR	3	4	5	4	5	5		4.00		11.22
Skandia	4	3	4	2	3	2		3.22		10.64
Swiss Life	5	5	3	5	4	5		4.72		11.32
Swiss Re	1	3	1	2	1	5		2.33		8.30
Unipol	5	5	5	5	5	5		5.00		12.26
ZIS	3	3	2	3	2	5		3.06		9.29
AMB Generali	3	3	3	3	3	3		3.11		8.99
Assicurazioni Milano	3	4	2	5	4	4		3.89		10.34

- ➔ ◆ Investor/analyst input/appreciation on valuation often happens here!

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Achievements to date – work in progress

Issue	Tool	Improvement to date
◆ Transparency	IFRS → IFRS4 EV → EEV	Not really Better, work in progress
◆ Consistency	IFRS → IFRS4 EV → EEV	Not yet Somewhat better
◆ Comparability	IFRS → IFRS4 EV → EEV	Not much better Better, not widespread yet

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Measuring Insurance Companies : There is good news!

- ◆ Overall, reporting is improving (see slide on „reporting mess“ in last year’s presentation)
- ◆ Industry awareness of a „problem“ starts to produce actions/solutions (CFO Forum, IASB new setup, EEV, Internal Capital Models)
- ◆ Product & legal diversity in Europe (especially life) remains a challenge for the search of a reliable & useful accounting framework
- ◆ **My view:** a global „ideal“ framework remains an illusion – better a good solution fast than „the best solution“ after 2010...

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