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Exit value based financial statements: A value added for the capital markets?

(Review of the discussion paper of the IASB on IFRS 4 Phase II)

Munich, July 12th, 2007

Allianz 

Agenda

Key objectives of the CFO Forum

We agree

- With the conceptual framework
- With the three building blocks of liabilities valuation

Issues

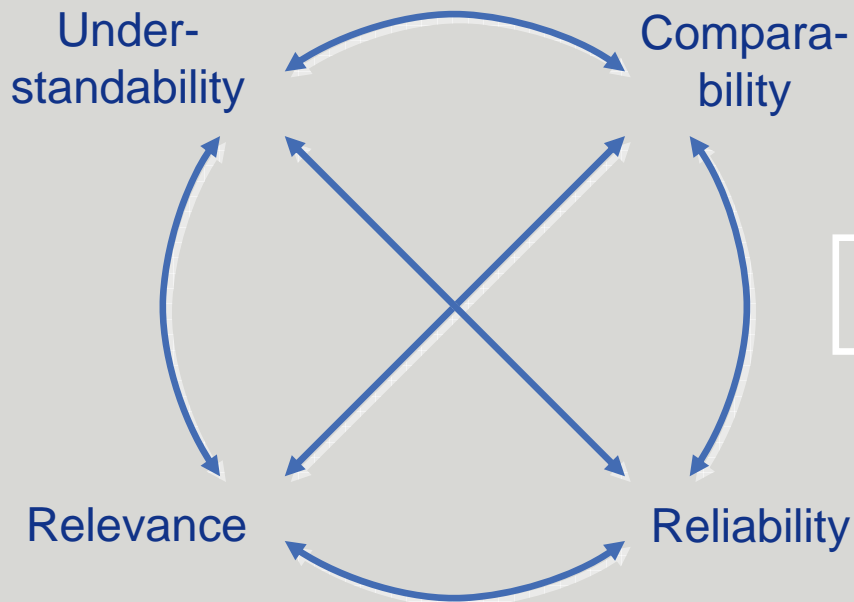
- No economic view on cash flows
- The margin split
- Upfront profit recognition caused by market average exit value
- Artificial volatility

Preliminary assessment

The way forward

Key objectives of the CFO Forum

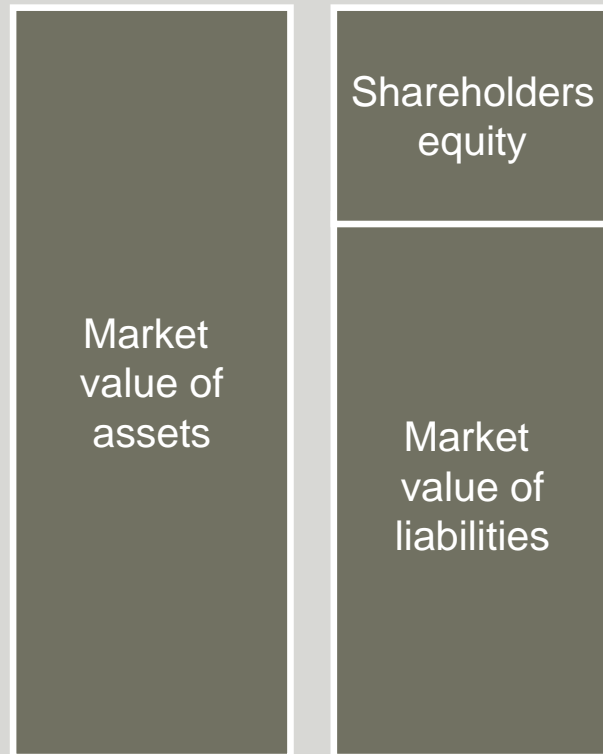
What we are seeking in our financial statements...



...and how it will benefit users and other stakeholders

- Better reflection of insurance business model
- Transparency and comparability of insurance contract accounting
- Global convergence of insurance accounting
- Level playing field for companies
- Reconcilability with Solvency II

We agree: With the conceptual framework

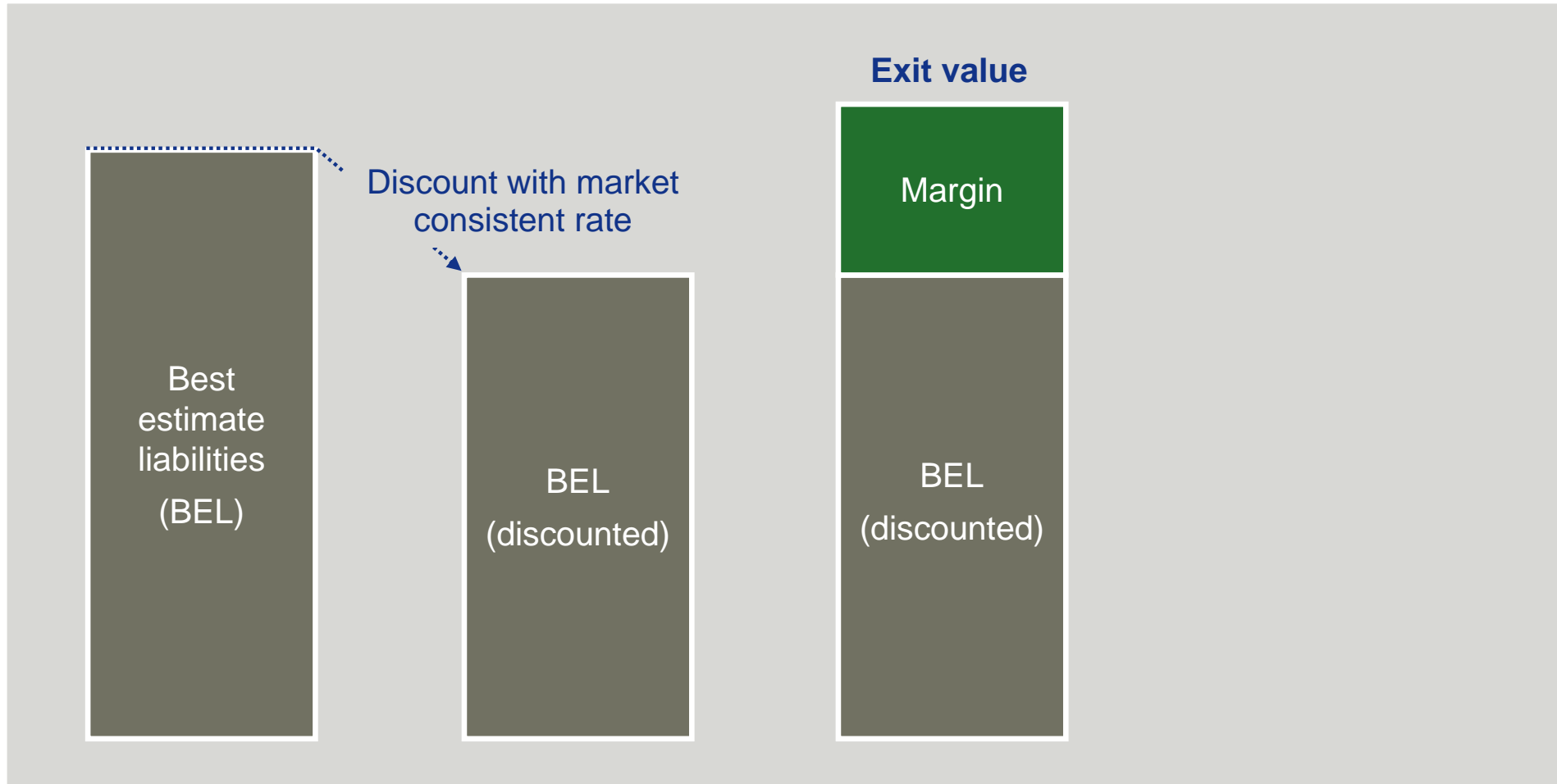


- Economic approach
- Eliminates accounting mismatch
- Covers options and guarantees

but:

- There are still conceptual flaws
- Some objectives not yet adequately addressed (i.e. presentation issues, revenue recognition)

We agree: With the three building blocks of liabilities valuation



▶ But there are major issues

Issue 1: No economic view on cash flows

Unbiased
best
estimate
liabilities
(undiscounted)

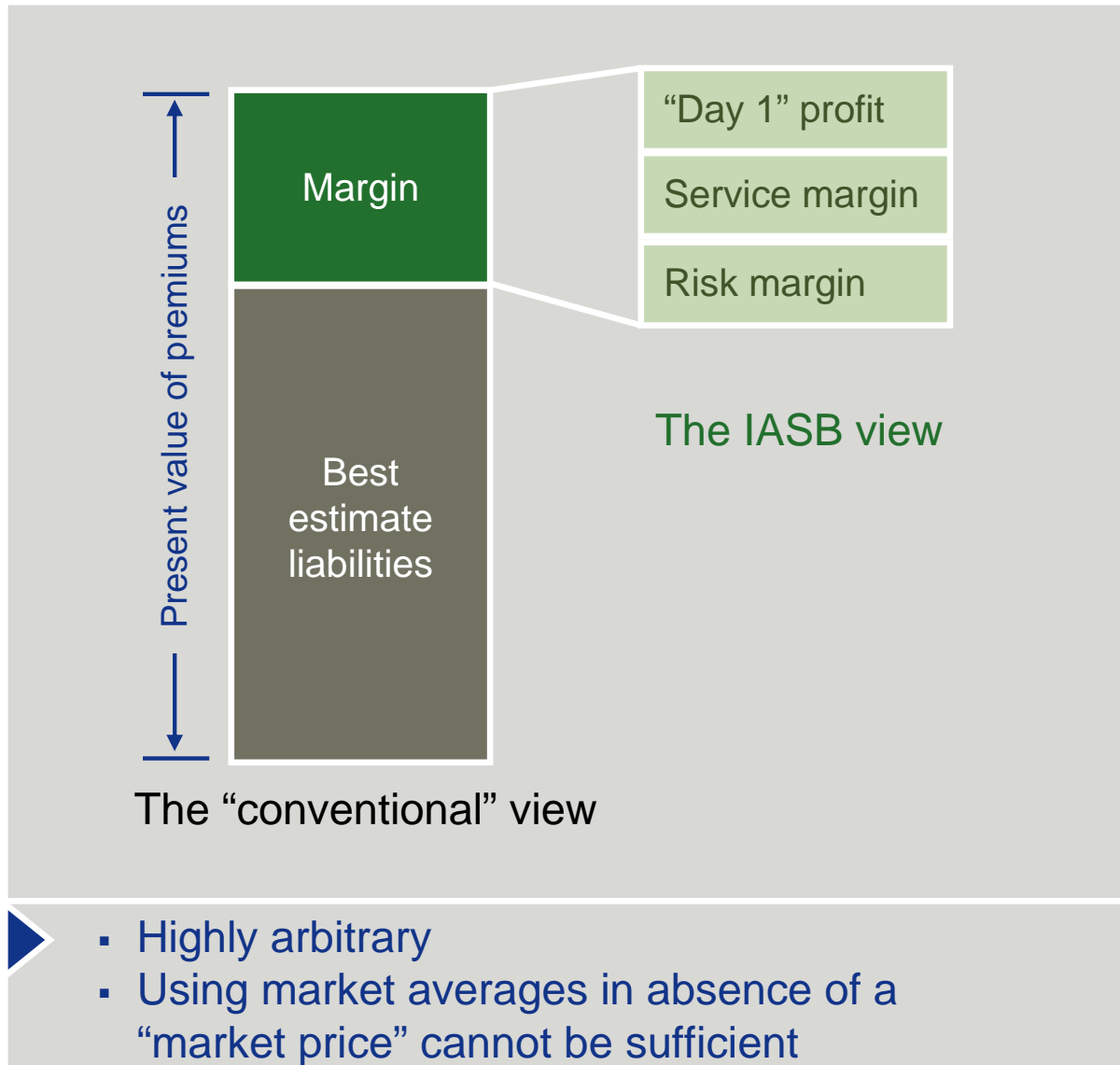
- We agree with the basic idea of an unbiased probability weighted best estimate of cash flows as the basis
- We agree with a single model for Life and General insurance
- Values options and guarantees are fully reflected

However, we disagree with:

- Recognition of only contractual and enforceable cash flows unless the insurance contract is so beneficial that a policyholder would have no desire to terminate the policy (guaranteed insurability)
- Major impacts on large portfolios:
 - Participating contracts
 - Annuities

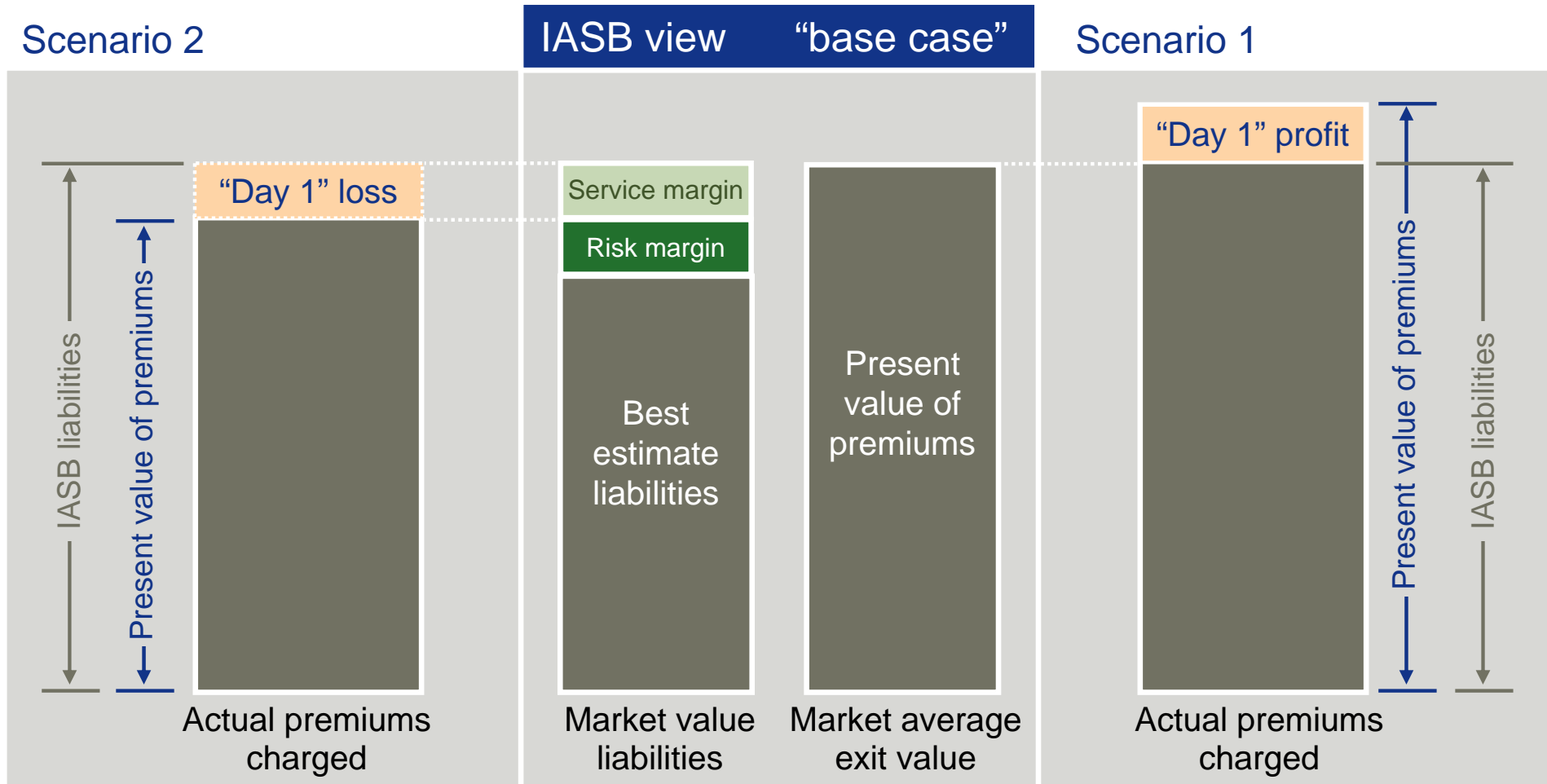
▶ Policyholder behavior not adequately reflected

Issue 2: Margin split



- Concept not well defined
- Split based on "market average" assumptions
- "Day 1" profits according to IASB are rare exceptions

Issue 3: Upfront gain recognition caused by market average exit value

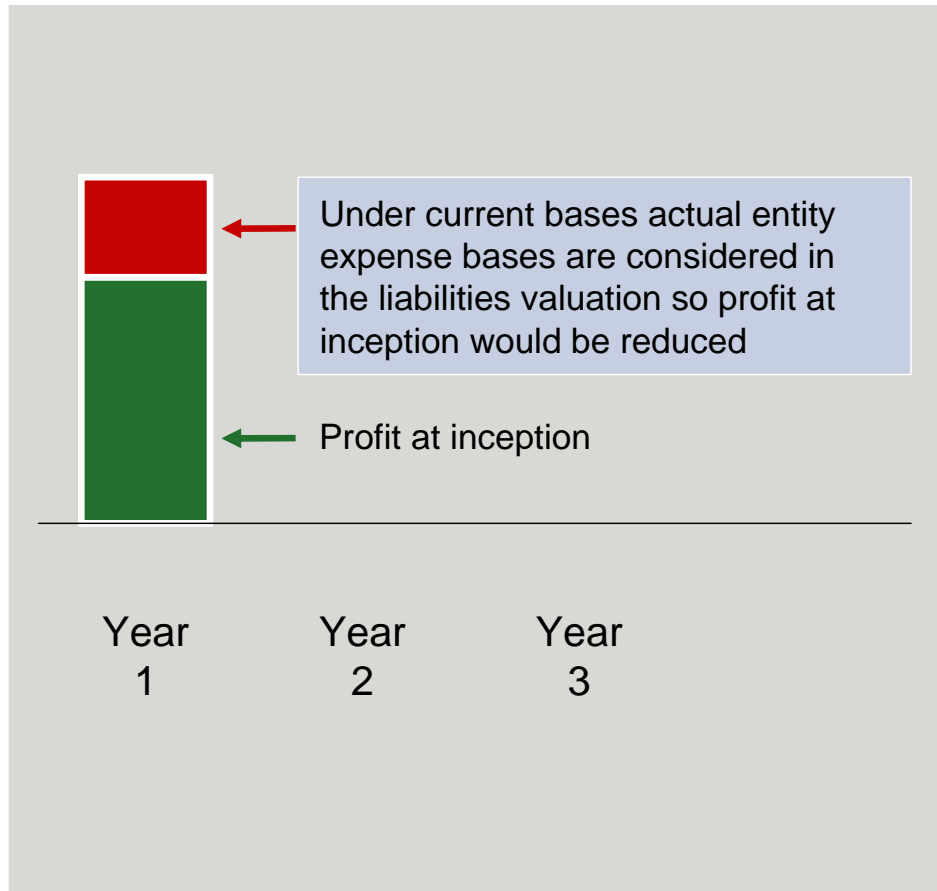


▶ Significant upfront profit recognition to be expected because the exit value is market average which leads to ...

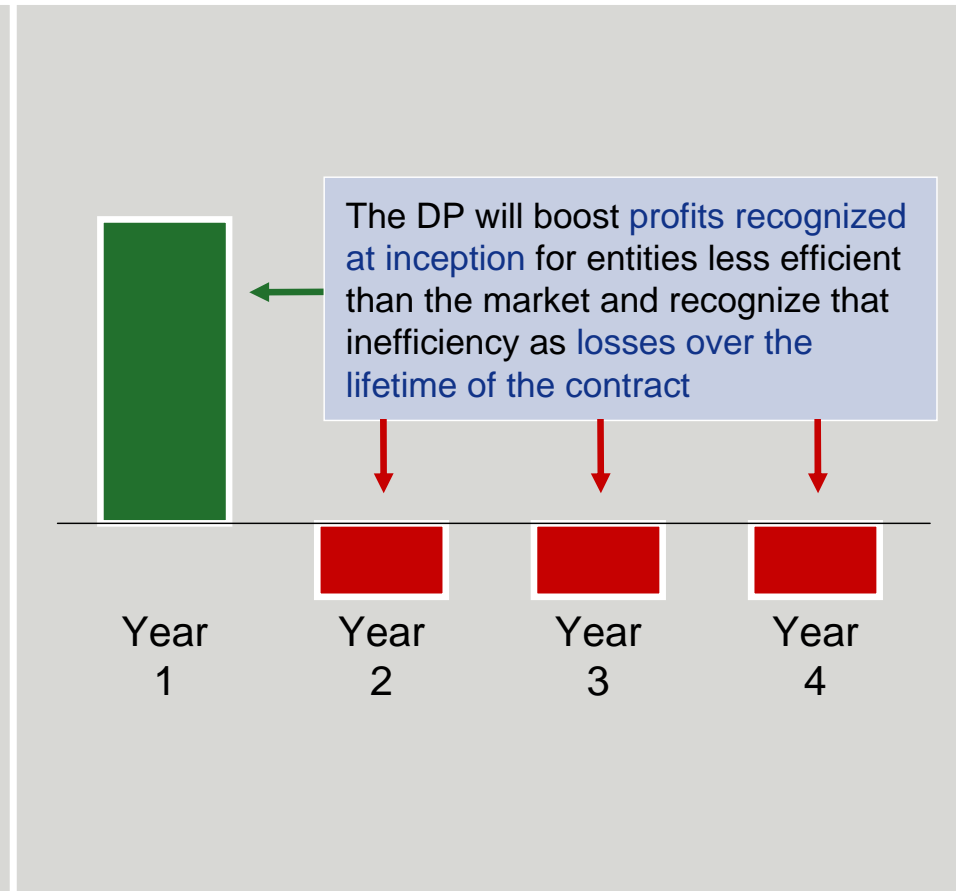
Issue 4: Artificial volatility

- Example 1: Expenses

Current bases



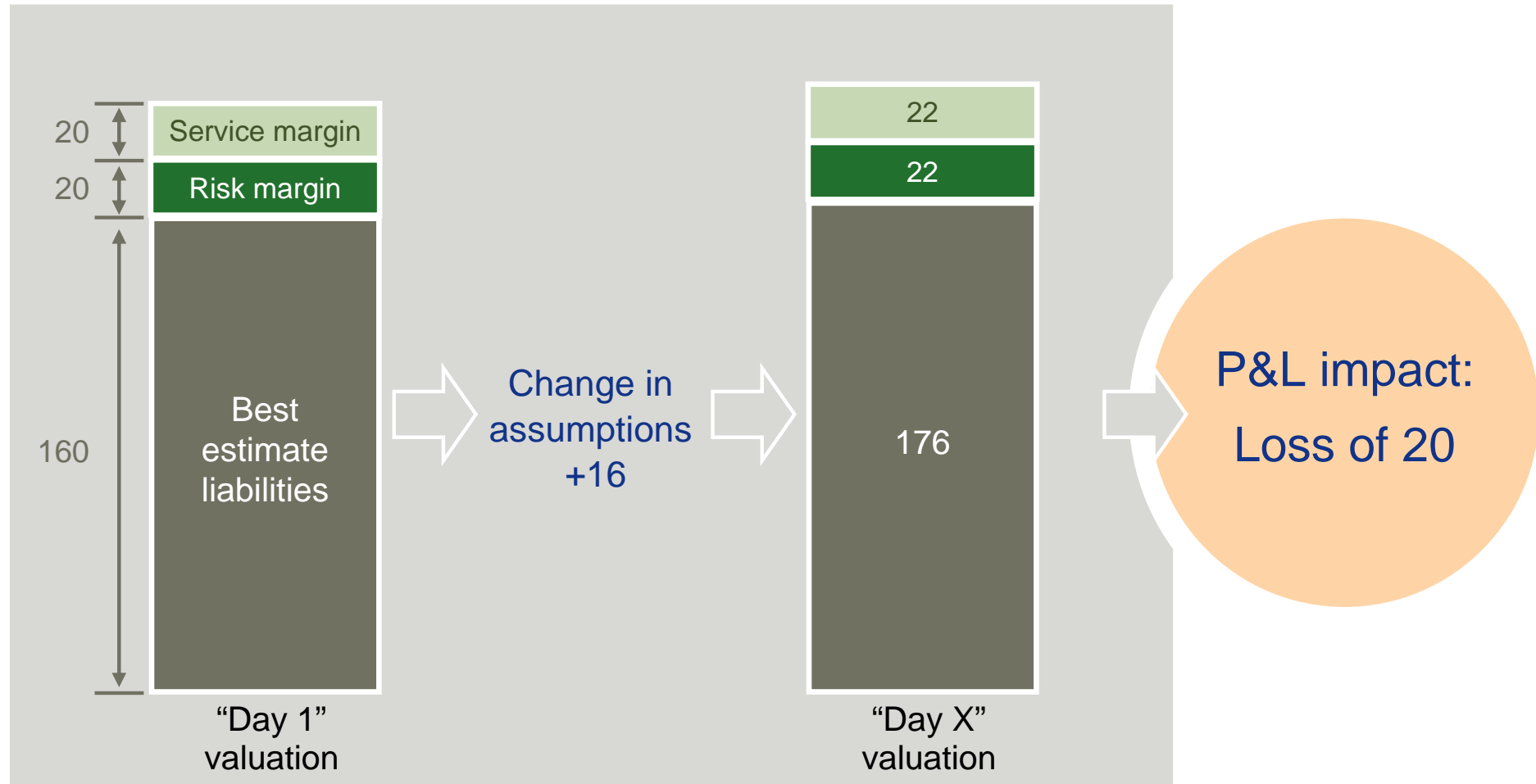
Discussion paper (DP) proposals



▶ Entity specific valuation of certain cash flows is a must

Issue 4: Artificial volatility

- Example 2: Change in assumptions

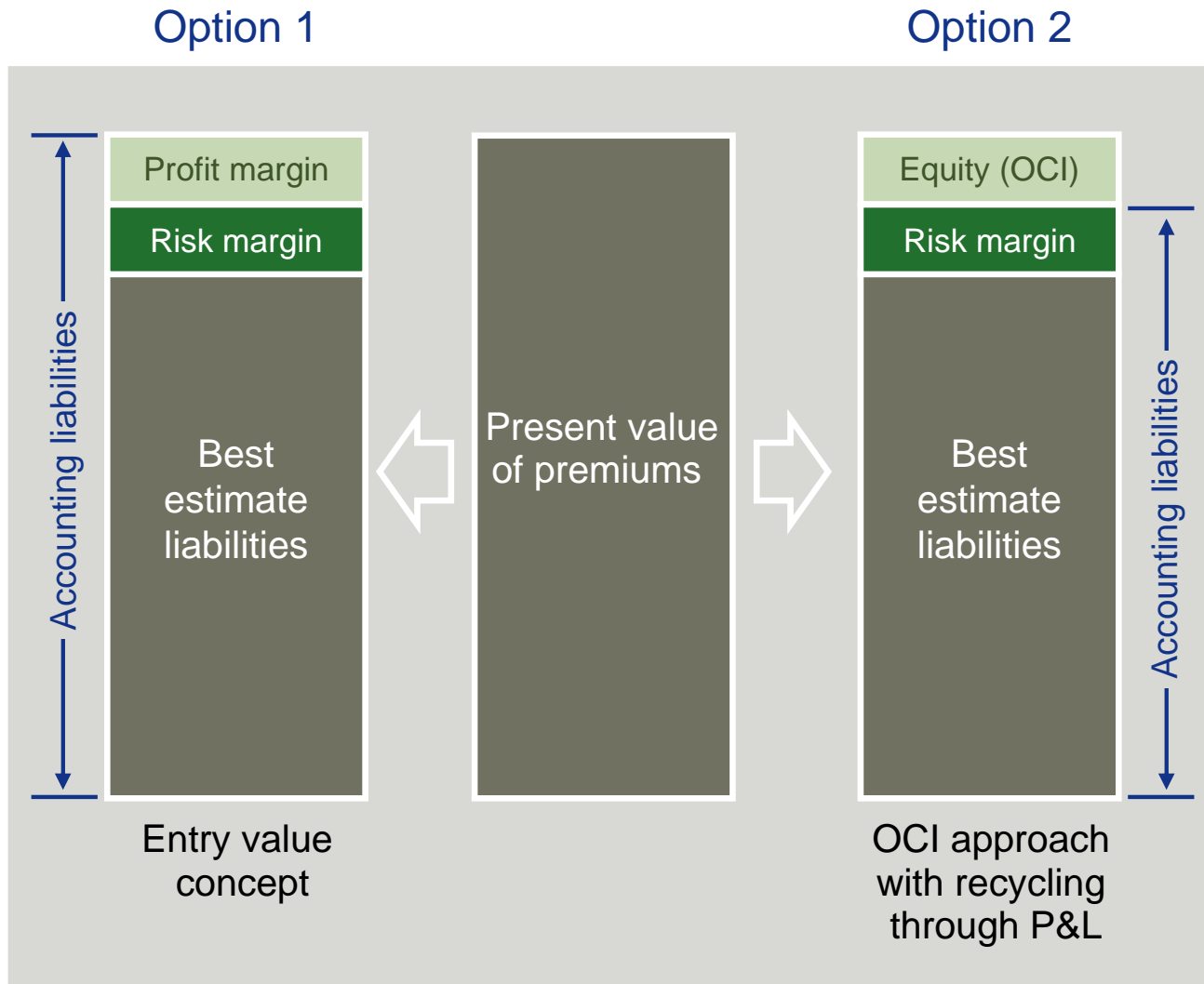


► Recognition of losses even if the contract still carries a service/profit margin

Our preliminary assessments

		Status
1	<p>Level playing field</p> <ul style="list-style-type: none"> - improve transparency - allow cross sector comparability 	
2	<p>Reflect business model of insurance</p> <ul style="list-style-type: none"> - the way we manage risk - eliminate accounting mismatch - no upfront gain recognition 	
3	<p>Allow for convergence</p>	
4	<p>Coherent framework with Solvency II and market consistent embedded value (MCEV)</p>	

The way forward



- Difference between option 1 and 2 rather philosophical
- No upfront gain recognition
- Profit recognition in line with release from risk
- Margin/equity works as “shock absorber”
- Non financial risks based on entity specifics

Does the IASB discussion paper meet your expectations and needs as one of the most important addressee of financial statements

⇒ We want you to become an active part of the discussion



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