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Is the business model of insurance companies jeopardized?

Société Générale IFRS Conference
Paris, 5 October 2010

Conclusions

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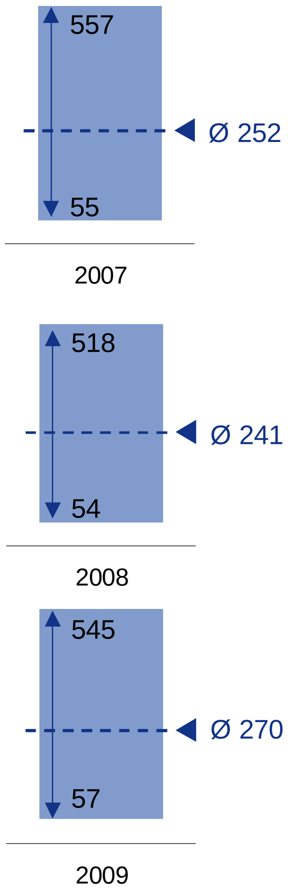
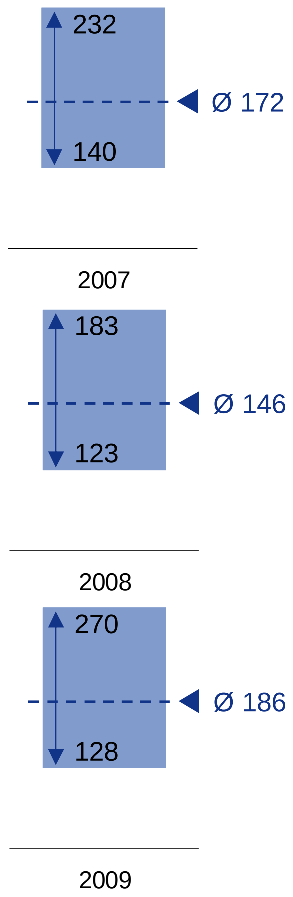
- Insurers mastered the crisis relatively well, however, no appreciation by the market to date
- Since 2008 the banks are in a position to account everything – except the trading book – at cost
- The IFRS 4 exposure draft would force the insurance industry into mark-to-market valuation for the entire book
- We could be supportive of the current/current approach for some of our products, but the IASB has to grant a “cost option” to be consistent with IFRS 9

Insurers managed to master the crisis relatively well

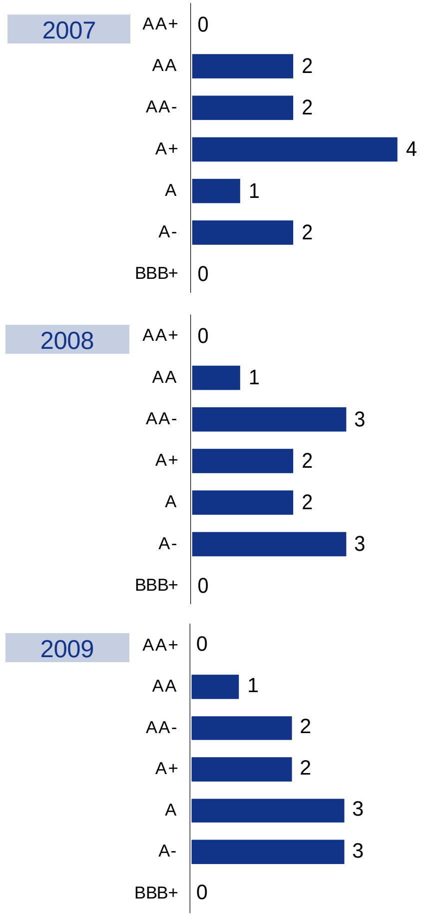
Gross technical reserves[1]
(EUR bn)



Solvency ratio
(in %)



Credit ratings of top European insurers[2]



1) Including reserves for insurance/investment contracts where the investment risk is borne by policyholders
2) Excluding Bancassurance players with banking focus

Allianz

However, our resilience has not been rewarded with investors trust

P/E development

March 31st, 2000	
Technology	52.6
Reinsurance	42.9
Food + beverage	17.3
Insurance	**15.6**
Industrial	14.6
Banks	13.6
Auto + parts	10.0
Average	23.7

June 31st, 2007	
Food + beverage	17.1
Technology	16.7
Industrial	15.6
Auto + parts	12.5
Banks	11.4
Insurance	**10.8**
Reinsurance	8.7
Average	14.5

July 6th, 2010	
Industrial	13.0
Technology	12.1
Food + beverage	12.1
Auto + parts	9.5
Banks	8.0
Reinsurance	7.4
Insurance	**7.1**
Average	10.9

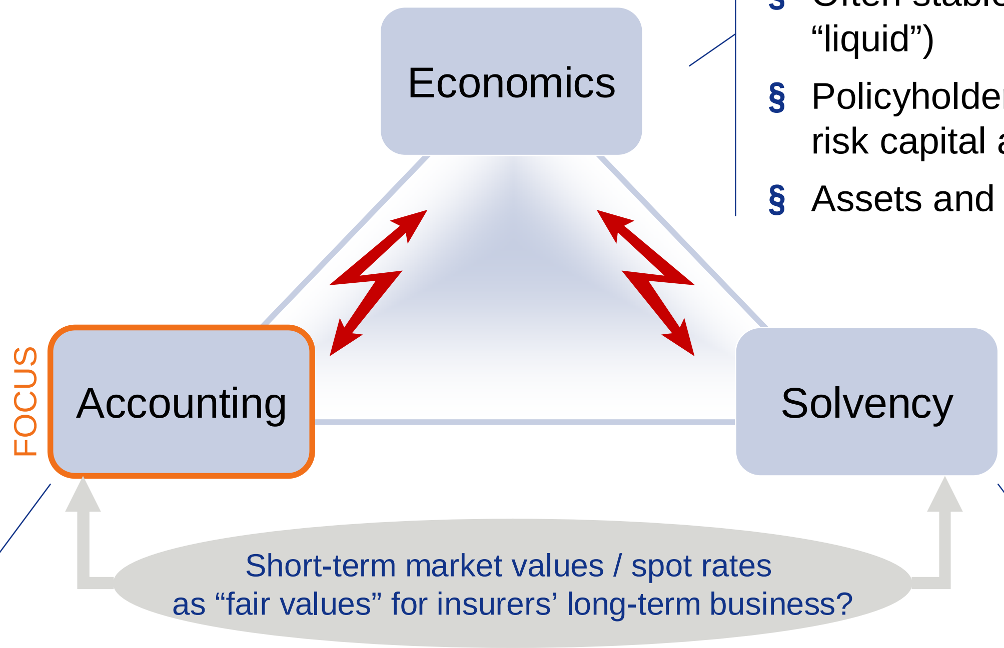
Our products function well, but regulatory and accounting changes could threaten our business model

Markets treat insurers similar to banks

Regulatory changes	§ Solvency II is a step in the right direction, but continues to create huge uncertainty and high complexity § Distribution-related regulation initiatives across Europe are driving up distribution expenses and complexity § Shift of focus from "community of policyholders" to "individuals" undermines the business model, especially in life (e.g. guarantee of surrender value in Germany)
Capital availabilities/ requirements	§ Capital becomes a scarce resource as institutional investors limit their allocation to the insurance industry § Investments as pure re-allocations between insurers rather than positive net inflows to the industry § Additionally, increased capital requirements from regulators – often without sound economic logic
Standard setting	§ IFRS 9 does not reflect the specifics of the insurance industry so far § IFRS 4 Phase II may introduce excessive volatility, which is not relevant for a long-term investor

A “spot market value” view is not adequately reflecting the economic reality of the insurance business

- § Often stable, long-term liabilities (not “liquid”)
- § Policyholders provide important part of risk capital and funding
- § Assets and liabilities are strongly linked



- § To date still no appropriate integration of assets and liabilities
- § In recent years inadequate increase in accounting volatility and noise

- § Risk-by-risk charges
- § Asset/liability disintegrated (except partially for interest rate risk)
- § Policyholder view only for required capital, but not for available capital

Lessons learned from 2008 credit crisis

"Looking into different reform measures, it is necessary to recall that the crisis had multiple reasons, e.g. the weaknesses in the accounting standards such as the deficiencies of fair value accounting applied for illiquid assets."

Dr. Josef Ackermann, CEO of the Deutsche Bank AG

"Theoretically swap markets are liquid even for securities with a maturity of 30 years, but those markets are not deep enough to be a valid source for valuations."

Investment bank analyst

IFRS 9 – a consequence of the 2008 credit crisis

Learning from 2008

- Illiquidity distorts mark-to-market valuation
- Economic substance of assets is often misstated if assets are held long-term
- Fair value accounting at least exacerbated the credit crisis

Resulting

IFRS 9 "mixed measurement" model:

- Cost category

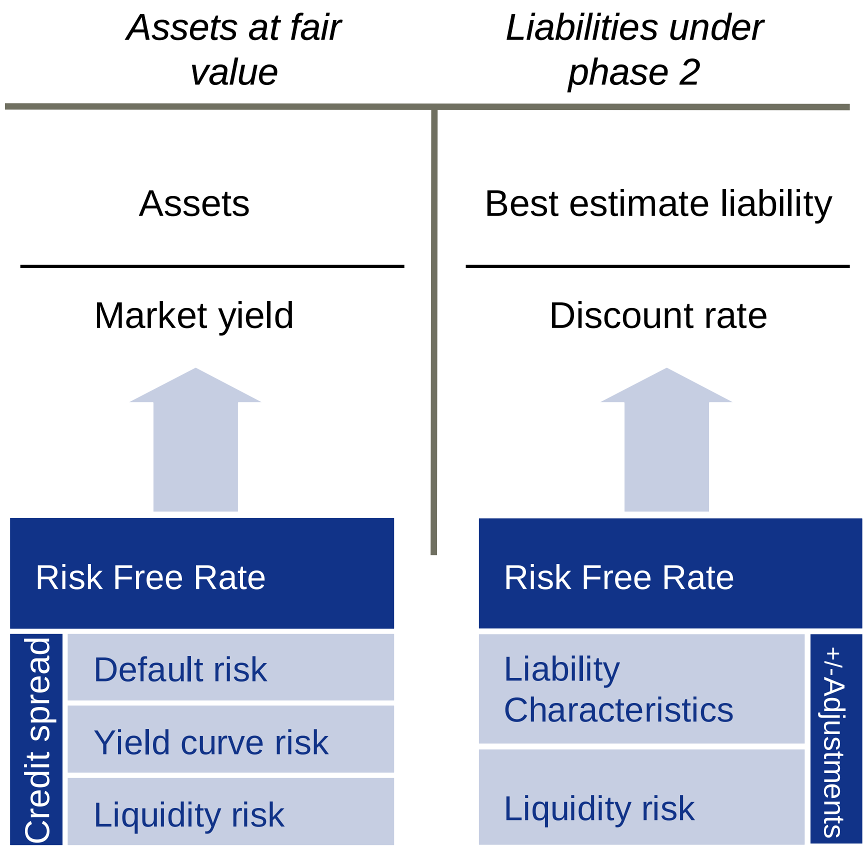
+

- Mark-to-market category

Banks can hold assets and liabilities of the "bank book" at cost!

IFRS 4 Phase 2 ED requires discounting with “market rates”

Fixed income securities at fair value through income

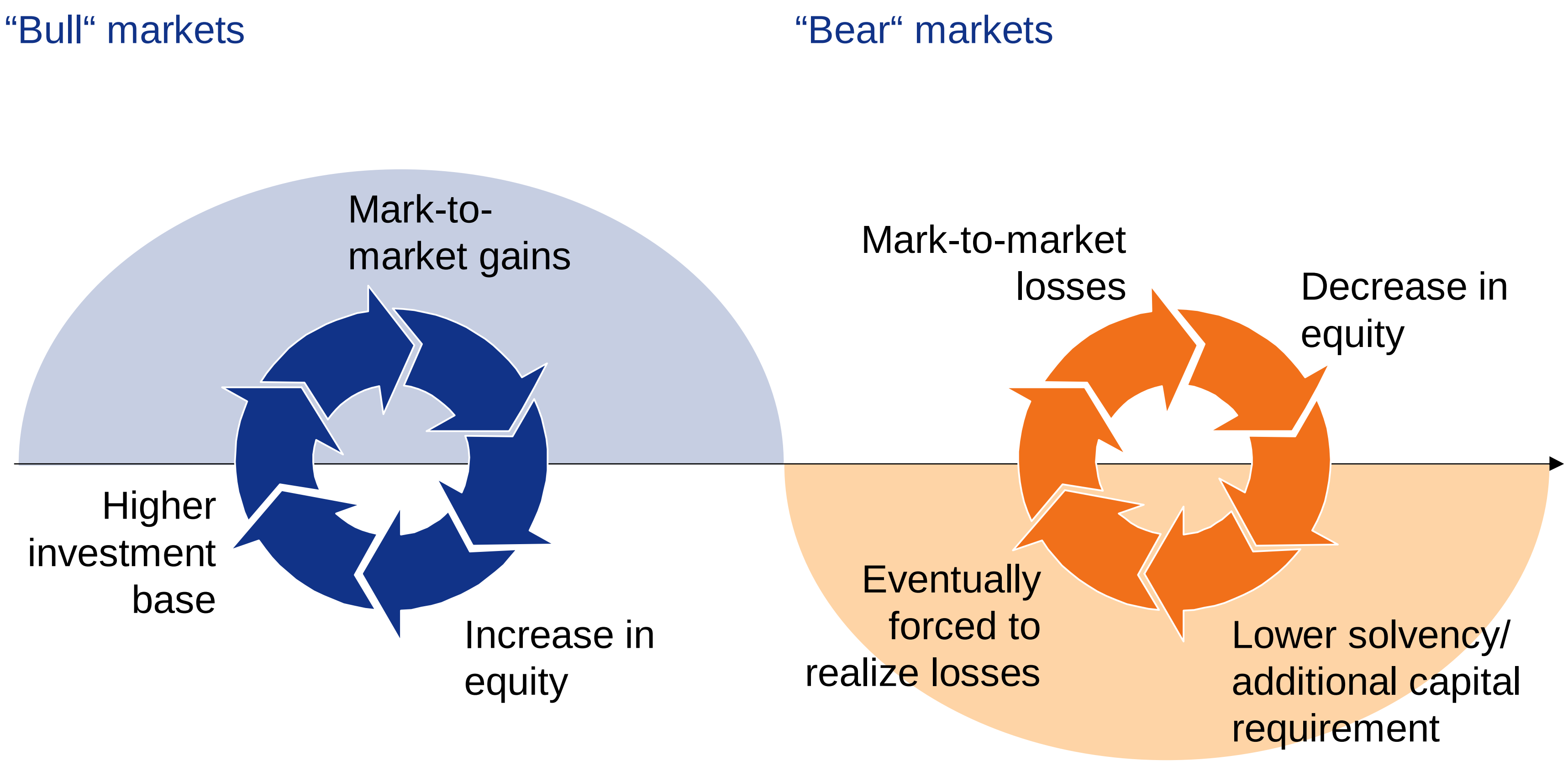


P/L gets very volatile for the wrong reasons:

- Credit spreads
- Liquidity

Limits investment strategy

What are the consequences of the current accounting model



Why is a current/current accounting regime requested?

! Increase in comparability

! Reduce judgment of management

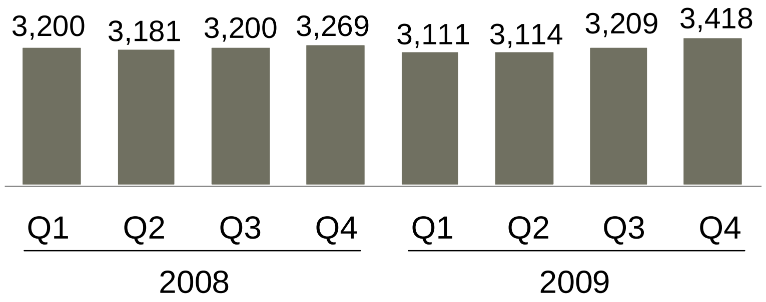
! Analysts are interested in operating profit, market noise is “understood”

Let’s review a current/current disclosure

Example: UK insurance company

(in GBP mn)	1Q 2008	2Q 2008	3Q 2008	4Q 2008	1Q 2009	2Q 2009	3Q 2009	4Q 2009
Revenues	**6,924**	**6,860**	**6,359**	**5,901**	**6,567**	**6,756**	**7,355**	**8,744**
thereof: net investment income	2,111	2,145	2,076	2,100	2,051	2,055	2,075	2,111
Benefits and Expenses	**5,977**	**5,718**	**5,727**	**7,075**	**5,646**	**6,081**	**6,403**	**7,778**
thereof: Interest credited to php	806	803	853	881	831	818	883	1,049
thereof: Interest expense	283	233	271	288	229	241	251	258
Adjusted operating income	**947**	**1,142**	**632**	**-1,174**	**921**	**675**	**952**	**966**
Total reconciling items	**-678**	**-486**	**-547**	**-511**	**-57**	**-56**	**-195**	**18**
Thereof total real. investm. gains, net	**1,634**	**-1,971**	**-3,078**	**29**	**-226**	**44**	**-84**	**212**
Income fr. continuing operations b/tax	**80**	**597**	**-72**	**-1,739**	**864**	**619**	**757**	**1,124**

“Operating” investment income (in GBP mn):



- Fictitious “normalized” investment margin flattens operating profit impact
- Volatility reflected below the line within non-operating profit
- Does this really dampen profit volatility and reduce management judgment?
- Has this approach helped life insurance valuations?

What do we need?

A level playing field for banks and insurance companies must be maintained

Option 1:	Eliminate the IFRS 9 option for the cost category for everyone	§ Would ignore the learning from 2008	û
Option 2:	Introduce cost option for insurance contracts	§ Would respect the 2008 lessons § Would better reflect our business § Would create a level playing field	ü
Option 3:	Current/current approach with changes recorded through OCI	§ Would imply to change IFRS 9, which is not favored by the IASB	?

We could be supportive of the current/current approach for some of our products, but the IASB has to grant a “cost option” to be consistent with IFRS 9

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