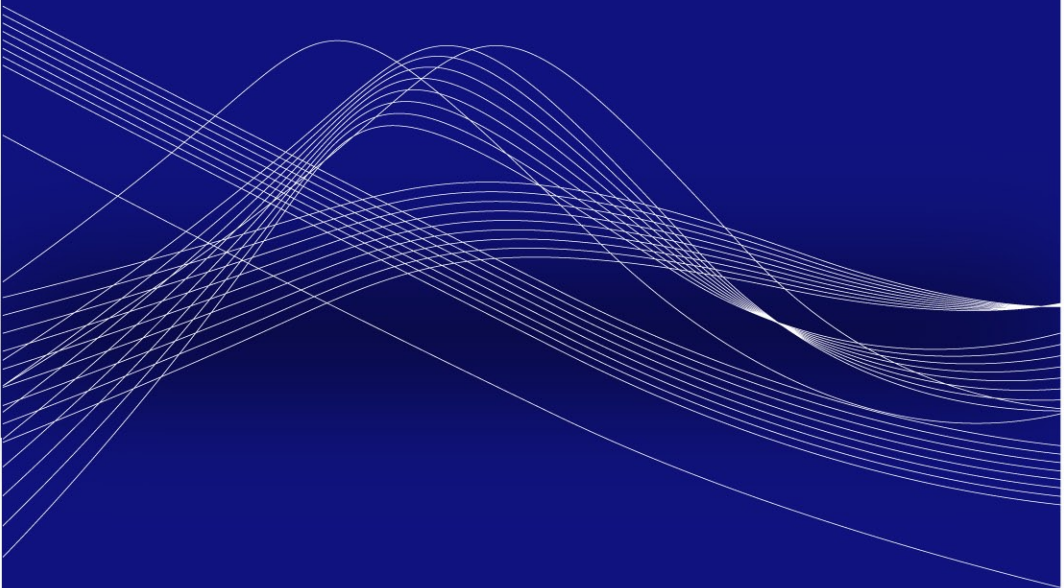


Additional Guidance on European Embedded Value Disclosures



CFO Forum

1. Introduction

This document sets out additional guidance on minimum required disclosures of sensitivities and other items under European Embedded Values. This guidance is an extension of the existing guidance given in the European Embedded Values launch document published in May 2004. The CFO Forum does not plan to consider publishing any revisions to the existing guidance before at least 2007.

The guidance aims to standardise further the disclosures among member companies and enable analysts to understand better the underlying assumptions and dynamics of the EEV results.

The guidance covers what sensitivities should be disclosed, their frequency of calculation, and clarification of other calculation/disclosure issues. As with the original guidance, any non-compliance with the guidance in this document should be explicitly disclosed.

The guidance includes some background information and rationales, to avoid the need to create a separate Basis for Conclusions document.

2. Application date

The additional guidance will become an integral part of the EEV principles for financial reporting relating to the year ending 31 December 2006. Early adoption is encouraged where possible.

3. General recommendations on the disclosure of sensitivities

Sensitivities should be calculated at least annually. It is only necessary to calculate sensitivities in a single direction unless a movement in the opposite direction gives a significantly different movement in which case both directions should be shown.

Sensitivities should be provided for total embedded value results. New business values should also be subject to sensitivity disclosures, except where a particular sensitivity is not meaningful to the assessment of new business values.

Sensitivities provide very useful information, but they are very demanding of company resources to produce. Accordingly, attention should be focussed on those whose information value justifies the cost of production.

In some jurisdictions the reserving basis that underlies shareholder distributable cash flows is dynamic, and in theory some or all sensitivities could change not only future experience but also reserving levels. Because modelling dynamic reserves is extremely complex and the effect on value is second-order, it is recommended that in performing sensitivities companies keep reserving bases constant and only vary future experience assumptions, unless it is misleading to do so. In any case, the choice of methodology should be clearly disclosed.

For companies that publish EEV results more frequently than annually, it is not necessary to update sensitivities for interim periods unless there is a substantial change in the nature of the business that leads to a significant change in the sensitivities during the course of the year.

Due to significant practical difficulties with the preparation of segmental level sensitivities, the preparation of sensitivities at segmental level is not required.

4. Minimum sensitivities to be disclosed

4.1. INTEREST RATES AND ASSETS

4.1.1. 100 basis point increase in the risk discount rate

In this sensitivity the risk margin as reflected in the discount rate is changed in isolation from all other assumptions.

This sensitivity is optional for companies that use a methodology in which discount rates are an output rather than an input (for example, if a complex set of deflators is used to produce values, but these can be translated into

an implied discount rate). However, it remains a useful way of comparing the results of different companies, so it is encouraged in these circumstances as well. Companies who choose to omit this sensitivity should disclose appropriate sensitivities to the margins for risk in non-market assumptions and frictional costs included within their EEV calculations.

4.1.2. 100 basis point pa reduction in the interest rate environment

This sensitivity is designed to indicate the impact of a sudden parallel shift in the risk-free yield curve, which increases the current market value of fixed-interest assets but reduces future reinvestment rates. It is not performed in isolation from other assumptions. Rather, there are associated impacts on most other economic assumptions.

Where possible, when calculating this sensitivity, companies should allow for all consequent movements including future asset returns to change consistently through maintenance of constant risk margins above the risk-free rate. However, the level of capital assigned to the business should not be changed in this sensitivity.

For some territories with low interest rates, a 100 basis point variation could lead to negative interest rates. Risk-free interest rates should not fall below 0% in this sensitivity, even if it creates a variation from the standard of having a parallel shift.

4.1.3. 10% decrease in equity/property capital values at the valuation date, without a corresponding fall/rise in dividend rental/yield

This sensitivity is designed to indicate the impact of a sudden change in the market-values of assets. The situation being reflected is the equivalent of a fall of 10% of the absolute amount of the future dividends or rental yields.

Separate disclosure of equity and property movements is not mandatory. However, an insurer may choose to disclose separately if the results were significantly different for these asset classes.

It is optional for a preparer to assume that the portfolio is re-balanced after a significant market movement to achieve the same asset mix as currently persists. Companies should disclose whether such an action is assumed.

4.1.4. 100 basis point pa increase in the yield on equity/property assets (as a change in the equity or property risk premium with no consequential changes to discount rates)

For companies adopting a bottom-up approach to discount rates calibrated to the market, this sensitivity is not required, as in such an approach it is artificial to change future yield assumptions without adjusting discount rates. However, if companies wish to create such a sensitivity they can do so provided the method is clearly explained.

Separate disclosure of equity and property movements is not mandatory. However, an insurer may choose to disclose separately if the results were significantly different for the different asset classes.

4.2. EXPENSES AND PERSISTENCY

4.2.1. 10% decrease in maintenance expenses (i.e. the ongoing cost of administering contracts)

This sensitivity is applied to the projected level of expenses. A sensitivity to changes in expense inflation is not required.

4.2.2. 10% proportionate decrease in lapse rates (multiplicative, i.e. a base lapse rate of 5% pa becomes $0.9 \times 5\% = 4.5\%$ pa)

This sensitivity should reflect a single, downwards movement in lapse rates. Separate analysis of contracts that are either positively or adversely affected by reduced lapse rates is not required.

4.3. INSURANCE RISK

4.3.1. 5% proportionate decrease in base mortality and morbidity rates (disclosed separately for life assurance and annuity business)

It is useful information for companies to disclose separately the effect of mortality on life assurance and annuity business, as the future experience for these different insured populations might vary significantly. A 5% reduction has been chosen as the standard sensitivity because this is considered to be a more realistic scenario than a 10% reduction.

However, there are likely to be some contracts whose classification in one category or the other is somewhat arbitrary (due to the availability of different types of benefit within a single contract). The basis for classification should be disclosed where the effect on the sensitivity results is material.

The disclosure should also include a description of whether any future management actions (such as changes to pricing or valuation bases) are modelled in reaction to the changing mortality/morbidity rates.

No sensitivity to different trends in increasing longevity is required. An insurer may choose to disclose such a sensitivity providing the basis for the sensitivity calculation is disclosed.

5. Additional disclosures

5.1. DISCLOSURE OF REQUIRED CAPITAL

Companies should disclose the basis on which Required Capital has been established including how local minimum statutory capital and group economic capital requirements have been assessed. Existing EEV guidance requires that capital levels satisfy at least the minimum statutory solvency requirements of national regulators. Economic capital considerations in excess of these amounts should be considered for the group as a whole.

If economic capital is the base for the published EEV calculations, a sensitivity showing the EEV results assuming only the statutory minimum capital should also be disclosed. The change in capital levels should not be accompanied by potentially consequent changes in other risk measures such as the risk margin.

The assumed capital levels should be consistent with pricing assumptions.

5.2. DISCLOSURE OF THE ANALYSIS OF RETURN ON EV BETWEEN THE ADJUSTED NET WORTH AND THE VALUE OF IN-FORCE

Companies should present the analysis of return on EV separately between Adjusted Net Worth (defined as Free Surplus plus Required Capital) and Present Value of In-force (PVIF), to better explain the movement in capital flows.

5.3. DISCLOSURE OF DERIVATION OF RISK MARGINS

For those companies developing risk margins, either top down (based on WACC) or bottom up (based on product line market volatilities), the methodology used to derive risk margins should be disclosed.

For those companies adopting a market consistent approach, the derivation of frictional costs and risk margins for non-market assumptions should be disclosed.

5.4. DISCLOSURE OF THE PATTERN OF REINVESTMENT YIELDS

Companies should use current implied market rates as a starting point for future reinvestment assumptions. Companies should disclose the methodology used to derive future assumed re-investment rates.

6. Preparation of “Group EEV” accounts and disclosures relating to covered business

Some companies have provided EEV results and disclosures for the identified covered business. Others have provided EEV results on a full “Group EEV” basis with non-covered business being included on a variety of bases. The CFO Forum does not propose a

comprehensive treatment of non-covered business at this time, but some guidelines related to certain key issues are presented below. We use the term “Group EEV” to refer to any disclosure of total company value that includes covered business on an EEV basis, regardless of the treatments used for non-covered business.

6.1. Marking debt to market

For “Group EEV” results, debt should be marked to current market value without any adjustment to eliminate or smooth own credit ratings or should be valued using a basis consistent with the primary accounts. The impact of marking the debt to market should be disclosed if that is not the treatment in the EEV results.

For EEV results relating only to covered business (as opposed to an entire Group), the manner in which debt is allocated between covered and non-covered business and then valued should be disclosed quantitatively.

6.2. Pension scheme deficits

For “Group EEV” results, accumulated surpluses or deficits on defined benefit pension schemes should be reflected in the Group EEV value, either through the Adjusted Net Worth or through the Present Value of In-force by adjusting future unit costs. The manner adopted should be disclosed.

In determining the surpluses or deficits to recognize, the actuarial and economic assumptions used should be consistent with the primary accounts, rather than restated to be consistent with the EEV basis. If there is any difference between the approaches used for pension valuation in the “Group EEV” calculations and in the primary accounts, then the impact should be disclosed.

For EEV results relating only to covered business, the manner in which pension surpluses or deficits are allocated between covered and non-covered business and then valued should be disclosed quantitatively.

