KNIGHT VINKE

Insurance Accounting

March 2018

Introduction

- Knight Vinke Asset Management: institutional asset manager, regulated by SEC, FCA
- Manage money for SWF, public/corporate pension funds and family offices
- Concentrated investment style (never >15 stocks in portfolio) with focus on deep-dive research and governance
- Particular expertise in financial services sector (HSBC, UBS, Ag Bank, research papers, L/S equity fund)
- Emphasis on long term investment horizons within governance and stewardship framework

Investment Process

- Research
  - Deep dive, fundamental research into sectors on a cross–border basis, adjusting financials to make comparisons where needed
  - Use of external consultants where needed (economic modelling, asset review, academic research, legal and accounting)

- Interview executives across sector to assess
  - how they see sector economics
  - how these translate into the sector financials
  - management style and temperament
  - how this leads into strategy, capital allocation and capital structure decisions

- Interview non-executives of particular companies of interest to assess
  - how they see sector economics
  - their understanding of company financials
  - their understanding/use of comparative information from peers/competitors to assist in supervision
  - their understanding of regulatory position

- Sellside review

Insurance sector summary

- In past 15 years, Knight Vinke has conducted six reviews into insurance sector globally (c20 large caps on each occasion)
- Unable to analyse comparative performance through our own research or with help from expert consultants
- Not clear if executives understand the financials of competitors (possible that strategic and capital allocation decisions are being made by sector on basis of different policies relating to profit and liability recognition)
- Not clear if non-executives across sector can offer effective challenge and support on the basis of proper understanding of financials of their own companies or those of competitors
- Solvency II a help but important data and inputs only available to regulators, not subject to market testing or audit
- As a result, Knight Vinke has never made an investment in sector and has advised clients not to do so: unclear if sector mispricing or misallocating capital on basis of information that is available

Key problems in IFRS 4

- Inconsistent accounting policies across sector make comparative use of financials by executives, non-executives and investors difficult, if not impossible

- Difficult to make sense of some accounting policies adopted in light of fundamental economics of industry

- Different profit recognition policies lead to earnings trends and profiles which are impossible to compare and obfuscates assessment of comparative dividend capacity

- Liability recognition is a mess: huge range of discount factors leading to complications in assessing risk in models

- Consolidation policies in some (many?) cases provide misleading information through consolidation of subsidiaries with different policies on profit and liability recognition without conforming to parent's accounting policies

- Sector consolidation is hampered by these issues and investors cannot allocate capital or support consolidation on any sensible basis across geographies – a big issue for big institutional investors

Fragmented sector would benefit from better standardised accounting policies

➢ Sector is fragmented but consolidation would be hard for investors and Boards to evaluate

Geographical region of listed companies	Number of companies	Total assets ($ trill)
Europe	95	8.6
Asia	191	7.2
North America	110	5.8
Africa and ME	184	0.3
Latin America	46	0.2
Total	626	22.1

Source: IASB May 2017

Reporting framework	Number of companies	Total assets (USD trill)
IFRS	449	13.3
US GAAP	128	4.7
Japanese GAAP	11	4.0
Other	38	0.1
Total	626	22.1

Source: IASB May 2017

We welcome IFRS 17

- Accounting policies more closely tied to fundamental economic principles
  - valuation of liabilities
  - profit recognition (contract service margin)
  - updating of discount rates
- Potential for significant improvements in corporate governance
  - Implementation of systems to capture information currently not apparently accessible
  - Better understanding of pricing policies, onerous contracts and risks
  - Comparability for Boards offers non-executives framework to discharge responsibilities effectively
- More transparent, relevant and comparable flow of information for investors
- We see benefits for consumers through more effective competition if all companies compete on same basis with respect to profit recognition and recognition and management of liabilities
- We see benefits for regulators in more effective corporate governance and public scrutiny of financials
- Increased costs for firms but in our view overall benefits are significant