

Embedded values – Factors to consider

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Components of Embedded Value / Appraisal Value



Note that the **Embedded Value** reflects the value from business written to date (as at the valuation date).

The NAV reflects the surplus assets in a Company that can be attributable to shareholders, whereas the VIF reflects the value from the projected run off of in-force business.

It does not include the value of future new business. Inclusion of the value of future business would result in an **Appraisal Value**.

Value of in-force business

A calculated value, or metric. Widely used in the life insurance sector.

Value to shareholders of future profit expected from the run-off the portfolio of business in-force as at the date of assessment.

A function of underlying assumptions:

- Economic assumptions
 - Investment return, inflation, taxation etc.
- Demographic assumptions
 - Persistency, mortality, morbidity, maintenance expenses, commissions etc.

Allowance for the cost of holding regulatory capital.

Allowance for future policyholder bonuses/dividends on participating business.

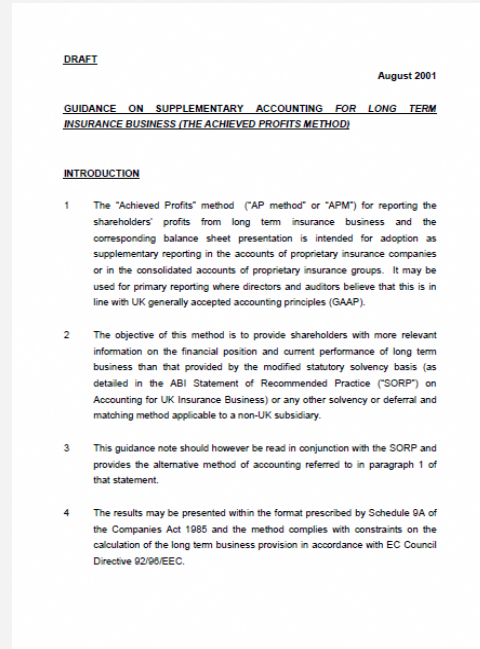
Profits discounted at the assumed risk discount rate.



Various embedded value reporting bases have emerged

Examples

Traditional Embedded value most commonly adopted in Asia Pacific.



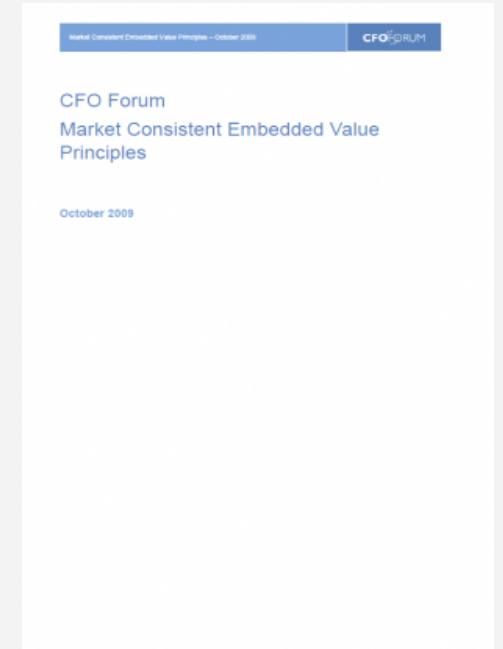
Traditional Embedded Value (TEV)

ABI Guidance 2001
"Achieved Profits Method"



European Embedded Value (EEV)

Introduced in May 2004 by
the CFO Forum



Market consistent Embedded Value (MCEV)

Introduced in June 2008 by
the CFO Forum(*)

Observations on methodology and assumptions



Embedded value methodologies

- Notwithstanding the various standards which exist, there are a **very wide range of approaches** for producing EVs.
- The degree of prudence within assumptions and allowances for risk can vary considerably from company to company.
- This can make it more **difficult for analysts and the market to compare and understand results**.



Assumptions

- Some assumptions can be on the optimistic side, for example allowances for **expense overruns** are often excluded in some markets, but on the contrary, the benefit of future **expense efficiencies** is excluded in other markets (India).
- **Lapses** may be “long term” allowances.
- **Allowances for required capital** (often linked to regulatory capital) can often fall short of what is required by internal capital management policies.
- **Allowances for risk**, and in particular operational risk, can also be perceived to fall short of what a full own risk assessment may require.



Perception

- These points can contribute to a market perception that EV is generally optimistic.
- The life insurance industry and individual companies genuinely think their EVs are realistic, but the market can form the view that they are optimistic.
- An EV considered realistic by the market would be considered prudent by the life industry and individual companies.
- This is not to say who is right and who is wrong. It is just a difference of expectations.

Other Observations



Embedded value as a metric

- Nevertheless, EV is an accepted way to judge value, and give comparators vs other companies/ industries.
- Embedded value **excludes** allowance for new business, which would be included in an appraisal value:
 - For smaller companies, embedded value would be a small proportion of appraisal value.
 - For larger mature companies, embedded value would be a larger proportion of appraisal value.



Listed companies

- For listed companies analysts often compare **Price to Embedded Value (P/EV)**. Price will not reflect EV for a variety of reasons:
 - Insurance is a regulated industry (which can result in EV being 'marked down').
 - Is there enough allowance for a third party's assessment of risk?.
 - Is the stock actively traded? If not, then market can result in giving a discount to EV.



Disclosures (in some markets)

- Embedded value can be a very useful management tool (**analysis of movement in embedded value** and variance analysis can be very illuminating). Can equally expect positive and negative variances but does the market react the same way for positive and negative variances?
- Also, sensitivity analyses can be helpful, but often information is not granular enough.

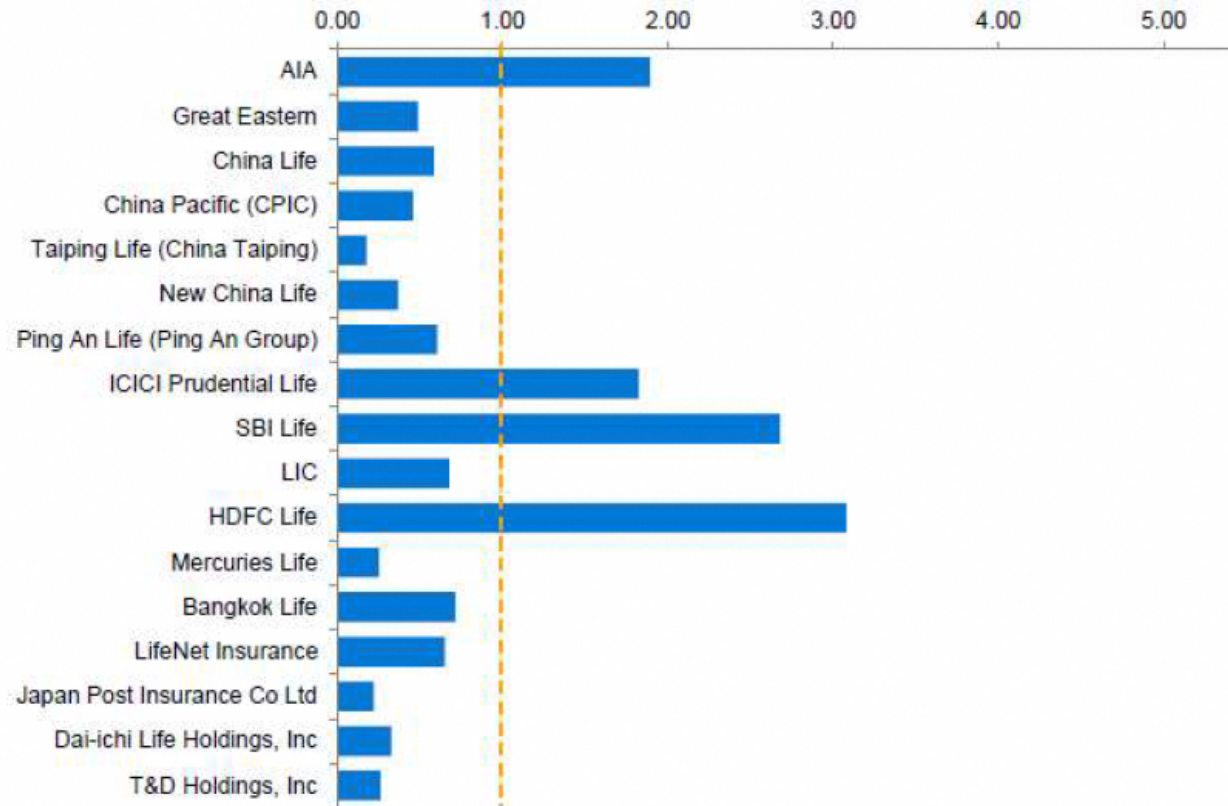
Asian Companies

Limited amount of disclosure of EV for Asian companies

Price-to-Embedded Value Milliman Report – 2022

Most insurers are trading below 1.0x of P/EV, except for AIA and several insurers in India.

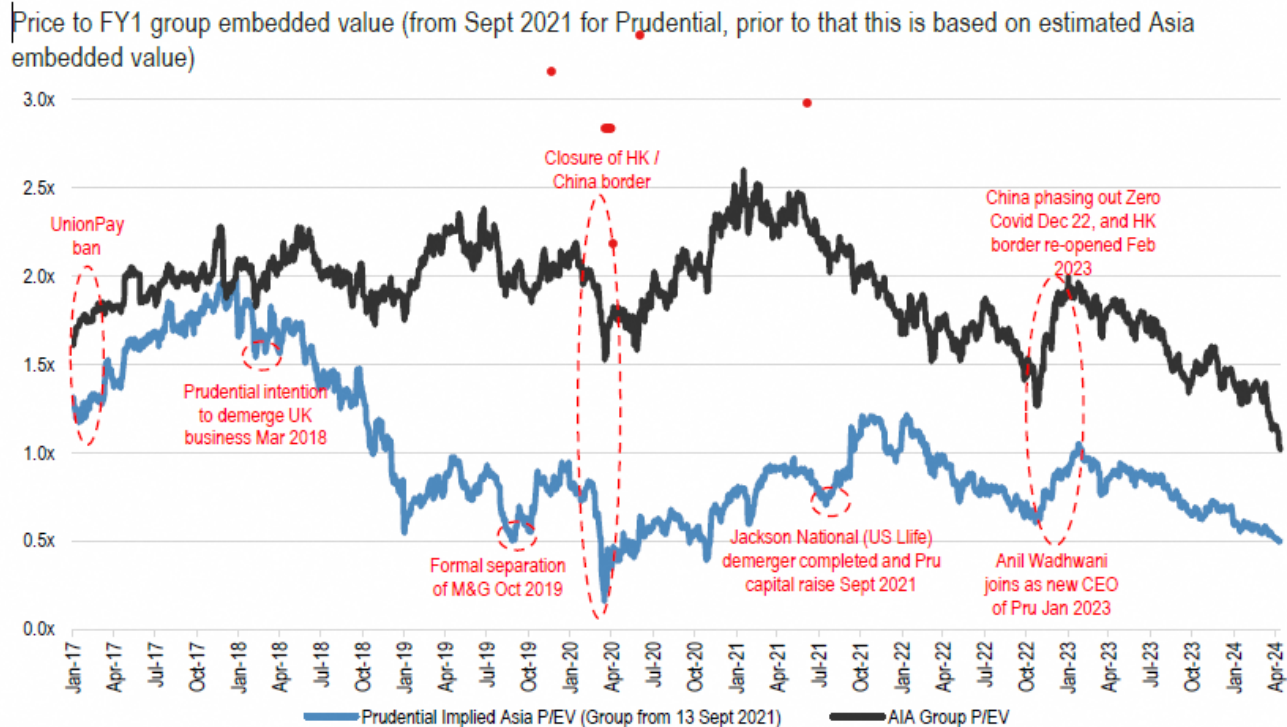
Source: Milliman 2022 Embedded Value
Results: Asia



Price can be more volatile for traded stocks

Prudential & AIA recent P/EV ratio – JP Morgan publication

P/EV ratio



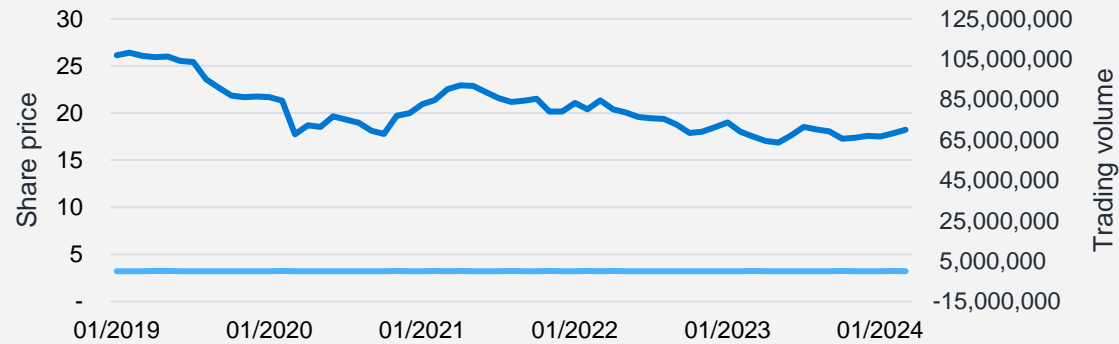
Source: Each company's annual report and J.P. Morgan estimates.

For the more actively traded shares of Prudential and AIA, the stock price can be seen to move in line with external events.

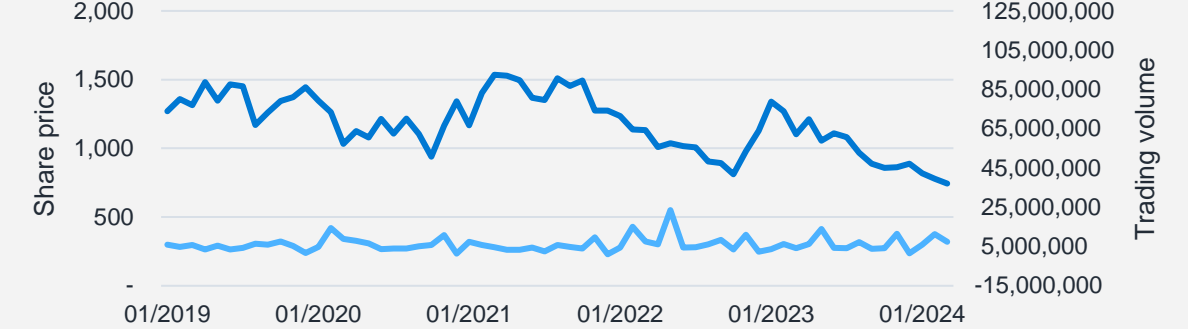
Asian examples

Trading volumes vary

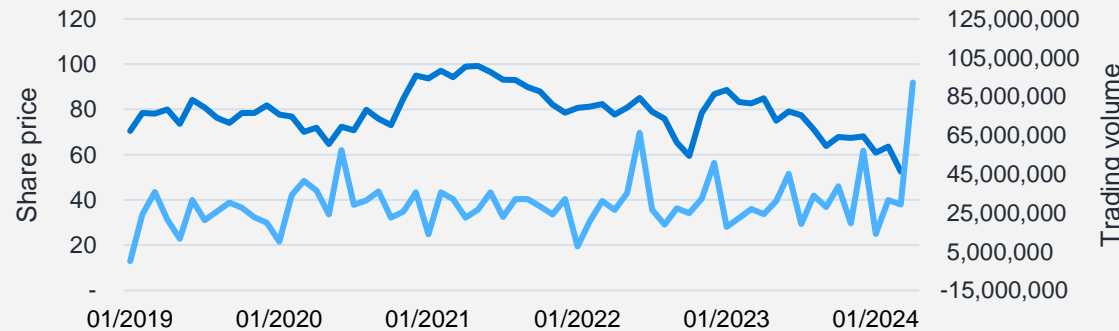
GE SP



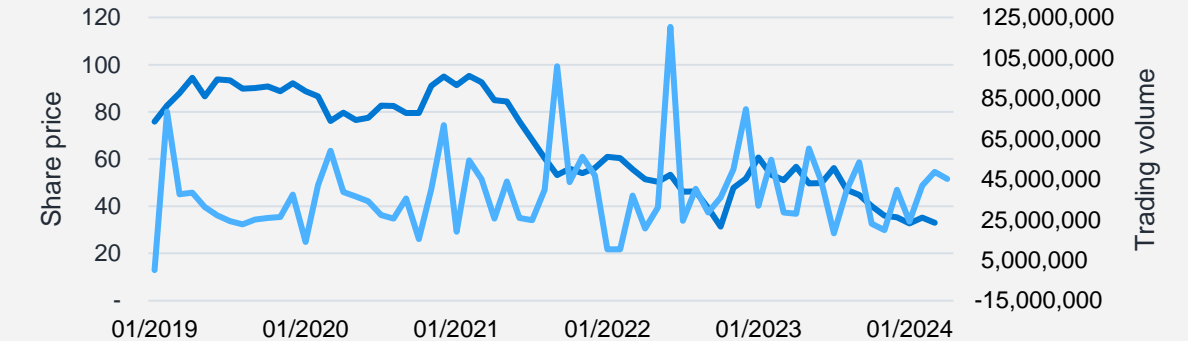
Prudential



AIA Hongkong



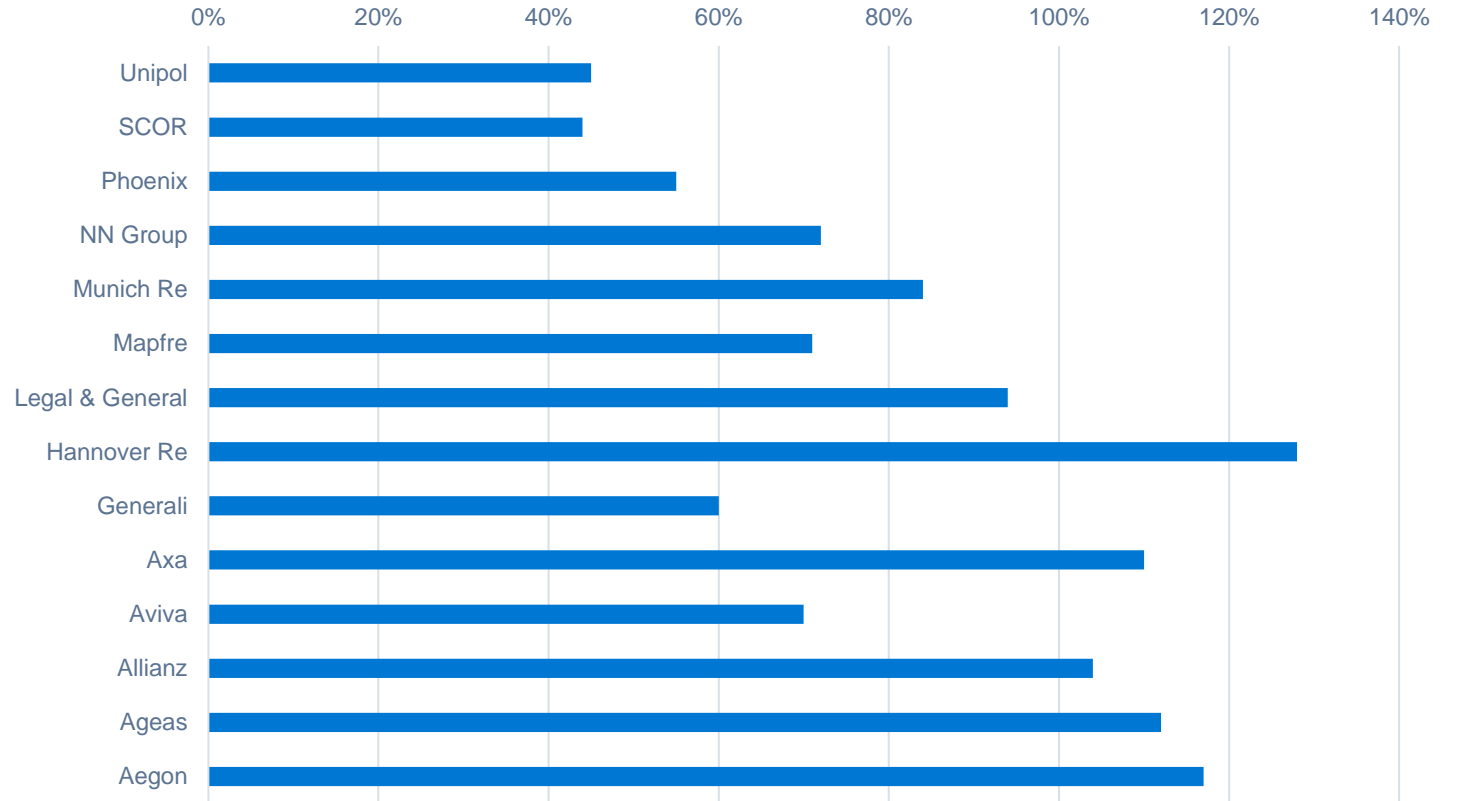
PingAn Hongkong



UK/EU market

We show the ratio of market capitalisation to Group Own Funds for a number of the biggest insurance groups in the UK and EU for year-end 2022 (year-end 2023 data is not available yet). [In Europe Solvency 2 Own Funds is often used to approximate Embedded Value]

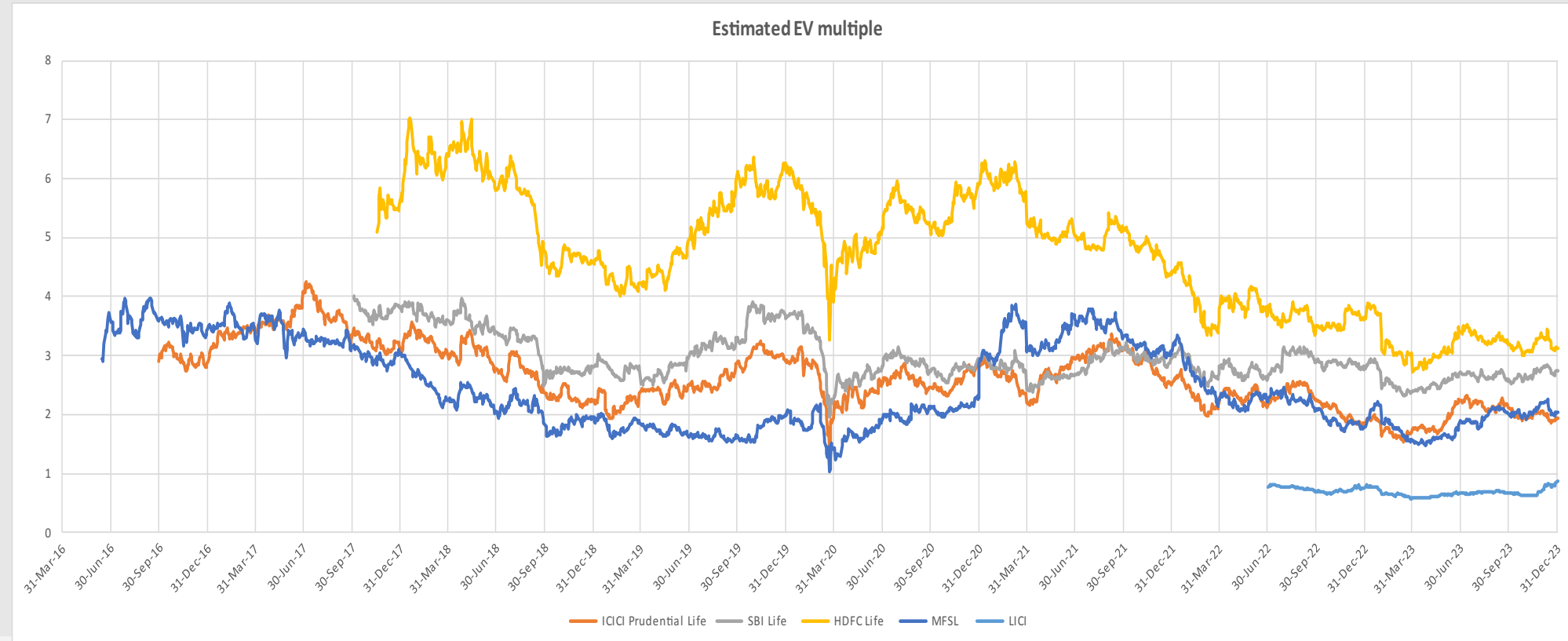
The table shows that for 9 out of 14 of the groups the market capitalisation is less than the Group Own Funds, with some firms showing a market capitalisation that is less than half of their Own Funds. For the other 5 groups the Own Funds exceed the market capitalisation.



India P/EV multiples

Indian IPOs commenced in 2016; LIC more recent but a very mature company (trading with P/EV <1)

Estimated EV Multiple



Conclusions

- GEH is not alone in having with a P/EV of less than one, a trait that is exhibited by more mature life insurance companies, globally.
- EV can be calculated using a variety of methodologies and assumptions which makes comparison of EV across companies somewhat challenging.
- EV has been an accepted metric for life insurance companies for close to 30 years. The emergence of IFRS17 will likely see the emergence of other metrics (AIA/Prudential have started to disclose IFRS17 metrics and other Asian insurers are starting to follow). EV is likely however to remain a core metric for many years and will be a cornerstone for M&A related transactions (where future new business is also considered).
- The life insurance sector in South East Asia remains an attractive sector, with scope to expand into many underpenetrated segments.



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Thank You

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