IFRS 17 Hiscox 2022 restatement event

8th June 2023

Group CFO script

Title slide and Paul Cooper overview

- Welcome and thank you for joining me for our IFRS 17 restatement event today. I'm Paul Cooper, the Hiscox Group CFO. I'm pleased to share with you our restated 2022 full-year and half-year numbers. While getting to this point involved a huge amount of effort to cut through complexity and break some deeply established habits, hopefully our presentation today will deliver sufficient information in good time for you to rebuild your models ahead of our interim results in August, as per our usual schedule.
- Please treat our materials today as a build on the December teach-in, although, as you will see, our thinking has evolved in some areas, following a detailed analysis of our restated numbers and as reporting conventions and disclosure standards start to emerge from peers.

Slide 1: Disclaimer

- As always, please be aware that all numbers presented today are unaudited and may be subject to further change.

Slide 2: What I will cover today

- A few words about the agenda for today.
  - I'll start by walking you through the income statement bridge from IFRS 4 to IFRS 17, including our new written premium APMs and explain seasonality of earnings.
  - I'll then talk you through the impact of discounting on claims liabilities, a topic I know you are all keen to understand better for modelling purposes.
  - Next, I'll cover our primary profitability metric which under IFRS 17 remains the combined ratio. We will look at some of the complexities introduced through the treatment of reinsurance commissions and reclassification of expenses.
  - We will also take a look at the balance sheet bridge, risk adjustment, and new confidence level target range.
- I will conclude with some key take aways and comments on outlook. There is a lot to cover, so 'fasten your seat belts' and I'll begin.

Slide 3: IFRS 17 is merely a new accounting standard… no change to…

- As I mentioned back in December, IFRS 17 is merely a new accounting standard. While there are changes in the presentation of our financial results, and new concepts to grapple with, notably on discounting claims liabilities, it doesn't change the way we run the business.
- There is no change to our strategy, economics of the business, investment result and SAA, reserving philosophy, capital and dividend approach.
- Let us now look at the full-year 2022 numbers. There's a lot to digest but the changes will start making sense to you as we move through the presentation.

Slide 4 : Recap of FY22 numbers

- As you can see, there are positive movements to PBT, ROE and NAV. Discounting of claims reserves of \$196 million is the main driver of PBT increasing from \$45 million under IFRS 4 to \$276 million under IFRS 17. This flows through to the ROE, getting us into the double-digit territory. Discounting is a material contributor to the increase of \$218 million in closing shareholder equity, improving NAV per share by 63 cents.
- At the bottom of the slide you will see our three segmental combined ratios. In Retail there is a marked decrease, broadly no change in London Market and also a notable increase in Re & ILS.
- There's a lot to unpick here, so let's jump straight into explaining the detail to help you understand the movements, starting with growth.

Slide 5: Growth

- As you know, IFRS 17 only presents earned premiums, but to understand the volume dynamics in our business and for comparability, we feel it is important to give a volume growth measure in line with how it's been presented historically. Therefore, we have introduced two new alternative performance measures to present written premiums on a gross and net basis, which you would have seen reported as part of our Q1 trading update.
- What will be helpful to you is that growth trends are broadly consistent with the old IFRS 4 world, and the rate of growth is not impacted on transition, it's just that the starting point is slightly different. This is due to two reasons:
  - insurance contract written premium, or ICWP for short, is a little lower than gross written premium due to reclassification of inwards reinstatement premiums to claims, and inclusion of reinsurance overrider commissions on inwards reinsurance;

  - net ICWP is 8% higher than NWP, as outwards reinsurance commissions were previously deducted from acquisition costs, however, they are now offset against allocation of reinsurance premium.
- This means that on a net basis, things do look a bit different in our Re & ILS segment meaning there is an uplift to NICWP versus NWP. However, we expect the gap to track on a consistent basis, subject to any material changes in the reinsurance programme.
- The treatment of reinsurance commissions also has knock on implications for the combined ratio which I will come to later on.
- So as you can see written growth will be relatively easy to model in the new world; earned growth will be subject to one quirk, namely seasonality.

Slide 6: Written to earned premiums path
- It is important to start by saying that seasonality has no material impact on an annual basis, it is only a half-year phenomenon in our big-ticket business, and in particular in Re & ILS. You will see this when I bridge the income statement at half-year and full-year in a moment.
- What I mean by seasonality here is that more premiums are earned in H2 compared to H1 in cat exposed lines. IFRS 17 requires us to earn the premium in line with the risk profile of the business, i.e. the period where the risk exposures are concentrated at a more granular contract grouping level. Our nat cat business is impacted by the US wind season in H2, giving rise to the shift in earnings pattern.
- The seasonality impact varies by segment:
  - it is most prominent in Re & ILS which writes a greater share of the nat cat business, where only 29% of written premium was earned in the first half, compared to 44% on a Group basis. This seasonality impacts half-year profits, but this is just a tilt with no overall change to the full year profitability;
  - for London Market, there is a moderate impact;
  - finally for Retail, the path from written to earned premium is linear, as it was under IFRS 4, so no change here.
- This seasonality impact is important for your modelling of half-year versus the full year, so please bear this in mind ahead of August! Notably, we expect Re & ILS's insurance service result to follow the premium earnings profile and thus will also be lower in H1. This will naturally flow through to the half year combined ratio.
- Let me now bridge our profit from an IFRS 4 to 17 basis for 2022.

Slide 7: Income statement bridge
- Let's start with the full-year 2022 bridge at the top of the slide. There are notionally two main changes which result in an uplift to profit of $231 million for the full year to $276 million. In order of magnitude, these changes are:
  - firstly, <u>discounting</u>, which had an overall net benefit on our profits of $196 million. This comprises of three main steps resulting in $76 million, $18 million negative and $138 million movements, which I will talk you through on the next slide. This means that the mark-to-market losses in our bond portfolio in our IFRS 4 2022 profit, now have some offset because of discounting of claims liabilities.
  - secondly, <u>FX movements</u> of $24 million. There is now more symmetry in the balance sheet as unearned premium reserves and deferred acquisition costs are revalued at closing FX rates, in line with the rest of the balance sheet, resulting in a favourable impact on transition.
- As I talked about in December, the impact of onerous contracts on 2022 profit is small. I've prepared a slide on this, which is included in the appendix, as the impact is so negligible. As a reminder we will re-evaluate the onerous contract position twice yearly, and set up and subsequently run-off any new positions as needed.
- Let's now have a look briefly at the half-year bridge at the bottom of the slide. You can see the $18 million negative impact of seasonality I talked about a moment ago on the half-year profit, which is largely earned through in the full-year result, as shown in the FY walk.
- Having just seen the material impact of discounting on profit in 2022, $196 million at full year and $119 million at half year, it is worth spending some time to unpick the core components.

Slide 8: Discounting
- Well, isn't IFRS 17 complicated! As I showed you on the previous slide there are three steps to discounting. Let me talk you through how each one works and what the impact is on the numbers.
- Starting with step one. This is the initial discounting of claims on recognition. You can use the weighted Group discount rate and duration to get the estimated PV of the incurred claims and initial discount benefit to claims. In 2022, the average weighted Group discount rate was 2.9%, with a duration of 1.9 years. This gets you to a $76 million favourable impact from initial discounting. The size of the impact is dependent on the prevailing

interest rate in the period. In 2023, the initial favourable impact from discounting on claims recognition will be larger than 2022 due to an expected higher blended rate. As a reminder here, the discount is applied to net earned claims in the region of $1.3 billion in 2022.

- Moving on to step two which is the unwinding of the initial discount over the settlement period of the claim. Opening reserves unwind at the opening forward interest rate, and new claims in the period unwind at the prevailing forward interest rate in the period. You can think of this as removing the appropriate portion of the discounting benefit that has already been applied. This will have an unfavourable impact on profit. In 2022 the size of the unwind was negative $18 million. In 2023, we estimate the unwind will be a negative in the region of $110 million–$140 million. At half year this is expected to be in the region of $60 million–$65 million. The 2023 numbers are significantly higher due to the impact of higher interest rates.
- Finally, to step three. This is the impact of discount rate movements in the period. For 2022, the circa. 4% rise in interest rates led to a $138 million favourable impact and this is recognised in the IFIE. To make 2023 estimates we suggest you use the sensitivity analysis set out on the slide.
- The overall impact of discounting is the sum of the three steps. In 2022 it was a positive $196 million impact. Please do remember this is a non-cash item.
- Let me now turn your attention to the combined ratio.

Slide 9: Group combined ratio – net/net rationale

- As I noted at the start of the call, combined ratio remains our key profitability KPI, although our thinking on the definition has evolved since December, as reporting convention starts to emerge. We have taken the decision to adopt a net/net definition of the COR, which I'll define on the next slide, and many of our peers are arriving at the same conclusion.
- There are limitations with either approach but ultimately the KPI should be a fair reflection of our business model. Our big-ticket businesses make extensive use of reinsurance as a risk management tool and IFRS 17 does not deal with this in an intuitive way.
- Let's take a look at the new definition.

Slide 10: Group combined ratio walk

- The combined ratio comprises the insurance service expenses less amounts recoverable from reinsurers, as a proportion of insurance revenue less allocation of reinsurance premium.
- Before I talk about the IFRS 17 impact, the transition to own share presentation increases Group COR by 1.7 percentage points. As some of you who have followed us for many years may remember, 100% basis was introduced to present the Hiscox's combined ratios when our ownership of Syndicate 33 was moving notably from period to period, thus introducing comparability issues to our KPI. As our ownership of Syndicate 33 has been relatively stable for a while, it appears appropriate to now streamline disclosures and align COR presentation with the income statement.
- Without going into too much detail, the difference between 100% and own share basis, is down to the mix of Syndicate 33 business across net premiums and net claims. This change in definition resets our starting point for the IFRS 17 walk.
- Moving from left to right:
  - the first two bricks, the 0.6 percentage point increase due to change in treatment of reinsurance commissions, and 1.4 percentage point decrease due to reclassifications of some expenses as non-attributable to outside the COR, arise from a onetime step change in definition. I will explain in detail how this works on the next two slides;
  - the next two bricks represent movements which continue to occur period on period, but as you can see these are very small. Notably onerous contracts are a small benefit to COR in 2022 as some of the loss component has unwound;
  - and lastly, there is a 2.4% benefit from discounting, which in the interest rate environment is favourable given the relatively higher interest rates in 2022.
- A point to note is that not all of the lines necessary for the calculation of the combined ratio are included on the face of the IFRS 17 income statement, so we will be providing some additional disclosures to help you calculate it.
- Before we look at how reinsurance commissions impact the ratio; a point of housekeeping. The impact of LPTs has been reclassified in the definition as they net to nil in the insurance service result, but would have created volatility in the net COR as they distort earned premiums.
- Before I move on to talking you through the claims and expense ratios, it is worth me explaining the impact of change in reinsurance treatment and reclassification of expenses to non-attributable. Firstly, reinsurance.

Slide 11: Reinsurance commission treatment

- This slide uses IFRS 17 numbers to illustrate how IFRS 4 and IFRS 17 standards treat reinsurance side by side. Please bear in mind that what you see on the screen will not reconcile to the published IFRS 4 numbers. This is just for illustrative purposes to show you the mechanics.
- Under IFRS 17, fixed reinsurance commissions are no longer deducted from acquisition costs. Instead, they are deducted from the allocation of reinsurance premium. While the impact on profit is identical, and the economics of our reinsurance contracts are unaffected, it can have a material impact on the COR when extensive reinsurance, such as in our Re & ILS business, is used.
- Splitting this out: for the expense ratio, reinsurance commission has moved from the numerator in the old definition, to the denominator in the new definition, increasing the ratio.
- For the claims ratio it has the opposite effect. Reinsurance commissions now appear in the denominator, and so the claims ratio decreases.
- The move of reinsurance commissions from numerator to denominator means that we are rebasing the COR to a higher number. This is rather counter-intuitive but the more reinsurance or third-party capital we use, the higher the combined ratio. This bears no relevance to the underlying profitability of the business.
- Moving on to reclassification of expenses.

Slide 12: Non-claims expenses

- As you can see, the classification of non-claims expenses is slightly different under IFRS 17. As a reminder, attributable expenses relate to costs associated with writing insurance contracts and are included in the insurance service expense.
- We then have non-attributable expenses, being the other operational expenses line in the income statement, such as brand marketing, a portion of overheads and training. Unsurprisingly, corporate centre expenses are deemed to be non-attributable.
- Where judgement comes into play is with partially attributable expenses, such as management time and IT expenses. Under IFRS 4, we previously included the vast majority of these in the underwriting result, but they have now been redistributed between attributable and non-attributable expenses. The vast majority of the expenses are attributable and remain part of the insurance service result.
- As I told you on an earlier slide, this improves the COR by 1.4 percentage points.
- Looking at non-attributable expenses, our corporate centre costs will be carefully controlled and we expect to continue with increased investment in brand to support growing the business. Now that I have explained the main building blocks of the COR transition, I will dive into claims and expense ratios individually.

Slide 13: Group claims ratio

- As you can see, it is 5.7 percentage points lower than our reported claims ratio. 3.8% of this benefit is due to the changes to treatment of reinsurance which I have just talked you through.
- Discounting is the only other material movement.
- You will note, there is no impact of reinstatement premiums, or RIPs, in the claims ratio walk as these were immaterial in 2022. However, it is worth mentioning that under IFRS 4 RIPs formed part of the denominator, as they were included in net earned premiums, whereas under IFRS 17 they are a part of the numerator, as they are netted off against incurred claims or amounts recoverable from reinsurers.
- Moving on to the expense ratio…

Slide 14: Group expense ratio

- To start from an obvious point, please note that the expense ratio is not impacted by discounting!
- As you can see on the slide, it's 3.8% higher from our previously reported expense ratio. This is mainly due to the change in treatment of reinsurance, driving 4.4 percentage points of increase, so more than the benefit to the claims ratio I mentioned earlier.
- On a positive note, there is a 1.4 percentage point favourable impact from the reclassification of non-attributable expenses.
- Now let me walk you through the combined ratios by segment.

Slide 15: Retail combined ratio

- Before I jump into the explanation of how IFRS 17 impacts the Retail combined ratio, let me remind you that there is no change to the economics or expected profitability of our Retail business. We are not introducing any new guidance today and there is no change to the outlook.

- Now to the Retail combined ratio walk shown on the slide. As you can see, the starting point has increased by 0.8 percentage points from the previously reported 94.8% in 2022 as we move to an own share presentation. This is not an IFRS 17 change. This is due to the impact of business mix with the own share having a lower weighting of business written on Syndicate 33, including our UK fine art book, which in most years will operate at a lower combined ratio than the average for our Retail portfolio. Please note, that the 0.8 percentage points move is not a fixed number, and will vary according to the performance of the retail business written in Syndicate 33, although as you will note this change from 100% to our share does not change the profitability of the Retail business – it is purely a ratio change.
- There are three components under IFRS 17 which will drive the undiscounted ratio going forward.
  – The largest moving part is the benefit from a reclassification of non-attributable expenses, as required by the standard, out of the combined ratio, which results in a 1.6 percentage point reduction in full year 2022. This is a presentational change to the COR which leads to no change in PBT. Again, it is important to note here that 1.6 percentage points is not a fixed number and it may be higher or lower period to period depending on the level of non-attributable expenses.
  – The other two building blocks relate to a change in reinsurance treatment and onerous contracts. These in aggregate reduced the ratio by a modest 0.3 percentage points in 2022 but will vary from period to period.
- So overall, the impact of IFRS 17 change on the Retail combined ratio in 2022 was a decrease of 4.6 percentage points, of which 2.7 is due to discounting.
- Moving on to the Retail combined ratio target range, which is 90%–95% under IFRS 4 on a 100% basis. We are planning to release the quantified target range in 'new currency' with our half-year 2023 results in August, when we report under IFRS 17 for the first time.
- However, to avoid any confusion, I am happy to confirm three things today:
  – firstly, that this range will be on an undiscounted basis as we have no control over interest rate movements;
  – secondly, that it will incorporate the directional benefit of expense reclassification I have just highlighted; and
  – thirdly, our expectations of ultimate Retail profitability and cashflows remain unchanged.
- Let's move on to London Market.

Slide 16: London Market combined ratio
- The London Market combined ratio is broadly consistent between the two standards.
- You are now familiar with all the buildings blocks, the only thing I would note is that the impact of discounting is slightly less than retail due to the business mix of shorter-tail cat exposed lines, and longer-tail casualty lines.
- Another point to remind you about is seasonality. You won't see it on the slide but there is a moderate impact at half year, which becomes negligible by full year.
- Let's turn to Re & ILS.

Slide 17: Re & ILS combined ratio
- In contrast to London Market, there is a step change to Re & ILS's COR due to extensive use of third-party capital. To give visibility on this, we will be calling out the drag on Re & ILS's combined ratio from the impact of reinsurance treatment. The off-setting benefit from discounting is also less pronounced due to the shorter duration of the Re & ILS book.
- Again, as a reminder the half-year combined ratio will be impacted by seasonality meaning you should expect a higher combined ratio in H1, returning to expected levels by the end of the year.
- Let me be clear that this is not a reflection of any change in the underlying profitability of the business but rather an outcome of the earnings pattern, where we earn around two thirds of our premiums in H2. In contrast, expenses continue to be recognised in a linear fashion and the expense ratio is increased by the treatment of reinsurance in H1.
- Looking at the closing balance sheet.

Slide 18: Closing balance sheet
- It is important that you understand our change in equity for calculation of return ratios. There is only one point to draw out. There is a $218 million increase in closing shareholders' equity, mainly due to discounting, driven by steep interest rate increases in the period accounting for $196 million of the movement. This will reduce our leverage ratio accordingly.
- It is worth noting that our previously reported full year IFRS 4 2022 ROE never benefited from initial discounting of claims, but as we have now moved to IFRS 17, you will see the unwind negatively impact ROE and earnings in future periods.

- As this is the only slide that touches on tax, it is worth a brief mention here. The increased tax charge for 2022 is purely due to timing differences on taxable versus accounting profit. For 2023 onwards we do not expect a meaningful impact to ETR as a consequence of adopting IFRS17.
- I will now take you through the impact of IFRS17 on our reserves.

Slide 19: Impact on Group net earned reserves
- As I mentioned earlier, there is no change to our reserving philosophy, and we remain conservatively reserved.
- Just as a reminder in old money, our best estimate was measured as a mean estimate of expected losses and our reserve margin represented an additional buffer to compensate for the uncertainty in the timing and amount of claims.
- The risk adjustment of $246 million replaces the IFRS 4 reserve margin, with events not in data, or 'ENIDS', being reclassified from margin to best estimate.
- Overall, net reserves have increased by $178 million, with a reclassification of $534 million of legacy portfolio transactions or (LPTs), more than offsetting the decrease from discounting of $250 million. As a reminder, IFRS 17 requires LPTs to be reclassified into the asset for remaining coverage. To be clear, the economic benefit of the LPT does not go away, but just moves to a different part of the balance sheet.
- Now to the new IFRS 17 KPI of confidence level which represents a measure of reserve conservatism in the new world. In reality the concept of confidence level is not new, and our actuaries have had visibility of this internally. What's new is that there is now a requirement to disclose it. The overall confidence level is very similar between IFRS 4 and IFRS 17. Roughly speaking in eight-out-of-ten years our reserves should be adequate and there has been no significant change to this as a result of IFRS 17, as you would expect. Our long history of reserve releases bears this out.
- For 2022, the risk adjustment of $246 million equates to a confidence level at the 78th percentile Let me talk you through the confidence level in a bit more detail on the next slide.

Slide 20: Introducing the reserving confidence level
- As I mentioned on the previous slide, the risk adjustment, plus best estimate, is equivalent to a confidence level of 78% under IFRS 17. The ENID reclassification I have just talked about means that for the same confidence level the risk adjustment will be a smaller percentage of a larger best estimate than under IFRS 4.
- Our business is made up of segments with different volatility profiles. For example, our big-ticket reinsurance business typically has margin held against specific cat or other events, which tends to lead to a higher confidence level. Conversely, our more stable retail business would have smaller event-specific reserves, which trends towards a lower confidence level.
- Based on this, going forward we expect to operate in the range of 75%–85% under normal business circumstances demonstrating our prudent reserving methodology. This means that the pattern of consistent reserve releases you are used to seeing would be expected to continue barring unforeseen circumstances. Our retail business is less volatile than big-ticket, and as its share grows the 75th to 85th percentile range becomes even more robust with a high likelihood of positive run-off.
- Just to remind you, confidence level ranges are not really comparable company to company, as different insurers have different reserve volatility. What would make more sense is to compare how Hiscox's reported confidence level moves from period to period, and the nature of our business means we expect it to move. We will certainly explain if it falls outside our target range.
- You will be pleased to hear we are nearing the end of the presentation, so let me run though key takeaways.

Slide 21: Key takeaways
- For those of you who started to drift off during the presentation, now is the time to wake up and refocus your attention as I'm about to summarise the key points to remember from today.
- The overarching message you should take away is that there is no change to the economics of our business or cashflows.
- The slide is a little busy, so let me briefly touch on each key take away:
  - firstly, discounting – as you've seen, this is by far the most significant factor on our restated numbers, and I've talked about it in some detail:
    - it has been introduced to represent a more economic view of claims liabilities on the same discounted basis as assets, which ultimately reduces volatility in the income statement;
    - an important thing to bear in mind when you come to do your modelling is that discounting gives a non-cash benefit to the income statement, which will unwind in future periods, in other words, the overall impact is simply timing;

    - the initial recognition of discounting is now included within the combined ratio, with the unwind and rate change through the IFIE.
  - secondly, as we have already flagged in December and recapped today, the impact of seasonality is skewed to H2 for cat exposed business in line with the risk profile of the business, particularly in Re & ILS. This results in lower profits and a higher expense ratio in H1, but there will be minimal impact at full year. For the avoidance of doubt this will be the case going forward and you should build that into your expectations for each set of H1 and H2 results split;
  - thirdly, there is a new treatment of reinsurance commissions, which are now offset against premiums, increasing the combined ratio, notably for Re & ILS with no change to profit. Also remember the LPTs net out in the income statement but would have distorted the combined ratio view, so we reclassified them for the definition.
  - next, there is a change in how expenses are split under IFRS 17, which is between attributable and non-attributable, with the latter excluded from the combined ratio. This means the expense ratio decreases, thus partially off-setting the deterioration caused by the change in reinsurance treatment;
  - and finally reserving, and our confidence level. Our reserves remain robust; there is no change in measurement, although there is now greater transparency through presentation of our risk adjustment and confidence level.
- So what does this mean for our 2023 numbers.

Slide 22: 2023 numbers
- On discounting, as I outlined earlier, on discount unwind, we are currently forecasting some $110 million–$140 million unfavourable impact for the full year, which is of course much higher than the $18 million we saw in 2022. At half year the equivalent number is around $60 million–$65 million. This will be a non-cash drag on profit so please bear this in mind.
- On growth, all the guidance we issued in March is unchanged.
- On combined ratios, as I mentioned earlier, the Retail target in 'new currency' will be released with the half-year results. It will be on an undiscounted basis and will incorporate the directional benefit of expense reclassification seen under IFRS 17.
- Another point I want you to keep in mind for half year is that seasonality of earnings will depress Re & ILS's underwriting result and combined ratio in H1 versus H2. This is not a drop in underlying profitability but a matter of timing.
- Finally, on confidence level, I have now stated our target confidence level range of 75%–85% under normal business circumstances, and expect to travel within it in 2023.

- That concludes the presentation and I am now going to hand over to the moderator for Q&A. Thank you.