Hiscox Ltd
IFRS 17 supplementary presentation
Interim results for the six months ended 30 June 2023

9 August 2023

Agenda

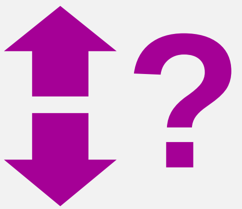
What I will cover

- Discounting
- Legacy portfolio transactions
- Analysis of change

What I aim to achieve

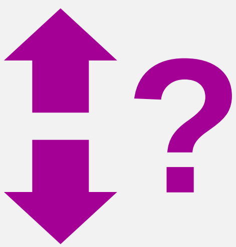
- Explain accounting principles of discounting and LPTs
- Highlight modelling challenges and limitations
- Provide practical suggestions on how to separate noise
- Suggest how to analyse analysis of change disclosure

Claims discounting
Increases profit by $32.4m in H1 2023

	Methodology	H1 2023	H2 2023
Step 1: Discount on recognition	• Net claims discounted at interest rate at the time of occurrence • Calculated by reserving class and by currency; use weighted average rate as a proxy	**$70.2m (H1 2022: $28.0m)** • Increase due to higher average weighted rate • Weighted average rate of 4.2% **Income statement line** • Recognised in insurance service expenses and amounts recoverable from reinsurers	
Step 2: Unwind	• Discount unwinds*** on both opening reserves and new claims – opening reserves unwind based on opening yield curve – for new reserves, use mid-period yield curve i.e. 31 March, to estimate	**$(63.7)m* (H1 2022: $(6.8)m)** • Increased initial discount due to increased rates means subsequent unwind also increased **Income statement line** • Recognised in IFIE	• Full year guidance unchanged $(110)m-$(140)m**
Step 3: Rate change	• As rates change new discount rate is applied to reserves at each period end – impact on prior period claims calculated by difference in rate from start and end of the period – current year claim impact calculated as difference between prevailing rate and period end rate	**$25.9m (H1 2022: $94.6m)** • More stable rate environment with only modest rises gives much smaller impact in H1 2023 • Rates**** increased by 0.4 ppts to 4.7% in the period **Income statement line** • Recognised in IFIE	

*H1 2023 contains $4.2m of interest from funds withheld.
**Assuming no changes in business mix and claim settlement pattern.
***Unwind calculation done on monthly basis using interpolated rates.
****Average rates across currencies and duration.

Bond movements
Total income from bonds of $90.5m

	Calculation	H1 2023	H2 2023
Bond income	• Comprises coupon from bond portfolio	**$84.0m (H1 2022: $43.3m)** • Significant increase from bond coupon due to reinvestment of matured bonds at higher yields as interest rates continue to increase **Income statement line** • Investment result	
Mark to market (MTM) movements on bonds	• Includes movement in: – risk free rate – credit-spread on corporate bonds – manager alpha – credit rating changes	**$6.5m (H1 2022: $(214.1)m)*** • Benefit from reduction in spreads, credit rating movements and manager alpha more than offset negative impact from small interest rate increases **Income statement line** • Investment result	

*Also includes gains/(losses) on other fixed income holdings.

Income statement volatility reduced

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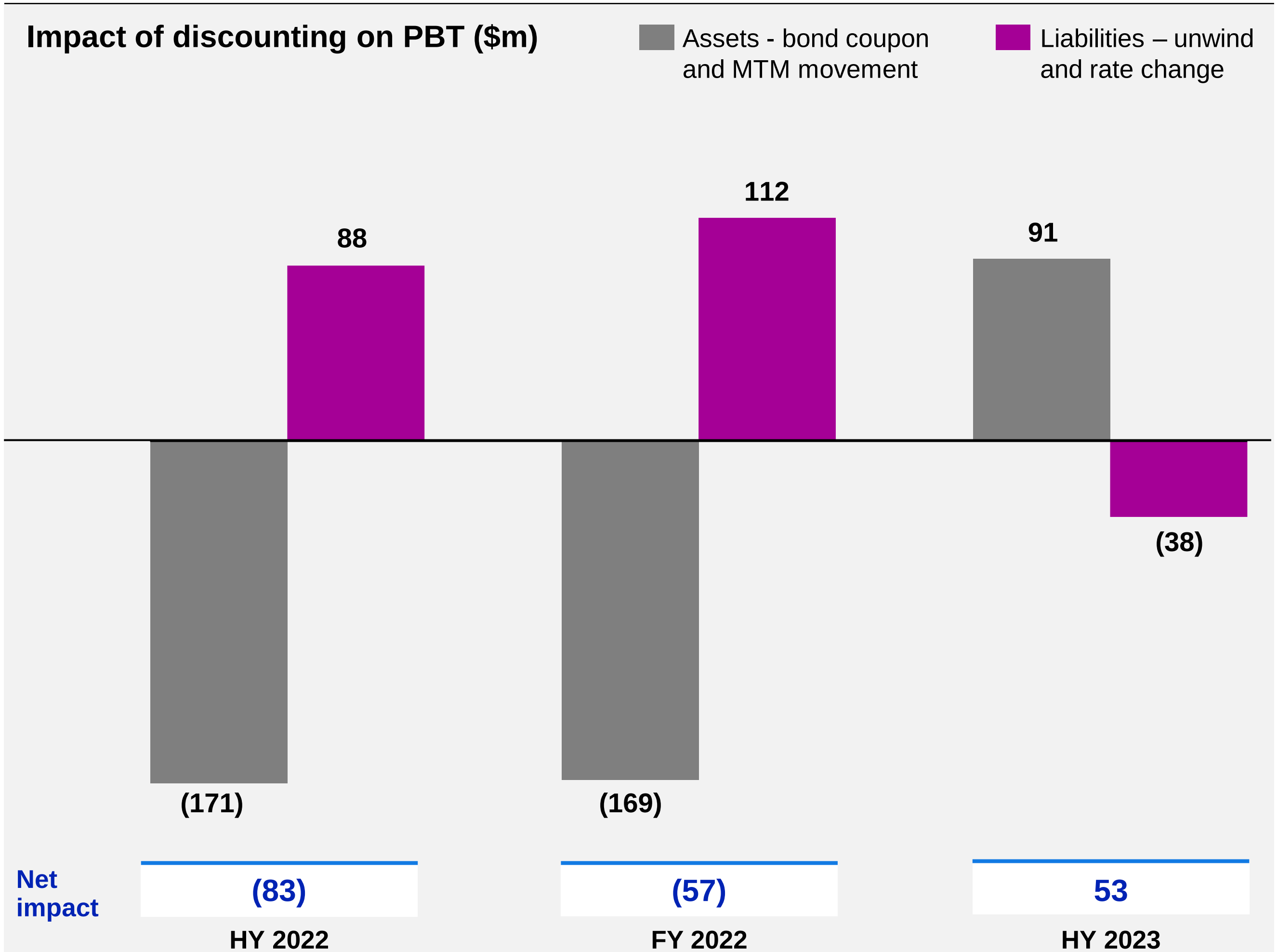
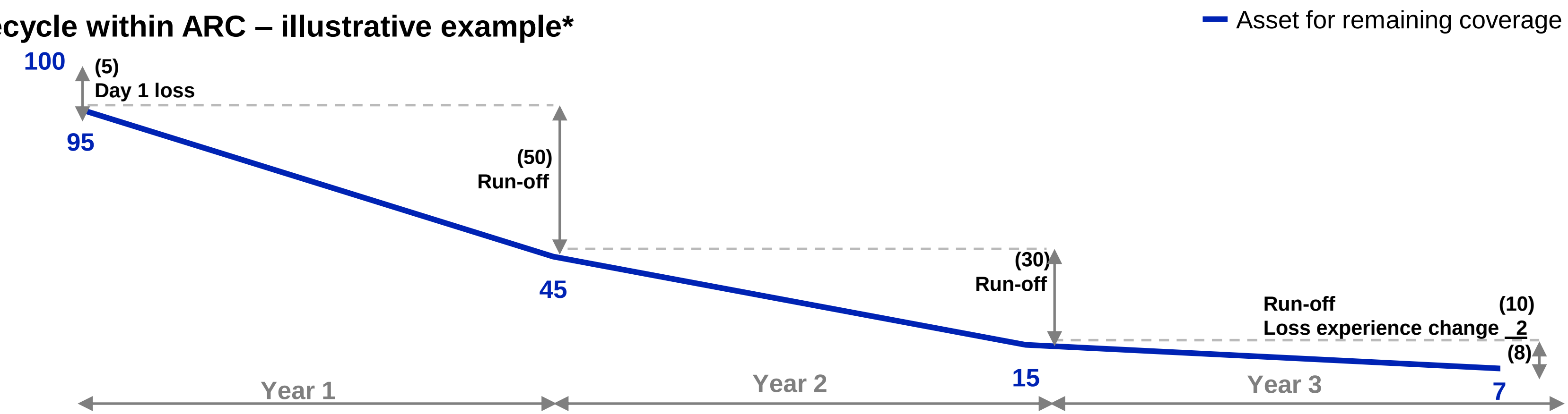


- Volatility reduced but not eliminated
  - bond portfolio of $5.8bn with duration of 1.6 years
  - liabilities of $3.3bn* with duration of 1.9 years

*Discounted best estimate reserves.

Legacy portfolio transactions
Reminder of treatment in the financial statements

LPT lifecycle within ARC – illustrative example*



	Year 1	Year 2	Year 3
Balance sheet**	• At **inception**, recognise – unearned LPT asset in ARC, net of premium payable • This offsets the liability which the LPT now protects (which already existed in LIC)	• **Run-off** of LPT assuming no loss experience change – reduces ARC in line with gross claims settlement (under LPT protection)	• **Change in loss experience** estimate – ARC increase by size of gross reserve deterioration (under LPT protection) • Run-off treatment unchanged
Income statement	• Recognise reinsurance premium equal to day 1 loss • Day one loss difference between LPT cost and expected recoveries	• Run-off component 'grosses up' income statement in – allocation of RI premium – amounts recoverable from RI • Net nil impact on profit	• Triggers an additional LPT recovery to offset the gross reserve deterioration – recognised by reducing RI premium rather than increasing RI recoveries • Run-off treatment unchanged • Overall net nil impact on profit

*Ignoring impact of discounting and non-performance risk for simplification of illustration.
**Cash and equity movements excluded for simplification of illustration.

Legacy portfolio transactions

Economic benefit unchanged but some lines in income statement distorted

LPT impact on loss ratio - illustrative example*

	IFRS 17 exc. LPT	LPT run-off	Experience adjustment	IFRS 17 as reported	LPT reclassification	Income statement view for COR calculation
Insurance revenue	100	-	-	100	-	**100**
Incurred claims	(75)	-	(2)	(77)	-	**(77)**
Allocation of reinsurance premium	(25)	(10)	2	(33)	**8**	**(25)**
Amounts recoverable from reinsurers from incurred claims	20	10	-	30	**(8)**	**22**
Insurance service result	**20**	**-**	**-**	**20**	**-**	**20**

- LPT treatment under IFRS 17 artificially inflates allocation of reinsurance premium and reinsurance recoveries
- Modelling LPTs accurately is challenging
  - run-off of LPT – depends on claims settlement pattern and is not linear
  - experience of LPT – depends on claims development pattern and is not easily predictable
- Reclassified in COR definition as distortive

LPT treatment in H1 2023 COR ($m)

Group COR 85.7% =	Insurance service expenses 1,486.7	-	Amounts recoverable from reinsurers 184.3 **LPT reclassification** **(24.3)** 160.0	
	Insurance revenue 1,941.1	-	Allocation of reinsurance premium 417.3 **LPT reclassification** **(24.3)** 393.0	

*Ignoring impact of discounting and non-performance risk for simplification of illustration.

Analysis of change

Analysis of change

Opening balance sheet position

+

Income statement

+

Cash flows

=

Closing balance sheet position

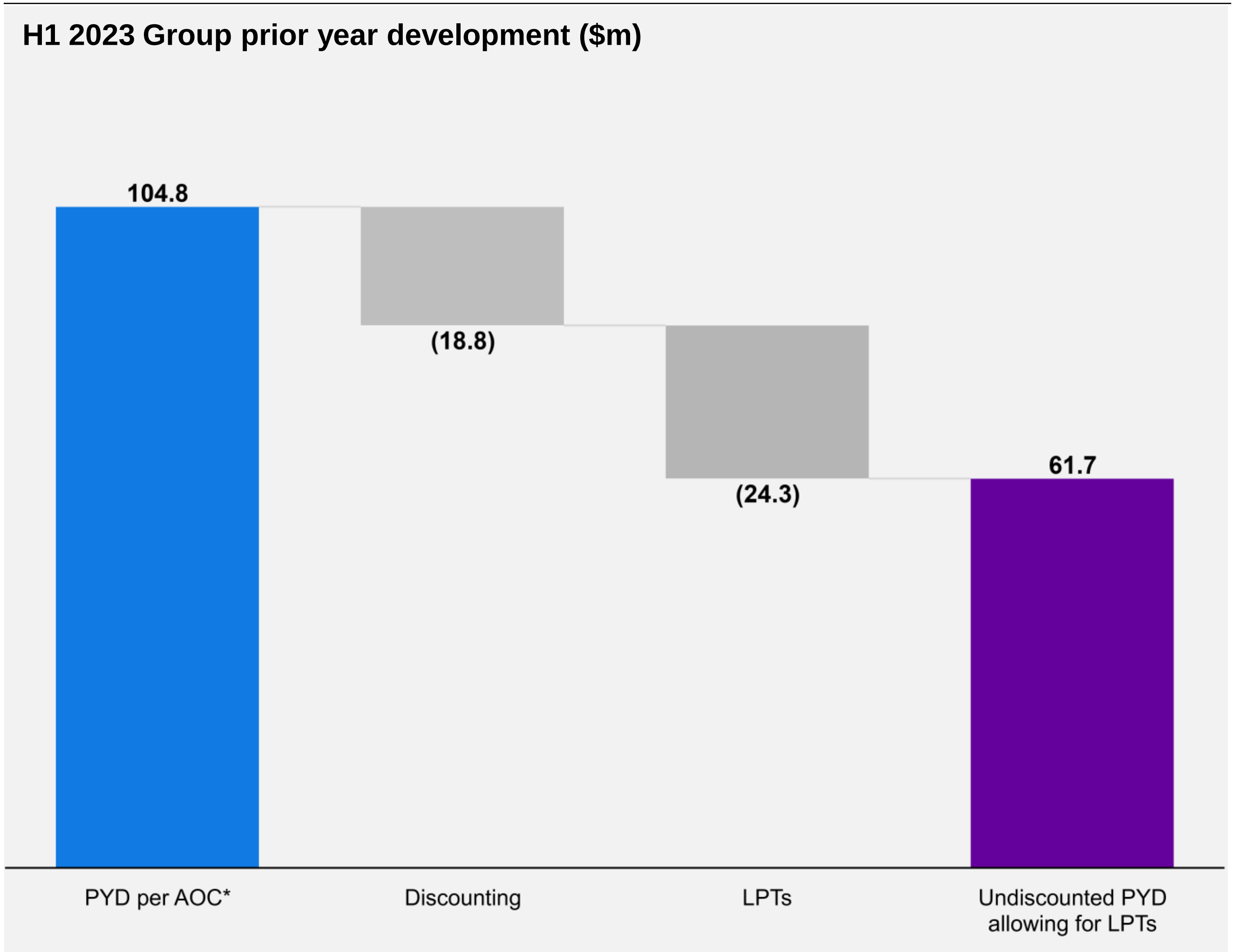
Insurance service expenses

	LIC / AIC		LRC/ARC
Current accident year	Estimates of present value future cashflows	Risk adjustment	Onerous contracts
Prior accident years			LPTs

Tips for analysis

- Analyse movements in
  - best estimate and risk adjustment, for current and prior years
  - onerous contracts
- Adjust your analysis for
  - discounting (risk adjustment is not discounted)
  - LPTs
- Focus on confidence level rather than ratio of risk adjustment to best estimate
- Disregard line ‘transfer to other items in balance sheet’

Analysis of change
Additional disclosures to show underlying trend in PYD



- The AOC shows changes in assets and liabilities excluding LPTs
- Prior year development (PYD) disclosures in the AOC therefore will include impact of discounting but not LPTs

*Includes risk adjustment movement.