Swiss Re

Understanding profitability in life insurance is a vital, yet challenging endeavour for its many stakeholders. Swiss Re's newest *sigma* publication offers a guide to the fundamentals of understanding and measuring life profitability

Contact:

Lukas Steinmann, Zurich
Telephone +41 43 285 4687

Milka Kirova, New York
Telephone +1 212 317 5639

Clarence Wong, Hong Kong
Telephone +852 2582 5644

Media Relations, Zurich
Telephone +41 43 285 7171

Swiss Re Ltd.
Mythenquai 50/60
P.O. Box
CH-8022 Zurich

Telephone +41 43 285 2121
Fax +41 43 285 2999
www.swissre.com

Zurich, 7 February 2012 –While life insurers have a good value proposition for their policyholders, they lack an easy and understandable way to explain to other stakeholders how they create value and earn profits. Swiss Re's latest *sigma* study, "Understanding profitability in life insurance", discusses the need to arrive at a standard framework for communicating the value and performance of life insurance companies.

Unlike many other industries, life insurance is a business with long-term products and services whose profitability cannot be measured without a long-term lens. Insurers monitor and manage performance on an ongoing basis, but because life insurance policies remain in force for many years, the ultimate profitability of the business is only known years later when all policy obligations have been fulfilled. To understand competitiveness and operating performance, different stakeholders rely on different measures, making communication difficult and resulting in a kaleidoscopic view of profitability.

"Life insurance plays a key role in managing risks in modern societies. Today, many generations rely on life and health insurance products and this will also be the case in the future as state-funded social health and retirement programmes feel the burden of their ageing societies. Understanding how the life industry is performing is important for all stakeholders. Investors need to understand profitability to assess investment decisions, policyholders and regulators have a vested interest in the financial viability of life insurers, and for management, accurately reporting and understanding profitability is crucial for business steering," says Lukas Steinmann, co-author of the *sigma* report.

How do life insurers create value?
Life insurers create value through insurance and investment operations. There are three principle sources of profits — underwriting margin, investment result, and fee income. The earnings profile of a company is significantly influenced by its product mix. The products that the industry offers today range from pure risk protection, such as term or disability insurance, to predominantly savings, such as unit-linked products or deferred annuities. The drivers of profitability vary significantly along this spectrum and depend on how risks are allocated between the insurer and the policyholder. For example, insurers' results for protection products rely heavily on underwriting

experience, while earnings from savings products depend mostly on fee income and the allocation of investment results.
More transparency and detailed profitability reporting by product segment may help investors to better understand and judge company performance.

Why is understanding profitability in life insurance so difficult?
"Life insurance companies tend to report their profits using accounting-based quarterly reports. The statutory and GAAP/IFRS accounting-based indicators do provide a high-level picture of life insurers' historical performance, but they fail to fully capture the long-term nature of life and health insurance operations. Also, comparison across countries and companies is hampered due to differing rules and practices," says Milka Kirova, co-author of the *sigma* study. There is limited disclosure of performance at the product level and few insights into a product's risk profile and its consequences for future earnings. Also missing from accounting-based metrics is the cost of capital required to support the business.

Together, these issues result in rather opaque profitability figures which make it difficult for stakeholders to truly understand and judge a company's earnings and sustainability in the future. However, a more forward-looking approach to measuring life insurance profitability, though it is often used only by life insurers' top management, is available through the embedded value framework.

Embedded value-based reporting in life insurance is indispensable for holistic decision making
Embedded value (EV) is a framework that seeks to quantify future cash flows of insurance products and the cost of capital for business lines with varying risk profiles. While EV concepts are indispensable for internal purposes, they have not gained acceptance everywhere for external reporting to investors. Today, insurers face a dilemma: in many cases top management makes decisions based on embedded value concepts, while investors often rely on traditional accounting-based measures.

Steinmann adds that "a growing number of companies are developing and promoting their own performance metrics to supplement traditional accounting-based financial reporting. But there is a thin line between providing more valuable information and confusing stakeholders with varying profitability measures. A sophisticated measure, such as the market consistent embedded value concept (MCEV) or Swiss Re's very similar Economic Value Management framework, may also be useful for external reporting if it gains acceptance. In the future, insurance specific accounting rules and new regulatory frameworks may also help to standardise financial reporting and make insurance profitability more accessible to all stakeholders."

Swiss Re

Notes to editors

Swiss Re
The Swiss Re Group is a leading wholesale provider of reinsurance, insurance and other insurance-based forms of risk transfer. Dealing direct and working through brokers, its global client base consists of insurance companies, mid-to-large-sized corporations and public sector clients. From standard products to tailor-made coverage across all lines of business, Swiss Re deploys its capital strength, expertise and innovation power to enable the risk taking upon which enterprise and progress in society depend. Founded in Zurich, Switzerland, in 1863, Swiss Re serves clients through a network of 56 offices globally and is rated "AA-" by Standard & Poor's, "A1" by Moody's and "A+" by A.M. Best. Registered shares in the Swiss Re Group holding company, Swiss Re Ltd, are listed on the SIX Swiss Exchange and trade under the symbol SREN. For more information about Swiss Re Group, please visit: www.swissre.com

How to order this *sigma* study:
The English, German, French and Spanish versions of the *sigma* study No 1/2012, "Understanding profitability in life insurance" are available electronically on Swiss Re´s website: www.swissre.com/sigma. The versions in Chinese and Japanese will appear in the near future.

Printed editions of *sigma* No 1/2012 in English, French, German and Spanish are also now available. The printed versions in Chinese and Japanese will be available shortly. Please send your orders, complete with your full postal address, to:

e-mail:	sigma@swissre.com	
Zurich:	Telephone + 41 43 285 3889	Fax +41 43 282 0075
New York:	Telephone +1 212 317 5400	Fax +1 212 317 5455
Hong Kong:	Telephone +852 25 82 5703	Fax +852 25 11 6603

How to obtain a copy of this *sigma* media information:
The English, German, French, Spanish and Portuguese versions of this *sigma* media information are available electronically on Swiss Re´s website:

www.swissre.com