IFRS 17 & 9

Presentation for analysts and investors

21 April 2023

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Key messages

IFRS 17 & 9

Key messages as at transition date (1 Jan 2022)

Business fundamentals remain unchanged

- IFRS 17 **does not affect** our **business strategy** and **management**, nor the **dividend policy,** which will continue to be conducted in accordance with local GAAP.
- **The solvency position will not be affected** by having own metrics on both funds eligible for solvency and on capital charge.
- The cash position **and liquidity management are not affected either.**

STATEMENT OF PROFIT OR LOSS

- The capacity to **generate income** remains **unchanged.**
- The income statement changes format. **The current business management indicators and the current layout of the income statement will be maintained in parallel.**
- **Unrealised capital gains and losses of investment funds are recorded in the income statement**, which adds volatility.

BALANCE

- The **transitional Own Funds are very similar** to those calculated under IFRS 4.
- **There are no significant differences in the claims reserve,** although it is now discounted at the risk-free curve. The Group's risk adjustment is positioned at the 85th percentile, similar to the margin for prudence under IFRS 4.
- **Provision for remaining coverage** measured by simplified premium allocation approach (PAA)

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Overview of IFRS 17 & 9 and criteria adopted

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IFRS 17

Three valuation methods for insurance contracts

- The most significant change in IFRS 17 relates to the valuation of insurance contracts at **market value** in order to eliminate accounting asymmetries with assets.
- Grouping of contracts with similar and jointly managed risks should be carried out. In the case of Linea Directa, these are the Motor, Home, Health and Other insurance business lines.

Building Block Approach (BBA)

- The BBA includes 4 components:
  - Expected value of future cash flows
  - Discounting of future cash flows
  - Risk adjustment
  - Contractual Service Margin (CSM)
- The contract will be onerous if the CSM is negative. In such case, the CSM is 0, and the loss is recorded in the income statement at the beginning of the contract.

Variable Fee Approach (VFA)

- The Variable Fee Approach is a variant of the default model (BBA) and is to be applied to contracts with significant direct participation components.

Premium Allocation Approach (PAA)

- This premium allocation method is a simplification of the BBA and is optional for hedging contracts of less than or equal to one year or, for contracts with a longer duration, where there is no valuation materially different from the BBA.
- Simplified liabilities based on premiums collected

ALL LINEA DIRECTA'S INSURANCE AND REINSURANCE CONTRACTS ARE MEASURED BY PAA

IFRS 17

Methodology for calculating provisions

PROVISION FOR CLAIMS INCURRED

ADJUSTMENT FOR NON-FINANCIAL RISK

Explicit estimation of the effect of uncertainty on future flows
A risk adjustment is applied with 85% confidence

PRESENT VALUE OF CLAIMS FLOWS

Best estimate of future claims payments discounted at the risk-free curve

PROVISION FOR REMAINING COVERAGE

(PAA)

PREMIUMS COLLECTED

DEFERRED ACQUISITION COSTS

Outstanding issue premiums and deferred acquisition expenses are eliminated from both assets and liabilities

PROVISION OF REMAINING COVERAGE

IFRS 9

Valuation based on the classification of financial assets and business models

- IFRS 9 establishes a classification of financial assets based on the business model and the characteristics of their cash flows. This classification determines how each financial instrument is valued.
- Property is not covered by IFRS 9.

Classification and valuation

- Cash flow criteria or compliance with the SPPI test. Measured if contractual cash flows represent only principal and interest payments)
- Financial instruments are classified at fair value through profit or loss (FVPL) or equity (FVOCI)
- The standard requires additional recording of potential losses In the previous regulations, losses were registered only when they occurred or there were significant indications that they would occur
  - Fixed income impairments: move to an expected loss model instead of an incurred loss model

Business models

- The regulations define three possible business models depending on the purposes for which the financial assets are held:
  - Hold to Collect (HTC) model, whose objective is to obtain the contractual flows of the assets during the life of the instrument; it allows for slight portfolio turnover
  - **Hold to Collect and Sell model (HTCS[1]); it allows for some portfolio turnover**.
  - Others: allow for 100% portfolio turnover; in these models, sales and purchases are actively occurring

1. Model adopted by Linea Directa; old model available for sale

IFRS 9

Comparison in the recording of fair value and realised capital gains at Linea Directa

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	Capital gains (losses) realised		Mark-to-market	
	IAS 39	IFRS 9	IAS 39	IFRS 9
FIXED INCOME[1] (1)	P&L	**P&L**	OCI	**OCI**
LISTED EQUITIES	P&L	(2) **OCI** *No recycling in P&L*	OCI	**OCI** *No recycling in P&L*
INVESTMENT FUNDS & OTHERS (including non-listed)	P&L	**P&L**	OCI	(3) **P&L**

1 **Fixed income**

- The effects of the recalculation of impairment are not significant given the credit quality of the fixed income portfolio.

2 **Equities**

- Listed equities with changes in Other Comprehensive Income without recycling in P&L (irrevocable option)

3 **Investment funds**

- Classified at fair value with changes in P&L, adding volatility to the result. These portfolios are not subject to impairment testing

	Capital gains (losses) realised		Mark-to-market		
INVESTMENT PROPERTY	P&L	**P&L**	Off balance sheet	**Off balance sheet**	Not affected by IFRS 9

Statement of profit or loss

The new statement of profit or loss pays attention to the margins generated

IFRS 17	
Income from insurance service	Equivalent to gross premiums earned
Expenses from insurance service	Gross claims cost + Operating and claims expenses + Acquisition expenses + Onerous contract result
Gross income from insurance service	
Income from reinsurance	Reinsurance result presented separately
Net income from insurance service	
Net income from investments	Financial income and expenses from investments, including unrealised gains/losses on FVP&L (investment funds, in Linea Directa's case).
Net income from insurance and investments	
Other income/other expenses	Non-insurance income and expenses
Profit before tax	

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Transition balance

IFRS 17

Transition balance (1 Jan 2022) – equity remains stable in transition

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IFRS 4 BALANCE	
Financial assets	992
Investment property	65
Receipts	54
Reinsurers' share of technical provisions	20
Deferred acquisition costs	87
Provision for certain recoveries	43
Other assets	107
Total assets	1,368
Equity	378
Provision for claims	285
Provision for unearned premiums and unexpired risks	453
Provision for settlement liabilities	22
Other liabilities	230
Liabilities and Equity	1,368

Million euros

IFRS 17 BALANCE	
Financial assets	992
Investment property	65
Reinsurers' share of technical provisions	24
Other assets	107
Total assets	1,188
Equity	378
Transition reserve	0.3
Liability for claims incurred	263
Remaining coverage liability	317
Other liabilities	230
Liabilities and Equity	1,188

Million euros

The transition reserve reflects the net effect of all changes in the balance sheet at the transition date.

Liabilities for claims incurred follow a similar approach to **Solvency II.**

A risk adjustment is applied with 85% confidence

Includes settlement claims and the provision for certain recoveries

The remaining coverage liabilities are the unearned premium less deferred expenses and outstanding receipts.

The Ongoing Risk provision is replaced by the Loss Component.

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