TRANSCRIPT

AIA Group IFRS 17 Update

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Good afternoon from Hong Kong and welcome to our IFRS 17 update.

AIA adopted IFRS 9 and IFRS 17 from 1 January 2023 and our upcoming interim results will be published on the new accounting standards. For comparative purposes, today we have published our consolidated financial information under IFRS 9 and IFRS 17 for both the first half and the full year of 2022. This presentation is intended to assist in understanding these new disclosures and, in particular, the main drivers of operating profit after tax, which remains our key IFRS performance metric.

Firstly, it is important to note that IFRS 17 is an accounting change and does not impact the underlying economics of our business, or the way in which we operate. There is no change to our capital management framework, or our dividend policy. We continue to focus on executing our proven strategy to leverage Asia's tremendous opportunities for profitable new business growth which, in turn, delivers sustained growth in earnings, capital and cash generation.

As we indicated at the full year in March, the adoption of IFRS 17 had a positive impact on AIA's 2022 results compared with those reported under IFRS 4. You will see that profitable new business is the core driver of our OPAT growth. As we add successive layers of new business this delivers sustained growth in OPAT and shareholders' allocated equity over time. And while OPAT represents the accounting view of earnings from our business, VONB, EV and free surplus are based on a prudent valuation of distributable cash flows and remain the key measures of shareholder value creation. In summary, with the adoption of IFRS 17 we are continuing our proven growth strategy of driving earnings, capital and cash generation through large scale and profitable new business.

Consistent with our guidance at the full year, as a result of adopting IFRS 17 all our key IFRS metrics improved in 2022. OPAT was up one per cent to 6.4 billion dollars while net profit was significantly higher, an increase of 3 billion dollars, as the new accounting treatment is better aligned with the underlying economics of the business. Similarly, shareholders' allocated equity and shareholders' equity are higher under the new basis at the end of 2022. Our leverage ratio improved to 11.4 per cent based on an updated definition under IFRS 17, further reinforcing AIA's strong credit and financial strength ratings.

AIA has a strong track record of sustained year on year increases in OPAT since IPO. The adoption of IFRS 17 does not change this, with 2022 earnings at the Group level higher than under IFRS 4. OPAT remains the key measure of our underlying earnings as it continues to remove the short-term volatility from market movements. There are new enhanced disclosures breaking out the different components of OPAT, providing greater visibility on the sources of our earnings. Our earnings remain of very high-quality and arise predominantly from insurance services, which in aggregate contributed 74 per cent of the total in 2022.

There are three major components of OPAT, the insurance service result, the net investment result, and other revenue and expenses. The largest contribution is from the insurance service result which accounted for 5.5 billion dollars of OPAT in 2022. Within this, CSM release of 5.1 billion dollars is the most important, and I will be explaining this in detail. The net investment result of 3.3 billion dollars relates mostly to non-participating business and the return on surplus assets. Other revenue and expenses are mainly composed of overhead expenses in business units and the Group Office that under IFRS 17 are not directly attributable to the insurance service result.

We have separately provided a mapping that should be helpful in deriving each of the figures shown on this chart to the detailed line items in the various notes to the accounts. Now let me take you through each of these OPAT components in turn, starting with the insurance service result.

As I said, under IFRS 17, contractual service margin, or CSM, is the key driver of OPAT and forms part of insurance contract liabilities alongside the best estimate liabilities, and a risk adjustment for non-financial risks. The calculation of each component of the insurance contract liabilities involves discounting, based on current risk-free rates and an illiquidity premium depending on product type. Details are provided in the appendix.

The CSM represents the stock of future profits that are yet to be earned on our in-force business and will release over time into OPAT and net profit. We have built up a very large CSM over time through the addition of successive cohorts of profitable new business over many years with a cumulative discounted value of expected future profits of 52.9 billion at transition on 1 January 2022. You can see that our insurance contract liabilities were broadly stable on transition from IFRS 4 to IFRS 17 at slightly over 200 billion dollars. The explicit allowance for future profits of 52.9 billion in the CSM demonstrates the historical prudence of our IFRS 4 reserving basis.

Now let’s look at how the CSM moved over 2022 and how this flows into the CSM release and OPAT.

On top of the 52.9 billion dollars of CSM at the start of the year, the 2022 new business added 6 billion with a further 2.4 billion coming from the expected return on the in-force CSM as it unwinds by one year. Driven by our continued delivery of large-scale, high-quality new business, the CSM increased by 15.9 per cent to 61.3 billion dollars during 2022. Successive layers of new business CSM are the key driver of future CSM, and hence OPAT growth over time. Before calculating the release to OPAT, the CSM is adjusted to allow for the mark-to-market of assets and liabilities for participating business which formed the majority of the 3.9 billion of variances. Other variances related to persistency experience and operating assumption changes. We have provided estimated sensitivities of the CSM to interest rate and equity market movements in the appendix.

The 5.1 billion CSM release is at a rate of 9.3 per cent on 55.3 billion. While we expect this release rate to remain relatively stable in the near-term given the large size of our in-force business, the rate does vary by product and by market. Overall, despite the extreme investment market movements in 2022, our CSM remained broadly stable over the year at over 50 billion dollars, again demonstrating the resilience and quality of our business.

Next, moving to the net investment result of 3.3 billion dollars.

Total investment return of 5.3 billion dollars equated to a 4.5 per cent average return on assets backing our non-par business and surplus assets, which stood at 115.2 billion dollars at the end of 2022. Fixed income and cash, which account for more than 85 per cent of the invested assets, generated interest revenue of 4.2 billion dollars at an average book yield of 4.2 per cent. The remaining 1.2 billion came from equities and real estate largely held within our surplus assets, and is based on long-term expected returns.

The investment return is partially offset by 1.8 billion of insurance finance expenses, which represents the unwind of the discount rate on non-par insurance liabilities. We expect the unwind to move in line with non-par liabilities with changes driven by the gradual addition of new business and the timing of maturing policies. We have also netted off 0.3 billion of investment management expenses that relate to managing the non-par and surplus assets to derive the 3.3 billion net investment result.

Finally, to derive operating profit before tax we need to allow for other revenue and expenses of 1 billion dollars and finance costs on our external debt of 0.4 billion.

Under IFRS 17 certain expenses are not attributable to the insurance service result. These form the bulk of the other expenses and we have shown separately the non-attributable expenses within our local business units and those related to the Group Office. After allowing for these expenses our operating profit before tax was 7.5 billion dollars. As you can see, our sources of earnings are high-quality with 74 per cent from insurance services and only 11 per cent from spread income.

Our OPAT is well diversified across our geographical markets under IFRS 17 and the breakdown between Mainland China and Hong Kong versus the rest of our businesses remained broadly stable compared with IFRS 4. At the business unit level, there is more variation in OPAT when comparing IFRS 17 to IFRS 4. Remember that this does not represent any change to the underlying cash flows within our businesses, rather it relates to movement in the accounting emergence of earnings.

While Hong Kong's 2022 OPAT was stable on moving to the new basis, faster emergence of earnings on non-par business increased OPAT for AIA China by 9 per cent. The more gradual emergence of earnings from unit-linked business led to reduction in OPAT for our businesses in Singapore and Malaysia. Other Markets reduced mostly due to the short contract boundaries imposed on retail insurance business in Australia, which we treat as long-term business within EV. And finally, in Thailand the annual OPAT drag from legacy negative spread business under IFRS 4 is removed as it is now fully provisioned for within IFRS equity, contributing to the 25 per cent increase in OPAT. As a reminder, our EV methodology has always provisioned for negative spread business across the Group.

Next, moving to net profit.

OPAT is our key IFRS measure of earnings and removes the impact of short-term market volatility under both IFRS 17 and IFRS 4. Therefore, the bridge from OPAT to net profit retains similar steps. Under IFRS 17 the accounting treatment of assets and liabilities is more economic, resulting in higher net profit in 2022 and lower volatility going forward.

With the mark-to-market movements for participating business now absorbed directly within the CSM, the effect from short-term market fluctuations on equities and real estate only relates to non-par business and surplus assets and as a result reduces from 2.3 to 1.1 billion dollars. The interest rate hedging programme that protects policyholders in the Hong Kong participating business is now treated economically under IFRS 17, eliminating the 2 billion reported in March this year under IFRS 4.

Finally, other non-operating items includes non-recurring expenses, mark-to-market movements and realised capital gains and losses on bonds, and additional credit risk related provisions introduced under IFRS 9. Overall, net profit in 2022 was 3 billion dollars higher compared to IFRS 4.

This higher net profit also flows through to an increase in shareholders' allocated equity. As a reminder, shareholders' allocated equity is shown excluding some of the other comprehensive income items otherwise known as OCI. Removing these mark-to-market effects provides a clearer reflection of the underlying drivers of the change in shareholders' equity.

Supported by higher net profit, shareholders' allocated equity under IFRS 17 increased over the year to 53 billion dollars before returns to shareholders. It also increased from 44.8 billion under IFRS 4, to 47.2 billion dollars under IFRS 17 as at the end of 2022. The increase in our shareholders' allocated equity means that there has been no significant reallocation of historical retained earnings under IFRS 4.

Our shareholders' equity as at 31 December 2022 was 6.6 billion higher under IFRS 17, driven by the increased net profit and a 4.2 billion reduction in negative OCI reserves. Historically under IFRS 4, fair value reserves within the OCI captured mark-to-market movements on the vast majority of bonds. Under IFRS 17, the fair value reserve is smaller as it now includes only non-participating business and surplus assets, with all movements from participating business flowing to insurance contract liabilities, including the CSM.

In addition, for non-participating business, there is also an OCI for liabilities called the insurance finance reserve, that captures the corresponding movements from discount rate changes. When best estimate liabilities are positive, both the fair value reserve and insurance finance reserve will move in tandem, largely offsetting each other. However, bonds that are within our surplus assets will continue to generate short-term fluctuations that reflect market movements. This results in a smaller absolute magnitude of OCI and a more stable shareholders' equity going forward.

A new measure under IFRS 17, comprehensive equity, is the sum of shareholders' equity and the CSM, net of reinsurance, tax and non-controlling interests. Comprehensive equity represents the aggregate value of historical and expected future profits from the in-force business net of cumulative cash returns to shareholders. As you can see our comprehensive equity at the end of 2022 was 86.4 billion dollars, roughly evenly split between shareholders' equity and net CSM. We understand that the major rating agencies will include the net CSM at least in part in their own assessment of leverage.

The inclusion of net CSM in the financial leverage calculation reduces our leverage ratio by 11.1 percentage points as at end of 2022 to 11.4 per cent, further supporting AIA's already very strong financial strength and credit ratings.

Here we show how IFRS 17 comprehensive equity and new business CSM compare to EV equity and VONB, demonstrating the prudence of AIA's embedded value reporting. Importantly, all expenses as well as regulatory and Group capital requirements are fully captured within our EV and VONB, with significant allowance for risk premiums in our risk discount rates. Free surplus represents the shareholders' view of capital and is the primary measure used when considering capital allocation. EV and VONB fully capture future distributable cash flows to shareholders and are therefore more representative of shareholder value creation.

As I said earlier, the change in accounting standards does not affect the underlying economics of our business and we will continue to focus on delivering growth, earnings and cash. We have tremendous opportunities to deploy capital at very attractive returns in the fastest growing region for life and health insurance in the world. OPAT and shareholders' allocated equity remain the key IFRS metrics and both measures improved as a result of adopting IFRS 17, with the high-quality sources of our earnings reinforced. Net profit and shareholders' equity are higher and also less volatile.

AIA's robust balance sheet is a key competitive advantage ensuring we retain financial capacity and flexibility to invest in the enormous potential for profitable new business growth in the region, creating sustainable shareholder value and returns.

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