



# 2013 Embedded Value Report





2013  
EMBEDDED  
VALUE REPORT



**BRUSSELS**  
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# 1 HIGHLIGHTS 2013 Embedded value results

This document only covers the consolidated Life insurance activities that are controlled by Ageas and where the equity associates are not taken into account. The concepts of Embedded Value are further explained in Annex I.

KPMG has performed a limited assurance engagement on this Embedded Value Report. Their report is included in Chapter 6.

All amounts are reported in millions of EURO unless otherwise stated.

## 1.1 Highlights of 2013 Embedded Value

Highlights Embedded Value	2013		2012	
	Total	Insurance	Total	Insurance
<b>Embedded Value previous Year-end restated (Year-start)</b>	<b>5,542</b>		<b>4,008</b>	
Operating Embedded Value Earnings	326		236	
Operating return on Embedded Value Year-end restated	5.9%		5.9%	
Total return before dividend on Embedded Value Year-end restated	678		1,557	
Total return before dividend on Embedded Value Year-end restated in %	12.2%		38.9%	
Dividends paid	(433)			
<b>Embedded Value Year-end</b>	<b>5,787</b>		<b>5,565</b>	
Total return after dividends on Embedded Value Year-end restated	4.4%		38.8%	

Ageas's Embedded Value grew solidly during 2013. Supported by increasing interest rates, stronger equity markets and a 74% increase in Value Added by New Business, Ageas's Life businesses have realised a 12.2% return on Embedded Value before dividends.

Last year, the total return before dividend amounted to 38.9% mainly due to tightening of credit spreads on Belgian government bonds.

## 1.2 Value Added by New Business

Value added by New Business	2013	2012	Change
<b>Total Insurance</b>			
Value Added by New Business	120	69	74.3%
Present value New Business premiums	4,924	5,755	(14.4%)
Margin	2.4%	1.2%	
<b>Belgium</b>			
Value Added by New Business	67	44	53.1%
Present value New Business premiums	2,996	4,243	(29.4%)
Margin	2.2%	1.0%	
<b>UK</b>			
Value Added by New Business	4	(1)	-
Present value New Business premiums	228	291	(21.5%)
Margin	1.9%	(0.3%)	
<b>Continental Europe</b>			
Value Added by New Business	17	1	-
Present value New Business premiums	1,021	504	102.6%
Margin	1.7%	0.1%	
<b>Asia</b>			
Value Added by New Business	32	25	28.3%
Present value New Business premiums	679	717	(5.4%)
Margin	4.7%	3.5%	

The VANB increased by 74% or EUR 51 million to EUR 120 million. The main driver is the increase in Belgium and Continental Europe where the VANB has increased by respectively EUR 23 million and EUR 16 million. Overall, the margin increased from 1.2% in 2012 to 2.4% in 2013.

Savings business has benefited from an increased interest rates environment while at the same time management has revised the guaranteed rate down as seen in Life business in Belgium, and Individual Life products Asia and Annuities in Continental Europe.

Although freezing the guaranteed rate in our Belgian Retail Savings at 1.5% has impacted the New Business Premiums negatively, the effect on the VANB is positively impacted.

The VANB in Continental Europe increased mainly due to the shift towards Unit-Linked products with higher margins, increased sales performance with lower unit costs and lowering the guaranteed rate of Annuity and Savings products.

Since 2011, our Asian entity has shown significant improvement in their new business value mainly due to active monitoring of their product mix and converting existing products into products with lower guaranteed rates and higher premiums.

A change in the UK tax regime has negatively impacted on the overall UK Life protection market significantly. This is also reflected in New Business Premiums of our entity. However, this change has improved our business's competitiveness with peers leading to an improved VANB.

## 2 2013 Movement Analysis

The Movement Analysis explains the movement in Embedded Value starting from the 2013 year- start to the value at year-end by showing the different underlying components. The underlying principles are described in detail in chapter 4 and the background on VANB is covered in Section 2.4

Embedded Value	2013					2012				
	Total	Continental				Total	Continental			
	Insurance	Belgium	UK	Europe	Asia	Insurance	Belgium	UK	Europe	Asia
Embedded Value previous Year	5,565	3,977	163	689	736	3,686	2,446	161	440	638
Opening adjustments	(23)	(77)	(2)	(3)	59	322	160	1	71	91
<b>Embedded Value previous Year-end restated (Year-start)</b>	<b>5,542</b>	<b>3,900</b>	<b>161</b>	<b>686</b>	<b>795</b>	<b>4,008</b>	<b>2,606</b>	<b>162</b>	<b>511</b>	<b>729</b>
Expected return	285	189	1	75	20	372	239	2	115	16
Experience variance and assumption changes	(79)	23	(5)	7	(104)	(205)	(140)	(3)	(9)	(53)
Value added by New Business	120	67	4	17	32	69	44	(1)	1	25
<b>Operating Embedded Value Earnings</b>	<b>326</b>	<b>279</b>		<b>99</b>	<b>(52)</b>	<b>236</b>	<b>143</b>	<b>(2)</b>	<b>107</b>	<b>(12)</b>
Operating return on Embedded Value Year-end restated	5.9%	7.2%		14.4%	(6.5%)	5.9%	5.5%	(1.2%)	20.9%	(1.6%)
Variance on Investment income	213	139	(1)	67	8	741	644	0	70	27
Changes in Interest rates and market conditions	139	118	(2)	(7)	30	580	584	3	1	(8)
<b>Total return before dividend on Embedded Value Year-end restated</b>	<b>678</b>	<b>536</b>	<b>(3)</b>	<b>159</b>	<b>(14)</b>	<b>1,557</b>	<b>1,371</b>	<b>1</b>	<b>178</b>	<b>7</b>
Total return before dividend on Embedded Value Year-end restated in %	12.2%	13.7%	(1.9%)	23.2%	(1.8%)	38.9%	52.6%	0.6%	34.8%	1.0%
Dividends paid	(433)	(391)		(4)	(38)					
<b>Embedded Value Year-end</b>	<b>5,787</b>	<b>4,045</b>	<b>158</b>	<b>841</b>	<b>743</b>	<b>5,565</b>	<b>3,977</b>	<b>163</b>	<b>689</b>	<b>736</b>
Total return after dividends on Embedded Value Year-end restated	4.4%	3.7%	(1.9%)	22.6%	(6.5%)	38.9%	52.6%	0.6%	34.8%	1.0%

Elements of the Movement Analysis table will be discussed in detail in the subsequent paragraphs.

### 2.1 Restatement 2012 Embedded Value

Restatement of Embedded Value	2013					2012
	Total	Continental				Total
	Insurance	Belgium	UK	Europe	Asia	Insurance
Embedded Value previous Year	5,565	3,977	163	689	736	3,686
Opening Adjustments	(23)	(77)	(2)	(3)	59	322
<b>Embedded Value previous Year-end restated (Year-start)</b>	<b>5,542</b>	<b>3,900</b>	<b>161</b>	<b>686</b>	<b>795</b>	<b>4,008</b>

The opening adjustments include:

- Alignment with industry practice, the extrapolation part of the yield curve has changed from 10 years to 40 years of convergence, with an overall negative impact of EUR 109 million;
- Modeling enhancements with a positive impact of EUR 129 million:
  - Revised profit sharing model in Belgium to better reflect reality increased the value by EUR 120 million;
  - Upgrade of liability modelling to better reflect the product features in Asia entity has a positive impact of EUR 59 million;
- Other modelling improvements have an overall negative impact of EUR 50 million (e.g. market value adjustments modelling, introduction of dynamic interest rate guarantee and other improved local cashflow modelling).
- Restated equity due to missing technical provisions in last year results decreased the value with EUR 43 million within Belgium.

After the restatements, the 2012 Embedded Value Year-end restated (Year-start) amounts to EUR 5,542 million.

## 2.2 Expected Return

The principles of the Expected Return are described in paragraph 4.9.

Expected Return	Free Surplus +	Required Equity +	Value of In-force business =	2013 Embedded Value	2012 Embedded Value
Embedded Value previous Year-end restated (Year-start)	603	2,604	2,335	5,542	4,008
Operating assumption changes	87	(56)	(98)	(67)	(176)
<b>Embedded Value Year-end restated after assumption changes</b>	<b>690</b>	<b>2,548</b>	<b>2,237</b>	<b>5,475</b>	<b>3,832</b>
<b>Expected return</b>	<b>594</b>	<b>(151)</b>	<b>(160)</b>	<b>283</b>	<b>372</b>
reference rate	4	15	13	32	68
<i>in % of Embedded Value Year-end restated after assumption changes</i>	0.6%	0.6%	0.6%	0.6%	1.8%
in excess of reference rate	18	35	198	251	304
<i>in % of Embedded Value Year-end restated after assumption changes</i>	2.5%	1.4%	8.9%	4.6%	7.9%
transfer to shareholder's equity	572	(201)	(371)		

- The decrease of **reference rate**<sup>1</sup> from 1.8% for 2012 to 0.6% for 2013 is the result of the decrease in risk free rate between 31 December 2011 (basis for 2012 expected return calculation) and 31 December 2012;
- The 2012 **in excess of reference rate**<sup>2</sup> includes a one-off item relating to the calculation of Belgian tax facilities, mainly explaining the decrease in 2013 compared to 2012.

## 2.3 Experience variances and Assumption changes

The underlying principles of the operating assumptions are described in paragraph 4.7.

Detail on assumption changes and experience variances	Free Surplus +	Required Equity +	Value of In-force business =	2013 Embedded Value	Continental				2012 Embedded Value
					Belgium	UK	Europe	Asia	
<b>Experience variances and Operating assumption changes</b>	<b>11</b>	<b>(27)</b>	<b>(63)</b>	<b>(79)</b>	<b>23</b>	<b>(5)</b>	<b>7</b>	<b>(104)</b>	<b>(205)</b>
Non-economic variance	(76)	29	35	(12)	(3)	(5)	10	(14)	(29)
<b>Impact of operating assumptions</b>	<b>87</b>	<b>(56)</b>	<b>(98)</b>	<b>(67)</b>	<b>26</b>		<b>(3)</b>	<b>(90)</b>	<b>(176)</b>
Mortality / Morbidity	32	(3)	(33)	(4)	(12)			8	24
Costs (expenses / commissions)			(78)	(78)	(53)		(25)		(17)
Lapse / renewals		1	(73)	(72)	8		10	(90)	(72)
Tax	1		39	40	40				(43)
Premium Persistency			11	11	19			(8)	(22)
Level of Required Equity	54	(54)	11	11	11				11
Change in target asset mix / asset investment rules			14	14				14	(44)
Profit sharing rules									16
Cost inflation			14	14	14		12	(12)	(21)
Other			(3)	(3)	(1)			(2)	(8)

1) At page 18, paragraph 4.9, the reference rate is further defined.

2) At page 18, paragraph 4.9, the in excess of reference rate is further defined.



- The value is negatively impacted by EUR 78 million due to changes in **costs (expenses/ commissions)** assumptions. EUR 53 million is reported in Belgium mainly due to the inclusion of strategic project cost and using actual cost amounts as starting basis instead of forecasted cost assumptions and costs. Furthermore, our French entity has entered into a partnership with Avenir Finance Gestion Privée. The additional cost linked to the commissions that France gives to this partner has a negative impact of EUR 20 million;
- The changed **lapse** assumption decreased the value by EUR 72 million. In Asia, better persistency is observed in Traditional Life products. However, this has generated an increase in the future liabilities. In Continental Europe (Portugal), the lapse assumption has been revised down in the Term Assurance product which represents a high portion of the product mix. This resulted in a positive impact of EUR 7 million;
- A positive impact of **taxes** on equities of EUR 40 million is reported within Belgium, as improved equity markets enable our Belgian entity to extend the modeled holding period and therefore benefit from tax exemption on capital gains on more of their equities;
- The **premium persistency** impact of EUR 19 million in Belgium stems mainly from Group Life contract prolongations;
- **Required Equity** of EUR 54 million is transferred to Free Surplus originated from an update of required capital repartition between life and non life businesses;
- **Cost inflation** in CEU and Belgium improved by EUR 12 million and EUR 14 million respectively due to a decrease of the inflation swap rate. The decrease of EUR 12 million in Asia is related to an increase in maintenance cost.

## 2.4 Value Added by New Business

The table below gives a breakdown of the VANB for the various Life insurance entities, including the key indicators for sales and margins. The reported IRR is calculated based on a traditional deterministic projection using real-world assumptions.

Value Added by New Business	2013					2012
	Total Insurance	Belgium	UK	Continental Europe	Asia	Total Insurance
Value Added by New Business	120	67	4	17	32	69
New Business Strain	(146)	(19)	(59)	(6)	(62)	(155)
Value of In-force business	266	86	63	23	94	224
Certainty Equivalent Value	310	114	65	26	105	301
Cost of Financial Options and Guarantees	(20)	(12)			(8)	(44)
Cost of Non-hedgeable risks	(9)	(5)	(1)	(1)	(2)	(13)
Cost of Capital	(15)	(11)	(1)	(2)	(1)	(20)

Value Added by New Business	2013				
	Total Insurance	Belgium	UK	Continental Europe	Asia
Value Added by New Business Evolution					
VANB Current Year	120	67	4	17	32
VANB Previous Year	69	44	(1)	1	25
Present Value New Business Premiums (PVNBP)					
PVNBP Current Year	4,924	2,996	228	1,021	679
PVNBP Previous Year	5,755	4,243	291	504	717
Sales & Margins PVNBP basis					
VANB/PVNBP Current Year	2.4%	2.2%	1.9%	1.7%	4.7%
VANB/PVNBP Previous Year	1.2%	1.0%	(0.3%)	0.1%	3.5%
Annualised premium Equivalent (APE)					
APE Current Year	532	292	36	105	99
APE Previous Year	615	417	44	53	101
Sales & Margins APE basis					
VANB/APE Current Year	22.5%	22.9%	11.8%	16.3%	32.3%
VANB/APE Previous Year	11.2%	10.5%	(1.6%)	1.3%	25.1%
IRR					
IRR Current Year	10.9%	11.9%	2.6%	13.5%	9.0%
IRR Previous Year	8.8%	11.2%	1.9%	5.8%	7.2%

### Belgium

The VANB in Belgium has increased significantly due to the management decision to freeze the guaranteed rate at the level of Q4 2012 despite a market rate increase in the course of 2013. Savings products benefited from the higher interest rate environment and also the sustainable profitability of the Term business and the higher production in Unit-Linked products have contributed to a higher VANB in Belgium.

### Continental Europe

The VANB has increased significantly from EUR 1 million to EUR 17 million. This is mainly driven by Portugal with improved margins in the Unit-Linked business and higher volumes in the Term business, while the Savings business is also benefiting from the positive interest rate environment.

In France, the main drivers explaining the positive VANB are the global increase of sales volumes in Savings, increase of sales on

the Unit-Linked part of contracts with higher margins, and due to economies of scale as the sales have increased more than the cost.

### UK

For the first time the VANB in the UK shows a positive number compared to previous years. A change in the UK tax regime has negatively impacted on the overall life protection market significantly. Under the previous tax regime competitors could use net of tax assumptions in their pricing allowing them to price more competitively. Since January 2013 all new business has been taxed on profits, which has improved our business's competitiveness with peers leading to an improved VANB.

### Asia

The VANB has increased from EUR 25 million to EUR 32 million. This is the result of successful adjustments in the product mix and lowering the guaranteed rates for certain Savings products.

## 2.5 Variance in investment income – changes in market conditions and dividends

Variances in Investment Income, Changes in Market Conditions and Dividends paid	2013					2012
	Total Insurance	Belgium	UK	Continental Europe	Asia	Total Insurance
<b>Variance in Investment Income</b>	<b>213</b>	<b>139</b>	<b>( 1 )</b>	<b>67</b>	<b>8</b>	<b>741</b>
Shares	144	131		10	3	39
Real Estate	23	36		( 7 )	( 6 )	20
Unit Linked funds	14	6		8		22
Fixed Income	32	( 34 )	( 1 )	56	11	660
<b>Changes in Interest Rates and Market Conditions</b>	<b>139</b>	<b>118</b>	<b>( 2 )</b>	<b>( 7 )</b>	<b>30</b>	<b>580</b>
<b>Dividends paid</b>	<b>( 433 )</b>	<b>( 391 )</b>		<b>( 4 )</b>	<b>( 38 )</b>	

- The **Variance in Investment Income** reflects the impact of deviations of actual experience from expectations during the year with respect to economic factors. The amount of EUR 213 million shows an increase in the value mainly due to better performance of shares (EUR 144 million) and real estate and decrease in credit spreads on predominantly Italian and Portuguese government bonds;
- **Changes in Interest Rates and Market conditions** increase the value by EUR 139 million due to increased interest rates during 2013. This includes a positive EUR 64 million for Asia which is partly offset by a negative currency impact of EUR 34 million due to the depreciation of the Hong Kong Dollar. Within Continental Europe the introduction of the new yield curve showed a positive impact of EUR 11 million which is negative impacted by an unexplained of EUR 18 million;
- Upstream **dividends** for a total EUR 433 million to Ageas's General Account.

## 2.6 Equity Reconciliation

The table below provides an overview of the adjustments made to the IFRS group Shareholder Equity to arrive at the Embedded Value for reporting year 2013. The detailed principles are described in paragraph 4.10.

Equity Reconciliation	2013			2012		
	Life	Non-Life & Other Insurance	General Account	Life	Non-Life & Other Insurance	General Account
<b>Total IFRS Shareholder's Equity 1)</b>	<b>5,865</b>	<b>1,748</b>	<b>913</b>	<b>6,310</b>	<b>1,835</b>	<b>1,656</b>
Activities not included in Embedded Value 2)	(733)	(1,748)	(913)	(711)	(1,835)	(1,656)
<b>IFRS Shareholder's Equity of activities included in Embedded Value</b>	<b>5,132</b>			<b>5,599</b>		
<b>Adjustments from IFRS to EEV</b>						
Deduction Deferred Acquisition Costs	(467)			(415)		
Deduction of Intangible Assets (Goodwill/VOBA) 2)	(564)			(606)		
Valuation adjustment Technical Provisions	1,402			1,809		
Market value adjustments	1,167			1,374		
Reallocation of UCG to assets backing provisions	(3,692)			(4,549)		
Adjustments for participation differences	56			84		
<b>Value of Shareholder's Equity 3)</b>	<b>3,034</b>			<b>3,296</b>		
<b>Value of In-Force Business 3)</b>	<b>2,753</b>			<b>2,269</b>		
<b>Embedded Value Year-end</b>	<b>5,787</b>			<b>5,565</b>		

1) 2012 comparative numbers have been restated for the change in IAS 19.

2) In our 2012 report, the goodwill on our Asian activities was included in the line "activities not included in Embedded Value". This goodwill has been restated in the 2013 report to the line "Deduction of Intangible Assets". The 2012 comparative numbers have been restated as well.

3) The definition of "Value of Shareholder's Equity" and "Value of In-Force Business" is described in Annex I.

The "activities not included in Embedded Value" mainly relate to the Equity Associates (2013: EUR 707 million).

The overall decrease of the adjustments is the result of the increased interest rates during 2013.

### 3 Sensitivity analysis

Note that all sensitivities are performed without any management actions, e.g. the sensitivity Reference Rate – 100bp assume the same technical interest rate as of today for Value New Business. The principles of the sensitivities are described in detail in paragraph 4.11.

Sensitivities - Embedded Value	2013					2012
	Total Insurance	Belgium	UK	Continental Europe	Asia	Total Insurance
<b>Embedded Value Year-end</b>	<b>5,787</b>	<b>4,045</b>	<b>158</b>	<b>841</b>	<b>743</b>	<b>5,565</b>
Reference rate +100bp	1.5%	1.3%	2.7%	1.0%	3.2%	2.2%
Reference rate -100bp	(4.5%)	(4.8%)	(4.1%)	(2.8%)	(4.7%)	(7.1%)
Asset values shares and real estate -10%	(5.0%)	(6.3%)		(2.3%)	(2.1%)	(6.1%)
Volatilities equities and properties +25%	(0.1%)	(0.0%)		(0.2%)	(0.3%)	0.2%
Volatilities risk-free yields +25%	(2.0%)	(1.8%)		(1.0%)	(5.0%)	(4.3%)
Illiquidity Premium 0 bp	(5.1%)	(5.8%)	(0.9%)	(1.9%)	(5.7%)	(9.1%)
Illiquidity Premium +10 bp	1.6%	1.7%	0.3%	0.9%	1.6%	2.8%
Required Equity (minimum regulatory level)	1.8%	1.9%	1.0%	1.4%	2.1%	2.1%
Costs -10%	2.9%	3.1%	2.3%	2.3%	2.8%	3.2%
Mortality rates -5%	0.4%	0.3%	1.4%	(0.6%)	1.8%	0.6%
Lapse rates -10%	2.7%	3.6%	(1.8%)	1.2%	0.7%	0.7%

Sensitivities - Value Added by New Business	2013					2012
	Total Insurance	Belgium	UK	Continental Europe	Asia	Total Insurance
<b>Value New Business</b>	<b>120</b>	<b>67</b>	<b>4</b>	<b>17</b>	<b>32</b>	<b>69</b>
Reference rate +100bp	9.1%	6.9%	11.1%	11.5%	12.4%	46.3%
Reference rate -100bp	(23.7%)	(26.0%)	(26.0%)	(16.6%)	(22.3%)	(67.1%)
Volatilities equities and properties +25%	(3.9%)	(6.5%)		0.3%	(1.3%)	0.6%
Volatilities risk-free yields +25%	(5.9%)	(5.5%)		(0.5%)	(10.5%)	(28.2%)
Illiquidity Premium 0 bp	(16.0%)	(22.0%)	(4.1%)	(7.8%)	(9.4%)	(60.3%)
Illiquidity Premium +10 bp	2.5%	2.3%	1.3%	4.1%	2.4%	24.1%
Required Equity (minimum regulatory level)	5.2%	4.3%	9.4%	7.4%	5.4%	11.8%
Costs -10%	9.8%	10.1%	18.0%	4.6%	10.9%	20.0%
Mortality rates -5%	1.4%	2.2%	7.8%	(7.1%)	3.4%	23.6%
Lapse rates -10%	10.0%	9.1%	9.2%	2.7%	16.1%	28.4%

All sensitivities in 2013 show a lower impact compared to 2012 mainly due to the discounting effect in an increased interest rate environment. This impact is mainly visible within the Savings Business with Discretionary Participation Features. Further, an improved matching between assets and liabilities decreased the interest sensitivities compared to 2012.

## 4 Embedded value at Ageas

### 4.1 Principles

Ageas's Embedded Value Report complies with the following guidance issued by the CFO Forum:

- European Embedded Value Principles, issued 5 May 2004;
- Additional Guidance on European Embedded Value Disclosures, issued 31 October 2005.

In addition to these principles, Ageas has already applied principles 2- 6, 7.1, 7.4, 8, 9.1 – 9.3, 10, 11.1 – 11.5, 11.7 – 11.10, 11.13, 11.15 – 11.16, 12 - 16, 17.1 – 17.3.7, 17.3.10 – 17.3.20, 17.3.22 – 17.3.36, 17.3.46 – 17.3.47, 17.4 – 17.8.8 from the Market Consistent Embedded Value Principles issued in October 2009.

The applied Market Consistent Embedded Value principles mostly relate to actuarial and economic assumptions and methodologies. Furthermore, some of the applied MCEV principles relate to instructions on the disclosure of results, assumptions and methodologies used. The applied principles have not changed compared to 2012.

Ageas's Embedded Value reporting is a supplementary reporting to the primary financial statements and represents a measure of the shareholders' interest in Ageas's Life insurance businesses, comprising the market value of the Shareholder's Equity plus the value of the operating business. Annex I gives a detailed description of these elements.

### 4.2 Statement of directors

We confirm that this Embedded Value Report has been prepared in accordance with the European EV Principles as detailed in paragraph 4.1. The Board of Directors reviewed the Embedded Value Report on 18 March 2014 and authorizes its issue.

### 4.3 Value Added by New Business (VANB)

The VANB represents the Value Added by New Business written in the period, and is calculated in a similar way to the embedded value. It is calculated as the value of the new business written in 2013 and In-Force at 31 December 2013 plus the first year losses (New Business Strain).

The Value Added by New Business includes only contracts sold during 2013 and does not include future new business.

### 4.4 Scope

All amounts in the tables of this Embedded Value Report are denominated in millions of euro, unless stated otherwise.

The Embedded Value of Life insurance operations provides additional information on the value of existing contracts and acquired new business and is based on a market consistent approach.

Ageas is organised into five operating segments:

- Belgium;
- United Kingdom (UK);
- Continental Europe;
- Asia;
- General Account.

### 4.5 Covered business

The scope of this Embedded Value Report covers value that arises from major Life insurance activities sold through Ageas's Insurance entities. It does not include any of the Non-Life activities, such as Property & Casualty Insurance, the General Account and the non-consolidated Asian and European partnerships. These activities are considered non-covered businesses.

The Ageas's Life entities included in the scope of Embedded Value are:

- AG Insurance in Belgium, with Ageas's share of 75%;
- Continental Europe, which includes:
  - Ageas France in France;
  - Millenniumbcp Ageas in Portugal, with Ageas's share of 51%.
- Ageas Asia Holdings in Hong Kong, which includes Ageas Insurance Company (Asia);
- Ageas Protect Limited in the U.K.

The business under scope includes Life business, such as Traditional Life, Term, Annuities, Unit-Linked, Universal Life and Group Business. Accident and health products sold through the relevant entities are considered Non-Life products and are therefore treated as not covered business. Only in the event that types of products appear as a policy rider to Life business, is their value included in the Embedded Value calculations.

In our IFRS Financial Statements, AG Insurance and Millenniumbcp Ageas have been consolidated 100%. For Embedded Value reporting purposes, these businesses are included for the share Ageas holds in them, as mentioned above.

The valuation of all the subordinated liabilities issued by the entities of the covered business has been valued on the basis of the credit rating of the issuing entity.

## 4.6 Economic assumptions

### 4.6.1 Reference rates

For 2013 reporting purposes, Ageas continued its approach for the reference rates to be in line with the recommendations set out by the CFO/CRO forum to EIOPA under Solvency II and QIS5. The approach taken by Ageas mainly consists of applying the illiquidity premium on the risk free forward curve, the methods used to determine the risk free rates and illiquidity premiums are described below. Ageas uses these reference rates to extract forward reinvestment yields that are used for all asset classes.

Ageas uses a stochastic economic scenario generator to produce 1,000 arbitrage free scenarios of future investment returns on each asset class, based on the reference rate mentioned above and the volatilities given in section 4.6.2.

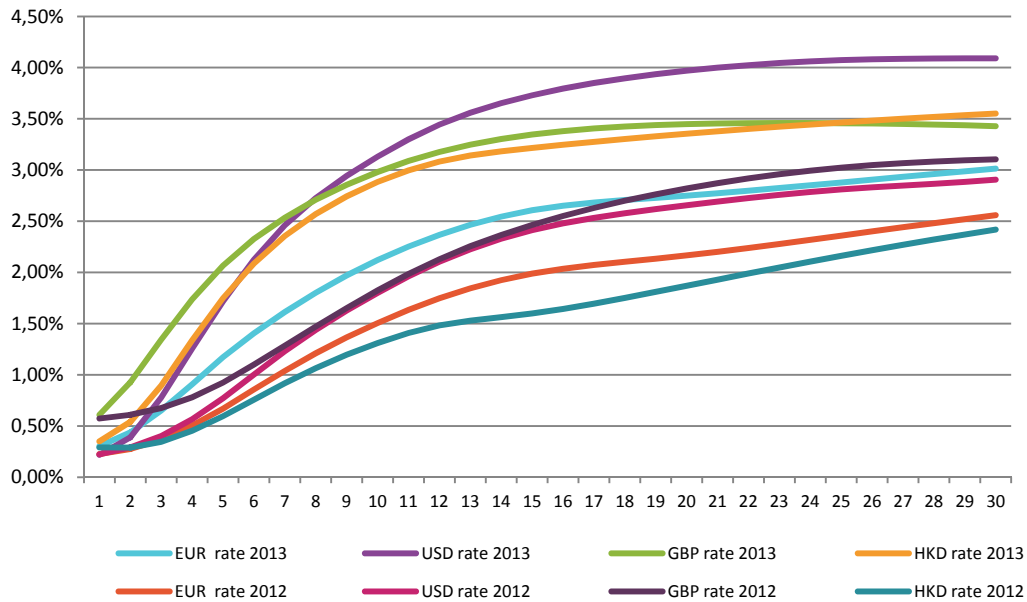
### Risk free

The risk free rate is derived from the forward zero coupon yield curve which is reduced by 10 bps credit spread until the last liquid point. The forward zero coupon yield curve is derived from the swap curves at 31 December 2013 for the relevant currencies and these are sourced from market sources for rates up to year 20 for the EUR, up to year 15 for the HKD and up to year 50 for the GBP. For rates beyond these maturities, the extrapolation method (Smith-Wilson) is used to converge from the last observed liquid market data point to an unconditional ultimate long term forward rate. At year-end 2013, Ageas has changed the period of convergence from 10 years to 40 years to align more closely with what is specified or recommended by the most recent Solvency 2 guidelines and what is applied by peers.

Samples of the risk free rates up to year 30 are plotted in the graph below.

Risk free rates	2013				2012			
	Euro	GBP	HKD	USD	Euro	GBP	HKD	USD
1 yr	0.30 %	0.61 %	0.35 %	0.22 %	0.23 %	0.57 %	0.29 %	0.22 %
5 yr	1.17 %	2.07 %	1.75 %	1.72 %	0.67 %	0.92 %	0.60 %	0.77 %
10 yr	2.12 %	2.98 %	2.88 %	3.13 %	1.47 %	1.77 %	1.28 %	1.74 %
15 yr	2.61 %	3.35 %	3.22 %	3.73 %	1.91 %	2.34 %	1.55 %	2.29 %
20 yr	2.75 %	3.45 %	3.35 %	3.97 %	2.07 %	2.64 %	1.96 %	2.50 %

The table above and chart below show the risk free rate in spot format. This explains why e.g. the Euro rates at 30 years are below 4.2%.



**Illiquidity premium**

The illiquidity premium is calibrated using the method that has been described by EIOPA in the QIS 5 exercise. Depending on the illiquidity of the liabilities, a weight is assigned to the liability buckets (100%, 75% and 50%) per entity and currency. Ageas uses a weighted average illiquidity premium for each insurance company based on their liability mix. For EUR, the illiquidity

premium is fully applied on the first 20 years risk free term structure; all other currencies still follow the QIS5 illiquidity premium term structure, until year 30. For the subsequent 5 years the illiquidity premium declines linearly to zero (refer to Annex II). The illiquidity premia in 2013 have decreased overall as shown in table below:

Illiquidity premia		2013	2012
EUR		20 - 24	29-35
HKD		29	35
GBP		27	43
USD		38	46

Maturity of the Illiquidity premia (in years)	EUR	HKD	GBP	USD
Full illiquidity premium	20	30	30	30
Additional amortisation period	0	5	5	5

#### 4.6.2 Volatilities

The scenarios used in the economic scenario generator are calibrated to fit to market data at the valuation date with the aim of achieving certain target of accuracy set by the group. Each operating entity has its own set of 1,000 scenarios. For the

Belgian, French and Portuguese entities, these are Euro based scenarios. At year end, the swaption volatilities have decreased, in particular for the long term maturities. For AICA, the scenarios are still produced by the previous group tool.

Volatilities			2013	2012
10 yr Sample swaption quote	5 yr option / 10 yr option	EUR	25.9% / 23.3%	27.5% / 24.6%
		HKD	22.8% / 22.9%	32.9% / 37.8%
		USD	20.3% / 16.4%	
15 yr Sample swaption quote	5 yr option / 10 yr option	EUR	24.6% / 22.8%	25.9% / 23.5%
		HKD	21.9% / 21.6%	32.8% / 38.4%
Real Estate	Imo APFIPP Index	EUR	2.1%	1.8%
	REBE Funds	EUR	14.0%	12.6%
	REBE Offices	EUR	7.0%	6.3%
	SX86E Index	EUR	31.3%	31.2%
Equity	HSP Index	HKD	28.3%	28.9%
	MSCI EMU	EUR	11.9%	16.6%
	MSCI US	USD	10.2%	12.7%
	MSCI Europe Ex EMU	EUR	9.5%	15.4%
	PSI 20	EUR	13.7%	17.0%
	MSCI World Free	USD	8.8%	11.8%
	MSCI Far east ex Japan	USD	11.2%	13.1%
	MBCP	EUR	37.8%	
	MSCI Emerging Market	USD	12.6%	
	MSCI Asia	USD	11.6%	
	EUROSTOXX50	EUR	17.9%	
	SP500	USD	15.3%	
	MSCI Japan	JPY		21.5%
	MSCI Hong Kong	HKD		17.3%
Hang Seng	HKD		19.3%	



#### 4.6.3 Actual and Target asset mix

The table below provides information on the asset mix.

The actual asset mix is the investment portfolio in the balance sheet as at 31 December 2013. It excludes assets held in funds for which the policyholder bears the investment risks and assets backing shareholder's equity which do not impact on the Cost of Financial Options and Guarantees (CFOG). In the table the assets are classified according to their economical characteristic, e.g. equities in fixed income funds are classified as fixed income.

The long-term target asset mix represents the investment mix used in the projections to which the actual investment portfolio is gradually rebalanced. The Target Asset Mix is measured on a market value basis for assets backing policyholder liabilities. The change in investment portfolio from the actual to the target asset mix has an impact on CEQ VOB and CFOG and hence the Embedded Value.

The economic scenarios have been generated taking into account target correlations between the major asset classes, being equities, real estate and fixed income.

Asset mix - operating business	2013									
	Total Insurance		Belgium		UK		Continental Europe		Asia	
	Actual	Target	Actual	Target	Actual	Target	Actual	Target	Actual	Target
Fixed income	90.6%	87.7%	87.9%	88.0%	100.0%	100.0%	93.5%	93.5%	99.0%	85.0%
Shares	2.4%	4.2%	2.9%	2.9%	0.0%	0.0%	1.4%	1.8%	1.0%	10.0%
Real Estate	7.0%	8.1%	9.1%	9.1%	0.0%	0.0%	5.1%	4.7%	0.0%	5.0%

Asset mix - operating business	2012									
	Total Insurance		Belgium		UK		Continental Europe		Asia	
	Actual	Target	Actual	Target	Actual	Target	Actual	Target	Actual	Target
Fixed income	89.8%	88.8%	89.0%	88.4%	100.0%	100.0%	93.5%	92.3%	98.8%	85.0%
Shares	1.7%	2.0%	1.9%	1.9%	0.0%	0.0%	0.8%	1.5%	1.2%	10.0%
Real Estate	8.5%	9.2%	9.1%	9.7%	0.0%	0.0%	5.7%	6.2%	0.0%	5.0%

#### 4.6.4 Real world investment return assumptions

The assumed investment returns include future investment risk premiums that are used to generate the expected return in the Movement Analysis. The real world investment return assumptions used in this report are:

- **Equities;**  
The Equity Risk Premium has been assumed to be 300bp above the reference rate.
- **Real Estate;**  
The real estate risk premium has been assumed to be 200bp above the reference rate.
- **Debt Securities;**  
The investment return on debt securities real world projections are based on actual cash flows (coupons and principles)

Any deviation as a result of defaults or spread changes is included in the "Variance on investment return" in the analysis of change.

Note that these assumptions do not influence the final valuation, since higher expected returns, will have an equally opposite effect on the variance, representing the difference between actual and Expected Return.

### 4.7 Operating assumptions

#### 4.7.1 Expenses

Modeled expenses start at the actual 2012 expense level and are modeled taking into account the assumed inflation rate over the projection period. Future commission payments follow the schemes agreed with the parties entitled to the payments. No account is taken of the effect of future expense reduction program, productivity gains or integration synergies.

Outside the scope of Embedded Value, there are no Ageas companies that provide services related to the life business, such as distribution channels.

The total unallocated central overheads in 2013 were EUR 55 million (2012: EUR 52 million). The share for the Life insurance activities of these expenses or any recurrence of these has not been included in the year-end Embedded Value or Value Added by New Business.

#### 4.7.2 Expense inflation

The expense inflation assumption is used to increase future expenses and is based on observed price inflation index as well as wage inflation.

#### 4.7.3 Operating assumptions

Each entity sets operating assumptions such as mortality and lapse rates at best-estimate level, based on its knowledge of the local markets and experience studies. All assumptions are reviewed each year and revised if required.

#### 4.7.4 Tax

Both local corporate tax and local taxes e.g. dividend taxes have been incorporated in the calculation of the Embedded Value based on the local tax position and local applicable tax rates. If this leads to deferred tax assets, an assessment has been made to determine that appropriate tax rates have been applied to direct and indirect returns on equities, real estate and fixed income. In all other cases the appropriate local corporate tax rate is applied.

#### 4.7.5 Premium persistency

Each entity sets premium persistency rates at best-estimate level, based on its knowledge of the local markets and experience studies. All assumptions are reviewed each year and revised if required.

#### 4.7.6 Profit sharing

Based on contractual obligations and management actions, profit sharing dividends are reflected in the group modeling platform and included in the Embedded Value calculations as a future outgoing cashflow.

### 4.8 Required equity

The required equity has been calculated as set out in section 1.1. of Annex I.

### 4.9 Expected return

The “expected return at the **reference rate**” shows the projected change over one year at risk free applicable at the start of the year. The VIF contains also the unwinding at the first year risk free rate. The VIF increases as all future profits now require one year less discounting.

The “expected return **in excess of reference rate**” is the additional Embedded Value expected to be created if “real world”

expected investment returns applicable at the year-start were to emerge. It also includes the release from risks with respect to options and guarantees and non-financial and residual non-hedgeable risks. The margin for the year built into the valuation for uncertainty with regards to asymmetric financial risk and non-financial risk is released in this step.

The “**transfer to shareholders’ equity**” shows the effect of the realization of the projected net profits from the VIF and the release of Required Equity. The change on shareholders’ equity has no impact on the Embedded Value overall as it contains the release of profits included in the VIF to the Free Surplus during the year.

### 4.10 Equity reconciliation

To arrive at the Value of Shareholder’s Equity for Embedded Value an adjustment is made to reallocate Unrealised Capital Gains. Under IFRS, all Unrealised Capital Gains, including those on assets backing technical provisions are accounted for as Shareholder Equity. For Embedded Value purposes these assets, including their Unrealised Capital Gains/Losses, are projected and valued as part of the Value of In-Force business and therefore need to be excluded from the EEV Shareholder’s Equity.

The line “Valuation adjustment Technical Provisions” includes several adjustments, including unallocated profit sharing and shadow accounting, whereas “Market value adjustments” relates to the revaluation to market value of the real estate and Held to Maturity portfolio.

### 4.11 Sensitivities

Following the CFO Forum guidance sensitivities are required to be provided for the in-force portfolio and the new business. These sensitivities are performed with respect to underlying best estimate assumptions and based on current market conditions as at 31 December 2013. Both economic and non-economic sensitivities are tested. The same management actions and policyholder behaviours have been assumed in the sensitivities as for the base case. Each sensitivity analysis is calculated by changing the relevant assumption in isolation. It does not take into account second order effects this may have on other assumptions underlying the projections.

- Reference rate + 100 bps – This sensitivity assumes an upward shift of 100 bps in the reference rate and still converging to the UFR of 4.2% following the changed yield curve methodology. This sensitivity has a significant positive impact on the overall new business following;

- Reference rate -100 bps – This sensitivity assumes a downward shift of 100 bps in the reference rate and still converging to the UFR of 4.2% following the changed yield curve methodology, without taking into account any possible management actions on the guaranteed interest rates. In contrast to the upward shift, the VANB suffers as no repricing of the new business is included in this sensitivity. Due to the asymmetric and non-linear impact of embedded financial options and guarantees, falling market rates have a higher impact on EV than rising interest rates;
- Asset values of equities and real estate -10% – This sensitivity assumes a decrease of the asset values of both equities and real estate by 10%. Since the modelled investment strategies take into account a certain target allocation based on market value, this shock may lead to a rebalancing of the modelled assets at the end of the first year, when defined boundaries for each asset class are exceeded. A drop of equity and property values by 10% reduces EV by 5%;
- Volatilities equities and properties +25% – This sensitivity assumes a 25% increase of both the equity and real estate volatility by multiplying the base assumption by a factor of 125%. As Ageas's entities show a low exposure to equities and properties, this sensitivity test has a limited impact on the overall EV. However the VANB is negatively impacted by 4%, particularly for savings products which will be repriced following the new market conditions;
- Volatilities risk-free yields +25% – This sensitivity assumes a 25% increase of the volatility of the risk free yields by multiplying the base assumption by a factor of 125%. Given that the interest rates have increased compared to last year and the swaption volatilities have decreased, the impact of this sensitivity has significantly come down and is in line with expectations;
- Illiquidity Premium 0 bp – This sensitivity assumes the illiquidity Premiums are set at 0 for all currencies, or in other words, a reference rate equal to the risk free rate. This sensitivity test remains an important impact on the overall EV and VANB, though the impact has significantly reduced compared to last year, given the sensitivity of the savings products to the improved interest rate environment and the enhancement of the profit sharing model;
- Illiquidity Premium +10 bp – This sensitivity assumes the Liquidity Premium includes 10bp on the existing Liquidity Premia for Euro, Hong Kong Dollar and Pound Sterling. The outcome is in line with expectations.
- Required Capital on the local regulatory minimum level – This sensitivity assumes that the Required Capital to hold is only to meet the minimum local regulatory requirements. This sensitivity is assumed to impact the Frictional Cost of Capital and the Cost of Non-Hedgeable Risks resulting from a lower level of Shareholders Equity needed to meet the minimum level of Required Capital. For the majority of entities the minimal regulatory capital is set at 100% of solvency 1 capital.
- Costs -10% – all maintenance costs excluding commissions and acquisition expenses decrease by 10%. Cost inflation remains unchanged. The positive impact on the VANB is significant as compared to the in-force business. This is mainly due to the fact that high acquisition costs are associated with first year new business written;
- Lapse -10% – This sensitivity assumes that the lapse rates used in the base scenario are multiplied by a factor of 90%. The outcome of this sensitivity is in line with expectations; only the UK portfolio shows an adverse effect in the in-force business due to the nature of their products with along stream of negative net cashflows in future later years;
- Mortality -5% – This sensitivity assumes that the mortality rates used in the base scenario are multiplied by a factor of 95%. This has been applied on both annuity and life assurance business. In Continental Europe we observe a longevity risks especially on annuity portfolio which impacts the VANB negatively;

## 5 Cautionary statements

This report is intended to provide investors with additional financial information. The figures are provided for information purposes only and are subject to the conditions and restrictions mentioned hereafter.

Certain of the statements contained herein are statements of future expectations and other forward-looking statements that are based on management's current views and assumptions and involve known and unknown risks and uncertainties that could cause actual results, performance or events to differ materially from those expressed or implied in such statements. Future actual results, performance or events may differ materially from those in such statements due to, without limitation, (i) general economic conditions, including in particular economic conditions in Ageas's core markets, (ii) performance of financial markets, (iii) the frequency and severity of insured loss events, (iv) mortality and morbidity levels and trends, (v) persistency levels, (vi) interest rate levels, (vii) currency exchange rates, (viii) increasing levels of competition, (ix) changes in laws and regulations, including monetary convergence and the Economic and Monetary Union, (x) changes in the policies of central banks and/or foreign

governments and (xi) general competitive factors, in each case on a global, regional and/or national basis.

In addition, the financial information contained in this presentation, including the pro forma information contained herein, is unaudited and is provided for illustrative purposes only. It does not purport to be indicative of what the actual results of operations or financial condition of Ageas and its subsidiaries would have been had these events occurred or transactions been consummated on or as of the dates indicated, nor does it purport to be indicative of the results of operations or financial condition that may be achieved in the future.

No warranty can be given by Ageas, either explicitly or implicitly, regarding the reasonableness, correctness or completeness of the information, forecasts and assumptions contained in these pages. The information here provided could be subject to changes. This report and the information contained herein in no way replace any formal reporting. Investment considerations should continue to be based on periodical reporting and other information Ageas is required to disclose by law or stock exchange regulations.

## 6 Limited assurance report on the Ageas 2013 embedded value report

### 6.1 Introduction

We were engaged by the Board of Directors of Ageas SA/NV (hereafter: “the Board of Directors”) to report in the form of an independent limited assurance conclusion on the Ageas’ Embedded Value Report for the covered life insurance business as at 31 December 2013 including the related movements in embedded value, including restatements and operating embedded value earnings (as stated on pages 1 to 20), for the year then ended and management assertion thereon (the “Ageas 2013 Embedded Value Report”) that based on our work performed, described in this report, nothing has come to our attention that causes us to believe that the Ageas 2013 Embedded Value Report is not properly prepared, in all material respects, in accordance with the following Principles as set out on page 13 of the Ageas 2013 Embedded Value Report, the “EEV Principles”:

- The European Embedded Value Principles and Guidance as developed by the CFO Forum and published on 5 May 2004.
- Additional Guidance on European Embedded Value Disclosures, issued 31 October 2005.
- Principles 2 - 6, 7.1, 7.4, 8, 9.1 – 9.3, 10, 11.1 – 11.5, 11.7 – 11.10, 11.13, 11.15 – 11.16, 12 - 16, 17.1 – 17.3.7, 17.3.10 – 17.3.20, 17.3.22 – 17.3.36, 17.3.46 – 17.3.47, 17.4 – 17.8.8 from the Market Consistent Embedded Value Principles issued October 2009.

### 6.2 Ageas responsibilities

The Board of Directors is responsible for the preparation of the Ageas 2013 Embedded Value Report in accordance with the EEV Principles that is free from material misstatements and for the determination of the assumptions to be used, and information contained therein.

This responsibility includes designing, implementing and maintaining internal control relevant to the preparation and presentation of the Ageas 2013 Embedded Value Report that is free from material misstatement, whether due to fraud or error. It also includes selecting and applying the appropriate methodology; and using assumptions that are reasonable in the circumstances; selecting and applying policies; making judgments and estimates that are reasonable in the circumstances; and maintaining adequate records in relation to the Ageas 2013 Embedded Value Report.

The Board of Directors is also responsible for preventing and detecting fraud and for identifying and ensuring that Ageas complies with laws and regulations applicable to its activities. The

Board of Directors is responsible for ensuring staff involved with the preparation of the Ageas 2013 Embedded Value Report are properly trained, systems are properly updated and that any changes in reporting encompass all significant business units.

### 6.3 Our Responsibilities

Our responsibility is to examine the Ageas 2013 Embedded Value Report prepared in accordance with the EEV principles by Ageas and to report thereon in the form of an independent limited assurance conclusion based on the evidence obtained.

We conducted our engagement in accordance with International Standard on Assurance Engagements (ISAE) 3000, Assurance engagements other than audits or reviews of historical financial information, issued by the International Auditing and Assurance Standards Board. This standard requires that we comply with ethical requirements, including independence requirements, and plan and perform our procedures to obtain a meaningful level of assurance whether nothing has come to our attention that causes us to believe that the Ageas 2013 Embedded Value Report is not properly prepared, in all material respects, in accordance with EEV principles.

The procedures selected depend on our understanding of the preparation of the Ageas 2013 Embedded Value Report, and other engagement circumstances, and our consideration of areas where material deviations to EEV principles are likely to arise. In developing our understanding of the Ageas 2013 Embedded Value Report, we developed an understanding of internal control over the preparation of the Ageas 2013 Embedded Value Report in order to design assurance procedures that are appropriate in the circumstances, but not for the purposes of expressing a conclusion as to the effectiveness of Ageas’s internal control over the preparation of the Ageas 2013 Embedded Value Report.

Our engagement also included:

- evaluating the appropriateness of the compilation process of the Ageas 2013 Embedded Value Report and the appropriateness of the methods, policies and procedures used as well as the determination process of the assumptions described on pages 13 to 19,
- verification of the consistent application of the methodology across Ageas. Furthermore we have performed analytical procedures on the results of the calculations of the embedded value as at 31 December 2013 and the 2013 movements.

Limited assurance is less than absolute assurance and reasonable assurance. Evidence-gathering procedures for a limited assurance engagement are more limited than for a reasonable assurance engagement and therefore less assurance is obtained than in a reasonable assurance engagement. We did not perform model validation procedures and/or reperformance of calculations to assess the reliability of the models involved, nor did we assess the completeness and correctness of the calculations in those models underlying the Ageas 2013 Embedded Value Report, that would have been performed if this were a reasonable assurance engagement.

As part of this engagement, we have not performed any procedures by way of audit or review of the Ageas 2013 Embedded Value Report nor of the underlying records or other sources from which the Ageas 2013 Embedded Value Report was extracted.

#### 6.4 Criteria

We refer to the section introduction for the principles, we have used for the basis for our conclusion.

#### 6.5 Conclusion

Our conclusion has been formed on the basis of, and is subject to, the matters outlined in this report. We believe that the evidence we have obtained is sufficient and appropriate to provide a basis for our conclusion.

Based on our procedures performed, described in this report, nothing has come to our attention that causes us to believe that the Ageas 2013 Embedded Value Report is not properly prepared, in all material respects, in accordance with the EEV principles.

#### 6.6 Other matters

We draw attention to chapter 5 of the Embedded Value Report, which indicates that the calculations underlying the Embedded Value Report are necessarily based on numerous assumptions with respect to economic conditions, operating conditions, political conditions and other matters with respect to future cash flows. Many of these are beyond the control of Ageas and actual cash flows in the future are likely to be different from those assumed in the calculation and such variation may be material.

Brussels, 18 March 2014

KPMG Réviseurs d'Entreprises/Bedrijfsrevisoren

Represented by  
M. Lange / O Macq

## Annex I: Components of embedded value

The components of the Embedded Value are:

Embedded Value (EV)	=	Value of Shareholder's Equity (VSE)	+	Value of In-Force Business (VIF)
Value of Shareholder's Equity (VSE)	=	Free Surplus (FS)	+	Required Equity (RE)
Value of In-Force Business (VIF)	=	Certainty Equivalent Value (PVFP)	-	Cost of Financial Options and Guarantees (CFOG)
			-	Cost of Non-Hedgeable Risks (CNHR)
			-	Frictional Costs of Capital (COC)

### 1 Value of Shareholder's Equity (VSE)

The Value of Shareholder's Equity equals the market value of the tangible assets backing Ageas's Life Equity including adjustments to ensure consistency with the calculation of the Value of In-Force Business. For example, unrealised capital gains that originate from assets backing the customer liabilities but appear on the IFRS balance sheet within shareholder equity are modeled within the Value of In-Force Business and therefore are deducted from the value of shareholder equity. Intangible assets such as VOBA and DAC are given no value because the Embedded Value they represent is valued explicitly within the Value of In-Force. See Section 2.1.6 for an overview of the reconciliation from IFRS to the Value of Shareholder's Equity.

The Value of Shareholder's Equity breaks down into two components, the Required Equity and Free Surplus.

#### 1.1 Required Equity (RE)

The operating business cannot exist without Ageas meeting a number of solvency capital requirements including local regulatory, rating agency and economic capital. Meeting these requirements necessitates locking in of a portion of the Shareholder Equity. This Required Equity represents the amount of Shareholder Equity that, in combination with other admissible capital items (such as subordinated liabilities) that are allowed to fund the overall capital needs, is required to meet the local solvency capital level.

All Ageas businesses must hold sufficient solvency capital to meet their local regulatory requirements and target a buffer above this to ensure they can withstand a range of adverse events. The level solvency capital is usually funded with a combination of Shareholder's Equity and other admissible capital items such as debt instruments. For Embedded Value reporting, the amount of Required Equity to meet the solvency capital level should only contain the Shareholder's part.

As capital and equity measures from various local regulatory regimes differ from a market consistent valuation framework, the translation to Required Capital for valuation purposes follows the subtraction method. The principle of this method is to assume that a surplus in local target capital is really free for distribution and that the remainder is needed to meet the solvency requirements and the amount of free capital should therefore be consistent in any framework. Therefore, by assuming a fixed amount of free surplus, any remaining amount of Shareholder's Equity should automatically be locked in for solvency requirements. It is possible that the Required Equity in the Embedded Value is lower than the Solvency I requirement.

This is the result of non Embedded Value elements that qualify as Solvency I Available Capital e.g. subordinated liabilities and components that are part of Value of In-Force Business under Embedded Value e.g. unrealized capital gains.

#### 1.2 Free Surplus (FS)

Free Surplus is the market value of assets allocated to the operating business over and above the amount required to support the operating business (i.e. the Required Equity) under the local regulatory regime.

### 2 Value of In-Force business (VIF)

The Value of In-Force business represents the value of assets and liabilities based on a market-consistent valuation approach. It reflects the risk-adjusted value of the expected cash flows emerging from the In-Force policies and is valued by deducting the market consistent value of liabilities from the market value of assets. The Value of In-Force represents the value of In-Force life insurance activities at the valuation date and excludes any value of business that is expected to be sold in the future.

## 2.1 Certainty Equivalent Value (PVFP)

Certainty Equivalent Value (Present Value of Future Profits) corresponds to the value of the business without taking credit for any future investment risk premiums and represents the value as if all cash flows are fixed and certain and all investment assets earn a return equal to the reference rate (risk free return), with the cash flows discounted at the same reference rate. This value captures the intrinsic value (or in-the-money value) of the financial options and guarantees. The reference rate is defined in section 4.6.1.

## 2.2 Cost of Financial Options and Guarantees (CFOG)

Cost of Financial Options and Guarantees (CFOG) represents the time value of financial options and guarantees. The CFOG places a value on the asymmetry of shareholder profits around the expected cost of financial options and guarantees embedded in the insurance cash flows. It is determined based on stochastic techniques. Due to the complex nature of options in insurance contracts, a range of economic scenarios are simulated to project cashflows. The CFOG is then calculated as the difference between the Certainty Equivalent Value and the value resulting from the cash flows under the different economic scenarios.

The contractual financial options and guarantees include guaranteed interest rates, profit sharing arrangements and minimum surrender and maturity benefits. Stochastic scenarios include management decisions that may vary under different scenarios, such as portfolio rebalancing and discretionary profit sharing. All material financial options and guarantees in the portfolio are accounted for in the Embedded Value.

## 2.3 Cost of Non-Hedgeable Risks (CNHR)

The Cost of Non-Hedgeable Risks is an allowance for risks that are currently not allowed for in the Cost of Financial Options and Guarantees, including those which cannot be hedged as a result of the absence of liquid and well developed markets for these risks.

While within a market consistent framework the financial risks arising from options and guarantees are addressed through the CFOG, an additional separate adjustment is necessary for all other risks. The CNHR is an explicit deduction to the Certainty Equivalent value to place a value on the uncertainty of shareholder profits around the expected insurance and non-hedgeable risks embedded in the insurance cash flows.

The CNHR is calculated based on an annual charge on a part of the solvency capital required to be held for these specific risks. This is structurally in-line with our understanding of the approach proposed for calculating the Market Value Margin under Solvency II.

The annual charge on the solvency capital held for these risks is calculated by a 0.5% post-tax charge of the projected total Required Equity each year.

## 2.4 Frictional Cost of Capital (CoC)

The Required Equity is the part of shareholders equity needed to support the life insurance activities. Since this part of Shareholders Equity is locked in and can only be released to the shareholder over time in line with the run-off of the business, the shareholder can only benefit via the investment yield earned on the investment assets backing the required equity and therefore pays both the tax costs on this investment yield as well as any investment expenses. The Frictional Cost of Capital represents the value lost through incurring these tax and investment expenses on the Required Equity.

The remaining part of Shareholder Equity, the Free Surplus, is assumed not to incur a cost of capital because it could in principle be released without constraint and therefore avoid additional tax and investment expenses.