Discovery

IFRS 17 INSURANCE CONTRACTS

Investor presentation

Notes to investors

Purpose

This investor presentation has been prepared to provide investors an overview of Discovery Group's transition from IFRS 4 to IFRS 17 in the measurement of Insurance Contracts. The presentation also sets out the key drivers for the transitional impact on the statement of financial position as at 1 July 2022.

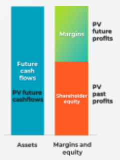
Information

In this communication, Discovery Limited ("Discovery"), its subsidiaries, and, where applicable its joint ventures and associates are referred to as Discovery. Unless otherwise noted, all amounts are in South African Rand.

The quantification disclosures are made on an unaudited basis and are the responsibility of the directors. The external audit verification of IFRS 17 information relating to prior reporting periods has not yet been concluded. Any forecast financial information contained in this announcement has not been reviewed or reported on by the Company's external auditors.

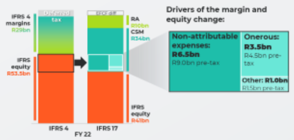
For the sake of convenience illustrations are presented by reference to a midpoint value, however here quantification should in all cases be interpreted as an indicative range until final audit sign-off is received.

Key messages



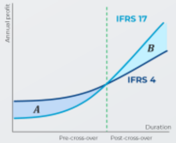
1

Value is largely unchanged



2

IFRS 17 margins increase by cR15bn with a concomitant cR12.5bn reduction in shareholder equity



3

Discovery's earnings is close to the cross-over point

4

Volatility of future earnings buffered by CSM and use of OCI

Most significant impact is on the long-term insurance lines

Main businesses	Impact resulting from IFRS 17	
Health	N/A	Not applicable
Life (Individual)		**Significant**
Life (Group)	≃	Minimal
Invest		**Significant**
Insure	≃	Minimal
Bank	N/A	Not applicable
VitalityHealth	≃	Minimal (but some impact regarding acquisition costs)
VitalityLife		**Significant**
VHI - Ping An Health Insurance	≃	Minimal (but some impact regarding acquisition costs)
Vitality Network	N/A	Not applicable
Vitality Health International	N/A	Not applicable

Discovery impacts across business lines

Short-term business lines

Life (Group) | Insure | VitalityHealth | VHI - PAHI

- Short-term business will apply the simplified measurement approach, Premium Allocation Approach (PAA)
- Immaterial impact on revenues, expenses and profit recognition profile
- Under IFRS 17, insurance acquisition cash flows are allocated to initial and renewal periods of insurance groups, i.e. DAC which amortises. The treatment of the DAC for VitalityHealth is similar to the existing FinRe treatment. IFRS 17 only includes the insurance acquisition cash flows considered directly attributable to the group of insurance contracts

Long-term business lines

Life | Invest | VitalityLife

- Full retrospective approach applied to all material groups of insurance contracts
- Combination of the General Measurement Model (GMM) and the Variable Fee Approach (VFA) on unit linked business has been applied
- Substantial CSM and risk adjustment at transition
- In the early years, the total amount of IFRS 17 profits relative to IFRS 4 profits is lower, and it gradually surpasses IFRS 4 profits as businesses mature
- Use of OCI for Life Insurance policies under the GMM provides protection to earnings of volatility of financial risks such as changes in interest rate, foreign currency rates and inflation assumptions

From this point forward, the focus will on the impact from long-term business lines as these have the most significant impact for Discovery.

Key messages | no change in the underlying value, but a change in timing

What doesn't change

No change in underlying value and of underlying economics

1. No direct change to **cash flows, underlying risk and reward** of contracts. Tax cash flow impact expected to be immaterial
2. No impact on **regulatory or economic solvency**, capital position and capital management
3. Immaterial impact on **Embedded Value**
4. **Ability to pay dividend** unaffected as cash flows and solvency remain unchanged

What does change

Accounting standard change that effects the timing of profit recognition

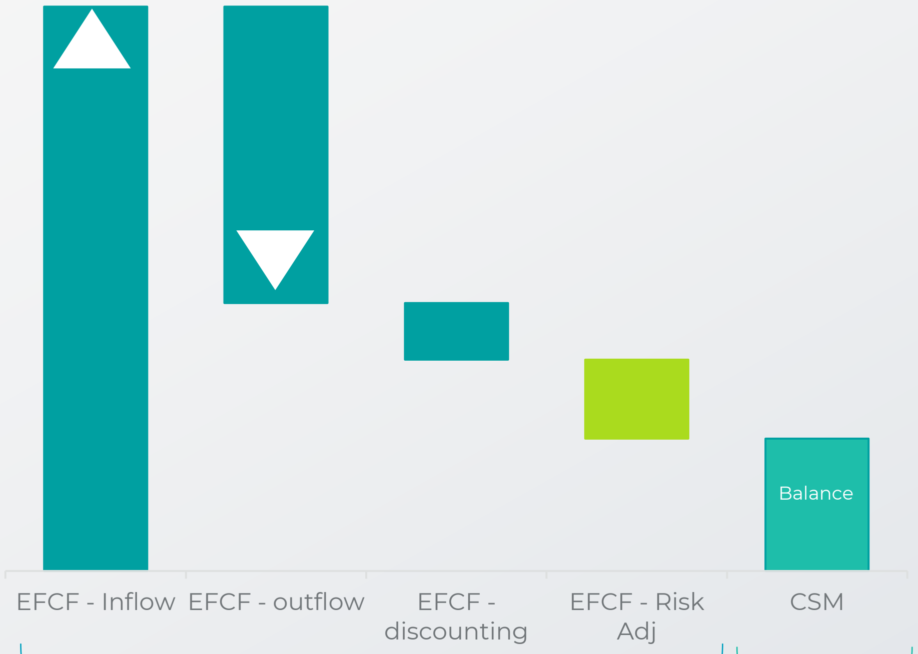
1. Total IFRS 17 **margins significantly strengthened, with a concomitant impact on shareholders equity**
   - Definition of directly attributable expenses
   - Contracts measured at more granular level
2. **Less volatile IFRS reported earnings**
   - Higher IFRS 17 margins protect earnings against non-economic experience variances
   - Use of OCI protects against volatility from economic variances and financial risk
3. **Future earnings profile**
   - Mature businesses of Discovery Life, Discovery Invest and VitalityHealth IFRS 17 earnings in near future exceed IFRS 4
   - New and rapidly growing VitalityLife earnings further away from crossing over IFRS 4 profile

01

INTRODUCTION TO IFRS 17

Long-term insurance measurement model (1/3)

General Measurement Model (GMM) - overview



Insurance contracts = Present value of expected fulfilment cash flows + Unearned profit

Under IFRS 17, Insurance Contracts are measured as the sum of:

The expected fulfilment cash flows (EFCF) – representing the present value of current estimates of amounts that the insurer expects to collect from premiums and net of pay out for claims, benefits and directly-attributable expenses, including an adjustment for the risk of those cash flows.

+

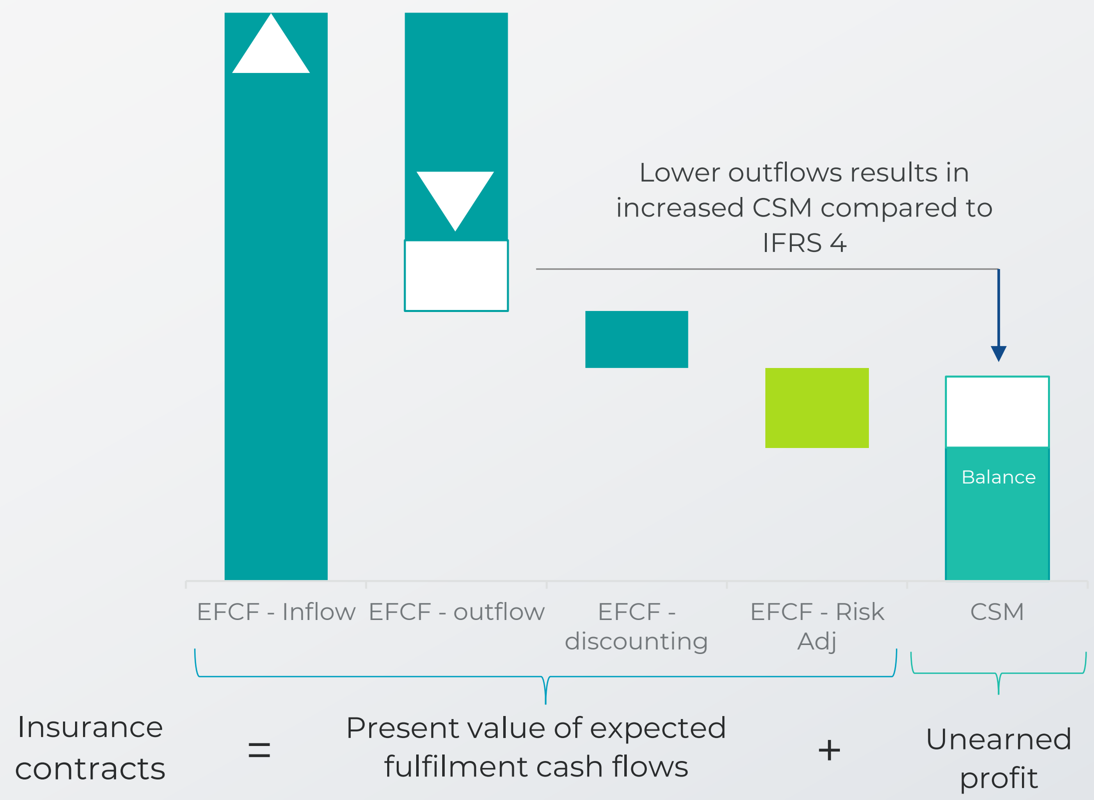
The contractual service margin (CSM) – unearned profit for providing future insurance coverage.
On initial recognition, for profitable contract, the CSM is the equal and opposite amount of the net cash inflow, resulting in no income or expense arising on initial recognition.

Drivers of CSM on initial recognition

1. Cash in- and outflows
2. Rate of discounting
3. Confidence level of risk adjustment for non-financial risk (Discovery long-term confidence level at 90%)

Long-term insurance measurement model (2/3)

General Measurement Model (GMM) – impact of non-directly attributable expenses

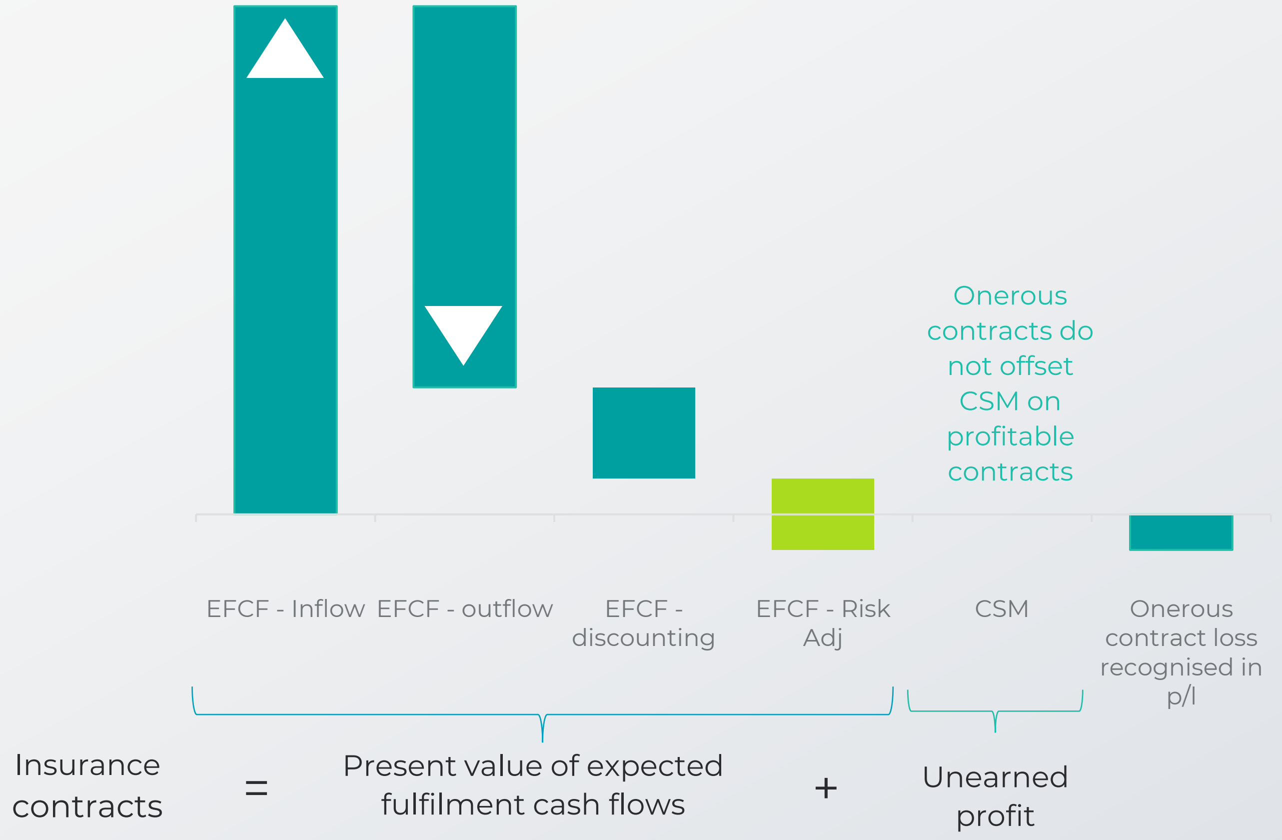


Under IFRS 17 non-directly attributable costs are immediately expensed

This results in an increase in CSM on initial recognition of contracts relative to IFRS 4.

Long-term insurance measurement model (3/3)

General Measurement Model (GMM) – impact of onerous business



Under IFRS 17 losses on onerous contracts are immediately recognised in p/l

CSM on profitable business is not encumbered by the immediate recognition of the loss on onerous contracts. Relative to IFRS 4 this results in a higher overall margin

IFRS 17 presentation of Insurance performance

INSURANCE PROFIT OR LOSS = INSURANCE SERVICE RESULT + FINANCIAL RESULT

INSURANCE SERVICE RESULT

Depicts the profit earned from providing insurance coverage

Primarily relates to:

- Release of the CSM
- Release of the RA
- Increases in losses on onerous contracts
- In-period experience variances

FINANCIAL RESULT

The Insurance Finance Income or Expense (IFIE) reflects the effects of financial variables such as discount rates and inflation assumptions on the value of insurance rights and obligations.

Accounting policy election to present IFIE:

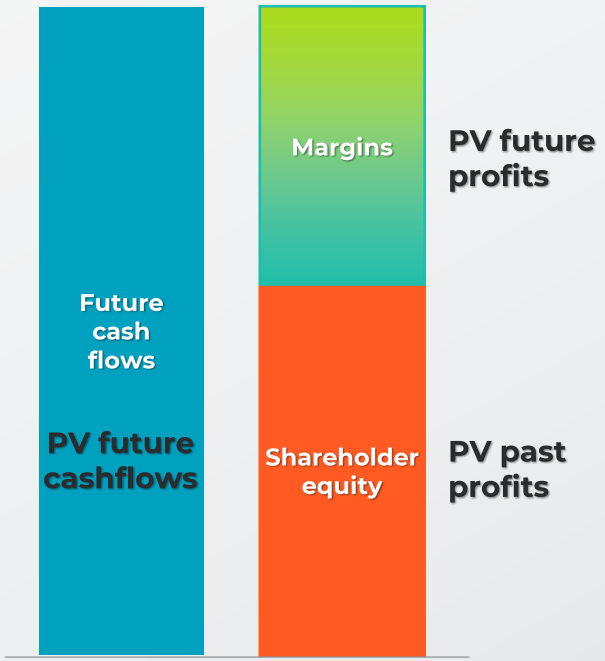
- Alternative 1: Present all changes in p/l
- Alternative 2: Present IFIE using systematic allocation in p/l, with the difference in OCI

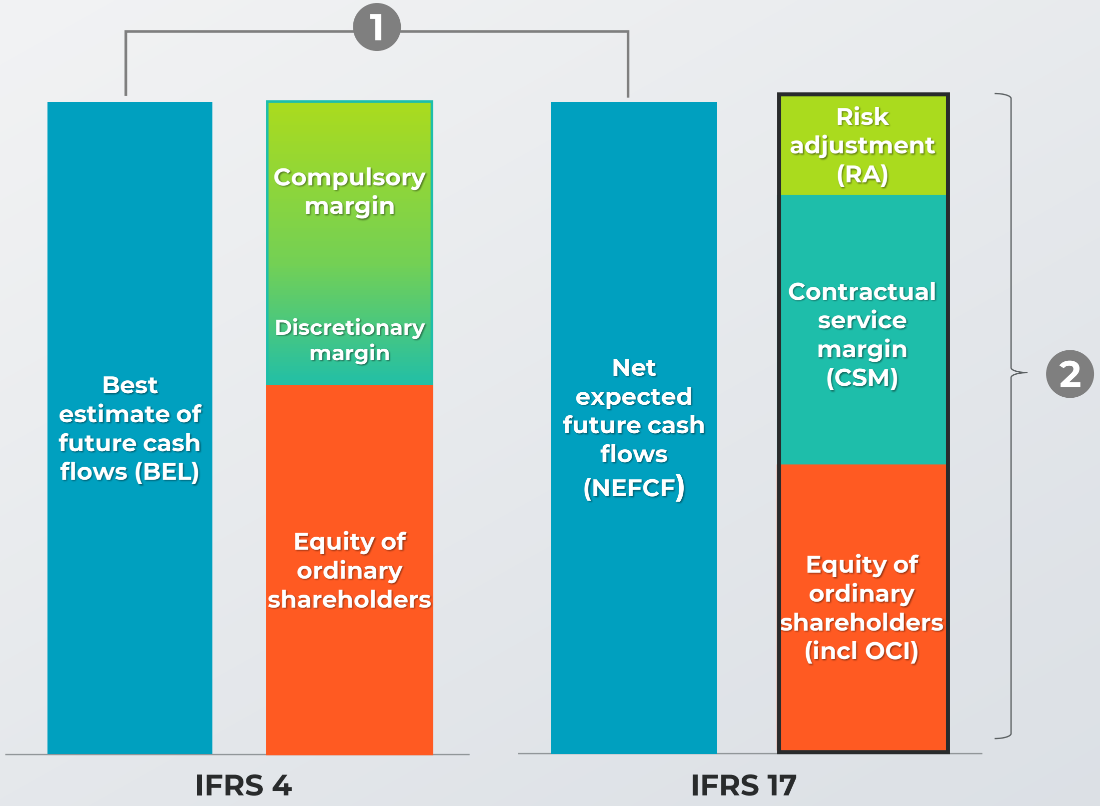
Value unchanged but reallocated

Components of long-term insurance contract assets and liabilities

Three conceptual value drivers

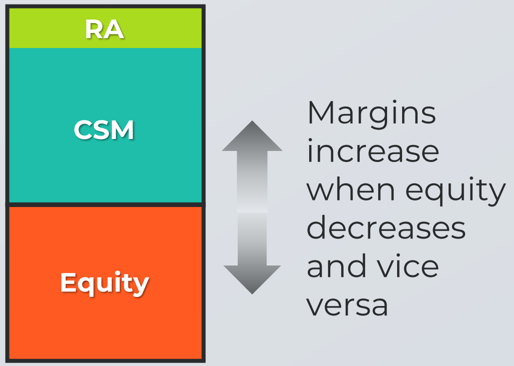
Total value the same but reallocated





1 **BEL is similar to NEFCF**

2 **Total value the same meaning that value shifts between equity and margins**

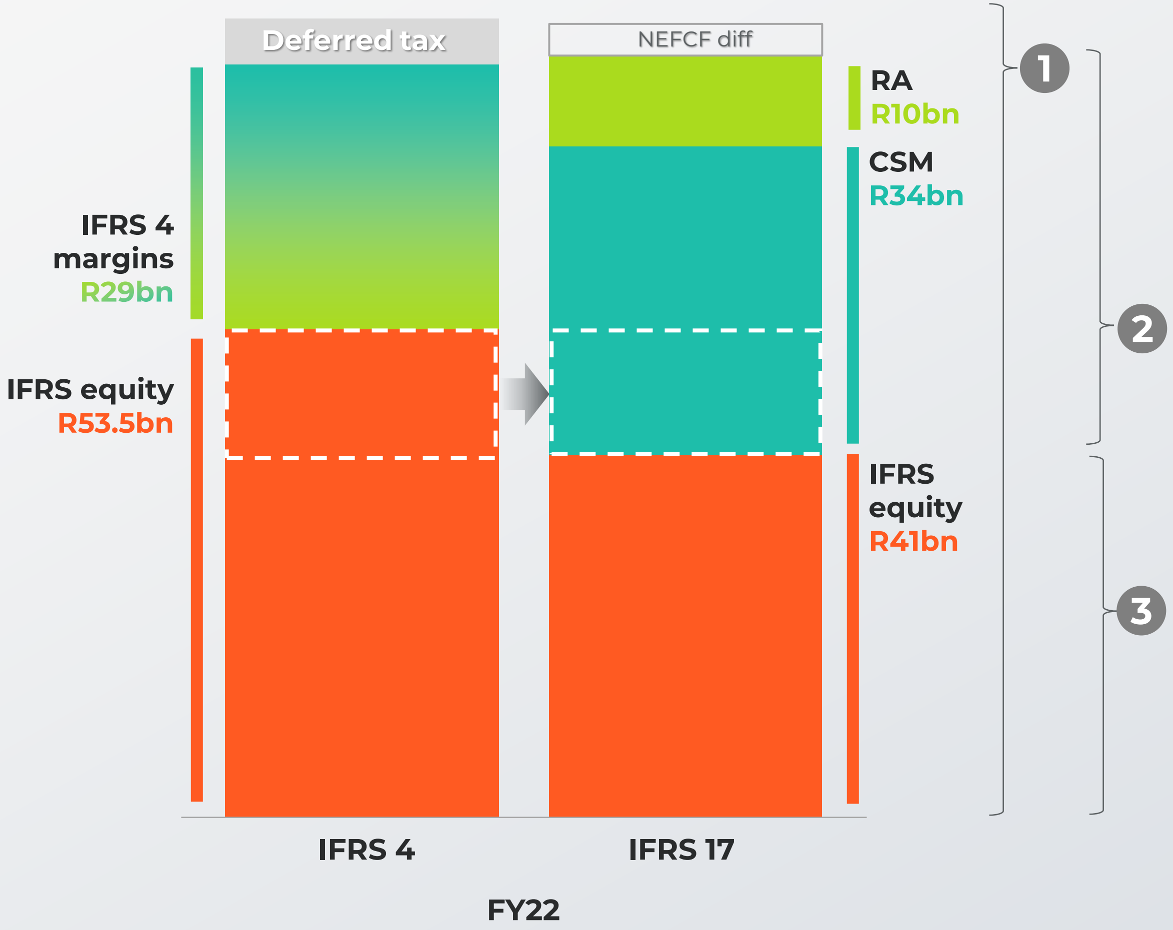


02

IMPACT OF TRANSITION ON DISCOVERY

Value unchanged but reallocated

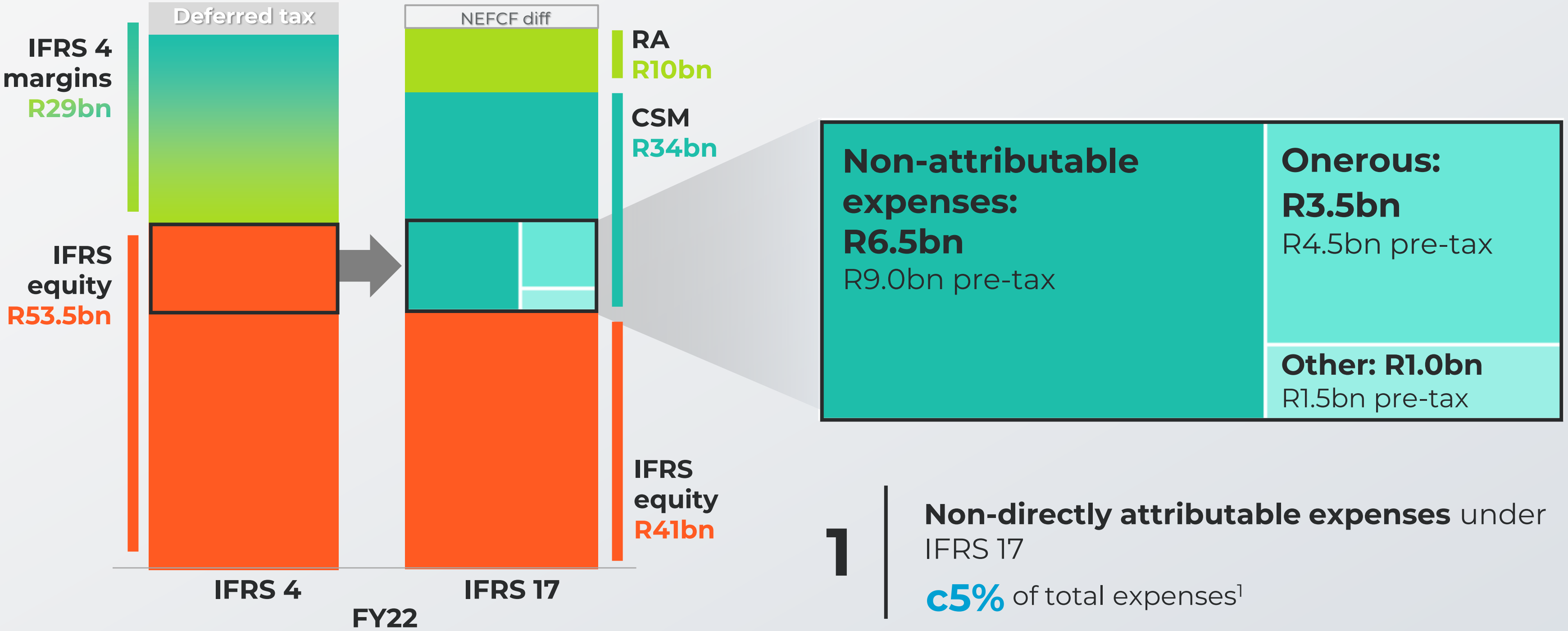
Fully retrospective approach over 20 years – comparison of total value at transition on 1 July 2022



1. **Total value largely unchanged**
2. **Total margins strengthened by cR15bn** as at 1 July 2022
3. **Strengthening of margins with a concomitant reduction in equity** in the range of R12bn-13bn (R12.5bn used in the illustration)

Full retrospective approach over 20 years

Drivers of the margin and equity change



Total value largely unchanged

Total margins strengthened by cR15bn as at 1 July 2022

Strengthening of margins with a concomitant reduction of equity in range of R12bn to R13bn

(R12.5bn used in the illustration)

1. **Non-directly attributable expenses** under IFRS 17
   c5% of total expenses[1]

2. **Cohorting and onerous contracts:** immediate expensing of loss making (onerous) contracts under IFRS 17
   c9% onerous[2]

3. **Other**: impacts incl. different treatment of basis changes and discount rates through the margin under IFRS 17

1 Proportion of FY22 non-directly attributable expenses to the total Discovery marketing and administration and acquisition costs for insurance business lines in FY22
2 Proportion of FY22 portfolio that is onerous

R6.5bn

(R9.0bn pre-tax) Cumulative impact over 20+ years

1. Non-directly attributable expenses under IFRS 17

Rationale

Under IFRS 4, Discovery established margin to ensure no upfront recognition of profits on day one at a portfolio level. Margin is therefore directly impacted by level of expenses included.

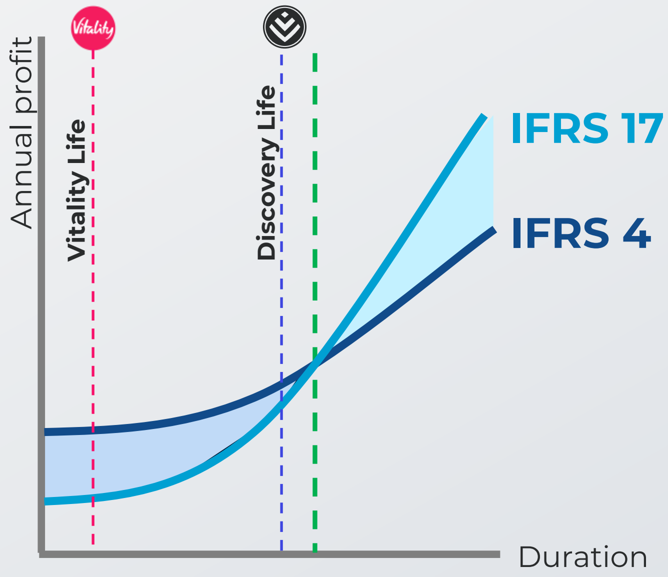
IFRS 17 deems certain expenses not directly attributable and immediately expensed (not offset by margins):

- Non-specific marketing and sponsorships
- Certain allocated Group Executive and Group Functions
- Research and development activities of new products
- Corporate initiatives

c5%

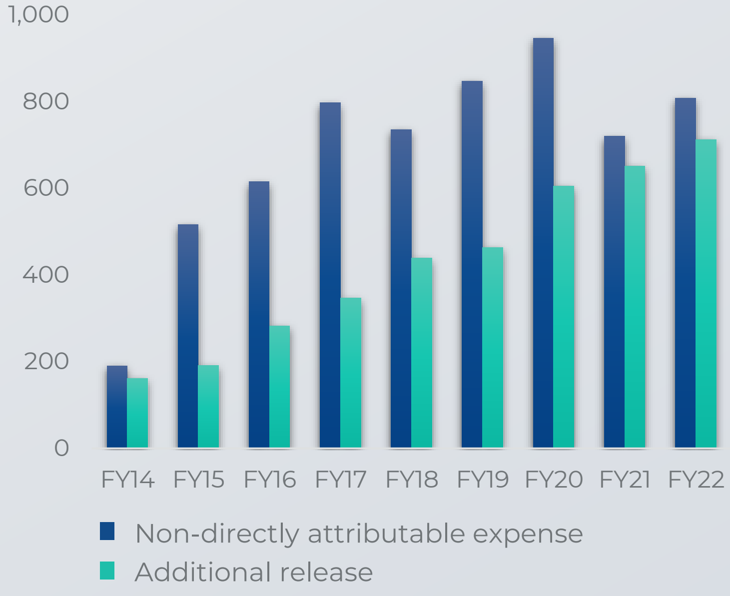
FY22 proportion of non-directly attributable expenses to the total Discovery marketing, administration and acquisition costs for insurance business lines

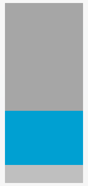
Group is close to cross-over



Release close to exceeding annual non-directly attributable expenses

Non-directly attributable expenses over time against the additional reserve release (Rm)





R3.5bn
(R4.5bn pre-tax)
Cumulative impact over 20+ years

2. Cohorting business and recognising onerous contracts separately under IFRS 17

Explanation

Under IFRS 4 onerous contracts reduced overall future margins of profitable contracts within portfolio.

Under IFRS 17 onerous contracts immediately expensed, thereby preserving margins on profitable contracts.

The split of in-force business at FY22:

91% of groups profitable

9% of groups onerous

Under IFRS 17 onerous contracts have an immediate profit or loss impact instead of a margin impact

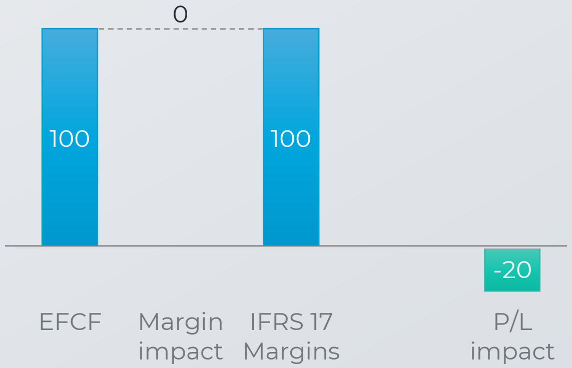
IFRS 4

Margin impact

Onerous contracts **reduced overall future profits on profitable contracts within portfolio**

IFRS 17

P/L impact



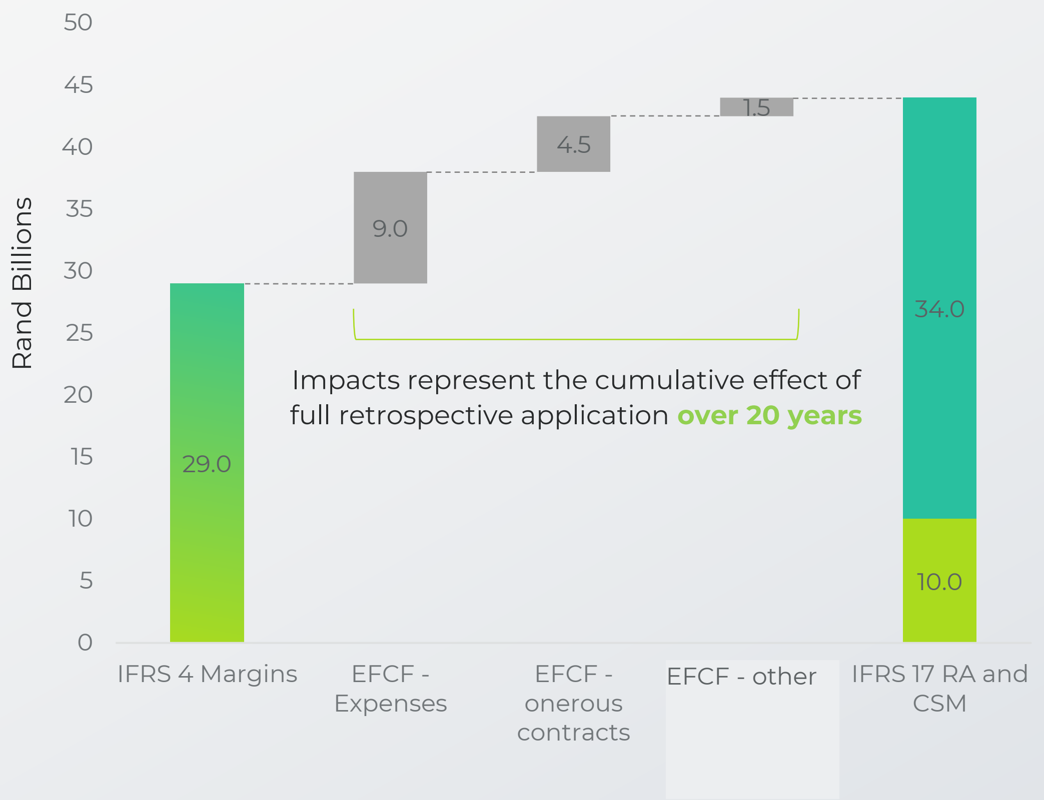
Onerous contracts **immediately expensed,** thereby **increasing future profits on profitable contracts**

It's important to understand that **onerous contracts are not necessarily unprofitable throughout their lifespan; most of them are expected to be profitable but may not fully cover the conservative risk adjustment at initial recognition.**

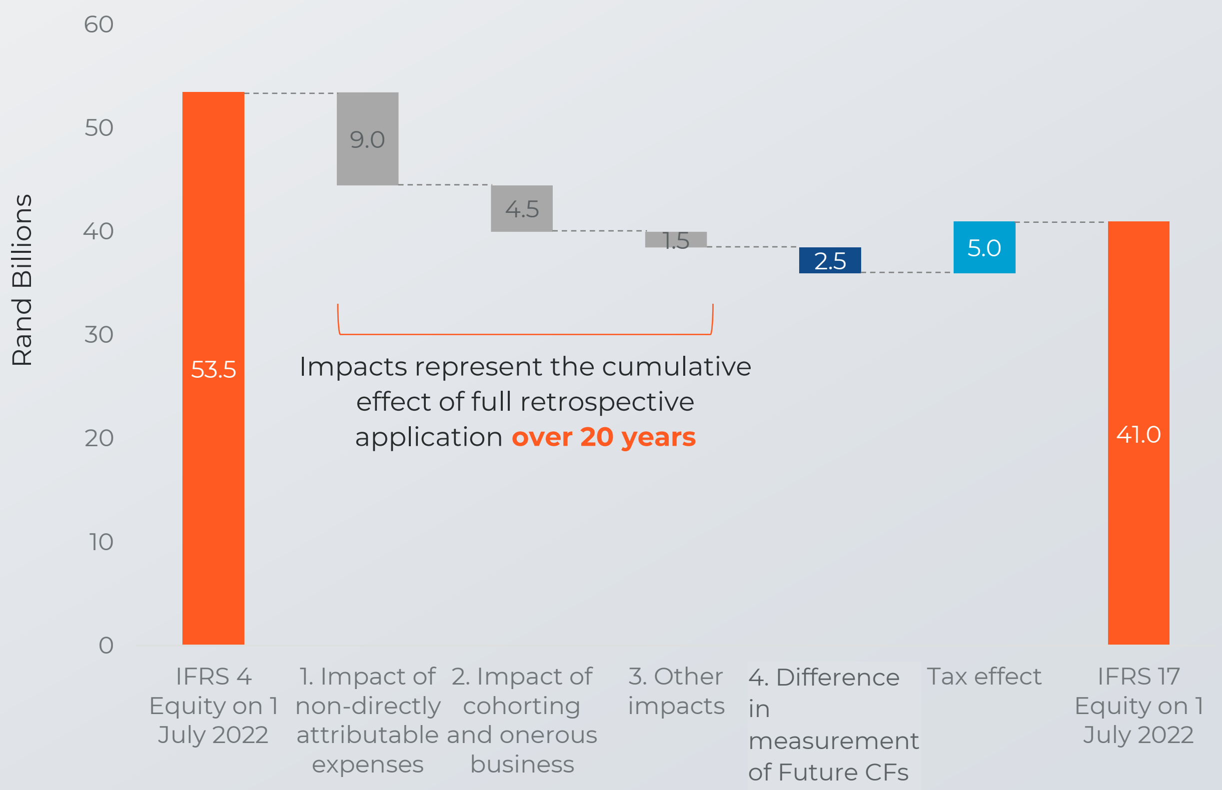
Strengthened margin with a concomitant reduction in equity

Cumulative impact over 20 years of full retrospective consideration of IFRS 17

Strengthened margin on transition



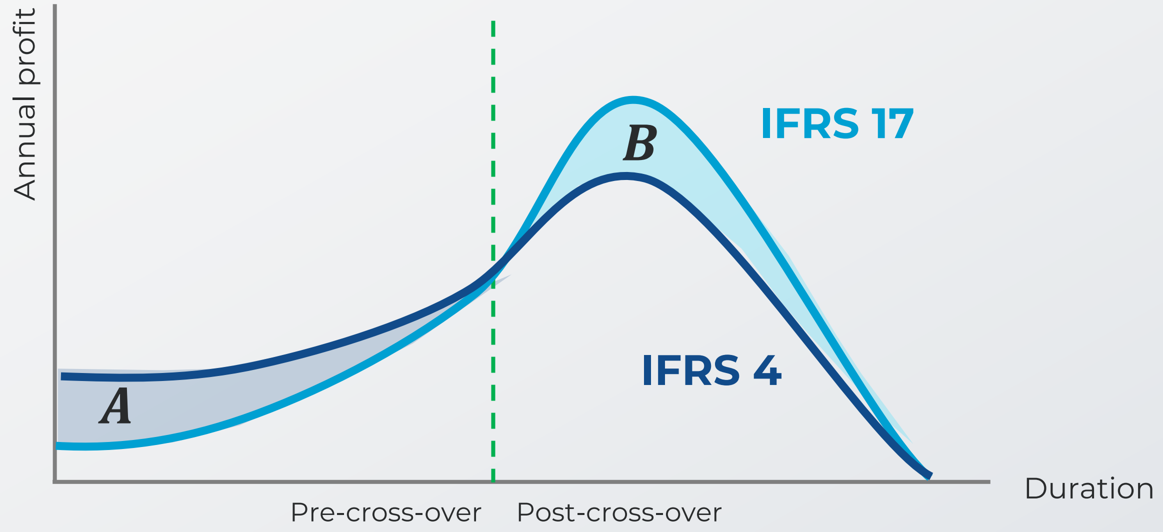
With a concomitant reduction in equity



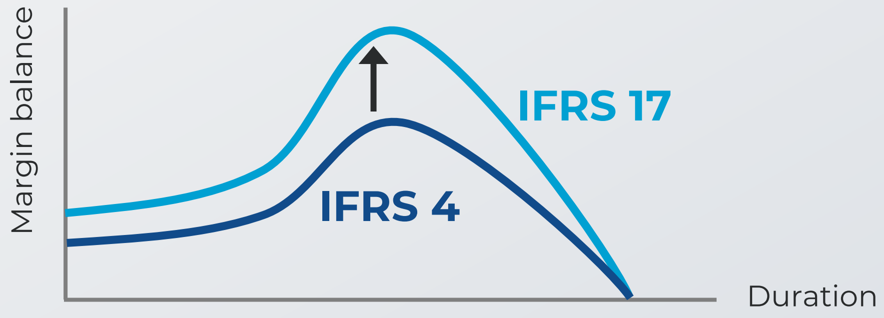
Discovery's dynamics between margins and equity

Simplified illustration for a cohort

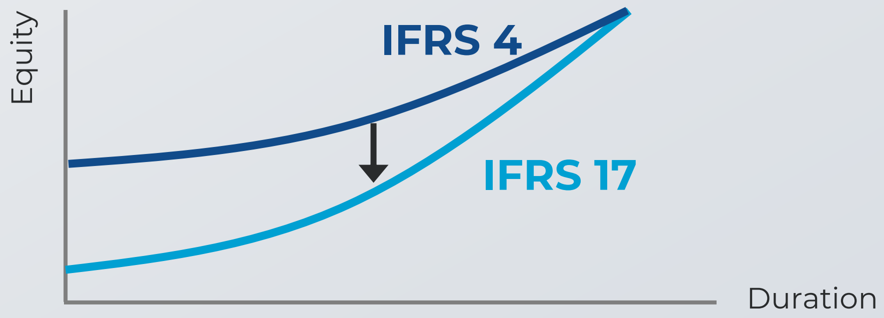
Earnings



Margin



Shareholder equity



At cross-over:

- Annual earnings of IFRS 4 and IFRS 17 are the same
- Margin release under IFRS 17 becomes higher than under IFRS 4
- Difference in equity between IFRS 17 and IFRS 4 starts closing

Insurance finance income and expense

Understanding the operation of OCI for Discovery (1/2)

Insurance finance income and expense (IFIE)

=

Effect of and changes in time value of money

+

Effect of and changes in financial risks (inflation + forex)

Change in financial assumptions affect valuation of insurance contracts

This change in valuation is recognised in full in the period of the change

Treatment introduces volatility where the change is not offset by equal and opposite change in valuation of financial or other assets

Accounting policy choice

1. All changes in IFIE immediately in profit or loss

OR

2. Changes in OCI & reclassify in profit or loss using systematic allocation over life of the contract

Insurance finance income and expense (IFIE)

Understanding the operation of OCI for Discovery (2/2)

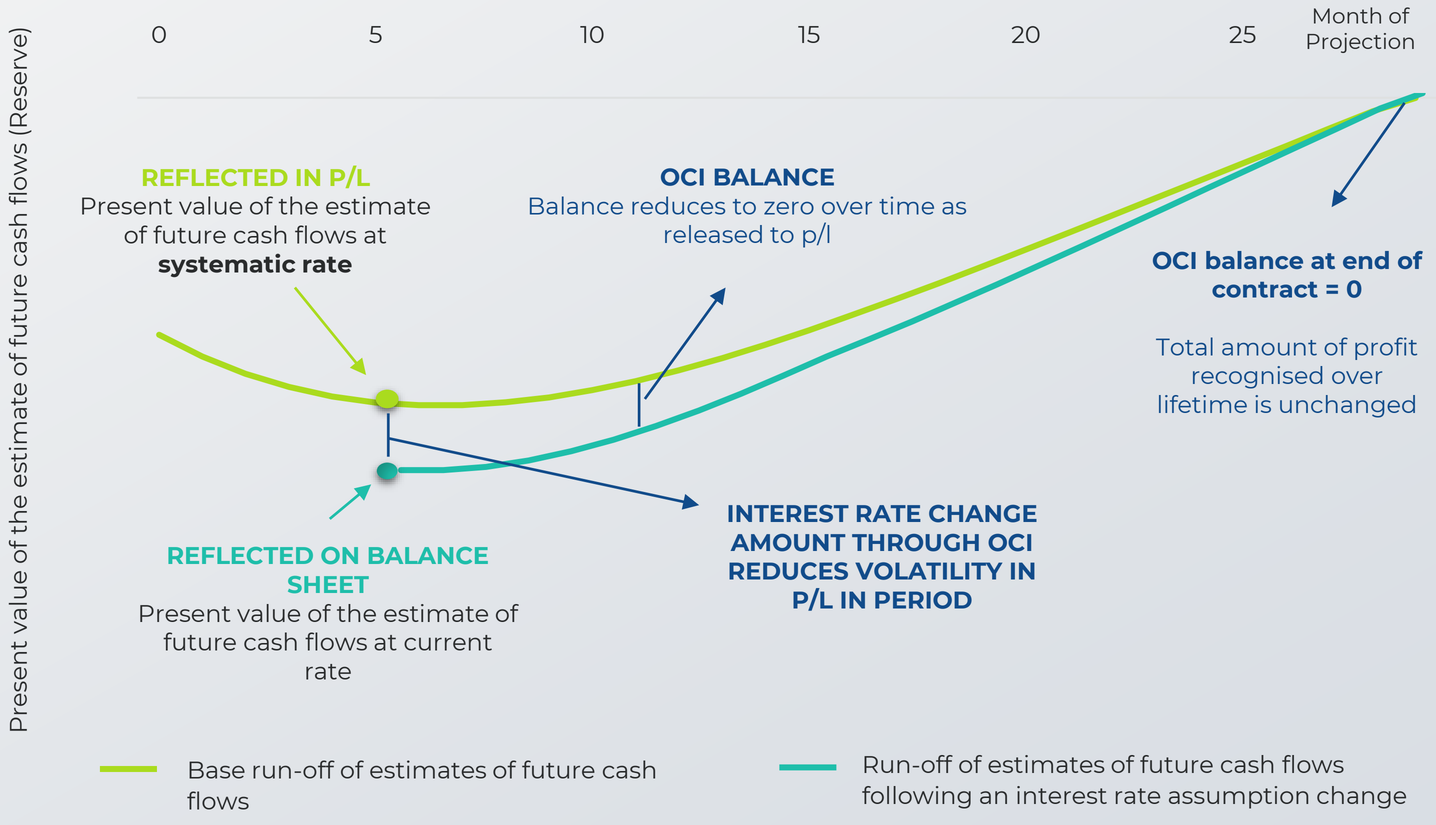
OCI will reduce the volatility of the IFRS earnings

The OCI balance adjusts each period for the following:

1. The impact of a change in either the nominal or real yield curve assumption
2. The impact of in-period variances in inflation relative to assumptions
3. The difference in measurement of variances, model and basis changes at initial recognition rates and current rates
4. The difference in interest accretion of the components of the carrying value of the insurance contract liability measured on the balance sheet and on the statement of profit or loss

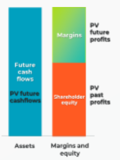
Example operation of the OCI following an interest rate assumption change

Runoff of the present value of estimates of future cash flows

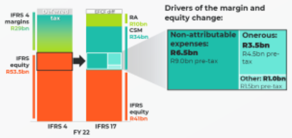


Key messages

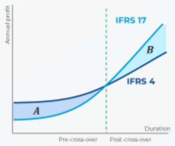
On transition to IFRS 17:



The value stays largely the same



IFRS 17 margins increase by cR15bn (gross of tax) with a concomitant reduction in shareholder equity ofcR12.5bn (net of tax).



Since Discovery on transition to IFRS 17 is close to the cross-over point, earnings should within the short term be at the same level as under IFRS 4, but should grow more strongly with the release of the additional margin over time

Future earnings should be less volatile due to additional CSM - buffering against basis changes for non-economic variances and a more stable release of profits. The use of OCI also buffers against basis changes for economic variances and reclassifies to profit or loss on systematic variances

APPENDIX

Timing of market communications

Feb 2023

Interim FY2023

Key observations and directional impact

Year-end 30 June 2023 **(IFRS 4 reporting)**

Mid-Sept 2023

Investor presentation

- Unaudited expected impact
- Overview of IFRS 17, comparison to IFRS 4, key elections
- Directional steering

21 Sept 2023

FY2023 results

IAS 8 disclosures for new standards not yet effective

Interim 31 December 2023 **(IFRS 17 reporting)**

Feb 2024

Interim FY2024

- H1FY2024 IFRS 17 with H1FY2023 comparatives (restated IFRS 17)
- FY2023 (restated IFRS 17)

Year-end 30 June 2024 **(IFRS 17 reporting)**

Sept 2024

FY2024 results

FY2024 IFRS 17 with IFRS 17 comparatives

PwC & KPMG (June 2023 year-end) and KPMG & Deloitte (post July 2023) are external auditors on IFRS 17 transition position, policies and methodologies

Glossary

Abbreviation	Meaning
CSM	Contractual Service Margin
DAC	Deferred Acquisition Costs
EFCF	Expected Fulfilment Cash Flows
FINANCIAL RISK	The risk of a possible future change in one or more of a specified interest rate, financial instrument price, commodity price, currency exchange rate, index of prices or rates, credit rating or credit index or other variable, provided in the case of a non-financial variable that the variable is not specific to a party to the contract
GMM	General Measurement Model
IACF	Initial Acquisition Cash Flows
IFIE	Insurance finance income and expense comprises the change in the carrying amount of the group of insurance contracts arising from: • the effect of the time value of money and changes in the time value of money, and • the effect of financial risk and changes in financial risk
IFRS 17 margins	IFRS 17 margins refers to the contractual service margin plus the risk adjustment
ISE	Insurance Service Expenses
LIC	Liability for Incurred Claims
NEFCF	Net expected future cash flows
LRC	Liability for Remaining Coverage
OCI	Other Comprehensive Income
PAA	Premium Allocation Approach
PAHI	Ping An Health Insurance
P/L	Profit or loss (Income statement)
RA	Risk adjustment
VFA	Variable Fee Approach

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