IFRS GUIDE

MAPFRE

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1. EU-IFRS 17

EU-IFRS 17 "Insurance Contracts", which will substitute the current EU-IFRS 4 "Insurance Contracts", will be applicable to annual periods starting January 1, 2023.

The 2023 consolidated annual accounts will be presented following this new standard, including restated comparative information from 2022, recording in the transition reserve any valuation differences between the two standards.

The EU-IFRS 17 "Insurance Contracts" and EU-IFRS 9 "Financial Instruments" requires the company to revise its accounting processes and internal controls, which MAPFRE Group has already been working on in recent years, and is currently in the final stages of the assessment and verification of the new controls and systems implemented.

This guide includes the most relevant judgements and estimates used to date, considering that the new standard allows for certain accounting elections, which MAPFRE Group is finalizing reviews of, and which can affect transition impacts.

In the following pages you will find a breakdown of the transition methods that will be used and the valuation standards that will be applied to insurance and reinsurance contracts.

1.1 TRANSITION

MAPFRE Group will use a retrospective approach for the majority of Non-Life insurance contracts as well as Life insurance contracts with a duration of less than one year, and those in which, although duration is greater than one year, it is not expected that the assessment varies materially from the building block approach (BBA). To this end:

- All contract groups have been identified, recognized, and measured as if EU-IFRS 17 had always been applicable.

- Any items recorded in the financial statements which would not exist if EU-IFRS 17 had always been applicable have been derecognized, and

- Any net difference that could arise is recorded in equity.

Additionally, the fair value approach will be used for those Non-Life and Life insurance contracts, as well as accepted and retroceded reinsurance contracts, for which the retrospective approach is impracticable. The fair value approach considers the determination of the Contractual Service Margin (hereinafter CSM) or the loss component at the date of the transition for a contract group based on the difference between the fair value and the fulfillment cash flows for the group of contracts at that date. The Group measures fair value of the insurance contracts as the sum of the present value of IFRS 17 fulfillment cash flows adjusted to reflect the perspective of a market participant, plus an additional margin that a market participant would require to provide coverage.

MAPFRE is making use of the optional exemption to not apply the requirement to group annual cohorts for certain insurance products sold in Spain. These include those products which, for solvency purposes, use the matching adjustment, and insurance contract groups with direct participation features measured using the variable fee approach (hereinafter VFA).

Further, the Group will provide, in both Life business measured using the BBA in Spain and insurance contracts with direct participation components (VFA), a breakdown of financial revenue and expenses from insurance, retroactively in net equity when relevant.

1.2 VALUATION APPROACHES FOR INSURANCE CONTRACTS

EU-IFRS 17, fulfilling its purpose of homogenizing international insurance accounting practices, includes three valuation approaches for insurance contracts:

- General Assessment Approach (Building Block Approach, BBA), default approach.
- Variable Fee Approach (VFA)
- Premium Allocation Approach (PAA)

MAPFRE Group, based on technically defined directives, will assess insurance and reinsurance contracts as follows:

Insurance contracts	
Life and Non-Life lines with duration of less than one year *	PAA
Burial line	BBA
Life contracts with duration greater than one year	BBA
Contracts with a direct participation component (i.e. Unit Linked, some Life products with profit-sharing)	VFA
Reinsurance contracts	
Ceded	PAA
Accepted	PAA/ BBA
Retroceded	BBA

*Non-Life contracts with duration greater than one year but with no material difference from the BBA expected will also be measured using the PAA.

Given the composition of the Group portfolio, the PAA will be used for products that represent approximately 70 percent of premiums.

When assessing insurance and reinsurance contract groups, all future cash flows falling within the boundary of each contract in the group will be included.

A substantive obligation to provide services will be considered to be over when:

- The company has the practical ability to reassess the risks of the particular policyholder and, as a result, can set a price or level of earnings that fully reflects these risks; or

- The company has the practical ability to reassess the risks of the portfolio of insurance contracts that contain the contract and, as a result, can set a price or level of earnings that fully reflects the risk of that portfolio. This repricing shall not take into account the risks that relate to periods after the reassessment date.

EU-IFRS 17 establishes that if a group of contracts is estimated to generate losses, these must be fully recognized on the income statement as soon as this is known.

The following is an explanation of the valuation methods established by the standard:

I. Building Block Approach (BBA)

The amount recognized on the balance sheet for each insurance/reinsurance contract group valued using this method comprises the liability for remaining coverage (LFRC) and the liability for incurred claims (LFIC). The liability for remaining coverage includes cash flows from allocated future service obligations and the CSM.

All future cash flows are included in the valuation of a group of insurance contracts, using the current information to make estimates for these flows, as well as discount rates and non-financial risk adjustment.

The liability for incurred claims comprises those fulfillment cash flows coming from claims incurred but not paid. Claims incurred but not reported will also be included. These flows are adjusted for the time value of money and the financial risk effect. The adjustment for non-financial risk is also included in this liability for incurred claims. Under this approach, insurance contract groups are valued at their initial recognition as the total of:

A. Fulfillment cash flows, which include:

- Expected future cash flows that will arise over the length of the contract.
- An adjustment to reflect the time value of money and other financial risks related to future cash flows where the financial risks have not been included in the future cash flow estimates.

- An explicit risk adjustment for non-financial risk

B. Contractual Service Margin (CSM)

The CSM is a component of the liability or asset or liability for the group of insurance or reinsurance contracts that represents the unearned profit they will be recognized as services are provided in the future. The accrued part of the CSM is recognized as Insurance revenue in each period to reflect the services provided.

At the end of each period, the CSM is the amount recorded at the beginning of the year, adjusted for:

- The effect of new contracts added.
- The interests accredited to the CSM, calculated according to the discount rates determined at the date of initial recognition.
- The changes in fulfillment cash flows where the change is related to future services, unless the change comes from a change in fulfillment cash flows assigned to a group of underlying insurance contracts that does not affect the CSM.
- The impact of currency differences on the CSM.
- The amount recognized in the result for the period due to the services provided in the period.

The general criteria for releasing CSM will be based primarily on insured services, depending on the product type, considering that the method reflects insurance coverage provided in each period. The amount of services expected for policyholders at each moment depending on the different levels of coverage will be considered for this.

II. Variable Fee Approach (VFA)

The VFA will be required to be applied for those contracts that meet the criteria of contracts with direct participation features.

The MAPFRE Group criteria to classify an insurance contract as having direct participation is the following:

- The contract clauses specify that the policyholder participates in a combination of clearly identified underlying elements, i.e. when the contractual terms and conditions (including both explicit and implicit contract terms) specify a clearly identifiable combination of underlying elements.

  In the Transition portfolio this requirement will be considered to be met if, though the investment portfolio information or the associated underlying elements are not initially recognized in the conditions, the company has been providing the Policyholders with said information prior to the Transition (bond, information o allocated assets) or keeps the investment and management information of the different managed portfolios, and their corresponding volume of associated liabilities, identified.

- The company expects to pay the policyholder an amount equal to a substantial part of the fair value yield of the underlying elements. It establishes that participation percentages of greater than 80 percent in the underlying assets at fair value transfer a substantial part of the return to be paid to the policyholder.

- The company expects, in the initial recognition, that a substantial part of any change in the amounts to be paid to the policyholder varies with the change in fair value of the underlying elements.

As a result, MAPFRE Group will use the VFA to measure Unit-Linked, products “with profit” sold in Malta and traditional products with profit-sharing sold in Spain.

Under this valuation approach, changes in obligations to pay the policyholder an amount equal to the fair value of the underlying elements are not related to future service and do not impact the CSM. However, changes in Group participation in the fair value of the underlying elements is related to future service and therefore impact the CSM.

Contractual Service Margin (CSM)

As mentioned, the CSM will be a significant component of the liability of those contracts valued using the BBA and VFA, and it will represent the expected earnings from those contracts which will be released on the P&L as insurance services are provided.

III. Premium Allocation Approach (PAA)

The Premium Allocation Approach is used to measure the liability for remaining coverage for those contract groups in which the period of coverage of each contract is one year or less, or in those contracts with a coverage period greater than one year, in which this simplification is not initially expected to vary materially from the BBA. The liability for incurred claims will be calculated including all those future fulfillment cash flows related to claims that are incurred but not yet paid, using the discount rates and the adjustment for non-financial risk.

In the initial recognition, the asset/liability for remaining coverage will consist of:

- Premiums received in the initial recognition.
- Minus the insurance acquisition cash flows at that date.

- Plus, or minus the amount arising from cancelling in the accounts at that date the asset or liability recognized for those insurance acquisition cash flows.

The Group has opted to not recognize insurance acquisition cash flows as expenses when they occur, as these have been included in the valuation of the liability for remaining coverage.

Given the composition of the Group portfolio, the majority of the insurance contracts (70 percent of the premiums, approximately) are valued using this method. However, as this is the method that is the most similar to the current EU-IFRS 4, there will not be a material equity impact on the first application.

Initially, as well as over the contract coverage period, an evaluation will be carried out to determine if there are facts and circumstances indicating that said contracts generate losses. A contract group is considered to be loss-making when the fulfillment cash flows exceed the book value. In these cases, a loss is recognized in the result for the year and the liability is increased for the remaining coverage, which will be amortized over the course of the contracts' effective period.

1.3 VALUATION OF CEDED AND RETROCEDED REINSURANCE CONTRACTS

The PAA has been used to assess the value of ceded reinsurance contract groups, and the BBA, the general method, is used for retroceded reinsurance. The hypotheses used to estimate the present value of future cash flows for these contracts on congruent with the assumptions used to estimate the present value of future cash flows for underlying insurance contract groups, including the effect of any default risk and also the effects of possible collateral guarantees and losses from litigation.

In the initial retroceded reinsurance contract recognition, an asset or liability is recognized for the CSM or the recovery of the loss component, respectively, based on whether this is expected to generate losses or earnings.

1.4 INSURANCE REVENUE

Revenue from ordinary insurance activity includes amounts related with changes in the liability for remaining coverage and the allocation of the part of the premium that is related to recovering insurance acquisition cash flows.

On the other hand, insurance service expenses include claims and other incurred insurance service expenses, the amortization of insurance acquisition cash flows, changes related to past services (i.e. changes in cash flows related to the liability for incurred claims); and losses on groups of contracts and reversals of such losses.

The loss component corresponds to those losses attributable to each group of contracts - both those that are onerous at the initial recognition as well as those that become onerous subsequently.

The loss component is released based on the systemic allocation of fulfillment cash flows. Further, it is updated for subsequent changes in estimates for fulfillment cash flows related to future services.

Ordinary insurance revenue and insurance service expenses exclude any investment component, with the amounts that an insurance contract requires a policyholder be reimbursed if there is no insured event being understand as such.

1.5 FINANCIAL RESULT FROM INSURANCE

Insurance financial expenses and income comprise changes in the book value of insurance contract groups that arise from the effect of the time value of money and changes thereof; and from the effect of financial risk and changes thereof, excluding any change for groups of contracts with direct participation component that would adjust the CSM but do not in the circumstances included in the expenses for insurance services.

In the recognition of financial expenses and income from insurance contracts that arise as a result of a change in the discount rate, (both from the effect of the time value of money and changes thereof as well as the effect of financial risk and changes thereof), the criteria adopted by MAPFRE Group is the following:

- For product portfolios valued using the simplified method (PAA), including reinsurance portfolios, the accounting policy of not disaggregating between OCI and P&L will be used. Similarly, this option will be used for some products valued using the VFA, like Unit-Linked.

- For product portfolios valued using the general method (BBA), including reinsurance portfolios, the accounting policy of disaggregating between OCI and the annual income statement will be chosen. Similarly, some contracts valued using the VFA will also opt to disaggregate.

On the other hand, the Group has chosen to disaggregate changes in the risk adjustment between financial and non-financial risk, so that the change in value from the risk adjustment resulting from the effect of the time value of money and changes thereof is recorded as financial result from insurance.

1.6 DISCOUNT RATE

Estimated cash flows are discounted at a risk-free curve, adjusted, in the case of business valued under BBA or VFA, to include characteristics of the liability cash flows and the referenced investments and liabilities that cover them

To this end, the Group prefers a "Top Down" approach to determine a spread between reference portfolios of assets and the corresponding risk-free curves. In a first step, these spreads will adjust to eliminate credit risk, much in the same way as the Solvency II volatility adjustment. In a later step, an adjustment is made to reflect the differences between the characteristics of the insurance contracts and the reference portfolios of assets.

In the recognition of financial expenses and revenue from insurance contracts that arise as a result of a change in the discount rate (both from the effect of the time value of money and changes thereof as well as the effect of financial risk and changes thereof), the standard allows the option of:

- Including all these financial expenses and incomes in the result for the period.
- Disaggregating these financial expenses and incomes between P&L and equity.

The chosen option must be applied to all groups of contracts in a portfolio.

From the analysis carried out, it is clear that the majority of the Group financial investments could continue to be measured at market value and recognized in OCI, therefore the option of disaggregating financial income and expenses from insurance between P&L and equity will be the most appropriate in order to avoid asymmetries in the valuation and recognition of the financial investments and the insurance contracts. As such, initially, this is the treatment that will be followed for products with longer duration, that is those valued under BBA.

1.7 RISK ADJUSTMENT FOR NON-FINANCIAL RISK CALCULATION

The risk adjustment for non-financial risk represents the compensation required to handle uncertainty regarding the amount and schedule of associated cash flows.

The risk adjustment has been estimated using a percentile-method approach, based on calculations of Value at Risk (VaR) for obligations associated with the Life and Non-Life business, using the Solvency II calibration. An 85 percent percentile is used for Life insurance and burial business and a 65 percent percentile is used for Non-Life insurance business.

The risk adjustment for each segment and country is calculated consistently with the non-financial risks managed, and is distributed between groups of contracts consistently, using methodologies based on a rational and systematic distribution, considering only diversification benefits within each entity.

2. MAIN CHANGES IN THE FINANCIAL STATEMENTS AS A RESULT OF EU-IFRS 17

The entry into force of EU-IFRS 17 implies a significant change in the valuation and presentation of insurance and reinsurance contracts on the balance sheet and the income statement. The following is an explanation of the most relevant changes:

Balance sheet

On the balance sheet, the changes imply the elimination of those insurance assets and liabilities, like technical provisions for insurance and reinsurance, as well as all receivables and debts related to insurance and reinsurance activity. With the new standard of valuation for insurance contracts, all cash flows coming from these items will be included in two headings: one for liabilities or assets for insurance contracts and another identical heading for reinsurance.

The following is a breakdown of liabilities for insurance contacts that will be included on the balance sheet:

INSURANCE CONTRACT LIABILITIES
I. BBA Liabilities for remaining coverage valuation
Estimates of present value of future cash flows
• Present value of future cash flows
• Present value of future cash flows Loss component
Non-financial risk adjustment
Contractual service margin
II. BBA Liabilities for incurred claims valuation
Estimates for present value of future cash flows
Non-financial risk adjustment
III. VFA Liabilities for remaining coverage valuation
Estimates of present value of future cash flows
• Present value of future cash flows
• Present value of future cash flows Loss component
Non-financial risk adjustment
Contractual service margin
IV. VFA Liabilities for incurred claims valuation
Estimates of present value of future cash flows
Non-financial risk adjustment
V. PAA Liabilities for remaining coverage valuation
Premiums allocated to future periods
Acquisition expenses allocated to future periods
Loss component
VI. PAA Liabilities for incurred claims valuation
Estimates of present value of future cash flows
Non-financial risk adjustment

The amounts for assets and liabilities from insurance contracts are broken down by valuation method and also within each method differentiating liabilities for remaining coverage (LFRC) and liabilities for incurred claims (LFIC).

MAPFRE Group will mainly measure insurance contracts using the PAA, recording in the heading for premiums allocated to future periods the part of the premium that is unearned, and the corresponding expenses in a separate line. As previously mentioned, a breakdown will be given of the loss component of onerous contract groups where the loss was initially recognized and said loss will be released on the income statement as the service is provided.

Additionally, another change is that the adjustment for non-financial risk will be broken down in the liability for incurred claims.

In the case of the BBA and VFA, all components will be broken down separately in the liability for remaining coverage:

a) Present value of future cash flows, separating those corresponding to onerous contracts.
b) The amount of the adjustment for non-financial risk, and
c) Contractual Service Margin.

Ceded reinsurance contracts will be presented similarly.

EU-IFRS 17 eliminates the possibility of applying shadow accounting established in EU-IFRS 4 to avoid asymmetries, as a result of valuation differences between insurance assets and liabilities.

This elimination will be partially resolved as EU-IFRS 17, in the recognition of financial income and expenses from insurance contracts arising from a change in the discount rate (both from the effect of the time value of money and changes thereof as well as the effect of financial risk and changes thereof), allows the option of:

a) Including all financial income and expenses in the income statement for the period, or
b) Disaggregating the financial income and expenses between the income statement for the period and OCI.

Income statement

Revenue from premiums is eliminated from the income statement and replaced with insurance revenue, which will include the release of the liabilities for remaining coverage, which will basically consist of the release of the CSM in the contracts valued using BBA and VFA and the release of the premium in contracts valued using PAA, the simplified method, as well as the non-financial risk adjustment.

The presentation of insurance contracts in the income statement will be the following:

INSURANCE REVENUE
Release of Liabilities for remaining coverage
Claims and other expected insurance service expenses
Changes in non-financial risk adjustment
Release of CSM
Release of PAA premium
Release of acquisition expenses allocated to the period
INSURANCE SERVICE EXPENSES
Claims and other insurance service expenses
• Claims
• Fulfillment expenses
Acquisition expenses
Losses in groups of onerous contracts and reversals of such losses
Changes in liabilities for incurred claims

The heading "Losses in groups of onerous contracts and reversals of such losses" will record both the initially recorded loss as well as the release thereof which will take place over the course of the contract life.

Initially, as on the balance sheet, reinsurance contracts will give a similar breakdown to the above.

Alternate performance measures.

The implementation of the standard implies significant changes in the valuation and presentation of the financial statements, with special emphasis on the following:

- The substitution of premiums with real figures for insurance revenue which includes estimated amounts.
- Technical provisions disappear and are substituted for assets and liabilities for insurance contracts, excluding investment components.
- The presentation of results by both financial as well as insurance business margins versus revenue and expenses from the insurance and other activities.

Additionally, the changes also modify the composition and the result of the ratios and alternative performance measures used by the company.

The following are the main changes in indicators:

EU-IFRS 4	EU-IFRS 17
Premiums	Insurance revenue
Technical provisions net of deferred acquisition costs and unpaid unearned premiums.	Assets and liabilities from insurance contracts
ROE Average annualized attributable result / Average shareholders' equity	ROE Average annualized attributable result / Average shareholders´ equity *The result will change in valuation
Non-Life Combined Ratio Non-Life loss ratio + Non-Life expense ratio	Combined Ratio Insurance service expenses / Insurance revenue

EU-IFRS 17 New KPIs
Contractual Service Margin (CSM) Unearned profit recognized by the company as the service is being provided
CSM release pattern Criteria to recognize revenues based on the coverage units defined for each year and the part of the service already provided
Importance of new business (%) CSM of insurance contracts issued / Total CSM

3. EU-IFRS 9

EU-IFRS 9 "Financial Instruments" which will substitute EU-IAS 39 "Financial Instruments: Recognition and Measurement" will be applied starting on January 1, 2023, as the Group made use of a temporary EU-IFRS 9 application deferral for companies with primarily insurance operations, regarding the classification and measurement of financial assets and liabilities, the impairment of financial assets and hedge accounting.

The Group plans to provide comparative figures for 2022 in the 2023 annual accounts using an overlay approach, and accordingly it will report comparative information for financial assets applying only the IFRS 9 measurement and classification criteria to avoid accounting asymmetries.

EU-IFRS 9 is a new method for classifying and measuring financial assets, which reflects the business model used to manage assets and their cash flow characteristics, and it provides three categories to classify financial assets: at amortized cost, at fair value through other comprehensive income, and at fair value through profit or loss. Additionally, it eliminates the categories existing in the EU-IAS 39 for investments held to maturity, loans, and receivables, available for sale and for trading.

Two tests are required for the classification of financial instruments at amortized cost or at fair value through other comprehensive income: the business model and the assessment of the contractual cash flow, most commonly known as the "Solely payment of principal and interest criterion" (hereafter, SPPI Test).

The purpose of the SPPI Test is to determine if, according to the contractual characteristics of the instrument, its cash flows only represent the return of its principal and interests, understood basically as compensation for the time value of money and the credit risk.

The Group has reviewed the existing business models and the contractual characteristics of portfolios to establish its classification under EU-IFRS 9, and it has defined criteria to determine the acceptable frequency as well as the reasons for sales so that the instrument can be held in the category that makes it possible to receive contractual cash flows.

Portfolio reclassifications will have a negligible impact on the transition shareholders' equity, in view of the analysis made thus far.

As with EU-IAS 39, the majority of the portfolio is classified as financial assets at fair value through other comprehensive income, since 98% of the fixed income assets included in the available-for-sale portfolio pass the SPPI Test, and therefore their current measurement can be maintained in almost all cases, with barely any change in equity resulting from the regulatory change.

Additionally, some portfolio reclassifications will be made, although no significant impact is expected.

As established in the standard, gains and losses from equity instruments at fair value through other comprehensive income will be recognized in reserves, with no impairment losses being recognized in the income statement and with no reclassification of gains or losses on disposal in the income statement.

EU-IFRS 9 substitutes the "incurred loss" model under EU-IAS 39 for an "expected loss" model. The new impairment model is applied to financial assets valued at amortized cost as well as to financial assets at fair value through other comprehensive income, except for investments in equity instruments, as no recycling in profit and loss is made. Likewise, all financial instruments at fair value through other comprehensive income are excluded from the impairment model.