Q4 2014 Earnings Call

Company Participants

- Catharina Elisabeth Hellerud
- Helge Leiro Baastad
- Janne Merethe Flessum
- Jostein Amdal

Other Participants

- David T. Andrich
- Gianandrea Roberti
- Jakob Brink
- Matti Ahokas
- Sami Taipalus
- William F. Hardcastle

MANAGEMENT DISCUSSION SECTION

Operator

Good day and welcome to the Fourth Quarter and Preliminary 2014 Results Call for Gjensidige. Today's conference is being recorded.

At this time, I would like to turn the conference over to Janne Flessum, Head of IR. Please go ahead.

Janne Merethe Flessum {BIO 19368607 <GO>}

Welcome to this presentation of the fourth quarter results and also the preliminary full year results for Gjensidige. As always, our CEO, Helge Leiro Baastad will start by commenting the highlights for the quarter and also the key takes for the full year 2014. Then our CFO, Catharina Hellerud, will comment the numbers in more detail before we open up for Q&A. We also have present today in the room our Head of Capital Management, Jostein Amdal, in case of questions related also to details around the capital.

Before we start, I want to remind you that we have – you can download the presentation from our website, gjensidige.no/ir.

And with that, I hand over to you, Helge.

Helge Leiro Baastad {BIO 5865247 <GO>}

Thank you very much, Janne. Good morning, everyone, and thanks for calling in. Yet again, I'm pleased to present a strong set of figures, in fact, the best-ever fourth quarter underwriting result for Gjensidige.

If you look at page two in the presentation, you can see the fourth quarter results where we reported profit before tax of NOK 1.159 billion and record high fourth quarter underwriting results for more than NOK 800 million, NOK 807 million. The underlying premium growth of 5.1% is an important contributor to this result, together with the benign weather situation in the quarter.

Investment yield is increasingly a challenge. This quarter, the return was 0.7%. The pre-tax return on equity ended at a solid 23.3% for the full year.

Moving quickly over to page three in the presentation, we will take a look at the year as a whole. Summarized, we have had a solid growth in premiums and good profit performance, which had secured that we are delivering on or above all of the financial targets. We delivered a pre-tax profit of NOK 5.4 billion and a strong underwriting result of NOK 2.9 billion. This is actually the best ever both for pre-tax profit and underwriting result in Gjensidige.

The board has proposed a divided of NOK 2.95 billion, which means NOK 5.90 per share and a payout ratio just about 70%.

If you turn to page four, you will have – see further information about the dividend. You know our dividend policy; we aim at delivering high and stable dividends, over time representing at least 70% of net profit. 2014 is the first year this dividend policy is effective, meaning that the proposed dividend for 2014 should be seen as a starting point for high and stable dividends going forward. The solid results I have commented and an assessment of our capital position is basis for the payout ratio. Catharina will comment on the capital position in more details in few minutes.

Now, on to page five, where I'd like to tell you about our evolving basis for profitable growth going forward. This slide is very important actually. Customer orientation is an important priority for us. And seeing that our customer satisfaction scoring is increasing means that we're doing something right. In turn, this gives more loyal customers, which is important in order to keep the cost down. Our loyalty and affinity customers in the private segment in Norway had been with us for more than 15 years, on average, and hold more than four products. We intend to keep up the good work to meet our customers' preferences.

To attract new customers, we have had targeted initiatives in relation to customer groups where we see a potential. This being for example, customers in the car dealership channel, where we have unique combination of finance and insurance. In addition, the customer dividend model has been marked especially towards those who are not customers of Gjensidige to increase the knowledge and awareness of the model.

In 2014, as you heard on the Capital Markets Day, we enter into a new partnership again with the Norwegian Automobile Association, NAF, which enters into force from March this year. NAF will sell Gjensidige products based on leads from Gjensidige, and NAF has a membership base of 500,000 Norwegian customers, 200,000 of whom are currently customers, leaving a quite large potential to customers base to work with going forward.

Then looking at renewal within the commercial segment, this is – it has been strong competition, once again, but given this, we are comfortable within renewals once again.

Summarized, we have a solid platform for continued solid organic growth going forward. In addition to this, we have continued to make smaller acquisitions through 2014 and in the beginning of this year in Sweden and Denmark. The portfolio fits in well with the existing portfolio in these markets and also adds new competences to Gjensidige.

As you know, Gjensidige has established a scalable platform, both with regards to group functions, processes, IP system, pricing, et cetera. We are working on the integration of new portfolios, adding them to this infrastructure. Then let me make some comments on the announcement yesterday of the acquisition of PZU Lithuania with €50 million in premiums.

This will, together with our existing operation, bring Gjensidige to number three position in the Baltics and our pan-Baltic market share will move from 7% to 13%. In December, we also decided to strengthen our initiatives in the Baltics; and with this latest acquisition, we finally reached critical mass. We see the Baltics as an attractive market going forward due to several reasons. There's a population of 6.3 million people there. In Norway, we have just about 5 million people. The infrastructure penetration is low and expecting increase in GDP going forward is relatively high, 67% compared to the Nordics and Norway, which is significantly lower.

In addition, there is a great potential when it comes to restructuring the distribution. The three main players in the Baltics now will be PZU, Sampo and Gjensidige, listed players, and we think this will drive the region going forward in a very effective way. You will see modern distribution and it will be front for Gjensidige and profitable in the long-term to take part of this market going forward.

We will implement group processes and best practice into the Baltic business in line with what we have done in the rest of the group. We will work systematically with the integration of the business, and we'll take out synergies within areas such as reinsurance at once, distribution, IT, claims handling and support functions as well as pricing and targeting.

The synergies are expected to be fully realized by 2018, so this PZU Lithuania is a restructuring case, and we are confident that we will take up significant synergies within 2018. Closing of the transaction is expected in the beginning of third quarter 2015.

So then, to sum up, you see we made continuous effort to keep our existing customers and to attract new (8:58) organic growth within – in the long run is expected to be in line with GDP. In addition, we make acquisitions, which reflect our strategy to grow structurally outside Norway; and in total, the new portfolios we have added into our business throughout 2014, and now in the beginning of 2015 represents around NOK 800 million, which is significant.

So with that, I'll hand the word over to Catharina to briefly comment on the figures. Thank you.

Catharina Elisabeth Hellerud {BIO 17276650 <GO>}

Thank you, Helge, and good morning, everyone.

If you turn to page (9:37) various contributions to the results. First of all, the underlying results ended at solid NOK 807 million in the quarter. The strongest underwriting results we have ever reported for our fourth quarter. And the result is also around NOK 50 million, better than in third quarter, which is quite unusual.

The strong underwriting result is due to good underlying risk selection and pricing, which contributed to a favorable underlying frequency situation. In addition, the proportion of large losses was relatively low with a low impact of weather and natural peril claims. In addition to that, the run-off gains are higher than in the corresponding quarter in 2013.

The Retail Bank and Pension and Savings also showed good underlying profit growth. I'd like to mention two issues affecting the results in these segments. The bank profit is marginally weaker this quarter compared with 2013.

Increased revenues and the lower losses were offset by increased costs largely relating to growth, and the depreciation of IT systems, in connection with the new contract being signed with a system provider. The underlying profit performance in Pension and Savings is still good, but was affected by our run-off expense of NOK 28 million in the quarter.

Investment portfolio yielded 0.7% in the quarter, a satisfactory return given the prevailing market conditions. The return is affected by weak results for current equities, especially because of a fall in value of shares in SR-Bank, which was partly offset by a positive development in property. That together with strong underwriting results the profit before tax expense came to NOK 1.2 billion for the quarter.

For the year as a whole, the profit before tax expense amounted to NOK 5.4 billion, up from NOK 4.6 billion in 2013. The main explanation for this development is the favorable frequency and weather situation as well as higher run-off gains and that's the most lower proportion of large losses.

So, moving to page nine; you can see that we have a solid combined ratio of 84.5% in the quarter. This is a very strong fourth quarter result and also stronger than in the third quarter where we have a combined ratio of 85.5%. This was driven by favorable weather and run-off gains.

The cost ratio was 15.3% for the fourth quarter and 15.0% for the year as a whole. We aim to further reduce the underlying cost ratio. This will be used to increase our investment in IT, the brand, and expertise in order to ensure our future competitiveness. Going forward, the reported cost ratio will, therefore, continue to be around 15%.

The claims ratio improved by 7.7 percentage points compared to the fourth quarter in 2013. And the most important explanation for the improvement is a considerably lower proportion of large losses in this quarter, which explains as much as the 5.4 percentage points of the improvement.

On page 10, you can see the solid premium growth in – reported growth is as much as 9.4% with an underlying growth of 5.1%. Premium growth of 4% and 3.4% in the private and commercial segments respectively shows that we are competitive despite the strong competition in the Norwegian market.

The Nordic segment reports growth as much as (13:35) when adjusted for currency effects. It is especially in the acquisitions, of course, that contribute to growth. In addition, the conversion of one product in the Gouda portfolio in Denmark from net to gross recognition had a run-off effect in the quarter of around NOK 39 million, of which NOK 29 million was due to correction for previous quarters in 2014. Correcting or adjusting for these effects, the underlying growth is also a very solid 3.9% in the quarter in the Nordic segment. A lot of the organic growth is due to new commercial customers.

As you can see from the illustration, the Corporate Centre also makes a positive contribution of NOK 85 million to the growth in the quarter. This is because of reinstatement premium of minus NOK 8 million was charged to the Corporate Centre in the fourth quarter in 2013. That was a result of the very extensive natural disaster claims in that quarter in 2013. Over time, we expect organic growth in line with GDP in our market.

Drop in oil prices in combination with lower interest rates, the weakened Norwegian currency will affect the Norwegian economy, it's still too early to say and there are forces working in different directions.

We have a limited direct exposure to the oil sectors, and this mainly relates to accident and health and workers' comp product. If we are to see substantial workforce reduction within the oil sector or increased unemployment in Norway, this is mainly where we will see lower activities.

But according to statistics in Norway, we should not expect a significant decrease in the unemployment rate in Norway over the next years.

So, turning to page 11, you can see that we have had a lot of impact from large losses this quarter, affecting the combined ratio 3.8 percentage points versus the expected level of 5.1 percentage points. The biggest individual loss announced this time was the flooding in Norway in October, which affected the Gjensidige's results in the amount of NOK 95 million. In the fourth quarter, the year before, large losses affected the combined ratio with 9.2 percentage points mainly due to several severe storms.

It is worth mentioning that randomness can have significant effects, of course, on looking at the weather and large losses. And in January 2015, Norway was hit by storm Nina. And so far, the total market loss is estimated to NOK 450 million and Gjensidige's share of this will be around 25%.

So, moving down to page 13, we had a run-off gain with a positive effect of 4.5 percentage points in the combined ratio in the quarter. It is a relatively high run-off gain in the private segment in this quarter. There are several effects that kick in, but part of the run-off result is due to the fact that we have used somewhat more conservative estimate for the capitalization interest rate than what's finally situated by the Supreme Court in a ruling in December, and the interest rate was reduced from 5% to 4%.

The illustration on the left hand side on the shares to run-off gains for the operational segments, however there is also run-off gain in the Corporate Centre representing an effect of 1.2 percentage points from the combined ratio, and this is primarily due to a reduced estimate from the natural perils pool for expenses related to flows on funds in 2013 where we adjust our provisions correspondingly.

So, on page 13, the most important message is that we have delivered on the target of a cost ratio of 15% by 2015. There has been good cost control in the segment through the year. The nominal increase in costs has primarily come from the Nordic segment. It is due to a combination of currency effects and acquired businesses.

So turning to page 14, let's take a look at the capital position. Looking at the rating requirement from S&P in the graph on the left hand side, we have NOK 1.3 billion of capital – in excess of the capital requirement and the tactical buffer at the end of the year and that is after deducting the proposed dividend. This is an increase from NOK 1.0 billion at the end of the third quarter.

Available cash flow increased by NOK 400 million in the quarter and that is due to several effects. Firstly, the total comprehensive income after deducting the proposed dividend is added, and this nets to NOK 800 million.

As you can see, the total comprehensive income is about NOK 400 million lower than the profit after tax, and this is primarily due to increased pension liabilities as a result of significant reduction in the current bond yield that is used when discounting the pension liabilities.

And in addition, there is a higher deduction from available capital for intangible assets of NOK 300 million, and that is because of the strengthening of the Danish kroner in relation to the Norwegian kroner.

At the same time, the capital requirement has increased by around NOK 150 million, evenly split between asset and liability risk. We have also have some changes occurring after the balance sheet date. In the graph, on the right hand-side, you can see an illustration of these changes and how they affect the strategic buffer.

Firstly, we have now received confirmation from S&P that quantitative credit for the internal outlook will be included when calculating the capital requirement. Elements in the calculation used by S&P are confidential that's based on our understanding and used all the model. This will imply a reduced capital requirement of around NOK 800 million. The main driver behind this figure is the difference between the capital requirement in the S&P model and the capital requirement in the internal model with deduction (20:20) Pension and Savings departments.

It is firstly share of this difference, which is given us credit in the calculation of the capital requirements. Secondly, we have made two acquisitions this year: Mondux in Denmark and PZU in Lithuania. The total capital effect for these two acquisitions will be around NOK 800 million. As these two events more or less offset each other, you can see that the net effect on the strategic buffer is marginal.

Then finally on page 15, I will comment the investment portfolio, which yields 0.7% in the quarter. This is seen as satisfactory given the interest rate levels on the prevailing market conditions. The matched portfolio yielded the return of 0.6% in the quarter that is down from 0.9% in the third quarter. We have seen a significant fall in interest rates in the quarter and particularly Norwegian interest rates, but also damage interest rate. This means that we must continue to work hard to find good investment opportunities in the future, but still within the same risk appetite and the same risk limits as before.

Despite the fall in interest rates, the average reinvestment rate for the bonds traded in the Norwegian held to maturity portfolio was 3.9 percentage on average in the quarter, and that is up somewhat from 3.3 percentage points in the third quarter. And that is due to – as we managed to find good investment opportunities at the beginning of the quarter, thus the level has fallen significantly since then.

At the end of the year, the excess value in the held to maturity portfolio amounted to as much as NOK 2.2 billion and that is compared with NOK 1.7 billion at the end of the third quarter, and NOK 1 billion at the end of 2013. This excess only means that the accounting return on the portfolio continues to be relatively stable, and is falling more slowly than the fall in the interest rate level would indicate.

The free portfolio yielded a return of 0.7% in the quarter. It was especially current equities that recorded a weak result affected by the negative development in the value of the shares in SR-Bank. Disregarding the SR-Bank holding, the remaining equities yielded a positive return of 4.9%.

Credit and private equity also showed a weak development. On the other hand, the property portfolio yielded yet another strong quarter.

So in sum, this resulted in a return on the total investment portfolio of 0.7% in the quarter. For the year as a whole, the investment portfolio yielded a return of 4.3%, which is on par with the return in 2013.

And with that, I hand the word back to Helge, who will make some final comments before we open for Q&A.

Helge Leiro Baastad {BIO 5865247 <GO>}

Thank you. Catharina.

Some very few final remarks; if you take a look at page 16, you can see on the left-hand side five strategic priorities we presented on to CMD in November. These are areas, where we see an important to work with in audit to ensure competitiveness and target achievements also going forward.

On the right hand side, you can see our financial targets. Starting this year, the return on equity target is 15% after tax. The other targets should be well-known. But I'd like to remind you that we said on our Capital Markets Day in November that we expect to be in the lower half of the targeted range on the combined ratio, driven by continuous work on cost discipline and cost monetization. And also remind you that this has given zero in run-off and a normalized level of large losses.

Finally in December, I made some changes in the group management including establishing a new technology and development unit. This was done to ensure that we develop and improve our business processes, and implement best practice across the group. In turn, I believe that this will reduce our time to market and hence, support our competitiveness going forward.

So, with that, maybe I'll just start the Q&A, Janne or-

Janne Merethe Flessum {BIO 19368607 <GO>}

Yeah. Operator, we are ready for the Q&A, please.

Q&A

Operator

Thank you. We will pause for just a moment to allow everyone to signal. We will take now our first question from David Andrich from Morgan Stanley. Please go ahead.

Q - David T. Andrich {BIO 15414075 <GO>}

Hi. Good morning. Thank you for taking my questions. My first question was on the dividend and in particular, the dividend payout ratio. And I understand this is the first year you're going with the new payout target. And I was just wondering if you could give a bit more color on the reduction in the payout ratio from 80% to 70% just in kind of the context of having quite a comfortable capital buffer.

And as a follow-up question to that, I was wondering, are you going to place, I guess, greater emphasis on the nominal level of the dividend then as opposed to the payout ratio?

And then, I was just wondering, just sort of curiosity, but in terms of the recent acquisition you guys did, I guess, how much did the reduction in S&P capital requirements kind of play into your decision to go ahead with that? And I guess this is kind of a backward way of asking, were you comfortable with a greater reduction in the strategic buffer? Thank you.

A - Helge Leiro Baastad {BIO 5865247 <GO>}

I can just start with a short comment, and I can see here that both Catharina and Jostein can fill in afterwards.

You asked the question if we focus on the nominal level; what we have said should be at least 70%. But of course, we will focus on the nominal level going forward, but at least 70% and high and stable and nominal payout of dividend.

So, maybe Catharina or Jostein could take you through the reduction from 80% to 70% and the question afterwards.

A - Catharina Elisabeth Hellerud {BIO 17276650 <GO>}

Okay. I can give some comment to the dividend payout ratio. Of course, if you look at the dividend payout ratio in 2013, it was 79%, if you adjust for the write-down of the stake in Storebrand. And the level of the proposed dividend for 2014 mostly then be seen in relation to all new dividend policy having a high and stable dividend going forward, nominal on the number level and also that we now have more optimal capital structure. But we have paid out 80% since the listing reflecting that we had a – or a capital position with excess capital. And we now wish to build more excess capital.

Today, we are having a more optimal capital structure and a new dividend policy where the main focus, as you said, is the high and stable nominal dividend going forward. And the excess capital will be paid out over time to our owners, if there is any, when we look at the strategic buffer.

Q - David T. Andrich {BIO 15414075 <GO>}

Okay. Thank you.

A - Catharina Elisabeth Hellerud {BIO 17276650 <GO>}

Yeah. You had a question also about the acquisition, David?

Q - David T. Andrich {BIO 15414075 <GO>}

Yeah, just on the strategic buffer. And I guess – I mean basically, I was just wondering how much of the acquisition decision – or how did the reduction S&P required capital play into the acquisition decision? And I guess like I said, that's kind of a backward way of asking, were you comfortable with the greater reduction in the strategic buffer from kind of the NOK 1.3 billion level down to the NOK 500 million level essentially?

A - Catharina Elisabeth Hellerud {BIO 17276650 <GO>}

You're right in starting the other direction. We had a strategic buffer in place to be able to do these bolt-on acquisitions, and that we are operating in very consolidated markets both in the Nordic markets and obviously in – as well as in the Baltic. And when we have this opportunity, we allocated parts of the strategic buffer to this acquisition in line with what we have said about the – where we want to use the strategic buffer.

Q - David T. Andrich {BIO 15414075 <GO>}

Okay, great. Thank you, very clear. Thanks.

A - Janne Merethe Flessum {BIO 19368607 <GO>}

Next question, please, operator.

Operator

We will take now our next question from Matti Ahokas from Danske Bank. Please go ahead.

Q - Matti Ahokas {BIO 2037723 <GO>}

Yes. Good morning. It's Matti here from Danske Bank. Still on the dividend, I was just wondering, you have awesome underwriting results and very strong buffers. So, the only reasons I could think of that pay a dividend in the low range of – low end of the target range would be either that you expect earnings to fall in 2015 or then you would like to leave more room for acquisitions. Were these two things in any way in play when you considered or when the board considered the dividend proposal for 2014?

Second question is what was the duration and the running yield on the bonds on amortized cost in the match portfolio? Thanks.

A - Helge Leiro Baastad {BIO 5865247 <GO>}

Maybe you can start with the last question for Matti.

A - Catharina Elisabeth Hellerud {BIO 17276650 <GO>}

Yeah. The duration in the portfolio is around 3.5 years, which corresponds to the duration on the liability side. And so that's the answer to your question about that. If you look at the running yield in the held to maturity portfolio, it's 4.7 percentage. But of course, the – going forward as we have now invested at 3.9% during this quarter or during the fourth quarter, we've seen the yields coming down.

Q - Matti Ahokas {BIO 2037723 <GO>}

So, did you say 4.9% was the-

A - Catharina Elisabeth Hellerud {BIO 17276650 <GO>}

Sorry, 4.7% is the running yield in the held to maturity portfolio.

Q - Matti Ahokas {BIO 2037723 <GO>}

Great, thanks. And then the dividend?

A - Helge Leiro Baastad {BIO 5865247 <GO>}

Yeah. As we commented both myself and Catharina, we think that the starting point, it's the right starting point. And it reflects a strong year and also the target that it's going to be high and stable going forward.

You asked if it's reflecting any plans on the acquisition side or falling earnings going forward. We are in strong position, competitive and that's wise as I commented both in Norway. And we have strong earnings, and we think we will continue to deliver strong earnings. It's lots of uncertainty related to regulation in Norway, and you know 2015 is the year with lots of releases on that topic.

So, it doesn't reflect any specific plans on the M&A side. We think you also should see the strategic buffer and the technical buffer slightly in connection going forward in short term. So, we think actually this was the right starting point, given the strong year uncertainty in 2015, and we will know much more at the end of 2015 related to those other topics.

Q - Matti Ahokas {BIO 2037723 <GO>}

When you talk about the uncertainties, is it the natural perils treatment or I mean-

A - Helge Leiro Baastad {BIO 5865247 <GO>}

Yeah.

Q - Matti Ahokas {BIO 2037723 <GO>}

Great. Thanks.

A - Janne Merethe Flessum {BIO 19368607 <GO>}

Next question, operator?

Operator

We will take now our next question from Will Hardcastle from Bank of America. Please go ahead.

Q - William F. Hardcastle {BIO 16346311 <GO>}

Hi there. Just a follow-up there from Matti's question on the natural perils. I'm just wondering if there's any update at all that you can provide at this stage. And the second one was, sorry, Catharina, I missed the – some of the description on the reserve releases. I heard a bit on the natural perils fund. But just really, if you could try and split out what came from natural perils fund and what came from elsewhere, and what that – what were the main drivers of the elsewhere component, I guess? Thanks.

A - Helge Leiro Baastad {BIO 5865247 <GO>}

Maybe you can start with it, Catharina and Jostein will give you some update on the regulations.

A - Catharina Elisabeth Hellerud {BIO 17276650 <GO>}

I can start with the gain – the run-off gains.

As you can see on page 13, there are positive run-off gains from all the segments this quarter, and a small loss from the Baltic operation. What I commented was that part of the run-off gains from the private segment is due to – that we have a more conservative estimate for the capitalization interest rates. This has been a case that has been handled in different courts in Norway for some years now and the final ruling from Supreme Court came in, in December. The interest rate was reduced from 5% to 4%. And we have, as I said, somewhat more conservative estimates in our reserves. And this is the kind of uncertainty that we need to calculate in our reserves on, in – or part of our liability.

And I also commented one extra element, which is not – if you look at the slide, what you see are the results from each and one of the operational segments. In addition, there were also positive run-off gains coming here in the Corporate Centre, which is due to the Norwegian natural perils pool. They reduced the amount that was relating to funds from 2013. And we just made an adjustment to other provisions correspondingly to the adjustment that they made from the natural perils pool. We get our market share on the natural perils events that happened in Norway, and we use the figures from natural perils pool to the cost and the liabilities in our books.

A - Helge Leiro Baastad {BIO 5865247 <GO>}

I'll comment on the regulatory uncertainty, as you remember from third quarter, the bank had three main issues. The natural perils fund, the guarantee provision and the possible tax effect from changes in the solvency regulation. There are no specific news on these items compared to last quarter. We are still positive that the resolution will be positive for us with all accounts. Natural perils fund and the guarantee provision is included in our available capital figures as we present them. And we work towards the authorities to try to get that outcome. That's all I can really say for now.

Q - William F. Hardcastle {BIO 16346311 <GO>}

So just to be clear, it's not that you've become more hopeful that the outcomes will be favorable. You're kind of thinking it's exactly the same as we were three months ago?

A - Helge Leiro Baastad {BIO 5865247 <GO>}

I'm at least not less positive.

Q - William F. Hardcastle {BIO 16346311 <GO>}

Okay. That's helpful.

A - Janne Merethe Flessum {BIO 19368607 <GO>}

Operator, next question, please.

Operator

We will take now our next question from Gianandrea Roberti from Carnegie.

Q - Gianandrea Roberti {BIO 6786731 <GO>}

Yes. Good morning from me as well. I have three questions and the first one is a little bit on math that I was doing on your S&P model. I'm calculating – looking at the NOK 15.8 billion, which was the requirement of your S&P model at the end of 2014, dividing that by the premiums earned of NOK 20.3 billion, you have an implied solvency margin, if I can call it like this, of 77%, which of course it is very high and it has been discussed previously.

But I'm just wondering if I assume that you grow, let's say, NOK 1 billion premiums next year, it doesn't really matter if it's right or wrong. But this makes me think that out of that NOK 1 billion, there is around NOK 770 million, which is an increased capital requirement in the S&P model, which is of course is very high and limit somewhat your dividend capacity, if you don't decide to move any other lever there. That's my first question.

The second question is regarding to your internal model, I think it was around – the requirement was around 10.2 at the end of the third quarter and it's 10.8 now. And I'm sure you have a slide with lots of moving parts. But if you can just recap what has changed there, it would be interesting. But I also do remember that in meetings, you pointed out to the fact that in reality, this 10.2 at Q3 was too high because you have added some buffer. The real number was more closer to weight, and that was one of the reason why you could unleash a little bit more sub debt. If you wouldn't mind explaining that again to me that would be very helpful.

And the last question, I just want to make sure I understood correctly, is 2.9% the reinvestment rate right now. I think, Catharina, you mentioned it before, but the line was pretty bad. Thank you.

A - Jostein Amdal {BIO 19939645 <GO>}

Okay, Gianandrea. I mean what's your first question really if you're thinking of, correct, around the 77% of capital as a part of premium or I got your reasoning, but I didn't quite catch your question.

Q - Gianandrea Roberti {BIO 6786731 <GO>}

I mean the question really – I'm just checking. So, all else equal, $1 billion of premiums growth imply NOK 770 million on this capital model in S&P for you. So, all else equal, that's what I'm looking at, because it's a very – I mean, it's a very high number so-

A - Jostein Amdal {BIO 19939645 <GO>}

I mean, brief comment is that it is a bit too high, because if we have a portfolio growth of NOK 1 billion, it doesn't – and we can finally start within our current equity. The amount of asset-base doesn't grow proportionally. And the NOK 15.8 billion that we present includes all the assets which are both handled (40:17) by reserves and equity. But it's an exaggerated if you take those 77%.

Q - Gianandrea Roberti {BIO 6786731 <GO>}

Okay.

A - Jostein Amdal {BIO 19939645 <GO>}

Better is of course our capital growth and the capital requirement if we grow by so and so much in premium. And you can take insurance base part of S&P, and then add something about that for some asset growth, that's a more likely proxy for how much it costs us to grow.

Your second question on the internal model, I think when we discussed the CapEx before subordinated debt, we discussed that that capacity must be seen in line of the capital requirement of Gjensidige Forsikring, also the parent company. And the figures of the group, that's one difference. And the second one is that we and the board has decided on a 20% buffer to the risk base perspective. That buffer is part of the legal capital requirement. So, when we moved from 10.8 to what is the basis for calculating sort of the capacity unit of just both those factors.

And as I pointed out, when you compare Q3 to Q4, there are lot of moving parts. And all of these is that we have now included the NCB Pension Savings business integrated those in numbers instead of using the current regime of capital efficacy using the Solvency II regime, using standard formula for NCB and Pension and Savings, which does something to the numbers there. That's the main comment.

A - Janne Merethe Flessum {BIO 19368607 <GO>}

And then – sorry.

Q - Gianandrea Roberti {BIO 6786731 <GO>}

Sorry. I just had one question, can you tell us, Jostein, what's the standard model capital requirement for Gjensidige?

A - Jostein Amdal {BIO 19939645 <GO>}

We did present it in the third quarter. We haven't presented that for the fourth quarter.

Q - Gianandrea Roberti {BIO 6786731 <GO>}

Well, what was it on the third quarter, just to remind me?

A - Catharina Elisabeth Hellerud {BIO 17276650 <GO>}

The excess capital was NOK 4.6 billion in the standard formula. That is the figures as of the second quarter 2014. That is what we presented in connection with the third quarter results. Yes.

Q - Gianandrea Roberti {BIO 6786731 <GO>}

Thank you.

A - Catharina Elisabeth Hellerud {BIO 17276650 <GO>}

Yes. And then you asked about the reinvestment rate. It was 3.9%, not 2%. So, we managed to do some very good investments in the beginning of the quarter. This was 3.9%, but we have seen rates coming down further after that.

Q - Gianandrea Roberti {BIO 6786731 <GO>}

Okay. Thank you.

A - Catharina Elisabeth Hellerud {BIO 17276650 <GO>}

It's also timing that was just – yes.

A - Janne Merethe Flessum {BIO 19368607 <GO>}

Next, operator.

Operator

We will take now our next question from Jakob Brink, ABG. Please go ahead.

Q - Jakob Brink {BIO 7556154 <GO>}

Thank you. I just have a few follow-up questions. Regarding run-off gains, we have heard from your Danish competitors, both Tryg and Topdanmark now stating that there's a great likelihood that run-off gains will be higher than normal in the years to come, sort of 4% to 6%. Part of Tryg's at least is also from Norway. Are you seeing as well that sort of your models are overshooting these days? Could you maybe give us some details on that?

And then secondly, coming back to the natural perils pool treatment; I think after Q3, we discussed that kind of you're ending up in a sort of quite worst case situation, because you can't issue more tier 2 capital if it's pushed down to tier 2. However, a lot of this problem is, as Gianandrea just referred to that you have an NOK 8 billion capital requirement on the internal model.

However, would you now use the stand-up model of Solvency II rather than your internal model? You could have actually room to issue even more subordinated capital. I know this is kind of a stupid thought, but still it seems like the way you're doing it now is not optimal. Could you maybe give us some details on that as well, please? Thank you.

A - Helge Leiro Baastad {BIO 5865247 <GO>}

I can start with the run-off gain – question related to the run-off gain. As you know, we have released positive effects lately. It was a special situation in fourth quarter. We have seen positive effects from run-off gains last few years. That's partly relating to positive development within the Norwegian accident and health products and also workers' compensation in Denmark as you know.

Our policy is best estimate reserving, and that implies sale contribution expected from the run-off; that's long term. And also that's important when we price our products. And I think we also have commented that it's more probably with gains than losses in short, medium term. So, I think that's the right comment on that question now.

Q - Jakob Brink {BIO 7556154 <GO>}

But you're not seeing any sort of increase to the potential positive margins?

A - Helge Leiro Baastad {BIO 5865247 <GO>}

No, we don't have a comment on that beside what I have said. So, you have the history, you know where we have had gains the last few years. The pricing of the products is based on best estimates. Long term, it should be zero and it's more probably with positive gains in the short, medium term than losses.

Q - Jakob Brink {BIO 7556154 <GO>}

Okay. Thank you.

A - Jostein Amdal {BIO 19939645 <GO>}

And the answer to your second question is – I mean the short answer is that we feel intent to apply for an internal model approval. I actually commented a bit in the report, timing of that is a bit further out than we further expected, but it's not making any major shifts there. We still think that having the internal model as our legal capital requirement as well will give us long term benefits around this company.

Q - Jakob Brink {BIO 7556154 <GO>}

But then, I guess my – I could follow up, is Tryg, for example, seems to be willing to even go below the S&P A rating requirements on capital, if needed. It seems like they have got sort of an improvement from S&P to do that. I don't know, it seems like you are again – you're taking a very conservative approach both on the internal model and the rating base. Yes, I'm just wondering, given that this natural perils pool is now being treated as to two capital (47:37) most likely, which will then hit your ability to issue subordinated capital. Shouldn't you maybe consider changing your – the way you're looking at capital?

A - Jostein Amdal {BIO 19939645 <GO>}

I don't have any comments on what Tryg does or what kind of relationship they have with S&P. We use the same model. As opposed to Tryg, we can use partly our internal model to set the capital requirement also from a rating perspective. And they use that as one measurement of how much capital they need from rating perspective. We're not slaves of that model (48:26) is really what I'd say.

Q - Jakob Brink {BIO 7556154 <GO>}

Okay. Thank you.

A - Janne Merethe Flessum {BIO 19368607 <GO>}

Next question, please.

Operator

We will take now our next question from Sami Taipalus from Berenberg. Please go ahead.

Q - Sami Taipalus {BIO 17452234 <GO>}

Morning, everyone. Thanks for taking my question. You mentioned the reinvestment rate of 3.9% in Q4; it sounds quite high given where interest rates have gone over the year. I mean I guess in particular it sounds strange at the time I wonder what it was in Q3. So, I'm wondering just if you could tell us a little bit more about what you've been investing in.

Then second of all, just with regard to the movement in the oil price recently. If I remember correctly, you've got some unrated bonds related to the Norwegian energy sector in your balance sheet. Now, if I remember correctly, they're not actually related directly to the oil sector. But I guess the energy sector will be affected too. Is this anything we should worry about? Thank you.

A - Catharina Elisabeth Hellerud {BIO 17276650 <GO>}

I can comment on the reinvestment phase first. It was 3.9 percentage points on average in the quarter. But what I also said was that we did the investments in the beginning of the quarter, and we have seen the rates coming down further after that.

So, it's about actually having good timing on the investment that we did in the hold to maturity portfolio in this quarter. And it's Norwegian bonds, investment-grade bonds, some municipalities, some real estate, but again, it's about the timing and the rates have come down after our investment has been down.

Q - Sami Taipalus {BIO 17452234 <GO>}

Just – sorry, just on that; was it quite small volume of bonds, your investment?

A - Catharina Elisabeth Hellerud {BIO 17276650 <GO>}

We don't invest very much in every quarter. It depends on the, of course, the tactical reserves or the increase, and also how bonds come to maturity during the quarter. It was not very much, that's correct. We didn't have very high need for investments in the quarter. And again, we were lucky with the timing.

Q - Sami Taipalus {BIO 17452234 <GO>}

Okay.

A - Helge Leiro Baastad {BIO 5865247 <GO>}

Exposure on oil.

A - Catharina Elisabeth Hellerud {BIO 17276650 <GO>}

Yeah. We do not have very much oil exposure in our investment portfolio. If I should point to anything, it should be the private equity portfolio, part of it being exposed to the oil sector. But other than that, that's where we'll find the direct exposure towards oil.

Q - Sami Taipalus {BIO 17452234 <GO>}

Okay. In terms of the kind of – there are some hydro power plants and stuff, there's nothing there that we need to think about, no? Prices in that market will probably follow oil prices to some degree.

A - Jostein Amdal {BIO 19939645 <GO>}

I can comment briefly on your question regarding unrated bonds related to the energy sector. It's more energy, utilities, energy distribution than energy production. And energy production have, it's still (51:38) hydro power and we don't really see a big – given that the very high share of Norwegian energy supply is hydro power, it's not that sensitive to international oil prices.

Q - Sami Taipalus {BIO 17452234 <GO>}

Okay. Fair enough.

A - Janne Merethe Flessum {BIO 19368607 <GO>}

Next question, please?

Operator

There are no more questions in the queue.

A - Janne Merethe Flessum {BIO 19368607 <GO>}

There are no more? Okay, thank you then for participating. We look forward to seeing some of you in London tomorrow, and we will also do road shows this quarter to Edinburgh, Frankfurt, Stockholm, Toronto, Boston, and New York.

Thank you again for participating and have a nice day.

Operator

That will conclude today's conference call. Thank you for your participation. Ladies and gentlemen, you may now disconnect.