Q2 2016 Earnings Call

Company Participants

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

Other Participants

- Blair Stewart
- In-Yong Hwang
- Jakob Brink
- Jonny Urwin
- Matti Ahokas
- Paul De'Ath
- Vinit Malhotra

MANAGEMENT DISCUSSION SECTION

Operator

Good day, and welcome to the Gjensidige Q2 2016 Results Presentation. Today's conference is being recorded.

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

Janne Merethe Flessum {BIO 19368607 <GO>}

Thank you. And good morning and welcome to the second quarter presentation for Gjensidige. Our CEO, Helge Leiro Baastad, will start by giving you some highlights for the quarter before our CFO, Catharina Hellerud, comments the numbers in more details. And then, we will, of course, have good time for Q&A. Before we start, just remember, you can download the presentation material from our website.

Helge?

Helge Leiro Baastad {BIO 5865247 <GO>}

Yeah. Thank you, Janne. And welcome from me as well. If you look at page 2 in the presentation, we deliver another second quarter, with a profit before tax expense of NOK 1.7 billion. It's very strong insurance results, NOK 1.072 billion, which gives 80.6% in combined ratio. We have a strong growth in premiums, 6.7%; underlying is 1.2%. I will come back to the growth and the situation operationally afterward.

Still a good underlying frequency claims development and were not as expected. The proportion of large losses, it's somewhat lower than expected, but it's significantly above last year. Cost ratio is 15.6% and it's negatively affected by the Baltics and the integration there. The financial result became – of NOK 570 million, and that gives us return on financial asset of 1%. Annualized return on equity, 21.7%. Catharina will go back to the detailed figures afterward.

If you turn to page 3, this quarter, we recorded growth in premiums of 1.4% in Norway; it's 0.2% for private and 2.7% for the commercial segment. The slowing growth rate is in line with expectations, and it's also as communicated earlier, given the general slowdown in the economy and the increase in competition in its way. Generally speaking, we see that growth in the Norwegian insurance market has leveled up, and that we have strengthened our leading position, both in absolute terms and in relation to the main competitors, as you can see from the chart.

The competition is intense, but the development illustrates that our competitiveness continues to be good. We are especially pleased with development given that we continue to deliver a combination of good profitability and high customer satisfaction.

We continue, however, to prioritize profitability over growth. Over time, though, we expect to continue to grow organically in step with the nominal GDP, but at the moment, as we have seen, growth in the insurance market is lower. Weaker growth requires continued good cost of discipline, and we will maintain a strong focus on further cost efficiency measures to ensure that the cost base will remain in the peak scene and that we deliver combined ratio at this low end of the target rate.

Long-term partnership agreements are important to Gjensidige, as partnership agreements and participation in new ecosystems really become even more important to grow profitability going forward. The agreements helped to increase our customer base and strengthen loyalty.

In the second quarter, we expanded our agreement with the Norwegian Society of Engineers and Technologists, NITO, to also included accident and health insurance with effects from January 1, 2017. NITO has 80,000 members in Norway and a significant percentage of them are Gjensidige customers via our long-term P&C insurance agreement.

In Denmark, we entered into a new agreement with the Danish Community of Senior Citizen Organisation, which has 140,000 members. The agreement in Denmark covers a wide range of products, including the 55-plus product launched in Norway earlier this year.

Over time, as communicated in connection with the first quarter figures, accident and health insurance would grow in scope and importance in our total portfolio, driven by the technological and demographic development we see around us. The situation outside Norway remains relatively unchanged compared with the last quarter. The situation in the Baltics will continue to get worse before it gets better, but we remain on track towards achieving probability in 2018, as earlier communicated.

The acquisition of Vardia was closed on July 1, and we are looking forward to starting the integration work in Sweden as well. The portfolio will make a positive contribution to achieving profitability in Sweden over the next year.

Then moving to page 4. The Gjensidige Foundation has again distributed its dividends to Gjensidige general insurance customers in Norway, as it has done every year since our stock exchange listing in 2010. The unique customer dividend model helps to both increase familiarity with Gjensidige and increase customer loyalty. At the total since the listing, almost NOK 11 billion has been paid in customer dividends since, as I said, the stock listing in December 2010; and that corresponds to between 11% and 16% of premiums paid every year. This year, it was 13.5% of premiums paid for 2015; and that corresponds, as you can see, to NOK 2 billion.

More than 80% of customers now receive their customer dividend automatically into their accounts and the model this year as well has been (06:42) digital marketing and in social media. And the awareness of the customer dividend among non-customers was record high at 62% at the end of the second quarter.

And then, we can go into more detail in the figures, Catharina.

Catharina Elisabeth Hellerud {BIO 17276650 <GO>}

Thank you, Helge, and good morning. I'll start by commenting on the figures on page 6. We report of strong insurance result this quarter as well, NOK 1.072 billion, which is the best development compared with the corresponding quarter last year.

The main explanation for the good insurance result is the combination of good tariff, solid growth and the continued good underlying frequency claims development. Large losses on the other hand are NOK 134 million higher than in the corresponding quarter of last year, although it's been significantly lower down than the expected level.

However, the increased proportion of large losses was more or less offset by the run-off gains. And the run-off gains are now more or less in line with what we expected over the coming two-and-a-half years and four-and-a-half years. Pension and savings recorded a good performance in the quarter. Improvement is primarily due to higher financial result.

The Retail Bank reported very strong profit this quarter, about NOK 30 million higher profit before tax than in the second quarter last year. Improvement in profit performance is due to combination of increased volumes and somewhat reduced provisions for losses and a higher financial result. The Retail Bank continues to show rigid growth, although the growth rate is slowing somewhat. Lending has increased by 24% for the last 12 months.

The investment portfolio yielded a satisfactory return of 1% in the quarter; and the profit before tax was NOK 1.7 billion compared to NOK 1.6 billion in the second quarter last year.

So turning to page 7. The combined ratio was 80.6% in the quarter, corresponding to 79.8% on a discounted basis. The cost ratio was 15.6%, up from 15% compared to last year. As I had commented before, the increase is due to acquisition of business of Norway with a higher cost ratio; and in addition, there is integration cost in the Baltics. As a result, the degree of the project cost ratio will be somewhat above the 2015 level, both this year and the next, but it will still be in the 15%. If we exclude the Baltics, the cost ratio was 14.5%, which is unchanged from second quarter 2015.

The loss ratio was 65.0%, which is 0.6 percentage points higher than in the corresponding quarter last year. The underlying loss ratio is actually unchanged from last year. The motor portfolio in private Nordic continues to show good profitability. There are some increases in claims within additional coverages, particularly relating to rental cars, rescue and (09:59) claims.

However, the long-term frequency reduction in serious personal injuries, major material damage will continue, and we still expect claims inflation to remain at about 1% going forward.

The property portfolio in Norway shows a very good profitability in the quarter; both the frequency and average length are below our expected levels.

The commercial portfolio in Norway had also very strong results in the quarter. The situation in our commercial property is much the same as from private portfolio property with the loss frequency and also a few large losses in the quarter. The accident and health service also – they also show stable and good development. Price pressure is increasing, particularly in the large account accident and health schemes that we see now signs of the frequency increase as the result of a somewhat weaker macroeconomic situation.

The Nordic region recorded a poor performance in the quarter. A large part of the reason was significantly higher proportion of large losses, but there's also weaker underlying possibilities, particularly within motor and property in Denmark. About half of the underlying weakening in this quarter is related to the weather, which especially affects property products.

For the motor portfolio in the commercial market, we will be keeping a close eye on the possibility going forward to see whether there's we need to adjust the motor tariff.

Moving on to the premium growth on page 8. As you can see, we continue to have some premium growth, 6.7% in the quarter, with underlying growth of 1.2%. Helge has commented on the growth in the Norwegian insurance market. Nordic reported growth of 14.9%, with underlying growth of 0.5%. The underlying growth in the damage portfolio was SEK 3.9 million in local currency, which we are satisfied in. It is especially the commercial property portfolio that is contributing to growth.

The Swedish credit portfolio is also growing, but they still are missing a lot of customers in the Swedish commercial portfolio as a result of the re-pricing that we are undertaking in order to ensure a more profitable portfolio.

The Baltics reports growth of 108.4% and 2% adjusted for currency and acquisition. The underlying growth is influenced by the repricing of the portfolio, as well as implementing new tariffs. However, we are seeing the positive effect of the measures which are implemented in distribution, including measures to get customers purchase a broader range of product.

And turning to page 9, you can see that most of the nominal increase in cost of NOK 90 million comes from the Baltics and the Nordic segment, and it's due to our acquisitions last year and also some currency effect. And as you can see, the cost control in the Norwegian segment is still very good.

On page 10, you find details on our large losses in this quarter. Large losses amounted to SEK 198 million, which is significantly lower than expected, and the expected level was SEK 318 million. But the level of this quarter also seem significantly higher than large losses in the second quarter last year, however, it was very low, SEK 4 million.

Fires were (13:36) main cause of the large losses in the quarter. And as you can see, the increase in large losses are especially related to the Nordics, which is significantly higher than the same quarter last year.

Turning to page 11. Run-off gains of NOK 227 million first half, the positive impact on the combined ratio of 4.1 percentage points, which is around the expected level the next two and a half years to four and a half years. The effect of the corresponding quarter last year was 2.0 percentage points.

Page 12 gives you some details from the investment portfolio. The portfolio was NOK 54 billion. This yielded a return of 1% in the quarter. The match portfolio, over NOK 36 million, makes a stable contribution to the financial results is a return of 1%. The held to maturity portfolio is one of the profit driver in the match portfolio. So far, this year, the average investment rate for the whole majority portfolio has been 3%, while its running yield is 4.6%.

The excess value in the held to maturity portfolio increased by NOK 100 million in the quarter to NOK 1.7 billion, which will make a positive contribution to the (14:56) in the years ahead as well. The free portfolio amounted to NOK 18 billion and we derived a return of 1.1% in the quarter.

The fall in the interest rate and the narrowing of the credit spreads contributed to the bond portfolio which yielded a good return in the quarter. Convertible bonds were an exception and were yielding a weak profit return (15:17).

The shares in SR-Bank showed a good development and contributed positively to the result with NOK 66 million while other current equities yielded zero profit in the quarter.

Current equities portfolio yielded a slight negative return of minus 0.5% in the quarter and there were no special events in the portfolio in this quarter. And the property portfolio also delivered a satisfactory result.

Then turning to page 13, the presentation of our strong capital position in three relevant perspectives. The rating requirement is the most (16:01). The capital adequacy ratio on the rating perspective is 110% the strategic buffer is NOK 1.4 billion, which represents an increase of NOK 500 million since the end of the last quarter.

Few special elements affects the numbers this quarter. We have included the capital effects on the Vardia acquisition of NOK 500 million even though the transaction was closed on July 1. So there we have gained S&P's acceptance for reducing the technical provision as a result of expected (16:35). This reduces the capital requirement by just under NOK 500 million.

Therefore, also the underlying increase in the strategic buffer is NOK 500 million from last quarter. This increase is mainly due to the 30% retained earnings that we add to the weight of capital during the year, and the lower market risk gives a lower investment portfolio after the different payments in the quarter and also somewhat lower excess (17:04). And they also have some of our insurance risk due to (17:08) somewhat lower at the end of the quarter partly due to the currency effects.

The solvency margin under the internal model factor increased from 181% to 187%, and under standard formula, it increased from 139% to 148%. Based on our understanding of the guarantee scheme, the solvency margin was 191% and 151%, respectively. Also in this perspective, the Vardia acquisition has been taken into account in the calculation with around NOK 500 million.

Looking at price come back (17:46) for the underlying improvements are the same as for the rating perspective. In addition, cost increased due to profit in premium provisions in general insurance due to seasonal effects and also increased due to profitability growth in the pension company. And lastly (18:05) in the pension company in the quarter.

So to sum up, we have a solid capital position in all perspective. We still consider it possible to achieve a further improvement in capital efficiency by using some of the Tier-1 capacity, which amounted to NOK 2.7 billion by the end of the quarter. And as mentioned earlier, we are not (18:28) the whole capacity and we are seeing a substantial buffer.

Then, I'll hand the word back to Helge for a quick wrap-up before the Q&A.

Helge Leiro Baastad {BIO 5865247 <GO>}

Yeah. Thank you again. Then, it's on final comments on page 14. We have strengthened our market position in Norway, and we are maintaining our competitiveness as you have seen through the presentation. We manage to do this in combination with continued good profitability and high customer satisfaction.

We are also seeing that it's limited organic growth and we expect that to continue in short to medium term. This is driven by weak macroeconomic and consequently increased competition. Over time, though, we expect to grow in that with nominal GDP. In addition, we are well positioned to take part in structural changes in our region to exploit economies of scale product. It's also important to continue with cost discipline. And we have lots of initiative to continue what we have done for a number of years. In order to achieve all the financial targets which remain unchanged. It is all about balancing underlying cost efficiency measures with relevant investment to secure competitiveness also longer term. This includes initiatives related to increase the utilization and automation. For instance, the utilization of robotics.

We will continue to deliver good customer experiences in combination with high value creation and a predictable high and stable cash dividend for owners. Our strong capital position as Catharina presented provides an important support. And with this, I'll hand it back to you, Janne.

Janne Merethe Flessum {BIO 19368607 <GO>}

Yeah. Operator, we are then ready for taking questions please.

Q&A

Operator

Thank you. We can now take our first question. It comes from Jakob Brink of ABG. Your line is open, sir. Please go ahead.

Q - Jakob Brink {BIO 7556154 <GO>}

Thank you and good morning. I have three questions please. The first one is regarding the NOK 500 million adjustments to the S&P model due to your excess reserves. How will this NOK 500 million be adjusted going forward? I mean, when you actually book those run-off gains, will they then reduce this NOK 500 million? Or how will S&P actually treat this?

Secondly, any news on your potential hybrid or Tier 1 issue? And final question is on other bonds in the free portfolio. The return here has been very strong for the past two quarters. What should we expect from this line going forward, please? Thanks a lot.

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

The first question was related to the S&P in terms of when the NOK 500 million in effect. What's expected is that we reduce the reserved when we calculate the requirement for the insurance, which means that of course when these run-off gains are actually reported in our results, it will be part of P&L and we understand they were successful, but the reduction in the capital requirement has been taken in the accounts as from this quarter's (22:31) reduction.

Q - Jakob Brink {BIO 7556154 <GO>}

Sorry, why is it only NOK 500 million?

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

It's a reduction – the capital requirement is reduced by NOK 500 million due to the technical reserve. So that's the effect on the capital requirement.

Q - Jakob Brink {BIO 7556154 <GO>}

Okay.

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

And news on the Tier 1 hybrid. Well, the news there is there's no news this quarter, only that we continue to see that possibility to do this during 2016, and this is something that we do to optimize the capital. So if you don't find the terms effective, we will – and we will push it into 2017. But it's something that we view as possible to do during the second quarter.

Q - Jakob Brink {BIO 7556154 <GO>}

Okay.

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

And then you asked about the bonds portfolio and the free portfolio. And, of course, it's due to what happened on the interest rate side (23:47) from the margin. So it was a (23:48) based on market movement in the interest rate and sometimes credit spreads.

Q - Jakob Brink {BIO 7556154 <GO>}

And what is your maturity on that portfolio?

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

It's now around somewhat about three years. We have the exact figure in the report. It was 3.5 years.

Q - Jakob Brink {BIO 7556154 <GO>}

Okay. Okay. Thanks for the...

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

And go back to benchmark. You could look at internationally managed investment grade on high yield (24:23). These are internationally managed (24:28).

Q - Jakob Brink {BIO 7556154 <GO>}

Great. Many thanks.

Operator

Thank you. We can then move on to our next question, it comes from Jonny Urwin of UBS. Your line is open. Please go ahead.

Q - Jonny Urwin {BIO 17445508 <GO>}

Good morning, all. Thanks for taking my questions. Just two from me. Firstly, I'm interested to hear your commentary on the dynamic between pricing movements and claims inflation across each of your key market. So you mentioned earlier that claims inflation is running about 1%. I mean, are you able to price that out? What sort of action are you putting through the book?

Secondly, just thinking about the customer dividend model, I'm sure you gave us some interesting stats at the Capital Markets Day about what the customer dividend model does to retention for customers that are aware of it versus customers that aren't aware of it. I wondered if you had any similar sort of statistics, and then if you could quantify the impact of retention. Just any commentary there would be interesting? Thank you.

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

Thank you, Jonny. The first question, it was related to pricing and inflation; although pricing is, of course, to meet the combined ratio. And as you know, our target is to be in the lower end of 86% to 89% in the period a run-off gain. And, of course, we have to compensate for claims inflation to manage that over time.

We are also working analytical with dynamic and segmented approach to price adjustment and trying to balance profitability with growth. And so, pricing in Norway is based in expectation is the same as you have heard before. Medium, long-term, it's around 1% related to motor, and it's more 3% to 4% related to private property. But in the situation we are now, we have also very, very strong profitability, so we have to look at the pricing up against what we deliver at the profitability level. More normal results going forward, we have to secure that that can price in line with the claims inflation.

What I said also to my presentation is that we see generally low price increases from our competitors. We expect this to continue short term, medium term and long term. We have to price in line with the claims inflation to secure the profitability long term. So it's nothing new related to our estimates for claims inflation actions.

Q - Jonny Urwin {BIO 17445508 <GO>}

Just to comment...

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

We have had a couple of years with very benign weather situation, very mild winters and of course that's also part of the estimate at the moment.

Q - Jonny Urwin {BIO 17445508 <GO>}

Okay. And did you say, was that pricing increases of 1% on motor, 1% to 4% on home, or was that claims inflation or both?

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

No. No. The price increase is at the moment and there's always long-term estimates for claims. And estimates for claims inflation is the same as before, 1% for private model, 3% to 4% related to property. And the price increase is below that at the moment, and we expect that to continue in short-term.

Q - Jonny Urwin {BIO 17445508 <GO>}

Great. Thank you.

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

And then, you had a question about the customer dividend model. And what we see there is that – we know that more than seven out of 10 customers say that this model is part of their decision staying customer with Gjensidige. So it's definitely an important loyalty tool for us.

Q - Jonny Urwin {BIO 17445508 <GO>}

And do you have any sort of view on the difference that that leads to between customers that are aware of the dividend and customers that aren't aware?

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

We know that out of our customers, nine out of 10 customers are aware of the model, but probably closer to 100% now. But when it comes to non-customers, we also stated now that we have the record high awareness of 62% after the campaign this quarter. So it's gradually increasing also among non-customers.

And if you look into our retail book, just to give you a sense of the retention that we have in our retail book in Norway, 85% of the premium in the retail book are premiums to our loyalty and affinity customers. And, there, the retention level is 92% in that part of the book. And, of course, also again, the customer dividend model is supporting this.

Q - Jonny Urwin {BIO 17445508 <GO>}

Great. Thank you very much.

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

And it's a very, very important preference, of course, for Gjensidige also for non-customers.

Q - Jonny Urwin {BIO 17445508 <GO>}

Thank you.

Operator

Can we move on to our next question?

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

Yes.

Operator

Thank you. We can now move on to our next question. It comes from Paul De'Ath from RBC. Your line is open, sir. Please go ahead.

Q - Paul De'Ath

Yeah. Hi there. And thanks for taking my questions. A couple from me please. Firstly, on the Norwegian commercial business, so you've won another large scheme this quarter, and there's one last quarter as well. And I believe on this quarter, and it's from one of your major peers and judging by what they said during this week. I guess, on that point, just kind of a – can you give us any more detail on why is that you're winning this game? Is it – or these games, is it based on price? Is it brand? I guess, what's the driving factor for why you're getting – winning these off your competitors? And are you going to be as profitable as they would have been had they want it, if that makes sense?

And then, the second question was just going back to the capital point and the buffer on the S&P rating is now NOK 1.4 billion, and can you give any indication of where you're comfortable for that buffer to be because it was at NOK 0.9 billion previously, and I think that point, you were still talking about potentially being able to reduce it. And so, is your base assumption still you're happy with lower than NOK 0.9 billion on that going forward? Thanks.

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

Yeah. If I understand your question related to the Norwegian commercial operation, we are really pleased with the combination of profitability and growth in that part book as well. And it's important to comment the situation, we had growth driven, in particular by one large new customer in that book came in 1st of January this year. So, we will have that large account in our figures through the year.

We expect underlying growth to be limited on the commercial side especially related to accident and health, its strong competitiveness that's being managed actually to price in a way that we continue with strong profitability. So we are really pleased with the whole operation in Norway, but it's limited growth and the growth we reported partly driven by one large account.

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

Yeah. And then you asked about the strategic buffer, which is now NOK 1.4 billion. The main purpose for the buffer is, of course, the same that it has been all the time. It's to meet regulatory uncertainty, to be able to finance smaller acquisitions, and obviously to support stable dividend. And the buffer used to be higher last year, and that was due to the higher regulatory uncertainty related to the implementation of Solvency II. So the level has been reduced, reflecting that we now consider the regulatory uncertainty to be even much lower than before we saw the full consequences of Solvency II implementation in the Norwegian regulation.

But it's now mainly there for supporting M&A activities and also to support stable dividend. And of course, it's up to the board, especially once a year, when they consider the dividend for the year, to discuss the price of the buffer. And that said, just to remind you that we have our ROE target and prospect, and we are very eager, of course, to deliver on that target. So, we will not give any unnecessary buffers. So, let's think – thinking it's the same as it's been before, that is – the buffer is higher than we need. These are the remaining two main purposes of the buffer. The board will discuss cash and dividend.

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

And just to add to your first question of our competitiveness in general related to commercial in Norway. It's important to remember that our commercial book is first and foremost, the SME book is only 20% to brokers. So, we have managed to build up a very modern multi-client distribution model based on the principle from the private line. So, I think that's also an explanation. And if you compare over business in the commercial book in Norway up against our two main competitors, I think we have more direct business compared to our main peers.

Q - Paul De'Ath

Okay. Great. That's very interesting. Thanks.

Operator

Thank you. We can now move on to our next question. It comes from Vinit Malhotra of Mediobanca. Your line is open. Please go ahead.

Q - Vinit Malhotra {BIO 16184491 <GO>}

Hi. Can you hear me? Just a few questions please. First is on the – in the Nordics, I understand the underlying gross ratio of the group level was – in this quarter was driven by the Nordics segment. And then we also see that the Nordics segment had some large losses. Could you just comment a bit about whether it's Sweden mostly or Denmark driving, because as I understand it's largely Denmark. But if you could just comment a little bit there on this trend please.

Second thing you said, we picked up that the free portfolio has had some portfolio reallocation in the bonds more towards U.S. Has it been just towards the end of the quarter? Is it something that was very practical? I mean, it's reasonably a sizable shift from 30-odd percent to 45-odd percent of bonds. If it's just a currency play, so that's one thing.

And last question please on the commercial – for the last two quarters where we have seen one of the large transactions driving commercial growth in Norway, is it partly attributable to the dividend model? Or how would you consider those one-off transactions because now both quarters have seen some large deals and commercial only? Thank you very much.

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

I think Janne (37:48) try to find out how to answer your second and third question and I can start with the first one. And that's related to the Nordics segment. And as you know, we report now Denmark and Sweden together. And it's completely a different situation between Denmark and Sweden.

Just to start with Denmark, we are really pleased with the situation in Denmark, it's positive underlying growth of 2.9% in local currency. If you include numbers related to acquisition, it's 9.5%. Then you understand that we had a negative growth in Sweden, and the Swedish operation is around or less than 20% of the Nordic premiums. 40% commercial in Sweden and 60% private. We do repricing of the commercial book in Sweden, so we have reduced premium volume related to commercial. And we have a positive and good development in the private segment in Sweden.

In Denmark, as we communicated, we had several large losses in the second quarter. Last year, it was zero. And this quarter, it was NOK 90 million, nine zero. In addition, we have had also, as you have heard, also commentary earlier this week; it has been some local heavy rains through the second quarter. And that has given some claims. And in addition to that, somewhat weaker underlying growth or somewhat increased sales level underlying. And I think this is, more or less, just in line with what you heard from earlier this week.

So, you have to understand the split between Sweden and Denmark, and if you adjust for large losses, we are really pleased with the situation in Denmark.

Q - Vinit Malhotra {BIO 16184491 <GO>}

Okay.

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

And then, you asked about the allocation in the free portfolio. There is no special reason why there is almost higher exposure towards this quarter. It's just based on ordinary management of the portfolio. There is no specific reason behind that bond shift.

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

And then, Vinit, you had the third question. I think you need to repeat that, we didn't quite get your question.

Q - Vinit Malhotra {BIO 16184491 <GO>}

Sorry. Sorry. If it's clear now, let me try again. In both 1Q and 2Q in Commercial Norway, we have seen you point to some of the large deals which helped the growth. I am just curious whether these large deals are partly the result of the ongoing customer dividend model or is it something just normal business?

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

No. We need one new large customer, significantly premium volume came into our book January 1, and that will flow into the figures through the whole 2016. And then, when we come to January 1, 2017, we will not have – we will have it on...

Q - Vinit Malhotra {BIO 16184491 <GO>}

I'm sorry, I thought that there was another one this quarter. Sorry. Apologies. I misunderstood. I thought it was fourth quarter something.

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

It's the same customer.

Q - Vinit Malhotra {BIO 16184491 <GO>}

Okay. Okay. That's clear. Thank you very much. Thank you.

Operator

Thank you. We can then move on to our question. It comes from Matti Ahokas of Danske Bank. The line is open. Please go ahead.

Q - Matti Ahokas {BIO 2037723 <GO>}

Yes. Hi. It's Matti Ahokas here from Danske. Two questions please. First thing on the capital, a bit surprised that the economic capital is up NOK 1 billion quarter-on-quarter, and there seems to be some kind of new calculation taking up on the provisions in Life Insurance. Is this a kind of one-off thing or is this dependent on interest rates? Or how should we see this going forward?

And the second question is regarding the Baltic operations. Has something happened underlying here because at least if I listen to Helge, you sound relatively still bearish overall about the Baltic situation? Or are this kind of is the sub-scale profitability more a function of the recently acquired assets? Or a clarification on what's going there would be very helpful. Thanks a lot.

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

I can answer the question about the capital requirement. There are two one-off that explain some of the movement. The rest are more ordinary and change is more ordinary, changes, some specific events or anything. It's the Vardia transaction, it's a one-off. And then, it's the S&P, the change in (43:02). So those are the one-offs this quarter. The rest is just ordinary and mainly (43:11).

Q - Matti Ahokas {BIO 2037723 <GO>}

Sorry. I'm talking about the economic capital, the S&P way, is that also in the economic capital calculation?

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

Yes, the S&P. Yes, it's a lower – no, the change in S&P model is a lower capital requirement; and the Vardia transaction; it's both the capital requirement and the economic capital. So the Vardia transaction has a fall through effect on cash flow of NOK 500 million. Around NOK 200 million is increased capital requirement and around NOK 300 million is reduced capital available.

Q - Matti Ahokas {BIO 2037723 <GO>}

Okay. But still to clarify, the S&P has nothing to do with the economic capital of NOK 20.8 billion, I guess?

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

No. You're talking about the solvency capital available?

Q - Matti Ahokas {BIO 2037723 <GO>}

Yeah. Exactly – or the economic capital available. Actually, on page number 27, that was up NOK 1 billion from NOK 19.8 billion in Q1 to NOK 20.8 billion. And it's a very sizable increase taking into the account the fact that your profits, excluding dividends, would have gone up by something around NOK 300 million?

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

Yeah. One thing is, of course, that we assume that 30% from that result is added to the capital during the year. So we retained 30% of net profit. We also took a subordinated loan in GDF, the pension company, NOK 300 million which also adds to the available capital. We talked about the Vardia acquisition, and it has a small effect – a negative effect on available capital. And then you have future profits in provisions both within the general insurance business and the lifestyle business. And in the general insurance business, it's mainly due to seasonal effects. And within the pension business, it's mainly due to some growth.

Q - Matti Ahokas {BIO 2037723 <GO>}

All right. Great.

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

Related to the Baltic question, I was rather short, but the communication should at least be just the same as last quarter. It will be worse until it gets better. So we are working with integration and improvement program, and we are on track with that. And that means that we will see profitability in 2018.

Regarding the Baltic market, it's also fierce competition out in these three countries. We are trying to go from broker to multi-channel distribution, and that requires investment and you have seen that in our cost figures. We are also implementing tariffs and processes portfolio management based on our knowledge from Norway and the Nordic; and we have started with motor in Latvia, and we are continuing with Lithuania.

So what we actually overall want to do out there is leveraging Gjensidige's brand and best practice from Nordics to the Baltics. We want to launch better risk-based pricing using GLM models. It's about claims handling processes, efficient and effective claims handling. So we're actually building a completely new company and that requires investment. And we also try to get faster to market with products and tariffs compared to before.

And finally, of course, we want to integrate the PZU with our own companies, and it's a significant job related to leadership and employee and culture. But we are on track as the communication should actually being just same as last quarter.

Regarding the market, it's very price-sensitive standardized products. Most competitors fail to breakeven on motor products. But we also see some encouraging and interesting development, health insurance products, marketing; it's growing rapidly, 15% to 20% in Latvia. So it's something interesting also happening in the market. So we use more group resources and we are according to plan.

Q - Matti Ahokas {BIO 2037723 <GO>}

When you say it's going to get worse before it gets better, does it mean that the quarterly underwriting profit will still go down from current levels or how should one interpret that?

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

It may happen. But we will breakeven and get profitable in 2018.

Q - Matti Ahokas {BIO 2037723 <GO>}

Great. Thanks a lot.

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

We are in the investment period. So from broker to multi-channel is biased investment; and building tariffs and building the systems around the claims handling processes and the pricing processes require investment. So it's on the cost side, as you have seen, but we are comfortable.

Q - Matti Ahokas {BIO 2037723 <GO>}

Thanks.

Operator

Thank you. We can now move on to our next question. It comes from Blair Stewart of Bank of America. Your line is open. Please go ahead.

Q - Blair Stewart {BIO 4191309 <GO>}

Thanks very much. Good morning. All the good questions have gone, so mines are pretty rubbish. Here we go. First one is in The Pensions and Savings segment. I noticed there was a drop in premium income, and that's unusual given that's a growth market. So I just wonder if you could comment on that and the outlook.

Secondly, I wondered if you had a cost income ratio target or something in mind for the bank, which had a very good Q2. And thirdly, you mentioned in the commentary that claims frequency is still lower than normal. I think that's what you said anyway. I may be paraphrasing. But if that is the case, is it possible to comment on how favorable that has been so far this year in terms of the combined ratio effect? Thank you very much.

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

I can start with the latter, Blair, and Catharina is looking for the two other questions together with Janne and (49:44).

Claims frequency is – we have had very good situation for a long period now. If you go back to 2010, we had a significant freeze in the whole Nordic area. And as I remember, in our figures then, we had almost NOK 400 million, NOK 360 million to NOK 400 million, in extraordinary claims related to that hard, harsh winter. We haven't really had that kind of winter since 2010.

And if we have a very hard winter coming in November and leading maybe in March, April, we will have a completely different trigger situation on motor, private and property. And that's the difference between then and the years later.

So, it's warmer climate, but still it's the – that's the long trend. So, we should – if we have winter lighter next winter. And then we will have a completely different frequency situation. When we operated claims inflation, it's more long term based on the situation that we will have harsh winter now and then.

I don't know if I answered your last question with that comment. But if not, try once again, Blair.

Q - Blair Stewart {BIO 4191309 <GO>}

No, no. (51:15). I think I've probably been asking the question since 2010 actually, but it seems that you're saying that a harsh winter cost about NOK 400 million in additional claims. You haven't had that since, so if we did get a harsh winter, then that's the magnitude of the impact that might have on your underwriting result, which would be about 10% of your underwriting result, more or less.

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

Yeah. It was – I think it was NOK 350 million on that premium volume.

Q - Blair Stewart {BIO 4191309 <GO>}

Yeah.

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

But the competition we have today, lots of the new players, they haven't really experienced that winter. And that's – that could actually happen again next winter.

Q - Blair Stewart {BIO 4191309 <GO>}

Yes. Of course. Thank you, that's great.

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

Yeah. When it comes to the cost income ratio in the bank, we don't have a target that we can (52:08), the target is to be a lean bank, to have a low cost income ratio, of course. This is interest based bank. They did not have their own physical distribution. The target has been a lean bank supporting the Private segments in the Norwegian market.

Q - Blair Stewart {BIO 4191309 <GO>}

Okay. Would it be fair to say then that you should expect the cost income ratio to reduce over time? If that's your objective, presumably, you'd want to continue to grow the top line.

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

It's about scale. That's correct.

Q - Blair Stewart {BIO 4191309 <GO>}

I'm sorry?

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

Yeah. It's about scale. That's correct.

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

Should reduce over time, absolutely.

Q - Blair Stewart {BIO 4191309 <GO>}

Yeah. Okay. Thank you. And on the pension side?

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

Yeah. It's a reduction in the income is, I think, it's more or less seasonal fluctuation. So, we do have a good competitive position in this market, competing market, the three others bigger players. There's no specific reason behind the fall in the premiums for the quarter.

Q - Blair Stewart {BIO 4191309 <GO>}

Yeah. It was – is this the first time that the premiums have reduced as far as I can see for quite some time both in Q1 and Q2.

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

Yeah, we continue to compete harder in that market, and we think we still have a very good position. And it is done, again, the support of our commercial book and very good of less 85% of the premium customers are also P&C customers. And of course, that's the main reason why we have this pension company. But as I see it, it's very hard – these products are very often found (54:09) health products with the P&C. And as we have commented, it's very hard, competitive landscape out there now within these schemes. And if we look at, for example, the workers' comp market in Norway within the (54:27) product within the P&C market, the market has actually fallen over the last 12 months.

Q - Blair Stewart {BIO 4191309 <GO>}

Right. Okay.

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

So this is – yeah.

Q - Blair Stewart {BIO 4191309 <GO>}

Okay. Okay. Thank you.

Operator

Thank you. We can then move on to our next question. It comes from In-Yong Hwang of Goldman Sachs. Your line is open. Please go ahead.

Q - In-Yong Hwang {BIO 18784369 <GO>}

Good morning. Yeah. Thank you for taking my question. And I've got a couple. Firstly, on your appetite for M&A, it now seems that you've got quite a hefty integration going from both Baltics and in terms of Vardia. So, I was just wondering what your kind of capacity, not in terms of capital, but in terms of, as an example, management resources to do a further bolt-on M&A that you've talked about in the past.

And secondly on digitalization, I think you have a target for 2018 to have 75% digital customers and over 50% of claims supported online. Just wondering if you've got a update against those metrics. Thank you.

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

Yeah. If you can find the update on the metrics for the latter question, Janne. Your first question is good. It's lot of work. Every time we have bought – we have now bought 16 companies the last 10 years – 10 years, 11 years. And it's a significant job every time to integrate the company. And today, we are working in Sweden and Baltics, as you said. That means that we will not acquire small portfolios, small companies that are too complicated to integrate.

So the appetite short term will be robust. We will, of course, have appetite all the time to buy and integrate it, particularly important companies, which is possible to actually handle for us regarding integration.

So we have a very skilled team. They look at things all the times. And if the right target occur, we will, of course, look seriously into that. But too complicated and too small, we are short term, we do not have appetite short term if it's complicated and small.

Q - In-Yong Hwang {BIO 18784369 <GO>}

Okay.

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

And then when it comes to difficult customers, the number at 63% updated. So, that is the last number we have versus the target that you mentioned. And when it comes to claims reported online, we are actually approaching very fast now, that's over 50% already.

Q - In-Yong Hwang {BIO 18784369 <GO>}

Brilliant. Thank you very much.

Operator

Thank you. Okay. We have another question. It comes from Jakob Brink of ABG.

Q - Jakob Brink {BIO 7556154 <GO>}

Yeah. It's Jakob again. Just one follow-up please. In the bank, I also noticed that your net interest margin is quite strong in the second quarter, and actually, it has been quite flat since last year when it dropped into Q3. If we look at other Norwegian banks, it seems as if there's a competition in the beginning of the year, so I was just – this year. So, I'm just wondering why don't you see the same pressure on margins.

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

Well, if we look at the margin, it's 1.82%. And it's, of course, the combination of the kind of (58:22) it's combination of healthy mortgages which is, of course, a low margin product. We also offer consumer finance, as well as car finance. It's a combination of the healthy portfolio which (58:34) this 1.82%.

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

Although competition is not actually comparable with the large banks because we have a relatively high proportion of the business outside mortgages, consumer finance and car finance with better margins.

Q - Jakob Brink {BIO 7556154 <GO>}

And you're not seeing any pressure on these segments?

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

Pardon? Not seeing...

Q - Jakob Brink {BIO 7556154 <GO>}

And you do not see the same pressure in car finance and consumer finance as the larger banks are doing in the mortgages? Is that what you're saying?

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

Specifically loans.

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

Yeah, mortgages. Of course, we see the same pressure as the other one. But the composition in our bank is different compared to the large bank.

Q - Jakob Brink {BIO 7556154 <GO>}

Yes. Okay. Fair enough. Thank you.

Operator

Thank you very much, sir. As we have no further questions at this time, I would now like to hand the call back to the speakers for any additional or concluding remarks. Thank you.

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

Thank you. And just before we end the call, I just want to remind you of the Analyst Meeting that we're holding also then on 18th of August. We hope most of you will join us, and we're also doing road shows after summer in Oslo, Helsinki and Swedish Geneva, New York, London, Stavanger and Bergen.

And once again, thank you for participating and have a nice summer holiday. Bye.

Operator

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