Q3 2019 Earnings Call

Company Participants

- Kjetil R. Krokje, Group Head of Finance, Strategy, M&A
- Lars Aasulv Loddesol, Group Chief Financial Officer
- Odd Arild Grefstad, Group Chief Executive Officer
- Unidentified Speaker

Other Participants

- Ashik Musaddi
- Blair Stewart
- Matti Ahokas
- Peter Eliot

Presentation

Operator

Hello and welcome to the Storebrand's Third Quarter Conference call. My name is [ph] Wall and I will be your coordinator for today's event. Please note this conference is being recorded and for the duration of the call, your lines will be on listen-only. However, you will have the opportunity to ask questions at the end of the presentation.

(Operator Instructions)

I will now hand you over to your host Kjetil Krokje to begin today's conference. Thank you.

Kjetil R. Krokje {BIO 20060140 <GO>}

Good afternoon, ladies and gentlemen. Welcome to Storebrand's third quarter 2019 conference call. My name is Kjetil Krokje and I'm the Head of Finance and Strategy at Storebrand.

Together with me today, I have a Group's CEO, Odd Arild Grefstad, and CFO, Lars Aa. Loddesol. In the presentation today, Odd Arild will give an update on the development fees in the third quarter. CFO, Lars Aa. Loddesol, will give an overview of the financial developments and dig into some of the more technical elements in the period.

The slides will be similar to the analysts presentation released this morning and are available on our webpage. After the presentation, the operator will open up for questions. To be able to ask questions, you will need to dial into the conference call.

I now give the word to Storebrand's CEO, Odd Arild Grefstad, who will start the presentation on Slide 2.

Odd Arild Grefstad {BIO 5483351 <GO>}

Thank you, Kjetil. Storebrand presented solid group result of NOK 700 million in the third quarter and NOK 2 billion year-to-date. For the quarter, we have booked performance related costs of NOK 49 million without the corresponding NOK 99 million in performance related income being booked -- without this income being booked this quarter.

Year-to-date the performance related costs are NOK 111 million and the corresponding income not booked NOK 265 million. As you know, the performance related income will be booked just at the end of the year at the fourth quarter.

Storebrand are succeeding in our core markets. According to the NKB, the Norwegian customer survey we have the most satisfied customers within occupational pension. The drive -- this drives the solid growth in our unit linked business as well as asset under management within our asset management business.

Our solvency ratio is strengthened during the quarter from 167% to 177%. If we then move to slide number 3, this is our two-fold strategy that is well known. We plan to release capital overtime to our shareholders through active management of our guaranteed products that are in long-term runoff.

In addition, we are well positioned for capital light growth within occupational pension and the individual markets for savings and insurance in Norway and in asset management. At the same time, we operate in markets in constant change. And there are now several regulatory processes running both in Europe and in Norway, that can affect our business but EIOPA to each their consultation paper, they will give their final recommendation to the commission around sometime next year. For Storebrand, the most important topics are interest rate stretch, the ultimate forward rates and the volatility adjustments.

We're also preparing for the new International Financial Reporting Standards, IFRS 17, that entails new accounting rules for insurance contracts. The preparations are well enrooted in Storebrand, for the implementation in 2022.

In Norway, we are expecting a consultation around the proposed changes to the framework for managing the guaranteed pension products, and lastly, I want to mention that the Ministry of Finance has proposed changes to the rules regarding transfer of customer buffers within public pensions. Expected implementation is estimated 2019, and this is good news for increased competition and market dynamics within public pension going forward. And as you know, this is a market where we were allowed to challenge changes to KLP going forward.

If you then move to slide number 4. The growth in savings continues. Compared to third quarter last year, we see a growth of 11% in our Unit Linked assets both in Norway and in

Sweden. Our asset management has strengthened its position as the best leading Norwegian asset manager, with a growth of 8% in assets under management, now amounting to NOK 786 billion.

Our banking business sees moderate growth but has strengthened its margin. Growth in our retail lending is continuously being weighted against profitability. As previously announced, we see positive development in our insurance business. Within P&C and health insurance, we now have a 10% growth while areas within corporate insurance have had more moderate growth rates. In total the insurance business grew by 4%.

Moving to slide 5. As a means to elaborate on growth in our unit linked business. I wish to give you a bit close look into the development of our Swedish subsidiary SPP. SPP is taking a position as the fastest-growing provider of occupational pension in Sweden.

So this is illustrated through a 40% growth in new sales, a 22% growth in premiums and a strong net transfer from our competitors. In fact, in a report, Swedish krone moved in the non-unionized occupational pension is now moved to SPP. This is making SPP to aspire to be the largest player within non-unionized occupational pension in Sweden, too.

An important factor high sustainability, has been its digitalization strategy providing several new digital and truly optimized services to its customers.

Then moving to Slide 6. This quarter Storebrand further strengthened its position as a leader within sustainable investments. We have been acknowledged by PRI, the world's leading sustainable investment organization, as an investor with excellent responsible investment practice and as the only Norwegian asset owner included in the PRI global leaders group. The heavy fires in Amazonas has brought reinforced attention to the problem of deforestation. And in August, Storebrand committed to an investment policy, strengthening our position as an active owner. Our goal is an investment portfolio with zero contribution to deforestation and we have joined forces with 230 other investors in this work.

During the UN Climate Action Summit in September, we as one of 12 founding members of the US-backed Net-Zero Asset Owner Alliance, committed to carbon neutral investment portfolios by 2050. On this backdrop, it is encouraging to see an increasing demand for fossil free investments from our customers. We now have 19 fossil free funds and NOK 100 billion invested in fossil free portfolios and that is actually 13% of our total asset under management.

And with that I give the word to Lars.

Lars Aasulv Loddesol {BIO 3969188 <GO>}

Thank you Arild. Let move to page 7 key figures.

I'm happy to present numbers with the operating profit, once again exceed NOK 600 million a quarter . We have had two quarters with somewhat weaker results, but with no significant surprises, positive financial markets and continued growth in the business. The proper development is now back on track. The solvency has been significantly strengthened since the second quarter, and with satisfactory financial returns buffer building continues.

The returns from good equity markets and falling interest rates are reflected in balance sheet growth and strengthen buffers.

Moving over to page 8, showing the solvency movement between the second quarter and the third quarter. As for the second quarter, the solvency was 165% without transitional capital and 167% with transitional capital.

During the third quarter, we've done the following. One, further model improvements and updated assumptions. This is something we do every quarter, combined contribution just below neutral. There has been a significant drop in rates in the quarter, which leads to 6 percentage points drop in solvency.

The fall in the 10 year swap rates, they were - sorry, were 16 basis points in Norway and 30 basis points in Sweden. This drop in interest-rates has largely been reversed so far in this fourth quarter.

Increased volatility adjustment and reduced equity stress in the standard model have contributed a positive 4 percentage points in the quarter. Volatility adjustment is off by 5 bps in Norway and 2 bps in Sweden. Please note that volatility adjustment in the Norway now stands at 45 bps. This is a historically high level. Business mix and asset allocation contributes positively with two percentage points. This is the result of optimized risk management actions in the guaranteed portfolios. Furthermore, old and higher guarantees are maturing and new guarantees come in at much lower guarantees and with better buffers.

Operating earnings after reserving for 50% business contributes a little more than one percentage point. This quarter, we have optimized our lapse reinsurance program by reducing coverage in Norway and increasing coverage in Sweden. This gives a three percentage points positive contribution.

Finally, we have issued a subordinated loan of SEK 1 billion. This gives a positive three percentage points. Please note that this loan may be used to repay a loan that comes to call in March 2020, in which case it will be taken out of the solvency capital by the end of this quarter. This gives us a solvency without transitional of 172%. With a fall in interest rates that we saw during the third quarter, we once again get transitional capital from interest rates, and the transitional rules gives us five percentage points in additional regulatory capital and a regulatory solvency capital overall of 177%.

Moving over to the next page called Solvency position Storebrand Group, page 9. This picture shows our conditional overview of solvency sensitivity. In many of the sensitivities, we are close to or about 180%. With normal operating profits and market development, end counting in the fact that the three are -- counting that the three percentage points solvency capital derived from the recently issued subordinated loan is likely to be excluded in the fourth quarter. We do not expect to reach 180% this year.

At our capital markets day in 2018, we stated that we expect to reach 180% in 2021. And following this we estimated that we would be able to return a total of NOK 10 billion up until 2028.

With the volatility in interest rates seen over the last few months, it has been speculated that the start of the capital release could start earlier or later than 2021. Rest assured that we work hard to deliver on stated targets.

Moving over to the following page, as in Storebrand Group. Fee and administrative income shows a positive development with a 4% growth year-on-year. Results from insurance is down from last year, primarily due to runoff gains and reserve releases last year. There is still good cost control in the group, even when including costs relating to portfolio management bonuses because of good relative performance.

As you are well aware, we are not allowed to account for the earned performance fees before year end. Tax is estimated at NOK 124 million or 21% in the quarter.

Moving over to the following page the Storebrand Group at Page 11. In order to further illustrate the consequences of current accounting rules, we have included a new picture showing our operating results, excluding the performance related cost and income from bonuses, showing operating earnings of NOK 635 million in the quarter. That's the middle table in this -- on this page.

We have also included the table including all bonus related income and cost estimated which gives us an estimated result of NOK 685 million in the quarter. The latter a number could be called actual value creation in the quarter. We think the number is NOK 635 million in adjusted operating earnings is the most accurate number but at the same time, we have built significant contingent performances that will be booked at the end of the year and included in the fourth quarter accounts

Moving over to page 12. This picture is basically the same as the last Q1, but we see it here the split between the results-segment, savings, insurance and guaranteed. Within savings, we have good profitability growth when adjusting for the NOK 49 million in performance-related cost in the quarter.

In fact, I think it is the best underling results for the segment ever. The insurance segment has been hit by some larger claims in the quarter during (inaudible) results. We do not however see this is the tranche and we do not envisage any significant changes in reserves caused by the recorder claim. Guaranteed pensions continue at gradual decline according to plan and previous communications.

And that concludes the presentation now and we are opening up for questions.

Questions And Answers

Operator

(Question And Answer)

(Operator Instructions) And the first question comes from the line of Peter Elliot from Kepler Cheuvreux. Please go ahead.

Q - Peter Eliot {BIO 7556214 <GO>}

Thank you very much. I have three questions, please. The first one was you mentioned the EIOPA consultation at the start of the call. And I guess one of the key points of that was then consulting on moving the last liquid point. I'm just wondering if you can give any sensitivities of your ratio to that?

And the second question was on the reinsurance deal that you did and I guess that's similar to the one you did in Norway a couple of years-ago and you'd flagged that you had reinsurance as a key tool to use for solvency. I guess too many questions on that. One, are you able to share what the cost was? I mean the Norwegian one, you're one of only two players, so it's very easy win for both yourselves and the reinsurance companies. I'm just wondering if the sort of economics work just as well in Sweden. And secondly, are you able to share if you still have sort of further tools in the toolbox as it were.

Final question was on the consolidation ratio. SPP I mean, you're at 107% still. Could you just sort of share what that means in terms of fees that you can take if you're still there at year end and what the possible upside or downside risk is? Thank you very much.

A - Odd Arild Grefstad {BIO 5483351 <GO>}

Okay, Peter. that can give you -- give us the shock. On the area of consolidation paper, last liquid point was there have been many different proposals there and we are trying to calculate the different proposals and the impact and it's too early to give you an impact analysis as of now.

However, it's quite obvious that the interest rate market in Norway is quite limited compared to European markets. So the actual last liquid point is not very much different from what you see today.

from what you see today.

Secondly, on reinsurance cost, what we look at is, this is luxury insurance, and the cost for the luxury insurance has to be competitive to taking of subordinated loans and other tools that we have in the toolbox. And the pricing has fallen since we started doing this initially as everyone are getting more familiar with the structures, and the Swedish reinsurance was very competitive compared to what we've done previously.

On consolidation in Sweden, you're right in saying that this is now slightly above 170%, and we have indeed been able to book a consolidation fee of NOK10 million for the quarter. And we do expect this to be -- go slightly upwards from here on a quarterly basis. But there will be some volatility in that going forward. Yes. And I think just our comment on that is, we have a roughly 40 basis point higher expected return on the assets than the liabilities in that portfolio, meaning that you will slowly build up towards little bit more than 108% level. That means at that level you can take full indexation.

Q - Peter Eliot {BIO 7556214 <GO>}

Thanks. Thanks very much.

Operator

The next question comes from the line of the Matti Ahokas from Danske Bank. Please go ahead.

Q - Matti Ahokas {BIO 2037723 <GO>}

Yes. Good afternoon. Two questions. Firstly, continuing on the mass lapse insurances. Is this toolbox now utilized in full or do you see kind of potential to increase it. And also on the same note, what was the reason for you kind of deciding to use this tool in Q3? Was it just the pricing thing? Or was it related to the interest rates?

The second question is regarding as Lars you mentioned that or was it Odd Arild that you don't expect to reach the 180% solvency margin at the end of the year. Is this based on the current interest rates? Or is this what do you base the view on? Thanks.

A - Odd Arild Grefstad {BIO 5483351 <GO>}

Okay. Let me start with the reinsurance. On one hand, we can do more. And there is a constant evaluation of the tools in the toolbox and how much we want to use at any point in time. What I actually said was that it's an optimization. We reduced the coverage in Norway, and we've built it up in Sweden. So this is the way to get more bang for the buck by making these ships. And there is a possibility to do more, and we always have to trade it towards the cost.

A - Lars Aasulv Loddesol {BIO 3969188 <GO>}

Yeah. I can take the 180 solvency movement. I think it's fair to say that, first of all, you have to take out as Lars has said, the subordinate debt, that's 3% and also any increased interest rate as we have seen so far this quarter have washed out again, the transitional rules. Then we are just well maybe 1% to 2% points in transitional room that arrives from the equity element but that is also supposed to move out. So we are very close to being out of the transitional rules by year end with the interest rates we already see in the market. And there is a need to augment on normal operation of the solvency capital in the fourth quarter. We guide that we are below the NOK 180 million at the end of this year.

Q - Matti Ahokas {BIO 2037723 <GO>}

Great.

Operator

The next question comes from the line of Blair Stewart from Bank of America. Please go ahead.

Q - Blair Stewart {BIO 4191309 <GO>}

Good afternoon, thank you. I've got three questions. Firstly, on the EIOPA Solvency II review. Have you -- can you make any comment around the interest rate stress? That seems to be one thing that will definitely be changed. Then just you could perhaps remind us what interest rate levels you assume, do you assume negative interest rates, for example, which is one thing that EIOPA's talked about. I realized that's maybe not quite as big an issue in Norway, but it would be interesting to hear your thoughts around the interest rate stress scenario and just the issue, in general.

The second question is you talked, Odd Arild, about a new framework for managing guarantees within the Norwegian markets, which is being looked at by the regulator. Could you give us an indication to what's going on there? And what the likely timing is? And finally, just the comment you made, Lars, on the volatility adjuster and it stands at 45 basis points, which is a historically high level. I just wondered why that was. Have you been changing your actual assets against the reference portfolio? Or what's actually driving that increase in the volatility adjuster? Thank you.

A - Odd Arild Grefstad {BIO 5483351 <GO>}

Thank you, Blair. I can start on the interest rate question. Today, we have negative interest rates in our base calculation but with -- as according to the standard model, we don't stress negative interest rates. I guess the general comment here is that all increases in interest rate stress are in isolation, a negative aspect. And then, of course, there's a long political process here before we get to the end result.

When it comes to the proposals around the guaranteed products in Norway, you have -- I think we have touched upon that earlier. And you should bear in mind that this was made to make these products better for the customers to give a better capital return over time. So it's a lot of different elements in it. Some of them are absolutely positive. Some might be negative. But in some, we expect this to be a positive development, making it possible to give surplus return to our policyholders over time. And that is also a positive for Storebrand.

A - Unidentified Speaker

On the VA,

Q - Blair Stewart {BIO 4191309 <GO>}

Sorry, Odd Arild, what's the timing on that review What was the timing on that review?

A - Odd Arild Grefstad {BIO 5483351 <GO>}

We wait now for the Minister of Finance to give out a hearing process in the market. And we just have to see what that moves out and when it's actually going to be -- could be ineffective with the uncertainly actually.

And on the VAs, it comes out of the calculation in EIOPA, which is published by the EIOPA every month. So we basically take into account what comes there. We just made the comment that it's historically high now. So there's an implicit. I guess there's more downside than upside from this level compared to many other countries. But it's approaching normals --

Q - Blair Stewart {BIO 4191309 <GO>}

So it's nothing that you've done, it's just what comes out from EIOPA. Okay, very clear

Thank you very much.

Operator

The next question comes from the line of the Jackie (inaudible) from JP Morgan. from JP Morgan. Please go ahead.

Q - Ashik Musaddi {BIO 15847584 <GO>}

This is Ashik. I'm just using Jackey's [ph] line. I just have a couple of questions. First of all, with respect to the 180%, I mean, if you just remind us, is this 180% that you had guided earlier -- I remember that it's including transitionals, right? And I mean, it looks like you will be there again by mid-next year, if things don't change, if interest rates don't change, you will be there mid-next year. So what's the visibility of additional capital return to be announced around, say, mid-next year or later next year? So that would be my first question.

Secondly, any thoughts on your spread that you are making -- asset spread you're making on the guaranteed book in Norway because interest rates have gone down, so that must have put some pressure on the duration mismatch portfolio. So do you have any negative spread book at the moment and the Norwegian book or you still believe that, in Norway, you still have a positive spread book? So any thoughts on that would be great.

And last question would be about P&C results. P&C results were a bit weak in this quarter. I mean group life clearly improved quite a lot, but P&C was a bit weak. What was the reason behind it and any thoughts on outlook for that?

A - Odd Arild Grefstad {BIO 5483351 <GO>}

Okay. Should I start on the 180%. As I said the -- in mind that both subordinated just hand the transitional rules will in most well we expect to be out of this transitional by year end. So then we are down at the level without these two factors and it's based on that means that the unexpected the normal generation of solvency capital. And I think, we have guided about the forth and back on this issue of the timing, I think as Lars said in our Capital Markets Day, we said 2021, and we want and we are working hard to make that come true of course.

Talk about the results half of the year, I think what you should just bear in mind is that we will use a combination of dividends and share buybacks. And that, of course, make it more attractive for us to use these tools also during the year. And most likely, the board will look at this at the end of the year, not at -- in the middle of the year.

Q - Ashik Musaddi {BIO 15847584 <GO>}

Okay.

A - Odd Arild Grefstad {BIO 5483351 <GO>}

And with respect to the asset spread, it's still positive on an average basis, and we can still invest above the interest rate guaranteed on the vendors' basis. But clearly, the lower interest rates fall, this has a negative effect on solvency and a negative effect on reinvestment levels. But as I said, it'll stay positive. And just to add on that, we also, of course, have long customer buffers both in Norway and Sweden and in the Norwegian portfolio specifically, we don't expect to make any IFRS losses or anything like that with the current buffer levels and the current Minister of Finance.

And on P&C, we did have some large claims in different business lines this quarter, but none that changes our -- in any significant way, changes our view on the future. And you said that the reserves were weak, but I don't think the reserves are weak. I think we just had weaker results in certain P&C lines.

Q - Ashik Musaddi {BIO 15847584 <GO>}

Okay, that's helpful. Thank you.

Operator

The next question comes from the line of Peter Eliot from Kepler Cheuvreux. Please go ahead.

Q - Peter Eliot {BIO 7556214 <GO>}

Thanks for allowing, two follow-ups. Maybe just a couple on the numbers. I mean, obviously, a great set of results. If I was being picky, maybe there was only one small item that I thought was a little bit negative which was the SPP risk result. I'm just wondering, if you can talk about that at all, whether it was a one-off or anything.

And then second, obviously, you've mentioned that it's great that you're seeing growth in the P&C division. I mean, I just wondering whether you can talk a little bit more about that in terms of the growth we see in this quarter is that something we should expect to continue in future quarters? Yes, if you could comment on that, that would be great. Thanks very much.

A - Odd Arild Grefstad {BIO 5483351 <GO>}

Okay. On the SPP risk result, it's longevity that is weak in the quarter. However, unlike the Norwegian longevity risk, the Swedish longevity can be repriced on an annual basis. And we are constantly doing adjustments to make that recently profitable on an ongoing basis. So this is a quarterly weak results, but this is not a reserve risk or anything else. It's just a repricing issue.

A - Lars Aasulv Loddesol {BIO 3969188 <GO>}

Yes. When it comes to the P&C market that both -- Storebrand has a very strong brand name in the market when it comes to P&C. We also due to our business have huge capital effects, positive capital effects compared to other companies when it comes to insurance business. So we have appetite for growing our insurance business. We are very happy to see the growth now coming through, and we'll work, of course, to make sure that the growth in insurance comes through as we have guided on.

Q - Peter Eliot {BIO 7556214 <GO>}

Okay. Thanks a lot.

Operator

Next question comes from the line of Blair Stewart from Bank of America. Please go head.

Q - Blair Stewart {BIO 4191309 <GO>}

Just two follow-ups. Just on decisions with regards to capital return, would that be right in thinking that you would want to wait for clarity from the Solvency II review before you would make any decisions on capital return? And we talked -- you talked about maybe the summer of next year before the EIOPA results are out. What -- do you expect to have enough clarity at that point in time to be making appropriate decisions on capital return? Or will it take longer than that?

And secondly, just on the NOK 10 billion that you talked about at the last capital Markets Day. I think you indicated at that time that the release of that capital would be somewhat back-end loaded within the 21 to 27 timeframe. I just wonder if your views on that have changed at all. Thank you.

A - Odd Arild Grefstad {BIO 5483351 <GO>}

First of all, when it comes to our decision around 180%, I think, of course, we'll wait. The Board needs to make views on their knowledge, their insights, the situation and forward-looking view of the company, when they should -- and dividends. They have to do that also when this comes into a situation where we are above 180%. But saying that, I think, we feel very comfortable about our guidings. We use our subprocesses to set these limits, both for being overcapitalized and setting limits for our capital situation. And due to that, we have, put forward this level of 180%, and we are very committed to, of course, fulfill that in the market.

Q - Blair Stewart {BIO 4191309 <GO>}

Are you saying Odd Arild, that, that's somewhat independent of what the Solvency II review then brings out? I would have thought that the solvency review would be integral of this.

A - Odd Arild Grefstad {BIO 5483351 <GO>}

I think it's fair to say that we and the Board needs to take into account all the knowledge we have when we are making decisions around dividends. I don't have that kind of knowledge now, but if I do get new knowledge about, this is a kind of situation, of course, we need to take that into account.

Q - Blair Stewart {BIO 4191309 <GO>}

Yes. I guess the question is if there's too much uncertainty as to what the impact from the Solvency II review is going to be then, I guess, that would be a problem.

A - Odd Arild Grefstad {BIO 5483351 <GO>}

That might be a problem. But I think also, it's fair to say that Storebrand's business will be all the same. It's just the way you measure it into Solvency II, that is done different. And we have to look at that situation, look at our business, what is our re-capital situation as we view it and make new decisions based on that together with the Board.

Q - Blair Stewart {BIO 4191309 <GO>}

yes. I understand. .And the NOK10 billion?

A - Lars Aasulv Loddesol {BIO 3969188 <GO>}

Yes, hopefully, there are other NOK10 billion. I think it's still the same message there that is back-end loaded, the released assets.

Q - Blair Stewart {BIO 4191309 <GO>}

Okay great. thank you.

Operator

We have no further questions in the queue. (Operator Instructions). There are no further questions. So I will hand you back to your host to conclude today's conference.

A - Odd Arild Grefstad {BIO 5483351 <GO>}

Before we end, I would just like to remind you all that we will be present in London, tomorrow; Frankfurt on Friday; and Boston and New York, next week. And we hope to see several of you there. I'd like to end up by, thank you for joining the call, and wish you all a good afternoon. Thank you.

Operator

Thank you for joining today's call. You may now disconnect your handsets. Hosts, please stay on the line and await further instructions.