Q4 2016 Earnings Call

Company Participants

- Helge Leiro Baastad, Chief Executive Officer
- Janne Merethe Flessum, Head of Investor Relations
- Jostein Amdal, Chief Financial Officer & Executive Vice President

Other Participants

- Bengt Kirkøen, Analyst
- Blair Stewart, Analyst
- In-Yong Hwang, Analyst
- Jakob Brink, Analyst
- Jonny Urwin, Analyst
- Matti Ahokas, Analyst
- Niccolò Dalla Palma, Analyst
- Paul De'Ath, Analyst
- Steven Haywood, Analyst
- Vinit Malhotra, Analyst

MANAGEMENT DISCUSSION SECTION

Janne Merethe Flessum {BIO 19368607 <GO>}

Good morning, and welcome to this Fourth Quarter Presentation for Gjensidige. My name is Janne Flessum, and I'm Head of Investor Relations.

We will start with our CEO, Helge Leiro Baastad, giving you some highlights from the quarter before our CFO, Jostein Amdal, runs you through the numbers in more detail. And then we will open up for the Q&A session.

And with that, I give the word to you, Helge. Thank you.

Helge Leiro Baastad {BIO 5865247 <GO>}

Thank you. Good morning, and welcome from me as well.

I will start with the fourth quarter. We delivered a satisfactory result. The profit before the expense amounting to NOK 1.3 billion, and underwriting result was NOK 700 million, corresponding to a combined ratio of 87.7%. Growth in premiums was 3.5%, with underlying growth of 2.4% when adjusted for currency effects and acquisitions. Underlying growth in Norway was 1.7% and 2.3% in Private and Commercial, respectively, which is satisfactory given the slowdown in the economy and continued fierce competition. Growth in the Nordic segment was 10.8%, driven partly by acquisitions and partly by a strong underlying growth of 5.9%.

Competition is still fierce, but the situation is relatively stable from last quarter. Overall, Gjensidige continues to experience good competitiveness in all markets. The loss ratio was 70.6%, positively affected by a somewhat higher run-off gain and somewhat lower large losses than normally expected. We faced the tough comparison this quarter, with the fourth quarter 2015 when the underlying claims level was record strong due to a very benign weather situation.

The fourth quarter 2016 was more normal winter quarter, with a generally higher frequency claims level. However, we have also experienced higher claims inflation than expected, something Jostein will talk about in more detail afterwards.

I would nonetheless like to make a few comments about development we see in the motor insurance in particular. As you remember, in the third quarter 2016, we communicated that we saw signs of increased claims inflation in the motor segment. The development during the fourth quarter confirmed this and measures have been taken to mitigate higher claims inflation than previously expected.

Going into 2017, we now expect claims inflation of around 3% to 4% for motor insurance at from around 1% the last couple of years. We are increasing premiums, and effects will gradually feed into our P&L. That said, the absolute profitability level for motor insurance is still very good.

In general, I would like to remind you that total premium increases should compensate for claims inflation over time. The cost ratio was 17.1% this quarter, 16% adjusted for one-offs, reflecting continued good cost control. The finance result was NOK 561 million, reflecting a satisfactory return on financial assets of 1%.

Looking at the year as a whole, we once again reported a record strong result, well within our financial targets as shown on the right. We delivered the profit before tax expense of NOK 6.1 billion. The underwriting result was NOK 3.7 billion, corresponding to a combined ratio of 83.4%. Adjusted for one-offs as well as for run-off gains and large losses at expected levels, the combined ratio was 86.9% which is in the lower end of the target corridor of 86% to 89%.

Based on new actuarial review, annual run-off gains are now expected to be around NOK 900 million on average over the next three to five years, still related mainly to motor TPL and workers' comp in Norway. This reconfirms the targeted 86% to 89% combined ratio corridor for slightly longer period. The financial result was solid at NOK 2.1 billion, corresponding to return on financial assets of 3.9%. The return on equity was 21.4% for the full year and earnings per share were NOK 9.34.

Then based on the full year result, the board has proposed a dividend of NOK 3.4 billion, corresponding to NOK 6.80 per share. Based on yesterday's closing price, the proposed dividend corresponds to a dividend yield of 4.8%, which is in line with our dividend policy of distributing a high and stable nominal dividend on regular basis and at least 70% of profits after tax.

A dividend of NOK 6.80 per share corresponds to increase in the nominal dividend of 6.3% from 2015 and a payout ratio of 72.9%. I would like to remind you that we also paid NOK 2 billion in special dividends in November 2016. Including the proposed dividend, total dividends from Gjensidige since the IPO in 2010 has been NOK 29 billion, equal to our market cap at the same time of the IPO.

Of this amount, our general insurance customers in Norway have been entitled to NOK 13 billion through our unique customer dividend model, and they have received customer dividends corresponding to as much as 11% to 16% of premiums they have paid every year. Gjensidige's business model is characterized by high and stable cash generation and as an investment alternative, Gjensidige has been and will continue to be a yield story for our shareholder.

On the operational side, we are delivering on our strategy and targets. As shown on the right, we are on track and ahead in relation to reaching our 2018 KPIs that we communicated back in November 2014. I'm particularly proud to be able to report record high customer satisfaction once again, as well as continued high and stable retention levels. We are making dedicated efforts in relation to digitalization, analytics, and organization capabilities, and are comfortable that we are well positioned to meet the gradual change in customer behavior and participation in new ecosystems going forward.

Gjensidige is the number two general insurance player in the Nordic region. During 2016, we have further strengthened our already strong and leading position in Norway, as well as our position as a challenger in the Danish market. Progress towards profitability in Sweden and the Baltics is according to the plan.

Before Jostein gives you the details on the numbers, I would like to spend a few minutes illustrating how we work proactively to further strengthen our position as a true Pan-Nordic general insurance player. Looking to Denmark, we have recently taken important steps to further strengthen our growth platform.

Firstly, last month, we acquired Mølholm Forsikring, making us number one in the market for health insurance in Denmark with a market share of around 18%. This initiative is in line with our recently updated and communicated group strategy to take our share of the growing personal health insurance market. Premiums in the Nordic segment will increase by around DKK 400 million or more than 8%, and acquisition will give us a unique platform for further developing of our product offering, both in Denmark and cross-border.

Secondly, we recently entered into a new partner agreement with Interdan, which takes effects from the first quarter 2017. Interdan is a large Danish car import company, and the new agreement give Gjensidige a direct access to more than one third of the new car sales market, doubling our previous access.

Thirdly, we had gradually strengthened our position in the growing housing market. We have increased insurance penetration in this market through the launch of new product packages containing all product lines. We have a leading position in change of ownership insurance and through partnership with three large real estate brokers in Denmark, Gjensidige has started access to 45% of the housing market.

And last but not least, this week, we have signed a long-term strategic agreement, partnership agreement with Dansk Supermarked Group, the largest retailer in Denmark. This agreement represents a large potential utilizing the distribution network of Dansk Supermarked. The partnership is exclusive and will bring us a unique platform to further expand our brand awareness and develop our digital platform and CRM activities to support further organic growth in the Danish market.

Gjensidige's brand awareness is now higher than ever in Denmark and customer loyalty is on the rise. In the short term, we will work on improving profitability in our Danish franchise but in the long term, we are confident that we have strong and scalable growth platform in this market.

With that, I give the word to Jostein who will give you more details about the figures. Thank you.

Jostein Amdal {BIO 19939645 <GO>}

Thank you, Helge, and good morning, everybody.

We report yet another good underwriting results of NOK 700 million. We saw a more normal winter this quarter and thereby a more normal overall frequency claims level compared to the corresponding quarter the previous year, which was record strong due to a very benign weather situation.

In addition, the underwriting result was negatively affected by an underlying growth in claims inflation, as well as one-off costs totaling NOK 67 million.

On the positive side, large losses were lower and the run-off gains higher than normally can be expected. The retail bank and pension and savings continued to show a positive development and contributed a total of NOK 123 million in the quarter, mainly driven by growth. The investment portfolio yielded a satisfactory return of 1.0% in the quarter corresponding to NOK 561 million.

The profit before tax expenses thereby amounted to NOK 1.3 billion compared with NOK 1.5 billion in the same quarter the year before. And the profit before tax expenses for the full year is a record high NOK 6.1 billion compared to NOK 5.1 billion the year before reflecting improvements in all the group's business areas.

The loss ratio was 70.6% this quarter or 75% when adjusted for normalized large losses and our run-off expectations. This is a satisfactory asset level taking into consideration that the fourth quarter is a winter quarter in the Nordic region. The reported level is 2.6 percentage points higher than the corresponding quarter the year before. Adjusted for changes in run-off and large losses, the underlying loss ratio was 5.5 percentage points higher. This reflects the very benign weather situation in the fourth quarter of 2015 compared to a more normal winter this quarter.

Motor and property insurance in Norway were particularly affected by more cold weather. And as Helge commented, the development for motor insurance both in Norway and Denmark during the fourth quarter confirmed a less benign claims inflation development than anticipated, and measures have been taken to offset the higher expected claims inflation going forward. The reason is more expensive repairs due to a combination of higher input costs, currency movements and more advanced cars that contain more technology. We still expect the frequency of personal injuries to develop positively long term due to safer cars and safer roads, but at a slower pace than before.

All in all, this made us revise our claims inflation expectation for motor to 3% to 4%. We adjust our premiums accordingly. Please remember that the profitability level is still very good for motor insurance in Norway.

The underlying loss ratio for the property products in Norway were also higher compared to the corresponding period in 2015, due to a more normal weather situation. Claims inflation expectations are stable at around 4%. The Nordic segment recorded a high loss ratio than the same quarter in 2015. This was mainly due to weaker underlying profitability in Denmark for agriculture and property insurance. In addition to frequency of mid-sized claims within the agriculture sector especially was unusually high in the quarter. Measures have been taken to compensate for higher expected overall claims inflation in Denmark. Better risk selection and re-underwriting will be prioritized in addition to premium increases. Putting new tariffs in place and continuously improving existing tariffs will gradually give effect.

The Swedish portfolio continues to develop in a positive direction driven by re-underwriting of the Commercial book and a more diversified Private portfolio. We are on track to reach profitability during 2017 in Sweden.

The Baltics recorded an improved loss ratio driven by lower run-off losses, the implementation of new tariffs and a lower level of frequency claims. We are well on track to reach breakeven during 2017 and profitability in 2018.

We got a good premium growth this quarter, 3.5% or 2.4% adjusted for acquisitions and currency effects. In Norway, growth was driven by a combination of price and volume. We are competitive and continuing to strengthen our market position. The underlying premium growth was positive in both Denmark and Sweden driven especially by growth in Private insurance in the Swedish portfolio and property insurance in the Danish Commercial portfolio. The negative development in the Corporate Centre line is mainly due to the Vardia reinsurance (17:15) program which is being gradually phased off over 12-month period from takeover.

Renewals of Commercial lines coming into 2017 have been satisfactory and over time, we still expect growth in line with nominal GDP growth, although the growth rate for the whole insurance market is somewhat lower at the moment. Disciplined structural growth that supports our overall strategy is still on the agenda as witnessed by the acquisition of Mølholm, but our main focus is still on profitability.

Cost control is still good. We continue to focus on efficiency measures to create room for investing in the brand, technology and competencies. The increase in nominal cost is driven by the acquisition of Vardia last year. In addition, a provision of NOK 20 million was made for the announced increase in payroll tax from 2017. The provision is related to holiday pay and compensation in connection with announced restructuring program, which will be paid out in 2017.

A provision of NOK 44 million was also made in connection with the restructuring program itself. This is related to more staff reductions than initially anticipated from 190 to 230, as well as somewhat higher average severance pay.

The cost ratio excluding the Baltics and one-offs is now at 15.0% for the quarter. The cost ratio adjusted for one-offs only was 16.0%. The annual cost ratio is unchanged at around 15%. But as we have communicated earlier, 2016 and 2017 are affected by integration activities outside Norway, leading to a somewhat higher ratio. It will still be in the 15%s.

Large losses amounted to NOK 182 million in the quarter, which accounts for 3.2 percentage points on the combined ratio. The level of large losses was lower than expected and lower than the corresponding quarter in 2015 when large losses amounted to NOK 261 million. The storm Urd contributed NOK 75 million to large losses this quarter.

The runoff gain of NOK 314 million had a positive effect of 5.5 percentage points on the combined ratio in the quarter compared to 4.2 percentage points in the fourth quarter of 2015. The gain is related to motor TPL workers' comp in Norway, as well as a positive effect from Danish worker comp this quarter. Helge has already commented that we now expect average annual run-off gains at around NOK 900 million over the next three year to five year period. This will still be related to personal injuries in motor TPL and workers' comp in Norway.

The investment portfolio yielded a return of 1.0% for the quarter. The portfolio amounted to NOK 54 billion. The match portfolio of NOK 35 billion continued to make a stable contribution to the financial results with a return of 0.0% compared to 0.9% (20:13) in Q3. The portfolio at amortized cost is a large part of the match portfolio. The running yield in this portfolio was 4.5% at the end of the quarter, and the average reinvestment rate was 2.8% for 2016. The unrealized excess value amounted to approximately NOK 1.3 billion.

The free portfolio of NOK 18.9 billion yielded return of 1.6% in the quarter. The result was positively impacted by good returns on the investment in SR-Bank, properties, and more short-term tactical allocations. This was partly offset by negative returns in particular from global investment-grade bonds, but also to some extent from private equity funds and convertible bonds.

In the appendix, we have this time added some more detailed information about the composition of the investment portfolio and relevant benchmark. And in January this year, we announced the sale of a further 10 million shares in SR-Bank at NOK 61 per share, resulting in a limited realized gain in the first quarter. The proceeds have been reinvested, so that the concentration risk in the portfolio is now reduced.

This quarter, we have also included Gjensidige Bank. The bank will celebrate its 10th anniversary this year. Gjensidige Bank is a retention tool in relation to our Private general insurance customers in Norway, enabling us to offer a combination of banking and insurance product. It is especially important for our Gjensidige Group (21:45) customers who are among our most loyal customers.

The lending volume totals NOK 41 billion and today 76% of the bank's customers are shared customers with insurance as measured by lending volume. And the bank is becoming increasingly important to the group. As an example, the bank launched car financing through car dealers in 2013 which has contributed to our strengthened position in insurance market for new cars.

The bank has a relatively low risk lending portfolio, as proven by low loan losses over time. Since breaking even three years after its establishment in 2007, the bank has strong growth combined with good cost control. The bank's pre-tax profit was NOK 94.4 million in the fourth quarter, totaling NOK 428.5 million for the year as a whole, and the return on equity was NOK 11.7% after tax.

Last but not least, looking at our capital position, the rating model is still the most binding perspective with a capital surplus of NOK 1.3 billion at the end of 2016, up from NOK 0.9 billion in the previous quarter when including the sale of SR-Bank shares in October. Available capital increased in all three perspectives, mainly driven by retained earnings. The fair value adjustment of bonds at maturity decreased due to increased interest rates, but that also increased the discounting effect of (23:12) both in non-life business and in Gjensidige Pensjonsforsikring.

The capital requirement changed only slightly. Market risk is lower in all three perspectives due to the sale of shares in SR-Bank in the fourth quarter and due to the expiry of a forward contract at year-end reducing the property exposure. Underwriting risk is stable, but increases slightly in the internal model perspective due to changes in some parameters for some lines of business. Expected increase in future run-off gains is also accounted for in the rating perspective which reduces the capital requirement there. The capital margin from a rating perspective is now 109%, which, as already mentioned, results in NOK 1.3 billion strategic buffer. This is adjusted for the proposed dividend. When also adjusted for the purchase of Mølholm Forsikring, which is expected to be effective in Q2, the strategic buffer is NOK 0.9 billion or a capital margin of 106%. This is a strategic buffer level that is regarded as comfortable in relation to the purpose it's intended to serve and given the current situation.

The solvency margin is 147% based on the standard formula and 180% based on internal model, both adjusted for the proposed dividend. We expect the internal model to be approved this year.

In summary, we have a solid capital position in all perspectives, and we'll continue to balance our capital structure in a disciplined way in order to support the return on equity target, while at the same time, having some leeway for further bolt-on acquisitions and stabilization of the dividend.

And with that, I give the word back to Helge for some concluding remarks.

Helge Leiro Baastad {BIO 5865247 <GO>}

Thank you.

Then to sum up, we delivered strong full year results in 2016, and we have managed to further strengthen our Pan-Nordic position. We have measures in place to compensate for increased claims inflation and have pricing power and prioritized profitability before growth and market share.

We are on track to reach profitability in Sweden during 2017, and in the Baltics from 2018. Over time, we still expect growth in line with GDP growth, and the combined ratio target corridor is unchanged. Our capital position is strong and we are confident that we will continue to deliver high and stable cash dividends to our shareholders.

Thank you. We will now then open for Q&A session.

Q&A

Operator

Our first question comes from the line of Jakob Brink. The line is open. Please go ahead.

Q - Jakob Brink {BIO 7556154 <GO>}

Thank you. I have two questions, please. The first one is regarding your comments on motor claims inflation. I think last quarter you said that you had previously been seeing around 1% but now you're seeing it higher. I don't think you quantified it back then. So, it basically only six months ago, we're talking about 1% and your pricing for less than 1% as far as I recall. Now, we're talking about 3% to 4%.

Thinking about how long time it took to go down from 3% to 4% a few years ago, down to 1%. It seems like a very sudden move up to 3% to 4%. And in that context, now I was thinking when should we actually expect it to have fully implemented the price measures you're telling us you have taken in order to compensate (27:09) 3% to 4%, i.e., will we see continued deterioration of the underlying combined ratio during 2017 and a good way in 2018 or how should we look at that?

The second question is regarding your running yield on the total fixed income portfolio, I just the – based at the coupons paid. What was that in this quarter? I think it's at 2.7% last quarter. I see that in this quarter the actual return on the fixed income portfolio was 2.4% in weighted. So, basically just to confirm that this quarter is actually pretty normal on the fixed income, please. Thank you.

A - Jostein Amdal {BIO 19939645 <GO>}

Hello. It's Jostein Amdal. To your first question on the change of the motor inflation, as we commented on the third quarter, we have at that time seen a change and didn't want to be very specific on the numbers. I think what Helge said was – confirmed kind of the figure we had in mind during the third quarter, and we were taking action gradually to the second half of 2016.

That said, it takes 12 months to run all the policies to renewals and also then further 12 months to get everything reflected in the accounts. Meaning that, from accounting perspective, there will be some delay in the increase in premiums compared to when we see the increase in claims. For new policies, the price increases are in place quicker because we don't need to wait for the renewal cycle. There would be a faster effect on new policies.

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

On your second question, Jakob, it's Janne, here. The running yield for the total fixed income portfolio, you're correct, was 2.8%. And looking just isolated on the bonds at amortized cost in the match portfolio, the running yield there was 4.5%.

Q - Jakob Brink {BIO 7556154 <GO>}

Okay. So, 2.8% and standalone (29:26) 4.8%. Okay. And just to come back, sir, but so, you're basically saying that you did price now for 3% to 4% higher claims inflation and you have been doing that throughout the second half of 2016, or is it only now that you have increased all the way to 3% to 4%?

A - Jostein Amdal {BIO 19939645 <GO>}

We did see this in the second half and have gradually improved – or increased prices to meet that expected claims inflation going forward. It means that, as I said...

Q - Jakob Brink {BIO 7556154 <GO>}

Okay. Many thanks.

A - Jostein Amdal {BIO 19939645 <GO>}

Yeah, policies won't be getting the new price level and from there actually have the renewal date.

Q - Jakob Brink {BIO 7556154 <GO>}

No, of course.

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

And, Jakob, maybe to give you...

Q - Jakob Brink {BIO 7556154 <GO>}

Thank you.

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

...some more insight into the claims inflation, we are talking about short-tail part of the motor product. TPL has been positive development for many years. We see a more stable – we expect a more stabilized situation going forward. But the reason for our expectation regarding claims inflation for motor is related to input cost, currency and technology related to the short-tail part of the product. So, it's the frequents (30:51) part.

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

Operator, the next question, maybe?

Operator

Thank you. We will now move to our next question from the line of Vinit Malhotra. Your line is open, please go ahead. Your line is open, please go ahead.

We will now move to our next question from the line of Paul De'Ath. Your line is open, please go ahead.

Q - Paul De'Ath

Hi, there. And thanks for taking the questions, and a couple from me, please.

Firstly, going back to the motor claims inflation, is it something that you feel the rest of the market is aware of? I know that one of your large investors has been talking about this as well, but they seem to suggest that some of the smaller players in the market weren't necessarily catching on to the fact that the claims inflation in terms of the prices and the payers and stuff has been going up and just what the market dynamic means then going forward?

And then the second question would be related to M&A. I think, you've mentioned in the slides that you still look at potential options of the, maybe, smaller acquisition in January. But if you could just give any thoughts on where you might still feel that you're missing anything or anywhere that you might be looking at, that would be very helpful. Thanks.

A - Jostein Amdal {BIO 19939645 <GO>}

Okay. To your first question, I think, the major Pan-Nordic players have all seen the same. I would - I don't have any specific information of companies not seeing this. But our impression is that the big players need to take lead here and kind of (33:22) see something happening in the market. We have done so in Norway, I think, but it has been (33:27) very disciplined than Denmark. So, this is something that, I think, more space we'll need to adjust.

For your second question about M&A, we use bolt-on acquisitions as part of our overall strategy to improve our total position. You can see from market geographies (33:45) that we have a smaller position in Sweden and partly Denmark than we have in Norway and the Baltics. But we have kind of no specific targets for M&A. We will continue to scan the market for good opportunities which supports our strategy and within the financial targets that we have stated.

Mølholm is a good example of this. We stated that we wanted to grow in the health insurance market. And with this acquisition, we get a leading position in Denmark, which is our number two market. So, it fits perfectly with what we have stated.

Q - Paul De'Ath

Excellent. And I mean, just to go back on that slightly, and I know in the past at various points, you've mentioned that potentially some of the smaller challenger players in Norway might come under some pressure if the pricing environment changed (34:45) that kind of thing, and we're not at that point yet presumably with the higher claims inflation?

A - Jostein Amdal {BIO 19939645 <GO>}

I don't have any information about the particular place being in the financial difficulties. But as I stated, our main interest in growing is outside of Norway. We have (35:06) 25% market share approximately in Norway. There is not that much we can get from buying any small player in Norway.

Q - Paul De'Ath

Yeah. Thanks a lot.

Operator

We will now move to our next question from the line of Matti Ahokas. Your line is open, please go ahead.

Q - Matti Ahokas {BIO 2037723 <GO>}

Yeah. Good morning. It's Matti Ahokas here (35:35) from Danske. Two questions on the motor insurance side since you brought it up and have talked about it quite extensively. What is the combined ratio for the motor business overall? And also, I'm a bit puzzled when you talk about the increasing prices to adjust for the claim inflation, at the same time talk about fierce competition. So, how does this all kind of match together in your book? Thanks.

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

Hi, Matti. I can start to give you an overall comment regarding the competition and Jostein could then handle your first part of the question. I would say that overall, we are comfortable regarding our competitive position. It's no increase in competition. It has been fierce competition for years actually, and we have a very strong position in Norway. As I said during my presentation, our pricing power is strong. And with the proposed dividend now, it's 14% customer dividend back to our customers. So, we are very confident and it's - I would not way that it's increased competition, our confidence is even better compared to one year ago.

And then Jostein could handle the first part of the question. I don't think he will give you the answer there, but he can say it himself.

A - Jostein Amdal {BIO 19939645 <GO>}

I can say no myself. But as I commented without giving specific numbers for motor as such, but what I can say is that motor insurance in Norway is among our most profitable products this quarter and it's been for many years. It's an extremely profitable product for us.

Q - Matti Ahokas {BIO 2037723 <GO>}

So, it's fair to assume that the average combined ratio is lower than what you report for Private overall?

A - Jostein Amdal {BIO 19939645 <GO>}

You need to make your own assumptions. But it's a very profitable line of business.

Q - Matti Ahokas {BIO 2037723 <GO>}

Great. Thanks a lot.

Operator

We will now move to our next question from the line of Jonny Urwin. Your line is open. Please go ahead.

Q - Jonny Urwin {BIO 17445508 <GO>}

Hi. Good morning, all. Thanks for taking my questions. Just two quick ones. So, first to go back to claims inflation again. But just thinking about the loss ratio developments over the next few years, couple of years really, I mean, it sounds like there's going to be a lag here before the pricing kicks in to meet the higher claims inflation. So, should we think about the combined ratio drifting a little bit from pretty strong levels?

Secondly, I mean, just thinking about it more strategically, I mean, could this be an opportunity to take market share? You guys are better than the market especially in Norway, I mean, how are you thinking about the growth versus margin trade off? I mean, in theory, if everyone is putting their prices up, then maybe you guys could see some of this as (38:31) an opportunity to grow a bit more given your strategic positioning? Thanks. That's it.

A - Jostein Amdal {BIO 19939645 <GO>}

As you know, the pricing dynamics in non-life insurance is that there it takes some time for a price increase to be fully reflected in the accounts. We don't guide on specific combined ratio development. But our combined ratio targets remain firm and we are very confident that we'll meet them. The combined ratio corridor is still 86% to 89%, and we will deliver in that range.

As regards to market share, we will not use the situation to gain market share in Norway. The positive side, however, is that the claims inflation is a business opportunity itself. It is actually future business volume for us as long as we're able to price it correctly. So, it's not all bad that the (39:23) claims inflation is going up. It means that we have high growth on the top line.

Q - Jonny Urwin {BIO 17445508 <GO>}

Okay. Thanks.

Operator

We will now move to our next question from the line of Niccolò Dalla Palma. Your line is open, please go ahead.

Q - Niccolò Dalla Palma

Hi. Good morning, everyone. Thanks for taking my questions. So, my first one is on – so, coming back to the investment results – thanks for providing slide 26, that's very useful, I just wondered whether you would feel commenting on the outlook for the match portfolio for 2017. Would you say it's fair to assume that, on aggregate, the match portfolio should go back to something below 2015 levels assuming that interest rates stay of course where they are?

And my second question is on the dividend. Yes, you've been growing at 6% this year, 8% previous year. Now, the longer-term challenge I guess is that at some point, the special run-off gains will fade off in 2020 or 2021. Do you think that it's fair to assume that that effectively puts a cap on how fast you can grow the dividend from here, or is that the wrong way of thinking about it?

And last question is on the cost ratio, the 16% adjusted number. If you could give us some idea in terms of the speed at which you expect improvement from here and whether still the Baltics is most of the downturn (41:07) there? Thank you.

A - Jostein Amdal {BIO 19939645 <GO>}

Yeah. Your first question on the future yield of the match portfolio, it's – we do not really guide there, but you see the composition of portfolio and in all that the (41:32) money market running yield is much lower than the amortized cost when we've given you the information on the current running yield of the amortized portfolio which is a large part of the match portfolio.

And you need to make your own interest rate assumptions about kind of where money market rates going and you have the running yield on the amortized cost portfolio from us. The rates there will not drift very fast down because it's not that much that is actually renewed every year. So, it will have a book yield of similar levels that you're seeing now.

I think that's kind of what I can say. Yeah. The obvious point is that...

Q - Niccolò Dalla Palma

Okay. And last quarter, you gave me some idea on the current yield that you have on the current bonds portfolio which are mark to market. So, is that still around 0% as a fair assumption? That's what you said last quarter, I think.

A - Jostein Amdal {BIO 19939645 <GO>}

Yeah. It's slightly higher now due to (42:40) general interest rates movements. I mean, if you look at the three-month NIBOR, (42:45) slightly above 1% is a bit higher than it was three months ago, if I remember correctly. So, you can use kind of those general money market fluctuations (42:57).

Q - Niccolò Dalla Palma

Okay. Thank you.

A - Jostein Amdal {BIO 19939645 <GO>}

Your second question was on the dividend and how this is linked to the planned run-off gains. We are very much behind our dividend policy that there will be a high and stable nominal ordinary dividend. That's why we've kind of used special dividends to take out kind of the steam (43:21) of the high profits we've had for periods. So, that means you should not expect the nominal dividend or no dividend to go down, and we kind of calibrate the dividend every year, so we won't have this cliff effect (43:37) that when the run-off gains are over, we will have to reduce it. So, that is into our dividend planning. Yes.

Your last question was about the cost ratio and as we said, 16.0% this quarter, a bit higher in 2016 and 2017 due to the integration efforts in Sweden and the Baltic. It will be in the 15%s also in 2017 and around 15% going forward after that. We continue to takeout underlying ordinary kind of operating costs to make room for investment improvements on all – kind of in every area, really. So, that is a continuous effort (44:24).

Q - Niccolò Dalla Palma

Okay. Thank you very much.

Operator

We will now move to our next question from the line of Blair Stewart. Your line is open, please go ahead.

Q - Blair Stewart {BIO 4191309 <GO>}

Thank you and very good morning. A couple of questions left. On the run-off gains, I just wonder, has there been a slight upgrade to your expectations there? I think, a year or so ago, you said NOK 800 million a year for three years to five years. You're now saying NOK 900 million for three years to five years. So, the actual number has gone up, and partial timeline has been extended. Just wondering, if you can clarify that.

Second question, just a technical one, just on the SpareBank disposals. How have those proceeds been invested and what would you expect the (45:22) to be in the coming quarter?

And finally, just a question on your debt headroom, just an update as to what your plans are for that in terms of your ability or willingness to use that headroom. Thank you.

A - Jostein Amdal {BIO 19939645 <GO>}

Yeah. First of all, your observation is correct. We have now extended the number of years as we this planned run-off gains. It was three to five years in Q3 2015 when we first communicated. Now, say it's three to five years going forward from now. So, we kind of extended it kind of one quarter a year approximately. And also the annual kind of run rate on the run-off gains is also increased slightly. We have said around NOK 800 million before and now it's around NOK 900 million, yeah, corresponding to around 4 percentage points of the combined ratio.

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

The proceeds from the sale of the...

Q - Blair Stewart {BIO 4191309 <GO>}

And what's driven that? Sorry. Is that just based on an updated actuarial opinion?

A - Jostein Amdal {BIO 19939645 <GO>}

That is correct. We have seen this trend on the – it's a long tail personal injuries in Norway both in the workers' comp line and in the motor line.

Q - Blair Stewart {BIO 4191309 <GO>}

Okay. Thank you.

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

Proceeds from (46:46) sale is reinvested in the ordinary day-to-day management of our investment assets. We don't have any specific guidance on that. This is (46:58) investment department within their mandates and their risk limits to make the best of those proceeds. The accounting gain was kind of more or less zero. It was sold. The stake has been mark-to-market for a long time. So, not...

Q - Blair Stewart {BIO 4191309 <GO>}

Just to – sorry – just to come back on that. So, the reinvested as per normal mandates, should we assume that it's gone back into a basket of equities, or is it sitting in cash?

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

It's an inter-basket of – diversified basket of equities, fixed income, yeah, any type of investment that we do. We have limits around the allocation and the proceeds could be – will be changed according to the kind of the ordinary market operations that we have, not necessarily equities, it could be international equities, Norwegian equities, fixed income, whatever. We don't give any guidance in that.

Q - Blair Stewart {BIO 4191309 <GO>}

Okay. Thank you.

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

Debt headroom, we say NOK 1.6 billion as a theoretical capacity and as before, we say that we will never use the full theoretical capacity for reasons that we talked about sometimes. Our thinking around the traditions of kind of hybrid capital sub debt is that this is a tool we have. We can use it when we feel it's a good time in the market or if we have some needs for capital. (48:32). And, yeah, I think that's what we'll say. We'll communicate when we do something.

Q - Blair Stewart {BIO 4191309 <GO>}

So, I guess, then the question was you – or the question was intended to ask you raised debt the last time and then used that effectively to pay a special dividend. I think that that in and of itself was – is something that you're not going to replicate. You seem to be suggesting that it's there as a tool if you need to raise capital for some other purpose. I think the debt equity – effective debt equity swap is something that you're not looking to repeat at this stage.

A - Jostein Amdal {BIO 19939645 <GO>}

So, I think you kind of have a new guidance, it could be either. We (49:25). We thought of it as a good cost of capital exercise. But will we do it the same or for some other reason next time, we won't really guide you on that.

Q - Blair Stewart {BIO 4191309 <GO>}

Yeah. Okay. Understood. Thanks very much.

Operator

Our next question comes from the line of In-Yong Hwang. Your line is open. Please go ahead.

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

Good morning. Thank you very much for taking my questions. I've got three, hopefully, quick ones. First on the underwriting deterioration of 5.5 percentage points, could you give us an idea of how much of that is purely down to the benign weather that we saw in 4Q 2015? I appreciate that, given that impact is not easy to segregate, but just an idea of how you see the weather impact will be helpful?

Secondly, on the Mølholm acquisition in Denmark, given as a premium, is there any idea you can give us around the profitability of the acquired business and what it might be for your Nordic combined ratio going forward?

And lastly, on your capital position, you're saying outlook that the uncertainty around Solvency II has largely decreased, but there's still a couple of outstanding issues. Could you give us a quick update on that, whether that's something that we should be thinking at all for 2017? Thank you.

A - Jostein Amdal {BIO 19939645 <GO>}

Kind of splitting up the 5.5 percentage points in loss ratio deterioration from fourth quarter 2015 to fourth quarter 2016, I think you should start with that a quarter in non-life insurance is really a fairly short period and there will be quarter-to-quarter volatility always in the loss ratio. So, one of the reasons is that there will be volatility every quarter.

As you pointed out, the precise effect of the difference from a kind of a mild winter quarter to a more ordinary winter quarter we had this year, I don't have that number. It is kind of one part of the explanation, but I cannot really quantify very precisely to you.

And thirdly, as we have communicated, in Denmark, especially, and for property claims within the agriculture sector and partly also elsewhere, we saw what we think is a volatility of kind of what you call the medium-sized claims which are less than what we report as large claims but higher than the kind of your frequency claim.

And there was a (52:08) kind of quarter-to-quarter, you can see that it was unusually high for the fourth quarter of 2016. We think it's a pure volatility effect. I think there is no trend or information that gives you a read from that going forward.

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

Loan (52:25) profitability?

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

Yeah. I'm going to take that one, In-Yong. We acquired the company, and the earned premiums was around DKK 400 million. The company is profitable but the profitability is a bit weaker than our target. But we of course aim for the portfolio to reaching or approaching our target corridor in two to three years ahead.

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

And the last question (53:02), if there any kind of update on the outstanding issues that we have talked about for a couple of years now?

A - Jostein Amdal {BIO 19939645 <GO>}

There has been no changes to the outstanding issues. We think the most important ones were taken away a year ago on the Natural Perils Fund. We still have uncertainty relating to the tax treatment of technical reserves, whether that will follow the Solvency II or the accounting perspectives going forward.

So far, there are no change. It will still follow the accounting perspective, but there is a risk somewhere there. That probably the main uncertainly at least on downside going forward. On upside, we still have still the Norwegian guarantee scheme provision, which we have now kind of taken for the last several quarters, reported as kind of the negative outcome (53:55). But we think there's an upside there because we think the Norwegian guarantee scheme provision is really an ordinary part of equity. If our view will somewhat prevail, then that's an upside to the capital position of around NOK 600 million.

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

Great. Thank you very much for your details.

Operator

Our next question comes from the line of Steven Haywood. Your line is open. Please go ahead.

Q - Steven Haywood {BIO 15743259 <GO>}

Good morning, everybody. Just a couple of quick questions hopefully. The reinvestment rates you gave for 2016 was 2.8%, but do you have the reinvestment rates for the Q4 period only? And then on the motor and claims inflation again, can you tell us whether that's also an increasing claims frequency as well and what sort of level increase in claims frequency this might be? Thank you.

A - Jostein Amdal {BIO 19939645 <GO>}

We didn't provide this in Q4 but it is – reinvestment rates, but it's actually been fairly few investments, that's why we provided the whole year figure. Of course, the turnover and the amortized cost portfolio isn't really very big. Its long-term positions usually help the (55:18). On your – so, we need to come back to that. But I think there's, if I remember correctly, three investments on that. So, it's a bit sensitive to the specific (55:30) involved.

In terms of the motor, there is a combination of increased frequency and average size of claims. In combination with our communication regarding run-off gains, it's still important to reiterate that we're talking about increased inflation in the kind of the hull, motor hull damages, not personal injuries. We see a combination where technology and the cost of imported parts are increasing. So, it's kind of – even the Mercedes low-severity accident, you will then have quite expensive repairs, use of sensors in all around the car, really. So, it's all kind of repairs are more expensive than they used to be and we see that trend still on the increase.

As well as there might be a small uptick in the frequency and the speculations on our side is maybe related to the increase in hybrid cars which have a quicker acceleration than your average-size ordinary fossil-fuel cars. But we don't (56:36) numbers to substantiate that claim, but that's one hypothesis.

Q - Steven Haywood {BIO 15743259 <GO>}

Okay. Thank you very much.

Operator

Our next question comes from the line of Vinit Malhotra. Your line is open. Please go ahead.

Q - Vinit Malhotra {BIO 16184491 <GO>}

Thank you. Good morning. Thanks for taking my questions. Just – I wanted to follow up on the – I do remember that the S&P model gave you a credit of around NOK 0.5 billion for reserve in the strategic buffer. Have you heard from S&P recently on – given the fact that the claims inflation is picking up? So, that's my first question.

Secondly, very quick check on the investment side and apologies if this was already addressed because I was not on the call all the time for the (57:33). But the property gain – or the property investment income was quite big relative to recent history as well. Is there some – is there an effect of the index that you had invested in and that gave you a leverage gain of some sort or could you just comment on the property investment income in the fourth quarter? Thank you.

A - Jostein Amdal {BIO 19939645 <GO>}

On the first question, we do speak to S&P every quarter, at least and they fully acknowledge the way we report our capital position, although the reported capital position is our own responsibility and our own interpretation.

So, when we increased communicated reserves or run-off gains, then that means that the effect on the cap requirement also increase more in parallel with that, meaning that on the capital requirement effect of the reserve run-off gains and not the run-off gains themselves are taking into account. So, it reduces the capital requirement but it doesn't increase the capital available.

On your second, on the property investment gain, if you ask about the underlying reason, that is that we have – that actually there is a fairly good commercial property market especially in the Oslo area, where we have kind of the bulk of our investments. It is not specifically related to the index as such, it's just a general insurance market – sorry, general property market in Oslo, which is – it's fairly good.

Q - Vinit Malhotra {BIO 16184491 <GO>}

Okay. All right. Thank you very much.

Operator

Our next question comes from the line of Bengt Kirkøen. Your line is open. Please go ahead.

Q - Bengt Kirkøen

Yes. Hello. Good morning. Just a question on competition. For the last year, we have seen an increase (59:44) higher market shares. But at Q3, I believe you said that you saw increased competition from the larger established players. Is that the same situation now that the competition from the large player is increasing?

And one more question, on the motor claims inflation. Isn't it a bit strange that you see this sudden increase within, I mean, six months in claims inflation. I mean, the technology changes has been going on for at least a few years now with more sensors and so on. Thank you.

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

I can give you some comments regarding the competition, just to start with Norway and the Private segment in Norway. As I said, we have good competitiveness. We have stable/positive customer developments and we had pricing power. The main competitors we are dealing with, I would say, the last few months to the last couple of quarters, is still the large players, it's If, Tryg, SpareBank1 and then we gradually see (01:01:01) and the DNB, they're bancassurance players. They're really small ones, I do not hear that much about them compared to one, one-and-a-half years ago.

So, it's dominating among the large competitors. The rational competitors, the competitors that see the same trends like ours.

A - Jostein Amdal {BIO 19939645 <GO>}

And the second part of your question, motor claims inflation, you could probably usefully split that into two, what is happening kind of to the physical and motor hull damages and the personal injury claims. The long-term trends have been there for several years. The personal injury claims have been going down. That slow down in the personal injury claims actually kind of – was sort of that reduction in personal injury claims slowed down in 2016 and this probably also limit kind of how far that we can get but there is no uptick again in the personal injury claims.

And the combination then of downtick in personal injury claims and an increase in the kind of the physical damages is the – results in our previous communication of 1% underlying claims inflation overall in the first half of 2016, which we down then said in the third quarter was higher without quantifying and then this quarter quantifies to between 3% and 4% as a total. I think that is – it is a long-term perspective on this.

Q - Bengt Kirkøen

Okay. Thank you.

Operator

It appears there are no further questions at this time. Thank you.

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

Okay. Thank you, everybody, for participating. Just to remind you of the roadshows we are doing this quarter, we're going to London tomorrow and then we are doing U.S., Boston, New York, Chicago and also Canada, Toronto and Montreal next week. So, hope to see some of you there. Thank you and good-bye.