Storebrand ASA Disclosure of Embedded Value for 2011 Conference Call

Company Participants

- Lars Loddesol, Group CFO
- Odd Arild Grefstad, Managing Director Life Insurance
- Trond Finn Eriksen, Head of IR

Other Participants

- Blair Stewart, Analyst
- Peter Eliot, Analyst

Presentation

Trond Finn Eriksen {BIO 17132188 <GO>}

Good afternoon, ladies and gentlemen. And welcome to Storebrand's 2011 Market Consistent Embedded Value conference call. My name is Trond Eriksen, Head of Investor Relations at Storebrand. Together with me, I have Group CFO and COO, Las Loddesol; Managing Director, Storebrand Life Insurance, Odd Arild Grefstad; Head of Balance Sheet Management, Staffan Hansen; and Head of Economic Capital Modeling, Lars Dahl.

As we have notified, the slide presentation will be running on the webcast available on storebrand.no/ir. The slides are similar to the analyst presentation released this morning.

After the presentation, the operator will open up for questions. To be able to ask questions, you need to dial into the conference call.

Let us turn to slide number 2, as I give the word to Group CFO, Lars Loddesol.

Lars Loddesol {BIO 3969188 <GO>}

Hello. As we look at page two of the presentation, lower interest rate level and higher volatility in financial market reduced Storebrand MCEV by a total of NOK5.4 billion in 2011. This gives a negative return on embedded value opening balance of 17.5%. And a positive operating return of 3%.

The value of new business has been reduced, compared to 2010. This is, first and foremost, a result of lower nominal new sales after a very good year in 2010. But it's also a result of a changed [ph] channel mix in Sweden, where the broker channel has sold very good last year, with following sales provisions. And there were also certain model adjustments. And a reduction in margin in certain products.

Even if the competition is set to be as tough in all the markets that we operate in, we have implemented measures to balance out the pressure on margins last year. Furthermore, it's important to notice that the inherent growth in existing business is strong.

The changes in the tax regulations, or tax laws, in Norway has not be built into our economic value figures for 2011. But we'll show a sensitivity a little bit later on in the presentation.

By combining the Life embedded value with booked equity in the other companies in the Group, we come out with a total embedded value of NOK63 per share by the end of 2011.

Flipping over to the next page, value of new business in Norway was NOK227 million in 2011. In the fall of 2009, Storebrand had several large pension funds. And other clients, moving their occupational pension schemes to Storebrand. And these were registered into our balance sheet in 2010. This created strong numbers for value of new business in 2010.

In 2011, registered new sales was, on a gross basis, NOK2.3 billion. Partly, the fall is a result of somewhat lower ambitions in the municipality market, after significant margin pressure in this market. We expect margins to normalize again in this market. And to revert to this market, in due course.

The overall margin on new business was weakened, somewhat, by lower price for the price war interest rate guarantee, as you will recognize and remember from the IFRS accounting. As announced in relation to the Q4 presentation, this price element has been repriced into 2012 and go up again next year or [ph] this year.

The margin is furthermore reduced by lower interest rates, which gives a lower expected return in guaranteed business. Furthermore, we've had a change in our cost allocation model. And this change in cost allocation model is according to the way we run our business, where we allocate now some more of the cost to the business that is growing, i.e., the non-guaranteed business, with longer cash flows.

The overall cost level is still being reduced. But the model changes, where we've allocated more cost to new products and long-life products, gives a reduction in MCEV for 2011. I will refer to that in a moment.

What does not come clearly out of this picture is the value of the growth inherent in existing contracts as a result of employment growth and turnover of employees in existing contracts. This is shown on the following page.

Strong growth in members on existing DC contracts and, as I mentioned, the growth is a result of both employment and turnover. When an employee in a DC customer, or DC corporation, or DC customer of ours leaves the Company, they will get a capital certificate. This is embedded value positive for Storebrand.

As you can see from the picture, there has been a growth in number of employees in the DC occupational pension contracts of 14% per annum for the last couple of years. The bulk of this comes from new members on existing contracts. And the value of this part of the growth is about NOK500 million for 2011. Furthermore, there's a positive contribution by very low lapse rate amongst our DC clients.

Moving over to SPP on the following page, in Sweden there has been a pretty flat development in sales measured in annual premium equivalent. At the same time, we see a reduction in margins as a result of channel mix, where we've succeeded well in the broker channel where we've paid sales commission.

The works that we're doing in order to strengthen our own sales force has happened through 2011. And indicates that 2012 will see a stronger contribution from this part of our sales in 2102 and, therefore, a normalized margin, going forward.

There is also some weakening of margins as a result of changes in the financial markets, which gives lower expected return in the future as a result of lower interest rate level, higher volatility.

And our equity markets.

On page six you see that, as we showed in the Q4 results, we continue the change from guaranteed to non-guaranteed business in Sweden. The DB portfolio in Sweden has been closed for any new sales in 2011. The SPP market share, in the non-guaranteed, competitive, part of the occupational pension market, has grown to 15%. And we're now number 3 in the Swedish market, according to our strategy.

The part of non-guaranteed business has grown from 46% to 58% of premium income over the last two years. It's also very nice to be able to say that we were notified, on Monday, that we have been allocated the prize as the best Unit Linked provider in the Swedish market for the fourth year in a row, earlier this week.

Moving over to the next page, page 7, expected business contribution is consisting of expected existing business contribution. And expected existing business contribution in excess of reference rate. The overall number here is almost NOK2.4 billion. The experience variances are NOK1.4 billion. The main explanation is a result of lower lapse rates. And growth in employees on existing contracts.

We also see a somewhat higher premium volume in the Swedish business. The numbers are somewhat reduced, or weakened, by weaker disability results in DC in Norway. And some of your will remember that we had a cleanup operation in the First Quarter last year, to take away some dues [ph]. And did some reserve strengthening in that context. So this is related to the First Quarter numbers of last year.

In SPP, the premiums [ph] was also somewhat better than expected. And this gives a positive contribution. In both countries there are lower costs. And improved administration results, which are positively contributing.

Assumption changes gives a negative contribution of NOK1.7 billion. The reduction is caused by the cost allocation, allocating more cost to products with long cash flows. In reality, this is an investment in future growth. While, under MCEV, the methodology penalized us for investing in products which does not give income immediately. I will revert to this on the next picture.

The decreasing mortality; the MCEV result was a negative of NOK650 million. We have assumed, or made an assumption of best estimates for last year's mortality. And given a 1% reduction in mortality for the next 10 years.

It's worth a note that the MCEV methodology assumes a risk-free return. Any return, over and above the risk-free return, will enable us to take more of any reserve strengthening from a financial surplus and, thereby, give less away to shareholders.

The asset management contract between the Life Company and the Asset Management Company has an increased fixed fee. And a lower performance fees. This gives lower expected return in the Asset Management Company. And a negative MCEV contribution. However, it does increase predictability. And reduce the result swings, going forward.

Other operating variances reduced the result by NOK1.6 billion. This is a consequence of lower rates increasing the net present value of future uncertainty, i.e., the cost of future uncertainty will get a higher net present value when discounted at a lower rate.

Furthermore, it is a result of tougher model stresses under Solvency II. And a lack of liquid interest rate curve in the Norwegian and Swedish market over and above 10 years.

On the next page, we look at the cost level. Storebrand has been working well with costs over the last few years. This has given us significant contribution in relative costs, or a reduction in relative costs, from above 1% measured against customer funds, to 0.7% in 2011. The MCEV methodology expects, or assumes, flat costs, going forward.

Our ambitions are to continue to reduce costs also in the years ahead. We will keep the overall cost level, in nominal terms, pretty much flat, by reducing the costs in the old business significantly, combined with investments in growth products. And non-guaranteed products with good long-term value creation for shareholders.

By the fact that we have allocated some costs to products with longer life, MCEV methodology assumes that the costs will continue for longer and, therefore, get a higher net present value. In an investment phase we, therefore, are penalized by the model.

The effect of increased sales. And improved profitability, will come through in our MCEV accounting in the years ahead through positive experience variances, and [ph] assumption changes in the next years. We will also look at this when we come to sensitivities in a few minutes.

Moving over to page number 9, reduction in embedded value related to economic variances is big for 2011, at NOK5.6 billion. This is, first and foremost, a result of the lower interest rate level in Sweden and Norway. As you can see from the picture, the 10-year swap rate in Norway has fallen by 84 basis points in 2011. And 134 basis points in Sweden, i.e., in combination, more than the stress sensitivity in MCEV.

The numbers are also negatively impacted by increased volatility and falling equity markets, especially in Sweden, where a large part of our portfolio is non-guaranteed unit linked based, with a high proportion of equities. Last year's equity market fall reduced assets under management overall. And especially when compared to expectations.

There are some correlations and assumption that impact the attribution analysis. But our best estimate is that about NOK3 billion of the fall is caused by lower interest rate level, NOK1.8 billion by lower equity market. And NOK0.8 billion by higher volatility in financial markets.

The fall in interest rate level and equity markets is reducing the volume development in 2011. It gives a lower profit sharing in Norway and Sweden. It has given some cause for the shareholder, related to necessary longevity strengthening, according to plan in Norway. And somewhat lower expected return in the years going forward.

Moving over to page 10, showing the MCEV methodology setup, where lower interest rates have increased the insurance liabilities' value, especially in Sweden. There's also been a general growth in both Norway and Sweden, increasing required capital. This, together with a couple of technical consolidation issues, has reduced free surplus, i.e., the capital over and above what is required.

It's worth to notice that in this equation, the required capital is measured out of our own objective of 150% solvency margin, under Solvency I. And not according to the regulatory minimum of 100%.

Lower interest rate level and higher volatility gives the following main effects; lower expected return, going forward; higher value of guarantees, as the interest rate level approaches the guaranteed level and volatility increases; and three, Solvency II stresses that are, from a model point of view, become tougher. And also relatively increasing when the interest rate level is falling. Furthermore, as I mentioned before, the value of the contract on the asset management side has been reduced somewhat.

On page 11, we show sensitivities. They are quite stable, with one exception, which is the interest rate sensitivity. The relative impact of a fall of 100 basis points is larger by the end of 2011 than in the beginning of the year. The sensitivity has increased from 19% to 36% through the year.

On the positive side, the effect of an increased interest rate level will also be more positive than previously, from today's low interest rate level. And indeed, as you are aware, the interest rate level has increased somewhat in the First Quarter so far.

It's worth to notice also that the value of cost focus will increase. This is a result of the change to cost allocation model, giving costs a longer expected life and longer net present value. And, therefore, anything we can do on the costs will have a more positive effect than last year.

The discounting factor that we have used in our liabilities for this year's MCEV calculation is the same as we used in the financial accounting in Sweden, i.e., we used the so-called macromodel. If we were to use a Solvency II rate, our liabilities would increase.

The final Solvency II discounting model is not clear -- has not been finalized. But the so-called Smith Wilson curve, if we were to use that, it would give a negative contribution of 20% of values for the Life business, or NOK4.9 billion, divided between Sweden NOK2.1 billion and Norway NOK2.8 billion. As I said, there is uncertainty relating to the Solvency II model. And especially to the national changes that will take place to adapt to the local markets.

On page 12, we just combined the shareholders' surplus, the value of in-force, to get the MCEV for Storebrand Life. We add on the equity of the other businesses in the Group. And we get a better value for the Group as a whole of NOK28.1 billion, or NOK63 per share.

On page 13, we show you the sensitivity to tax. As you are well aware, the authorities in Norway have sent out a proposal to change the tax rules. It's still uncertain as to how this is finally going to end up. But we've shown you a couple of different scenarios here.

If we were to assume a 25% effective tax rate. And deduct the net present value of the tax carry loss forwards that we have, this would create a negative MCEV effect of 9.9%, or NOK2.8 billion.

On page 14, we show the development in value of in-force in the different parts of the portfolio for the last three years. As expected, the value of guaranteed business goes down, together with falling interest rate levels. It is, however, positive to note that the value of non-guaranteed business continues to grow, despite the fact that equity markets were down last year. And that there is somewhat lower expected return, going forward, as a result of lower interest rate levels. The overall value of non-guaranteed business is now 70% of total value of in-force in the Life business.

On page 15, we have the summary. There has been a significant fall in MCEV for Storebrand in 2011. This is a natural consequence of fixed guarantees and a historically strong fall -- or high fall in interest rate level in Sweden and Norway. It is, however, positive to note that there is a strong growth in existing profitable business. And there is a continued allocation from guaranteed to non-guaranteed business, which, over time, will reduce the interest rate level -- or interest rate movements' impact on Company results.

The development. So far in the First Quarter, has led to a higher interest rate level, an improvement in equity markets. And somewhat lower financial market volatility. Furthermore, new sales is satisfactory. We will revert to this in more detail when we get back to you on the First Quarter numbers in May.

On page 16, we have the sign-up from Towers Watson.

That's what I want to do, initially, in terms of the presentation. And then we're opening for questions.

Trond Finn Eriksen {BIO 17132188 <GO>}

Thank you, Lars. The operator will now open up for questions. To be able to ask a question, you need to dial in to the conference call.

Questions And Answers

Operator

(Operator Instructions) Peter Eliot, Berenberg Bank.

Q - Peter Eliot {BIO 7556214 <GO>}

Three quick questions, please. First of all, on the tax changes, I'm sure this is right. But perhaps you can you confirm that what you're showing assumes no benefit from any management actions, or restructuring, or anything else that you might undertake? And I'm wondering if, it's maybe optimistic. But I'm wondering if there's anything you could share with us on the work you've done in understanding that since the start of the year.

Secondly, I was going to ask on the traditional business where we're seeing negative value in-force, both in Norway and Sweden. You previously communicated your willingness to lose market share in the traditional business in Sweden. I'm wondering whether the negative values there changed your attitude in Norway at all, or whether you've got any thoughts on that, going forward?

Then thirdly on persistency, we saw positive experience variances this year; we've seen them very often in the past. I'm just wondering if there's a reason to change the assumptions there. Perhaps you could give us your thoughts on that? Many thanks.

A - Trond Finn Eriksen {BIO 17132188 <GO>}

If I may start, Peter, with the calculation of the value of the tax. When the impact has been calculated, it has been a calculation where we have just taxed on the value in-force, as they are released in the coming years. That has been discounted back to -- that has been taken present value out of.

The tax rate, we have [ph] give a sensitivity on. I guess any management actions will then lower that effective tax rate. So we leave it up to you to how much value you want to put on that tax change.

A - Lars Loddesol {BIO 3969188 <GO>}

And in terms of what the tax rate is going to be, it's difficult to say before the final legislation is clear. And that's still under discussions. It's likely to be clear in the end of the Second Quarter.

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

If I can then talk a bit about the traditional business and our appetite for that business, going forward, I will say it's very clear that we are now in a situation where we are working with the new legislation in Norway.

And the negative value here is very much based on the value from paid-up policies. And also the real run off portfolio, individual contracts in Norway. So it is related to that part of the portfolio. And as you know, there is opening now in the legislation for movement from today's paid-up policies into paid-up policies within investment choice that will help, very much, for the value of this kind of business.

Also expect new changes in legislation with the existing contracts that makes a possibility to move into more capitalized products. So everything here is based on today's legislation of course. And there is a lot of expected changes in legislation, going forward, that will be helpful for this situation. We are not at all aggressive to try to get any more paid-up policies and individual contracts into the balance sheet.

A - Lars Loddesol {BIO 3969188 <GO>}

And just adding one more comment, when the value is negative, that's based on a risk free return. Obviously, our expected returns are (multiple speakers) free return so, therefore, the results should still be positive from an expected point of view, however, not giving a very good ROE.

In terms of the lapse rate, your last question, the assumptions that we have are pretty -- we don't expect too much lapse. But we have seen even less lapse. And we changed the lapse rate assumptions a couple of years ago to a lower number. But I think it's around 2.5% currently. And moving it much lower than that would be maybe a little bit aggressive.

Q - Peter Eliot {BIO 7556214 <GO>}

Thank you very much.

Operator

Blair Stewart, BofA Merrill Lynch

Q - Blair Stewart {BIO 4191309 <GO>}

I've got a couple of questions. And I think you've probably touched on most of these, Lars. But I just wanted to clarify. Looking at the Norwegian business, there was a 25% reduction in the value of in-force for the fee business. And that's somewhat counter intuitive, given that that is higher quality income. Just to be clear, is that just an inflation of the options and guarantee cost. And if so, are you doing anything on the pricing to compensate for that major reduction in the in-force value?

A - Trond Finn Eriksen {BIO 17132188 <GO>}

When it comes to the fee, it's correct that during last year the increased volatilities in this market was of such a magnitude that it was not able to take it out in the pricing, i.e., there was a lower margin in the fee for the interest rate guarantee going into. And during, 2011 which is also reflected in the model. And bringing the value in-force down.

You can also read that from financial reporting, IFRS reporting, of that result element. Going into this year, we have a guided, when we released for the Q4, that that price has been increased. And after that, also that the DNB Life have been stopping selling that product, which also should be helpful for the margins.

Q - Blair Stewart {BIO 4191309 <GO>}

Has the price increase been aimed at, or is it the intention of the price increase to get the value of in-force back to where it was?

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

Odd Arild here. I think what we have guided on is that the price that you see is, for 2012, comparable to the number you saw on the IFRS earnings for 2010. Then again, it's like Trond Finn says, first of all, you have to put this price into the market once a year. And of course, there will be volatility during the year when it comes to reveal [ph] what the margin in the MCEV, what it comes out with.

I think I also would say that it has been a lot of work with our models during this year. And there've been some model corrections that takes down a part of this value reduction. Because we now have been quite down to each contract in the portfolio, not on a margin on top level. So that also is part of the explanation.

Q - Blair Stewart {BIO 4191309 <GO>}

Okay. Can I just ask another question? Presumably, these issues are also reflecting the value of new business on both the fee business and the defined contribution, the unit linked, the new business margins have gone down quite significantly. Are we talking really about the same issues on top of the fact that there's lower volumes as well, or is there anything else coming into that aspect?

A - Trond Finn Eriksen {BIO 17132188 <GO>}

I would say that that is the main issue also for value of new [ph] business of the fee based portfolio. But for other parts, there is also the cost allocation issue that Lars alluded to, for instance on the value of new business of the DC in Norway.

Q - Blair Stewart {BIO 4191309 <GO>}

Okay. And if I can just ask one more? As you mentioned, Odd Arild, there's been a lot of assumption changes and operational variances. I think I've counted NOK4.5 billion over the last two years. And you talk a bit about the cost allocation. Am I right in suggesting that there's development costs being factored into the future MCEV which is, perhaps, on the very conservative side?

And secondly, can I ask you just to expand on the comment you made with regards to increased expenses from the conversion of paid-up policies please?

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

The last one was a bit out really moving to the new product generation maybe, or talking to all our customers. And there's around 400,000 customers that has the paid-up policy in Storebrand today. And we are both working with the new product setup. But also to talk with our customers to make sure that they understand what the kind of changes and opportunities that opens up in the new regulation when we move from the traditional product into more mutual fund type of product generation here.

The first part of your question, I'm not sure if I understood. Could you repeat part of it?

Q - Blair Stewart {BIO 4191309 <GO>}

Yes, I think my point is that you're being very honest in your embedded value calculations, perhaps too honest in the sense that you're taking, what could be considered, one-off costs and extrapolating them well into the future. Things like the thing you've just mentioned with talking to customers, etc., from the conversion of paid-up. And it seems like a lot of development costs are, perhaps, being included in the EV, whereas some companies may decide to take them out separately.

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

Yes, of course, that is an ongoing discussion. And we feel that the framework area is quite conservative. It's based on existing cost base; we don't have any opportunity to take into account cost reduction in the future. It's also element, of course, discussing what kind of cost base can you keep outside the calculation and call them a one-off.

We are, as you say, very careful not doing that too much, because it's better to take a view that the result of this one we really have the reduction in the cost, instead of putting forward something that seems to be a one-off. But maybe it's a part of the ongoing cost base, because you need to do this type of development all the way. But of course, it is a matching history for cash flows where you tend to take more cost up front towards the growth you are going to see forward.

And I'd also like to say that, when you have these changes in models, of course, that goes also with our work now these days, where we are working a lot with models towards Solvency II. And that is a process where the framework of a market consistent embedded value is used more on a constant basis throughout the year, throughout each quarter. And where we are much more precise on the framework, compared to maybe what we was three or four years ago.

A - Lars Loddesol {BIO 3969188 <GO>}

So one analyst that we spoke to already today said, that's why aren't you using a cost allocation model based on what comes out well in MCEV. But we did it the opposite way round, we used the actual cost model that we use in our business. And that is being reflected in MCEV. And when that gets a negative result. So be it because that's how we run our business.

I'd like add also one more comment on your previous question in terms of the value of new business. It's also the margin in the fee based business is somewhat reduced when you have a lower expected return. So that also comes into the future margin expectation.

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

And I suppose it come through very well when Lars did the presentation. But you know that in Norway, especially, everyone actually got a pension contract, because that is mandatory. So what you see is very much a transfer market in Norway these days. And the real growth, what we see, is coming from growth in the businesses. And turnaround in the businesses we have on our client base.

So really, the way we calculate this is that if we have a newcomer into a company that is a part of our portfolio, then it's not calculated as new sales, it's calculated at the increase in the value in-force. And that is a different way of calculating it, compared to a lot of other players in the market.

So you have to bear that in mind. And we see that the total value creation in 2011 is as high, maybe higher, compared to what you saw in 2010, when you take together the value of the new business and the value of the newcomers into the different schemes.

Q - Blair Stewart {BIO 4191309 <GO>}

Okay, very good. I've taken up more than enough of your time. Thanks very much.

Operator

At this time no further questions.

A - Trond Finn Eriksen {BIO 17132188 <GO>}

Okay then, we would now like to thank everyone for participating in this conference call today. We will also host our analyst conference in London tomorrow at the Chartered Insurance Institute at 2pm. Thank you very much.

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