Q2 2014 Earnings Call

Company Participants

- Lars Aa. Loddesol, Chief Financial Officer
- Odd Arild Grefstad, Chief Executive Officer
- Trond Finn Eriksen, Head of Investor Relations

Other Participants

- Daniel Do-Thoi, Analyst
- David Andrich, Analyst
- Matti Ahokas, Analyst
- Paris Hadjiantonis, Analyst
- Peter Eliot, Analyst

Presentation

Operator

Ladies and gentlemen, welcome to the Storebrand Analyst Conference Call. My name is Jacob, and I will be a coordinator for today's conference. For the duration of the call, you will be on listen-only. However, at the end, you'll have the opportunity to ask questions. (Operator Instructions). I will now hand you over to your host, Trond Finn Eriksen, to begin. Thank you.

Trond Finn Eriksen {BIO 17132188 <GO>}

Thank you, and good afternoon. And welcome to Storebrand's second quarter 2014 conference call. My name is Trond Finn Eriksen, Head of Investor Relations of Storebrand. Together with me I have Group's CEO, Odd Arild Grefstad and Group CFO, Lars Aa Loddesol. In the presentation today, Odd Arild will give you an overview of the development in the second quarter of 2014 and Lars will give some more details on some elements in the results.

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

I will leave the word to Storebrand's CEO, Odd Arild Grefstad, who will start the presentation on slide number two.

Odd Arild Grefstad {BIO 5483351 <GO>}

Thank you, Trond, and thank you all for joining us today. Starting on slide number two. Storebrand delivers a strong result for both second quarter and the first half of 2014, with 750 million in the quarterly result and 1.477 billion for the first half. There have been strong equity markets and reduced interest rates during the first half, that has given a good financial result in the company portfolios and for the insurance reserves. It has also led to a profit sharing result of 188 million in our Swedish operation.

I'm very pleased with the good results, but I'm just as pleased with the increase in buffer capital. The buffer capital including longevity reserves has increased by 5.8 billion in the first half, (inaudible) increase in 4.5 billion in the second quarter.

These buffers are solid and important in a period with low interest rates and a need for longevity reserves strengthening. Operationally, the transition from guaranteed to non-guaranteed continues. Our guaranteed pensions, fee and administration income is reduced by 12% from the corresponding quarter last year, and our income on loan has increased by 13%. The cost reductions are following the plan we have set and is nominally down by 5.4%, compared to the same quarter last year.

Lastly, the asset management division is a lot developing positively, and have now passed 500 billion in assets under management, as our corresponding strong development in income and a strong reduction in costs, that is solid results from the asset management business.

Moving to slide number three. Lars would give some more insight in the results. I just want to comment upfront on the development in the fee and administration income. That shows quite a flat development in the first half of 2014 compared to the same period last year. There is two powerful forces that drives this development. First of all, the discontinued business with the corporate bank and the public sector, that is in rapid run-off and the income from these areas are declining.

Secondly, we see that shift in the business mix also impacted the top line. Non-guaranteed savings and insurance is growing quite rapidly, while income from guaranteed pensions is reduced. These effects will continue to affect the fee and administration income line also going forward.

Let's now turn to slide number four. As usual, this slide introduce our review, our measures taken in the quarter to transform the business into changed market and regulatory conditions. Our goal is clear and that is to move the business into Solvency II without raising new equity capital.

Let's turn into the next slide and look what is going on in the second quarter. We continue to adopt measures in the business to ensure the right capital realization of the business. I want to highlight the following action in the second quarter. First, on capital optimization. There has been a limited transfers from guaranteed to non-guaranteed in the quarter. The bulk of the transfer in the first half was done in the first quarter with 7 billion of public sector funds moving out of Storebrand.

However, we do expect that at least 85 clients with 5 billion in assets will move at the second half of 2014 out of the guaranteed public sector assets. I'm also delighted to see that we are managing to pick up speed in the non-guaranteed fee- based part of the public sector. During the second quarter, we have won two tenders to provide asset management and close pension funds solutions to two large municipalities in Norway; Baerum and Tromso, for those over who are familiar with Norwegian municipalities. That represents 7 billion in assets under management, that will be moved to Storebrand in the second half and in the first quarter next year.

It's also worth to note that the run-off of Storebrand corporate bank is being implemented in a good and effective manner. The loan book has been reduced by 36% to last year. Within risk reduction, I would like to spend time on the segmentation of the paid-up policy portfolio. We implemented the segmentation at the beginning of the year. This segmentation is important to reduce shareholder's direct contribution to the longevity reserve strengthening.

It will be further refined, going forward, to implement the conversion to non-guaranteed paid-up policies with investment choice. With that, we skip slide six and moving to slide seven. The regulations for longevity reserve strengthening was clarified in this spring. Storebrand will strengthen the reserves by 12.4 billion over a period of seven years. We have managed to increase longevity reserves with 2.1 billion in the first half of 2014, and that is without assuming the so-called solidarity.

In the graph, this 2.1 billion is grouped together with the 4.2 billion set aside by year end. The 4.2 billion will be recalculated during the third quarter as previously communicated and we expect the number to be reduced by about 500 million when it is arranged for solidarity.

Other (inaudible) capital is strengthened and our most flexible buffer, the market value adjustment reserve is now on 3.7 billion. On top of this, we have 8.9 billion in our values in bond held at amortized costs. We have not changed this quarter the assumptions about owner's share to longevity reserve strengthening, and have charged 90 million directly on the reserves also this quarter.

Moving down to slide number eight, the Ministry of Finance released regulations regarding paid-up policies with investment choice on the 27th of June. The content was as expected. That means, paid-up policies need to be fully reserved for longevity, a technical 3% rate in the payout phase to even out the payments has allowed it, and there is rules for customer advice.

We strongly feel this is good news for the paid-up policies customers, which get more options and possibility to increase the pension by moving to a more long-term asset allocation.

Storebrand is well prepared and ready to deliver the product during the autumn [ph]. We bill assets, the cost of propping up the contracts with equity to make it through reserve for longevity against the positive effect this will have for our customers, for capital release in the Solvency II, and increased sales on loan guaranteed products.

Then I hand over to you, Lars, to give some comments on the results.

Lars Aa. Loddesol {BIO 3969188 <GO>}

Then I would like you to move to page 11 with the heading Storebrand Group's strong investment returns. And I will only comment on this page. Mr. Grefstad has already commented on the results overall, and I would like to comment a little bit more on the result per line of business under the same picture.

And the savings, non-guaranteed, you will see that there is a 63% improvement in results year-on-year from last year. There has been a 26% increase in non-guaranteed reserves within the pension business unit linked business, driven by good customer returns and large payments into these reserves and very few payments out of these reserves as a consequence of that this being a young portfolio. Furthermore, I would like to comment on premiums, premiums have gone down from the second quarter last year.

That is a result of lower one-off premiums due to us leaving the public sector in the Swedish market and because of the transition in the way with that more savings-based unit linked solutions rather than one single payment. The underlying development in the defined contribution rates in Norway is 14% and 18% in Sweden. So, the underlying savings continued to grow, but single premiums have gone down, and therefore reduced the overall premium quarter-on-quarter.

Under the insurance business, the results are more normalized after a very strong first quarter as we commented on certain one-off effects in the first quarter. The results for the second quarter are strengthened by good financial returns, but weakened by reserves strengthening in certain business lines as a result of a somewhat higher visibility and deficit in certain product lines, we don't see any trend sets here, but we have increased provisions by 45 million altogether.

The combined ratio is 90 on an overall basis, but in the P&C business, the pure P&C business, the combined ratio is 83 and the growth in the P&C business is 11%. In the guaranteed pension business, the results seem quite stable. However, there is a weakening of the defined benefit profitability in Norway due to the reduction in municipalities and the longevity reserve strengthening, but that is compensated for by a very strong profit sharing in the Swedish market due to high booked return in the guaranteed portfolio at Sweden at the level of 7% year-to-date, that is giving good profit -- split of NOK188 million in the quarter standalone. The level of reserves in the guaranteed portfolio has gone up by 2% in the quarter, that is a real consequence of higher liabilities measured in Sweden when you discount by a market rate. So, even at the -- this guaranteed portfolio is in decline with a lower interest rate discounting factors in Sweden, the liabilities increased.

Within other, the good results are due to a good financial return on company portfolios as well as lower costs in the holding company. So that basically sums up somewhat more detailed discussion on the different business areas, and I now give the word back to Mr. Grefstad.

Odd Arild Grefstad {BIO 5483351 <GO>}

We'll the leave the floor directly back to Mr. Eriksen.

Trond Finn Eriksen {BIO 17132188 <GO>}

Thank you, Lars Aa Loddesol. Then, the operator will open up for questions. To be able to ask questions, you need to dial into the conference call.

Questions And Answers

Operator

(Operator Instructions) The first question comes from the line of Peter Eliot from Berenberg. Please go ahead.

Q - Peter Eliot {BIO 7556214 <GO>}

Thank you very much. I had three questions please, if I may. First one was, we heard from your main competitor recently that it was increasing some of the risk in its asset portfolios, but that policies that still need longevity reserving, to that top of the risk-reward profile of doing that was very attractive. It doesn't look like you're going down at least at the moment, I wondering whether you, that was something that you might consider and if not, then perhaps what the, why you might not consider doing that?

And the second question was, given your returns have been very good, the 90 million for quarter charge, I appreciate it's very early to revisit that. But I'm just wondering at what point that the marginal difference going to reduce that quarterly charge in the future? And then the third thing was on Solvency II, I mean, I appreciate it's very difficult to be scientific. But you referenced a reduction which obviously isn't surprised at all given the drop in interest rates, and but I was just wondering whether you can give any sort of qualitative feeling about at what level (Technical Difficulty) remain very comfortable of not needing or what level you might still start to think about transition rules. So, is there any comment you can give in that sort of area? Thanks very much.

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

Okay, thank you. If I start answering the first question about the risk profile, if you looked at slide number five, you will see that we have done actually already for the start of the year, a segmentation of the paid-up policy portfolio, and that is very much to make sure that we have the right risk profile in the different brand areas and especially based on the longevity reservation in the different sub portfolios.

We have also looked very closely into, of course, our competitor's asset mix. We see that we have a very comparable asset mix to our competitors, there might be some changes, differences in expected return on the different asset classes. But overall, I think you can see that research strategy of DNB and Storebrand by the way is very much the same on this area. And we do -- as we always have do look forward to have as good and even better return than DNB going forward.

Q - Peter Eliot {BIO 7556214 <GO>}

Could I just come back on that very quickly. Actually it's just my understanding of the slide five is that, it's the business with the lower buffers, that has the lower equity proportion, whereas they seem to be doing something a bit the opposite, maybe I misunderstood that. But--

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

No, this based on very much as we did by the start of the year. We saw that the life, the increased life length would come in place. And based on that, we actually made these portfolios and also focused on having more risk capacity on the portfolios with the need for the highest reservation based on the fact that we have a better risk reward for shareholders in that portfolio.

And that is an ongoing process, and it will be refined also now for getting as much speed as possible into the market of our investment choice products going forward.

A - Lars Aa. Loddesol {BIO 3969188 <GO>}

On the second question, Peter, whether we will revisit the 90 million. At the end of the year, we will know how much we'll set aside this year, we will know how the paid-up policy with investment choice market has started, and we will now expect that return next year. At that time it makes sense to revisit whether the 90 million should continue. I don't envisage that we will change it on a quarterly basis if nothing very large happen in between. So, if that's okay, does that answer your question?

Q - Peter Eliot {BIO 7556214 <GO>}

Yes. Thank you.

A - Lars Aa. Loddesol {BIO 3969188 <GO>}

And with respect to the Solvency II sensitivity, we can only refer to the embedded value reports and so on where you will see some on the economic value sensitivity to interest rates. And we are not changing any of our plans in terms of being able to go into that Solvency II regime without having to raise new equity as a result of the lower interest rate at this stage.

Q - Peter Eliot {BIO 7556214 <GO>}

Thanks very much.

Operator

Thank you. And the next question comes from the line of David Andrich from Morgan Stanley. Please go ahead.

Q - David Andrich {BIO 15414075 <GO>}

Hi, good afternoon. Two questions on my side. First, I was just wondering if you could maybe comment on the competitive environment in the DC market in Norway and in particular, when it comes to the risk products and the disability embedded within it, whether you're able to charge adequate amount to cover that risk?

And then second of all, just in terms of it sounds like it was about 29 billion or so in the paid-up portfolios where you think like there is a reasonable likelihood that the portion that would switchover. I was just wondering what kind of timeline do you see that happening over particularly with the longevity reserving that would have to be done, whether you would try and push that a little bit faster or take it more evenly or if you could just comment on that? Thank you.

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

Yeah. If I start with the environmental business in Norway, we don't see any large changes in the competitive environment I would say, it's quite stable. It's been -- of course, I've seen in all parts of the concentrated markets, especially for large corporates in Norway, we have over 30% to 31% market share in defined contribution in Norway. Then it's of course, other areas for some of the risk products, where there are much more competition and more players in the markets. And that of course, has also been a situation for quite a long time. So, that the basic question is that there is no change in that environment compared to what we have commented on the last quarter (Technical Difficulty).

Q - David Andrich {BIO 15414075 <GO>}

Okay.

A - Lars Aa. Loddesol {BIO 3969188 <GO>}

When it comes to the paid-up policy market of course, it's, I think we are all very eager to see how that develops, it's a new market, it's a lot of individual choices by individual customers, and the Storebrand has around 500,000 customers in this area. And we are very much prepared, and we feel that when you look at the media, that is quite concerned about this in Norway these days, and also the expert is talking about this, it's a positive expectation around the product.

I think everyone now understand that it's not a very good way of doing long-term and managing of the long-term assets by having it in a portfolio that is focused on having short one-year goals and it leads to a situation where long-term, very much of our customers will have a much higher pension by moving into investment choice.

And on your direct question, it's very hard to say how fast and how much of this market as we speak, we will be able to move. But on your question, I will say that we are prepared to use equity to make sure that some of the customers that want to move from today's paid-up policies into investment choice, had the opportunity to move into investment choice even if they are not fully reserved for longevity.

Q - David Andrich {BIO 15414075 <GO>}

Okay. Thank you.

Operator

Thank you. And the next question comes from the line of Matti Ahokas from Danske Bank. Please go ahead.

Q - Matti Ahokas {BIO 2037723 <GO>}

Yes, good afternoon. It's Matti here from Danske. Three questions if I may. Firstly, Lars you mentioned that 45 million was increased, the reserves were increased by 45 million in the insurance business area in the second quarter. Can we expect that these reserve increases will continue or was this more of a one-off effect so that kind of the normal run rate would be 45 million or higher than we saw during the quarter.

The second question is on the SPP unit linked margins, we saw a fairly significant increase but -- on the reserves, but the margins were down. If you could comment, what was the reason for that? And then on this page number eight on the paid-up policies, 29 billion that you discussed, how much of the 29 billion is currently fully reserved for longevity? Thanks.

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

On the first question on the insurance reserves, we've basically done three minor reserves strengthening as a consequence of adjustments in three different portfolios and we are not planning as a consequence of the results we've seen so far in the second quarter to do anything further in any of the business lines. So, these are only regular adjustments in three different portfolios and there is no expectation to do anything more to start at this stage.

A - Lars Aa. Loddesol {BIO 3969188 <GO>}

I think the second part of your question was about margin in SPP, I think to answer on that is more about cost allocation internally, it's not about really the price we are able to take to our customers, that is sustainable from quarter to quarter.

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

I will ask a question on out of those 29 billion which we have said, have a good value proposition to the transparent investment choices 3 billion is currently is now fully reserved.

Q - Matti Ahokas {BIO 2037723 <GO>}

Great, thanks a lot.

Operator

Thank you. And we currently have one final question from the line of Daniel Do-Thoi from JPMorgan. Please go ahead.

Q - Daniel Do-Thoi {BIO 17019775 <GO>}

Hi, good afternoon. Daniel Do-Thoi from JPMorgan. I have two questions. The first one is on defined benefit and the decline in the fee income margin here, I mean I appreciate that some of the margin contraction is related to mix effect with the public, and that has been transferred out, but the decline nevertheless seems to be a bit higher than my anticipated. So, I mean, if you could just comment on whether there any of the factors here.

And secondly, you've mentioned this 7 billion in closed pension fund solutions from municipalities. I was just wondering, if you could talk about perhaps the business opportunity from taking on additional closed funds going forward. I mean, how big is the market here and also what is a potential impact on your financials? Thank you.

A - Lars Aa. Loddesol {BIO 3969188 <GO>}

If I answer the first question, on the defined benefit margins in Norway, they are stable and if you the fall in revenues is generated as a consequence of the fact that municipalities have moved as you said, and also as a factor of companies closing the defined benefit plans. In addition, there is a periodic effect where we had slightly too much revenue generated from the counterpoint of view in the first quarter and slightly less in the second quarter, but the year-to-date numbers are more accurate than the quarterly numbers in this context.

Q - Daniel Do-Thoi {BIO 17019775 <GO>}

Okay.

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

Okay. When it comes to closed pension funds, I would say the market is, it's a large market actually, and we see it's more in a starting point for the large municipalities to start to up and up the closed pension funds. And especially in this situation, both Storebrand and DNB who was the only competitors to KLP in the public sector markets.

We see that now a lot of public sector clients only have one solution to it, they like to have a guaranteed business with our insurance company and as such and that is moving into KLP and that also open up for the opportunity to both reduced cost and more flexibility and move into closed pension funds.

So, I would say that, this is a growing market, this is a very interesting market. And we also see that there will be and we are in tender offerings with much municipalities as we speak, that will be closed during this autumn. So, it's an interesting market for us.

When it comes to the margin, of course, it's, well first of all, we have the results directly by managing this, but on top of that we also have margin in asset management by managing these assets is of course, margin that you see in the market today when it comes to this kind of a level sole assets under management, but then again, it is almost zero cost by taking on additional assets in asset management. So this, in that respect gives very good results to the company.

Q - Daniel Do-Thoi {BIO 17019775 <GO>}

Okay. But so if I were to look at for example, revenue margins in isolation, would it be a fair assumption for example, to take the 7 billion and assume your current average revenue margin of something like 15, 16 basis points within the asset management business or would it be considerably higher or lower than that?

A - Lars Aa. Loddesol {BIO 3969188 <GO>}

I think that a lot of this of course would be interest rate instruments. But it's around the 15, 16 basis points, that should be a ballpark.

Q - Daniel Do-Thoi {BIO 17019775 <GO>}

Okay. Thanks. And can I just follow up on a previous question that was asked? And that was on the paid-up policy transfers with 3 billion of the 29 billion being fully reserved at present. What -- of the remaining 26 billion then, what proportion of that is close enough to being fully reserved that you would be happy to facilitate conversion by contributing intra-holder funds [ph]?

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

Well, this has all to do with also the segmentation we're dealing in the portfolios these days. And we prepared for making a portfolio that is sustainable to start working with. And of course, we will use our sales force, we will use our marketing effort directly on the customers that has the, what we call like the green, the greenest value proposition. That means that they have most to gain from moving into investment choice in combination with also limited use of equity to move into investment choice.

And, what we have been working with is the portfolio of around 10 billion, that should be available and first goal to be able to move into that kind of a portfolio. And of course, going forward, as we are increased our reservation and as we have improved the first portfolio, it will be filled up with new customers and values of course. So, that is our sales direct. But we also expect of course some clients even if we are not doing direct marketing to them to contact us to move from today's paid-up policies into investment choice. And we are prepared to let also these people move into investment choice, but of course we'd probably need to solve some of the use of equity going forward.

Q - Daniel Do-Thoi {BIO 17019775 <GO>}

Okay, great. Thank you.

Operator

Thank you. And we have now another question from the line of Paris Hadjiantonis from KBW. Please go ahead.

Q - Paris Hadjiantonis {BIO 19703051 <GO>}

Yes, hi. Thank you for taking my questions. I have two today. The first one will be on debt. From what I can see you have one instrument maturing previously, and are you planning to refinance this? And also if you do, to what extend you are able to use additional debt to better your current solvency position? And the other one would be on MCV and sensitivities. Can you give us an idea of how your sensitivities have moved post the solidarity announcement, I would expect that actually your sensitivity to down [ph], or to move to interest rates would have increased. Am I correct in this assumption? Thank you.

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

I would answer your question, Paris. Yes you're right. (Technical Difficulty), the interest rates are down usually also increased interest rates of the business.

Q - Paris Hadjiantonis {BIO 19703051 <GO>}

Okay. And do you have an idea of how much that is or can you tell us how much of this in real [ph] terms?

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

I don't have any updated embedded value in calculation, it's something new. So, I don't declare, I should go (Technical Difficulty) move into after doing a proper calculation, but I think it's just say that if that has probably increased by how much, I don't think I should answer it.

Q - Paris Hadjiantonis {BIO 19703051 <GO>}

Okay. Thank you.

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

Well I can't answer.

A - Lars Aa. Loddesol {BIO 3969188 <GO>}

When it comes to the debt refinancing, we have refinanced all of the subordinated debt for this year, this summer, where else on -- that the only company is more new in late autumn that will be refinanced. And then there is another 1 billion of subordinated debt in that company next summer, which we are of course planning and in the process of replacing with another subordinated debt (Technical Difficulty) finding it right.

When it comes to the capacity of our solvency, I mean we do have room for more capacity on the Solvency I and we would have even more room for more subordinated debts on the Solvency II and during the last three to five years, the equity of the group has been growing. So, the relative portion of the debt is lower, and will -- the solvency, the optimization to what Solvency II will be -- will also include considerations of what's the right mix.

Q - Paris Hadjiantonis {BIO 19703051 <GO>}

Okay. Thank you.

Operator

Thank you. We currently have no questions coming in the queue. (Operator Instructions).

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

If there are no further questions, I would like to thank all of you for attending the call this afternoon. I would also like to remind you that we will be present in London tomorrow and we will hold our presentation at the Chartered Insurance Institute at 2:00 PM UK time tomorrow. So, I hope to see some of you there.

Operator

Ladies and gentlemen, thank you for joining this call. You may now disconnect your lines.