FINAL

Bloomberg Transcript

Q3 2014 Earnings Call

Company Participants

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

Other Participants

- David T. Andrich
- Gianandrea Roberti
- Jakob Brink
- Matti Ahokas
- Per Grønborg
- Sami Taipalus
- Vinit Malhotra

MANAGEMENT DISCUSSION SECTION

Janne Merethe Flessum {BIO 19368607 <GO>}

Welcome to this presentation of the third quarter results for Gjensidige. Today, our CEO, Helge Leiro Baastad will start by commenting the highlights for the quarter before our Head of Risk and Capital Management, Jostein Amdal, gives you more insight into our capital position. CFO, Catharina Hellerud, will then follow-up by commenting the results for the quarter in more detail. And then, we of course, open up for Q&A after them.

Before we start, I want to remind you that the presentation can be downloaded from our website, gjensidige.no/ir.

Then, I hand over to you, Helge.

Helge Leiro Baastad {BIO 5865247 <GO>}

Thank you, Janne. Good morning, everybody. Thanks for listening in. I'm pleased to present the third quarter figures with continued solid premium growth and good profit performance.

If you look at page 2 in the presentation, I will comment on the main figures for the quarter. The profit before tax for the quarter was NOK 1.337 billion, and the underwriting result was NOK 755 million, corresponding to a combined ratio of 85.5% which is a good result.

First I will give some overall comments to these results. Growth in premiums was 6.9%, 3.2% adjusted for currency and transactions. The experience continued due to underlying claims development for the motor products. However, it was somewhat weaker for the property product as a result of a lot of thunder and lightning at start of the quarter. The property products are volatile and vulnerable to the wind and the weather. Claims incurred in the quarter were approximately 27% higher than last year and 30% compared with the last five years.

The proportion of large losses was higher than last year, but nonetheless lower than we normally expect with only 3.8 percentage points hit on combined ratio. There was slightly more large losses in Norway in addition to a cloudburst as you know in Denmark and Sweden at the end of August. We also see continued good cost control with a cost ratio of 14.5%. I will comment the growth in some more detail.

We still experienced good competitiveness and very good profitability. In Private, we saw a 2.5% point growth in premiums. Adjusted for actuarial (2:52) effects between second quarter and third quarter, the growth was closer to 3%, which is somewhat lower than we have seen for some quarters.

As previously communicated, running premium increases are in line with the long-term claims inflation but market-related adjustments in attractive segments mean that the premium increases are lower than average. This has been the situation throughout 2014. Therefore, premium increases have a somewhat weaker effect on growth in earned premiums now than in recent years.

At the same time, we have seen a stabilization of the number of customers over time and we also saw a more positive development in the number of customers during the third quarter. We are very pleased that we are able to combine continued growth with good profitability, a positive customer development, and high customer satisfaction, which are signs that our work on risk selection and price adjustments in especially attractive segments is paying off in a market characterized by tough competition. The loss ratio is higher for customers who leave us than for customers who stay.

Moving to Commercial, we also see higher level of activity and solid growth of 5.7% combined with good profitability. Our systematic work of implementing best practice from Private continues. Nordic also delivered a satisfactory quarter with an underlying growth of 3.1%, primarily driven by an increase in the number of new Commercial customers. The work on implementing best practice and utilizing economies of scale continues.

Finally, on this page, the financial result was NOK 552 million, corresponding to a return on financial assets of 1%. And annualized return on equity before tax was 23.8%.

Then turning to page 3 in the presentation. As you can see, we announced increased dividends for 2013. The board decided to distribute excess capital in the form of increased dividend of NOK 2 billion for the 2013 financial year, corresponding to NOK 4 per share. The distribution is in line with the capital strategy that we communicated a year ago.

Various measures have been made to optimize the balance sheet and capital throughout 2014, which means that at the start of 2015, the group will have a balance sheet and a capital structure that supports the target of 15% return on equity after tax from 2015.

Measures implemented have been in the sale of Storebrand in the first quarter, eliminated risk relating to defined benefit pension from the balance sheet, excess capital of NOK 3 billion distributed in May. And on 15th of September 2014, a subordinated bond issue was launched with a nominal value of NOK 1.2 billion on a very competitive term. Coupon of three months NIBOR is 1.5% points per annum.

The terms of the bond issue are adapted to current and expected future requirements for the qualifying owned funds Tier 2.

The board also decided that the cost ratio target of around 15% for the general insurance operation will continue by also after 2014. This implies an underlying reduction in the cost ratio through continuous efficiently measures to find room for investing into future technology and skills and secure continued strong competiveness. In addition, the board yesterday also decided that previously communicated targets for the combined ratio and return on equity will remain unchanged.

And with that, I leave the word to you, Jostein.

Jostein Amdal {BIO 19939645 <GO>}

Thank you, Helge. On slide 5, you'll recognize presentation of our capital position. We manage our capital based on these three perspectives, the most binding one meaning the one that results in the lowest excess capital has been and is expected to be the rating perspective.

The strategic buffer is defined as excess capital in this perspective and it is our assessment of this buffer that results in our total dividend capacity. The size of the buffer was NOK 1 billion at the end of the third quarter. Please bear in mind that we will include this year's retained profit at year end.

We'll also remind you that our dividend policy is that least 70% of this year's profit should be paid out as dividends. The changes in the strategic buffer from the second quarter are largely due to the fact that we have deducted the adopted dividend while we have added the subordinated loan, resulting in a net reduction of NOK 0.8 billion. Underlying this is a slight increase in the capital requirement due to growth in the balance sheet. Later in the presentation, I'll talk some more about on the details from the rating perspective.

As the name indicates, the interim model is our internal management tool. We're working to have it approved as a model for calculating the statutory capital requirement once Solvency II is introduced. And we have a good dialogue with Norwegian FSA about the preparation of our application. During this process, both the model and the documentation of it will become more robust and changes to the model before the application is submitted may occur.

We expect the application to be submitted in the second quarter of 2015. The authorities will have six months to consider it. If we are required to make changes to the model during the application process, we will do so. And we therefore believe that the question is not so much whether but when it will be approved. We have also seen that authorities have introduced safety valves for the banks in the form of minimum capital requirements that are well-above their internal models, and that represents some uncertainty factor for us as well.

If we turn to slide 6, our base case is that we will obtain the approval to use the internal model to calculate the statutory capital requirement once Solvency II is introduced. We're, nonetheless, prepared for a situation where this does not necessarily happen from day one and are also calculating the capital need using the standard formula on a half-yearly basis.

And the numbers presented here are thus from June 30 and do not include deferred sub-debt nor approved dividends. There are two main points that should be emphasized from the figures we present here. First, even if the internal model is not approved, our statutory excess capital will be substantial. And secondly, the rating requirement is expected to be also in the future more binding than a standard formula. I'll briefly explain to you why the excess capital is significantly higher using the standard formula.

And the main differences are just for the capital available calculation. The treatment of subsidiaries differs. S&P excludes all capital invested in subsidiaries that are not general insurance companies, on the grounds that they're not assumed to have an excess capital.

Under Solvency II, the capital requirement is calculated from the consolidated insurance balance sheet, including Gjensidige Forsikring as a large insurance company. This means that we are credited for diversification advantages between general insurance and life insurance.

The Retail Bank (10:49) are included with the cap requirements under the capital adequacy directive. This means that they also benefit from excess capital in the Retail Bank and (11:01) at group level. And finally, the discounting effects are larger in the standard formula where the swap curve is used than in the S&P model that uses a 10-year government rate.

If we turn to capital requirements, these are, on average, somewhat higher under the Solvency II standard formula if you look at it based on each asset class or insurance product. But on the other hand under Solvency II regulations having a diversified portfolio of both different insurance products and in terms of asset allocation counts much more.

Hence, in total, the capital requirements are not that much different between the two perspectives.

In the calculations presented here, we have assumed that our interpretation of the regulations as regards natural perils fund and the guarantee provisions will apply. (11:48) that they will largely account as Tier 2 capital. There are two elements that are not yet included in the calculation as excess capital in the standard formula that will contribute to increasing the excess capital further, and these are the definition of premium provisions and potential tax effects on the required capital.

So, what are the most important uncertainty factors ahead of the implementation of Solvency II in Norway? If you look at slide 7, these are listed there. We have already commented on the FSA's letter of June this year. In our view, the reality underlying both natural perils fund and the guarantee provisions indicates that they should account as Tier 2 capital under Solvency II. This is a common understanding in the insurance industry in Norway, and we're making a concerted effort to work with the authorities to get our views across. And we view that outcome as likely.

As of September 30, the natural perils fund and the guarantee provisions amounted to NOK 2.9 billion, but also the Norwegian FSA proposal is that natural perils funds accounts to some extent. So, if their view becomes defined contribution, the negative effect on excess capital would be approximately NOK 2.5 billion. We view these items as part of Tier 2 capital, so if the FSA's interpretation were to become the final outcome, our capacity for subordinated debt will increase probably at the same amount.

In this letter, the FSA also addressed the valuation of technical reserves for solvency purposes as opposed to the tax values. At present, these two are the same, but when they switch to discounted values and risk margin on the technical reserves under Solvency II, that will no longer be given. More specifically, we believe that these are the three different valuations: tax, solvency, and IFRS. Our view is that the intention behind the new solvency regulation was not to increase the tax burden, and that the tax rules must be adapted to ensure that this is the case. Should the tax values be the same as the values for solvency purposes under Solvency II, this will result in a substantial increase in the tax burden.

In relation to excess capital measured using the internal model, this would amount to approximately NOK 0.5 billion as a result of the same change in provision for claims and NOK 0.7 billion if the security provisions are recognized as income. We do not believe that such an immediate increase in tax burden is likely to occur.

Provisions for premiums in Solvency II shall be the discounted value of future disbursements which means that the profit element that is currently embedded in this will increase the solvency capital instead. On the minus side, there is the capital requirement relating to the risk that the profitable customers will leave the company before the end of the contract period, so called lapse risk. Net this result is a positive effect on the capital position of between NOK 0.5 billion and NOK 1 billion, depending on the underwriting profit levels.

Calculation of capital requirements in Solvency II is a form of stress test. The capital effect can be calculated after tax. If it's sufficient, then likely that the company will be in a tax position after the stress test has been carried out. With high underwriting profitability, we've seen that we should be able to meet this criteria which will reduce the capital requirement (14:58). This can amount to NOK 1 billion to NOK 2 billion, depending on assumptions used for tax rate on the losses that arises in this stress test.

In summary, it's our assessment that the balance of these uncertainty factors are on the positive side for the legal capital surplus under Solvency II. This assessment is based on a strong belief that natural perils fund ends up as admissible capital, and that the balance sheet of the tax-related issues mentioned there also ends up in the positive. Furthermore, the uncertainty related to premium provision is more of a computational type than uncertainty regarding the Solvency II rules itself.

In the next two slides, I'll show some more details regarding our capital position in the rating model since this is the most binding legal capital requirement. Looking first at slide 8, you'll see that available capital in the rating model deviates substantially from IFRS equity. And I'll start with some more details on this. S&P has a more economic approach much like Solvency II, but as I have already described, there are some large differences in the actual numbers.

As of September 30, we have included the subordinated loan and deducted adopted dividend. As previously mentioned, we do not include the earned profit before the end of the year, and then minus the proposed dividend. Intangible assets are excluded entirely. As far as assets are concerned, our market value adjustment after the sale of Storebrand and the reclassification of SR-bank is now only related to bonds recognized at amortized costs. The market value adjustment of liabilities is based on discounting at a 10-year government bond rate. And then there's a haircut of 33% for discounting the provision for claims and 50% for provision for premiums.

Deferred tax liability relate to two items. Tax on properties owned in Oslo Areal firstly. Because the properties are also limited liability companies, which are tax exempt in Norway. This tax will not be paid. The other item is deferred tax on a security provision. In the IFRS group accounts, the current mandatory security provision is split into two with 73% to equity and 27% as deferred tax liability.

Security provision is a buffer without any foreseeable liability in other words a capital element. And this may be only used against very negative outcomes for the underwriting result. And S&P has included 6, (17:23) capital in their models. As mentioned, the book value of subsidiaries that are not general insurance companies is inducted in its entirety from their qualifying capital.

On the next slide, we have shown our capital requirements and how this is broken down into the most important capital drivers. You see that the capital requirement for insurance risk is somewhat higher than the investment risk and that this model includes relatively little diversification advantages. The most important individual risk on the asset side is equities where SR-Bank is included in the amount of approximately NOK 0.8 billion.

In the Norwegian market, there are much unrated papers, even though we can use third-party ratings in the rating models, a substantial part of our fixed income instruments are still unrated. This leaves Gjensidige with a somewhat higher capital requirement for credit risk compared to foreign companies.

On the insurance side, the capital requirements are particularly high for long-term products such as occupational injury and liability insurance while the (18:22) for motor and property insurance are high because they are such big products for us. The property requirement includes the effect of the natural catastrophes. In summary, our opinion, that is a reasonably balanced portfolio. The full effect of the diversification benefits is, however, (18:42) through the internal model which is also a tool that will be used as our active cap management tool.

Finally, looking at slide 10, I'll go through our capacity for subordinated debt. The capacity for qualifying subordinated debt must be tested against both the limitations in Solvency II and S&P's rules. S&P is relatively simple, hybrid capital with intermediate equity component as defined by S&P can amount to up to 25% of the qualifying capital. This assumes that a debt is replacing equity. In addition, however, it will also be the case that S&P will assume that hybrid capital that is to be included for rating purposes will have to counter the regulatory context. There is a link to this perspective.

Under Solvency II, the limitation is that Tier 2 capital can amount to up to 50% of the capital requirement. We assume that the capital requirement will be based on our internal model. If the model is not approved or if the approval process leads to an increase in the capital requirement, the capacity for Tier 2 capital will also increase. We also assume that most of the natural perils fund and the guarantee provisions account as Tier 2 capital which then reduces the capacity for subordinated loans in Q2 substantially.

Based on how we see the situation today, we have therefore utilized our capacity to raise subordinated loans that meet the Tier 2 requirements. Through the subordinated loan we have issued and the dividend now passed, we are where we want to be in terms of how we made the necessary balance sheet adjustments to be able to deliver on our communicated financial targets.

I'll then leave over to Catharina Hellerud, who will continue with the results for the third quarter.

Catharina Elisabeth Hellerud {BIO 17276650 <GO>}

Thank you, Jostein, and good morning, everyone. As both Helge and Jostein have spent time on the dividends, financial target and the capital position, and I feel quite confident that you have already seen the figures, I will make my section very short this time to save time for questions.

I would, therefore, only comment page 13 and 19, specifically. But first, overall, we are very pleased with the underwriting result in the quarter, reflecting a combination of solid premium growth and the continued strong underlying profitability. The proportion of large losses were lower than we expected for the quarter but, nonetheless, considerably higher than in the corresponding quarter last year and, therefore, the main reason why the underwriting result is lower in this quarter.

Effect on the combined ratio was 3.8 percentage points this quarter. The largest individual claim in the third quarter was the cloudburst over Copenhagen and the south of Sweden at the end of August which resulted in claims totaling NOK 78 million.

The run-off gain in the quarter was NOK 107 million, corresponding to a positive effect of 2.1 percentage points on the combined ratio. The Retail Bank and the Pension and Savings continue to show good growth with a profit before tax that is approximately 45% higher than corresponding quarter last year.

Turning to page 13, I will add some comments to what Helge mentioned earlier related to this quarter's profitability. The combined ratio was a solid 85.5% in the quarter and with a cost ratio of 14.9% year-to-date. We are confident we are well-positioned to achieve our target of a 15% cost ratio this year.

The loss ratio was 71%, which is very satisfactory, even though it represents a weakening of 3.3 percentage points in relation to the corresponding quarter in 2013. As mentioned, the proportion of large losses was higher than in the corresponding quarter last year, which explains 2 percentage points of the weakening of the loss ratio compared with the corresponding quarter in 2013.

On the other hand, the run-off gain was 0.2 percentage points lower than in the corresponding quarter in 2013. Adjusted for these effects, the underlying loss ratio was weakened by 1.1 percentage point.

In the motor product area, we have had yet another quarter with low claims frequency. This has lasted for some time now, but please remember that the frequency situation within the motor product is affected by seasonality, but can also be volatile, especially in the winter quarters. And the first quarter, this here is a good example and then a mild winter resulted in low claims frequency even though it was a winter quarter.

Accident and health products continued to produce favorable good results. But as Helge has already mentioned, the property product were on the weaker side this quarter due to many weather-related claims. With more fires and more water-related claims, some of it is normally expected. Finally, I will make some comments to the investment portfolio, which again contributes with the satisfactory return seen in the light of a challenging interest rate environment.

The investment portfolio amounted to NOK 55 billion at the end of the quarter, an increase of approximately NOK 1 billion from the previous quarter. The match portfolio amounted to NOK 33 billion and it continued to make a stable contribution to the financial results with a return of 0.9 percentage in the quarter. The continued fall in Norwegian and Danish interest rates throughout the quarter will be challenging for the return on the match portfolio going forward. The average reinvestment rates on both in the Norwegian held-to-maturity portfolio that traded in the quarter was as slow at 3.3 percentage.

We also see that the effect of the fall in the interest rates in the excess value of the held-to-maturity portfolio which is booked at the entire cost and at the end of the third quarter it amounted to NOK 1.7 billion. This excess value means that the good return on the portfolio in our account is falling more slowly than the fall in the interest rate level we indicated.

And the free portfolio amounted to NOK 22 billion at the end of the quarter and yielded a return of 1% in the quarter. A weak development for credit resulted in weak return in the quarter. This applies to high yield and convertible bonds in particular which yielded a negative return. Both equities delivered a weak result in the quarter. Price activity, on the other hand, delivered a solid performance in the quarter with a combination of increased valuation and realized gains.

The property portfolio also saw a strong quarter. There was a small yield fall for the portfolio as a whole in the quarter from 6.5% to 6.4%, reduced yield requirements combined with individual adjustments first on property, and the development has led to an increase of NOK 72 million in the value of the portfolio and in the quarter. All in all, this resulted in an acceptable return in the investment portfolio of 1% in the quarter, although it is considerably lower than in the corresponding quarter in 2013.

And by this, I leave the word back to Helge for a brief sum up.

Helge Leiro Baastad {BIO 5865247 <GO>}

Thank you, Catharina. On the last page, you are already familiar with our most important priorities. We have, throughout 2014, introduced measures to optimize the capital and balance sheet structure. And we will end the 2015 with a balance sheet and a capital structure that supports the goal of 15% return on equity, after tax expense from 2015.

To deliver on these targets, we need, first and foremost to concentrate on securing the numerator going forward. However, we will, of course, secure the denominator through continued good balance and capital management.

And with that, we open up for questions.

Janne Merethe Flessum {BIO 19368607 <GO>}

Operator, we are ready for questions.

Q&A

Operator

We'll now pause for a moment just to allow everyone to signal. We'll now take our first question from Jakob Brink from ABG Sundal Collier. Please go ahead. Your line is open.

Q - Jakob Brink {BIO 7556154 <GO>}

Thank you and good morning. I have a few questions regarding the capital. You didn't really discuss what would – what you thought would be the outcome from S&P regarding the natural perils pool. As far as I understand that they could decide to go against the Norwegian FSA or Department of Finance and not include it in total adequacy capital even though it might be included in regulatory capital. Could you maybe give us some your thoughts on that?

Secondly, you mentioned that also regarding the SR-1 Bank stake taking up quite a high capital consumption. And also that you in general have a relatively high capital consumption in your investment portfolio. Have you got any plans here to reduce that? And I know you tried to sell SR1 stake earlier in the year but didn't succeed, any progress here?

And then, maybe finally if I can just add a third question. What is your – I mean, I think you mentioned that you are now where you want to be with regards to leverage to reach 15% ROE target. But still, I mean, 25% of the total adequacy capital in S&P is NOK 4.4 billion subordinated capital, and you only issued NOK 1.2 billion. And even if you might have to treat the natural perils pool and the currency scheme as two capital, you can still assume around NOK 1.4 billion extra to two capital in the regulatory framework. And I guess, also 10% co-co, so, what are your thoughts on more leverage? Thank you.

A - Jostein Amdal {BIO 19939645 <GO>}

It's Jostein Amdal. I can start on question number one and three and Helge will comment on the SR-Bank question. As regards Standard & Poor's view on the natural perils fund and the guarantee provisions, they have taken their own view of these provisions so far. We have no indication that they'll follow the FSA or the Ministry of Finance either way, even if they – whether they actually approve of it or not approve of it, and we have not seen that S&P will change their position. We are, of course, in no position to make a forecast of what the S&P will mean further on, but this is kind of what we have and what we know so far.

In terms of sub debt capacity, we need to view that from two perspectives. And the most binding, as we see, is the Solvency II perspective. If we get the internal model approved, that will be the basis for the 50% of capital requirement that can be used for Tier 2 in Solvency II. Of that Tier 2 capacity, in our interpretation of natural perils fund and the guarantee fund, there is not that much capacity left for subordinated debt. If we are overruled on the guarantee fund and the natural perils fund, then our capacity for sub debt will increase, and also, for some reason, the capital requirement should end up higher than the internal model tells us that it is, then that also increases the sub debt capacity.

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

I can just give some comments to the stake in the SR-Bank. What we have said is that we are planning to sell the stake when the price and timing is correct. We have the capacity to hold on to the stake, but when the direction is clear, we will sell off the stake given that the timing and price is correct.

Q - Jakob Brink {BIO 7556154 <GO>}

Okay. Just coming back to the second question, the one with the sub-debt capacity. I mean, I guess you can cover 50% of the NOK 10 billion internal model requirement with non-equity capital. Isn't that correct?

A - Jostein Amdal {BIO 19939645 <GO>}

You can't actually read exactly the internal model capital requirement from our presentation since we use, when we present the total capital requirement that includes our internal buffer of 20% above the solvency requirement.

Q - Jakob Brink {BIO 7556154 <GO>}

Okay.

A - Jostein Amdal {BIO 19939645 <GO>}

And also includes the capital requirement for the non-insurance entities (32:17) directly from that.

Q - Jakob Brink {BIO 7556154 <GO>}

Okay. Thanks a lot.

Operator

Thank you. We will now take our next question from David Andrich from Morgan Stanley. Please go ahead, your line is open.

Q - David T. Andrich {BIO 15414075 <GO>}

Hi. Good morning. Thank you for taking my questions. Just three on my side. First of all, I was just wondering with your comments around Norwegian private market, are you seeing – are you indicating or are you seeing an increase in competition on that leading to not being able to put through quite as high kind of premium increases as what you have in the past, hence you're seeing slightly lower premium growth?

My second question is on the Baltic markets. For the last couple of quarters, you've had negative reserve leases so you've made reserve contributions there. And I was just wondering when you might see that starting to – I mean, those have actually, I think, been increasing slightly. When you might see that start to reverse?

And then finally, I wonder if you could comment quickly on paid-up policies in the Norwegian pension markets, what you're seeing in terms of capital requirements there under Solvency II and what kind of trends you're seeing? Thank you.

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

Okay. I can – it's Helge. I can start with some comments on the private market and the situation in Norway, while Catharina and Jostein can take the two other questions. I commented the situation related to growth in the Private segment. It's some actuarial (33:57) effects between second quarter and third quarter, so actually it's around 3% premium growth in the third quarter, and it's around 4.5% growth in the second quarter.

As earlier communicated, running premium increases are in line with long-term claims inflation. But we do selective adjustments into certain attractive segments, meaning premium increases are, on average, lower.

It hasn't – I actually think that the competition and the situation is more or less the same as we have seen throughout 2014. And our situation has been the same throughout whole 2014. Premium increases have, therefore, had somewhat weaker effect on growth in earned premiums lately than in past few years. But what I'll also comment in my presentation, we have seen the stabilization on number of customers through 2013 into 2014. And throughout third quarter, we saw a positive development in number of customers.

The main competitors is the same. It's Tryg, Aktiv, and DNB is also ambitious. We have lately seen Storebrand more active. And as you know, the Norwegian organization (35:10) Danske Bank. But we also meet the saving banks as before. And the situation is more or less the same actually. It's high competition. DNB is not more active compared to what we have seen a year before. Storebrand is more active compared to what we saw one year ago.

Q - David T. Andrich {BIO 15414075 <GO>}

Thank you.

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

I can comment on the Baltic's. It's correct that we have had a negative reserve release in this quarter. What we do every quarter is is use the best estimate for the reserves, so we try every quarter to get the results correct. But as you have seen, we have had some negative effects in the Baltic's. But it's also important to remember then that when you look at the Baltic's, the duration on the reserves are on average 0.7 years. So, we don't expect this to be anything a long-term change or something that affects our results going forward due to negative trend. This is a very short-term business. And again, we try to do it correct every quarter.

Q - David T. Andrich {BIO 15414075 <GO>}

Okay. Thank you.

A - Jostein Amdal {BIO 19939645 <GO>}

A comment on the paid-up policies. I mean, we're probably not the right company to ask about these capital requirements. This is not anything in that amount in our balance sheet at all. I think more general comment, there's obviously two rules including the transitional rules are softened, you could say, compared to earlier. But the problem, in our opinion, is more – it's not the capital requirements as such, but it's the longevity, which are increasing, and the low interest rates. That's the more problem rather than the capital requirements.

Q - David T. Andrich {BIO 15414075 <GO>}

Okay. Thank you very much.

Operator

Thank you. We will now take our next question from Matti Ahokas, Danske Bank. Please go ahead. Your line is open.

Q - Matti Ahokas {BIO 2037723 <GO>}

Yes. Good morning. Two questions on my side. Sorry as well. Going back to slide number 10, you talked a lot about this capital, but I'd like to revisit the question by Jakob about how much is the actual capacity increase to sub-debt. Is it the 25% total available capital S&P requirement and A, should we expect that you do something to increase the sub-debt going forward and/or why didn't you do it now? And how should we look at the real capacity for you guys to increase the leverage in this company?

The second question was on the falling interest rate. I missed a bit Catharina's comments on the falling interest rate challenge. Could you revisit a bit on where will the impact be the most? And also, we've seen quite a significant turmoil in the high yield bonds in the fourth quarter in Norway. Should we expect that to have an impact for Gjensidige as well?

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

Okay. I can start with the sub-debt. Our real capacity is that we need to be within the requirements both from a rating perspective as soon as we start with A rating and the regulatory perspective. And since we're close to Solvency II, we're looking at the Solvency II requirements.

The most binding for us at the moment in terms of capacity for sub-debt is the Solvency II requirements. And it is the capital requirement from the internal model as soon as that is approved, where we have 50% of that capital requirement available for Tier 2. And then of that Tier 2 capital, we assume that natural perils fund are a large part of that and the guarantee provision will be Tier 2 capital and use the substantial part of the tier 2 capital bucket. That leaves not more room for sub-debt than what we have already issued.

And then as I mentioned in the presentation, if somehow during the approval process for the internal model, the capital requirement is increased for some reason, or that there's a different judgment on the natural perils fund or the guarantee provision, that may increase the capacity for sub debt. But without those two items or those two topics cleared, we won't do anything more on sub debt.

Q - Matti Ahokas {BIO 2037723 <GO>}

But if they also are cleared, how much would the capacity be in that case, then?

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

That'll be speculative, depending on what the outcome, actually, and stuff. So it's more – that will be pure speculation.

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

And that your question regarding the yields, of course, the lower interest rate affects both the free portfolio and the match portfolio. But in the free portfolio, there is fair value adjustment, or the bonds are booked at fair value. But if you look at the match portfolio, a large part of the bonds are booked at amortized cost, which means that the running yield is not affecting the current interest rate level. It's – when you see this – call it the majority portfolio, and the value of NOK 1.7 billion. That is, of course, kind of a buffer for the booked returns going forward, meaning that the booked returns will be much more slow than what the actual interest rate levels should tell you.

Q - Matti Ahokas {BIO 2037723 <GO>}

And then the high-yield bonds?

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

Yeah. The high-yield bonds are in the free portfolio, and they are booked at fair value.

Q - Matti Ahokas {BIO 2037723 <GO>}

And what should we expect for the fourth quarter with regards to the market developments in the recent weeks?

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

Well, it's – we don't guide on the next quarter, of course.

Q - Matti Ahokas {BIO 2037723 <GO>}

Great. Thanks.

Operator

Thank you. We will now take our next question from Gianandrea Roberti, Carnegie. Please go ahead. Your line is open.

Q - Gianandrea Roberti {BIO 6786731 <GO>}

Yes. Good morning from me as well. I'm afraid I'll have to go back to the discussion on the sub debt and your capacity on that point. I just would like to check my math and I guess I'm doing some mistake here. You are showing capital requirements under your internal model of NOK 10.2 billion and you said before that there's around 20% buffer in that number that we couldn't see. So, I guess the real number ought to be around NOK 8 billion or NOK 8.2 billion odd something.

If that's correct, I guess you should be able to have around NOK 4 billion, 50% of that in Tier 2 capital requirements, but you have around NOK 2.5 billion of natural peril fund and guarantee schemes, so there should be another NOK 1.5 billion left for sub debt. And I guess you have issued NOK 1.2 billion.

Is this the math that we should look at it? So there's really around NOK 300 million or. Is this what you're referring to when you say that there's no sub debt capacity? And could you possibly give us the range looking at everything that you know right now for the future or how should we really look at this matter at this point?

A - Jostein Amdal {BIO 19939645 <GO>}

Your reason is quite correct. I won't comment on the specific numbers, but that's far away. I don't think we've given guidance on the range going forward.

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

Yeah.

A - Jostein Amdal {BIO 19939645 <GO>}

And also, we're not giving that.

Q - Gianandrea Roberti {BIO 6786731 <GO>}

Okay. Can I ask you something else here in the capital model? If I look at equities, you have a total charge in the model of NOK 3.4 billion which if I've done the math quick and dirty, it seems like it's a 60% capital charges on your equities portfolio which is even higher than what we used to know. I think previously we were talking about 45%, 50%, is that correct? And if so, does it really make sense to hold equities in a business like this considering the capital charge that you're having in there?

A - Jostein Amdal {BIO 19939645 <GO>}

When you look at us, yes, you need to include also private equity, SR-Bank, current equities and so.

Q - Gianandrea Roberti {BIO 6786731 <GO>}

Yeah. Yeah.

A - Jostein Amdal {BIO 19939645 <GO>}

The average charge from the Norwegian equity is 49%, and for private equity it's 62%.

Q - Gianandrea Roberti {BIO 6786731 <GO>}

62% you said, right? Just to understand, 62%?

A - Jostein Amdal {BIO 19939645 <GO>}

For private equity, that's correct.

Q - Gianandrea Roberti {BIO 6786731 <GO>}

Yeah.

A - Jostein Amdal {BIO 19939645 <GO>}

It's in a way you have 13% kind of top charge on top of the ordinary equity charge for unlisted equities. So, to the question when it makes sense to hold this. We manage our capital and kind of our asset allocation, our capital management activities based on the internal model and try to have a balanced portfolio where we utilize those diversification benefits that naturally arise in such a portfolio. And that is our kind of our perspective on how we manage it, and it's not the S&P cap requirement, it's a requirement of the total capital on there.

Q - Gianandrea Roberti {BIO 6786731 <GO>}

If I can just final – just really a couple of more questions. On a broader perspective I guess – sorry, the question is also for Catharina and Helge, because my understanding is that really you're mostly in Private lines in Norway and Commercial lines for SMEs. So – sorry, again. The rating doesn't really seem to be particularly needed for your insurance operation. But the answer that you gave us before was that it's mostly needed for the bank. It just seems to me that the capital that S&P ties up on this model, it's enormous compared to your own internal model. And I'm struggling a bit to understand why do you hold on to this or at least why you don't push S&P a little bit more. Perhaps you're doing it, we just don't know it, on aligning this model closer to your internal model. Is it possible to get any sort of answer to this?

A - Jostein Amdal {BIO 19939645 <GO>}

I'm afraid I have to give you the answer again. But, in terms of why and well what uses you have for an internal model, even though we are mainly have a higher market share in Private market and small, medium enterprises, we do also have substantial business that is in the higher end which is brokered or which is with municipalities. And they have credit committed, especially if it's broker with a U.S. headquarter that seemed to be focused on that. So, that for those parts of the business, we do like to have an A rating or at least an A minus rating.

Also, as you mentioned, the bank has a substantial external funding and the bank's rating is dependent upon our rating. That means either for the bank itself or for the...

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

Current bond company.

A - Jostein Amdal {BIO 19939645 <GO>}

For the current bonds company. Also, part – and you also have the advantages from having good rating in on the reinsurance side. So, there has been – there have not been – no discussion of changing that financial target.

Q - Gianandrea Roberti {BIO 6786731 <GO>}

Okay. Thank you.

Operator

Thank you. We will take our next question from Vinit Malhotra from Goldman Sachs. Please go ahead. Your line is open.

Q - Vinit Malhotra {BIO 16184491 <GO>}

Hi. Thank you. So, just have three points please. One is I noticed the strategic buffer. And it seems like going to go back to roughly speaking of NOK 1.5 billion level. I just wanted to know whether – and why I'm asking this question is because I was a bit surprised by the extra NOK 800 million or so that capital that was returned.

Given that your ROE, anyways, is not below 15% at the moment, what was the need to pre-empt this and why (47:40) strategic buffer is because unless you are going to keep the strategic buffer at NOK 1 billion, I thought it was quite strange to first pay down that NOK 800 million and then try to earn it back, keep it as a buffer. So, just if you could comment on the strategic buffer and the decision to pay more at a special dividend.

The second thing is on a going-forward basis, I know the ordinary dividend range is greater than 70%. Could you guide a bit more, is it likely to be closer to 100%, closer to 70%. And why I ask you is because now that a lot of the balance sheet excess has been shed – has been paid out rather, I just would like to understand the upside to the payout.

And just lastly, if I can just ask, I understand now the sub debt capacity. But it seems to me that sub debt is more like a hedge towards the FSA and FSA decisions. But virtually, are you really okay to use that hedge and really leverage up? That's maybe a comment from Helge as well for that, please. Thank you.

A - Jostein Amdal {BIO 19939645 <GO>}

On the size of the strategic buffer, we present NOK 1 billion but as we underlined, that does not include the amount of profits that will be withheld from 2014 accounts. So, it's kind of not including this year's results at all.

And in terms of the size of the strategic buffer, we haven't given any specific guidance on the minimum and maximum limits there. We have to remind you from third quarter last year, one of the reasons why we do have a strategic buffer. And also, from the third quarter last year, we presented our dividend policy that the excess capital will be distributed over time. And it has been natural for us to take out this excess capital in third quarter.

We will not comment or give any guidance on the actual dividend ratio. That will be up to the board to decide after the fourth quarter results are ready. And in terms of the last question?

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

We can relate to the dividends. We can repeat what we have said, actually, before. 2013 level is not the anchor for 2014 level. The dividend policy is 70% or more. It should be high and stable from 2015. And the target assumptions you can take with you is broad in line with GDP long term, somewhat lower risk appetite investment portfolio after the Storebrand sale and the corporate tax of 27% and increased capital need in line with growth. That's the communication around dividend. But, of course, it's like as Jostein said, it's up to the board to decide the starting point. And the last question was related to subordinated debt, wasn't it?

A - Jostein Amdal {BIO 19939645 <GO>}

Our willingness to use it if kind of the FSA ends up against our expectations. And we are willing to use sub debt and that is the point of telling you that there is an increased capacity if we do not get our views across bank debt (51:46).

Q - Vinit Malhotra {BIO 16184491 <GO>}

Okay. Thank you very much. That was very clear. Thank you.

Operator

Thank you. We will now take our next question from Matti Ahokas, Danske Bank. Please go ahead. Your line is open.

Q - Matti Ahokas {BIO 2037723 <GO>}

Thank you. A follow-up question from me regarding the other Nordic or general insurance Nordic segment. You talk about the loss ratio in the acquired portfolio being quite high. Could you elaborate a bit more about this? What is about typically in the third quarter, we've seen fairly good results seasonally so what is going on with the acquired portfolio? And what specifically do you refer to when you talk about the acquired portfolio?

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

When we talk about the acquired portfolio, we talk about the two portfolios that we bought in our Nordic segment last year. It was Gouda portfolio and the Solid portfolio.

Those are the two portfolios that we bought last year. And when we buy portfolios, of course, you have a time perspective on how long time it should take for these portfolios to be in line with the rest of our portfolio when it comes to profitability.

And when we look at business cases and look at the pricing of these cases, of course, we need to consider them, how much time we need to integrate this business into our current business, and what the costs are, and how long time we need. So, this is just to tell you that, of course, the Nordic segment in 2014, the results in Nordic segment is affected by new portfolios coming into the segment, and thus we need time to integrate them and to take off effect from entering new business in the segment.

Q - Matti Ahokas {BIO 2037723 <GO>}

Great. Thanks a lot.

Operator

Thank you. We will now take our next question from Sami Taipalus, Berenberg. Please go ahead. Your line is open.

Q - Sami Taipalus {BIO 17452234 <GO>}

Hi. Thanks for taking my questions. First of all on costs, I wanted to ask. I was a little bit surprised that you stuck with your 15% cost ratio target. And I guess, if we look at this segmentally, you're quite significantly below 15% already in both Private and Commercial. If we look at the other two segments, I guess part of driving those cost ratios down must be scale, which I'm assuming that you're hoping to build over the next few years. So, is there some reason why the current expense levels in Commercial and Private are not sustainable or are you anticipating some very substantial investments? Or why have you started with a high-cost ratio?

Then second of all, you mentioned about the new pricing for your best business, and increasing prices less for these customers and for others maybe. And that that's probably what's driving premium or I suppose adding premium growth. I was wondering is the margin unchanged on this business or are you actually willing to give up a little bit of margin in order to attract these customers?

And finally, I'm afraid I'm going to have to go back to the discussion about capital. And I guess, since the A rating appears to be something that you're quite keen on. Could you just tell us how much of your premiums and profits in the insurance business actually come from ratings-sensitive business? Thank you.

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

Thank you. I can start and make some comments related to the cost ratio target, and maybe Catharina, you can feed me out afterwards on the margin in the Private lines before Jostein take the latter.

I will start with saying that we are actually a cost leader in the Nordics today. So, I think we have a very strong position. As you have seen, we reported 14.5% in third quarter, 14.8% year-to-date. And we are actually more efficient than – much more efficient than the international peers.

We do not see any significant investment in any large core systems or things like that. But to be – to secure our competitiveness going forward, we think it's important to continue to drive the underlying cost ratio further down in Private segment, in the Commercial segment, and also in the Nordic segment. But we think it's important to give room for investing into future technology, brand and skills.

And you know, today, 25% of all contacts into Gjensidige is through a smartphone or a smartblet, smart tablet. And we have to be prepared to rapid changes in customer behavior, actually. So, this is to secure our future. But we will continue to deliver among the best cost ratios in the Nordic area. So, if we see a situation with lower cost ratios around our main peers, we will, of course, follow that.

Q - Sami Taipalus {BIO 17452234 <GO>}

Great. Thank you.

Operator

Thank you. We will now take our next question from Per Grønborg, Danske Bank. Please go ahead, your line is open.

Q - Per Grønborg

Yes. Good morning. It's Per from Danske. I have a follow up on the question that Matti asked a bit earlier on the other Nordic business. You addressed the issue that it was explained by the acquired business. I just wonder a bit, is this some seasonality because neither in Q1 nor Q2 where you also had these two businesses consolidated, you used that as an explaining factor for driving up the claims. Is anything special in this quarter where it drives up the claims significantly more than what you saw in the first two quarters?

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

Yeah, back to the Nordic, no, it's no seasonality in the figures. And it's still something that you will see probably at today's figures. So, it should probably have included at the comments in the last quarter as well. And so, it's nothing seasonality in these figures.

Q - Per Grønborg

But if that is the case, they also have a negative impact in the previous two quarters and it looks like you're seeing a significantly worse profitability this quarter in the other Nordics compared to what you saw the previous two quarters. And the cloudburst only explains a third of this the deterioration of the combined ratio.

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

Well, it's nothing in relation to both portfolios. It's no seasonality in the figures. But it's an effect that you will see through 2014 year-to-date.

Q - Per Grønborg

It's in the effect that you also were included both in the Q1 and the Q2 reported figures or is it a full-year effect you are now charging only to the third quarter?

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

No. No. It has been in the – I think the Gouda portfolio was acquired in the fourth – or it came into our figures in the fourth quarter last year and the Solid portfolio came in I think was 1st of February this year. So, the effects have been since Gouda since last year in the fourth quarter and the Solid portfolio since the 1st of February this year.

Q - Per Grønborg

Then my question is, what is it that is driving down the profitability in the other Nordics this quarter compared to what we saw in the previous quarters?

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

There are no specific comments of it – that we see effect from the both portfolio that we have also been in the first three quarters. There are, as we said, the cloudburst in Denmark which affects their profitability. Otherwise, there are no specific comments that we made to the profitability.

Q - Per Grønborg

Okay. Thank you.

Operator

Thank you. We will now take our next question from Gianandrea Roberti, Carnegie. Please go ahead. Your line is open.

Q - Gianandrea Roberti {BIO 6786731 <GO>}

Yes. One final question from me. I think at the beginning of the call, Helge, you gave some statistics of how much higher were the property claims this quarter compared to last year and the average of the last few years. Can you repeat these numbers because I'm not sure if I got them correctly? Thanks.

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

Yeah. It was related to property private Norway and claims incurred in the quarter, third quarter, were approximately 27% higher than last year. And if you compare to the last five years, it's 30% higher.

Q - Gianandrea Roberti {BIO 6786731 <GO>}

And would it – sorry.

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

Yeah. So, the point was that the property products are volatile and vulnerable to the wind and the weather as we have had in the third quarter, especially in the beginning of the quarter in the Norwegian market.

Q - Gianandrea Roberti {BIO 6786731 <GO>}

Thank you very much.

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

Operator, we have time for one more question, please.

Operator

Thank you. We will now take our last question from Sami Taipalus from Berenberg. Please go ahead. Your line is open.

Q - Sami Taipalus {BIO 17452234 <GO>}

Hi. Thanks. Sorry. I'm not sure if there was a technical glitch or something, but I didn't actually hear the answer to my last questions there that I asked before. Do you want me to remind you of what they were?

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

That is the question about how much of the business is actually rating sensitive?

Q - Sami Taipalus {BIO 17452234 <GO>}

Yes. Yeah.

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

You didn't lose that much because we're not giving a specific numbers on how much of the business is actually rating-sensitive. But this is within the business that is brokered or the directly sold to large clients or municipal clients. (01:01:59) sorry.

Q - Sami Taipalus {BIO 17452234 <GO>}

Okay. But could you give us a ballpark figure maybe? Because given that, it seems to be quite an important part of the capital management.

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

Well, if you look at the Commercial portfolio in Norway, at least we can use the parts of the portfolio that is brokered as a ballpark figure, around 20% of the portfolio in Norway is brokered.

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

Yeah. And then we have also significant part directed to municipality businesses or in the whole area of both Norway and the Nordics.

Q - Sami Taipalus {BIO 17452234 <GO>}

Okay. And then the margin on the business where you're more – where you have been putting through lower price increases? Is it unchanged or – that was my other question.

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

Yeah. No. We – what's important actually is that we will continue to calibrate our Private business in Norway to secure that we can deliver profitable growth, and deliver also within our financial – to meet our financial targets. And as I commented initially, we are very pleased that we can combine premium growth, profitable development, and increased customer satisfaction. But the communication I gave you is the same communication we have given you through 2014 with slightly lowered price increases in average due to our pricing in very attractive segments in Norway.

Q - Sami Taipalus {BIO 17452234 <GO>}

Okay. Thank you.

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

Operator, we'll have to end it there, unfortunately. Thank you for participating on the call. And we look forward to seeing some of you in London tomorrow. And hopefully, we will see many of you in at our Capital Markets Day on the 25th of November in London as well.

Thank you again for participating and have a nice day.

Operator

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