Q3 2021 Earnings Call

Company Participants

- Lars Kufall Beck, Chief Financial Officer
- Peter Hermann, Chief Executive Officer & Member of Executive Board

Other Participants

- Asbjorn Nicholas Mork
- Derald Goh
- Faizan Lakhani
- Jakob Brink
- Mads Thinggaard
- Martin Gregers Birk
- Per Gronborg
- Phil Ross
- Tryfonas Spyrou
- Will Hardcastle
- Youdish Chicooree

Presentation

Peter Hermann {BIO 20507411 <GO>}

Good afternoon, everybody, and good morning to the USA. Thank you for joining us at this Conference Call. My name is Peter Herman, and I'm the group CEO of Topdanmark; and with me is our new group CFO, Lars Kufall Beck; and Head of Investor Relations, Robin Lfgren. We're hosting this conference call because earlier today, we pop this report for the first nine month of 2021.

Now, I would like to start with a few opening remarks on our results. The DKK356 million post-tax Q3 result are performed consensus estimates on result and life. While both premium growth, the technical result and non-life, as well as the investment return and non-life, was in line with the consensus.

We delivered a combined ratio of 85.7 and a growth in non-life of 4.4% in the quarter. Compared to the first nine months of 2020, the non-life technical results improved by DKK245 million despite headwinds on rain, and frost, and large-scale claims. The improvement is driven by improving underlying trends within for instance house insurance, a slighter higher run-off gain, and the absence of weather-related claims in the first half of the year. Although, Q3 actually show a meaningful impact from the large number of cloudburst during the summer.

As you know, we have stopped reporting on the financial impact of the COVID-19 situation in general, lost frequencies continued to appear normalized except for travel, which increased substantially from Q2 to Q3, but still remains somewhat below our normalized level. Worth mentioning is also the good traction we are seeing in our partnership with Nordea.

The partnership continues to deliver strong results with our referral rate twice the size of the old Danske Bank agreement. And in the first nine months of 2021, the Nordea agreement has led to almost 50,000 referrals and has thus more than compensated for the outflow from the old Danske Bank agreement in terms of premiums.

We still expect this trend to continue through our '21. As previously addressed, we have seen a negative claims trend on house insurance towards the end of 2020. Our efforts to improve this continuous and we have made good progress on risk-based price increases, procurement initiatives, claims prevention, and more selective underwriting.

As a result, the claims strengthened house insurance has improved by around 5 percentage points in the first nine months of 2021, compared to the same period last year. As we continue to expect our efforts to improve the group combined ratio by 0.5 percentage point to 0.7 percentage point in 2021, will with full impact in 2022.

In our Life company, we have a strong Q3 results of DKK130 million, which besides including income from asset management for the first time, also saw higher investment return driven by property re-evaluation.

Looking at 2021, we have now narrowed -- we assume combined ratio for 2021 from before between 85 to 86 to now between 85 and 85.5, excluding run-off in Q4. This is among other things due to the run-off gain of DKK46 million in Q3, as well as the improving trends mainly within house insurance.

We have also narrowed the assumed premium growth for 2021 to now between 4% to 4.5% for the year. The underlying business momentum remains solid but we also saw provisions for unexpired risk within illness and accident in Q3 due to rising inflection that is taking some out of the premiums.

We have also improved -- we assume pre-tax result for the Life division for 2021 from earlier between DKK320 million to DKK370 million to now between DKK400 million to DKK425 million due to the higher investment return in Q3.

In conclusion, the post-tax profit forecast model for '21 has been improved from between DKK1.65 billion and DKK1.75 billion to now between DKK1.75 billion and DKK1.8 billion, excluding potential run-off in Q4.

Our solvency cover now stands at 243%, slightly lower than in Q2. The quarterly result was more than offset by an increase in solvency requirement as the impact from the solvency stress scenario on profit margin increased. The DKK850 million Tier 2 loan, which was already deducted from the solvency cover last quarter was redeemed during Q3, and our capacity to potentially issue new Tier 2 debt remains intact.

Then finally, let me briefly comment on our assumptions for the next year. We assume premium growth of 4% to 5.5% and a combined ratio between 86 to 89, excluding run-off. This is based on the assumptions of continued good traction on our partnership with Nordea, automatic premium indexation corresponding to a premium effect of 1.8%. Continuous positive effects from our pricing initiative on house insurance, and no material COVID-19 impact. In addition, we have based our assumptions on the normal levels for our weather-related and last year's claims, as well as an expense ratio of 15 to 16.

And we also expect to continue the strong delivery on our efficiency program into next year. A detailed profit forecast model for 2022 will be published in connection with the annual report of 2021.

This concludes the opening remarks. We are now ready to answer your questions, so please keep your questions to one or two at a time. And if you have more questions, feel free to enter the queue again for a second round.

So operator, may we have the first question, please?

Questions And Answers

Operator

(Question And Answer)

Thank you. (Operator Instructions). And our first question comes from the line of Asbjarn Mark of Danish Bank. Please go ahead, your line is open.

Q - Asbjorn Nicholas Mork {BIO 17028219 <GO>}

Yes. Good afternoon. A few questions from my side, if I may start with the outlook, just basically follow up on what you just talked about in detail. If I sort of look at the combined ratio ex run-off mid range, the 87.5 that's around 50 basis point deterioration from where you're going to land this year. And if I look at your building blocks for the next year with the improvements we're seeing already, I guess, you should actually leaving aside, I mean, including the large claims and I guess, weather claims which will be a little bit of headwind and COVID-19 as well. At least on my numbers it looks like you should have a tailwind next year. So what is it you're seeing giving you a headwind that is more than offsetting the impacts from the COVID-19 and well explain -- maybe a little bit you could touch it a little bit on that? Thanks.

A - Peter Hermann {BIO 20507411 <GO>}

Yes. First of all, we'll say that if we look at -- we have some headwinds -- tailwinds this year also from COVID-19, for example, that is taking away at least last year and the next year. And then you can say, yes, we will have as you mentioned the large scale claims and the weather related claims. But again, if we look at the next year, we can also see that, for example, that for now we're also looking at not an improvement within illness and accidents. We already saw inflation going up also on salaries that is increasing. You can say that the benefits we have to pay out on illness and accidents. So that will -- so we look into deterioration on illness and accident for next, but that's also included in the numbers for next year.

Q - Asbjorn Nicholas Mork {BIO 17028219 <GO>}

And I guess house insurance, the efficiency gains and the premium growth that you're guiding for me that should give you some -- I mean, the premium calls on the combined ratio, but the other should give you some tailwinds. But I guess, is it fair to say that there might be a little bit conservatism in the mid range?

A - Peter Hermann {BIO 20507411 <GO>}

You could say, yes. But the other thing is that we have also introduced you can say a higher range now when we look five quarters ahead and we will as I described also come to you after the annual result with a more detailed forecast. But you can say that if we are going to the bad end of the range, then you should -- we should see unexpected things. If we should achieve the best end of the range, we should in some way over achieve on some of our ambitions. So it's just to say that it is an interval, but yes, we have some good things going on with the pricing efforts and also some of the things and the momentum we have in some of the other product lines. But I think it's fair to say that it could be a little conservative in the mid range.

A - Lars Kufall Beck {BIO 20841753 <GO>}

Yes, exactly. Using the midpoint would be a little bit conservative, that's a fair statement.

Q - Asbjorn Nicholas Mork {BIO 17028219 <GO>}

All right. That put together nothing has changed on that. If I may then ask on life and the capital basically also for the group, but the outlook for life next year, you seem to be indicating that -- well, you indicated a Q2 reported that would take around DKK200 million, plus asset management, but then you had lowered the risk profile even I guess something like DKK270 million or something as a range for next year, which is also I guess what you have consensus about. But there seems to be a lot of solid momentum there. Is there any structural changes in the way you see the midterm profit outlook for life and the capital requirement for life cost going up this quarter? Is that a sustainable level? Will it grow further or are you going to do mitigating actions there on the capital requirement for life and hence the capital requirement for the group?

A - Peter Hermann {BIO 20507411 <GO>}

You can say, first of all, if you look at the profit for next year and also in life, this year has been dominated by very good investment results and especially, you can say, the degree valuation of our property portfolio that happened in Q1, so it's a little out of the normal. But if you do get then, we have transferred the asset management in the life business. So if we take that into considerations, we would normally say that with the new investment profile having a DKK30 million, you can say, lower that sounds assumed gain on investments -- on the investment equity, then it's -- it could be around plus DKK250 million that would be the normalized level in the life company. So that's still the case.

And if I look at the capital situation, it's true that the model for profit margin has of course released a lot of capital and we still have a very good, you can say, solvency level of 328 in the life company after this quarter. So there's still, you can say, a lot of room for additional -- we have to spare capital at least and then life that could be streamed up to the model and may be out later speak, but that's not the case. Then I would say that, yes, if you look at the solvency cover -- the solvency requirement now, it is probably at the level that we also expect going forward of course depending on the investment fluctuations, because if we get higher interest rates maybe it could be even lower. But if you get a crash on the equities, then it could get higher gain. So it is more volatile within life. But I think that the around DKK1.5 billion at the moment is a level that we expect. And then going forward in time, we would expect that to decrease because that the -- product portfolio would also, you can say, more, more run-off. So going forward, it will decrease, but it will be in the next coming for, you can say, a period. It will be in that level.

Q - Asbjorn Nicholas Mork {BIO 17028219 <GO>}

But wouldn't be the growth in the life business over the next couple of years also fundamentally mostly the -- you can say, the structural or normalized profit of the life business?

A - Peter Hermann {BIO 20507411 <GO>}

Yes. You can say that if we got a lot of growth, you can say, yes, then especially asset on the management. Then you can say, the trend could be improved, that's true. But you can also say -- but actually we'd not influence that much on the solvency requirement actually because all of the new business we gave is actually on lending and that's only operational risks coming in there. So it's not that big.

Q - Asbjorn Nicholas Mork {BIO 17028219 <GO>}

Yes. I was more talking about the DKK250 million that you mentioned as a profit point probably mid --

A - Peter Hermann {BIO 20507411 <GO>}

But, it's -- as you can -- as you also experienced as per on the -- the results has been volatile, but it's especially been volatile together with the asset on the management, because if we get higher asset on the management that is the key to get the even more profit in life company. So yes, if we have a bigger growth, but then you also have, you can say, higher sales cost and so on. But it's true that will increase the profitability.

Q - Asbjorn Nicholas Mork {BIO 17028219 <GO>}

All right. Thanks. I'll move back in the queue for more questions. Thanks.

Operator

Thank you. Next question comes from the line of Jakob Brink of Nordea. Please go ahead. Your line is open.

Q - Jakob Brink {BIO 20303720 <GO>}

Thanks very much. I'd like to continue where Asbjorn just let it on the life guidance and also the sales investment results. You have moved DKK25 million, I guess, in this quarter from parent company down to yourself (inaudible) and still you're only booking DKK8 million which is pretty much from COVID last year. So could you give us the sort of that DKK8 million, so what is going on within that and why can we not see the growth in the fact you're balancing the DKK25 million below. And then on the life guidance, it's not many quarters ago that you always last that normal life insurance cost was DKK220 million, DKK230 million and since then we have added 100 million and you're produce to risk a little. But how to get to choose DKK50 million that's a major reduction.

A - Peter Hermann {BIO 20507411 <GO>}

On the cost result within life that is, you can say, it's still depending on the development we do. So it will fluctuate from quarter-to-quarter. So that's at least one of the explanations for the reason why is DKK8 million here is still under year. It's DKK19 million. So it's a big improvement what we have seen historically, because we now have, you can say a good -- that's a good size of the asset under the management in the live company, but you can say, we still have you can say some development efforts within our system that will fluctuate from quarter-to-quarter. So that's one of the explanation for that. Yes, it's true. I can't remember, maybe you're right like about the DKK220 million to DKK230 million. But I think that when we set about the asset management company as between, it has been between DKK80 million or DKK90 million to DKK100 million that's been fluctuating a little as well as well.

So if you take the life company now, it is around DKK30 million we've taken off in expected gain on equities and investments. So if you take the -- around DKK200 million and plus almost DKK100 million and minus DKK30 million, it will be around to DKK250 million to DKK270 million or something. But you can say -- and that's still the case, but we're also looking into, you can say, investments within the systems and the platform. So that's the reason why a normalized result would be around DKK250 million, but let's see. When we reach the yearly accounts, then we'll come up with a, let's say, a little more detailed forecast for the life company.

Q - Jakob Brink {BIO 20303720 <GO>}

That's also new, because last time you said that was back in July that you had reached a steady state and the investment level in the life companies. Now you're saying that life investment should be higher.

A - Peter Hermann {BIO 20507411 <GO>}

We have always -- we're not saying it's stabilized. I would say that it's not been stable. So we say that we are still investing in the life company, but it's true that we have, you can say, the depreciations of course that is more stable now, because we have a -- but we still have some additional investments to do in order to also have even newer products on. We have a totally new platform working, but we also need some investments in there, new products and so on.

So you can say, that's the reason why it fluctuates a little. So it's not that stable yet. It's not like, you can say, a running level from quarter-to-quarter. So that's the reason why it's fluctuating a little. We still expect it to be positive going forward. We also expect it to increase above the cost result.

Q - Jakob Brink {BIO 20303720 <GO>}

Okay. Fair enough. I'm not quite sure I get the math, but okay. On the illness and accident and the right inflation in the DKK40 million if it's correctly understood that's a one-off kind of to take this quarter on the premiums and if everything else equal, you would have had DKK40 million higher premiums this quarter if you wouldn't have done that. And then in Q4, we should not expect to say negative impact everything else in COVID. Is that correct?

A - Peter Hermann {BIO 20507411 <GO>}

That's correct. But you can say that just depending if we experience that the inflation increases even more, then you could get, you can say, a new effect, right? But it's true that it's a -- when we look into the forecast for the combined ratio level of illness and accidents next year, then it's true. Then that has meant that we have taken DKK40 million out of the premium here in Q3.

Q - Jakob Brink {BIO 20303720 <GO>}

Okay. Thanks a lot.

Operator

Thank you. Our next question comes from the line of Derald Goh at Citigroup. Please go ahead. Your line is open.

Q - Derald Goh {BIO 20775137 <GO>}

Hey guys. Good afternoon, everyone. Just a couple of questions for you. So first one is just around inflation and within property specifically. So I'm just keen to hear if the rate that you're pushing through is enough given the inflationary pressure that the market is seeing, because I think you're pushing through rates about 9% since the start the year and you're still expecting -- you're still pushing about 9% today, whereas obviously seems that though material and labor costs have gone up quite a bit. So I'm keen hear if actually you're doing any more adjustments on that book there? And secondly, just on the non-life growth next year, 45.5% which is quite positive. Could you maybe break that down a little in terms of the cost deposit maybe by two business segments and also by premium -- sorry by prices and volume please? Thank you.

A - Peter Hermann {BIO 20507411 <GO>}

I'll start with the house thing. This year, we have as you know increased prices with a average about 9%. I would say that is as we have seen at least more than in line with the inflation this year, more than the inflation seen this year. It's true that we have seen materials in for example, timber, steel and so on have increased quite dramatically. But remember also, when we do claims -- when we do the claims, it's -- the ratio is around 15% in materials and 85% of salaries when it's the other way around when you're building your house. So you can say that -- so inflation material is not as bad as -- it's not hurting as much as just the 100% so -- only 15% of it.

And you can say, the 9% we've seen at least together with the procurement efforts we have done has been more than inflation this year. And we are looking into next year. We are still continuing traction, but also doing the price increasing. We still have a number of customers to be to be warned about price increases. We will not guarantee. It will be in the level of 9% depending a little on the competitive situation as well.

But if I think as for now, we have at least seen also with the price increases we have done on illness and accidents and also, you can say, we've done on salary insurances, then I think that actually we have priced, you can say, at least in line with inflation as we have experienced in the September month now together with procurement deals. But it will depend on little on inflation going forward. We've stated in the report if we see over the longer-term inflation between 2% to 4%, but that of course is a truth with modifications, because it's very dependent on the product line. But we will follow this and we have also stated that we'll be pricing at least in line with inflation to keep up profitability. I think it's important to say that we have other measures to doing business well, the procurement and also our own, you can sa,y efficiency within the processes. But we'll still expect to do some price efforts also going forward, at least seeing from now with the claims inflation.

And then the -- you asked about the growth, was it 3 to 4 to the 5.5, I don't have it split up in product line, you can say, but one thing is the indexation. We have 2.5% indexation next year for a lot of the policies and that's around 70% of the portfolio that gives around 1.8. Then we have workers' compensation. That we will not tell you the index we'll use because that is a competitive thing at least for now, but it seems like in a decent level. And then, of course, we have our pricing efforts that will still continue also in-house, but also on some of the other things we're doing. And then we have the of course new customers as well and also the partnership is actually giving a good thing into -- a good deal into the growth as well. But I think actually going forward, we still see a good traction on our agriculture and commercial division. They still have a good traction.

You can -- we have taken customers here on the that. So we have a good relation between what we are giving away, what we are getting from other competitors. They also see that actually the growth in life also next year will be better than we have seen this year, because this year has also been -- it has been influenced by some portfolios from private to the SMEs division here. And we also had a little churn, you can say, on the housing product and so on. But I think actually going forward, I think I was just saying that private will also have a higher growth than we are seeing this year at least. And I think that the growth will more or less continue maybe not as high as we've seen it this year, because that was being influenced by this switch of portfolios. But I don't have more details yet on for -- at least for now on the different segments. I hope that's okay.

Q - Derald Goh {BIO 20775137 <GO>}

Yes. That's fine. Maybe a quick follow-up if that's just fine. Just on illness and accident since of the combined ratio at the nine month stage, what are improvements that you've seen so far? And are you still confident in the 0.5% benefit to the full year combined ratio?

A - Peter Hermann {BIO 20507411 <GO>}

I would say that we have not seen an improvement in the combined ratio of illness and accidents in the first nine months. Actually it is going the other way. Actually we saw bettering of the combined ratio in the -- starting the year out and that also if you want to chew, but this inflation has meant that the combined ratio is now also giving both a runoff loss that's affecting the combined ratio and we're also seeing this about the unexpired risk that we have to put aside, but taking out of the premiums, the DKK40 million that Jakob also mentioned. So we have not seen an improvement on the, you can say, the combined ratio of the illness and economists. Actually it's deteriorating our combined ratio on the year with at least 2.5%. So it's just to say that if we deduct that, it will be even better combined ratio for the non-life part.

Q - Derald Goh {BIO 20775137 <GO>}

Yes. Got it. Thank you.

Operator

Thank you. And our next question comes from the line of Per Gronborg of SEB. Please go ahead. Your line is open.

Q - Per Gronborg {BIO 15910340 <GO>}

Yes. Thank you. Two questions from my side. Let's start off with the illness and accident. You stated earlier that you expect deterioration of the profit level next year. Does this imply that you have no ambition of adjusting further on prices despite quite strong pressure that is coming from the FSA to cope with this call it loss making a product?

A - Peter Hermann {BIO 20507411 <GO>}

To answer that question I can say that we have been in front of our competitors during this. This has meant churn higher than that we have seen historically at least that also the reason why we have minus 9% in growth this year. I would say that, yes, we have seen a deterioration due to this inflation on -- that could of course meet that overtime, but we have to raise prices even more and as you correctly mentioned Per, then the FSA is also saying that we should make more balance in this product. So yes, going forward, we will do price increases, but I think it's important that we also have a competitive situation here and we have been fund run-off. And we also like to see that some of the competitors moving as well. And then that will hopefully give us some room as well to do some price increases again. But so yes, we're looking into it, but I think it's important to say that we're also do looking at the overall probability also together with the investment income and so on. So if we're just raising prices even though with the growth would just be even more negative and then we will not earn that much on the asset management side. So it's a balance. But going forward, we will increase prices, but we need to work with the timing as well.

Q - Per Gronborg {BIO 15910340 <GO>}

It sounds like this is that -- the next round of price increase is more. Is it '23 effect than it is a '22 effect? Is that fair to say? And of course, I still give a credit that you are losing significantly less than you win this next that compared to some of the big players are able to burn off money.

A - Peter Hermann {BIO 20507411 <GO>}

Yes, and that's true and that's the reason why we are looking into it. I would not say that we couldn't do price increases next year, but it's true that they will not have full effects, because we're not doing it for the 1 January.

Q - Per Gronborg {BIO 15910340 <GO>}

Then you have a Slide 13 on prior year gains. What method is it more specific that you're trying to sell with Slide 13?

A - Peter Hermann {BIO 20507411 <GO>}

At the run-off level?

Q - Per Gronborg {BIO 15910340 <GO>}

Yes.

A - Peter Hermann {BIO 20507411 <GO>}

Okay. I think that has been in there for the last couple of times. I think actually, this is not -- it's not a new one, Per, just to say I think we've been challenged sometimes about the run-off level and we thought it was important. Actually I think it was three quarters ago something that we mentioned that we have seen historically this stated forward in risk premium of load and liability, and that has generated a lot of run-off profits. And the reason why we stated this was that we saw at the -- that someone expected still one-off levels between 4%, 5% and the message was just that we don't see that going forward. We don't know about the run-off level, but you can say the most systematic run-off gains we have had we can see that now, for example, more third party liability has, you can say, stabilized meaning that we'll not -- we cannot see that will get the same levels of runoff. But of course, you can say we will still work with the both technology and so on that could of course still be run-off gains to be taken, but it was actually just to say that it would not be in the same level that we've seen historically between 3.5%, 4%, 5%, but it has been there for the last few times. So it's not a new statement.

Q - Per Gronborg {BIO 15910340 <GO>}

Sometimes I just want to dig into this presentation and find things that might have been there for a long line. Can I just ask a clarifying question? You referred to Topdanmark's rate of return. Can you say, I mean, what's your rate of return is -- required rate of return is?

A - Peter Hermann {BIO 20507411 <GO>}

You're meaning that we are still even -- yes, it was just to say that if we get a lower run-off, we will have to improve our profitability. But no, I cannot give you -- we are now aiming for a combined ratio excluding run-off between 86 to 89 for the next year. Well that was what we have set. But as we also mentioned with the efficiency program when we talked about that, we are looking into improving our profitability going forward to work towards 2025. But I will not give you the number here because we are only, you can say, pointing for the next year. Sorry Per.

Q - Per Gronborg {BIO 15910340 <GO>}

I hope that we could give you a required rate of return. We had something to compare to our numbers, but thank you for now.

A - Peter Hermann {BIO 20507411 <GO>}

Thank you.

Operator

Thank you. And our next question comes from the line of Mads Thinggaard of ABG Sundal Collier. Please go ahead. Your line is open.

Q - Mads Thinggaard {BIO 15369662 <GO>}

Yes. Hi. Thanks for taking my question. I think number one is around your inflation outlook. You are addressing a 2% to 4% overall inflation level looking ahead. What are you actually building into your combined ratio guidance for 2022?

A - Peter Hermann {BIO 20507411 <GO>}

You can say -- and that is what we are building in, because we're seeing that if you look at -- if you look into the different product lines and that -- you can also say that's what I said before, it's a truth of modifications, right? Because at the moment inflation, for example, within moves s little high and also within buildings little higher, but we've also done price increases on those and we've also done price increases on building and house. So -- but just to say going forward, this is what we're building, but so if we -- that's what we're taking into consideration, but we have actually made into the guidance with 86 to 89. We have actually also put in some additional efforts on the next year for inflation. So -- but it's -- and that's actually more than the 2% to 4%, But we have a put aside a little more for the next year, but the 2% to 4% was more like going forward in time in a longer time frame. We have put aside a little more next year because we have seen that we still think that inflation will hit us at least in the beginning of the year. And then we think it will level a more out also in terms of logistics and so on coming and going forward. And we also already see now that in some of our building materials, we can already see that they are actually going down in price at the moment.

Q - Mads Thinggaard {BIO 15369662 <GO>}

Okay. So just to be sure, I mean, some areas you have more than 4% and so --

A - Peter Hermann {BIO 20507411 <GO>}

Yes, 2% to 4% is you can say that what we think in average for the headline going forward and next year, we have built a little more into the between the 86 (inaudible). We put a little more into it.

Q - Per Gronborg {BIO 15910340 <GO>}

Okay. More than 4% or more than the midpoint.

A - Peter Hermann {BIO 20507411 <GO>}

A little more than the midpoint.

Q - Mads Thinggaard {BIO 15369662 <GO>}

More than midpoint, okay. That's sweet. And I was also -- I mean in relation to inflation I was wondering a bit about the automatic indexation. Is that -- I mean, could you remind us what you are -- what your indexation is this year?

A - Peter Hermann {BIO 20507411 <GO>}

This year, I think it was around 2%, 2.3% or something and then again it was 70% of the portfolio. So it was 70% of 2.3%, almost the same. It's a little high next year.

Q - Mads Thinggaard {BIO 15369662 <GO>}

But shouldn't it go up next year?

A - Peter Hermann {BIO 20507411 <GO>}

It is 2.5% next year in the index.

Q - Mads Thinggaard {BIO 15369662 <GO>}

Okay. So only a slight index increase is what you factor in?

A - Peter Hermann {BIO 20507411 <GO>}

Yes. And you can say the reason for that is that the index is -- I think it's -- the time when it's put into force, it only counts for the year. So if inflation will stay at the same level as now, I would expect that the indexation in 2023 will be higher.

Q - Mads Thinggaard {BIO 15369662 <GO>}

Okay.

A - Peter Hermann {BIO 20507411 <GO>}

So it's a matter of timing when you decide this index, it's not us deciding it. It's an index we use, but I think it's the timing of it. So that's the reason why we expect it to be higher, but that will -- if things is the way the seems now, then it will be higher in 2023.

Q - Mads Thinggaard {BIO 15369662 <GO>}

Okay. Great. And then I will try to put just a little sneaky question. I think it was raised before, but in a different way. When you guide about the 4.5% premium growth next year, how much is from new clients and sold products and how much is from price increases in that times?

A - Peter Hermann {BIO 20507411 <GO>}

I cannot give you -- will not maybe or cannnot give you a full answer. But it's -- that will be indexation and price increases will be a good deal of it. And then you can say, then you have the little tailwind again from the what we have taken out of the premium now and due to unexpired risk, it is part of it. And then we have put in some, you can say, the some good momentum on sales on for example (inaudible) and also on agriculture and so -- but the main part of it's also indexation and price increases.

Q - Mads Thinggaard {BIO 15369662 <GO>}

Okay --

A - Peter Hermann {BIO 20507411 <GO>}

I cannot give anymore details on that.

Q - Mads Thinggaard {BIO 15369662 <GO>}

Okay. Fair enough. Thanks.

Operator

Thank you. Our next question comes from the line of Will Hardcastle with UBS. Please go ahead. Your line is open.

Q - Will Hardcastle {BIO 22230376 <GO>}

Good afternoon, everyone. A quick question from me hopefully just on the solvency. Just trying to understand what exactly has changed on the stress scenario from the profit margin deterioration. Is it the assumptions and perhaps any color on here of what the major moves have been and how we should think about the risk of that going forward as well?

A - Peter Hermann {BIO 20507411 <GO>}

I think it's a good question. It is actually the model we use for the stressing of the profit margin that we have worked with and maybe you can say better stress not that we're working together as high as possible, but it's just to say that we've improved the model. So I would say that going forward, this is in the level we think that the profit margin should be stressed unless something else happens in the stress scenarios. You know that there's market risk and the churn risk is the most important things for the stressing the profit margin. And there's this cyclical efforts as well as how much equity is going up and so on. But this is the level. It's due to the fact that now it's a better level of stress that we use now.

Q - Will Hardcastle {BIO 22230376 <GO>}

Okay. And so it wasn't driven necessarily from market moves and that's you're thinking,it's just a -- you've decided to amend, make it more robust. Is that correct?

A - Peter Hermann {BIO 20507411 <GO>}

Yes. That's correct. It's not to do with the market for the effects. It's a model thing and make it more robust. True.

Q - Will Hardcastle {BIO 22230376 <GO>}

Brilliant. Thank you.

Operator

Thank you. Our next question comes from the line of Stefan at Berenberg. Please go ahead, your line is open.

Q - Tryfonas Spyrou {BIO 21705826 <GO>}

Hi, this is Tryfonas. Can you just explain more the risk on what has come I guess in illness and accident books in the medium-term if wage inflation pursuits longer both when it comes to the asset and the retired? I guess, what will be the net impact on that? And the second question is on obviously solvency. How do you think about those hurdles this year? Thank you.

A - Peter Hermann {BIO 20507411 <GO>}

I'm sorry, can you repeat the first question? I didn't get that. Sorry.

Q - Tryfonas Spyrou {BIO 21705826 <GO>}

Yes. I guess, if you can just explain a bit more the risk in the medium-term on the sort of logical books on business if you have any expectation assisting about your expectations to get both the asset side and the claim side, will be the impact on that?

A - Peter Hermann {BIO 20507411 <GO>}

Yes. You can say that's true that inflation is not that nice, you can say, at least four in the beginning for the longer tail business as worker compensation ex illness and accident. We also have -- what we are doing is that we are also using inflation swaps trying to hedge. But it's -- in Denmark, we don't -- it's not an efficient market and it's an expensive market for doing inflation swaps. So -- but actually if you look the result this quarter, then infection has gone up, but actually inflation swap has actually performed quite well meaning that we actually have positive run-off due to this.

So of course, we can say claims will go up as inflation go up, but actually you can say, the hatching has actually performed even better this quarter within workers' compensation. So -- but we of cause keep tracking this, but we're looking into the hedging strategy and of course that we also look into the pricing of course. That's also the reason why I cannot say something about that the indexation on the workers' compensation for example. So that's one thing.

The other thing and if you look at the hedging within illness and accidents, we are doing a little differently. We're also using inflation swaps there. They have not performed as good meaning that we have a run-off loss there on the illness and accident, but there's another truth to it is that some of the hedging of the illness and incident is also done by properties and index bonds. And as you know the property has performed quite well, but the result that will end up in the investment results where the inflation swaps will end up in the risk results. So it's a little unequal. So when we look at illness and accident from a risk perspective, then we have a loss because the swaps are not giving enough. But together with the properties actually it is giving quite a fine, you can say, hedging but that's ending up in the investment results.

So yes, there's a risk going forward with the inflation if that keeps up and then the tool is either to use more hedging, but that's -- we're looking into that because the market is as I said is not that good for inflation swaps in Denmark. And the other thing is of course pricing, but we are very well aware that also as you can see that has affected this month results. But the hedging on the illness and accident is actually that you can find the good result on that. You can find that other places in the accounts. Hope that answers at least some of the question.

Q - Tryfonas Spyrou {BIO 21705826 <GO>}

Perfect. Thank you.

A - Peter Hermann {BIO 20507411 <GO>}

And I think you had -- you had a question on solvency as well. Sorry.

Q - Tryfonas Spyrou {BIO 21705826 <GO>}

Yes. Solvency 2 for the nine moths would be how do you thing about returning excess capital to shareholders? I know you've got also a lot of Q2 capacity as well. So you can maybe frame how do you think about the two. That will be great. Thank you.

A - Peter Hermann {BIO 20507411 <GO>}

Yes. We see from a management point of view that we think we are well -- we're over capitalized. We have a very fine solvency position. And as we also stated, yes, we have a possibility to check out more to (inaudible) redeem DKK850 million. So that's of course something we'll look into to optimize our capital. So the -- our aim is of course to be -- to have a situation where we can put money back to our investors, but that's a decision that of course will be taken by the board and I probably think that would be taken in together with the AGM next March I think it is. But we're working to -- we have worked this year to optimize our capital situation. I think that worked pretty well, the reason for the 243 and yes, we'll also look into additional tier 2 loans. So we will be having even better capital situation. So we'll have to return with, but we see some good possibilities here.

Q - Tryfonas Spyrou {BIO 21705826 <GO>}

Okay. Thank you.

Operator

Thank you. The next question comes from the line of Martin at Carnegie. Please go ahead. Your line is open.

Q - Martin Gregers Birk {BIO 19920552 <GO>}

Appreciate it. Thank you. First question goes on your 2022 guidance. What is the net effect assumed in the efficiency program in your guidance for next year? That will be my first question. Then the second question is going to be looking more specific on your excess capital position addressing of course the Q2 capacity, but also that your profit margin is still well below peers. Should we expect there's more to do on that front or is this sort of it for now?

A - Peter Hermann {BIO 20507411 <GO>}

Yes. In the guidance, we have not displayed exactly how much we have put into the 86 or 89, but we see, you can say, a larger positive net impact than we have had this year. And what we are seeing this year is that the net effect is around DKK70 million. It increased from the 20 million that we said in the beginning of the year because we saw that the effects were coming in faster. And next year we have included a higher amount, but not specified yet. We will do a follow-up after the year. We'll have a more follow-up on the efficiency program. So that's how I can answer that question.

Q - Martin Gregers Birk {BIO 19920552 <GO>}

But just before we move to the solvency, I guess, the old loss was pretty clear about the concave nature in your efficiency program.

A - Peter Hermann {BIO 20507411 <GO>}

I still think that the that the effects will come. When we're saying the 500 gross efficiency case towards -- yearly towards 2025, we still think that it will be as you said concave that it will be a higher amount of that coming in the first years and a small degree in the last years. So we still think that this is going up, but now we're talking about net effects, but w-- and e don't see that we will use. We said at the beginning of the year that we will spend around DKK100 million as a extra investment in the efficiency program. We haven't used that. So the net effect of DKK70 both due to our using less investment, but actually now also getting more out of the money and we do expect to use that much on investments next year. That's also why we think that the cost ratio also will go down next year. And you can say, the effects will also go up. So it will be we said before concave, but we haven't said exactly how much will come next year. But we'll follow up more in detail with the yearly result.

Q - Martin Gregers Birk {BIO 19920552 <GO>}

So if you take that answer and then look at the 86 which is the best possible outcome and your early explanation for that you basically had to be lucky to get to the 86 million worries me given that there should be such a large concave and given that you don't have to use 100 this year, why should the 86 be sort of very reasonable scenario.

A - Peter Hermann {BIO 20507411 <GO>}

We are saying 86 to 89 because we think it could be scenario, but it's just saying that some of the ambitions we have, we have to do very good also to achieve the 86 and over achieve in some parts. So not saying that we cannot reach the 86.

Q - Martin Gregers Birk {BIO 19920552 <GO>}

Okay. All right.

A - Peter Hermann {BIO 20507411 <GO>}

And then on solvency, the profit margin in life, I don't think it's that different. The profit margin we use in life is around 2.5% now of the provisions. I think that is in line with some of our competitors. We know that there's one competitor using an even higher amounts. I think it's in line with the most competitors. So that's what we see when we look at it. And you can say in terms of solvency, we have said that solvency between 170 to 190 would be a fine level of solvency ratio. And by using a lot of, you can say, profit margin, then you can say that we should be maybe in the higher end of the range. So -- but that's came from our point of view from management. But it's the board what that will decide, but at least also from us point of view, there's room for both dispersing some excess capital here, which is also a policy to access all the unnecessary capital.

Q - Martin Gregers Birk {BIO 19920552 <GO>}

But would it be reasonable to think that you guys were willing to go below 190 already as well in connection with the upcoming annual general meeting in this?

A - Peter Hermann {BIO 20507411 <GO>}

I don't know whether the board would think that this should be paid out in once or it should be paid out in a sequel. But at least, I think that the board will look -- at least look into what to do with the excess capital. And also, when we -- we'll continue working on optimizing the COVID situation as I mentioned before in the Q2 and so on. But whether it will be 190 or below 190, I can't give you a firm answer on that.

Q - Martin Gregers Birk {BIO 19920552 <GO>}

Excellent. Thanks so much.

Operator

Thank you. And our next question comes from the line of Phil Ross at Mediobanca. Please go ahead. Your line is open.

Q - Phil Ross {BIO 20618440 <GO>}

Hi there. Just a question on the underlying claims trend please. You reported I think four point, six point improvement year-on-year in Q3 or that's 5.4 depending on which number we take. If we look at claims trend of run-off large and weather. Obviously, those are good numbers. But in Q1 and Q2, the improvement year-on-year were bit more muted. I think at nine month stage, you're either two points or three points ahead on underlying claims and the claims trend excluding other bit. So just thinking about the run rate going forward sort of should we be looking at four to five point increase for the quarter year-on-year or should we all thinking about the nine month which is more of a two to three point year-on-year increase? Thank you.

A - Peter Hermann {BIO 20507411 <GO>}

I think that the nine month is probably a better bet here because you can say if we compared the Q3 last year, if you remember, Q3 last year was terrible that was when we also had -- that was a lot of headwinds against to there. And also you can say especially the house product really did not perform in the Q3 last year. So when you look at the Q3, there's a lot of things that's the biggest circulation. So I think that it will be more if to look at the Q3 -- Q1 to Q3 if you look at the improvements.

Q - Phil Ross {BIO 20618440 <GO>}

Sure. Thank you.

Operator

Thank you. And our next question comes from the line of Faizan Lakhani of HSBC. Please case go ahead. Your line is open.

Q - Faizan Lakhani {BIO 20034558 <GO>}

Hey, thanks for taking my question, I just have couple more. In the life business can we expect any sort one-off cost sort of fixing any of the IT systems or anything left remaining on that front? And the second question on solvency, just trying to say you expanded model for life product. Is there an opportunity to maybe use an internal model and could that be used in another way of optimizing capital? Thank you.

A - Peter Hermann {BIO 20507411 <GO>}

The first question on life was the question that could there come additional one-offs costs. Was that the questions? Sorry.

Q - Faizan Lakhani {BIO 20034558 <GO>}

Yes, correct.

A - Peter Hermann {BIO 20507411 <GO>}

That's not the assumption for now. Let's just to say that what we're also saying it's a little volatile because there will be some -- we have some deliveries and some development on the system, but it's not that we expect bigger one-offs at the moment. So that's a note to that. Looking at the solvency and looking at an internal model within life, yes, that we have -- we have looked into that, but I think that if you look at the size of a life company even though we have a pretty fair share of the market, I think we're a little small to do an internal model. So it could of course be a way to improve solvency even more, but we have looked into at once stage and at that stage, we didn't see that it was worth the cost of doing it because we didn't see that it could improve that much just from the expectation at least and also with the experience of got from working from other companies. But of course, going forward, also depending on the size of the company, then we could maybe look into that. But it's not that we have that in the plan for now.

A - Lars Kufall Beck {BIO 20841753 <GO>}

Just digging [ph] a little bit more on asset side in life. I mean, the project on changing the ecosystem has been finalized and we are now depreciating the cost we have on our balance sheet. And what we have done so far is that additional enhancements being done after it has been taken into used have been expensed. So clearly it's a choice what you do with further enhances, whether you expense them or whether you capitalize and also depreciate those, but the choice mix so far has been too expensive on an ongoing basis.

Q - Faizan Lakhani {BIO 20034558 <GO>}

Right. Thank you very much.

Operator

Thank you. And we have one further question in the queue so far. It's from line of Jakob Brink of Nordea. Please go ahead. Your line is open.

Q - Jakob Brink {BIO 20303720 <GO>}

Thank you. Just one last question here. I think last quarter, it was mentioned that due to the strong solvency ratio, you could move forward with the life investments in to IT. Is that still the case? And if so how much have you put into the expense ratio guidance next year prior amortizations? And secondly, if you move forward the investment should be then also realized the infinities of the issues into gain sooner than 2025?

A - Peter Hermann {BIO 20507411 <GO>}

We are accelerating the development of our new IT system within non-life. That is done and that's also why we said that depreciation level will be put forward that it will be the highest probably already in 2023. And so when we said it was from 2026 that the (inaudible) that's to put. But it will be the highest amounts at least from the planning now in 2023. So that's maybe the answer to the first question. And the second question, can you repeat that?

Q - Jakob Brink {BIO 20303720 <GO>}

No, just wondering if you have -- since you gave this guidance of the DKK500 million by 2025 October so that we would be moving forward the investments. I'm just wondering if that wouldn't mean that the efficiency gains could also be moved forward.

A - Peter Hermann {BIO 20507411 <GO>}

But actually I would say that no, because the efficiency gains that we have communicated to the market has actually nothing to do with the gains we will hopefully achieve when getting a new system. So the efficiency gains is actually the things we're doing also in order to finance the building of new system. So actually the efficiency gains from the new system has not been built -- has not been put into any of the gross efficiency gains for the DKK500 million yet. So that will be a new communication to the market when we're ready for that. So it's a no.

Q - Jakob Brink {BIO 20303720 <GO>}

Okay. Cool. Understood. Thank you.

A - Peter Hermann {BIO 20507411 <GO>}

Thank you.

Operator

Thank you. (Operator Instructions) And we've had one further question come for you that's from the line of Youdish Chicooree of Autonomous Research. Please go ahead. Your line is open.

Q - Youdish Chicooree {BIO 17430923 <GO>}

Hi. Good afternoon, everyone. I've got just one question left actually and to get on the topic of inflation. Just want to make sure I understand correctly your position. Basically you're saying in motor and property, you feel well positioned to handle rising inflation, thanks to your fixed price procurement agreements. And longer-term, you are pricing at least with expected claims inflation. However, the situation is quite different in illness and accident and workers' compensation where you think you're possibly more exposed to create further increases. Is that correctly understood?

A - Peter Hermann {BIO 20507411 <GO>}

Yes. It's true that -- it's not only the procurement. We have actually also done price increases on motor and on housing and building. So -- and yes, that's true there has been high inflation there and we have actually priced above that. So -- but it's true that we have on illness and accidents, we have seen that this inflation here has meant a deterioration of the combined ratio. So that has deteriorated the combined ratio, and of course that's an issue going forward. So -- but as I said before, it's a matter also, but is a competitive situation because the illness and accident is not a standalone product. If it were that, of course, we'll just price it, but it's different say sometimes it's the infra product to be able to get a pension scheme where we earn the money also on the investment income. So if you just price to get it to 100 in the combined ratio, then we'll be out of the market and we'll earn anything.

So if it were that simple, we would of course do it, but we have to do this in a way that we can still be competitive to actually get the full pension scheme and also have, you can say, the result in life as we have seen this year. It's quite high and also due to higher asset under management and so on. But it's true that at the moment, the inflation has -- we haven't priced illness and accidents to get down to 100 and also including the new inflation. Then we definitely need to have even higher prices on the illness and accidents to be able to get to a 100 in the combined ratio. And that's of course the aim going forward also seen from the FSA the regulators point of view, but it will take some time.

Q - Youdish Chicooree {BIO 17430923 <GO>}

Right. So it doesn't sound like you're hopeful for your competitors to be feeling the pain to an extent where they are more rational in how their pricing illness and accident. That's not your near-term expectation.

A - Peter Hermann {BIO 20507411 <GO>}

I'll not comment about the competitors. I would just say that we haven't seen at least until now that we have at least been the front runners in price increases, but I think that it will come also due to the FSA making new rules for this. But I also know that some of the competitors have some longer duration pension schemes with price guarantees for many years. So what will they do with them? So I expect that prices will still be low at least in some part of the markets for sometime, because due to these price guarantees that has been getting from some of the competitors to some of the customers. So -- but I cannot talk to them. I will just comment that of course we'll try to do a balance as we have actually have than most years within our own company. But it's half in call it a competitive to point of view. But still if you look at the overall profitability of our life company, then still together with the deficit on illness and accident, we still actually have profitability within life company. But we'll try to do it even better going forward, but yes, we have to respect the competition as well.

Q - Youdish Chicooree {BIO 17430923 <GO>}

All right. Thank you. Thank you very much.

A - Peter Hermann {BIO 20507411 <GO>}

Thank you.

Operator

Thank you. (Operator Instructions) Okay. There seem to be no further questions on the line at this time. So I'll hand back to last speakers for the closing comments.

A - Peter Hermann {BIO 20507411 <GO>}

Yes. That's well -- thank you for taking the time to attend this conference. And as you know you are always welcome to reach out to Robin if you have any further questions. Wish you all a pleasant rest of the day. So see you next time.