FINAL

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Q4 2014 Earnings Call

Company Participants

- Jarmo Salonen
- Kari Henrik Stadigh
- Peter Kristian Johansson
- Torbjörn Magnusson

Other Participants

- Blair T. Stewart
- Christian Hede
- Daniel A. Do-Thoi
- In-Yong Hwang
- Matti Ahokas
- Paris Hadjiantonis
- Thomas Seidl

MANAGEMENT DISCUSSION SECTION

Jarmo Salonen {BIO 1860650 <GO>}

Ladies and gentlemen, welcome to this Conference Call on Sampo Group's 2014 Results. I'm Jarmo Salonen, Head of Investor Relations at Sampo. And with me, at this call, I have our group CEO and President, Kari Stadigh; our Head of P&C Insurance, Torbjörn Magnusson; and Group CFO, Peter Johansson.

You can also follow this call on our website, sampo.com/results, and a recorded version of the call will later be available at the same address. We will have the same proceedings, as always. So I will hand now over to Kari for his comments on the Q4 and 2014.

Kari, please.

Kari Henrik Stadigh {BIO 1504152 <GO>}

Thank you, Jarmo. Welcome to the conference call on my behalf as well. As you have all seen already our numbers, I'll be brief and just start off with some best-ever comments as always. Our share price reached a new all-time for this year, at €43.84, up 11.6% year-to-date last Monday. Topdanmark performed well and reached earlier in this week DKK225, up 12.5% year-to-date. So a good start for the year.

Looking back at 2014, the best-ever comments are several. For the group, best-ever operating profit of €1.76 billion for the full year, up 6% from the previous year. In If P&C, highest ever operating profit for full year and lowest ever full year combined ratio at 87.7% as well as for Q4, 87.1%. And the story continues with lowest ever expense and cost ratio.

On the more challenging side, we also could see, in If, a very low running yield at the end of the year. With the situation concerning Norwegian interest rates still unclear, I think, there is a clear possibility and a bias for further lowering of this running yield.

We have been very transparent in our communication for the last two years on this point. So it shouldn't be a surprise to anyone that the low running yield and the effect of the short duration can be seen in our investment income. Our fixed income weight or allocation is at the moment roughly 88%. So the short duration is a very big issue as such.

Nordea delivers on plan, and we as the main owners see the results of the long-term work we have been participating in. Dividends up 44% and it translates to €533 million for Sampo this spring. I'm still seeing room for further improvements in Nordea, exactly as the company has guided the market.

Many of you have heard me over the years say 120 plus 20 for Mandatum. 100 in this context has been the margin we could, in theory, earn on the with-profit assets, and 20 plus 20 has been the €1 million return from expense and risk result. Last year was the first year when this 20 and 20 was reached in the Finnish operations.

The expense ratio delivered €20.9 million and the risk ratio €21.9 million in Finland, a very good result from the long-term work the management has been concentrating on. Also, our focus area, unit-linked, delivered highest ever gross written premiums at €960 million. The total premiums exceeded €1.1 billion, up 4% from the previous year.

Another important issue worth noting was the completion of the €1.3 billion portfolio transfer from Suomi Mutual by the year-end. The fact that we include this portfolio in the denominator when calculating the solvency lowers the solvency ratio clearly down to 22.9%. However, as this portfolio is a segregated portfolio, consuming almost no capital in reality, the drop in the solvency does not influence the dividend capacity of Mandatum Life. And you can therefore expect Mandatum Life to distribute its traditional €100 million in dividends in the first quarter of 2015.

Mandatum Life didn't suffer as much from the low interest rates as If, however, they had risk concentration on Russian equities, either a small position of direct investments or then the Finnish equities with an exposure to Russia. And therefore, the investment income on equities in Mandatum was weak, affecting the whole investment return.

All in all, 2014 was a good year for Sampo, which lays a solid foundation for 2015. And last but not least, I think you all appreciate today's board decision to propose to the AGM a record high dividend of €1.95. This is the sixth consecutive spring when we increase the dividend. That's all for me today.

Jarmo Salonen {BIO 1860650 <GO>}

Thank you, Kari. Ladies and gentlemen, we are now open for your questions.

Q&A

Operator

And we have our first question from Mr. In-Yong Hwang from Goldman Sachs. Please go ahead, sir.

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

Hello. Good afternoon. Two questions from me, both on P&C. So, the Norway combined ratio this quarter was very strong. I think it was 74%. So, could you give us a bit more detail on this and in particular whether there were any reserve releases in this?

And the second question is just on the outlook. You've maintained a 95% combined ratio by a margin outlook for a number of years. And I was wondering if – how you kind of perceive that margin to be compared to last year and whether – how you view the outlook on the P&C business, generally, going forward. Thank you.

A - Torbjörn Magnusson

Norwegian combined ratio at the end of the year, we had a decision in the Norwegian court about what's called the capitalization rate, which is really a discount rate for the annuities that you buy in Norway. We had reserved more strongly than the outcome of this decision, and we had some reserve releases from that and also some other sources.

The combined ratio is indeed very good in Norway, but not that good. The 95% combined ratio, this is a tradition we have. That should be always and every time, every year, we should have a combined ratio below 95%. It's been a longstanding tradition. And I see no dramatic changes in the marketplace compared to a year ago.

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

Okay.

Operator

And we take our next question from Mr. Thomas Seidl from Bernstein. Please go ahead, sir.

Q - Thomas Seidl {BIO 17755912 <GO>}

Yeah. Thank you. Good afternoon. Two questions, first on If, price changes, you outlined the pressure on the running yield, which of course is not a surprise. The question is now, is the Nordic market still disciplined enough and allows you corresponding price increases to set off these lower investment income, or should we expect overall slightly lower margins for If in this environment?

And the second question, with a look at your economic capital ratio, if I'm not wrong, it's down from 175% to 165%. I wonder, do you have any target on this economic capital ratio? And how do you think about this capital buffer going forward?

A - Torbjörn Magnusson

On price changes in If, of course, I can never reveal exactly how we think, but let me just remind you that, in the past five, seven years, the Nordic markets have proved to be more rational than any insurance market in history I think.

A - Peter Kristian Johansson {BIO 20728335 <GO>}

On the economic capital numbers that's actually, if you look at both Mandatum, If, and also Sampo Group, it's simply higher dividends that is driving down slightly the buffers on economic capital. Specifically, we've used internal target, which is not really a very official target in a sense that we tend to maintain on a group level, above 120, excluding diversification. So, we are clearly above that. But to be more specific on the targets, we're still waiting for the actual regulatory requirements to be in place.

Q - Thomas Seidl {BIO 17755912 <GO>}

Okay. Thanks. Very clear.

Operator

We have the next question from Mr. Matti Ahokas from Danske Bank Markets. Please go ahead, sir.

Q - Matti Ahokas {BIO 2037723 <GO>}

Yes, good afternoon. Three questions, if I may. Firstly, Kari was saying that the running yield is a big question mark. But at least to my view, that was actually surprisingly high. Is this just a function of the redemption profile that you guys are seeing?

And then if, Torbjörn, you could go a bit more into detail about these prior-year gains and losses, a minimal net amount, but fairly big gross amount so if you could get those figures, that'd be great.

And then the third question is regarding the dividend. Even though it was high, the payout ratio from the cash flow point of view was actually the lowest since 2010. So, if you would maintain the same payout, the dividend also would've been higher. Was this just a function of a nice increase rather than a payout ratio, or how come you didn't pay 100% like last year?

A - Torbjörn Magnusson

Shall I start with the prior year gains then since that's the easiest maybe? The cost for reducing the discount rate in Finland, the biggest single item in Q4, was €86 million, round about half of which was met with in reviewing very old reserves where a surplus was found, also in Finland. Then during the year but not Q4, the discount rate in Sweden has been – come down from 1. – I think – 18 to 0.58. That's a real interest rate, so a different type of calculation. That's round about €40 million in the reserve increase. And then as I said, we got some releases in Norway to meet much of that in the decision about the capitalization rate in Q4.

A - Kari Henrik Stadigh {BIO 1504152 <GO>}

Matti, I don't really see that the running yield as such held up. I think that you have to take into account that as if distributed dividends to the parent and that was yielding zero. That supported the running yield in the fourth quarter. But, year-on-year, the running yield came down by 0.5%.

And I still think that there is pressure on the running yield, especially if the Norwegian interest rates are lowered. So, I think that it's unavoidable that this wouldn't affect our investment income this year, the issue with the running yield. So, our investment income is under pressure.

On dividend, I don't think we have ever communicated any payout ratio the way you describe it, payout ratio from internal dividends to shareholders. I think that we have, on the other hand, communicated that we love the fact that we can year after year increase the dividends. And this we did this year as well.

Q - Matti Ahokas {BIO 2037723 <GO>}

Great, thanks.

Operator

We have next question from Mr. Christian Hede from Nordea. Please go ahead sir.

Q - Christian Hede {BIO 18642300 <GO>}

Yes, good afternoon. This is Christian from Copenhagen. I would like to ask you a more top down question, maybe a bit philosophical. Since I'm based in Copenhagen, I'm noticing that we now have basically a perverse negative interest rates. We're talking about people actually getting money for taking out mortgages. How do you see this affecting the whole banking sector and I guess also P&C if we continue to have these low interest rates? Well, yeah, that's my question. Thank you.

A - Torbjörn Magnusson

P&C will, of course, have a technical effect on discounting of reserves. But, so far, this effect is quite limited. And in terms of customer behavior, it has no big influence. Then its philosophy – and then I turn to Kari I think.

A - Kari Henrik Stadigh {BIO 1504152 <GO>}

Yeah. I think, concerning philosophy, we have to rely on the communication from your employer, Nordea. And so far, there hasn't been any – that type of communication that the effect on the results of Nordea would be especially big. I think that the low interest rates will have a bigger effect on insurance company investment income, because there are several insurers in Europe who have a very low equity weight.

And of course, those mark-to-market results going forward are going to be affected by this. I think it's – everybody must understand that this experiment is unsustainable long term and we are now in unknown territory. So, your guess is as good as mine. Our approach is that we have a very low duration. So, we are not then in a difficult spot if and when interest rates start to grow and/or increase. And we have taken the hit from this view in 2014 when actually one of the best investments was to be long in govies. But, so far, I don't think, on a group level, the banks will have anything dramatic to report on this.

Q - Christian Hede {BIO 18642300 <GO>}

Okay. Thank you. Could you also give me an update on the Finnish situation in general, so the growth prospects for the P&C business and also the general kind of macroeconomic trends over there? Thank you.

A - Kari Henrik Stadigh {BIO 1504152 <GO>}

Well, I think that, if we talk general macro, the quantitative easing in Europe was late. If they had done this in a timely manner as they did in U.S., we would probably not have seen these low negative interest rates because the quantitative easing would have had an effect on the economy earlier.

I think that the quantitative easing which is done now is the right choice, even if it's too late. And it will have an effect. It will also have negative effect so that we are going to see bubbles building up in certain asset classes. And of course, the first one where we see the bubble now is govies. It's not sustainable that this could continue the way it is now. It's artificial.

A - Torbjörn Magnusson

When it comes to growth in P&C, I have to be a bit careful with what I say because remember a number of years ago, 2008, I said that the economic climate would affect growth very negatively. And then we had a volume drop of 0.3%. And of course, that is much, much more stable than the rest of the world. P&C Insurance products are either mandatory or something that people buy in the Nordic region whether or not the economic climate is beneficial or not. So, yes, there – it will be more difficult to grow, but the effects will not be dramatic or huge.

Q - Christian Hede {BIO 18642300 <GO>}

Thank you very much.

Operator

We have the next question from Mr. Blair Stewart from Bank of America. Please go ahead, sir.

Q - Blair T. Stewart {BIO 4191309 <GO>}

Thanks very much. Good afternoon. Two questions left from me. The first is just, if possible, an outlook for the internal dividends you expect this year. We know what we can expect from Nordea. But, is there any reason to think any differently about what you might receive from Mandatum and If? And particularly, on that point, should we be concerned that the economic capital position at Mandatum is now below 100? Does that affect its ability to pay dividends?

Secondly, just going back to the ECB point, Kari, you've touched on this, but I just wonder what your view is of this risk of contagion of yield compression across lots of asset classes and particularly with regards to the risk that you need to keep tuning down your discount rates across the businesses. Thank you.

A - Peter Kristian Johansson {BIO 20728335 <GO>}

On the internal dividends, actually, Blair, if you look at – we expect, like the market is expecting, growing dividends from Nordea. And you can expect roughly the same amount of dividends, of course, from If and Mandatum, assuming normal market conditions. And even if our economic capital number or the economic capital requirement for Mandatum is higher than the actual available solvency, how we reported it, that's still an internal issue. So, looking at Solvency II, we have significant buffers with transition rules in Mandatum. So, there will be no restrictions on paying out dividends from Mandatum.

A - Kari Henrik Stadigh {BIO 1504152 <GO>}

And I think we have clearly communicated that the level from Mandatum – I think I said it actually in my opening remark that it's going to be €100 million in the first quarter.

On speculating about the interest rates, I think that there are two issues. One is that the euro model as such is not working too well. So, we have a 12% unemployment in the euro countries. We have 23% youth unemployment in the euro countries. We have close to €5 trillion of sovereign debt, of which more than a quarter is trading with negative interest rates at this moment. And of course, the quantitative easing is only fueling this.

But, on top of the quantitative easing, I think we have also an artificial regulatory demand because the regulator puts, as we all know, zero equity weight on sovereign debt. And that means that there is no real risk adjustment to the capital requirements of sovereign debt. And, of course, these two facts together, they make the market really a very, very artificial and subsidized market.

So, our conclusion at least will be that we shouldn't hold any sovereign debt with a negative interest rate because, why would we do that? The only reason we would do that is to – is if we assume that the negative interest rate will be even more negative in the future. And I think that's pure speculation, which is not our job. So, therefore, we are going to dispose of all govies when they are in the negative territory in a timely manner.

Q - Blair T. Stewart {BIO 4191309 <GO>}

Kari, can I just ask you as a follow-up to that? What are you doing on asset allocation at the moment for new money? And it's a general question as well as a specific one, does the current environment push insurance companies and institutional investors up the risk curve? Do insurers start buying more equities? And do you buy more real estate, or do you move into structured credit, that type of thing? Is that the temptation at the moment across the sector and at Sampo?

A - Kari Henrik Stadigh {BIO 1504152 <GO>}

Well, I think that the first thing to do is to go – to be in floating rate notes because, as we are sailing in unknown territory, it's good to have floating rates, then we will see how this plays out. I also think that institutions in Europe are going to participate in bank issues and substitute part of the sovereign debt with that.

And then, slowly but gradually, they are now, of course, we have seen what is happening in investment grade. And then, of course, when the appetite grows and the issues are scarce, then we will probably see a similar development in high yields. If we take out from the high yields the energy component, which is significant, I think rest of the high-yielders will see a compression of margins as well.

And finally, at the end of the tunnel, everybody will see equities. So there is more to be – more positive development to be seen in equities. And then when the tunnel comes to an end, of course, the question is who is the sucker at the end who is still with these assets when the interest curve turns? And I wouldn't like to be that one. So, it's a balanced effort now.

Q - Blair T. Stewart {BIO 4191309 <GO>}

Yeah. Fascinating. Thank you.

Operator

And we take the next question from Mr. Daniel Do-Thoi from JPMorgan. Please go ahead sir.

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

Hi, good afternoon. Just three very quick questions, the first one on the premium growth that you show on P&C on slide 32, and just wondering whether the year-on-year growth that you've shown, is that a good indicator of the current competitive situation and whether you also currently see the most and least attractive marginal profitability.

And then secondly, again on that slide, could you just give us the Swedish premium growth, excluding industrial lines?

And last question, just following up on the whole interest rate discussion, just wondering under what circumstances you would consider fully duration matching and consequently releasing some of that capital? Thank you.

A - Torbjörn Magnusson

Turning to page 32 then on premium growth, it's not a bad indicator, no, I agree, or yeah, I agree with that, the way that you've phrased the question. And on the Swedish premium growth, would be slightly higher actually without industrial lines, where we lost a little bit of business there. So, Sweden has benefited from the high car sales and some premium actions as well as some good affinity agreements that have turned out well this year.

A - Kari Henrik Stadigh {BIO 1504152 <GO>}

In hindsight – sorry, did you have another...?

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

I was just going to follow up on that on Sweden. You mentioned car sales and affinity. How much of that is from the agreement with Nordea, or is that still to come?

A - Torbjörn Magnusson

It's a not-insignificant part. I can't give you exactly what that number would be. But, it's – as I said, there are three components, and Nordea is one of the affinity agreements.

A - Kari Henrik Stadigh {BIO 1504152 <GO>}

With the development we have seen in interest rates, I think the – in hindsight, the full matching of duration should have been done five years ago or something. I don't think, with the earlier discussion we have had about what kind of abnormalities are building up in the market, I don't think this or the near future is the time for a full-duration match. If ever for – in our company, that comes in a more natural and stable market environment, when also there is such a yield environment that it leaves something for the owners. At this moment, it doesn't.

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

Okay. Very clear. Thank you very much.

Operator

We have the next question from Paris Hadjiantonis from KBW, please go ahead sir.

Q - Paris Hadjiantonis {BIO 19703051 <GO>}

Yes, good morning. This is Paris Hadjiantonis from KBW. I just have a couple of questions this afternoon. The first one on If, would you consider raising some debt capital at the subsidiary? And if so, is such a decision related to what happens with the Norwegian Perils Pool outcome under the Solvency II scenario?

And the second question is a more hypothetical one on Mandatum. Basically, we know that your economic capital does not look great at the moment, but you do have the transitional buffers. Under the scenario where the economic capital takes another hit from declining yields in the coming quarters, would you consider changing the asset mix at all, which attracts very high capital charges? Thank you very much.

A - Peter Kristian Johansson {BIO 20728335 <GO>}

Well, if we start with the economic capital from Mandatum, I think that the hit from the market would have to be quite massive because actually taking into account the transition rules we have roughly buffers, even if we now report in our own model that we have a small deficit on the capital requirement that takes into account full Solvency II and full discounting. But, if I take the transition rules, we actually have buffers around €600 million, starting from the beginning of next year.

So, in that sense, we don't have any pressure to change the allocation on top of the €600 million that we have buffers. So, moving into Solvency II day one, we could increase hybrids. So, actually, the true buffers are even bigger. The same goes with If that, let's see what the – when Solvency II steps in, so we could use more hybrids on the If level also. And – but, we have no final decisions on that side.

A - Torbjörn Magnusson

And furthermore, of course, the Solvency margin If is the strongest ever. So, even if in an adverse outcome of the Norwegian Natural Perils discussion, that wouldn't force us necessarily to do – to take up sub-debt with us.

Q - Paris Hadjiantonis {BIO 19703051 <GO>}

Okay. Thank you.

Operator

And there are no further questions at this time. Please go ahead, speakers.

A - Jarmo Salonen {BIO 1860650 <GO>}

Thank you. Ladies and gentlemen, thank you for your attention, and have, all, a very nice evening. Thank you.