Q3 2015 Earnings Call - Oslo

Company Participants

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

Other Participants

- Blair Stewart
- In-Yong Hwang
- Jakob Brink
- Matti Ahokas
- Steven A. Haywood

MANAGEMENT DISCUSSION SECTION

Operator

Good day and welcome to the Gjensidige Q3 2015 Results Presentation. Today's conference is being recorded.

At this time, I would like to turn the conference over to Janne Flessum, Head of IR. Please go ahead.

Janne Merethe Flessum {BIO 19368607 <GO>}

Good morning, and welcome to the presentation of our third quarter results. At this time, our CEO, Helge Leiro Baastad, will start by commenting some highlights for the quarter, as well as commenting on our expectations going forward. Then, our CFO, Catharina Hellerud, will comment numbers in more detail. And she will also spend some minutes this time discussing our capital position and how it looks in the Solvency II perspective.

Then there will be time for a Q&A, and in addition to Helge and Catharina, our Head of Capital Management, Jostein Amdal, is also present to answer your questions. Before we start, I would like to remind you that you can download our presentation from our website, gjensidige.no. Please, Helge.

Helge Leiro Baastad {BIO 5865247 <GO>}

Thank you, Janne, and good morning everyone. Then starting with page two in the presentation. I'm once again proud to announce that Gjensidige has reported a record high underwriting result, both for the quarter being in isolation and for the year-to-date. A more challenging financial market, however, results in a somewhat lower pre-tax profit for the quarter of NOK 952 million.

The underwriting result was NOK 1.091 billion corresponding to a combined ratio, 80.1%. And with discounted reserves, the figure is 78.6%. We reported 5.1% premium growth in the quarter and we experienced favorable claims development. Large losses, 4.7%, came in just below the expected level, while run-off gains, this quarter, 4.4%, contributed positively to the result.

The underlying frequency claims development, however, was very favorable, especially in the Private segment and especially then property and private, or sorry or motor.

The private segment reported and – I'm talking about Norway, now, the private segment in Norway's reported a much marginal decrease in premiums of 0.3% this quarter, but underlying premium growth was a positive 1.7% when adjusted for changes in the partnership agreement, as we have commented over the last couple of quarters. The commercial segment reported growth of 3.2% in the quarter.

As commented before, we are experiencing intense competition in the Norwegian market. Growth is slowing down somewhat in step with the economy, overall, as we expected and have commented on before. However, our competitiveness is strong and we have been able to maintain our market position.

For the Nordic segment, we reported growth of 17.1% but adjusted for currency FX and acquisition of Mondux in Denmark, the underlying growth was 1%. We are experiencing intense competition in the Danish market as well, especially in the large corporate segments.

However, the positive development in the Danish housing market continues to support good growth in the private portfolio. We are particularly satisfied with the strong profitability in the Danish portfolio combined with the fact that the Swedish portfolio is also developing positively.

Finally, if you then jump to the Baltic area, we are happy to have closed the PZU acquisition in Lithuania. Marius Jundulas, the former head of PZU in Lithuania has been appointed as the new head of Gjensidige Baltic. I had great confidence in our organization in the Baltics and look forward to starting the integration and realizational synergies as planned. Right now, our Baltic operation is unprofitable and it will get worse before it gets better. Our ambition is to secure a solid position in an interesting growth market for the future.

Moving to the investment return, we reported a loss of NOK 150 million in the quarter, mainly driven by the widening of credit spreads and weak equity markets. Catharina will comment more deeply back to this afterwards. Summarized then, the annual return on equity for the year-to-date is 15.8% and that's satisfying given the very challenging climate for investment returns.

Then turning to page three. Despite a rather more challenging operating environment, we are increasingly confident that we can deliver good earnings, and consequently, dividend growth over time. Strong underwriting profitability is expected to continue to offset a more challenging environment for investment returns.

So, first of all, we expect to deliver solid premium growth going forward. Secondly, we expect average annual run-off gains to double the next three years to five years compared to the average level in the last five years, and that we will continue delivering solid underwriting profitability. And last but not least, we are experiencing a more positive regulatory development that supports our capital position, and ultimately, our dividend capacity.

I will devote a few minutes to briefly walk you through each of these three drivers. So then, we can look at the page four in the presentation. We expect solid premium growth also going forward. We still expect to be able to deliver organic growth in step with nominal GDP growth over time.

In addition, we will continue with the strategy of buying companies and portfolios that are complementary to our existing operations. We will continue to capitalize on our scalable operating model and implement best practice across the Nordic countries and the Baltics.

We have successfully bought 12 insurance portfolios or companies since 2006 resulting in the share of premiums coming from outside Norway now approaching 30%. And the profitability in the Nordic segment is very good. It is important to emphasize, however, that we will continue our disciplined and rational approach to structural growth, and we will stick to the requirement that acquisitions have to support group targets within two years to three years.

Moreover, as highlighted on page five in the presentation, we will have to be even more disciplined as regards insurance operations going forward to compensate for low returns from the investment portfolio. We are even more confident that we – than before that we can deliver a combined ratio at the lower end of our target corridor. We note the measures implemented to ensure great efficiency and competitiveness are producing good results with the weak customers. As you're aware, the target of 92 to 93 requires the contribution from run-off to be zero. Our actuary function recently carried out a major review of the group's claims provision. This is a work we have been – this is a process, over one and a half to two years actually, internally, and it concluded that positive changes in the claims levels appear to be so systematic that the level of provisions should gradually be downwardly adjusted by some NOK 2.5 billion to NOK 4 billion.

These supplies in particular to the motor TPL and workers' comp products in Norway, where we have seen a positive development largely driven by better road safety, car safety and safety in the workplace.

As a result of this, we now expect the average annual run-off gains to double in the next three years to five years, compared with the average level in the past five years to approximately NOK 800 million. This means that we expect to report a combined ratio at the lower end of the corridor 86 to 89 for some years to come. And I remind you that this is still on a discounted basis. And it's also important to be clear that the prices we set today reflect the expected claims development in future. So, in the longer-term, it is therefore expected that the run-off result will be more or less zero as previously communicated.

Finally, increased use of analysis-driven business processes including more and more fine mesh tariff setting and involves CRM as well as rationalization measures and increased digitalization are producing positive results every day. And in combination with good underlying profitability, this will help us to ensure competitiveness also in the longer-term.

Last but not least, if you look at page six, the regulatory uncertainty in Norway now appears to be decreasing, which will be positive with respect to the capital situation, and thereby, also the future dividend capacity.

Based on the signals received during the quarter, as regards to Natural Perils Fund, we expect to achieve final and positive clarification of this issue before the turn of the year. And we expect that the Natural Perils Fund will qualify as Solvency capital from January 1, 2016.

Moreover, we now believe that the risk relating to tax has been reduced, although it will take time until we have final clarification of this issue. However, we now see the worst case scenario presented last quarter as unlikely.

All else being equal, it now appears that the need for the strategic buffer will be somewhat lower at the year end. In addition, the board has decided to remove the technical buffer with effect from the third quarter in the wake of the previously communicated change to the currency hedging strategy for foreign subsidiaries and branches.

So, then to sum up, based on our continued good growth, excellent underlying profitability, increased run-off gains and prospects of a strengthened capital position, I would like to remind you about Gjensidige's dividend policy. First and foremost, it is about delivering a high and stable nominal dividend over time. But it is also about not accumulating unnecessary excess capital. The aim of our capital management is to contribute to the achievement of the group's financial targets, including the target for the return on equity. In periods with growth in earnings, as I had commented today, it is therefore natural to expect growth also in the nominal dividend distribution. In addition, any capital over and above the group's defined capital need will be distributed to the owners over time. And by that, I leave the word to Catharina to close the presentation of the numbers and capital position.

Catharina Elisabeth Hellerud {BIO 17276650 <GO>}

Thank you, Helge, and very good morning, everyone. I will start by commencing on the figures on page eight. The underwriting result is record strong both for the quarter and year-to-date. The frequency claims development has been good during the quarter as a result of normal seasonal variation, but also because we again see that the frequency claims development, it's better than we normally we expect.

In addition, the run-off gain was higher during the quarter than in the corresponding quarter last year. And as Helge has commented, it is also expected to be at a higher level going forward. On the other hand, the proportional large losses is somewhat higher in the quarter than in third quarter last year, and it's also close to the expected level. Roughly, one-third of the large losses in the quarter around $80 million is due to the floods in Norway and in September. Pension and Savings and the Retail Bank continue to deliver good profit performance even though this quarter the bank reports a profit before tax expense that is lower than in Q3 last year. This is largely due to negative development in the liquidity portfolio, as a result of the widening of the credit spread. Looking at the development in the net interest income, it increased by 20% compared to Q3 last year, and the bank is still popular with our customers.

In the last 12 months, lending has increased by as much as 30%. Investment portfolio had a negative return over 0.3% in the quarter. This is – this result is primarily influenced by the widening credit spreads and the negative return on the current equities, including the shares in the SR-Bank. In all, this leads to profit before tax expense of NOK 952 million.

Turning to page nine. You can see that we reported a combined ratio, 80.1% in the quarter, corresponding to 78.6% on a discounted basis. The cost ratio was 14.5% and the loss ratio was 65.6%, which is 5.4 percentage points lower than in the corresponding quarter last year. The run-off gain was as much as 2.3 percentage points higher than in Q3 last year. And this expense part of the positive development, a proportion of large losses being one percentage points higher than in Q3 last year, partly offset this (15:14). But adjusted for these two effects, the loss ratio is 4.1 percentage points lower this quarter than in Q3 last year.

In addition to that, during this quarter, we have rewrite the provisions level for mobiles, for motor and workers' compensation in Norway. This has do with the development we see as regarding claims, which Helge commented on at the start of his presentation.

In that connection, we have also made certain adjustments to the provisioning level for the first half of this year, which makes a positive contribution to profitability in this quarter. It is particularly in motor private that this has a significant effect corresponding to NOK 70 million, affecting the combined ratio on the group level, 1.3 percentage points. The effect is considerably smaller in commercial motor and workers' compensation. The adjustment of the mobile will also affect the profitability on motor private going forward. But remember that lower provision levels reflect the lower expected claims inflation, which will also affect pricing. The inflation expectations in motor have been done where they adjusted from 1% to 3% to around 1% going forward.

The profitability in motor private has been very good in the quarter, of the one we take into account, the above mentioned mobile adjustments. That said, I should remind you that the result in motor are normally expected to be good in the third quarter. There are more claims and more (16:54) in the first and – first and fourth quarters and we may still see difficult winter with a completely different profitability level than we see this quarter.

Property private have also developed good or delivered good profitability in the quarter and better than in the corresponding quarter last year. We have a negative effect from torrential rain in Norway in September, but last year, there were many more water damage claims and thunder and lasting related (17:24) claims during the quarter.

The Norwegian commercial segment has also delivered some solid results during the quarter. The frequency claims development is good, that the impact of frequency claims was at a more normal level than at the same time last year.

Today, I will skip the next four slides and move directly to page 14 to comment on the investment return. The investment portfolio was NOK 57 billion at the end of Q3 and again a negative return of 0.3%. The main explanation for this weak return was widening of a credit spread combined with a weak equity market. I would also like to remind you that weak currency hedge closed (18:07) 100% of our exposure.

The match portfolio of NOK 36 billion yielded a return of 0.5% in Q3 compared with 0.9% in Q2. The hold-to-maturity portfolio yielded a return of 1.5% in the quarter relatively 1.1% (18:28) in the quarter, on par with a return in the second quarter when adjust the sort of price gain in second quarter related to a bond that was redeemed before maturity.

We have made a few investments in the Norwegian hold-to-majority portfolio during the quarter, amounting to slightly less than NOK 300 million. The average reinvestment rates for these investments has been 3.7%, affected by a combination of some decrease in the interest rates and the considerable widening of credit spreads.

The free portfolio amounted to NOK 21 billion and yielded a negative return of 1.5% in the quarter. The widening of credit spreads contributed to the bond portfolio yielding a negative return in the quarter. And this applies especially to a global high yield fund. Current equities also yielded a negative return, affected in particular by the development for the shares in SR-Bank. The shares, which we hold (19:28) that we are not in a rush to make here the same. Private equity have a negative return of 0.8% in the quarter and this also includes a realized loss of NOK 10 billion in connection with a sale of our stake in our technology funds. Adjusted for this loss in the portfolio yielded a more or less zero return. The property portfolio yielded a good return in the quarter. The general required rate of return has been reduced from 6% at the end of the second quarter to 5.9% at the end of Q3.

Altogether, a net increase in value of NOK 159 million was recognized in the quarter. After the end of the quarter, 50% of the shares in Oslo Areal, which is a company where we invest our property portfolio, were sold to the Swedish company AMF. This sale will result in a gain of NOK 350 million in the Q4, of which NOK 250 million is related to reversal of deferred tax. Our intention is to keep property exposure at around today's level and the concentration will be reinvested in property through Oslo Areal

So, moving onto page 15, you will see that we have changed the illustration of the capital position from this quarter. Returns really applicable lead infrastructure (20:48) has been removed since we assume that it is no longer interesting to monitor lead perspective (20:55). In addition to the rating model and the partial internal model, we now also show the capital position calculated by using the standard formula. As you can see, the capital position is solid, seen from all three perspectives and I will discuss all three perspectives in more detail.

Starting with rating perspective, which is still the most binding capital perspective for Gjensidige. We kept the current month increase (21:21) by around NOK 200 million from the previous quarter and this is primarily due to the insurances increasing, largely as the result of acquisition of PZU and Mondux now having been incorporated in our figures.

Available capital increased by NOK 100 million in the quarter. There are some major adjustments behind this small net increase. The main explanation for the increase in the available capital is we can now assume that 70% of the profit after-tax will be distributed, where we left the rest of the total comprehensive income be part of the available capital. And this is a change in principal that we have implemented for all of the three capital perspective. In order to give a more correct picture of the available capital throughout the year. And in Q4, we will then, of course, adjust with the actual proposed dividend.

In total, this means that the available capital increased by NOK 1.3 billion will include the whole effect for the year-to-date. On the other side, there are also some elements that explains (22:34) in available capital, which is increased deduction for intangible assets after the acquisition of Mondux and PZU. The main affect of acquisitions, obviously, it does inform or reduce available capital and not increase capital requirements.

In addition, the asset value in the hold-to-majority portfolio has been reduced by NOK 100 million during the quarter, due to the widening of credit spreads. And the – and on the other hand, reduced discount rate has also reduced the result of the discounting effect by NOK 200 million.

In addition to that, the board has decided to remove the technical buffer above the capital requirement, which result in NOK 700 million reduction in the capital requirement compared to the second quarter. In total, this means the capital margin from underwriting perspective of 170% at the end of Q3 corresponding to a strategic buffer of NOK 2.6 billion.

During the first half of 2016, we plan to submit an application for approval of the use of the internal model for calculating the standard structure capital requirement. Until the application has been approved, the standard formula will be used to calculate the legal capital requirement.

At the end of the quarter, the solvency margin based on standard formula was 155%. For capital management purposes, it has been decided that the solvency margin should be in the range of 115% to 140% when assessing this perspective in isolation.

Figures for the internal model perspective are currently setup in accordance with the version of the internals, which we will apply for approval. It is therefore our best estimate of what the relative solvency position will be once the internal has been approved.

As you may notice, the capital requirement is down from the second quarter. The main explanation is that from this quarter onwards report that solvency capital requirement in isolation and not the economic capital requirement.

I should also mention or remind you that from Solvency II regulations are based on principles. We have used our own interpretation, so there is some general uncertainty about whether our interpretations are correcting or compact (25:01). That said, we have for several years how to get a dialogue with the Norwegian FSA, concerning our interpretations, so that we assume that this the correct picture.

At the end of the quarter, the solvency margin based on the internal model was 206%. For capital management purposes, it has been decided that the solvency margin should be in the range of 120% to 175%. The minimum deferred above the capital requirement is there to ensure that short-term volatility in the capital position or risk taking, those things will lead to breach of requirement.

Any buffers above this represents financial flexibility. That, remember then, that it is the rating requirement that is the most binding.

So, if you look at page 16, I will talk you through the available capital and capital requirements from the statutory perspective for giving on the point where they defer (25:59). The basis for the available capital is the IFRS equity. The Natural Perils Funds and the guarantee scheme provisions are included in the IFRS equity and we have not excluded these elements from the available capital.

It is the same assumptions as we have always made. In the same way, as for the rating perspective, we have taken into account for a dividend payment corresponding to 70% of the profit after tax and the rest of the total comprehensive income is included in available capital. Moreover, the balance sheet shall be valid using market-based principals and our risk margin should be deducted. It is only because the risk margin that's available capital percent to the standard formula and the internal modal are not identical.

The risk margin is calculated based on the capital requirement, and is therefore greater in the standard formula than in the internal. As regards to the calculation of the capital requirements, we believe that the internal model best reflects the Gjensidige's risk profile. The general explanation for why the internal model leads to lower capital requirements than the standard formula is that internal model is a more comprehensive model and the model is more detailed and it is also based on the Gjensidige's observable (27:19) data as regards insurance risk.

As a whole group (27:23), partial internal has been used which means that part of the capital requirement almost 38% is calculated by using the standard formula. I will comment (27:33) but the two perspectives differ seeing differently.

The biggest difference between the internal model and standard formula is the insurance risk where the tax requirement, person-to-person to the internal model amounts to around 70% of the standard formula requirement.

While the standard formula calculations are not relatively – are at a relatively aggregated level. The internal model calculation are at a more detailed level. In order to model the risk correctly, insurance products with different risk profiles are modeled separately in the internal model. And in addition, the standard formula, it does not manage to capture the effect of the reinsurance (28:19) internal model. From market risk, the capital requirement according to the internal model amounts to around 80% of the standard formula requirement.

Again, this is because the internal model is more detailed particularly for bonds and equities. Moreover, correlations between different asset classes seems to be artificially high in the standard formula, especially the correlation between property and other asset classes. This is generally higher diversification in internal model, diversification between the main risk categories in the internal model makes up about one-third of the standalone capital requirement. In the standard formula, it is around 20%.

Adjustments of the base capital requirements concerned to risk reducing effect of deferred tax in the stress scenario in the two perspectives. Net capital requirement is highest in the standard formula because the effect on the capital requirement is of highest in this perspective. The current tax rate of 27% has been used to calculate the effect. If the tax rate is reduced, this effect (29:29). So the total capital requirements in the internal model perspective amounts to around 78%, now the capital requirement corresponds to the standard formula.

We have also included an illustration of the sensitivity for the capital position in the internal model. The capital position is not very sensitive to interest rate, since the interest rate risk on the asset side is largely hedged using that a precise exposure on the liability side, is greater sensitivity relating to changes in the credit margin since we do not have correspondingly hedge on the liability side. An increase in the credit spread of around 50 basis points will give a negative effect on the solvency position of 8 percentage points. We have a relatively high credit quality in the bond portfolio which to some extent reduces the probability of course of such wide credit spread to the entire portfolio.

Operator, with that, we are ready to take questions.

Q&A

Operator

We will now take our first question from Matti Ahokas from Danske Bank. Please go ahead.

Q - Matti Ahokas {BIO 2037723 <GO>}

Yes. Good day to you all. A question on slide number 15, you talk about that the capital above requirement is now NOK 2.6 billion, and of course, I guess the big difference here is the NOK 0.7 billion technical buffer, which was reduced. Should we expect this technical buffer will be paid out as dividends, and if not, why? And how much do you expect that the need for the strategic buffer would be reduced, is this only this NOK 0.7 billion or is it more than that?

The second question is basically, if you believe that your reserves are too high, why don't you actually decrease them in a one-step changes instead of taking them over a number of years. Is there accounting reason for this or one could think that, if you've come to the conclusion that your reserves are too high, why don't you just take it back in one-step? Thanks.

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

Hi, Matti. It's Helge. I can start with your first question and that's related to excess capital and payer potential. We cannot quantify, that what we have presented today, is the situation with less regulatory risk by year end. And that would mean lower need for strategic buffer, all else equal. Also the removal of technical buffer could imply extra payout, all else equal.

As you know, the board through the annual strategy or ORSA process gives it full review. And we can't go into the detail regarding the conclusions, that will be as a process with the board. And capital position analyzed in the forward-looking perspective is also important for us. You also had a question related to reserve releases, and I think I said that we have worked with this for a long period of time. It's both external and internal reviews. In depth reserve reviews have also been performed by actuaries in Gjensidige. And as we commented today, the reviews point to the conclusion that claims related to personal injury tend to be smaller than assumed up till now.

The gradual approach of releasing reserves secures that releases are based on actual trends that are permanent and not randomness. So this is to be 100% sure. We want to use three years to five years and have a gradual approach to be 100% sure. The development will be monitored closely every quarter over time of course.

Q - Matti Ahokas {BIO 2037723 <GO>}

Makes sense. If I may have a follow-up on the capital there, as previously the huge discrepancy between the rating-based approach and then the internal or the standard formula, is it fair to assume that the rating agencies could also kind of or these different ratios would converge in the future because at least now it seems that the differences are so big. How loudly could one think that the rating-based requirement could potentially be closer to the standard royalty internal one?

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

You know that we today have come effect from internal model where the difference in the capital requirements in the S&P perspective and the internal model perspective incorporated in the capital requirements in the S&P model. We have this M factors that we're allotted (35:21) to use to reduce the capital requirements in the S&P factor, which actually reflects that S&P takes into consideration the capital requirements in the internal model being lower than in the S&P model.

So the effect today is what it is, and of course, you can speculate whether it could be higher or lower, but at least we see that, yes, S&P look into internal model as long as you have or you need to have an ERM strong rating to be allowed to de-risk, but I would say that we have always seen that they're moving or at least looking closer to the internal model than we used to do before.

Q - Matti Ahokas {BIO 2037723 <GO>}

Great. Thanks. Very helpful.

Operator

We will now take our next question from Blair Stewart from Bank Of America. Please go head.

Q - Blair Stewart {BIO 4191309 <GO>}

Thank you very much and good morning. I've got two questions. The first one is just on your pricing strategy with regards to the decision on the reserving position. Presumably, you're having reserve releases because your pricing has been – your pricing assumptions have been too conservative, and that's why you're having the reserve releases. You say that going forward in the long-term, you still expect to have zero reserve releases. And I'm just trying to square the circle here and trying to understand have you already adjusted your forward pricing to reflect a view that these trends that you're seeing on claims are permanent and that's why you think over the long run you will still not see big reserve release. I'm just trying to get a feeling for where – if there's an impact on the pricing, given the results of the reserve. Hopefully, I've explained that question clearly enough. I suspect I haven't working, but I can come back if not.

And the second question is just on the – relating to the strategic buffer, et cetera. And you say that the risks – the worst case scenario you talked about in Q2 is unlikely and the need for the strategic buffer has somewhat reduced. I get the point about the Natural Perils Fund. I think you always expect to that outcome, but the risk relating to the tax issue, it seems to have reduced but hasn't entirely gone away. So I just wonder if you can, perhaps quantify again related to the first question, how much of that strategic buffer do you think is still necessary within the company in the near-term at least? Thank you.

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

I can start with the pricing and I'll just comment on the, I think we go to the reserve side (38:15). I actually commented that we have rewrite during this quarter, the provisioning mobile, for motor and workers' comp in Norway, which means that we now assume a lower inflation going forward than we have previously done. And I also commented specifically on the motor product where the expected claims inflation has been moved from 1% to 3% to 1%. So, yes, it will affect pricing going forward because when we look at pricing, we look at the underlying claims inflation and when the claims inflation is coming down, it will also affect the price efficiency going forward.

Q - Blair Stewart {BIO 4191309 <GO>}

Okay. Is it possible to quantify what the impact on the pricing is going to be? You said inflation has gone 1.3% down to 1.0%. Is that what the price of the inflation?

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

No, no, no. It used until – if you remember, we communicated until November or the Capital Markets Day last November that we expected the claims inflation to be 4%. Then we adjusted it to be between 1% and 3%.

Q - Blair Stewart {BIO 4191309 <GO>}

Okay. Yeah.

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

We adjusted it around 1%. And when we look at pricing, we look at increasing the prices in line with underlying claims inflation.

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

So long-term inflation, Blair, for motor is expected to be around 1%. And for property in Norway around 4%. And as you know, regarding pricing, it's differentiated market pricing all the time in attractive segments, so increases will be below long-term inflation in 2015. That's the situation just now.

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

And the tax, yeah, the tax element. I can comment on the tax element as well. The worst case scenario, the 3% the last quarter, NOK 1.4 billion both included tax effect on the premium provision, which we now think is very little likely. Which means that you need to pay tax on the future profit. We do not expect that to be part of our new proposal from Norwegian authorities. And so we have adjusted the risk down from NOK 1.4 billion to around NOK 900 million. And we also think that, given that they had to withdraw the proposal, that's a send off in May or so (40:53) this year. We actually expect that the new proposal will be a bit changed, we expect to see a kind of a transition (41:05), meaning that the tax hopefully be paid of more than one year. That's why, we say that, the risks regarding tax have come down.

Q - Blair Stewart {BIO 4191309 <GO>}

Okay. So I guess both wants a number (41:20) on it, but could you – could we assume that the strategic buffer perhaps could be halved in that respect?

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

We don't comment on the last.

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

I think it's difficult for us to have assumptions. No, as I said it did this on the discretionary basis, the discussion with the board and together with the board.

Q - Blair Stewart {BIO 4191309 <GO>}

Okay. Very good. Thank you very much indeed.

Operator

We now take our next question from In-Yong Hwang from Goldman Sachs. Please go ahead.

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

Good morning. This is In-Yong from Goldman Sachs. I've got two questions. Firstly on the underlying claims ratio improvement that you saw in both private and commercial in Norway. Could you just give us an idea of how much if any of that is down to kind of the more slower growth in the Norwegian economy, whether that's kind of machines going idle in some places for example or people driving less?

And second question is on your ROE target the 15%. So is it based on kind of no reserve releases. Do you now have kind of a high number, say 17% as something that you're kind of focusing on internally or are you still very much focused on the 15%? Thank you.

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

Looking at the claims review (42:48), we don't expect that to see or we don't see in this short time period and the impact now from the macroeconomic environment obviously. Let's say, we can see today that people are driving lesser than these (43:03-43:09) The Norwegian economy is, yeah, a part of the economy is actually doing very well due to lower (43:18), et cetera. Meaning that they have a better competitive position before. So it's kind of (43:23). Of course, effects from the (43:26) going forward as well. But we can't see these effects, so far it's – yeah.

If it happens here, it's still too early to tell (43:41) in the figures now. When it comes to ROE target, the targets are long-term targets, what you talked about and the higher level of loss gains (43:54) going forward is temporary effect that you will see probably for the next three years to five years. So we have not changed the ROE target. But we'll look at, if the discounting roof are changed, so that we will have to also use discounting in our group accounts, we will just (44:19) of the targets, but this is a long-term target. We will not change the effect temporarily.

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

Sure. Great. Thank you very much.

Operator

We will now take our next question from Jakob Brink from ABG. Please go ahead.

Q - Jakob Brink {BIO 7556154 <GO>}

Thank you. And I just have two questions I guess, one at least. I'm just thinking how should we think about those extraordinary run-off gains for the next three years to five years in relation to your dividends i.e. ordinary versus extraordinary. I'm just thinking that if you would include the extraordinary run-off gains as part of your sort of bases of paying out the ordinary dividend, I guess that could give you some problems three years to five years down the road when they disappear. So how should we think of that?

And then secondly, I know we have already been asked about this, so you've been asked about this twice about the strategic buffer. But if I would take the 70% payout ratio that you currently use in your capital up to the expected by consensus NOK 6.25 dividend for this year, the strategic buffer will be just below NOK 2 billion at the end of the year. Is that what you mean with the reduction or should we actually expect also an extraordinary dividend on top? Thank you.

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

Your first question related to the run-off gains and dividends and the mix between the ordinary dividends and extraordinary dividends. What we have presented today means that you will see higher dividends, all else equal, for the next few years. We will aim at high and stable nominal dividend over time so, and we will avoid a nominal reduction after five years.

So we will calibrate dividend stream to avoid that. We can pay extra dividends all the time in periods with excess capital. So this will be a calibration from our side and we will avoid a nominal reduction. And that's when I commented a dividend policy, it's for us important to have high and stable that's the first starting point. So it will be a mix.

Q - Jakob Brink {BIO 7556154 <GO>}

Okay.

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

You also have a question regarding the strategic buffer effect whether it was just a technical, when we talk about reduction outcomes (47:03), was it?

Q - Jakob Brink {BIO 7556154 <GO>}

Yeah.

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

Your question was whether this will be an extra ordinary dividend payout?

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

I think we commented that maybe when Matti asked that question. I think this will be – this is a part of the yearly ORSA process and it will be on a discretionary basis, a discussion for the board. But we have presented the situation today with excess position of NOK 2.6 billion. And we have also said that it's a reduction of regulatory uncertainty. We have said that we have removed the technical buffer and we need going forward some excess capital to support our growth strategy and it's still on the tax side, for instance, some uncertainty on the regulatory side. But we will come back to that in connection with fourth quarter.

Q - Jakob Brink {BIO 7556154 <GO>}

Okay. Many thanks.

Operator

We will now take our next question from Steven Haywood from HSBC. Please go ahead.

Q - Steven A. Haywood {BIO 15743259 <GO>}

Hi and good morning, everyone. Can I just ask on the S&P Capital model, your 117% ratio, you gave the target ratios, the target ranges on the Solvency II ones. But do you have a target range on the S&P rating requirement? Are you above or around 100%? Is that your kind of target metric here? And then second question on the Baltics, what is being done in the Baltics to turn things around? You mentioned it will get worse or it gets better, can you say how worse it will get before it gets better and how will the recent acquisition help here? Thank you.

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

I can comment on the S&P margin. It's about the strategic buffer of course. From the size of the strategic buffer, it's kind of (49:13) and then you will see the margin. So it's based on the size of the strategic buffer and the discussion with the board as Helge commented on the discretionary basis where we – the size, the need for the type of this strategic buffer. And we have not set (49:34) a fixed figure on the strategic buffer.

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

Yeah. On the Baltic side, we – as I said, we closed the PZU deal late in September. So we are in a situation now where we want to, of course, integrate our old Gjensidige Company with PZU in Lithuania. And it defined this as a restructuring case. We have had a situation without this election (50:07). And we also have had a situation with not satisfactory sales development.

So what we are doing now is actually to invest into the basics. First thing first, motor tariff, ICT system, training, we actually implement the best practice, light version I would say from the Nordic or Norwegian market. We will meet, we will achieve the plan we commented in connection with the release when we released the information regarding PZU that meaning profitable situation in 2017, but 2015 though and 2016 will be a loss situation in the Baltics. We will increase costs. We will invest into the basics of the company. I can't give you any more detailed answer, but you will see a worse situation I guess in some few quarters from now and then we'll turn it around and be making profit in 2017.

Q - Steven A. Haywood {BIO 15743259 <GO>}

Okay. Thank you very much.

Operator

There are no further questions in the phone queue at this time. I would now like to turn the call back to the speakers for any additional remarks.

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

Okay. Thank you. Before we end the call, I would just like to remind you that we are in London on Monday and have both an analyst meeting there and also a group lunch meeting and we're also doing road shows to Dublin, Frankfurt, Paris, Amsterdam, Copenhagen and the Norwegian West Coast in October and November. So please just contact us if you would like to set up a meeting. And once again, thank you for participating and have a nice weekend. Thank you.

Operator

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