Q3 2018 Earnings Call

Company Participants

- Lars Thykier, Chief Financial Officer
- Peter Hermann, Chief Executive Officer

Other Participants

- Asbjorn Mork, Analyst
- Jonny Urwin, Analyst
- Mads Thinggaard, Analyst
- Steven Haywood, Analyst
- Vinit Malhotra, Analyst
- Wajahat Rizvi, Analyst
- Youdish Chicooree, Analyst

Presentation

Peter Hermann {BIO 20507411 <GO>}

Good afternoon, everybody, and good morning to the USA. We thank you for joining us in this conference call. I'm Peter Hermann; and with me is Lars Thykier, CFO; and Steffen Heegaard, Group Communications and HR Director. We are holding this conference because earlier today, we published our interim report for the quarter one to quarter three 2018.

And we are now ready to answer your questions, so please ask them one at a time. Operator, may we have the first question? Thank you.

Questions And Answers

Operator

Thank you. (Operator Instructions) And our first question comes from the line of Mads Thinggaard from ABG. Please go ahead, your line is now open for your question.

Q - Mads Thinggaard {BIO 15369662 <GO>}

Yeah, hi. This is Mads from ABG. Thanks for taking my questions. The first one I have is on the -- I guess, what you call the underlying claims trend. It seems to be much better here in Q3 than were the case Q2. I don't know, if you could put a bit of flavor on, I mean, the moving parts, why the kind of underlying claims are so much better here in Q3?

A - Peter Hermann {BIO 20507411 <GO>}

We have couple of different -- what -- okay. Yeah, a couple of different reasons. One is that personal costs or cost for personal transportation has performed a little better than expected and we have seen a better development on theft as well. And then on top of this, we have the change in risk margin. On the other hand, we have seen piping being a little more expensive than expected in the prognosis.

Q - Mads Thinggaard {BIO 15369662 <GO>}

Okay. And what about the finance in this kind of the underlying, not the large claim part for this part, is there any change here?

A - Peter Hermann {BIO 20507411 <GO>}

No, the fire level, which are not big declines is more or less in line with what was expected.

Q - Mads Thinggaard {BIO 15369662 <GO>}

Okay. Okay, thanks. Then my second question is on the downgrade you made -- make fewer life insurance income on page 10 in the report. I can see -- I mean, when you came with the improved guidance, it was very much related to better profits from sales and admin. I can see you did actually make a 5 million profit from that area in Q3. Could you kind of help with -- I mean, why did you downgrade the guidance to the 220 million to 250 million for '18 now? And what should we expect kind of in a normal year normalized life income pre-tax profit? Thanks.

A - Peter Hermann {BIO 20507411 <GO>}

Yeah. There's a couple of reasons for the downgrade. One is -- one of the thing is actually a positive thing is that when we do have transfers from customers leaving September, we get normally a transfer fee. And we've seen this here that we have lower transfers out of September, meaning that we get lower fees, but that will also, on the first year here, will have a negative impact on the cost result. But that would, of course, be a better thing going forward. That's one aspect. The other aspect is that we are in the process of developing and implementing a whole new operational system for our life company and we can see that we need more resources to be able to do that testing and so on to be able to introduce at the right time next year. So in quarter four, we will have more expenses on people side that will deteriorate the sales and the sales results -- sales and administrative results.

A - Lars Thykier {BIO 16427122 <GO>}

And we will see these extra expenses continuing to 2019, where we expect to spend more money on launching the system. But in the '20 or '21 at the latest, we'll see the administrative easing come through as lower expenses.

Q - Mads Thinggaard {BIO 15369662 <GO>}

Okay. So in 2020, we can kind of expect the numbers to go up again from this level. Okay, thanks.

Operator

Thank you. Our next question comes from the line of Jonny Urwin from UBS. Please go ahead, your line is now open for your question.

Q - Jonny Urwin {BIO 17445508 <GO>}

Hi, there. Thanks for taking my question. Just one actually. So could you please update us on pricing and claims inflation trends across key lines? And where are you pricing versus claims inflation at the moment? Thank you.

A - Peter Hermann {BIO 20507411 <GO>}

We haven't made any changes in our pricing, so it's very much as it was before. We can see that physical claims of -- physical damage in motor is going wrong way, so to speak. And we can see that the savings we have made on handling claims and houses do not result in the savings we would have expected, and that is probably due to this claims inflation. But it is not a matter that we are very concerned about and we do not intend to increase prices due to the pretty small changes we've seen.

A - Lars Thykier {BIO 16427122 <GO>}

We could add to that the automatic indexation, which covers up for the claims inflation goes up from 1.6% this year to 2.0% next year.

A - Peter Hermann {BIO 20507411 <GO>}

And this will hit around 70% of the portfolio.

Q - Jonny Urwin {BIO 17445508 <GO>}

Okay. So pricing roughly in line with claims inflation then, is that a fair representation?

A - Peter Hermann {BIO 20507411 <GO>}

Yes.

Q - Jonny Urwin {BIO 17445508 <GO>}

Yeah. In that -- I mean, in that instance, we've obviously seen quite strong improvement in the underlying come through, which is obviously driven by self-help improvement in the claims, handling, et cetera. Do you -- would you expect that to continue going forwards?

A - Peter Hermann {BIO 20507411 <GO>}

Yes.

Q - Jonny Urwin {BIO 17445508 <GO>}

So continued improvement here from self-help measures?

A - Peter Hermann {BIO 20507411 <GO>}

That was the idea. We launched a project a couple -- in 2016, where we wanted to rationalize our operations. We are still working on it and we are still spending on it. But sooner or later, we'll be through, then we -- and we'll do something else, but this project at least will end in substantial benefits.

Q - Jonny Urwin {BIO 17445508 <GO>}

All right. Great, thanks very much.

Operator

Thank you. Our next question comes from the line of Youdish Chicooree from Autonomous Research.

Q - Youdish Chicooree {BIO 17430923 <GO>}

Good afternoon, everyone. I have got two questions, please. The first one is on claims inflation. You mentioned that the automatic premium indexing for next year will cover claims inflation broadly speaking. Could you split out the level of inflation you're seeing in motor and property, please? And then my second question is just a clarification on your combined ratio guidance for next year. I mean, am I right to think that you are assuming 1 percentage point improvement in the underlying loss ratio for next year?

A - Peter Hermann {BIO 20507411 <GO>}

Sorry, I didn't get the last one.

Q - Youdish Chicooree {BIO 17430923 <GO>}

Your combined ratio guidance for next year, does that -- what kind of underlying improvement do you assume in that forecast?

A - Peter Hermann {BIO 20507411 <GO>}

That is a combination of the lower claims handlings cost, a little lower expense ratio, but I remind you that we are still guiding around 16 for 2019 and there's a slight improvement in risk.

Q - Youdish Chicooree {BIO 17430923 <GO>}

Fine. Okay, understood.

A - Peter Hermann {BIO 20507411 <GO>}

And I'm afraid that I can't give you any precise estimates of the how the claims inflation is in different business lines. Of course, we can see that a comprehensive is -- so it's clearly above general inflation, while on the other hand the personal injury is falling.

Q - Youdish Chicooree {BIO 17430923 <GO>}

Okay. All right, understood. Thank you.

Operator

Thank you. Our next question comes from the line of Steven Haywood from HSBC. Please go ahead, your line is now open.

Q - Steven Haywood {BIO 15743259 <GO>}

Excellent. Thanks very much. Can I just confirm a couple of things you've already said. The 2% indexation you said, you say -- will that actually offset the increase you're seeing from most damage claims?

A - Peter Hermann {BIO 20507411 <GO>}

Yes. Actually I should mention that we have another index and workers compensation and this will, as a starting point, increase workers compensation premiums to the tune of 9%.

Q - Steven Haywood {BIO 15743259 <GO>}

9.0%, yeah?

A - Peter Hermann {BIO 20507411 <GO>}

Yeah.

Q - Steven Haywood {BIO 15743259 <GO>}

And your 2019 combined ratio guidance of 89% to 90%, excluding one-off, that's improved from the 90% to 91% averaging forecast for 2018. I wonder, if you can say how much of this is driven by the claims initiatives and actions you've done and how much is driven by interest rates going up slightly?

A - Peter Hermann {BIO 20507411 <GO>}

I think the impact from the change in interest rates is pretty small actually.

Q - Steven Haywood {BIO 15743259 <GO>}

Okay, that's good to know. Do you provide or can you provide any guidance on run-offs for 2019?

A - Peter Hermann {BIO 20507411 <GO>}

Unfortunately not. We're not supposed to know anything about run-offs in '19.

Q - Steven Haywood {BIO 15743259 <GO>}

Okay. Okay. And the last question. EIOPA published a technical document for the Danish risk-free rate and volatility adjustment on the 14th of August. You haven't put any change through your earnings this quarter. What is Topdanmark waiting for or what is the regulator waiting for to include the new volatility adjustment?

A - Peter Hermann {BIO 20507411 <GO>}

I think they probably have done or made some mistakes in the first place and then they have tried to correct these mistakes and we are waiting for EIOPA to be completely sure about what they should ask us for. And if they -- what I think is likely ends up with the volatility adjustment of, say, 10 or 15 basis points, we will probably have this hit spread over a couple of years.

Q - Steven Haywood {BIO 15743259 <GO>}

Okay. And then -- sorry, you said 10 to 15 basis points down or to 10 to 15 basis points?

A - Peter Hermann {BIO 20507411 <GO>}

That is my guess. I don't know. We have not received any information yet.

Q - Steven Haywood {BIO 15743259 <GO>}

Okay. Thank you very much for your help.

Operator

Thank you. (Operator Instructions) And our next question comes from the line of Asbjorn Mork from Danske Bank. Please go ahead, your line is now open.

Q - Asbjorn Mork {BIO 17028219 <GO>}

Yes, good afternoon. A couple of small questions from my side. First of all, on the life expectancy changes from the Danish FSA, you mentioned in the report that the workers compensation impact that it has, it sounds like it's rather small. But could you just quantify this? And then, while we are talking life expectancy, maybe a bit of comments on how this impacts your life insurance operations.

A - Peter Hermann {BIO 20507411 <GO>}

It doesn't impact our life insurance operations, it was just a question of us using T-82 in the workers compensation. We -- and actually, it has a very small impact because we just move one buffer to another place, so to speak. We had a buffer for longevity, it was just not specific. Now, it is specified on the cash flows. So really, it is -- it doesn't cost anything. If it's -- it's combined ratio would be low.

Q - Asbjorn Mork {BIO 17028219 <GO>}

But very small, I guess?

A - Peter Hermann {BIO 20507411 <GO>}

It will be around -- impact on combined ratio, it's hard to do calculations, this calculation on the top of my head. A couple of points actually.

Q - Asbjorn Mork {BIO 17028219 <GO>}

A couple of points, I mean --

A - Lars Thykier {BIO 16427122 <GO>}

On combined ratio.

Q - Asbjorn Mork {BIO 17028219 <GO>}

Couple percentage points or a couple of basis points?

A - Peter Hermann {BIO 20507411 <GO>}

Percentage points.

Q - Asbjorn Mork {BIO 17028219 <GO>}

Okay. Well, okay. Okay, fair enough. Then on weather claims. So basically no weather claims in the first three quarters. If I remember correct, I think you said at Q2 that we should expect some weather claims because some of these fire risks, you would also probably classify as weather claims. Maybe you could just tell me how you actually classify weather claims? Thanks.

A - Peter Hermann {BIO 20507411 <GO>}

We haven't had any weather claims in Q3.

Q - Asbjorn Mork {BIO 17028219 <GO>}

Not exactly, yeah. But you -- I remember, you said in Q2 that you could have some of the fire claims could be booked as weather claims or maybe I misunderstood at Q2.

A - Peter Hermann {BIO 20507411 <GO>}

Yeah. Maybe you did. There are -- sometimes the fire claims will be driven by weather. If we have a small fire and a storm, then this will be big fire. And in that case, we will still regard it as a fire claim.

Q - Asbjorn Mork {BIO 17028219 <GO>}

Okay, fair enough. Then on your presentation slide nine, the retention ratio is sort of indexed at a 101.6. Maybe you could just tell me what is the retention actually in percentage?

A - Peter Hermann {BIO 20507411 <GO>}

I don't think we provide that information.

A - Lars Thykier {BIO 16427122 <GO>}

No.

A - Peter Hermann {BIO 20507411 <GO>}

But it's well known that this is above 90 in the private lines.

A - Lars Thykier {BIO 16427122 <GO>}

Well above 90.

Q - Asbjorn Mork {BIO 17028219 <GO>}

Okay, excellent. And then a final question from my side on the slide 11 on the motor insurance, the risk premium. Well, it seems as if your risk premium is actually pretty low that of your peers. Maybe, I'm not reading it correctly, but I would assume, considering that you have very limited leasing activities that you would actually have higher risk premium?

A - Peter Hermann {BIO 20507411 <GO>}

You are reading it correctly. That is -- that we have avoided parts of the market and this is the part of the market, where the risk premium is too high compared to the actual premium.

Q - Asbjorn Mork {BIO 17028219 <GO>}

Okay, okay. I understand, okay. It's perfect. Thank you. That was all from my side.

Operator

Thank you. Our next question comes from the line of Vinit Malhotra from Mediobanca. Please go ahead, your line is now open for your question.

Q - Vinit Malhotra {BIO 16184491 <GO>}

Yeah. So thanks very much. Good afternoon, everybody. So my question was actually -- I mean, have been addressed a little bit, but I'll just follow up. So if I were to look at slide 11 of the webcast presentation today or maybe even the roadshow presentation actually, there was trending risk on motor. Which one of these lines is the one which is causing this positive effect in 3Q, please if you could comment because I think these starts are only running up to beginning of '18 from what it looked like? If you could just comment on where this thing is coming from the positivity in 3Q, please?

A - Peter Hermann {BIO 20507411 <GO>}

I think -- sorry, but I'll have to ask you to repeat, please.

Q - Vinit Malhotra {BIO 16184491 <GO>}

Repeat the question? Oh, apologies. So I was on slide 11 in the roadshow presentation. And my question was, so which -- obviously, there's been a pretty reasonably good trend in motor that you talked about --

A - Peter Hermann {BIO 20507411 <GO>}

No, no. I think I got your point now. It is not recently, it has been developing since 2013, which we changed our tariffs in 2013. And since then, we have seen this development.

Q - Vinit Malhotra {BIO 16184491 <GO>}

But in 3Q, there was an offsetting positive motor effect, wasn't there?

A - Peter Hermann {BIO 20507411 <GO>}

Okay. That's what you are talking about, but that's a pretty small amount. And if you're looking at Q1 to Q3, it is actually negative.

Q - Vinit Malhotra {BIO 16184491 <GO>}

Okay. Okay. And could you please comment on theft, please? So there was also mention that theft claims -- are these usually random or is there some phenomenon there that we should be noting?

A - Peter Hermann {BIO 20507411 <GO>}

We have seen a very systematic decrease in the risk -- the six claims since 2010. Every year has been better than the year before during these 10 years or nine years. Sooner or later, this will end and we will see claims rise again. That's usual pattern that we see this long waves of increasing theft and decreasing theft, but now we've had this -- the nine very good years and we see no signs that '19 should be worse than '18.

Q - Vinit Malhotra {BIO 16184491 <GO>}

So you have a flat assumption for theft next year, generally speaking?

A - Peter Hermann {BIO 20507411 <GO>}

That is what is -- of course, this is our prognosis.

Q - Vinit Malhotra {BIO 16184491 <GO>}

All right. Thank you very much.

A - Peter Hermann {BIO 20507411 <GO>}

Welcome.

Operator

Thank you. Our next question comes from the line of Wajahat Rizvi from Deutsche Bank. Please go ahead, your line is open.

Q - Wajahat Rizvi {BIO 19928187 <GO>}

Hi. Thank you for taking my question. Just a couple of questions quickly. One is in terms of your underlying loss ratio improvement, you have talked somewhere about reduced risk margin contributing to lowest claims trend. Can you just please explain what you mean by reduced risk margin? Is this some change in your bookings assumptions or is there something else?

And secondly, just to follow up on Steven's question on EIOPA's change in VA. Can you quantify based on these new numbers what the impact on solvency will be? And from what time do you expect this impact to come through? I think you said there will be two years transitional period through that. So just a bit more certainty on timing and quantum would be helpful. Thank you.

A - Peter Hermann {BIO 20507411 <GO>}

If I may ask -- or may answer your last question first. I'd like to stress very much that I know nothing, I'm guessing. I don't know when we'll hear anything, I don't know how long the transition period would be and I don't know the size of the change, we will see. But if the volatility adjustment is changed, it will cost around 4.5 million after-tax per basis point. But on the other hand, this is a one-off, it will be easier for us to cover the return on the liabilities in the future with the lower volatility adjustment.

Q - Wajahat Rizvi {BIO 19928187 <GO>}

Okay.

A - Peter Hermann {BIO 20507411 <GO>}

And then you asked about the risk margin.

Q - Wajahat Rizvi {BIO 19928187 <GO>}

Yeah.

A - Peter Hermann {BIO 20507411 <GO>}

The risk margin, that is an amount that we have put aside, which must be sufficient to cover the price of own funds in all-time until our reserves have run completely off, if somebody should buy the reserves from us. And the fact of the risk margin depends on the SCR we have. And we have recalculated some of our business lines among others, working compensation and the content in the internal model and this has led to lower SCR. Since SCR is lower, the risk margin is lowered as well. When the risk margin is lowered, some of it goes into the claims that was -- that is -- the risk marketing is covered by both premium reserves and the claims reserves. So when it is reduced, this change is split between the premium reserves and the claims reserves. So this is a part of the reduction in the risk margin that comes out in the claims reserves that you -- that is in part of the explanation for the impact on claims trend.

Q - Wajahat Rizvi {BIO 19928187 <GO>}

Okay. So your change in solvency to assumptions is also changing your IFRS claims trend?

A - Peter Hermann {BIO 20507411 <GO>}

Sorry?

Q - Wajahat Rizvi {BIO 19928187 <GO>}

So the change in SCR assumptions and risks margin in Solvency II is also changing your claims trend in IFRS reserves?

A - Peter Hermann {BIO 20507411 <GO>}

Yes.

Q - Wajahat Rizvi {BIO 19928187 <GO>}

And how much is the impact from the change in the current claims trend improvement just in Q3?

A - Peter Hermann {BIO 20507411 <GO>}

In Q3, it was 28 million.

Q - Wajahat Rizvi {BIO 19928187 <GO>}

Okay. Thank you very much.

Operator

Thank you. (Operator Instructions) And as there are no further questions at this time, I'll hand back to our speakers for any closing comments.

A - Peter Hermann {BIO 20507411 <GO>}

Yes. Thank you for taking the time to attend the conference. And as you know, you're always welcome to call one of us, if you have any further questions. So we'll be happy to answer them. So thank you.

Operator

This now concludes our conference call. Thank you all for attending. You may now disconnect your lines.