Q2 2014 Earnings Call

Company Participants

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

Other Participants

- Daniel A. Do-Thoi
- David T. Andrich
- Gianandrea Roberti
- Jakob Brink
- Matti Ahokas
- Sami Taipalus
- Vinit Malhotra
- William Hardcastle

MANAGEMENT DISCUSSION SECTION

Operator

Good day, and welcome to the Q2 2014 Results Conference Call. Today's conference is being recorded.

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

Janne Merethe Flessum {BIO 19368607 <GO>}

Welcome to the presentation of the second quarter results for Gjensidige. As always, our CEO, Helge Leiro Baastad will start by commenting on the highlights for the quarter before our CFO, Catharina Hellerud, will comment the results in more detail. Then, we will spend most of the time on a Q&A session.

Before we start, I would just like to remind you that you can download the presentation from our website gjensidige.no/ir. And Helge and Catharina will refer to the different slides as they go along.

Then I hand over to you, Helge.

Helge Leiro Baastad {BIO 5865247 <GO>}

Thank you, Janne. Good morning, everyone, and thanks for calling in today. I'm pleased to present the second quarter figures with the record strong underwriting result and solid growth in premiums.

If you look at page 2 in the presentation, you can see the main figures for the quarter. We achieved a strong profit before tax expense of NOK 1.75 billion. The underwriting result came in to NOK 951 million, which is more than double the result for the second quarter 2013. What contributed to this result can mainly be summarized in four headlines.

The premium growth was 8.9% in the reported figures, and underlying premium growth, which is adjusted for currency transactions, was 4.1%. Secondly, the frequency claims development showed a favorable development in the quarter. And thirdly, the large losses were lower than expected, partly because we have had no large weather-related claims events. And finally, the continued good cost control expressed by cost ratio of 14.9%.

The combined ratio was a solid 81.2%. And if you discount reserves, we had 79% combined ratio. However, the 12-month rolling combined ratio adjusted to reflect the expected large losses level and the run-off of zero (02:34) was 89.6%. So I would like to remind you of our target corridor for the annual combined ratio on 90% to 93%.

We do experience good competitiveness and I will return to that later. The financial result was satisfactory with NOK 755 million, and this corresponds to return on financial assets of 1.3%. And finally, this give us annualized return on equity year-to-date of 23.9% before tax expense.

So if you turn to page 3, I would like to spend some time talking about Gjensidige's continued strong competitive position and to give you some examples on how we achieve this through different operational measures.

We are very satisfied to note that we've demonstrated good competitiveness in the market characterized by strong and increasing competition. We have a stable number of customers in Norway and a total underlying growth in premiums of 4.1%. At the same time, we delivered very good profitability.

We operate with premium increases in line with long-term claims inflation but we make adjustments in certain market segments, and this means that the premium increases, at the moment, are considerably lower than the inflation on average. As you know, within insurance, it takes some time before premium increases are fully reflected in the numbers.

Continuous work is being done to ensure good customer experience and efficient operations. As you are well aware of, there are many elements contributing to maintaining our competitiveness, and I would like to spend some time on some of these elements which you can see listed on page 3.

Optimal risk pricing is the core of insurance. We have spent several years working on developing tariffs. We continue to succeed in adapting prices not just to the risk situation, but also to the competitive situation in different customer segments.

The new tariffs not only improve our risk selection but also increases our market power. We also have extensive experiences in risk assessment. We have a broad database to utilize and we enjoy scale and strong confidence within analysis-driven insurance.

Meeting customers in their preferred channel through our efficient multi-channel distribution is important. We see that customers are increasingly making use of combination of channels, primarily the Internet and telephone when buying insurance or reporting claims.

Further, offering a broad range of products is a strength. As an example, we offer complete solution for car dealers in connection with car financing and insurance in Norway. This means we are involved in the customer's purchase process at an earlier stage also in the new car dealership channel. This solution is unique in the industry in Norway.

We have developed an analysis-based support for the customer dialogue which enable us to provide advice adapted to the individual customer. For example, a customer having a 19-year-old son or daughter staying at home should have a car insurance with a price discount for drivers over

23 years only. The relevant question to ask this customer is whether there is need for changing the coverage so that the car is covered also if the son or daughter drives the car.

Another example is how we adapt the written communication. The illustration on page 3 in the presentation shows an electronic newsletter to private customers in Norway. We currently have 22 customized brands of each customer's letter which is e-mailed to approximately 500,000 customers. We see a high quick rate on newsletters, indicating that information is relevant to our customers. We also see a high customer satisfaction for outbound sales activities on the phone which is again a proof of relevance.

Further, a claims situation is the moment of truth which is why it is vital that the claims handling process is efficient. Gjensidige is one of the biggest purchasers in Norway, so we have a lot of experience and negotiating power. We have mentioned several times our work on automized and self-service processes. This ensures both quality and tempo, and it frees up capacity for the more complicated cases. This is a win-win for the customer and the company.

Of the last one and a half years, we have also worked a lot of structural capital in the claims handling organization. This has led to several positive effects. Claims handling personnel are more on the top of the workload. They deal with better response times and are the better prepared for handling emergencies in connection with major events.

An element on this is that we can draw on the whole organization across geographical boundaries, meaning that we can exploit the economies of scale. And the proof that what we are doing is actually having an effect, the customer satisfaction is increasing, most in fact among those customers who have experienced a claim. Delivering on claims handling and process is becoming more and more important and is in fact particularly a key differentiator between the bigger and the smaller players.

And finally, in order to succeed on the measures, I have now mentioned skills development is important. We have our own school, Gjensidige Academy, which has had a strong increase in the number of courses days from 8,900 courses days in the whole 2013 to 10,400 in first half of 2014.

A training culture has been established in the private segment here in Norway where staff and managers have mandatory training time every week. The combination of the academy and continuous training is producing good results. It is helping to continuously increase customer satisfaction with Gjensidige as we have shown earlier.

Moving on to page 4, I want to remind you about another feature which is unique for Gjensidige, namely the customer dividend model. The disbursement of customer dividend for 2013 started at the end of May this year and amounted to 15% based on premiums paid for 2013. The annual customer dividend has represented 10% to 15% of premiums paid since Gjensidige was lifted. As you know, it is the Gjensidige Foundation which passes on the dividend received from the Gjensidige to our general insurance customers in Norway.

And as they (10:43) the customers in the period around the general meeting of the Gjensidige Foundation in order to qualify for customer dividend, the model has a lot of degrading effect. The foundation markets the model. In June, a tailored customer communication and a digital campaign resulted in record traffic on our internal portal. We saw 240,000 visits to the portal in a three-week period.

Furthermore, more than 500,000 e-mails were sent to customers with information about the customer dividend and a rare high proportion of the recipients click to the link to our Web site in this e-mail, it was a click rate of about 70%.

We have also launched the calculator at gjensidige.no, giving a specific sample for potential customers who can see how much they would have received in customer dividend if they had been customers. And finally, a new campaign period is planned for the autumn with TV ads and digital advertising which will attract further attention.

And then, we move to the figures and, Catharina, you can continue, please?

Catharina Elisabeth Hellerud {BIO 17276650 <GO>}

Thank you, Helge. Good morning, everyone. I would start by commenting on page 6 in the presentation where you can see that we have a strong performance across the board. As you can see, the underwriting result is more than double the results in the corresponding quarter in 2013 and at the historical high level. This is again the result of a combination of solid growth in premiums and a good profitability. All segments with a small exception for the Baltics showed strong improvements in their profit performance in relation to the corresponding quarter last year.

In addition to continued strong growth in premiums, the underwriting result is also enhanced by a favorable frequency claims development. And the proportion of large losses is also considerably lower than the expected level in the quarter and also significantly lower than in the corresponding quarter in 2013. The retail bank and the pension and savings segment also show good profit growth, with a profit before tax expense that is more than 60% higher than in the corresponding quarter last year.

The retail bank has also recently been given an adjusted rating by S&P from A-minus negative outlook to A-minus stable outlook. The investment portfolio yielded a solid return in the quarter which is also better than in the same quarter in 2013.

All our asset classes have contributed positively. In addition, the reclassification as a bank from associated company to ordinary equity (13:52) resulted in an accounting gain of NOK 127 million in the quarter. And taken together, this means a profit before tax expense of NOK 1.7 billion for the quarter corresponding to profit per share of NOK 2.1 billion.

For the year-to-date, the profit before tax expense amounts to NOK 2.9 billion, up from NOK 1.6 billion in the corresponding quarter last year. The underwriting result is NOK 500 million higher this year. But as regard to the financial results, you will recall that the first half year last year was affected by an impairment loss undertaken into the brand, (14:36) of course, affecting the corresponding figures.

On page 7, we can see the combined ratio for the general insurance operation of 81.2% in the quarter compared to 90.3% in Q2 last year. The cost ratio of 14.9% shows that we are well positioned to deliver the target of a cost ratio of 15% in the present year. The loss ratio is strengthened by 8.8 percentage points in relation to the corresponding quarter in 2015. Lower large losses explain the 2.2 percentage point while higher run-off gain explains the 1.1 percentage points.

The underlying loss ratio, hence, improved by 5.4 percentage point, showing that the underlying frequency claims development in the quarter was very good. Multi-private has in particular shown lower claims frequency at levels that you cannot expect to see going forward.

In property insurance, the underlying frequency has been within a more normal range. But a favorable, better situation has led to better results for these products this year compared with the second quarter last year. And there were many water damage claims particularly in the beginning of the second quarter last year.

Moving on to page 8, you will see the segments' contribution to the premium growth. The earned premiums continue to develop strongly with a reported increase of 8.9 percentage. Adjusted for currency FX and also the acquisition of Solid and Gouda, the underlying premium increased to 4.1% for the group.

The private segment saw strong growth in premiums of 5%. The development in the number of customer remains stable and good work is being done on activities and at retaining customers.

The commercial segment also report a good development with a growth in premiums in quarter of 3.8%. And we are seeing a positive effect of consistently high level of activity. Both the Norwegian and the Swedish portfolio developed well during the quarter. But the growth was negatively affected, however, by the (17:05) reduction in the municipal portfolio where we see that the price level is too low.

As you can see, the Nordic segment reports a strong growth in earned premiums of 29.3%, measured in Norwegian krone. In local currency, the growth is 20.3%. And adjusted for currency and also the acquisitions of Solid and Gouda, the underlying growth is 3%. And the increase has been primarily due to the new commercial customers.

Turning to page 9 in the presentation, you can see that the proportion of large losses was low in the quarter amounting to NOK 139 million. This represents 2.7 percentage points on the combined ratio and is considerably below the expected value of NOK 266 million or 5.3 percentage points.

The commercial segment has the largest proportion of large losses in the quarter but also for the commercial segment, the proportion of large losses is relatively lower in the quarter. In the corresponding quarter last year, large losses amounted to NOK 231 million, and around half of it, 2.4 percentage points were flood-related claims which we have had normal (18:36) in this quarter.

On page 10, you can see the run-off gain which was NOK 89 million in the quarter, corresponding to positive effect on the combined ratio 1.8 percentage points. The run-off result is still related to the positive effect for accident and health insurance project that we have noted for a while. In the second quarter last year, the run-off gain amounted to NOK 29 million, corresponding to an effect on the combined ratio of 0.6 percentage points.

I would also like to comment on our regulatory issue that has been commented in the report as well. At the end of October or the beginning of November this year, the Norwegian Supreme Court is expected to announce a judgment that is relevant to the stipulation of the capitalization interest rate used when calculating the present value or claims for future losses and expenses.

For most personal injury cases, the claims compensation level is standardized, meaning that it's based on the national basic amounts in Norway, the G amounts, or based on fixed insured amounts without using a capitalization interest rate.

So, the capitalization interest rate is primarily important in relation to the motor liability products. Approximately 2% to 3% of Gjensidige's provision for claims could be affected by a lower capitalization interest rate than the current level of 5% and potential changes in case law is one of several uncertainty factors that are taken into account when arriving at the best estimate for provisions of claims.

Moving to page 11, you can see that we have an underlying good cost control. The nominal expenses increased by a total of NOK 42 million in the quarter and there is good cost control in all segments. A substantial proportion of the nominal cost increase is related to the acquisitions of Gouda and Solid in the Nordic segment. In addition, the nominal operating expenses are also affected by currency effects.

Then moving on to the capital position on page 12, looking at the rating requirements from S&P, cash flow in excess of the capital requirements and the technical buffers amounts to NOK 2.1 billion as to the end of the second quarter and this is a reduction of NOK 0.5 billion compared with the end of the first quarter this year.

The main explanation for this reduction is the reclassification of the holding in the savings banks and SR-Bank as an ordinary equity investment. This has resulted in an increased capital requirement for asset risk but at the same time, however, available capital has increased as a result of the holding no longer being deducted from the capitals. So the net effect corresponds to reduction in the capital of NOK 350 million.

You will also recall that the strategic buffer amounted to NOK 2.1 billion at year-end. The board normally assesses the size of the strategic buffer and thereby also the size of the excess capital once a year. In Q1, we also commented that all else being equal, the sale of stake in (22:11) will contribute to the strategic buffer being somewhat lower than in the time ahead.

I would also like to make some comments to the letter sender from the Financial Supervisory Authority on Norway through the Ministry of Finance. The FSA gives its assessment of various elements relating to the implementation of the Solvency II in the Norwegian norm. And among other things, this concerns the natural perils fund and the guarantee scheme.

The FSA argues that these funds cannot be included as solvency capital. We believe that there are good reasons for this to be included in full as there have also been previous impacts of this. And we will put efforts into influencing the Ministry of Finance's final decision in this matter.

FSA also refers to possible tax consequences for their company in so far as the devaluation principles in the Solvency II affects the tax provision of that (23:13) provision. FSA, themselves, commented that the possible outcomes vary widely. On the one hand, the variation principles in solvency may not have any effect on the tax account. On the other, they may be given (23:29) and various solutions that lie somewhere in between these outcomes are also possible.

So even though the implementation of Solvency II is fast approaching, the regulatory uncertainty remains considerable. And this is also one of the elements that is taken into consideration in the strategic buffer.

And finally, I would like to comment on the return on financial assets of 1.3% in the quarter as presented on page 13. The investment portfolio amounted to NOK 54 billion at the end of the quarter, a reduction of approximately NOK 5 billion compared with the end of the first quarter. The reduction is done primarily due to the payment of NOK 6.4 billion in dividends this May.

The match portfolio represents NOK 34 billion, and it continues to make a stable contribution to the financial result. The result was 0.8% in the quarter, slightly down from 0.9% in the previous quarter. And of course, the continued fall in the interest rate level throughout the quarter will be challenging for the return on the match portfolio going forward.

We also see the effect of the fall in the interest rate in the excess value of the held to maturity portfolio which, at the end of this quarter, amounted to NOK 1.6 billion and that is up from NOK 1.3 billion at the end of the first quarter.

Moving onto the free portfolio amounting to NOK 21 billion at the end of the quarter, the return on the free portfolio amounted to 2.0% in the quarter meaning all asset classes making good returns. Fixed income instruments, generally, has a good return in the quarter. The same applies to private equity and the current equities and then which equities in particular delivered well in the quarter.

Return on current equities includes a tax gain of - sorry, a gain of NOK 127 million in connection with the reclassification of the shareholding in the SR-Bank. In addition, there is a positive estimated deviation of NOK 23 million from the previous quarter, so that in total, the stake in SR-Bank contributed NOK 150 million in the quarter. And the property portfolio made a solid contribution.

In summary, this resulted in a effective return on the investment portfolio of 1.3 percentage points in the quarter, somewhat higher than in the corresponding quarter in 2013. I will then leave it to you, Helge, to make some final remarks.

Helge Leiro Baastad {BIO 5865247 <GO>}

Thank you, Catharina. Some few comments on the last page, 14. You will see here a list of our most important priorities, which you already are familiar with.

First, we are further developing our cooperation with partners and distributors. We have a long-standing tradition with good experience with partners and distribution agreements. And in the second quarter, we signed an agreement with the Swedish Homeowners Association, [Foreign Language] (27:03-27:04) in Swedish, which has 320,000 members in Sweden to offer insurance solutions to its members, and that fits well with our growth strategy in Sweden.

We make continuous efforts to achieve more efficient operations to ensure continued good competitiveness. We build continuous (27:27) profitable opportunities for growth in the Nordic region and in the Baltic states but we are rationale and patient in our approach.

Work on optimizing the balance sheet will continue throughout 2014 and we will ensure continued capital discipline. We will also spend time looking into some framework conditions awaiting clarification. And as Catharina has talked about, the financial supervisory authority in Norway has sent out its assessments relating to the Solvency II relations in a letter to the Ministry of Finance, and we will make active efforts to ensure that the implementation of Solvency II is based on the economic realities.

And it's also important to comment that we take, among other things, regulatory uncertainty relating to Solvency II into account in our strategic buffer, which the board normally stipulates once a year. And, finally, as you can see here, I would like to remind you once again about our Capital Market Day in London on 25th of November.

And with that, I want to give you the opportunity to ask questions, please.

Janne Merethe Flessum {BIO 19368607 <GO>}

Operator, we are ready for the questions then.

Q&A

Operator

Thank you. We'll pause for a moment to allow everyone to signal. Our first question today comes from William Hardcastle of Bank of America.

Q - William Hardcastle {BIO 16346311 <GO>}

Hi there, guys. It's Will Hardcastle here. Just a quick - well, firstly, on the frequency of losses, it looks to be a very, very strong quarter in terms of that. I'm just trying to work out how much of that seems to be sustainable or is it all one-off in nature? I guess, if we could touch on both the rationale – the reasons for that on both the private motor side as well as on the commercial property motor, just a bit more detail than what's provided there, please.

And then the second question is just on the online retail bank, the cost/income ratio seems to be improving. Is there anything that you'd like to highlight there or is that's just a one-off in the quarter or is that a sustainable level?

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

Yes. Catharina could take the comments on the banks. William, we have had low claims frequency for private motor insurance in first and second quarter 2014 and with good results. We see indications of a more favorable long-term development in personal injury claims among other things driven by the technological developments.

So what we have commented before is that long-term claims inflation related to motor is around 4%. So what we're saying though that we indicate that we believe maybe that the long-term claims inflation probability that it will be reduced is higher compared to the opposite increase. But how much and how far, we can't actually give any details on.

For a long time, the normal claims inflation for property insurance has largely reflected the building cost index of approximately 4% to 5%. The development in the short term is volatile among other things in relation to weather effect.

First and second quarter 2014 as Catharina also commented show the more normal claims level. First quarter positively affected by the mild winter but negatively affected by large number of large and semi-large (31:47) on it. For the claims inflation related to the property, we think what we have said before is our best estimate also for the future.

I don't know if I gave some more flavor around the (32:04) situation and it's first and foremost the most interesting thing is to follow the motor situation next quarters and years actually.

Q - William Hardcastle {BIO 16346311 <GO>}

Yes. That's very helpful. Just a quick follow-up on that. I guess did I hear you correctly saying motor pricing is going up I guess lessen that long-term 4% level. Is that right?

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

That's right. What we have done – the increases in premiums are largely in line with long-term inflation. But at the same time as both I and Catharina commented, we do selective marketing initiatives giving a smaller total effect short-term. So that's right, yes.

Q - William Hardcastle {BIO 16346311 <GO>}

Okay.

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

And then you had a question related to the cost/income ratio in the bank. If you look at the cost/income ratio last year, it was 56.1% and the year-to-date and this year is 60.3%. So, I think the commentaries that it reflects that banking is, of course, scale and it's above scale. The bank is still quite a new bank, started, I think, in 2007, but we have now reached a level where we see that there is (33:38) and the cost-to-income ratio, it has reached a very satisfying level.

But it's a cost-efficient bank where we're able to fit on more volume with a higher (33:53) volume than in the underlying (33:54) So that's what is reflecting in the cost-to-income ratio.

Q - William Hardcastle {BIO 16346311 <GO>}

Yes. Very, very clear. And last one, just on the level of write-downs, so it's been trending fairly stable actually for a number of quarters now and I don't know what - if you've given guidance before on the level of NPL provisions you should be expecting. But, I mean, it's looking annualized at 25 basis points. Do you see that as abnormally low or is that a sensible number to be thinking about?

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

Actually, it's important to remember that the amount of unsecured lending versus the secured lending has been decreasing, of course. We're growing at a much higher rate within the secured lending, which will also reflect or be reflected in the results and losses if you look at the - yes.

Q - William Hardcastle {BIO 16346311 <GO>}

Sure. Thanks.

Operator

Our next question today comes from David Andrich of Morgan Stanley.

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

Hi. Good morning. Thank you. I just wanted to follow up on one of your comments around claims inflation for the motor insurance. It sounds like you're expecting that to come down over time with instruction of some technology. I'm guessing that's impact to telematics and allowing you to better underwrite the risk, is that true? And is that what you expect to kind of develop in terms of the claims inflation there?

And then second one, I just want to follow up on the run-off gains. It ticked up in Q2, and I was just wondering if they're just noise and you're still expecting run-off gains to be around 1% going forward, or is there any kind of change or something specific impacting that in the quarter? Thank you.

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

Hi. It was not, first and foremost, telematics I was thinking about. It's more the situation related to infrastructure more safer roads, safer cars. And we have seen, as I said, and that's actually for years now, a more favorable long-term development in personal injury claims. So, it's more related to lots of things happening around infrastructure and cars in general. It wasn't actually telematics that I was thinking about.

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

Okay. So, just to follow up on that, so you are expecting it is more favorable development than the 4% that we've kind of historically thought about in terms of claims inflation?

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

No. I didn't say that because what we actually think is 4% but I said the probability of lower frequency is higher compared to higher frequency. So, we think if the trend will go anyway, it will be a decrease more probably compared to an increase in the claims inflation-related to motor.

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

Right. Okay.

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

And your other question relating to run-off gains, the expectation when it comes to run-off gains still the same as it does, always been. It's in the long run zero. That should be in the expected levels. So, when you see again all of these from quarter-to-quarter it's our adjustments. And you have to remember that the total liability side is more than NOK 32 billion, so if you look at the total cycle of the technical reserves, it's still a rather small change (37:40) if you look at – or if you compare the numbers to the NOK 32 billion. But again, the expected level should be zero over time.

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

Okay. All right. Thank you very much.

Operator

Our next question comes from Daniel Do-Thoi of JPMorgan.

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

Hi. Good morning. Question from my side. The first one, again, following up on claims trends, I just wanted to get a better feel for the underlying claims trend particularly in Norway in isolation. If I compare the second quarter to the second quarter in 2013, adjusting for large losses, run-off and the effect of flooding that you mentioned earlier, there's still about a 4 to 5-percentage-point improvement year-on-year, and I just wanted to get perhaps your thoughts on how much of this is driven by things like improving tariffs that Helge mentioned earlier and how much of it is driven by more favorable weather.

And then secondly, a question regarding the S&P model that you showed on slide 12 of your presentation, if I take the capital requirements and I exclude the capital charge for asset risk, capital requirement's actually down by about NOK 100 million quarter-on-quarter, and I was just wondering what was driving this given the continued growth in the business.

And then the last question was just on the comments you made in the report about the various funds and the letter from the Norwegian FSA, and if you could perhaps provide some thoughts on first the time line that you're expecting here on any sort of decision. And secondly, on the impact on the S&P model in a scenario where these various funds are perhaps not deemed to qualify as capital by the Norwegian FSA. Thank you.

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

Yes. Let me see if I managed to get all those questions. But as I understood, first, we have the question related to claims inflation or underlying claims frequency. It's quite correct as you said. If you look at the second quarter this year and compare it to the second quarter last year, it's an underlying improvement in the loss ratio of 5.4 percentage points if you should take out the large losses and the runoff gain.

And that is – as I said, some of the explanation to that improvement is the very low frequency within the motor private portfolio which is an isolated effect in this quarter. We do not expect that in any way to be a trend.

But we also comment that even though the property and housing product had a more normal frequency level this year, if you compare it to last year, second quarter last year was impacted by a lot of weather – it was a lot of water-related claims and also flooding in Norway in the second quarter last year, explaining some of the improvements in second quarter this year.

So I think you had a – I think maybe your next question if I was right was referring to the (41:14) FSA – I'm sorry?

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

The second question was on the S&P model, the increase - sorry, the decrease in capital requirements excluding the capital charge asset risk. And then the third question was on the letter from the Norwegian FSA.

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

The main effect, if you look at S&P model, the main effect is the asset risk which has been reduced and also it has been increased. And there is some change to the available capital offer but just as an effect, it's NOK 500 million. So, the main effect is the SR-Bank reclassification. It's only a minor effect other than that.

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

I guess what I was trying to ask was if I take the total capital requirements for the A rating and I deduct from that the capital charge where asset risk for this quarter and also last quarter. So, I look at only the capital charge for insurance risk minus diversification benefit. There's a reduction in that amount quarter-on-quarter by about NOK 100 million, as I calculated that correctly. So, I was just wondering, what was the reason for that given that your business continues to grow?

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

I think one of the changes in the available capital or one of the changes that you will also see that since the capital requirements have improved or so you have to increase somewhat due to asset risk increasing. The technical buffer of 5% has also increased from NOK 700 million to NOK 800 million, taking away some of the (43:02) requirement. And then the main changes again, it refers to the asset risk increasing and their reduction in available capital due to the reclassification of SR-Bank and having them - or no longer having (43:22) on available capital, so that's the effect.

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

Okay.

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

Finally, the letter...

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

And then...

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

And the timing, the process was - yes...

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

Yes, the process, the timing and perhaps if you've had any discussion with the rating agencies regarding the S&P model and the scenario where the ruling is such that these funds are not included in equity going forward?

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

Yes. Well, the letter was sent from the FSA to the Ministry of Finance, Norway in the end of June, second half of June. What we know for sure is that these questions need to be solved before Solvency II is implemented in (44:14) regulation as of the 1st of January 2016. We will try to have a communication with the Ministry of Finance. But other than that, it's not actually up to us to decide the process or the timing of when we get these clarifications, unfortunately.

I think you also had a question related to the S&P model and how these funds are classified in the S&P model. And you just have to remember that today the systems are not included in the legal capital, if you look at the capital adequacy model and also if you look at the solvency margin model, with a small classification when it comes to the solvency margin model where we are allowed to include 25% of the natural peril fund.

But the situation today is these terms are, more or less, not included in legal capital, but S&P have a more economic view on this fund. These are funds that are included in the IFRS equity, and I've talked about that. S&P so far has different economic (45:33) to this fund and these are applicable within this available capital and we expect that to be the situation going forward as well.

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

Okay. Thank you.

Operator

Our next question comes from Matti Ahokas of Danske Bank.

Q - Matti Ahokas {BIO 2037723 <GO>}

Yes. Good morning. It's Matti Ahokas here from Danske. Two questions if I may. Firstly, Helge, you were saying that there might be a risk that this technical buffer might be increased. Was this the case or did I understand you correctly? And, overall, if you look at these regulatory issues that you've stated as being considerable, is there a risk that this might impact the dividend payout going forward?

The second question is regarding the investment income. We've seen a quite significant decline in the long bond yields and if you could shed us some light regarding on what is the impact on the running yield on the match portfolio. How quickly does that come down? Is it the 3.5 years or is there something special here to look at? Thanks.

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

The first question, Matti, just again on the FSA, the impact on dividend capacity, right?

Q - Matti Ahokas {BIO 2037723 <GO>}

Yes.

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

Yes, to start with that one, we don't expect this to have any effect on the IFRS running, so it shouldn't have any impact on the underlying dividend capacity, so to say. And then, you had another question before that on the effect on the buffer?

Q - Matti Ahokas {BIO 2037723 <GO>}

Yes.

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

Is that correct?

Q - Matti Ahokas {BIO 2037723 <GO>}

Did I understand it correctly that you might say that the 5% buffer might be increased or (47:22)

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

No. It's just a question of mathematics, if the 5% buffer above the capital requirement. Since the requirements increased, that has – it's actually increased this quarter due to reclassification of the SR-Bank stake. So there's just a 5% buffer above the capital requirements. So it's just a technical or mathematical adjustment of the nominal value (47:49)

Q - Matti Ahokas {BIO 2037723 <GO>}

Okay. So it has nothing to do with this capital or the regulatory uncertainty?

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

No. It's been just 5%, the large nominal number. And then, it was on the running yield, right?

Q - Matti Ahokas {BIO 2037723 <GO>}

Yes.

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

Yes. When we look at what's happening in the market, last quarter, we have – or in the first quarter, we have an average reinvestment rate of 4% in the Norwegian market. We haven't been very active in the market this quarter, so I don't have a figure for you when it comes to what we have been able to (48:32) in the market in this quarter. But we have seen that although there are, of course, investors in the Norwegian market, that the yield curve, of course, they have come down, as well as some tightening of the margin spreads. So of course, that will affect our investment portfolios going forward.

Q - Matti Ahokas {BIO 2037723 <GO>}

All right. Great. Thanks.

Operator

Our next question comes from Sami Taipalus of Berenberg.

Q - Sami Taipalus {BIO 17452234 <GO>}

Hello. Hi. Thanks for taking my question. Can I just start by clarifying the point you made about frequency and claims inflation in the motor line? Did you say that you feel that the balance, probably this is for claims frequency below it than what you're seeing now – or sorry, the low claims frequency being more sustainable than what you believed in the past or was it for claims inflation being below 4%? The count was a little bit unclear to me.

Then on the actual questions, you mentioned on the priorities slide that you'll be looking to improve efficiency as one of your core goals going forward. Could you just elaborate a little bit more on that, what kind of initiatives you're taking here, because it seems like you've been already quite good at this and you've got quite a few benefits for you already? And then finally, could you just give us an update on the yield on the unrated fixed income instruments in your portfolio and what the capital charge is related to this? Thank you.

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

If I understood your first question, it's once again the claims frequency for private motor. As I said, we have seen a very low claims frequency for private motor in first and second quarter far below what we actually believe the long-term frequency development for motor. And what we have said for some quarters now that we have – our overall pricing is in line with what we believe is the long-term claims inflation for motor and that's around 4%. But for sure we have seen lower frequency development for a couple of quarters now.

So, what we actually believe in, it's 4%. But I also said we see safer cars, safer roads. We have seen indications of a more favorable long-term development in personal injury claims. So, if you are going to give estimate for the long-term claims inflation for motor frequency development, we think it's higher probability that it will be lower than 4% compared to the opposite, higher than 4%. But what we, actually, at the moment take into consideration when we price is 4%. But I also said that we do select the market initiatives and we have done that during the second quarter, giving a smaller total effect on price effect, short-term than 4%.

Q - Sami Taipalus {BIO 17452234 <GO>}

Okay. Yes, that's great. Thanks.

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

Now, cost efficiency, it's the same initiative as always. It's to be even more efficient in the distribution. It's about lots of initiative into the claims handling process. It involves increasing automation and self-service. So, it's more of the same, actually, going forward. What we have said short-term is that 15% – within 15% is the cost ratio target. We haven't communicated any new cost efficiency or cost ratio target going forward because we had to also invest into CRM, we have to invest into business intelligence and ICT, et cetera. But it's more or less the same story. It's a never-ending story, actually. It's a continuously improvement operation we are talking about. Okay.

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

And on your final question there, Sami, I believe you asked about the unrated part of the portfolio, right?

Q - Sami Taipalus {BIO 17452234 <GO>}

That's right. Yes.

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

We don't have any number to give you on the yield for that particular portfolio but I just want to remind you, it's on the – that's page 24 in our presentation material. You will that we have internal ratings for the bulk part of that portfolio. So NOK 7.9 billion are internally rated while we have then NOK 2.7 billion left unrated within that portfolio. And when then looking on capital charges, if you go into the S&P model and look at their setup, you can see that it has to do with the duration and they have a matrix of duration and rating where you can see how the capital charges is calculated.

Q - Sami Taipalus {BIO 17452234 <GO>}

Is there any way of kind of saving us doing that work and maybe giving some indication of roughly where that charge sits on average?

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

On top our minds, I'm not sure if we can – we need to double-check that, actually, Sami.

Q - Sami Taipalus {BIO 17452234 <GO>}

Okay.

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

But it's pretty limited given that we have these ratings, which S&P has approved in accordance with the ordinary rating.

Q - Sami Taipalus {BIO 17452234 <GO>}

Okay. Thank you.

Operator

Our next question comes from Gianandrea Roberti of Carnegie.

Q - Gianandrea Roberti {BIO 6786731 <GO>}

Yes. Good morning from me as well. I have three questions, if I can. If I start with the slide where you show your priorities going forward, I'm just wondering if we should read this in line of importance or not because I suppose per our perspective, but there's probably - that's why we are analysts and you need to run this business. But I would put number one, optimize the balance sheet and make sure capital discipline include this discussion that we have now for several quarters about the potential issue on for sub debt. But I would like to hear a bit of your tone on that point.

And then I have a couple or more question. One is the growth in the Nordic segment, I think it's just above 3% if I adjust for the currencies in Gouda and Solid and if you can spend a bit, some comment on that. I think your growth has been quite a bit above that for a few quarters and - yes, if you can elaborate a bit, that would be interesting.

The last question is more of a spreadsheet question. I'm always a little bit puzzled by the expected large losses by quarter when I look them after your report. And now you are saying that in this quarter, you had expected NOK 266 million and you came out NOK 139 million. You expect NOK 240 million in Q1 last year. In this quarter you expected NOK 252 million, there's small difference but these numbers - I mean I would expect just a single number to be the same every quarter, to be honest. So, if you can try to explain to us why there are these small variation, it would be very useful. Thanks a lot.

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

Yes. Your first question, Gianandrea ,was related to potential subordinated debt, wasn't it or no?

Q - Gianandrea Roberti {BIO 6786731 <GO>}

Correct. Correct.

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

It was. Okay. Yes. Actually, it's no new communication. As you know, we are looking into all kind of measures considered to reach 15% from 2015 after tax. And we had allocation investment portfolio. We have done (57:04) We have said that we will do SR-Bank, and we have also said that we will look into a potential subordinated debt. So, all the measures to increase available capital or decrease capital requirement, we will also look into all kind of measurements.

So the 50% after tax return on equity target requires capital discipline going forward. It requires strong profit, and optimation continues also throughout 2014. So, yes, we will look into a potential subordinated debt. So that's the answer, Gianandrea.

The growth in the Nordic segment, we have - I think we commented last quarter over agreement with Nykredit. Since we acquired Nykredit Forsikring in 2010, it has been our most important distribution project in the Danish market. So, we entered into an agreement with Nykredit on an adjustment of our existing cooperation model with effect on April 2013.

The adjustment entail a number of changes in the value chain, and it helps to bring insurance expertise closer to the customers, both in connection with sales and in the day-to-day service to our customers. And we have seen improved sales since we renegotiated the agreement with Nykredit on 8th of April.

So, the growth in previous quarters has been more related to commercial business and we have a lower, I would say, growth in that segment now. So, what we expect, going forward, Gianandrea, is more top line growth in the private part of the business in the Danish market.

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

When it comes to the expected large losses level, Gianandrea, you're correct that we expect the same level every quarter. It was NOK 266 million also last quarter, and it will stay there during the rest of the year. But once a year, we do a calibration of our models. So, moving one year back, we were at the NOK 254 million, which was the expectation level. So, we do this calibration once a year to adjust. But there is no seasonal effect for instance. So, we expect the same amount every quarter.

Q - Gianandrea Roberti {BIO 6786731 <GO>}

Okay. Thank you very much.

Operator

Our next question comes from Jakob Brink of ABG.

Q - Jakob Brink {BIO 7556154 <GO>}

Yes. Hi, guys. Two questions, please. The first one is regarding the customer dividend model. Helge, you touched briefly upon it, and to me it sounds like you're integrating this customer or dividend model more into the Gjensidige sort of pricing. I don't know if I overinterpret you, but my view I guess, this can lead to two outcomes, which I would like to hear your thoughts on either.

You can basically go and embrace your prices since customers were becoming aware that they will get this 15% discount, or, secondly, you could actually see your competitors having to lower prices because people know that they get lower prices in reality from Gjensidige than the list prices. So, it could be interesting to hear your thoughts on this one.

And then secondly, regarding the FSA letter, what is it exactly you want to talk to them about? I mean, if I look at history, I guess, it's the normal, that the Department of Finance goes along with the recommendations from the FSA if I'm not mistaken. Then secondly on that topic, Tryg mentioned last week that they will use subordinated debt to cover a potential shortfall here. Is that the same way you're looking at it? That's it. Thank you.

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

Yes. While Catharina is preparing for the second question, I will be very short on the first one, actually. We do not take dividend model into consolidation related to pricing at all. So that's absolutely separated.

Q - Jakob Brink {BIO 7556154 <GO>}

I'm just thinking that didn't you say that going forward, it will be possible for customers - I mean, new customers to look on your website and see what would they actually have got as the dividend and would there have been customers? Was that not what you said?

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

No. The calculator is actually based on if you have insurance for 10,000, 15,000, 20,000, you can see what kind of dividend you will receive given that you have been customer last year. As other customers, you will then have 15% back.

But when we are pricing in our operation in Gjensidige, we do not take these into consideration at all. But of course, it's marketing vehicle we use this calculator on the website for new customers and of course for present customers as well.

Q - Jakob Brink {BIO 7556154 <GO>}

And you're not afraid that your customers will actually stop believing that they will get this 15% because then of course, you will get a lot - I mean, even stronger competitor stance with competitors.

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

We can't promise any dividend going forward. What we can say is that if you had been a customer with premium of 10,000 last year in our business model, you then receive 1,500 during the back as dividend. But the pricing if they want to become a customer is 10,000.

Q - Jakob Brink {BIO 7556154 <GO>}

Okay, sure.

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

Yes. Then you talked about the, I could say, letter, of course, there are four different issues that the FSA are discussing in the letter, and two of them are relevant for Gjensidige. So, of course, these are the two issues that we would like discuss with the Ministry of Finance. It's about how you should treat the (01:03:45) and also the guarantee scheme and then, of course, (01:03:50) So, these are the main issues.

Q - Jakob Brink {BIO 7556154 <GO>}

But I guess my question is more, I mean, they have written 106 pages, of which the main part is on those two topics I guess, and they discussed in very much detail can be treated as a liability or is it an equity and they come to the conclusion that it cannot be capital in any way. I mean, and isn't it correct also that the Department of Finance they typically listen to the FSA.

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

If you look at the letter from FSA, obviously, they point to a very - let's say, it is not the right expression, but they point to a way of solving this issue. Their concern is that it's not - if you look at the regulation for the natural peril fund today, it's not very clear or it's not 100% clear how the priority of these funds will be compared to the policyholders' liability in an important situation for the company.

So they point to the possibility and also the need to tighten up the regulation to make sure that it's clear for everyone with what happened in a situation within Solvency. And as we're saying in this letter as well, if it's clear that the situation or the natural peril foundation is ranked lower than other policyholders and other creditors, then of course this can be treated as a Solvency capital as well. I mean, they discussed it back from the current regulation but they also kind of point to another regulation or another situation that could change their conclusion.

Q - Jakob Brink {BIO 7556154 <GO>}

And then final, subordinated capital, are you looking at this as sort of a way to increase leverage or a way to prevent any sort of problems with regard to implementation of Solvency II?

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

You know that FSA is discussing the solvency capital. We do not know exactly, of course, since there are a lot of uncertainty regarding how Solvency II will be implemented or what the situation will be. But if you look at page - I think it's page 12 in the presentation, kind of the starting point there approximately for the Solvency II situation for Gjensidige is the internal risk-based perspective. I do not say that this is how it will work but this is kind of the starting point then there are still a lot of uncertainty here.

But you see that the cap level or the capital requirements, if you look at the term the risk-based perspective, it's NOK 11 billion. And so we still expect the S&P model to be the most (01:06:45) capital requirement of implementation of Solvency II.

Q - Jakob Brink {BIO 7556154 <GO>}

Okay. Thank you.

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

(01:06:54)

Q - Jakob Brink {BIO 7556154 <GO>}

Thank you.

Operator

Our next question comes from Vinit Malhotra of Goldman Sachs.

Q - Vinit Malhotra {BIO 16184491 <GO>}

Hi. Good morning. Just one question here from my side. Just on the number of private customers which you've highlighted in the report are constant over last year's 2Q and even in previous quarters, this number has more been stable. And this is sort of linked to one of the questions earlier asked. What do you think is stopping customers from taking a 15% effective price cut? Is it a bundling – is it a question of how the bundled products offered by the competition are also similar or more aggressive in discounting than you do or I'm just curious, what in your opinion is stopping back the number of customers from increasing in the private banks? Thank you.

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

The question is why customers are leaving us, or what kind of competitive measures our main competitors use or...

Q - Vinit Malhotra {BIO 16184491 <GO>}

No, why are they not coming to you because (01:08:14) 15% discount.

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

Why they are not coming to us – okay.

Q - Vinit Malhotra {BIO 16184491 <GO>}

Why they're not coming in greater quantities.

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

Yes, we really hope that the customers will come and that's why we increased our marketing effort. And I actually think that we have seen increased competition for some quarters now. And if you look at our figures and compare that to peers, I think it's a combination of stable customer development at 5% premium increase and profitability, that's a good mix actually. And I think the customer dividend model is one important factor.

Q - Vinit Malhotra {BIO 16184491 <GO>}

So you believe there's no real difference in the bundled products or - and just in a way in this which will grow and then people will start noticing the dividend model more, okay? All right.

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

Now, I'm not sure if I understand your question, but I think that we see good - we have good competitiveness, and we have seen increased competitiveness month by month. And we can see also increased competitiveness when we increase marketing efforts in the customer dividend model, but I think that's an important factor.

And I also commented lots of other factors, and the fact that we have bundled or we have a combined product offering - it's not bundling, but it's a combined product offering in the car dealer channel, that explains that we have significant, higher premium growth in the car dealer channel compared to other channels. And I think the combination of broader product offering is an important factor in the car dealer channel. So, I think on the competitiveness, there's lots of factors that explain the situation.

Q - Vinit Malhotra {BIO 16184491 <GO>}

All right. Thank you very much.

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

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

Operator

There are no further questions at the moment. As there are no further questions, I'd like to hand the call back to the speakers for any additional or closing remarks.

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

Okay, then, and we hope to see many of you in London, as well, tomorrow. Just to mention, we will also visit New York, Helsinki, Lugano, the Benelux, in addition to Bergen and Stavanger during August and September. Thank you for participating and have a nice summer.

Operator

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