

Looking for growth with a disciplined use of capital

Poul Almlund, CEO of Topdanmark

Looking for growth with a disciplined use of capital

Correlation between growth and capital requirements depends on the choice of capital model

- Solvency I
 - Proportionality between premium income and capital requirements
- Solvency II
 - Credit to size and stability

Disciplined use of capital

Existing official capital models

- Solvency I
 - Not taking into account
 - CR, risk profile etc.
- S&P
 - Taking CR only subjectively into account
- None of the models are optimal in relation to the necessary capital requirements

Disciplined use of capital

Solvency II

- Joint EU initiative
- Planned implementation from 2010
- Proposed model tested by the companies (QIS2)
- Capital requirements will depend on
 - Market risk
 - Credit risk
 - Operational risk
 - Insurance risk

Disciplined use of capital

Insurance risk

- Technical profits for the last five years
- Expected profits for the coming year
- Volatility in CR
- Level of provisions by line of business
- Level of premiums by line of business
- Diversification effect
 - For example, lower cost of capital due to non-life and life within the same group

Disciplined use of capital

Which lines of business should grow in order to minimise capital requirements?

- Short-tail lines with a stable and low CR level, i.e.
 - Household insurance
 - Motor own damage
 - Property insurance

Disciplined use of capital

Even though Topdanmark is not immediately restricted by the capital requirements of Solvency II we wish to trim capital expenditure

Example: Introduction of Profile Pension

Existing life products

- Guaranteed benefits
- Solvency requirement of 4% of customers' savings
- Profit restriction

Profile Pension

- Market rate product
- Solvency requirement of approximately 1% of customers' savings
- Profit governed by competition

Disciplined use of capital

Topdanmark believes that capital requirements under Solvency II will be lower than the existing level

- Capital requirements will not be a restriction
 - Therefore aiming for growth in the individual lines of business will not be restricted by capital requirements
- Does not intend to grow in lines that are not sufficiently profitable to cover the cost of capital

Disciplined use of capital

Effect of Solvency II on competitive position

- Size of premium income will impact capital requirements
- Reduced technical profit will increase capital requirements
 - CR will impact not only profitability but also the capital required
- Therefore Solvency II is expected to regulate behaviour and help maintain a relatively disciplined market

Disciplined use of capital

Examples of consequences of Solvency II

- 5pp CR increase per line of business
 - 16% increase in standard capital requirements
- 1999 storm
 - 13% increase in standard capital requirements
- Workers' compensation annuities treated as market risk
 - 17% decrease
- Lower provisions due to shorter pay-out time imply lower capital requirements

Looking for growth

Future growth depends on competitiveness

- Financial room available
- Distribution power
- Price

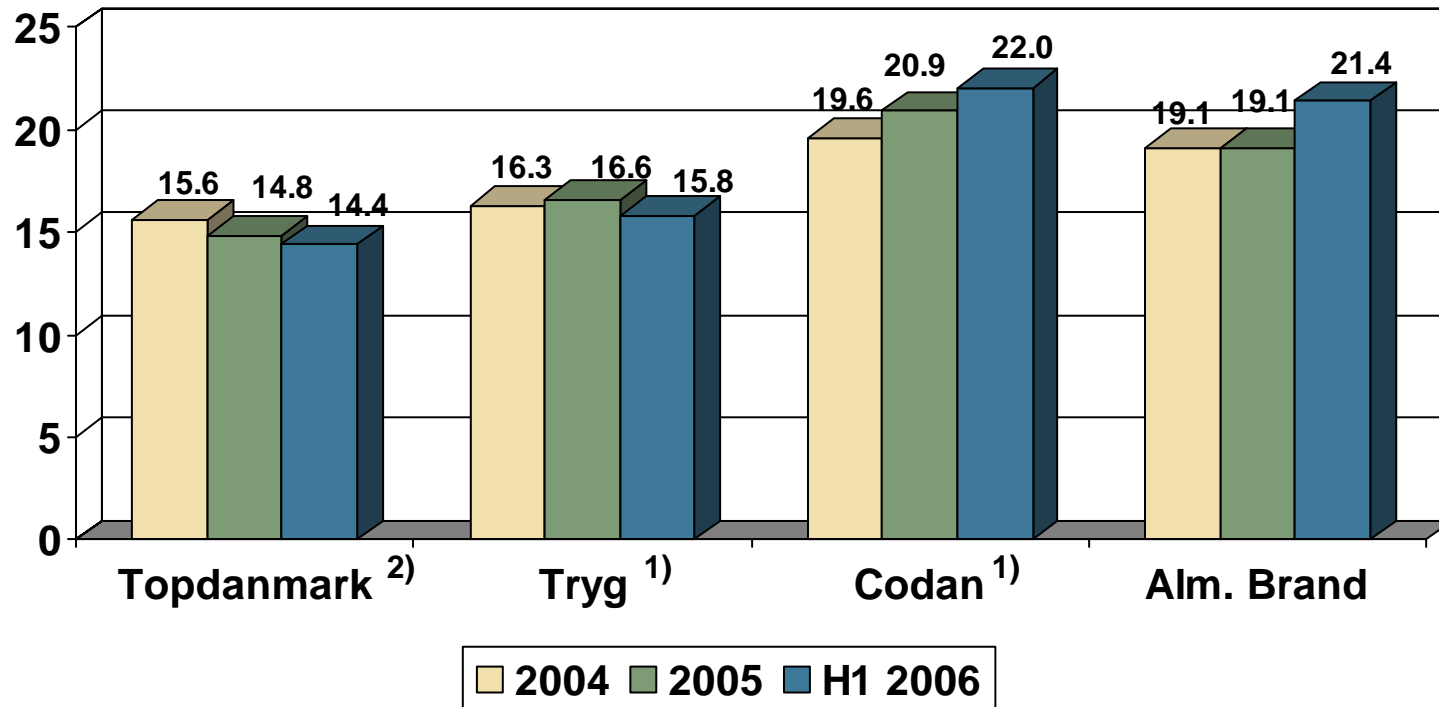
Looking for growth

Financial room available

- Comparison of expense ratio
- Comparison of CR

Looking for growth – Financial scope

Comparison of expense ratios

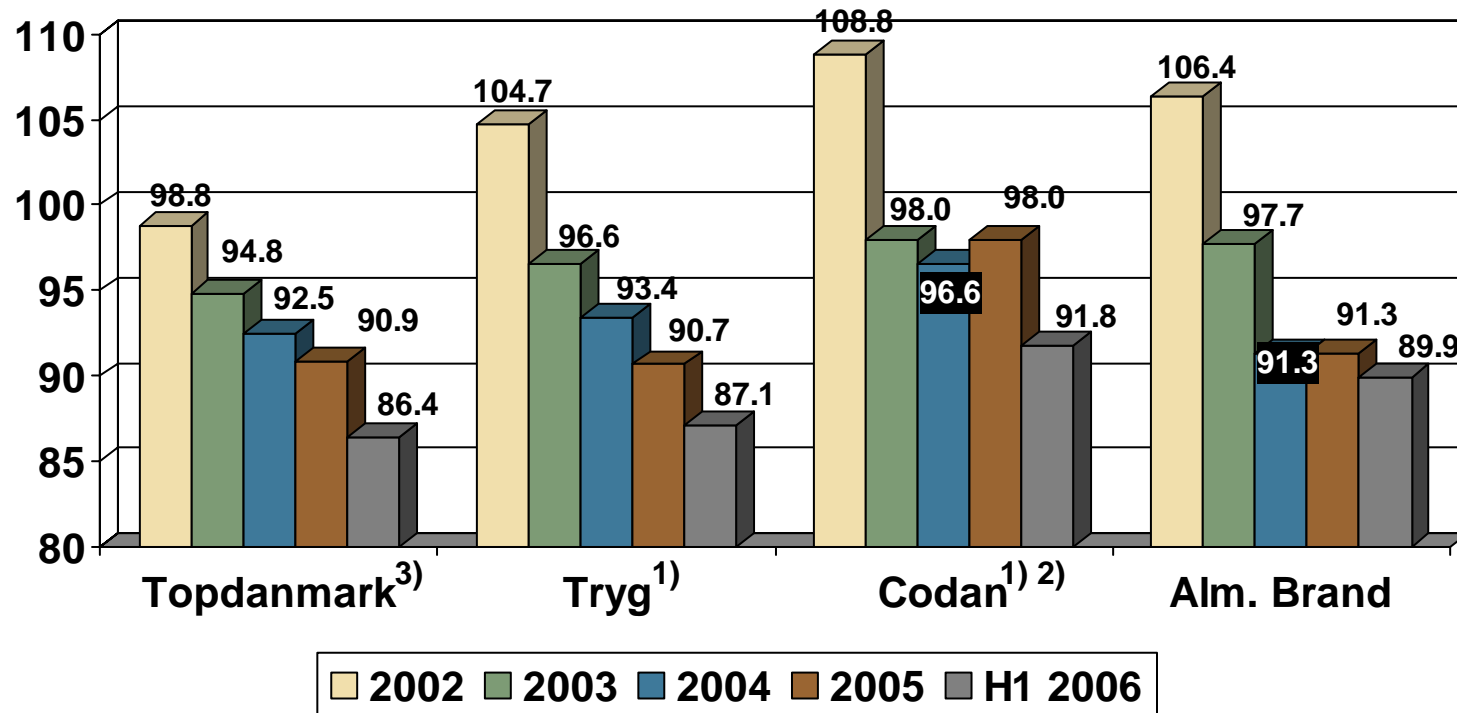


1) Rent from owner-occupied properties not included in expense ratio

2) Excl. rent from owner-occupied properties, the expense ratio would be 0.4 pp lower

Looking for growth

Comparison of CR



- 1) Rent from owner-occupied properties not included in expense and loss ratios
- 2) Excl. discounting of claims provisions
- 3) Excl. rent from owner-occupied properties, the combined ratio would be 0.6 pp lower

Looking for growth

Distribution power

- Good product range and competitive prices not enough
 - Interest in insurance is low
- Efficient referral and visit booking systems
- Strong distribution power targeted at each individual segment
- Multi-distribution
 - Topdanmark uses
 - Own sales channels
 - Distribution through alliance partners

Looking for growth

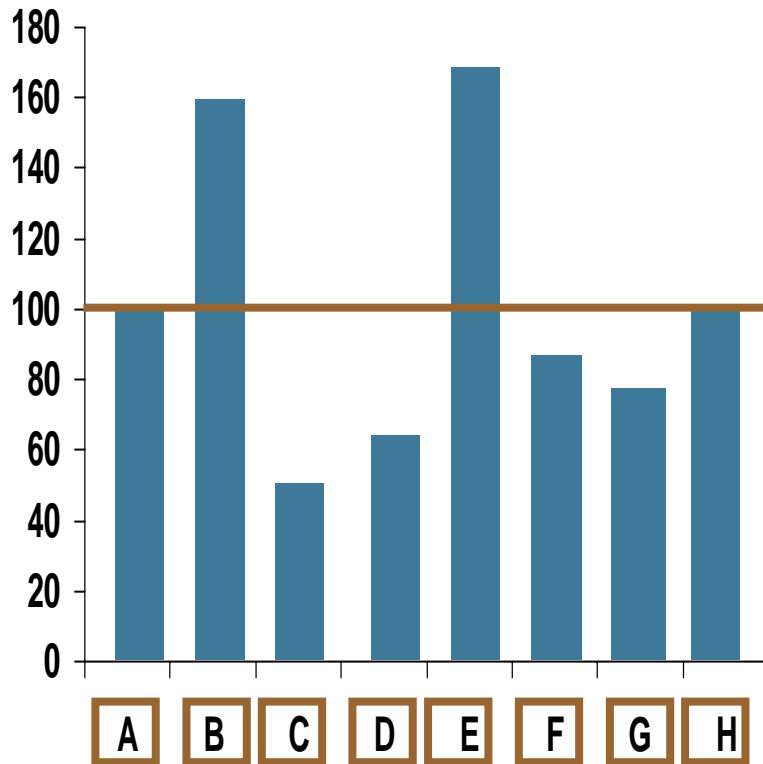
Pricing policy

- Those companies with the lowest expense ratios and stable CR will – in the long term – be able to offer the cheapest prices
- Increased use of micro rating

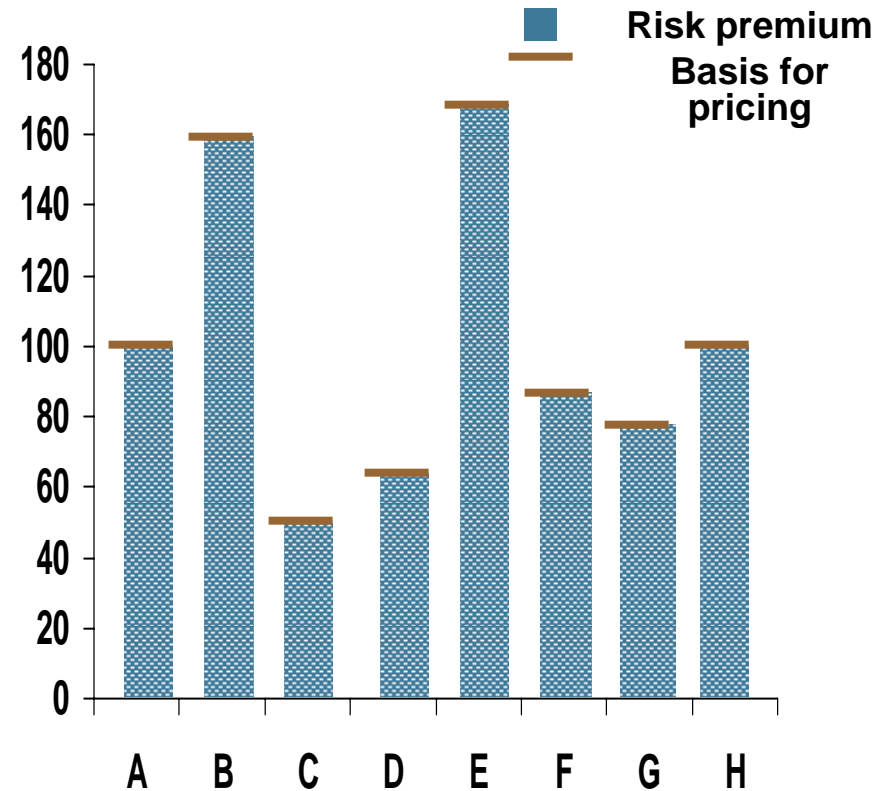
Looking for growth – Micro rating

How it works!

1/5



Company without price differentiation

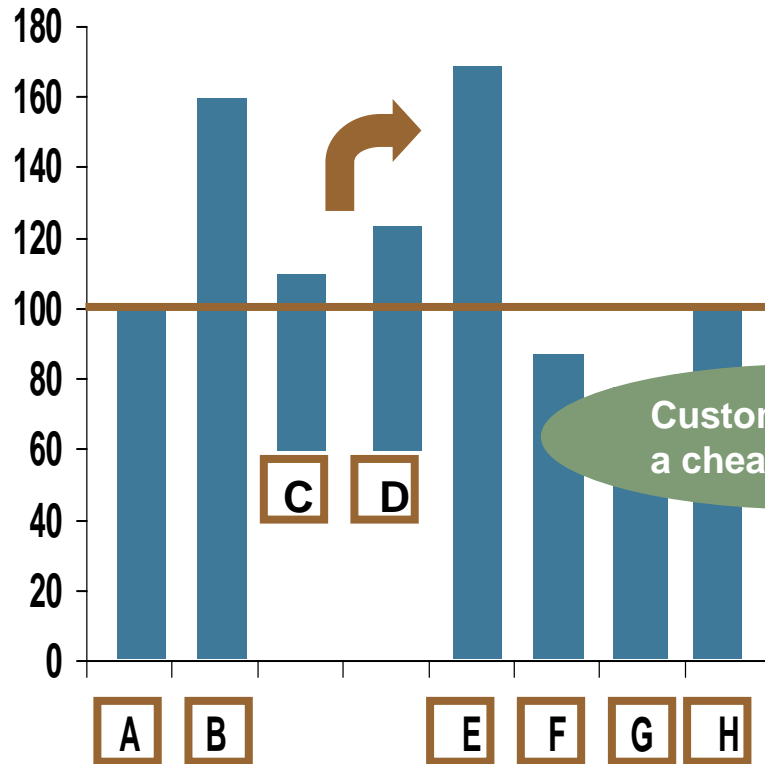


Company with price differentiation

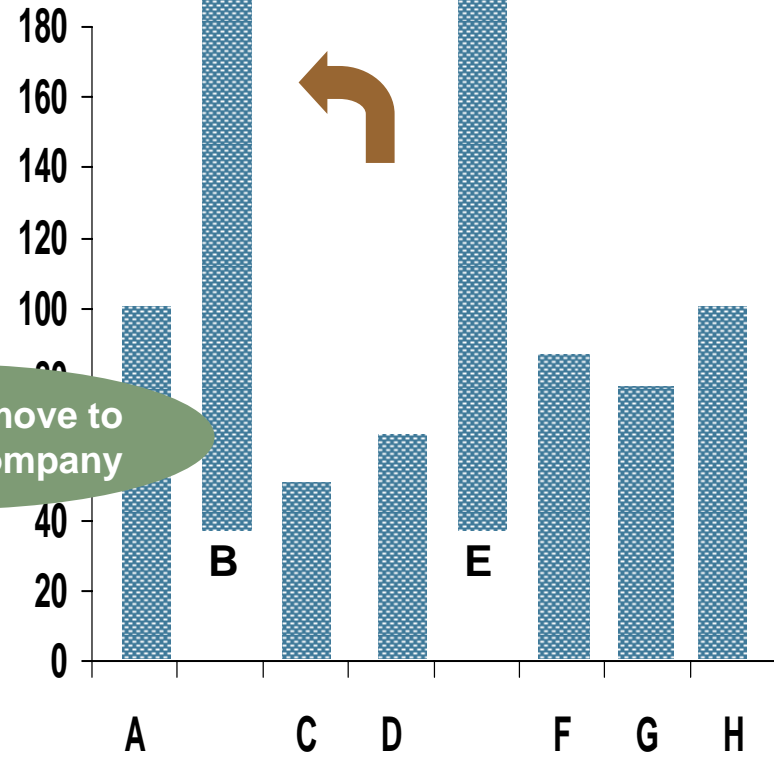
Looking for growth – Micro rating

How it works!

2/5



Company without segmentation



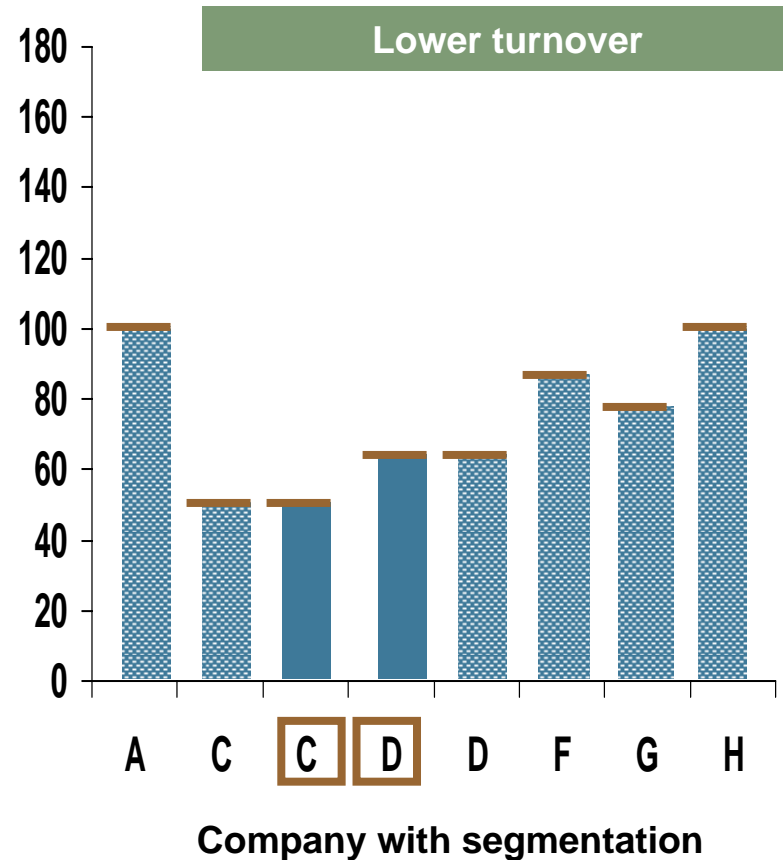
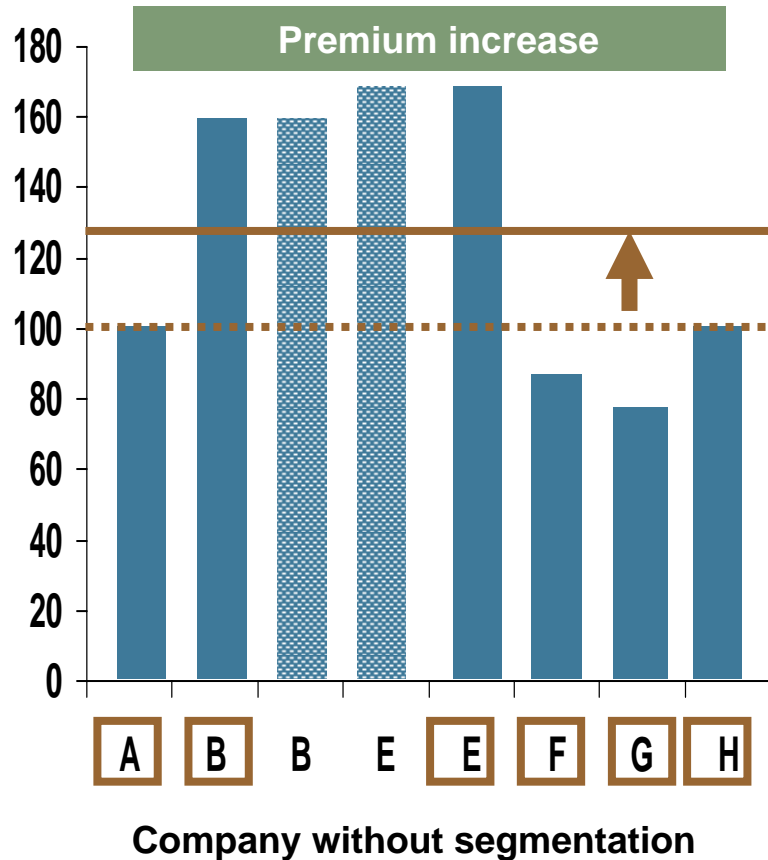
Company with segmentation

Customers move to a cheaper company

Looking for growth – Micro rating

How it works!

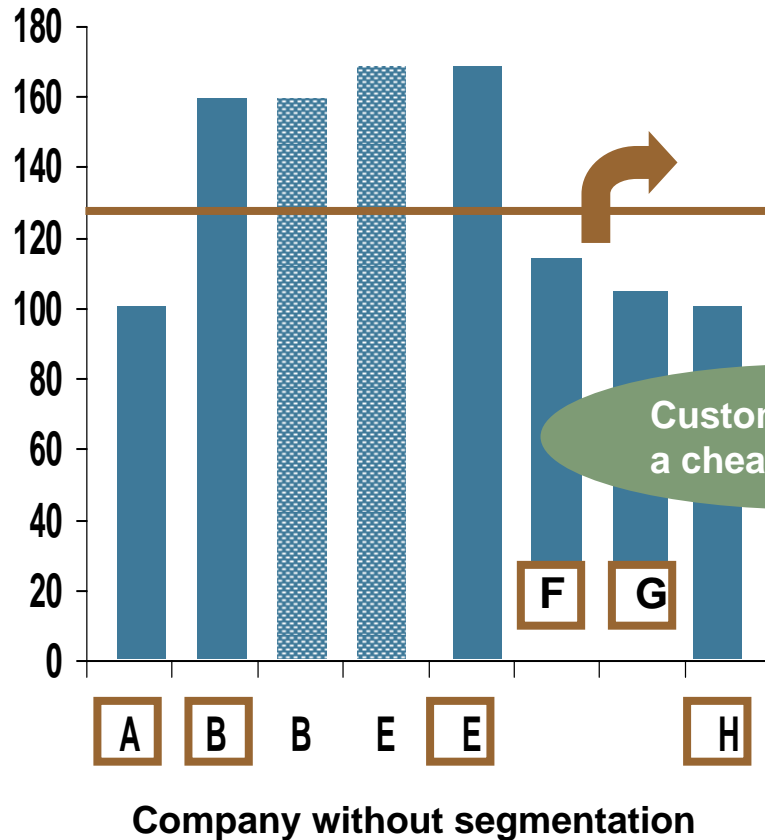
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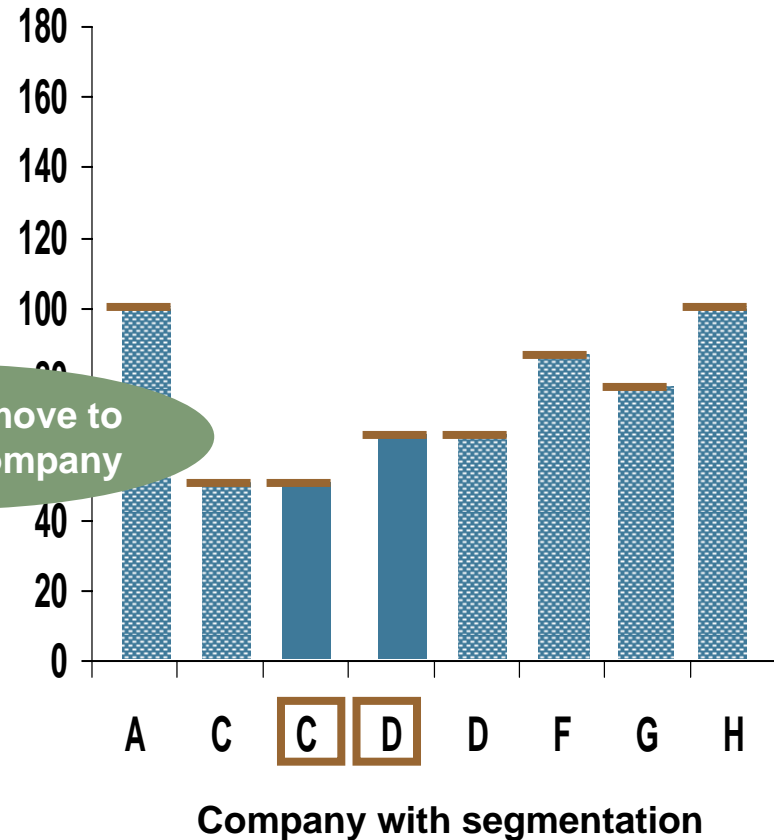
Looking for growth – Micro rating

How it works!

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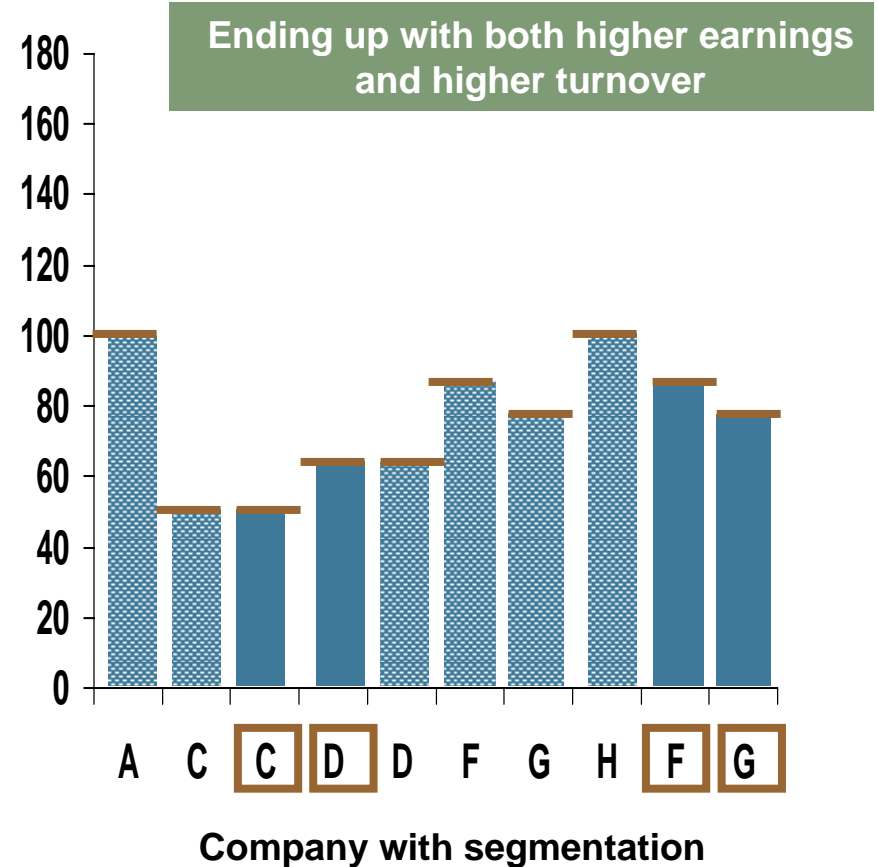
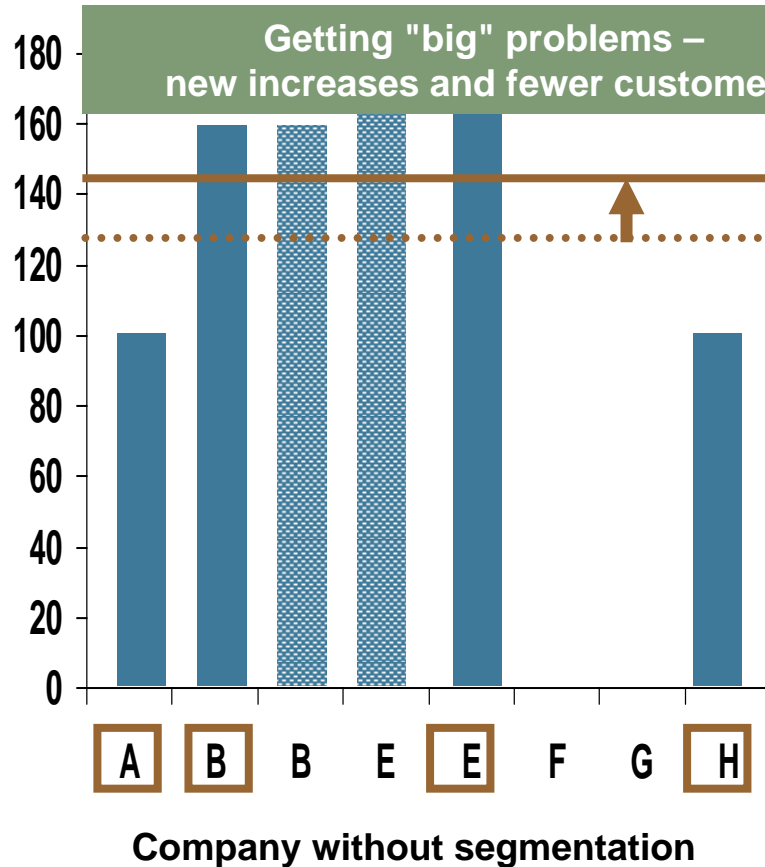
Customers move to a cheaper company



Looking for growth – Micro rating

How it works!

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Looking for growth – Micro rating

Summary

- Customers move to where they get the cheapest insurance policy
- A company with significant price differentiation attracts low risk customers and is not attractive to high risk customers. In the short term it results in a decrease in turnover which is later offset by competitors having to increase their prices to get the same earnings. When competitors increase their prices, the company gets the opportunity to again increase its growth without affecting earnings per customer
- A company with no price differentiation attracts high risk customers without charging an additional premium. In order to have the same earnings all customers must be charged a price increase which results in loss of customers

Looking for growth – Pricing policy

Micro rating

- Pricing of policies follow several criteria
- More risk-based pricing
- Micro rating not a new phenomenon
 - Has been used within motor insurance for many years

Looking for growth – Pricing policy

Consequences of micro rating

- Price in better agreement with insurance risk
- More differentiated and correct pricing
- The more data and the better actuarial competence a company has, the more precise its prices will be
 - Advantage for large companies
- Scope for more differentiated price adjustments
 - No general extraordinary price adjustments
- Improved tools for controlling CR and increasing its stability
 - And thus reducing capital requirements

Looking for growth – Pricing policy

Topdanmark's policy on micro rating

- Micro rating implemented within
 - Motor
 - Workers' compensation
 - Contents
- In the future we will improve our pricing in order to offer even more risk-based prices

Summary

Solvency II not expected to be a restriction for Topdanmark

- Capital requirements expected to be lower than existing level

Topdanmark wants to grow in those lines of business that are profitable to cover the cost of capital

CR will impact both P&L and required capital

- Solvency II therefore expected to regulate behaviour and help maintain a relatively disciplined market

Its strong expense ratio and CR put Topdanmark in a good position to invest in distribution power, if necessary

Micro rating is an appropriate tool for adjusting the CR and consequently the capital required