

January 2011

# Nordea Markets Insurance Seminar

10 January 2011

Company and capital strategy in insurance  
and the effect on ROE

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# Agenda

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- **Overall strategy**

- Capital strategy

- Key performance indicators

# Objectives, goals and strategies

## Objectives

- • **To carry out nation-wide, Danish non-life and life insurance and pension fund business**
- To be attractive to customers by being an independent and pre-eminent insurance group
- To ensure that our shareholders achieve a long-term, competitive, stable return

## Goals

- • **To improve our position in the Danish insurance market**
- To ensure that our expense ratio is lower than the general market level
- To ensure that our growth in non-life and life insurance as well as pension fund business is higher than that of the market
- To attract and keep profitable customers by delivering a high level of customer service
- To ensure that Topdanmark's shares reflect insurance risk rather than investment risk
- To ensure that Topdanmark's shares are both attractive and liquid
- To be able to attract and keep qualified employees

## Strategies

- To achieve primarily organic growth, supplemented by close co-operation with alliance partners, and opportune acquisitions
- To develop and improve the level of customer service
- To optimise our shareholders' return / risk profile by ensuring that shareholders' equity continues to reflect both the volume of business and a corresponding investment policy
- To be a dynamic organisation encouraging personal and career development
- To align the goals of Management and employees with those of our shareholders

# Share profile

## Clearly focused strategy

- • **Danish player**
- Stable insurance risks
- Low expense ratio
- Limited financial risk
- Efficient capital management
- Relatively limited top line growth
- Profitable growth - in that order
- Relatively high net result
- Large share buy-back programme
- No limitations set out in the Articles of Association

The Topdanmark share is a value case – not a growth case

# Financial targets

## Earnings

- ✓ CR of 91 excl. run-off – profit margin of 10% is the ruling factor
  - that is, the CR goal is adjusted each year dependent on interest rates

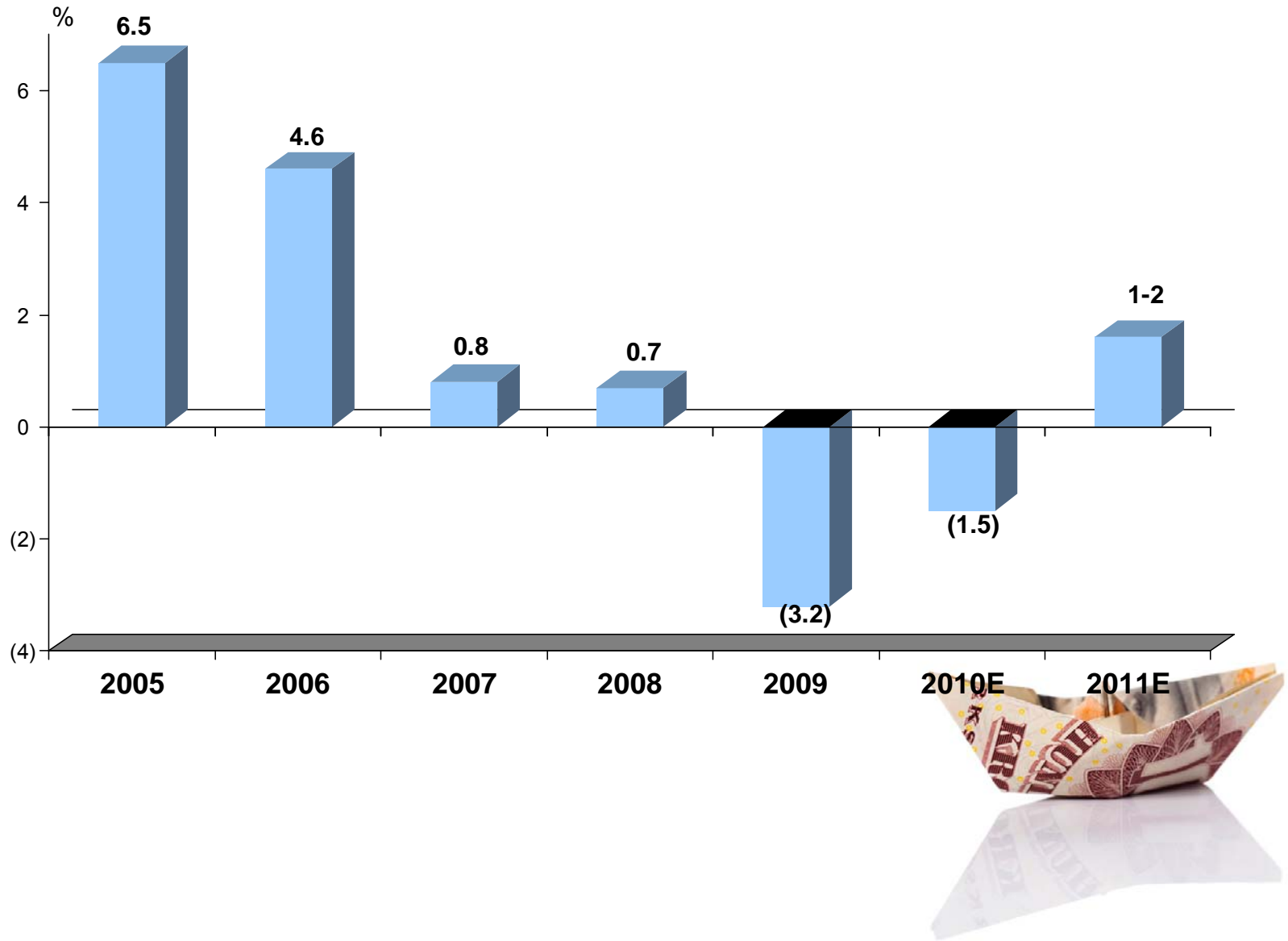
## Growth

- ✓ 1% p.a., in excess of wage inflation, in non-life gross premiums incl. I/A adjusted for any price changes

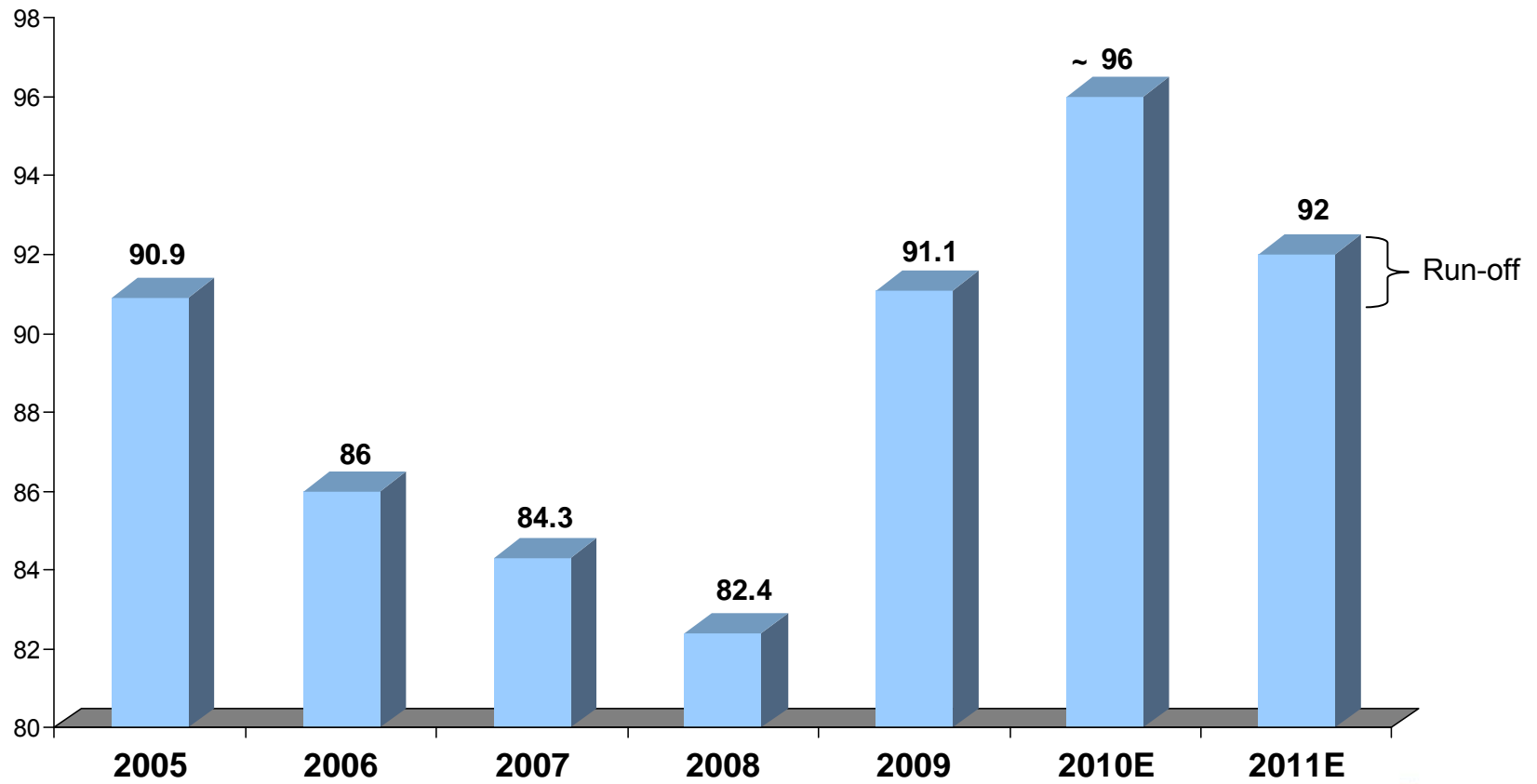
## Expense ratio

- ✓ No specific goal
  - ... but our goal for the expense ratio continues to be one which is lower than the general market level

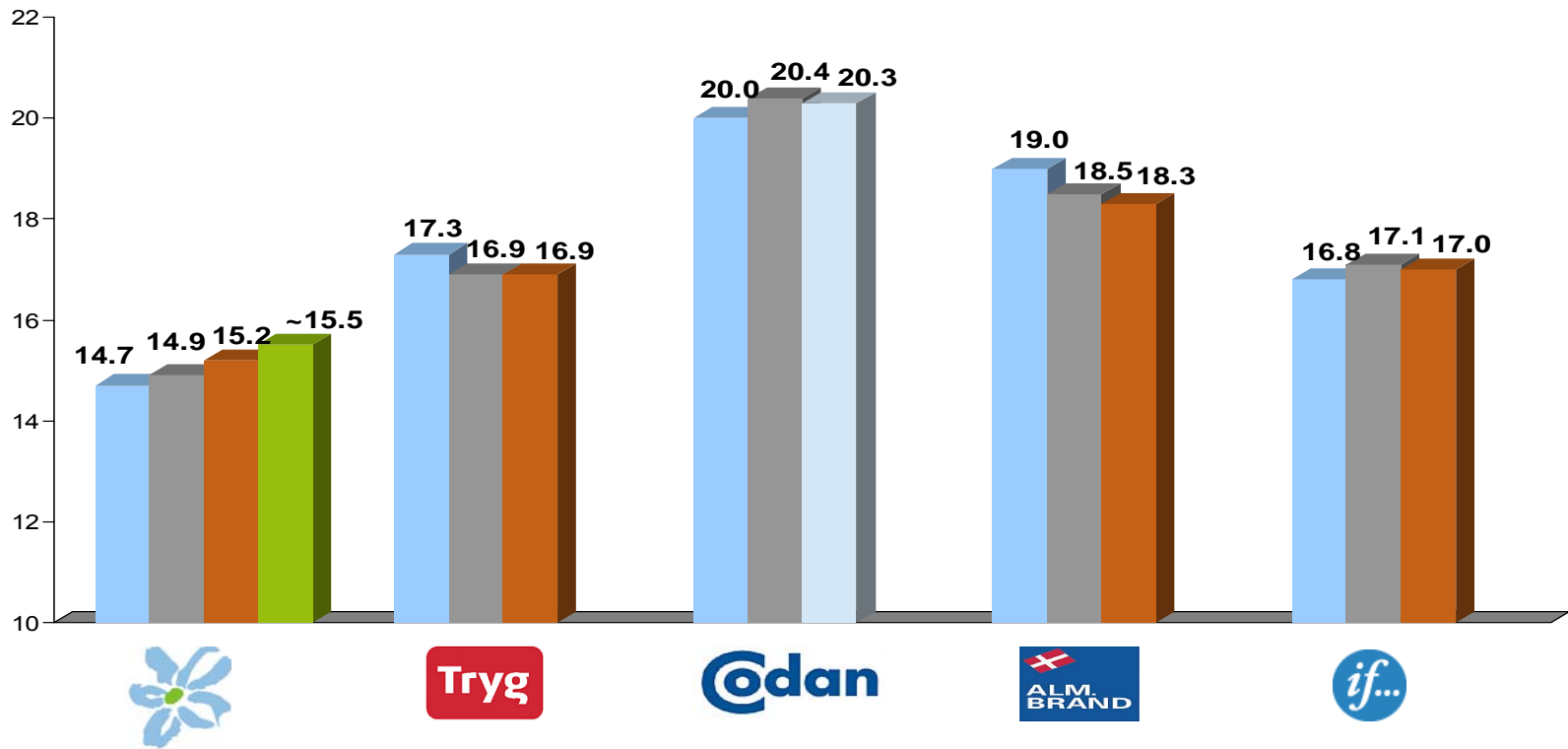
# Premium growth



# Combined ratio excl. run-off



# Comparison of expense ratio – at Group level





# Follow-up on strategy

## Strategy:

- Profitable growth – in that order

## Current position

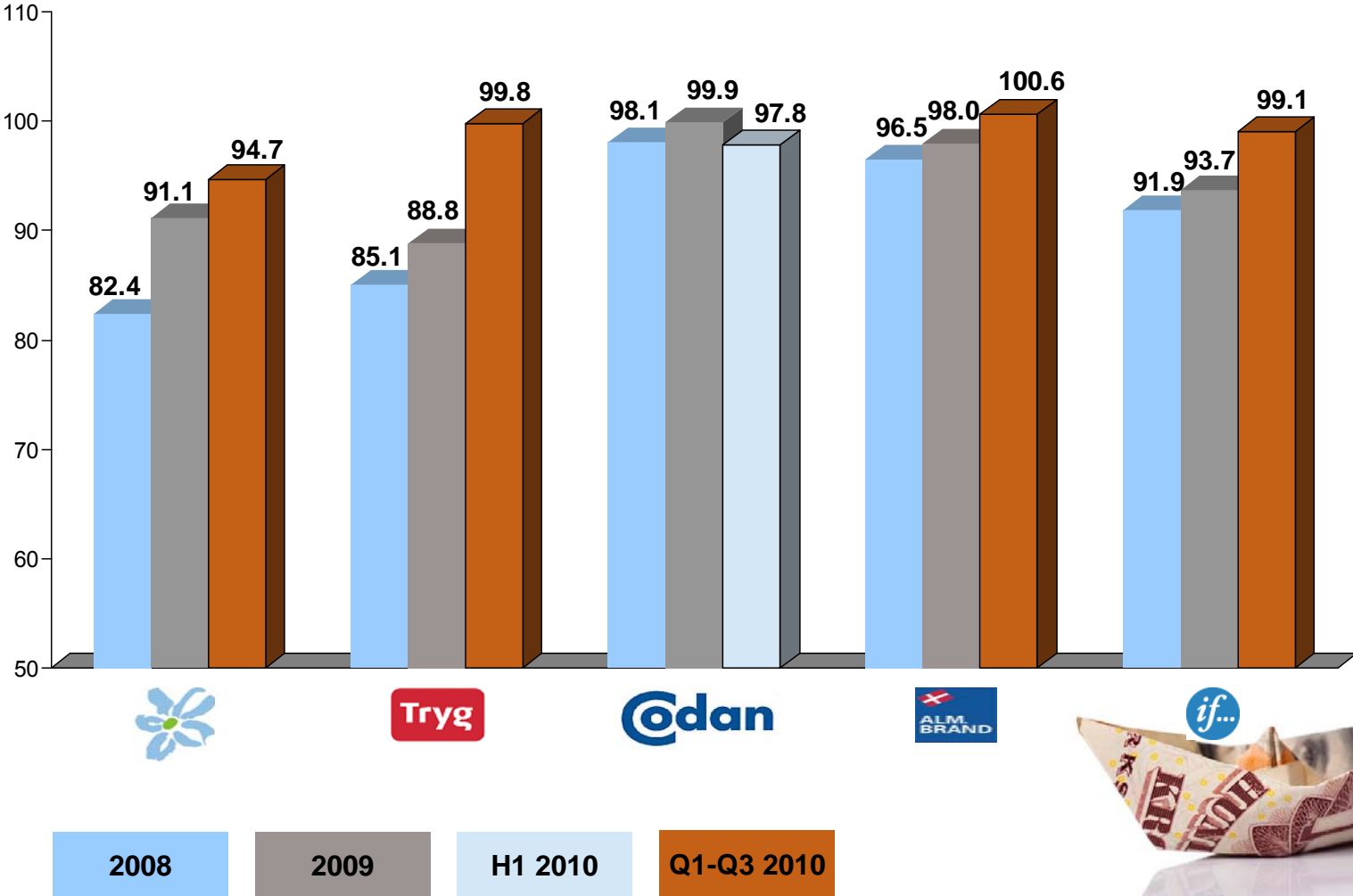
- Basically, goal of 10% profit margin corresponding to CR of 91 is close to being achieved
- Challenge now to achieve the goal of premium growth in non-life of 1pp above the index



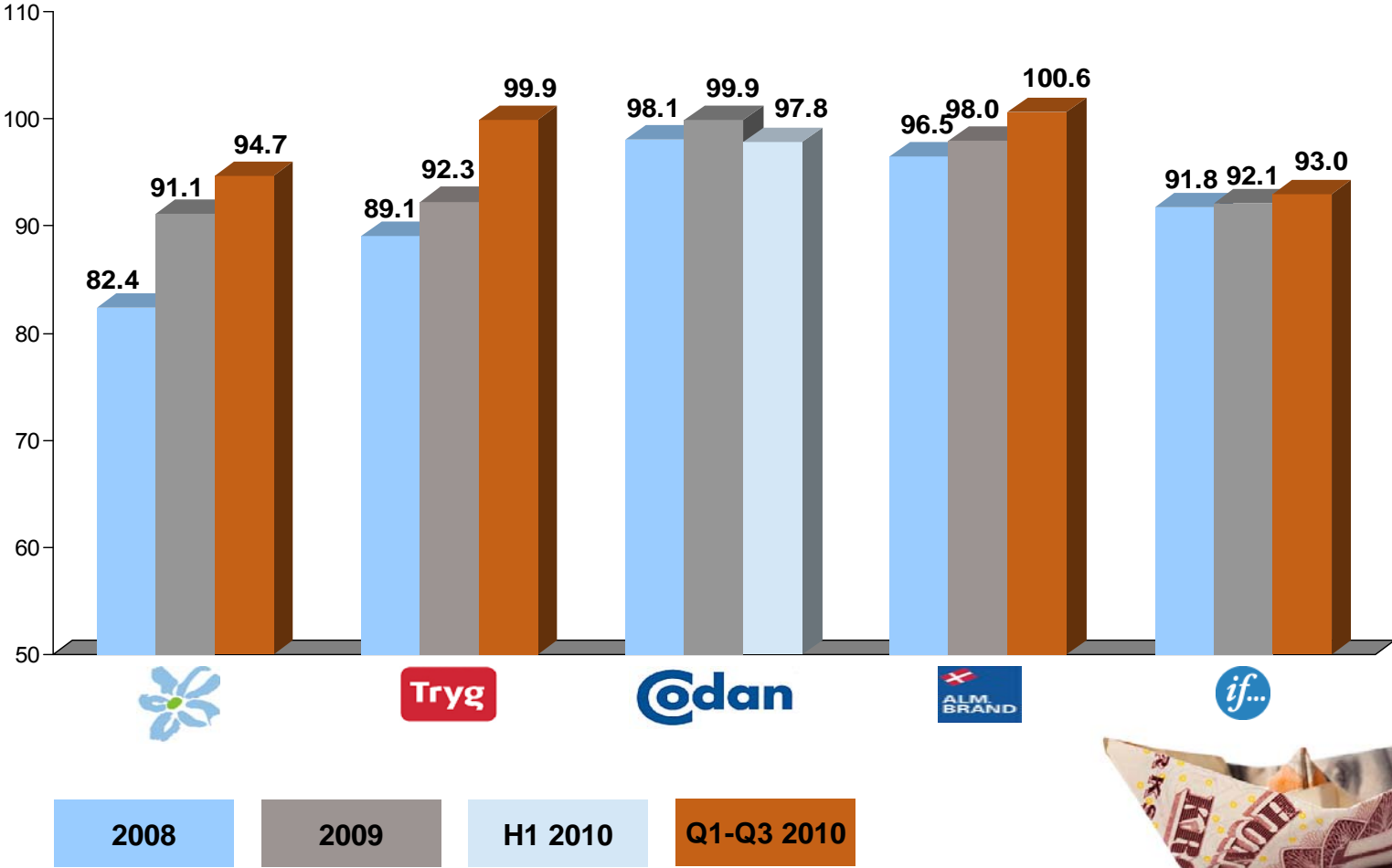
# Nordic vs local focused strategy

- What is the best strategy for one company is not necessarily the best strategy for another
- A global IBM study showed that the most value creating insurance companies are focusing on
  - Geography – within a country / state
  - Line of business – across national borders / states
- No documentation seen for correlation between efficiency and cross-national strategy
  - On the contrary the level of CR is normally lowest in the home market
- Not sure it will be value creating for Topdanmark to expand into, for example, the Swedish market
  - The Swedish market is dominated by mutual companies
  - Will increase the risk premium on Topdanmark's shares
- Relatively limited synergies for non-life activities across borders (reinsurance, IT, pricing etc.)
  - But also: Cultural differences, longer decision process, less flexibility etc. (tax regimes, regulatory regimes, market conditions)
- For Topdanmark the synergies between life and non-life in the Danish market are greater than those of expanding within non-life insurance across national borders
- Therefore it continues to be Topdanmark's strategy to be a focused player in the Danish non-life and life insurance market

# Comparison of CR – incl. run-off (Danish insurance)



# Comparison of CR – incl. run-off at Group level



# Synergies between Life and Non-life

(DKKm)

## Return on life insurance:

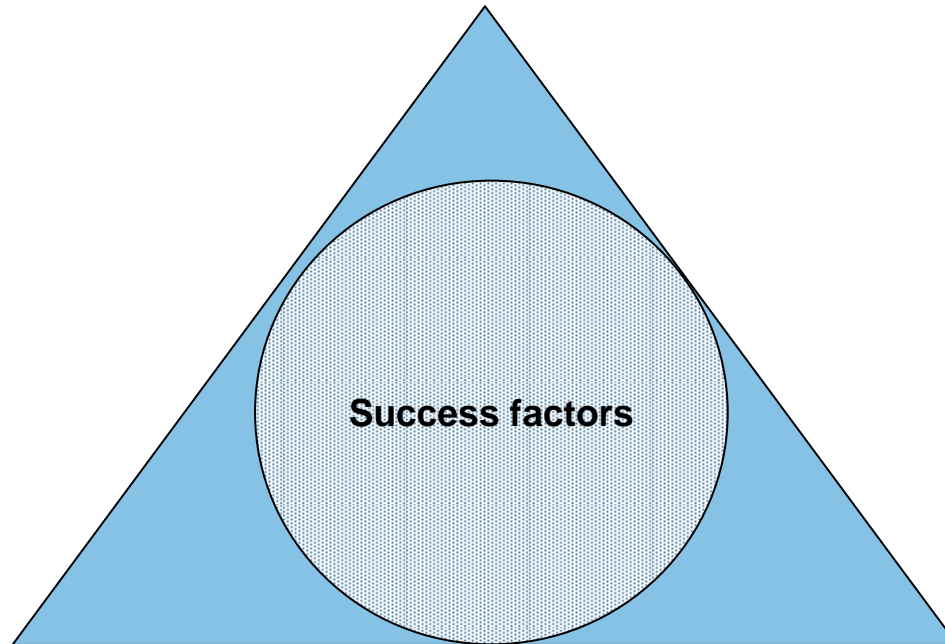
	Normalised Annual return	
Investment return on shareholders' equity, 4.5%	57	
Risk allowance: 0.50% / 0.65% of customers' savings	135	
Cost result of new business	(10)	
Result of Topdanmark Link	16	
Result of Nykredit Life	<u>2</u>	
Total	200	200 ~ ROE = 15.7%

## Other life-related result:

Life-related non-life (loss of earnings potential, health and critical illness etc.)	37	
Asset management	55	
Other synergies in e.g. distribution	<u>50</u>	
	142	<u>142</u>
		342 ~ ROE = 26.9%

# The way to success in a disciplined market

**Our distribution efficiency**



**Our pricing**

**Our efficiency**

# Distribution efficiency

## Increased focus in 2011

### **Personal**

- Re-establishment of the number of market pressuring jobs – certified insurance sales representatives, sales centre staff and customer service employees
- Transfer of Danica certified insurance sales representatives
- More resources on customer retention activities

### **SME and Industrial**

- Introduction of truck concept and aiming at broker sales channel

## Continued focus areas

### **Personal**

- Sales via Danske Bank (DB) => Dialogue with DB on future setup

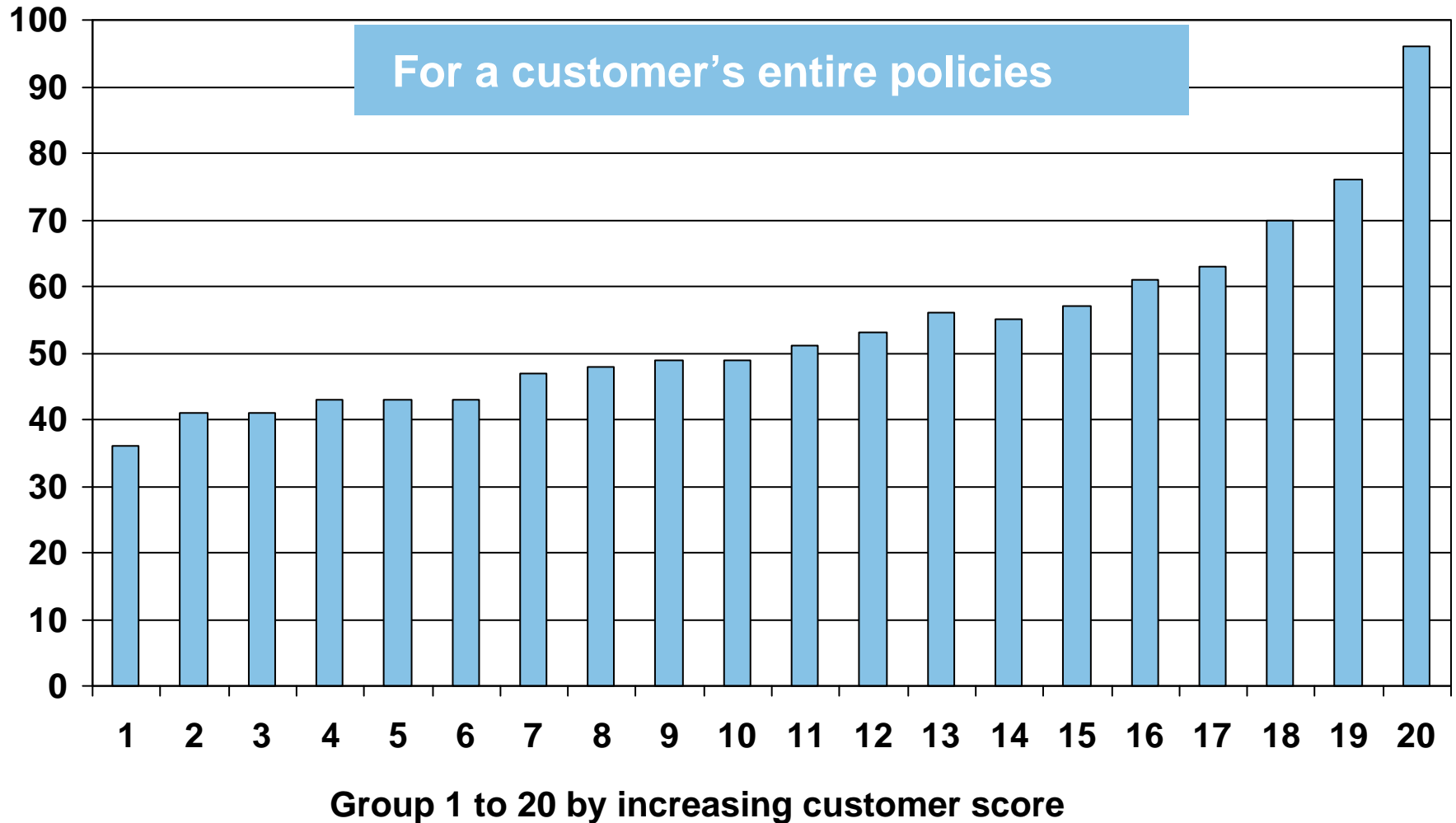
# Pricing: Significant core skills

- ✓ **Micro rating**
- ✓ **Acceptance rules**
- ✓ **Rescuing**
- ✓ **Portfolio reorganisation**
- ✓ **Price sensitiveness**

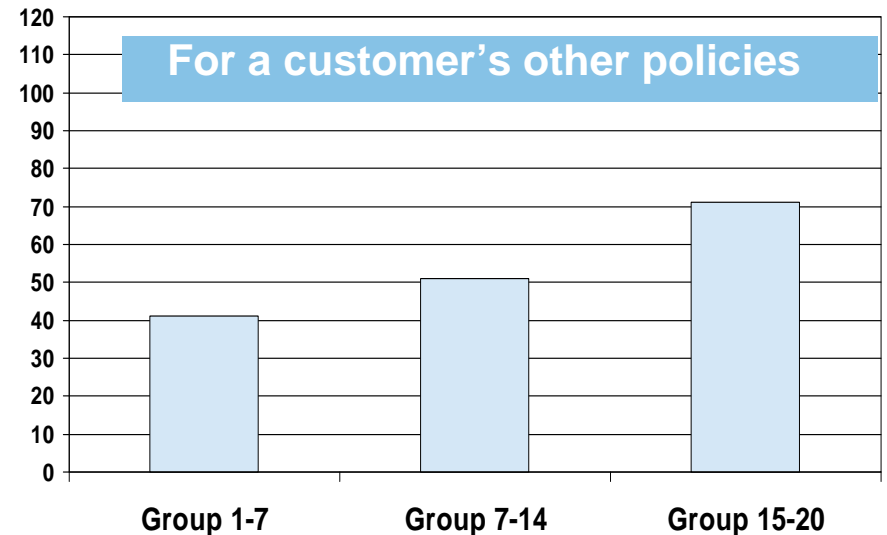
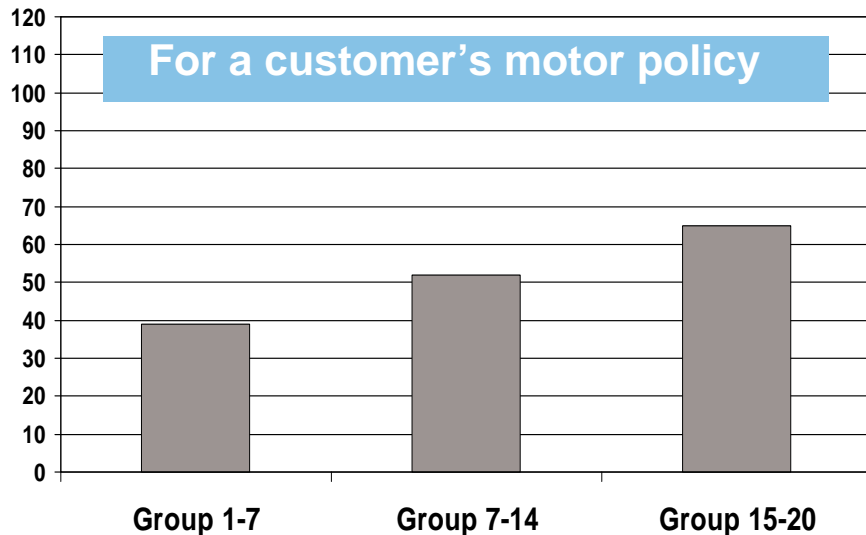
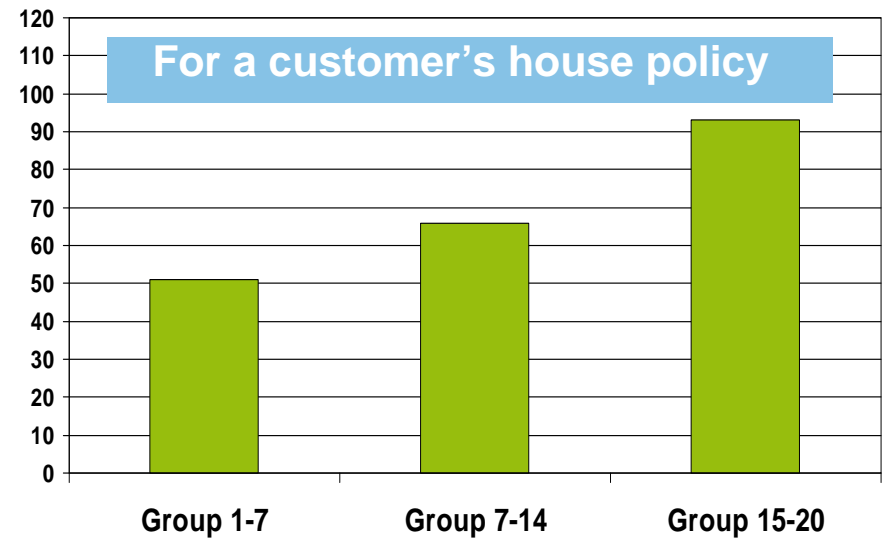
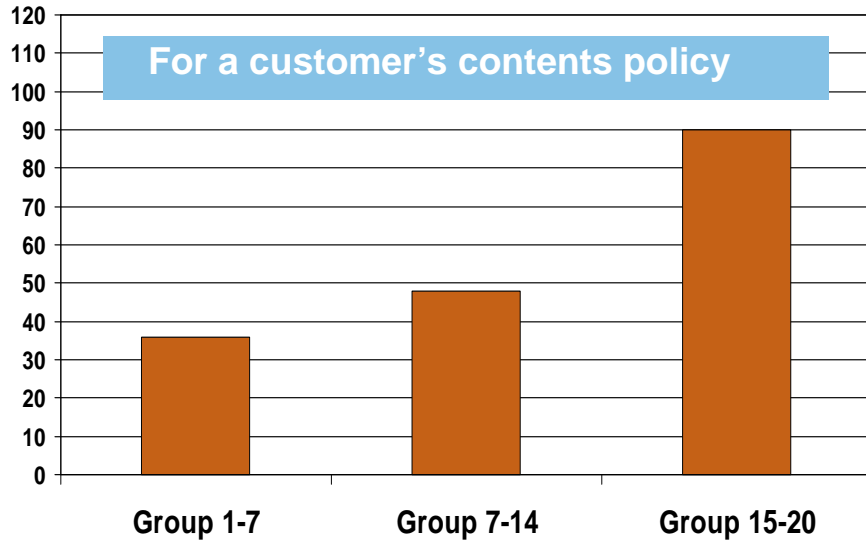


# Breakdown of existing customers by profitability

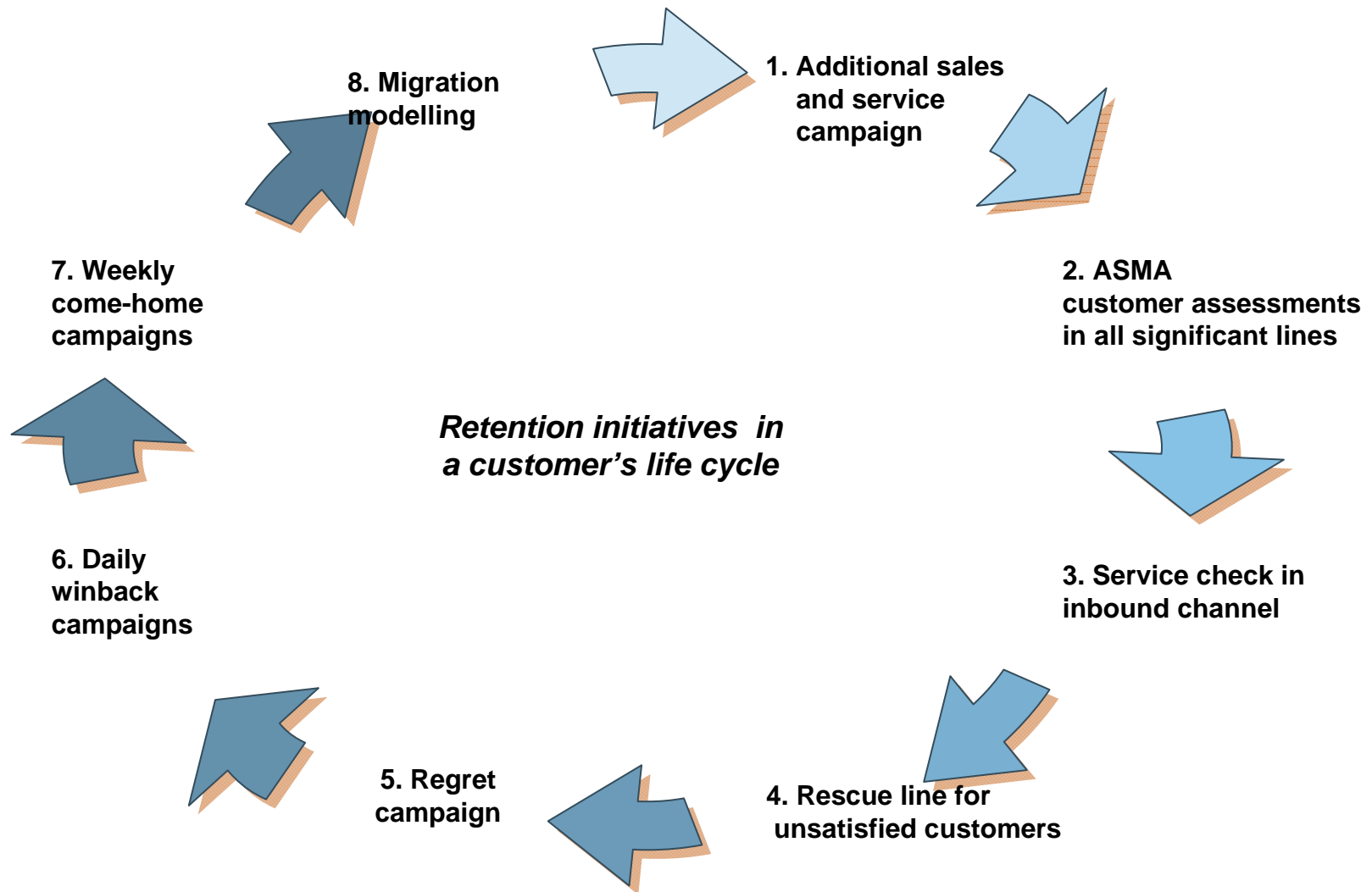
## Expected loss ratio



# Breakdown of existing customers by profitability



# Customer retention initiatives – Mass market



# Price increases

(DKK m)	2010	2011	2012	Total
Personal	69	76	17	162
SME/Industrial	52	13	0	65
I/A	30	0	0	30
Unemployment	10	10	0	20
<b>Total</b>	<b>161</b>	<b>99</b>	<b>17</b>	<b>277</b>



# Summary of price measures

Topdanmark believes that the price measures mentioned come close to ensuring the desired combined ratio in 2011  
- assuming, of course, a normal year

# Efficiency – Examples

## Intelligent employment freeze

- Fewer employees
- Cut down on overtime

Continued focus on  
non-performers

IT-solutions

## TRIM

- Life, non-life, agricultural and SME

More joint functions between  
Personal and Partners

Merger of sales centres

Merger of  
SME and Industrial

# Agenda

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- Overall strategy

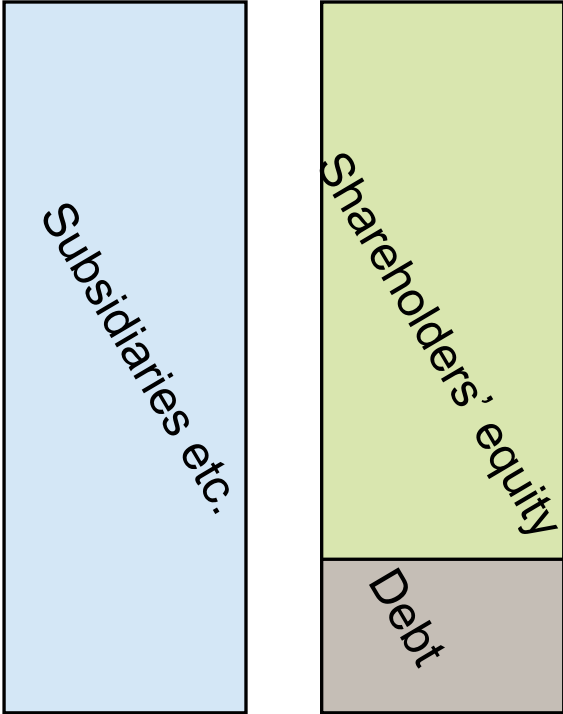


- **Capital strategy**

- Key performance indicators

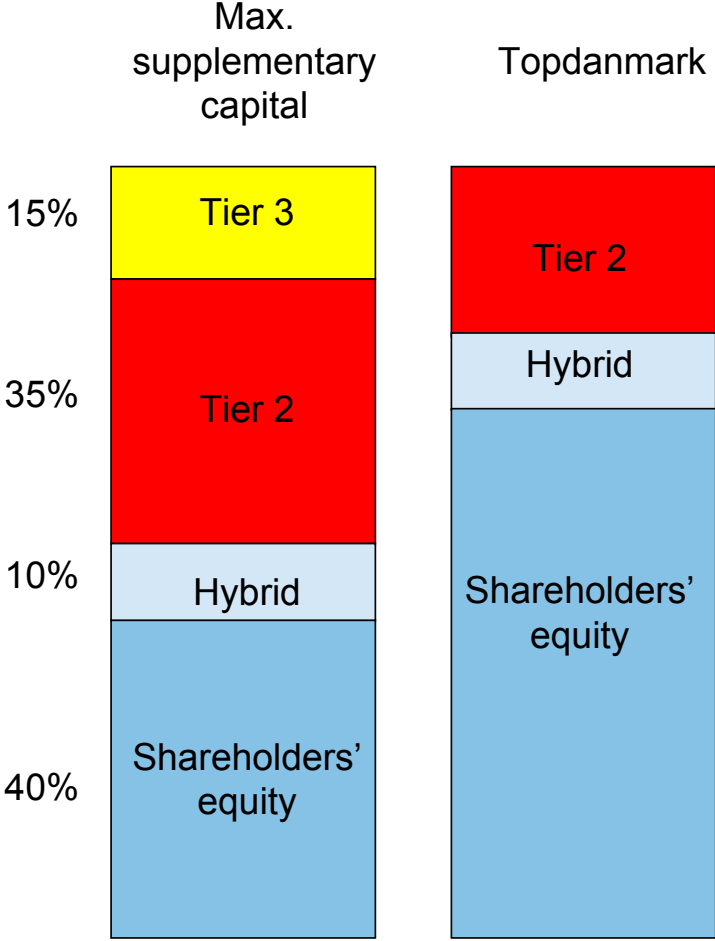
# Capital structure

Topdanmark previously:



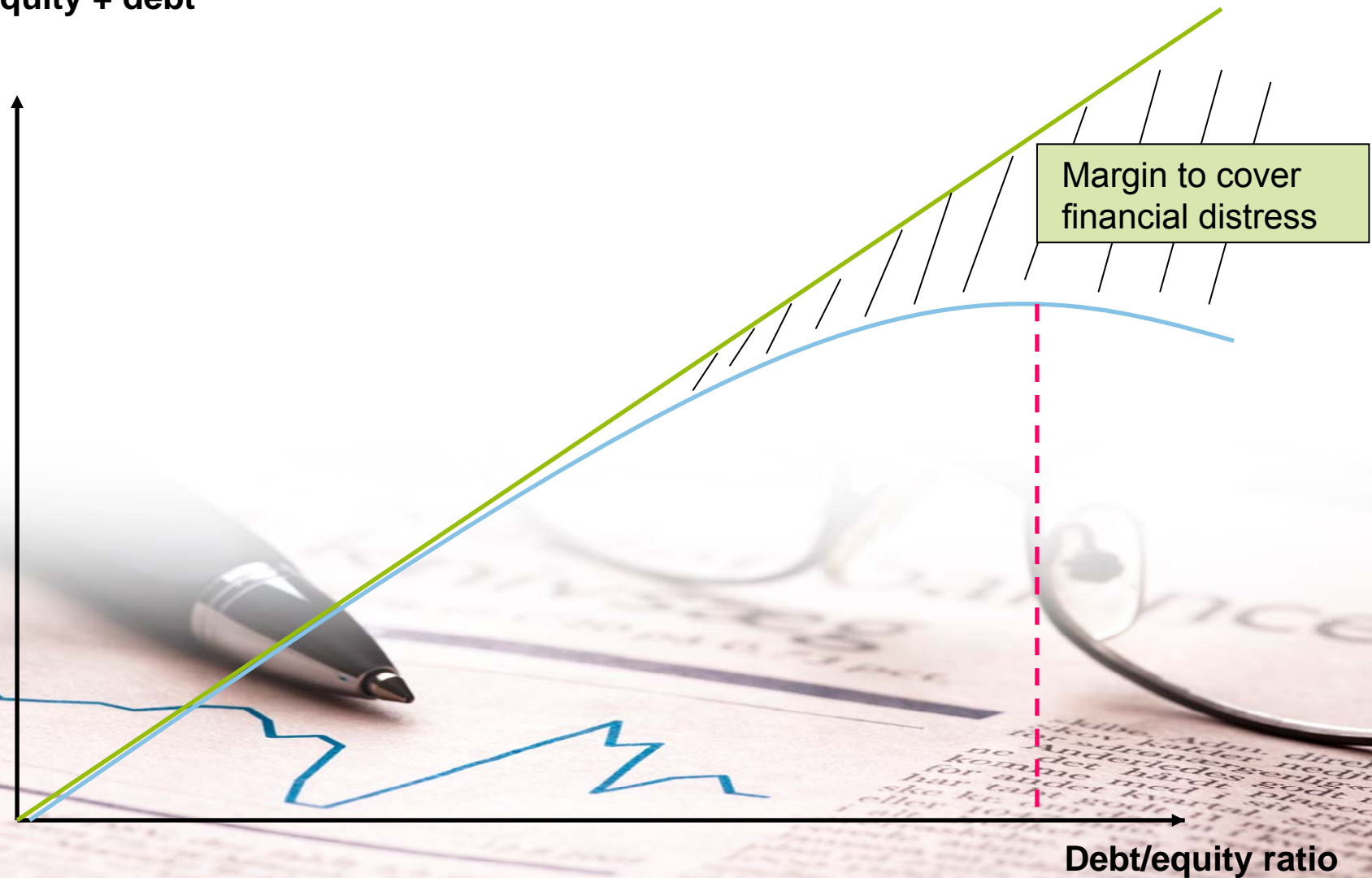


# Capital structure



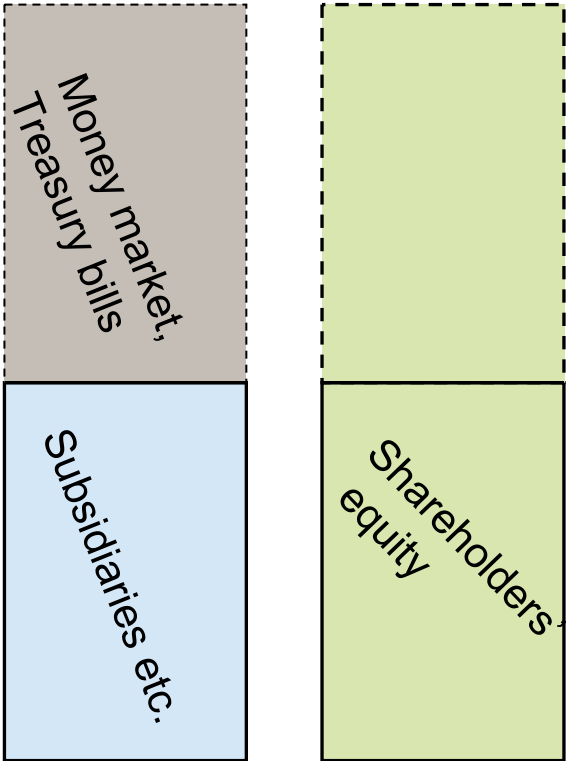
# Capital structure

Value equity + debt



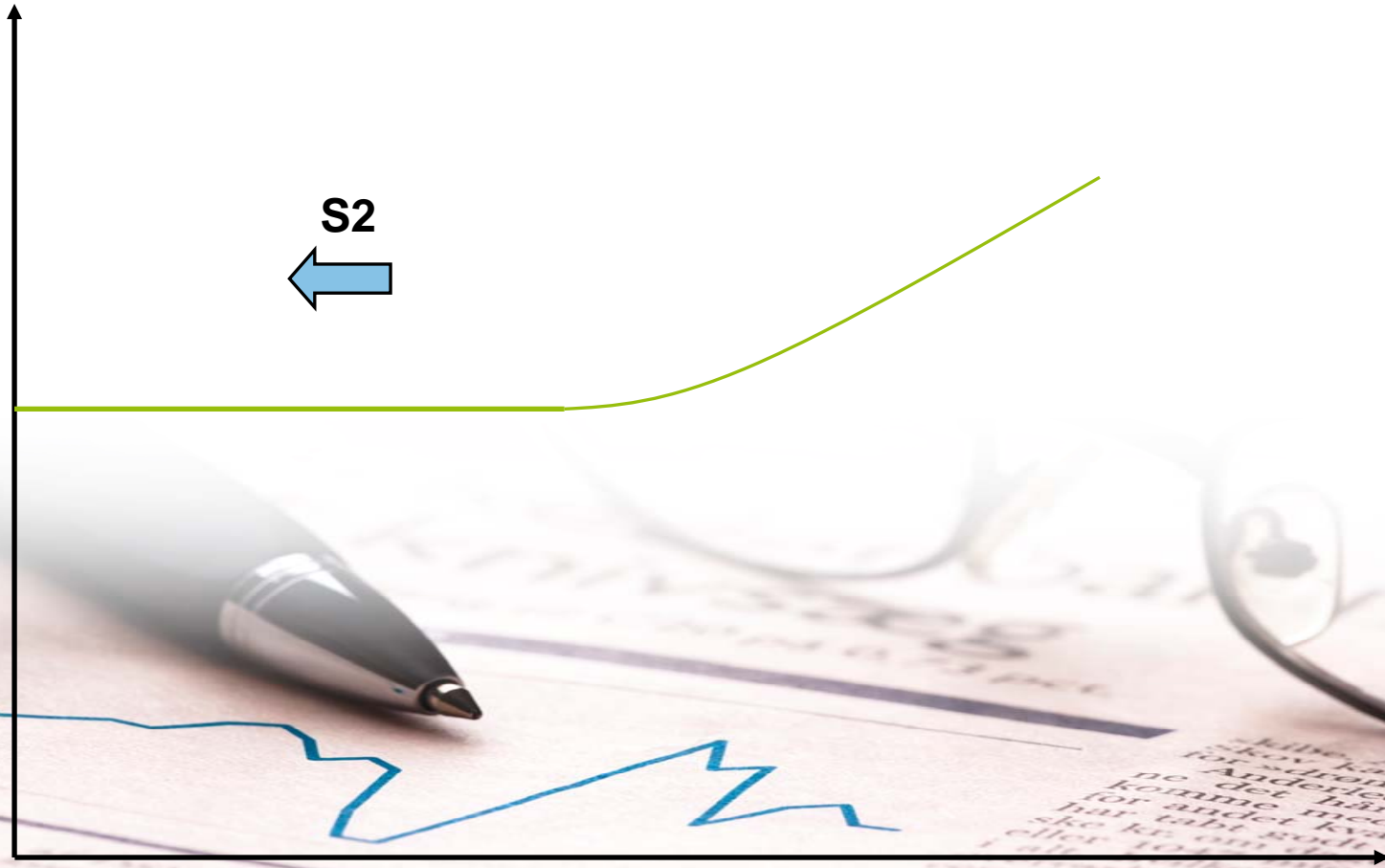
# Capital structure

## Topdanmark after Solvency II

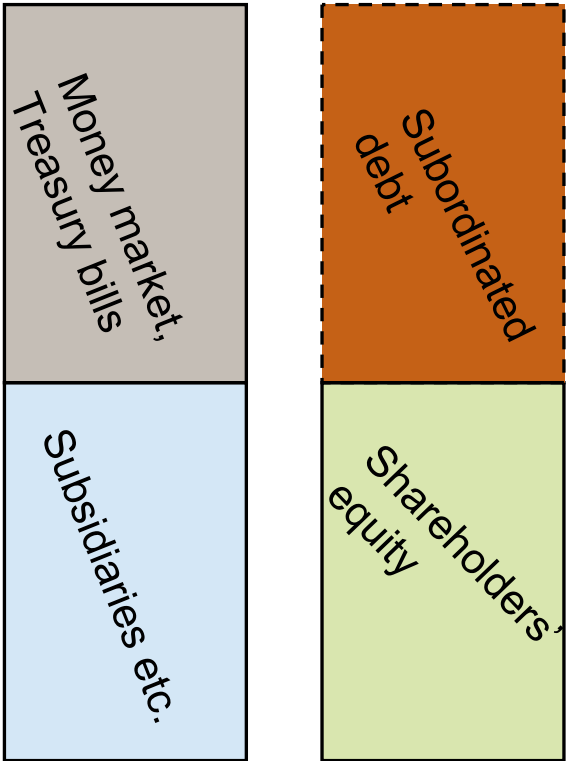


# Capital structure

Required return



# Capital structure



# Looking back - Buy-back potential 2010

(DKKm)	31 Dec 2009
Estimated necessary solvency capital 2012 - Before growth	4,500
Solvency accumulation 2010 and 2011 (shareholders' equity)	(500)
Subordinated loan capital - Insurance	(250)
<u>Necessary solvency capital - Holding 31 Dec 2009</u>	<u>3,750</u>
Shareholders' equity 31 Dec 2009	4,465
Hybrid capital	403
Goodwill	(441)
Other intangible assets	(288)
Tax asset	(40)
	<u>4,099</u>
Surplus capital 31 Dec 2009: DKK 349m	
Expected profit after the cash flow effect of tax (average value)	950
<u>Movements in shareholders' equity</u>	<u>150</u>
Expected capital cover 31 Dec 2010	5,199
Necessary solvency capital before growth and providing for Solvency II	3,750
Accumulation of shareholders' equity for Solvency II	250
3% growth in solvency requirements	135
<u>Necessary solvency capital 31 Dec 2010</u>	<u>4,135</u>
Surplus capital / buy-back potential in 2010	1,064

Any solvency capital requirement exceeding DKK 4,500m in 2012 will be covered by issuing further supplementary capital. In June 2010 Topdanmark Forsikring issued subordinated loan capital of DKK 100m with step-up in 2015 and expiry in 2018. This issue is intended as resources for the change to Solvency II and therefore it will not be included in the share buy-back potential until the actual Solvency II requirement is known.



# Significant changes in QIS5

- Risk on subsidiaries
  - Recognised as an equity risk corresponding to 22% of the shareholders' equity of the subsidiaries. This makes the group calculation – with diversification – the most burdensome requirement
- Life underwriting risk
  - calculated on the basis of a change in guarantees, where in QIS3 it was calculated on the basis of a change in overall life provisions. This causes a higher Life UW risk but also higher bonus potential to cover customers' risk
- Possible to count in some of next year's income
- Decline in illness / accident risk
- Increase in operational risk
- Increase in some stresses on assets

# Unchanged goal of Solvency II capital of DKK 4.5bn

- Topdanmark has participated in QIS5
- Unchanged expectation of solvency capital of DKK 4.5bn being sufficient by the end of 2012
  - Based on approval of internal model
  - Before allocation of solvency capital to growth
- Previously reported that if, contrary to expectations, Topdanmark cannot use an internal model on non-life insurance risks, the solvency requirement would be around DKK 1bn higher
- On the basis of the QIS5 calculations, Topdanmark now believes that the capital requirement will only increase DKK 600-800m if it is calculated using the standard model
- If so, it could be financed by issuing tier 2 capital
- Capital reserve of DKK 100m already accumulated as subordinated loan capital
- Issue of further supplementary loan capital intended by 2013



# Capital model Topdanmark Holding (1/4)

– Not guidance!

(DKKm)	2010	2011	2012	2013.a	2013.b
Estimated necessary S-II solvency capital 1 Jan	4,500	4,500	4,500	4,500	5,200
Shareholders' equity 1 Jan	4,465	4,616	4,616	4,616	4,616
Hybrid capital	403	403	403	403	403
Intangible assets	<u>(769)</u>	<u>(769)</u>	<u>(769)</u>	<u>(769)</u>	<u>(769)</u>
	4,099	4,250	4,250	4,250	4,250
Subordinated loan capital - insurance	<u>350</u>	<u>700</u>	<u>1,050</u>	<u>1,050</u>	<u>1,400</u>
Solvency capital	4,449	4,950	5,300	5,300	5,650
Expected profit after the cash flow effect of tax	950	950	950	950	950
Movements in shareholders' equity	<u>150</u>	<u>100</u>	<u>100</u>	<u>100</u>	<u>100</u>
Expected capital cover 31 Dec	5,549	6,000	6,350	6,350	6,700
No growth in solvency requirement from 2010	<u>0</u>	<u>0</u>	<u>0</u>	<u>0</u>	<u>0</u>
Estimated necessary solvency capital	4,500	4,500	4,500	4,500	5,200
Buffer	100	450	800	500	500
Surplus capital /buy-back potential	949	1,050	1,050	1,350	1,000
Tier 2's share of solvency capital	8%	14%	20%	21%	25%

# Capital model Topdanmark Holding (2/4)

– Not guidance!

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# Estimated cost of tier 2 capital

- Topdanmark issued subordinated loan capital of DKK 350m in June 2010 at 4.75% above the five-year mid swap rate
  - Now the subordinated debt is being traded at approx. 300bp above the mid swap rate
- If tier 2 capital of, for example, DKK 700m is issued with a 4pp margin to the reinvestment rate, the extra post-tax cost will be DKK 21m
- By way of comparison the post-tax profit for a normal year is around DKK 1bn

# Why share buy-back?

- Share buy-back initiated in 1998 in Topdanmark due to tax-free capital gains on equities held for more than three years by Danish institutional investors
  - Since then, 62% of share capital bought back (average price DKK 345 per share)
  - Has given the share a clear profile
  - Tax exemption removed in 2010
- Survey on earnings distribution prepared in 2009
    - Most of Topdanmark's shareholders prefer share buy-back
      - Tax payment deferred until realisation of capital gains
      - Withholding tax difficult for foreign investors
- Several shareholders have chosen Topdanmark's shares due to its way of earnings distribution
  - Change in way of earnings distribution => Change in shareholder structure
  - Disadvantage of share buy-back: In principle preventing income funds from buying Topdanmark shares
- Is dividend more committing for management than buy-back?

# Share buy-back since 2000

Year	Announced (DKKkM)	Buy-back (DKKkM)	Buy-back yield (%)
2000	200-350	350	7
2001	800-1.000	1,025	19
2002	400-500	682	13
2003	350-450	601	9
2004	800	803	10
2005	600-700	676	7
2006	1,200	1,396	10
2007	1,700	2,000	14
2008	1,050	366	3
2009	500	220	2
2010	900	732*	7*
2010E	1,000		9

\*(30 November)

# Agenda

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- Overall strategy

- Capital strategy

-  • **Key performance indicators**



# Key Performance indicators

- The best KPI is not one to be communicated: The company's own opinion of necessary capital requirements
- The more unnecessary capital due to regulation, the higher loan financing
- The cheaper alternative financing, the higher loan financing

**Thank you for your attention  
- questions?**

# Disclaimer

This presentation includes statements relating to the future. Such statements are uncertain and involve both general and specific risks.

Many factors may cause a significant deviation from the forecasts and assumptions set out in the interim report. Such factors could be, for example, cyclical movements, changes in the financial markets, the financial effect of non-anticipated events like acts of terror or exceptional weather conditions, changes in Danish and EU rules, competitive factors in the insurance industry and the trend in reinsurance market. Also see [www.topdanmark.com](http://www.topdanmark.com) → [Risk management](#).

The above description of risk factors is not exhaustive. Investors and others, who may base decisions relating to Topdanmark on statements relating to the future, should make their own careful considerations on these and other factors of uncertainty.

Topdanmark's statements relating to the future are solely based on information known at the time of the preparation of this presentation.

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