Profitability initatives in Corporate

Newsletter August 2020

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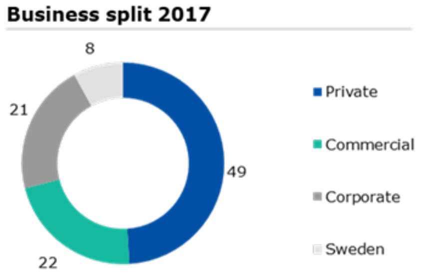
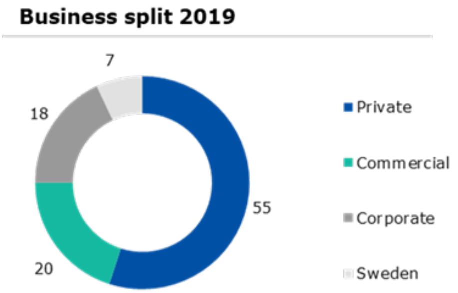
Profitability initatives in Corporate

Tryg's organization reflects the type of customers served, Private, Commercial or Corporate customers. A good organic growth and some acquisitions (notably Alka) have meant that Private segment has grown in importance in the last few years, while the Corporate segment has become smaller.





The Corporate segment has always displayed a lower level of profitability relative to the Private and Commercial segments (measured by the combined ratio) and also a lower level of return on capital employed. This is a structural issue as the Corporate business is more international and with professional buyers, which are skilled negotiators and put pressure on prices. The higher level of capital requirement is driven by the long-tail businesses such as Workers' Compensation and Liability (which carry higher reserves risk), and also by a higher level of volatility related to large claims exposure. Tryg believes that the Corporate business can create value for shareholders even if the overall profitability is unlikely to be similar to the one of the Private & Commercial segments.

It is important to remember that the Corporate business carries shared costs for the group. These costs are related to shared service units such as Claims, IT, Finance, Marketing and HR.

Profitability initiatives in the Corporate business
The Corporate segment differs in many ways from the Private and Commercial segments, we highlight below some of the key differences:

- January 1 is a big renewal date where approx. 50-60% of Corporate business is renewed
- Corporate customers are not very homogeneous
- Large claims (claims larger than DKK 10m) also have an important impact on profitability in the Corporate segment
- Medium sized claims (claims between DKK 1m and DKK 10m) also have an important impact on profitability in the Corporate segment
- Reinsurance is very important for the Corporate segment and is primarily related to large claims exposure. In the Private and Commercial segment reinsurance is bought primarily to protect from weather events
- Expense ratios are in general lower for the Corporate business compared to Private and Commercial. This is primarily a function of much higher average premiums in the Corporate segment while administrative costs are lower (in percentage of premiums)
- In Tryg's profit and loss, distribution costs are very low when the product is sold through brokers (approx. 50% of total Corporate premiums are sold via brokers) as customers are paying directly the brokers. The more brokered business, the lower expense ratio while the claims ratio would be higher as premiums are lower on brokered business

Profitability initiatives will start by determining a claims ratio target for each line of business based on overall return on equity target. The claims ratio targets for specific products in specific segments/distribution channel will be different primarily because of different capital requirements for each line of business, and different expense levels (e.g. broker versus direct distribution). The following calculation will be done:

Claims ratio target

÷ Normalised large claims
÷ Normalised medium sized claims
÷ Weather claims (storm and cloudburst)
÷ Reinsurance costs
÷ Claims handling costs

Frequency claims ratio target

In the above calculation many forward looking assumptions are included. A good example is the large claims level, where recent trends may be indicating that the large claims level should be higher or lower than the historical level. Additionally, if reinsurance prices are expected to increase, the higher level will be built in. The objective is to calculate the correct technical price.

The **frequency claims ratio target** will be compared to the actual level and the potential difference will be thoroughly analysed. In general, the frequency claims ratio is likely to vary between different products and segments. The frequency claims ratio is likely to be higher for motor insurance and lower for property for large Corporate accounts. Price initiatives will be implemented according to the calculated difference. If the difference between the frequency claims ratio target and the actual frequency claims ratio is not too large, initiatives will be fully implemented the following year while if the difference is large initiatives will be implemented on a multi-years horizon.

It is worthwhile to mention that price hikes are not the only way to improve profitability. Other measures include increased deductibles, changes in insurance cover, improved risk management etc. In general, price increases remain the most important profitability driver.

A simple example

Tryg communicated that average price increases of 10% in the Corporate segment were implemented on January 1 2020. In the table shown here, the planned initiatives for the entire portfolio can be found in the column to the left, while initiatives specifically addressing the January 1 renewal can be seen to the right in the table.

When looking at a FY impact, this means that an increase on the entire portfolio for a full year will have the impact as shown to the left, whereas the column with the January renewels demonstrates the consequence of the initiatives related specifically to these renewals. Hence, in the FY example, price increases of 10% (DKK 100m) would reduce the claims ratio from 80% to 73% (assuming no churn). However, it is highly unlikely that the churn would be zero. In the example, it is therefore made an additional assumption that 64% of customers (of the circa 45% in this example that are notified a price hike) will accept price hikes, which would result in a claims ratio of 75%, all else being equal. Typically, the most unprofitable customers (in this example with claims ratio on average at 90%) will receive the largest price increases and therefore leave. This will actually impact positively the claims ratio which would land at 73% after unprofitable customers leaving. It is important to note that in both cases (no churn and 16% churn) the result of the example is a claims ratio of 73% but this is just a coincidence, reality may well be somewhat different. The important point is that even in a case where some customers will be lost, profitability would still improve sharply.

As it can be seen, the portfolio is expected to be reduced from DKK 1,000m to DKK 958m, of which DKK 56m is new sales, following the price increases. Most importantly, the claims ratio improves from 80% to 73%.

In the example to the right of the table, the price increase are related “only” to the January 1 renewal, which results in a smaller overall impact compared to the example for the full year. It should be noted that when working with profitability initiatives, other pockets of claims inflation are likely to be identified which will partly offset the impact of the profitability initiatives. This is the key reason why Tryg will continue to work with profitability initiatives in all Corporate segments in the coming years.

Model portfolio initiatives	Full year DKK m / %	Premiums	Claims	January renewal	Premiums	Claims
Portfolio	1000	1000		1000	1000	
Claims ratio	80%		800	80%		800
Price increase	10%	100		10%	50	
Claims ratio if all customers accept	73%	1100	800	76%	1050	800
Proportion accepting price increase	64%	1064	800	64%	1032	800
Claims ratio with 64% acceptance	75%	1064	800	78%	1032	800
Cancellations due to price hikes	16%	-162		16%	-81	
Claims ratio cancelled customers	90%		-146	90%		-73
Claims ratio after initatives	73%	902	654	76%	951	727
New sales	5,6%	56		5,6%	28	
Portfolio Year and Expected		958			979	