Dividend and capital management
30 September 2014

Dividend and capital management in Tryg

In December 2012, Tryg adopted a new dividend policy which aims to achieve a higher degree of stability in the annual distribution. The dividend policy reflects expectations of high earnings from the insurance business and a low risk profile within the investment activities while maintaining a solid capital position based on Tryg's internal capital model (Individual Solvency).

Tryg's dividend policy is based on the following assumptions:

- A general objective of creating long-term value for the company's shareholders.
- A competitive dividend policy in comparison with those of our Nordic competitors.
- Distribution of 60-90% of the profit after tax.
- Aspiration to distribute a dividend which is steadily increasing in nominal terms.
- Objective of a return on equity of 20% after tax.
- The capital level must at all times reflect this objective as well as the Group's strategic plans.
- The capital level may be adjusted extraordinarily via share buy back.

Tryg reviews the size and set-up of the capital structure on an ongoing basis to ensure that the capital structure is optimised in line with the above-mentioned objectives. This review takes into account the present capital position, expected earnings as well as known or expected legisla- tive amendments which may particularly have an impact on the require- ments applying to the capital level.

The primary objective in connection with the different capital regimes is to ensure a solid capital position which is in line with the solvency needs. However, in addition to this, Tryg aims to maintain an 'A-' rating rated by Standard & Poor's. The above-mentioned objectives have some charac- teristics which mean that it is not possible to optimise all objectives at the same time. Consequently, Tryg prioritises between the different ob- jectives and chooses a capital level which both supports Tryg's financial objectives as well as various capital regimes.

In connection with the assessment of the capital position, the estimated level during the planning period will be exposed to a number of stress tests for the purpose of monitoring the effect on the financial objectives in various scenarios.

	- 31.12.3013	01.01.2014 - 31.12.2014	01.01.2015 - 31.12.2015	01.01.2016 -
Adequate capital	Free choise of method	Danish premimplementation of Solvency II		Solvency II
Available capital	Base capital	Adequate base capital	Expected Danish preimplementation of Solvency II	Solvency II

The timeline below shows the implementation of Solvency II in connection with Danish solvency legislation

Appendix (Capital Regimes)

Tryg currently operates with two different capital regimes in which there are significant differences as to which types of capital that may be included in the calculations of available capital. Below, there is a detailed outline of the two regimes for the purpose of making this issue more transparent to external stakeholders.

A.1. Danish solvency legislation

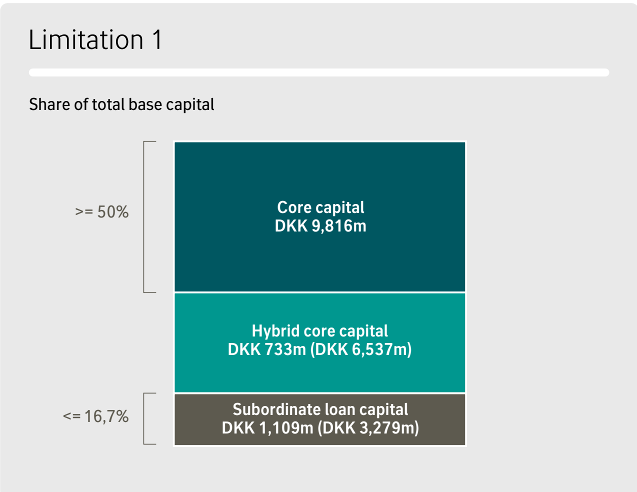
Due to the postponement of Solvency II until 1 January 2016, the Danish FSA has revised 'The Executive Order on Solvency and Op-erat- ing Plans for Insurance Companies' with effect from 1 January 2014. This has resulted in the early implementation of the future Solvency II framework in a number of areas.

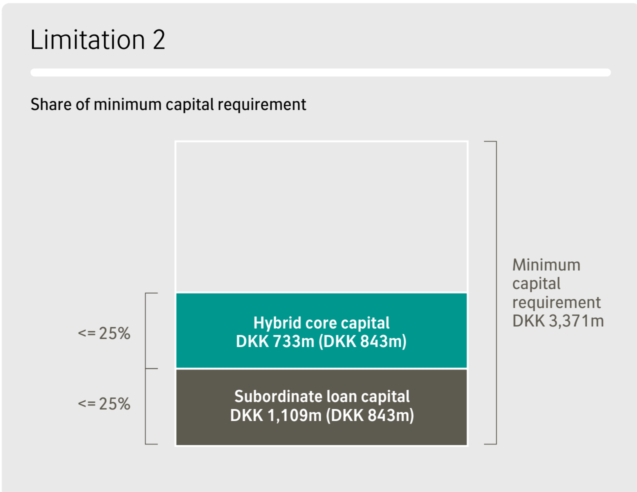
A.1.1 Base capital & adequate base capital

The base capital is divided into core capital and additional capital, respectively. The core capital consists almost exclusively of shareholders' equity with some specified deductions, whereas the additional capital consists of subordinated loan capital which is differentiated based on time to maturity (perpetual and non-perpetual terms, respectively (hybrid core capital)). There are two limitations in the current capital adequacy rules as regards the size of the subordinated loan capital that may be included in the base capital.

1. **Limitation I (Share of the total base capital)** As a rule, the base capital may consist of 50% core capital and 50% additional capital, where the additional capital with non-perpetual term may solely amount to 16.7% of the base capital. This is illustrated in the left side of the following figure.
2. **Limitation II (Share of minimum capital requirement)** Subordinated loan capital may maximum amount to 50% of the minimum capital requirement and only half of this may have non-perpetual terms. The minimum capital requirement is a formula-based requirement, which has been defined in applicable legislation, and as a main rule, the requirement amounts to the largest amount of 16% of gross premium income or 23% of net claims. This is illustrated in the right side of the following figure.

The figures illustrate Tryg's capital as of Q3 2014; where the numbers in brackets are the maximum amounts which may be included in each category. As the figure shows, the consequence of limitation II is that Tryg as of Q3 cannot include its entire subordinated loan capital.





The amended executive order which took effect on 1 January 2014 introduces the new concept 'adequate base capital' which is equivalent to the base capital with the following adjustments:

- **Risk premium** A risk premium must be deducted which corresponds to the total cost of capital a third party would be exposed to had this third party taken over these duties to insure.
- **Expetcted future profit** The possibility of including expected future profit (Tryg awaits the harmonisation of the solvency and accounting rules before utilise this option).
- **Equalisation reserve** It is no longer a requirement to deduct the equalisation reserve from the base capital.
- **Discounting effects** The discounting effect from the claims provisions should no longer be deducted from the base capital.

An amended executive order for the calculation of the base capital is expected to take effect from 1 January 2015. This will change the eligibility of subordinated loan capital which will remove the existing haircut on Tryg's subordinated capital and contribute positive to the base capital with about DKK 300m.

Solvency II is expected to be passed in Denmark as per March 2015 with commencement as per 1 January 2016.

A.1.2 Sources

- "Executive Order on Solvency and Operating Plans for Insurance Companies" retsinformation.dk
- "Financial Business Act" lovtidende.dk
- "Executive Order on Calculation of Base Capital" lovtidende.dk

A.2. Solvency II (SII)

A.2.1 Available capital (Own funds)

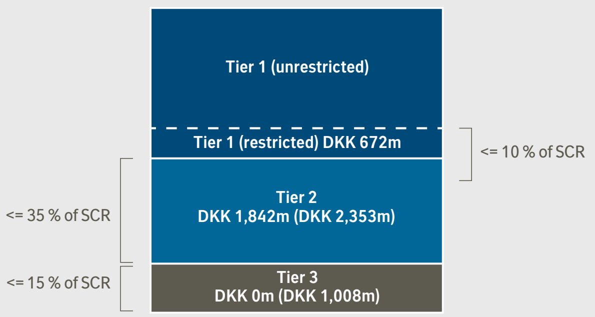
In accordance with the future capital adequacy rules in Solvency II, an insurance company must split its capital into three categories (Tier I- III), all depending on to what extent the capital contains shareholders' equity equivalent elements. These may be included with differing degrees in the calculation of the capital base of an insurance company.

The three capital categories can generally be described on the basis of the following criteria:

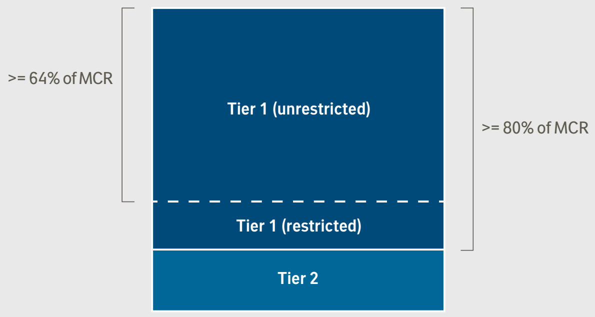
- **Tier 1** This consists mainly of shareholders' equity (unrestricted tier 1). However, there is an option to include certain types of subordinated loan capital (restricted tier 1) provided that this has both a very long maturity (minimum 30 years) and that it is loss- absorbing in a going-concern scenario. The subordinated capital may, however, maximum constitute 20% of the tier 1 capital.
- **Tier 2** This consists of other types of subordinated loan capital which do not necessarily have to be loss-absorbing in a going-concern scenario. However, the capital must as a minimum have a maturity of 10 years and it may not be possible to redeem it early until 5 years after the issue.
- **Tier 3** This category applies to the subordinated capital which does not fulfill the criteria for being part of tier 1 or tier 2.

The below figure shows the set-up in which the three different types of capital can be combined to cover the two capital requirements (SCR and MCR).

SCR (Solvency capital requirement)



MCR (Minimum capital requirement)



- **SCR (Solvency capital requirement)** is a going-concern capital requirement, in relation to which non-compliance will result in a limitation on capital distribution and measures that initiate any capital contingency plans.
- **MCR (Minimum capital requirement)** is a minimum requirement for the capital and non-compliance will be defined as a bankruptcy situation.

As presented in the left hand figure the transition to Solvency II will entail a lager option to increase the proportion of subordinated loan capital in the base capital. This option will depend on the future classification of the Norwegian Natural Perils Pool and the Guarantee scheme.

The total amount of tier 2 and tier 3 capital cannot exceed 50 % of the SCR and the total amount of tier 1 cannot consist of more than 20 % of tier 1 (restricted) capital.

Since MCR can maximum constitute 45% of SCR, this will mean that MCR will not make any limitations for the set-up of the capital provided that the capital requirements, both as regards the set-up and the size in SCR, have been complied with.

A.2.2 Sources

- Quantitative impact studies 1- 5 eiopa.europa.eu
- Long-term Guarantees assessment eiopa.europa.eu
- DIRECTIVE 2009/138/EC (Solvency II) http://eur-lex.europa.eu/LexUriServ/LexUriServ.do?uri=OJ:L:2009:335:0001:0155:EN:PDF