Newsletter March 2025

Hedging inflation

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Summary

- The hedging strategy of inflation risk towards long tailed lines has been updated
- Tryg has hedged its inflation exposure towards Swedish personal accident and motor third-party liability
- The Danish workers' compensation hedging has been unwound due to the poor hedging quality
- Changes in inflation assumptions for the claims will be booked as part of the investment result together with the value change in the inflation swaps. Previously, until the end of 2024, the change in inflation assumptions for the claims was booked in the insurance service result and the value change in the swap was booked in the investment result
- In the medium term, the hedge is effective, however mismatches may occur short-term
- Restated figures for 2024 published at the end of this document showing unchanged pre-tax results

Tryg runs a stable business

Tryg operates primarily in the stable and attractive Scandinavian non-life market, with its focus being primarily on the retail segment (Private & Commercial). The company aims to report stable earnings where fluctuations, at times, may come from large and weather claims. Reinsurance is used actively to mitigate this risk.

In the last few years, Tryg has deliberately reduced exposure to the Corporate segment and also more recently de-risked the "free" investment portfolio (assets backing the "net asset value" of the company). These moves have strengthened the earnings stability of the company.

The stability and predictability of the earnings support a progressive dividend policy with a targeted pay-out ratio (based on operating earnings) between 60% and 90% but secondary to the aim of growing the annual dividend. Additionally, at times Tryg has launched share buy-backs to further adjust the capital structure.

How inflation impacts Tryg

Inflation is undoubtedly the single most challenging external event that can impact the insurance earnings and may lead to volatility. It is important to differentiate between short-term and long-term inflation as Tryg manages these two differently.

Inflation related to **short-tailed business** (motor comprehensive and property as examples) is normally driven by a mixture of general wages development (specifically for workers repairing the damages) and the cost of spare parts used, this is often referred to as 'claims inflation'. Claims inflation cannot be observed directly in an index and develops differently over time depending on macroeconomic trends and portfolio changes. Pricing remains the key single factor to offset inflation developments in the short term, but other measures such as changes in coverage, deductibles etc. can also help to mitigate inflationary developments. Additionally, during the last many years Tryg has worked to expand its procurement agreements, which help contain inflation spikes giving more time to assess inflation developments and react via changed pricing.

Inflation related to **long-tailed business** (workers' compensation, motor third-party liability and personal accident as examples) is regulated according to different kinds of inflation related indexes. Payments related to Danish workers' compensation are adjusted following an index published by the Danish Ministry of Finance. The index is based on wage development. Swedish personal accident and motor third-party liability claims are regulated following the development in CPI.

Updated hedging strategy

The acquisition of Trygg-Hansa included long-tailed personal accident and motor third-party liability businesses. Following a thorough analysis, Tryg has therefore decided to update its hedging strategy, and this will be described in the following paragraphs by line of business and geography.

Workers' compensation

For many years, Tryg has hedged its exposure against wage developments related to Danish workers' compensation by issuing Danish CPI inflation swaps. This hedge was a strategic long-term hedge without a strong short-term benefit. Before IFRS 17 was implemented in 2023 the value changes in the inflation swaps was booked as part of the insurance service result. The mismatch from the hedge between the changes in inflation assumptions (wage development) in reserves and the value adjustment to the

inflation swap was booked in the run-off result and hence not quantifiable for external readers.

Following the implementation of IFRS 17, it was not possible to continue to book the value adjustment of the inflation swap as part of the insurance result. This forced the booking of two opposite movements offsetting each other broadly in the long term, to be booked on two separate lines. All else being equal, an expected wage hike followed by higher CPI will lead to a run-off loss in the insurance service result and a gain on the inflation swap in the investment result (and vice versa). This has been the accounting policy until the end of 2024.

Tryg has decided not to hedge Danish workers' compensation going forward as the exposure to this line of business has shrunk through the years (~2% of the Group insurance revenue in 2024). Furthermore, the Danish workers' compensation hedging has been unwound due the poor hedging quality and the high financial cost.

Motor third-party liability (MTPL)

MTPL claims in Denmark and Norway are paid as lump sums with the duration being relatively short. Considering the relatively short duration and the size of the reserves, hedging is not economically meaningful. Furthermore, it is not possible to identify relevant liquid financial instruments for a potential hedge.

Tryg has decided to issue Swedish inflation swaps to hedge its inflation exposure related to Swedish motor MTPL which have reserves with longer duration. The claim payments for this line of business are directly adjusted according to the CPI development, thus making the hedge efficient in the long term. An additional benefit comes from the depth of the Swedish swap market which is tradeable.

Personal accident

Personal accident claims in Denmark and Norway are paid as lump sums with the insured amount linked to the year of the claim as opposed to year of the actual settlement. Inflation risk is therefore non-existent.

Swedish personal accident claims payments are also paid as lump sums but adjusted according to the year of settlement, thus carrying an inherent inflation risk. Tryg has therefore decided to issue Swedish inflation swaps to hedge inflation exposure related to Swedish personal accident.

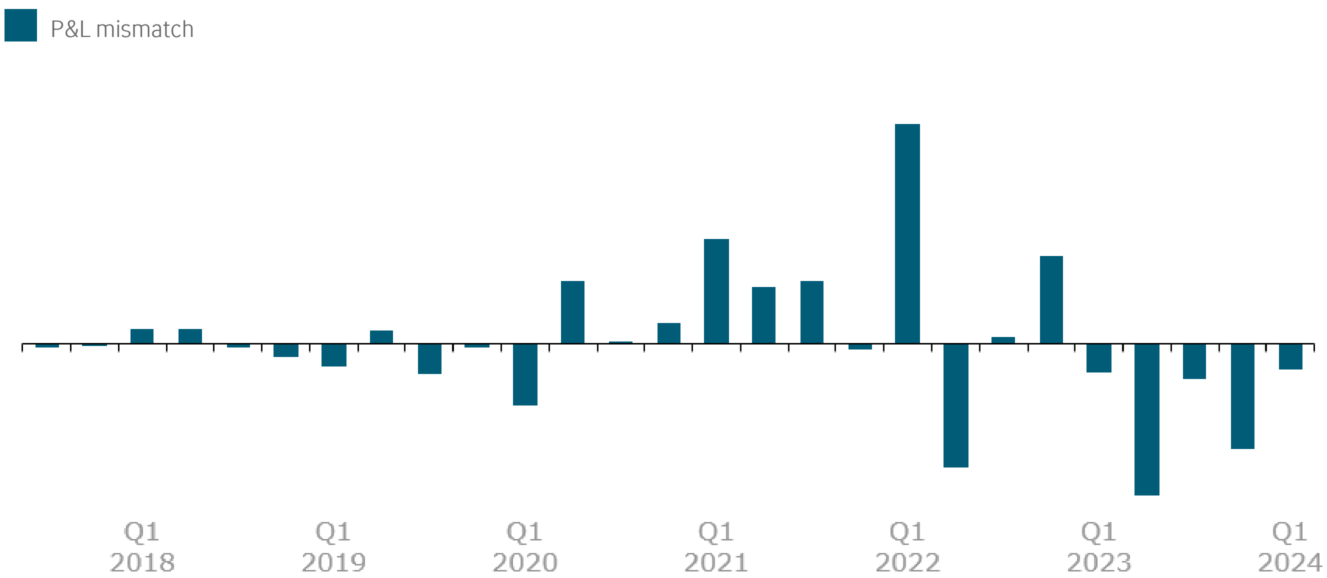
Updated reporting from the start of 2025

Until the end of 2024, changes in inflation assumptions for the aforementioned lines of businesses have been booked in the insurance service result. Starting 2025, these (including Danish workers compensation) will be booked under the investment result (specifically under “other financial income and expenses”). This means that the change in the value of the swaps for Swedish MTPL and personal accident will be booked against the same line as the change in inflation assumption.

What to expect going forward?

The hedge of Swedish MTPL and personal accident is central for Tryg in order to continue to produce stable earnings. The claims payments related to Swedish MTPL and personal accident follow the development in CPI, and the hedge is also made up by Swedish CPI swaps, still minor mismatches may occur when operationalising the hedge. Tryg has an active approach to its hedging strategy and swaps are traded on a weekly basis in order to rebalance the hedge as accurately as possible. The total hedged provisions amount to DKK 13bn, and a backtest of the hedging strategy shows that mismatches are averaging zero in the medium term while fluctuations can be observed on a quarterly basis. Periods with significant changes in inflation expectations may lead to larger mismatches in the short term as the claims are adjusted with one year lagged inflation, while the assets move with market expectations to future inflation changes. Looking at a backtest of the last seven years, mismatches of more than DKK +/- 200m have been observed three times in the more volatile quarters (in terms of changes in inflation assumptions).

Backtest of hedging approach



Mismatches are averaging ~0 in the medium term

Short term, mismatches can occur especially at times of large inflation spikes

Restated figures

Restated figures according to the new accounting practice on a quarterly basis for 2024 are presented below. As per Q3 2024 it was evident that market based inflation expectations in Sweden were higher than the central bank expectations. Therefore Tryg decided not to lower the inflation curves in Q4 2024. As a result there is no change in Q4 2024 and the restated numbers are identical to the reported.

	Q4 2024			Q3 2024			Q2 2024			Q1 2024		
	Reported	Restated	Change	Reported	Restated	Change	Reported	Restated	Change	Reported	Restated	Change
DKKm												
Insurance revenue	**9,734**	**9,734**		**9,786**	**9,786**		**9,545**	**9,545**		**9,531**	**9,531**	
Gross claims	-6,466	-6,466		-6,000	-6,082	-82	-5,759	-5,951	-191	-7,102	-7,097	5
Insurance operating costs	-1,299	-1,299		-1,304	-1,304		-1,303	-1,303		-1,290	-1,290	
Insurance service expenses	-7,765	-7,765		-7,304	-7,387	-82	-7,062	-7,254	-191	-8,392	-8,387	5
Profit/loss on gross business	1,969	1,969		2,481	2,399	-82	2,483	2,291	-191	1,140	1,145	5
Net expense from reinsurance contracts	-261	-261		-351	-351	0	-271	-271	0	135	135	0
Insurance service result	**1,708**	**1,708**		**2,130**	**2,048**	**-82**	**2,212**	**2,020**	**-191**	**1,275**	**1,280**	**5**
Net investment result	-265	-265		444	526	82	347	538	191	117	112	-5
Other income and costs	-409	-409		-441	-441		-430	-430		-384	-384	
Profit/loss before tax	1,033	1,033		2,134	2,134		2,129	2,129		1,007	1,007	
Combined ratio	**82.5**	**82.5**		**78.2**	**79.1**		**76.8**	**78.8**		**86.6**	**86.6**	
Run-off, net of reinsurance (%)	-2.4	-2.4		-2.4	-1.7		-2.5	-0.6		-3.9	-4.0	
Underlying claims ratio	69.3	69.3		67.2	67.3		66.7	66.8		72.3	72.3