DEN NORSKE KRIGSFORSIKRING FOR SKIB
GJENSIDIG FORENING
The Norwegian Shipowners' Mutual
War Risks Insurance Association

PROPOSED DISTRIBUTION OF EQUITY

The Board has, over time, addressed DNK's solvency capital position. The substantially altered requirements under Solvency II has made it difficult to maintain key components of DNK's cover in place without initiating risk mitigation measures. The main objective has been to mitigate insurance risks by increasing reinsurance protection, without effecting the overall insurance coverage for its members. Since 2018 DNK has transferred insurance risk corresponding to USD 325 million to the reinsurance market. As a result, DNK's risk retention for the major powers' war cover has been reduced from USD 700 million to USD 400 million. A further reduction in risk retention of USD 100 million is planned for the 2021-renewal program. While the aggregate cover for major powers' war is maintained at USD 1,0 billion, its duration was doubled in 2020 from 30 to 60 days. A second layer, or reinstatement, of USD 300 million protecting the major powers' war cover was added in 2018 to strengthen DNK's overall insurance capacity.

The implemented risk mitigation measures have strengthened DNK's solvency margin considerably. Existing insurance coverage has been retained, and new products have been added, while also adding services and strengthening the Association's loss prevention capacity. Because of the improved capital position, the Board of Directors proposes a USD 300 million distribution of equity and calls for an extraordinary general meeting on October 30, 2020. The proposed distribution of equity will be made in accordance with DNK's Articles of Association section 3-5.

Distribution of equity and impact on solvency position

DNK is subject to supervision by the Financial Supervisory Authority of Norway (FSAN – or Finanstilsynet) and the regulatory requirements under the Solvency II regime, which was introduced in 2016. DNK's solvency capital and its solvency capital requirement (SCR) for the period 2016 to 2019 is presented in a table below. Similar data is presented at the end of June 2020. The effect of an equity distribution and planned risk mitigation for the 2021-renewal is modelled pro-forma as per January 1, 2021. Further explanations to the data presented follows below.

Amounts in USD million

					Change versus previous period	
Line number	Period ending	Solvency capital	SCR	Solvency margin	Solvency capital	SCR
1	2016	918	824	111 %	--	--
2	2017	952	830	115 %	34	6
3	2018	947	600	158 %	-5	-230
4	2019	832	412	202 %	-115	-187
5	30.06.2020	881	378	233 %	49	-34
6	01.01.2021	570	299	191 %	-311	-79

Definition of common terms:

- **Solvency capital** is the capital available to meet DNK's obligations and possible losses arising from its insurance activities. DNK's solvency capital consists of two tiers; (i) equity, and (ii) supplementary capital, where the latter consists of additional calls as regulated by section 3-4 of DNK's Article of Association. For 2020, the supplementary capital is USD 158 million.
- **Solvency capital requirement (SCR)** is the regulatory capital requirement under Solvency II. It comprises of DNK's insurance risks, market (financial) risks, counterparty (reinsurance) risks and operational risks.
- **Solvency margin** is the solvency capital divided by the SCR.

The solvency capital changes with variations in net income and the calculation of supplementary calls. Tax on technical reserves was introduced in 2019 (line 4). The *solvency capital requirement* varies with changes in insurance risks, counterparty risks, markets risks and operational risks. Since tax on technical reserves are payable over ten years according to passed legislation, there is a deduction for deferred tax in the solvency capital requirement (SCR) starting as of 2019. From year-end 2016 through 2019 (lines 1 through 4) the total reduction in SCR amounted to USD 411 million, of which USD 287 million relates to a decrease in insurance risks through offset to reinsurance. Another USD 14 million is attributed to a combined increase in other risks. The loss absorbing capacity of deferred taxes reduced SCR by USD 138 million in the same period. Consequently, the solvency margin increased from 111 % at year-end 2016 to 202 % at the end of 2019.

The increase in solvency capital in the first half of 2020 (line 5) relates primarily to an increase in supplementary capital, while the reduction in SCR was driven by a decline in market risk. The solvency margin increased to 233 %.

Line 6 incorporates a distribution of equity of USD 300 million. The corresponding change in the solvency capital is somewhat greater, due to a reduction in supplementary capital to comply with Solvency II calculation methodology. The risk transfer of USD 100 million to DNK's reinsurers reduces the SCR by USD 79 million. The lower impact on SCR is explained by several coinciding factors, which include diversification effects, deferred tax and counterparty risk. In total, the distribution of USD 300 million in equity gives a moderate decrease in DNK's solvency margin, from 233 % in June 2020 to 191 %.

The Board of Directors aims to maintain a solvency margin in the range of 120 % to 130 %, also after stress-testing for a financial crisis, insurance losses and the effects of defaults in DNK's reinsurance program. A solvency margin of 191 % absorbs the impact of these modelled risks without jeopardizing the regulatory capital requirement.

The Board of Directors is of the opinion that the risk transfer from DNK to the reinsurers offers a better balance between the insurance products offered and the capital and risks retained by DNK.

We are observing that many of our members struggle with great losses as a consequence of the Covid-19 pandemic. The capital reduction is justified for other reasons than to help the members in a difficult situation, but the planned distribution of equity in 2021 will undoubtedly represent a welcome contribution in demanding times.

Withholding tax issues

A distribution of equity from DNK to its members is subject to withholding tax. The attached memo gives a detailed description of the documentation DNK requires from each member in order to avoid excessive withholding tax. The requested withholding tax documentation must be forwarded to DNK by January 31, 2021. Please use regular mail, or the following e-mail address: dividend@warrisk.no.

Premium history

The proposed distribution of USD 300 million in equity will be allocated between existing members in proportion to premiums paid during the past ten fiscal years, 2010-2019, as regulated by the Articles of Association, section 3-5 which has been in effect since 2007. Reported gross premiums will be subject to a limited audit by DNK's auditor (PWC) for the ten years mentioned. DNK will forward a list to each existing member with a detailed premium overview for the period 2010-2019.

Payment details

Distributed equity will be payable in USD. Each member must provide DNK with bank details in accordance with attached instructions. DNK asks that payment details are provided by January 31, 2021.

Proposal by DNK's Board of Directors

1. *The Board of Directors propose an equity distribution of USD 300 million.*

2. *Distribution of equity is regulated by DNK's articles of Association section 3-5. Distribution of equity can only be made to those that are members of the Association at the time when the resolution for distribution is passed, on October 30, 2020. The equity will be distributed in proportion to premiums paid during the past 10 fiscal years; 2010-2019.*

3. *The proposal is subject to approval of Finanstilsynet based on a formal application by DNK.*

4. *As it is difficult to predict the time frame of Finanstilsynet's review of DNK's application, the proposed equity distribution is not set to a specific date or time period. This will also ensure that the members are given ample time to complete the required withholding tax documentation.*