Q3 2016 Earnings Call

Company Participants

- Alberto Minali, Group Chief Financial Officer & General Manager
- Spencer Lee Horgan, Group Head-Investor & Rating Agency Relations

Other Participants

- Farooq Hanif, Analyst
- Giuseppe Mapelli, Analyst
- James A. Shuck, Analyst
- Lance M. Burbidge, Analyst
- Michael Igor Huttner, Analyst
- Nadine van der Meulen, Analyst
- Nick Holmes, Analyst
- Peter D. Eliot, Analyst
- Ralph Hebgen, Analyst
- Thomas Seidl, Analyst

MANAGEMENT DISCUSSION SECTION

Operator

Good day, and welcome to the Generali Group Nine Months 2016 Results Q&A Session Conference Call. Today's conference is being recorded. And at this time, I would like to turn the conference over to Mr. Spencer Horgan, Head of Investor and Rating Agency Relations. Please go ahead, sir.

Spencer Lee Horgan {BIO 4241901 <GO>}

Good morning, everybody, and welcome to our nine months 2016 call. As you'll know, we've changed the format this time, and also as a response to many of you who suggested that we reduce the large volume of detailed financial information we're producing every quarter and also in line with the longer-term nature of the insurance business.

So the new reporting calendar is therefore going to look like this. We are going to continue to produce the full package of details you are used to seeing in the full year and the half year. And then in the first quarter and the nine months, we will produce a much lighter document in the format that you've seen this morning. The purpose of this lighter document is to provide you with the updates on the most important trends and business developments.

To complete the new format, we're continuing to host this Q&A call to make sure that you've the chance to ask us about any business trends, market developments, or other aspects, which are not otherwise clear. However, in order to preserve the benefits of the new lighter approach, it's not going to be our intention to give additional numbers other than the ones you've seen in the release. We'll have plenty of time to dig into the financial details with the full year results.

So with those opening remarks, I'll hand it over to Alberto. Please?

Alberto Minali {BIO 16909383 <GO>}

Thank you, Spencer. I don't want to rob a lot of time for the questions that our friends on the line might have. I want just to state that we have closed very good operating results and the quality of them is very high because of the good contribution of the technical performance and a diminishing (01:44) contribution of the financial returns. The capital position of the group is very good, and so I think after these three very short messages, I will hand it back to the audience for questions.

Spencer Lee Horgan {BIO 4241901 <GO>}

Operator, we're ready to take questions now. Thank you.

Q&A

Operator

Thank you. We will now take our first question from Peter Eliot from Kepler Cheuvreux. Please go ahead. Your line is open.

Q - Peter D. Eliot {BIO 7556214 <GO>}

Thank you very much. I think that's me. I appreciate you don't want to give any additional numbers. So, I hope this doesn't count as such, but I was wondering if you could just sort of split out and comment on the moving parts within the solvency ratio. I mean, I guess you sort of had sort of 4 percentage points from solvency capital generation in the quarter, no dividend accrual. And because you use your own - you don't use that - you've got reference portfolio, you shouldn't have had a headwind from that. So, I'm just sort of struggling to see how financial markets would have offset the full 4 percentage points of solvency capital generation. And that was the first question, please.

And then the second one, I was wondering if you could just comment on the - any sort of seasonality that we've seen in the Life business. I mean, I appreciate you've got a low level of realized gains this quarter. But if I take the numbers you've given us on the year-on-year movements, it looks like that Q3 was sort of in the 6.70s (03:37), and I was just wondering if you could sort of comment on, let's say, any sort of seasonality that might be within that.

And then perhaps finally, I know the good news on Motor premiums growing, I was just wondering if you could give us any sort of update on the view on profitability? Thanks a lot.

A - Alberto Minali {BIO 16909383 <GO>}

Yeah. Thank you very much for the question, Peter. I will suggest not to focus too much on the quarterly generation of capital. I think that the yearly generation of capital is in the ballpark of 15 percentage point, 16 percentage point, more or less 8-percentage point in the first six months. On the quarter, in this particular quarter, we didn't have a very strong contribution from the P&C business in terms of normalized earning, but the other elements of the capital generation, I would say, exactly – exactly the same.

In terms of the seasonality in the Life business, my comment about the quarterly result is still valid. I have to say that the third quarter is lower than the first one and the second one, but higher than the 2015 third quarter. It seems a bit weak, but essentially what we see in the quarter is a substitution effect that the technical performance is contributing higher to the overall performance than the financial one. And we still have this prudent stance on the realization of capital gains also in the third quarter which have impacted heavily on the performance.

Having said that, the liability in the Life business do not change dramatically from quarter-to-quarter. So I will suggest that even if I understand your need of a better understanding the third Q, I would suggest not to focus too much on quarterly – intra-quarterly movement.

The Motor premiums growth, that's an important, in my mind, point. What we have seen, it's a decrease of the profitability in the Motor business. Overall, we run this business with a slightly good margin. We do expect some price upwards movement especially in Italy and in other countries. We think that especially in Italy, the price competition is almost over and we've seen in the last two months a clear indication that also other players that were very tough in the price competition, in the price battle are now changing their stance and their vision to increase the premium.

If this is the case, even if we write this business at profitable level, we will have a slight probably good improvement in the months to come in the Motor business, especially in Italy, which represent 40% of the total Motor business in the group. So, my expectation is to see this price war finishing or already finished and to have an improvement going forward in the Motor profitability.

Q - Peter D. Eliot {BIO 7556214 <GO>}

Thank you. That's really useful. Thank you very much. Could I just follow-up on one point there on the Life solvency capital generation from P&C? I mean, the earnings seem, to be honest, sort of normal quarterly run rate. I'm just – I wouldn't have expected the reported earnings to be very different to the solvency capital generation in P&C, did I miss something?

FINAL

Bloomberg Transcript

A - Alberto Minali {BIO 16909383 <GO>}

Yeah. What happens is that, if you look at the combined ratio, there is a slight deterioration in the loss ratio of the current generation, and a slight increase in the run-off (07:18) results on the results which compensate and the better expense ratio. What I'm trying to say is that if the price war on the Motor business is over, we might also expect the current generation to further improve, and this will contribute to the generation of earnings going forward. So, the two things are not in contradiction to each other. It's a different way of looking at the same coin.

Q - Peter D. Eliot {BIO 7556214 <GO>}

Yeah. My point was more on why the solvency capital generation was light this quarter and – but if I can follow up offline.

A - Alberto Minali {BIO 16909383 <GO>}

Yeah. Okay. Thank you.

Q - Peter D. Eliot {BIO 7556214 <GO>}

Okay.

Operator

Thank you. We will now take our next question from James Shuck from UBS. Please go ahead. Your line is open.

Q - James A. Shuck {BIO 3680082 <GO>}

Hi, and good morning, everybody. I had three questions please. Firstly, on the Solvency II development in the quarter also, I understand the reference portfolio has changed around the volatility adjuster. You don't use that reference portfolio, but you use your own portfolio. Could you just outline whether you're expecting to adjust your own reference portfolio before year-end and if so what the potential impact of that would be, please?

Secondly, around the German development, obviously there is a few operating entities here and you're looking to try and restructure, take out costs, et cetera. Could you just remind me of the situation with the DVAG distribution agreement? How long that lasts for and whether there are actually structurally (08:59) things you would like to do, but are unable to do because it may trigger a change to the terms of that distribution agreement?

And then finally, a kind of more big picture step-back, lot of things happening over the last couple of days, kind of view. I'm just interested to get your thoughts on whether you think there's a reflationary environment in Europe and into austerity and perhaps reduced regulation is something that we may see and if so, is that something you would welcome?

A - Alberto Minali {BIO 16909383 <GO>}

Thank you, James. Thanks also for the third question, which is the most difficult one, but so I will start from the first one. The solvency, yes, it's true. We have not used the EIOPA portfolio, we're still using our own portfolio. We're going to change this by the end of the year. So in the financial statement and solvency risk record of 2016, you will have also the benefits and the impact of the EIOPA portfolio, which we estimate between 6% and 8% of the solvency ratio in our economic internal view.

Q - James A. Shuck {BIO 3680082 <GO>}

(10:11) negative, yeah?

A - Alberto Minali {BIO 16909383 <GO>}

I would say so, yes.

Q - James A. Shuck {BIO 3680082 <GO>}

Yeah, yeah.

A - Alberto Minali {BIO 16909383 <GO>}

Yes, negative, between 6% and 8%. In terms of the German development, the contract with the DVAG (10:22) is excellent. It's an exclusivity contract with no termination. We do consider DVAG one of the most powerful financial network that really has made also the success of our operation in Germany. DVAG historically – and I have to say because I also talk to them, I was a board member of DVAG, they also support every single initiative of Generali in Germany that can create value for the shareholders and make the machine more efficient.

This is a fantastic – Germany, as I said, which allow us to enjoy the second position in the market. They got 15,000 financial advisors spread in the country. They are going in the same direction we're going, so selling unit-linked business and selling a protection business and trying to have an advisory service for the clients. So, I have to say honestly that DVAG is not an obstacle and not a stumbling block in our efficiency journey in Germany. On the contrary, they're supporting us in this journey. So I don't expect to have any single issue or renegotiation issue with them, because we are going exactly in the same direction to making – to make our machine more efficient for us and for them when we serve our customers.

Europe, the third question. Yes, certainly, we live in a world where we need some inflation, we need some pickup of rates, even if, as you know, the acquisition of the group in terms of financial return and operational return in the Life business is still very good. Having said that, I think we live in a world which is highly regulated and to have the benefit of a lower regulation, it will probably be also important for reducing the pressure on the sector. It's not clear to me how much of these enormous amount of regulation will cost the sector, but I can assure you that what we do in Generali is to take it very seriously. (12:18) amount of budget that we (12:24) every single year to regulation compliance, which honestly is becoming very important and I would say, very heavy.

The regulation will not change the shape of the industry, probably interest rate and inflation will do so. So, if we have a different macroeconomic environment, certainly we will benefit more than the others because of higher exposure to the Life business. As you know, the sensitivity of Generali Group to the interest rate is positive, which means that in a spread widening and interest rate going up, we might have some pick-up of performance.

Q - James A. Shuck {BIO 3680082 <GO>}

I guess, my – part of my question is kind of just whether you think a reflationary environment populist by government (13:13) is a feature that now looks a little bit more likely or less likely?

A - Alberto Minali {BIO 16909383 <GO>}

It's honestly difficult for me since I'm not a political expert to link the populist approaches on governments to the microeconomic condition. What we see – and this is also part of our assumption, in the planning phase in Generali, we do not see interest rate to go up in the next 12 months. There is a slight upward of the curve for 2018 and 2019, which we envisage, but I don't expect a change in the microeconomic condition in the short term because of different, let's say, political limitation of Europe.

Q - James A. Shuck {BIO 3680082 <GO>}

Okay. That's great. Thanks very much, Alberto.

A - Alberto Minali {BIO 16909383 <GO>}

Thank you, James.

Operator

Thank you. We will now take our next question from Thomas Seidl from Bernstein. Please go ahead.

Q - Thomas Seidl {BIO 17755912 <GO>}

Thank you. Good afternoon. First question, I'd like if possible some color on your exposure to the Italian financial sector, 40% of your equities is in financials, but there is no regional disclosure and €6 billion of financial corporate bonds in Italy. So, if you could provide some color what are your key exposures to some of the key players in Italian banks?

Secondly, while realized gains are down half to last year's levels, the regular yield is only down 10 basis points. So I wonder with the sharp drop in reinvestment rates this year, should we expect an acceleration of regular return on investment over the next one or two years.

And the third question then, German Life, the balance sheet buffers of Generali Germany and AachenMünchener Germany have dropped quite significantly 2015, and you are, to my knowledge, the only large company already using relaxed (15:14) rules. So what does it mean for your outlook on your German Life business, how big is the risk that this business needs at some point capital from the group?

A - Alberto Minali {BIO 16909383 <GO>}

Thank you, Thomas, for the question on the exposure to the Italian financial sector. Yeah, depends on the definition, but if you focus on the Italian banks, it's in the ballpark of 1% to the total asset base, 40% is in subordinated bond format, 50% or even more, it's in senior secure bonds. And we have a very small amount of equity exposure (15:58) from this point of view in terms of financial volatility.

The second question, yes, it's true, the current return has gone down only by 10 basis point. This is part of our ALM's size (16:14). The idea is in order not to disinvest from our portfolio assets with very high coupon and very high performance, we needed to balance quite carefully the amount of money we underwrite and the – these are part of the net inflow with the amount of money we need in order to secure the payment or maturity lapses and other exit of the (16:34) portfolio.

So, if we are able to keep these equilibrium between the money we're getting through the inflow and the money we've to pay out, there is no need of disinvestment from the portfolio. So, in essence, I would say that the drop of only 10 basis point comes from the very low disinvestment process of our portfolio, which has been achieved because of the good balance between cash-in and cash-out in our liability results profile.

The expectation regarding the current EPS (17:08) is to grow slightly down going forward. We live in the same market as everybody else, we cannot avoid the fact that some of the high yield and high coupon bonds will come to maturity sooner or later and then these when they will come will be reinvested much lower rate. But we'd say that the decay factor, the progression factor, it's lower for Generali because of very good integration between the commercial side and the financial side of our management of the book.

In terms of capital requirement for the German Life business, I don't think we have any need and we will have no need in the future for all the companies related to the AachenMünchener Group. We know that the acquisition of Generali Leben, it's certainly not as strong as the one of AachenMünchener and we're already investigating possibility going forward if there is need of capital, which will not materialize before 2021, 2022. And also, this very much will depend on the level of interest rate and the yields and the way the ZZR formula will be – maybe shaped by the regulation going forward.

So, my point on the German Life business, it's still profitable, we don't need capital injection in the short run. The position of the group is very solid in Germany with one exception that might be Generali Leben in the future if this level of interest rate will remain as low as it is at the moment and if the ZZR does not change. But I can assure you that we're working quickly on a potential solution to this situation.

Q - Thomas Seidl {BIO 17755912 <GO>}

Maybe just a follow-up on the first question, Alberto, and thanks for your clear answers. On the exposure to the Italian banks, are there any banks where you're particularly exposed to? And of course, on the equity side of your disclosure, you don't provide a regional breakdown. So, how much of the roughly €4 billion equities you have in financials is actually invested in Italian banks?

A - Alberto Minali {BIO 16909383 <GO>}

In the (19:26) – let me see, at group level, we have in – the equity position of the group level in Italy is €1.5 billion. But the equity position of the Italian banks I would say is virtually zero. We don't have a exposure to equity in the financial banking sector of the Italian system. We do have exposure through subordinated bonds and through senior and predominantly through cover bonds. So from an equity point of view, there is no exposure to the Italian banking system.

Q - Thomas Seidl {BIO 17755912 <GO>}

Okay.

A - Spencer Lee Horgan {BIO 4241901 <GO>}

So the €1.5 billion, to be clear, and, Thomas, is all equities...

A - Alberto Minali {BIO 16909383 <GO>}

All equities.

A - Spencer Lee Horgan {BIO 4241901 <GO>}

(20:05).

Q - Thomas Seidl {BIO 17755912 <GO>}

Just looking at the H1 disclosure where you say split by sector, group 3.951 (20:13) in financials.

A - Alberto Minali {BIO 16909383 <GO>}

Yeah, which is exactly. The 3.9 (20:23) is 1% of roughly €400 billion of total asset. So the exposure to financial is 1% of the total asset. Of this 1%, 40% is represented by subordinated bond. Zero, I would say, is equity. And the rest is split between senior and cover bond. With the vast majority of cover bond where as you know there is also an underlying assets in cover bond format.

Q - Thomas Seidl {BIO 17755912 <GO>}

Okay. Thank...

A - Alberto Minali {BIO 16909383 <GO>}

I think we have been clear on this.

Q - Thomas Seidl {BIO 17755912 <GO>}

Absolutely. Thanks a lot, Alberto.

Operator

Thank you.

A - Alberto Minali {BIO 16909383 <GO>}

Thank you, Thomas.

Operator

We'll now take our next question from Michael Hunter (sic) [Michael Huttner] (20:55) from JPMorgan. Please go ahead.

Q - Michael Igor Huttner {BIO 1556863 <GO>}

Interesting (20:59). Thank you so much. And on the solvency, I wonder if you could explain it again, I got confused why you were so closer from on the contribution of the non-Life. I think it's something to do with the loss ratio current year versus (21:17), maybe I get confused very easily.

And second is on – I wonder if you can provide an update on the (21:23) which was supposed to be – or is supposed to be the big recovery point in terms of cash flow, particularly I think in non-Life. And I just wondered if you can give a little bit of granularity on where you are in that process at the moment. And then, you had, maybe I misunderstood, mysterious provision in the non-operating item. A small – so it's not a big item, but whenever one hears of provision (21:56), could it be worse, what could happen here.

And then, the final thing is, if I understand – on the pricing in Motor, is it – is my understanding correct that effectively you were saying that going forward that Motor should be much better? Thank you.

A - Alberto Minali {BIO 16909383 <GO>}

Thank you, Michael. The explanation that I try to make is regarding the Solvency II, the new Life contribution to the Solvency II generation is the following. We see at the moment in the third quarter – but again this is a quarterly information, so it can change. We see a compensation between a decrease in expense ratio and a slight worsening of the loss ratio. The loss ratio is predominantly driven by the worsening of the current generation of loss ratio. So I do expect that if, especially in Italy, the price of the Motor business go up, I do expect that the current generation loss ratio to further improve. But once we consider these loss ratio in the fair value of the contribution in terms of capital generation, these had a negative impact. So, it seems that the P&C business is contributing less to the capital generation. But again, this is a quarterly evidence and we do not expect these to be the case in the next months going forward.

France. France is recovering heavily. The team in France has done a great job in reducing the combined ratio, especially in the Motor business, especially in the Motor fleet to a very decent level. At the moment, the combined ratio of the old (23:37) portfolio, it's around 100%. They are crossing the 100% combined ratio getting done and so we do expect that France will be improving also in the next month, even if the market in France is running roughly the business at 100% overall. In terms of cash flow, France is distributing a dividend to the foreign company, and so the cash flow position of France is positive both in Life and in the P&C business. Going to your third question, provision - mysterious provision I think is a trademark, you should probably make it (24:20).

Q - Michael Igor Huttner {BIO 1556863 <GO>}

Sorry about that. That was very bad, okay. Sorry, sorry.

A - Alberto Minali {BIO 16909383 <GO>}

No, no, no. Because this provision liability - mysterious provision is (24:29) is a one-off in Germany, which is not material, which we have moved from the operating to the non-operating. It shouldn't be extrapolated, it's related to a one-off provision in the German local balance sheet that we have brought in the consolidated account, but it's not a mysterious provision.

Q - Michael Igor Huttner {BIO 1556863 <GO>}

Okay.

A - Alberto Minali {BIO 16909383 <GO>}

Motor pricing, yes, we are seeing signs in Italy of a different behavior from some big players in the country in terms of price competition. The same players that have started this, let's say, price war or price completion now are changing their minds. So we do expect to have in Italy a slight improvement in the average premium at which we write the Motor business, and this probably could signalize a - at least a maintenance of the good level that we have at the moment or an improvement of the margins going forward.

Q - Michael Igor Huttner {BIO 1556863 <GO>}

Could I just ask - can you give us an update on the earthquakes both in Q2 and Q3?

A - Alberto Minali {BIO 16909383 <GO>}

Yeah. The earthquake at the moment - as you can imagine, the situation is a bit complicated because the area in the market region is - and Umbria region, excuse me, is devastating. So it's not very easy to collect claims certification. At the moment, it's around €16 million. We do expect these - these claims to be more or less similar to the one we experienced in the (26:10) situation some years ago. But it is very - these are very preliminary figures, very difficult to say what is the amount which will be book inevitably in the fourth quarter for the year.

Q - Michael Igor Huttner {BIO 1556863 <GO>}

How much was (26:24)?

A - Alberto Minali {BIO 16909383 <GO>}

It was in the ballpark of €100 million pre-tax.

Q - Michael Igor Huttner {BIO 1556863 <GO>}

Okay. Thank you so much.

Operator

Thank you. We will now take our next question from Nick Holmes from Société Générale. Please, go ahead.

Q - Nick Holmes {BIO 3387435 <GO>}

Hi, guys. Thank you very much. I had a couple of questions. First one is, going back to France, wondered if you could update us on the progress with the French regulator in respect to getting internal model approval?

And the second is on the Italy. I wondered if you could update us on the Italian non-Motor pricing. I mean, you said that Motor pricing is stabilizing, which is very good news. I know the non-Motor product is very profitable. Wondered if you're seeing a pricing pressure there at all? Thank you very much.

A - Alberto Minali {BIO 16909383 <GO>}

Thanks, Nick, for the question. France, the approval process with the French regulator is ongoing. We have submitted the application for – I remember for the life business. We do expect – but I cannot make any preemptive comment on what the regulator might ask us. We do expect that we have the final approval by the end of the first quarter, so to incorporate the French life business within the internal risk model of the group. As you can imagine, there is a lot of interaction between the team, the local team, the group central team and the regulator about the technical definition and technical aspects of the model. I have to say that at the moment I don't see any signs of perplexity or any signs of worrying coming from our teams working on these aspects. So, hopefully by the end of the first quarter we will get the approval.

Q - Nick Holmes {BIO 3387435 <GO>}

Sorry. Can I just very quickly clarify that for the full year result that you get it -

A - Alberto Minali {BIO 16909383 <GO>}

Yes.

Q - Nick Holmes {BIO 3387435 <GO>}

Or is it – it is for the full year results, right?

A - Alberto Minali {BIO 16909383 <GO>}

Yes, yes absolutely. If we have time and if we got the approval in time for incorporating these within the financial year 2016, hopefully this is our goal.

Q - Nick Holmes {BIO 3387435 <GO>}

Right.

A - Alberto Minali {BIO 16909383 <GO>}

The Italian non-Motor pricing, we enjoy a fantastic position in the non-Motor business in Italy. We have, I think, the market share of 30%, a very important presence in the country, fantastic underwriters in Generali Italia. We see always some signs of price and price cutting, but you have to understand that this is not a commodity. It's where the expertise of the underwriter, the ability of serving the client and also the proximity of our agents to the client make the difference.

Even if we think there is competition, we think that this market share can be defended because of the good position – I would say, excellent position of Generali Italia in the country. Question is why the business is not growing so much, even if are very well-positioned. For the simple reason that this is a business linked to the economic condition of the country. And the country is growing modestly at the moment, and hence also the P&C, non-Motor business follows this trend.

Q - Nick Holmes {BIO 3387435 <GO>}

Okay. Thank you very much. Very clear.

A - Alberto Minali {BIO 16909383 <GO>}

Thank you.

Operator

Thank you. We will now take our next question from Lance Burbridge from Autonomous. Please go ahead. Your line is open.

Q - Lance M. Burbidge {BIO 3978332 <GO>}

Thank you and good afternoon. A couple of quick ones for you, Alberto. On the Motor business, again, in Italy, I'm afraid, but this is on what you just experienced really as to why there wasn't – that was – it's just not Italy, but why there was an acceleration from 2.3% growth. I think you had in the first half 3.3% is what you've set for the nine months. So there is a kind of significant uplift in terms of premium growth, so I wonder if you could just give a bit more detail on what's behind that.

And then on the net inflows, which were down a little bit. But I just wonder if you could give a bit more detail in terms of what products are selling well, which ones you might be struggling to sell, given all the new products that have been coming in over France and Germany and Italy over the past couple of years.

A - Alberto Minali {BIO 16909383 <GO>}

Thank you, Lance, for the question. The Motor business in Italy, yes, we had an acceleration in the nine months. We have already started to, let's say, increase the Motor premium, so it's more a premium volume effect more than the number of contracts effect. Bear in mind that we are progressing very well in terms of telematics product. We are now over 1 million policies with the telematics feature, and this also is explaining why the Motor business in Italy is increasing. In terms of written premium, we do have a contraction compared to the last nine months, but the difference between the last year and this year is getting closer and closer over time.

The new inflows, what products are we selling? In France and Germany – Italy, France and Germany, as you know, we are trying and we have succeeded in moving the mix of production towards unit-linked business and protection. The saving business at group level are flattish, I would say, while the other products are in some cases growing very fast.

What we are doing in Italy, France and Germany for the unit-linked business is introducing in the underlying assets the so-called controlled volatility funds. We experienced a drawback in a way in Italy, France and Germany out of the financial market, the volatility of financial market. We have decided to change completely the underlying funds that are the constituents of the unit-linked, and we are now working on controlled volatility funds to have a lower type of product with a lower risk content for our customers.

Q - Lance M. Burbidge {BIO 3978332 <GO>}

Thank you.

Operator

Thank you. We will now take our next question from Giuseppe Mapelli from Equita. Please go ahead.

Q - Giuseppe Mapelli {BIO 7269722 <GO>}

Yes, good afternoon. I have only one question. I would like to understand what is the current propensity of your clients toward Life products. I mean, what is the reaction of clients in this rate scenario? Thank you.

A - Alberto Minali {BIO 16909383 <GO>}

Thanks for the question. The propensity of the clients, I would say in every European country is very high towards light capital product in general Life business. The real point here is not to increase the inflow, but to keep a very important balance between the inflows and the outflows of every single liability portfolio. So when we talk to the clients, we see that the clients have an enormous desire, an enormous need to invest their liquidity. So, when we offer them light capital products with capital protection and maturity, we see a very good response from the clients.

One important point is that, we are able to steer these production, because we have a very important franchise network in the countries. So the fact that the insurance company have a tight agency network also help very much in maneuvering the mix of production and in attracting customers towards light capital products.

Q - Giuseppe Mapelli {BIO 7269722 <GO>}

Thank you.

Operator

Thank you. We will now take our next question from Farooq Hedberg (sic) [Farooq Hanif] (34:26) from Credit Suisse. Please go ahead.

Q - Farooq Hanif {BIO 4780978 <GO>}

Hi there. It's Farooq Hanif from Credit Suisse. Thank you very much for taking my question. Returning to Italian P&C, could you please just give us a bit more detail on the loss ratio trends in Motor versus non-Motor? I know that non-Motor has been getting a lot better and Motor has been weakening. So, are you saying that you will be able to bring down Motor or non-Motor will get worse? I mean, what are you seeing as a trend?

Second question is, on policyholder sharing in your Life business. Could you share some data or give us a feeling for how much kind of reduction in policyholder payouts you have been able to use to help support your investment margins in Life and whether you think there is a lot more that you could do there? Thank you.

A - Alberto Minali {BIO 16909383 <GO>}

Going to your first question, Farooq, the Italian P&C combined ratio Motor/non-Motor, we see the nine months exactly the same trend that we saw at the six months and also in the first quarter. So, a deterioration of the Motor business, but I would like to say that we write the Motor business at profitable level, which is compensated by the non-Motor business. The two things offset – almost offset each other.

In terms of the profit sharing in the Life business, if there is a reduction in the rate, I don't understand the question, which kind of rate are you referring here? There is loan (36:08) guarantee rates.

Q - Farooq Hanif {BIO 4780978 <GO>}

No, I'm simply saying, you make a current yield, some of that go to pay the guarantee, but you also pay a bonus. And when we look at your figures, it seems that your – the amount of the shareholder margin, the shareholder percentage of that yield that you make has gone up in the last few years, because you can reduce what you are paying to policyholders a little bit. I was wondering if you think that's a trend that will continue.

A - Alberto Minali {BIO 16909383 <GO>}

Yeah, I understand. Most of the business we write in the Life - before in Life, it's a fee-based business, which means that with the reduction of the policyholder funds return, the share of the money that the shareholder take out of the total quota is proportionally increasing over time. So, I do expect that these also will be the case going forward, yes.

Q - Farooq Hanif {BIO 4780978 <GO>}

Okay. Thank you very much.

Operator

Thank you. We will now take our next question from Ralph Hebgen from KBW. Please go ahead.

Q - Ralph Hebgen {BIO 6297020 <GO>}

Hi, guys. Thank you for taking my questions. I've got two things. One is on P&C. Alberto, would you mind commenting a little bit on the loss frequency in Italy and how the trends are developing there? And also on the rate environment perhaps in Italy, but - you said that already, but in particular focusing on the regions you do business outside of Italy.

And the second point is on Life, similar sort of thing, would you be able to comment a little bit on the sales dynamics of hybrid products outside of the Italian market, in particular focusing on Germany. what are the trends in terms of selling Life and savings, unit-linked, and risk and protection in these markets?

A - Alberto Minali {BIO 16909383 <GO>}

Yes. Frequency in Italy is absolutely stable. We don't see any sign of deterioration in the claim frequency in Italy, which is around 6.7%. Here we have a reduction of the average premium, more than compensated by reduction of the average claim. So the profitability of the business for us remains the same. In terms of trend outside Italy, Germany and CEE are still hard market, where we see an increase of the gross written premium and the average premium in the portfolio.

We don't see at the moment the same phenomenon in France and in Switzerland and in Austria. But, for example, in Spain we enjoy a very important growth in the Motor business and a hardening of the market. In terms of the frequency, I don't see at the moment outside Italy signs of deterioration on the frequency. There might be some cases, for example, in Poland or in some small centers in European countries. But this do not change the shape of the group and also do not have an impact on the overall frequency of the group, which again remain stable.

The sales of hybrid (39:19) products in Germany and France, you ask specifically. So, I think for France, what we have it's an overall contraction of the direct premium and the inflow, in the sense that here we have decided together with management of France to reduce the saving business component and to push on protection. The margins in France are going up exactly for this reason, because protection business has increased dramatically in the last nine months.

In Germany, we do have a very strong contraction of the saving and pension business. We took the decision to completely stop the sale of some products and to completely stop the sale of products with minimum guarantee rates, and we are defending the position in the unit-linked business, where we remain the leader in the market.

Q - Ralph Hebgen {BIO 6297020 <GO>}

That's fantastic. Thank you very much.

Operator

Thank you. We will now take a follow-up question from James Shuck from UBS. Please go ahead.

Q - James A. Shuck {BIO 3680082 <GO>}

Hi, thanks. Thanks for the follow-up. A couple of things just to circle back on, again, on the net flows and specifically here in Italy actually in the last – this year and last year you've seen a huge amount of inflows given the unattractive nature of crediting rate particularly around the banks, but also the success of the hybrid products. I am just wondering, to what extent you actually view those Italian flows as being exceptional, and to what extent, if you look forward into next year and beyond, will they start to normalize at a lower level perhaps.

And then secondly, just interested on the German Life business. My understanding is under local German GAAP, there is a reference rate on the risk free that will lead to an element of DAC like that to come through. I am just wondering whether you've accounted for that in this quarter's earnings or whether there would be catch-up in Q4, indeed further dragging into next year, please. Thank you.

A - Alberto Minali {BIO 16909383 <GO>}

On the first question, Ralph, the P&C – sorry – the net inflow in Italy, the sustainability is a very tough question, because on one side what we experience is that this amount – enormous amount of liquidity in the country that needs to find its way in one investment or the other. So, the Life products are really very easy from this point of view to sell, if you offer minimum guarantee rates. But as we said, we are not offering minimum guarantee rates as such. We are offering hybrid products. So we need to balance very much in the hybrid products component what is the saving business component, which is the unit-linked. And there is a point in time and a moment in time, when we have in a way to slow down the production, because the dilution effect that we might generate through hybrid products on the saving business could be higher than the one we want.

So, the €5.4 billion of the net inflow is adequate on one side for keeping our profitability, our margins, and the other gives enough business to our sales network without jeopardizing the profitability of the policyholder funds attached to the saving business. It's a very complex and delicate element. It's true to say that the crediting rate will go down, but it's also fair to say that the crediting rate on the saving portion of the hybrid products is still at good level. The point for us is not to dilute too much this crediting rate without - because of any control on the inflows. If we open up the gate, we will have massive production, but I don't think this is in the interest of the shareholder and not even in the interest of the current customers of the group in the savings policyholder funds.

Sorry for asking you to be more precise on the second question, because I did not understand the point of RFR and DAC. If you can please repeat it/

Q - James A. Shuck {BIO 3680082 <GO>}

Sure. Yes, it's just a question around - is the low interest rate environment - is that going to lead to progressive write-downs of DAC in Germany? And how is that being captured in Q3 or will it come through in future periods? There is a reference rate based on local GAAP that mechanically feeds through. I'm just interested to know if that has actually...

A - Alberto Minali {BIO 16909383 <GO>}

No. No, no.

Q - James A. Shuck {BIO 3680082 <GO>}

...happened yet or whether it will happen in the future?

A - Alberto Minali {BIO 16909383 <GO>}

No. I will investigate with my colleagues and those with the German CFO this question of yours. But my understanding is that the very low reference rate at the moment will not generate an impairment of the DAC - or, sorry, write-down of DAC in Germany. But we will come back to this offline.

Q - James A. Shuck {BIO 3680082 <GO>}

Okay. Thanks very much, Alberta.

A - Alberto Minali {BIO 16909383 <GO>}

You're welcome. By the way, the DAC is very small, but we will come back to this.

Operator

Thank you. We will now take our next question from Nadine van der Meulen from Morgan Stanley. Please, go ahead.

Q - Nadine van der Meulen {BIO 15200446 <GO>}

Yes, hi. Good afternoon. Just a follow-up question on these hybrid product sales in Italy. As I understood you could charge high fees if there was a high component of savings, which was quite attractive to customer in relation to the unit-linked part. But if that savings component is lower, given the dilution that you mentioned, if the split between savings and unit-linked is reversing, if you will, doesn't that then mean that the customer is probably not willing to pay such a high fee as they have been willing in the past? And could that lead to margin pressure? Thank you very much.

A - Alberto Minali {BIO 16909383 <GO>}

Thanks for the question, Nadine. Again, an interesting question, because when we charge a fee – an upfront fee or recurring fee in a product, is not technically split between the saving component and the unit-linked component with the fee of the product. What we see at the moment in the market there is a huge appetite by customers in buying these hybrid products, because of this mixture of saving and unit-linked and the protection of capital at maturity.

So we don't see at the moment a margin pressure. On the contrary, we also experience in the country some other players to increase the price of this product, so I don't expect the margin in Italy to go under pressure because of the high level of fees. On the contrary, what we need to do quite quickly and we are working very hard on this is to replace the equity component of the unit-linked business with lower volatility controlled funds and to make the point to the customer that when the customer invest into a unit-linked product, he is not taking a huge gamble on the market. He is not taking a huge risk, is a way of protecting this capital. So the point is not the margin pressure for us, but the replacement and to enrich the underlying assets in the unit-linked products for the customer.

Q - Nadine van der Meulen {BIO 15200446 <GO>}

All right. Thank you.

Operator

Thank you. We will now take a follow-up question from Michael Huttner from JPMorgan. Please go ahead.

Q - Michael Igor Huttner {BIO 1556863 <GO>}

Fantastic. Thank you so much. (47:00) I wanted to know what was the earthquake loss in the previous quarter. (47:04) give the – announce on Q4.

A - Alberto Minali {BIO 16909383 <GO>}

It was €10 million.

Q - Michael Igor Huttner {BIO 1556863 <GO>}

€10 million. Okay, lovely, super. Thank you so much.

A - Alberto Minali {BIO 16909383 <GO>}

You're welcome.

Operator

Thank you. We will also take a follow-up question from Farooq Hanif from Credit Suisse. Please go ahead.

Q - Farooq Hanif {BIO 4780978 <GO>}

Hi, there. Thank you for taking my follow-up. Just returning to some of the other questions, especially James'. Could you tell us what your segregated fund return is in Italy at the moment? I believe it was sort of 3.7% or 3.8% or something like that in 2015. Could you update us on how that's tracking in 2016?

And then secondly, I sense from all the questions and all the answers that you've given that you are pulling back a little bit strategically from the idea of selling savings products at all – well, sort of the hybrid savings product, and wishing to switch maybe more to pure fee and pure protection. Is that correct or am I interpreting that incorrectly? Thank you.

A - Alberto Minali {BIO 16909383 <GO>}

Thank you. I don't know if you have a psychological counsel there to understand my words. But let me go back to the question of the segregated funds return and then on the saving business. The segregated funds return remains also during 2016 between 3.6%, 3.7%, 3.8%. As you know very well, in the policyholder funds, especially for the Italian business, you have a component of current (48:38) return and component of realized capital gains that build up the return. So there is no strong – absolutely no strong dilution effect in the returns of the segregated fund.

What we have decided to do, and your interpretation is correct, is not to completely move towards a fee-based business. But to use these hybrid products as a bridge between the old world, where our customers were offered only saving business, and the new world where our customer are offered hybrid products. So the idea is progressively to move towards more unit-linked business and to have the saving business only as a component of the hybrid products. In most of the countries of the group, I can mention Germany, for example, Austria, even France, Italy as well, we are not selling any more saving business as such per se. We are selling only saving business as a part of the hybrid products.

So, I didn't want to give you the interpretation that we are completely stopping the sale of saving business. Saving business remains an important contributor to our overall performance, but as part of the hybrid products offering we are making in the country so.

Q - Farooq Hanif {BIO 4780978 <GO>}

And may I just follow-up on that, so...

A - Alberto Minali {BIO 16909383 <GO>}

Please.

Q - Farooq Hanif {BIO 4780978 <GO>}

...are you able – I know from a embedded value point of view, the margin on this business must be much, much better than your traditional or your traditional hybrid business, but surely in earnings terms you can't get away with some of the really high fees that you've been charging when you move to a more pure unit-linked even with volatility controlled kind of business. I mean, I was wondering, do you still feel confident in maintaining your level of earnings in Life with that transition?

A - Alberto Minali {BIO 16909383 <GO>}

Yes. It's correct to say that the saving business have an internal rate of return which is a fraction of the one of the unit-linked. The average internal rate return is more or less 10% for the saving business, while for the unit-linked it's 20%, 21%, so it's double. So, the more unit-linked business we sell, the better it is for our performance.

At the same time, it's also fair to say that, once we move towards unit-linked business, the upfront fees might be reduced. But since we sell them in the hybrid format, I don't expect a reduction of the fees immediately. It might be a lowering of the fees in the future, yeah, that's something we can contemplate. But at the moment, the hybrid products have a good margin also coming from the fees component.

Q - Farooq Hanif {BIO 4780978 <GO>}

Okay. Thank you. Thank you for answering questions.

A - Alberto Minali {BIO 16909383 <GO>}

Thank you.

Operator

Thank you. Ladies and gentlemen, that will conclude today's Q&A session and I will now turn the conference back to Mr. Spencer Horgan.

A - Spencer Lee Horgan {BIO 4241901 <GO>}

Thank you very much everybody. Thank you for joining us. And all that remains for me to say is that we look forward to seeing you on the Investor Day on 23 November. Have a good rest of the day. Thanks.

Operator

Thank you. Ladies and gentlemen, that will conclude today's conference call and you may now all disconnect.