Q1 2015 Earnings Call

Company Participants

- Alberto Minali, Group Chief Financial Officer
- Nikhil Srinivasan, Group Chief Investment Officer
- Spencer Lee Horgan, Head of Investor & Rating Agency Relations

Other Participants

- Andrew J. Ritchie, Analyst
- Elena Perini, Analyst
- Farooq Hanif, Analyst
- Federico Salerno, Analyst
- Gianluca Ferrari, Analyst
- James A. Shuck, Analyst
- Matteo Ghilotti, Analyst
- Michael I. Huttner, Analyst
- Michael van Wegen, Analyst
- Nick Holmes, Analyst
- Paul C. De'Ath, Analyst
- Peter D. Eliot, Analyst
- Ralph Hebgen, Analyst
- Thomas Seidl, Analyst
- William H. Elderkin, Analyst

MANAGEMENT DISCUSSION SECTION

Operator

Good day and welcome to the Generali Group First Quarter 2015 Results Q&A Session. Today's conference is being recorded. 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 Q1 2015 results call. As the operator said, we're ready to take your questions. But before we do that, I'll hand it over to Alberto for a few brief opening remarks. Alberto?

Alberto Minali {BIO 16909383 <GO>}

Thank you very much, Spencer, for this call. And thank you very much to all of you for being on this call. I will just give you some numbers and some very short remarks on the very strong operating performance of the group in this first Q 2015.

Our volume of premiums has exceeded to €20 billion with a very strong performance in the Life business and also I would say with a very good resilient performance in the P&C. In the Life business, the growth of the unit-linked production is visible in every single countries where we do operate. At the moment, one quarter of the entire new production is based on unit-linked business.

The net income has increased by 3.3% to €682 million. And in terms of our profitability the combined ratio is 93.3%, slightly above the combined ratio of the first quarter 2014. But you have to remember that we pay a very huge price in terms of nat cat burden in the first three months of the year.

In terms of capital, the Solvency I ratio has reached 168%. If we also consider the likely outcome of the BSI transaction on a pro forma basis, we will reach 177% once we close this transaction. And the net shareholder equity has increased to €26 billion, plus 12.5%.

As we have noticed, we have not provided any information on our economic solvency ratio and I will ask you to wait for our investor day in London. We will provide some indication about the capital position based on our full internal model, based on Solvency II principles.

And I would like to take this opportunity to convey the message that to the old model anyway is in pension, and we are now starting a new phase of Generali, a new phase of understanding our risk profile through the new fully running model that we have been working on in the last two years.

I would now leave it to you for any questions you might have. Thank you.

Q&A

Operator

Thank you, sir. We will now take our first question and it comes from Gianluca Ferrari from Mediobanca. Please go ahead, sir.

Q - Gianluca Ferrari {BIO 15042989 <GO>}

Yes. Hi, Alberto. Good morning. Three questions from my side. The first one is on the current year loss ratio. I noticed that Q1 2015 has been a record ever with 67.5% if you can elaborate a little bit on the reasons behind these very, very good result on the current year loss? My second question is if you can give us an update as of today or the most recent data you might have on the equity and the AFS reserve, so where we are today with these two numbers.

And the third and final question, I will not ask you anything about economic solvency under the new internal model. But during the full year 2014 conference call, you were telling me that the economic solvency as at mid of March was more or less stable with full year 2014. So, it was in the region of 157%. Can you confirm that the economic solvency at the end of Q1 was in line with that at the end of full year 2014? Thank you.

A - Alberto Minali {BIO 16909383 <GO>}

Thank you, Gianluca. Start from the first question, the current year loss ratio. Yes, it's very low indeed. It's sort of a historical record, the 67.5%. I wanted to highlight two things. I'm sorry to bother you on this. The reserving policy of the group has not changed at all. We still keep a very prudent stance on the way we reserve the claims. This is just the 67.5%. This further improvement is because of the very good quality of our underwriting. We don't see signals at the moment of deterioration in the motor business, neither in terms of frequency nor in terms of increased cost of claims.

So, I will say that this improvement in the loss ratio of the current generation of business is entirely due to our technical ability. If you also look at the slide on the combined ratio, you'll see that the release of runoff is 4.2% versus 4.1%. Again, this is just an attritional thing, nothing to do with any maneuver of reserves that what we might think of.

In terms of the available-for-sale reserve, this has decreased of €600 million vis-à-vis the number we had of €8.8 billion at the end of the quarter. And so, we have lost roughly 3 percentage point of Solvency I because of the rally upward of the interest rate from the end of the quarter until the end of April.

In terms of economic solvency, I will ask you to be patient and to wait until the investor day, so a couple of days more, in London, and we will provide you with a lot of information regarding the economic solvency position of the group. But certainly, it's more than adequate.

Q - Gianluca Ferrari {BIO 15042989 <GO>}

Thank you.

Operator

Our next question comes from Mr. Peter Eliot from Berenberg. Please go ahead, sir.

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

Thank you very much. I'll refrain from asking a direct question on the economic solvency, but just if I look at the duration of your fixed income portfolio behind the Life business, I see that increase by 0.5 years across the quarter. I'm guessing that the duration of your liability has nicely going up by a bit more than that. So, just wondering if you could comment at all on what might have happened with the duration gap across the quarter.

And I guess related to that, if you can say anything about any sort of management actions that you may or may not have taken to help as well? A second thing was I note that you said you strengthened the policyholder reserves, and you gave a ZZR cost of net €27 million. Given where reference rates were at the end of the quarter, I guess that sort of sounds roughly in line with what I would've expected. So, I was wondering if you could just comment on whether you've done anything more than the minimum there.

Third and final question, I note that the acquisition cost ratios have gone up a bit both in Life and non-life, admittedly partly driven by volumes. But I was wondering if you could just sort of comment and perhaps give an outlook there? Thank you.

A - Alberto Minali {BIO 16909383 <GO>}

Thank you, Peter, for the question. In terms of the duration of fixed income, in anticipation of the market trend and I think the timing was really perfect, we have lengthened the duration of our fixed income portfolio. But at the same time, due to the duration of the liability, that does not change equal to 9.1 year. We have reduced the duration mismatch in the Life business.

Bear in mind that the reinvestment has been done in an average rate around 2.5%. And we have reinvested here roughly 3% of the stock. So, for the reinvestments we have done, we have really increased the duration buying assets, especially corporate bonds in the long-term part of the curve. But this has helped up to further reduce the mismatch, and so to keep under control the absorption of capital for interest rate risk.

In terms of the ZZR impact, yes, the accounting with ZZR is driven by the regulation. There is no maneuver behind ZZR, but I want to mention that in another country, for example in France, in the first quarter, we have allocated €200 million of realized capital gains to the reversement of this reserve, which when we inherited this company was very low, indeed, and we have continuously reinforced this provision for facing interest rate volatility in the French portfolio.

Going to your third question, yes, acquisition costs are up in the Life business and non-life, mainly driven by volume. But I must say that in the P&C business, because of the slight contraction of the premium portfolio in the motor and the higher production in terms of non-motor business, which usually attracts a higher acquisition cost, it's not a matter of volume. It's a matter of composition of the new production that we have underwritten in the P&C business.

Predominantly, it's a volume effect. That's right. But for the P&C business, it's also a switching effect from the motor one with – has a very low acquisition cost into more sophisticated business which requires higher acquisition and also administration cost.

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

Thank you very much. Could I just quickly check on that first point that I understood you correctly that the increase in the asset duration will have limited impact from higher liability duration, but we shouldn't necessarily expect the gap to have come down. Is that correct understanding?

A - Alberto Minali {BIO 16909383 <GO>}

Yes, it's correct. The gap between asset and liability last year was in the ballpark of one year. This year is six months. So by shortening this gap, we make our Life business less exposed to interest rate volatility. And we did have this room for lengthening the duration, especially through the investment process.

We did the same also in the P&C business even if in the P&C business, the duration mismatch has probably different meaning because the liability are not interest rate-sensitive.

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

Okay. Thanks a lot.

Operator

Our next question comes from James Shuck from UBS. Please go ahead, sir. Your line is open.

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

Good morning. Thank you for taking my questions. I have two questions, please. Firstly, on Italian Life sales, seen very strong flows, net flows, I think they doubled year-on-year in Q1. Presumably that's being driven by the Valore Futuro product. I've got kind of two related questions around this. Firstly, if the net inflows have doubled in Q1, could you just explain why the APE growth is only up 3%? I can't quite seem to reconcile those in my mind.

And then related to the Italian sales, just on Valore Futuro, I mean, the charges are quite high on this product and the crediting rates are quite generous partly because there's a form of cross-subsidy between old business and new business. I guess my question is that how sustainable are these assets going to prove? Because ultimately, gradually over time, the crediting rate is going to re-price downwards, and policyholders are not going to be quite as happy with the return that they're getting. So, how are you thinking about the scope for outflows if yields stay where they are?

My next question is on French Life sales and I was interested to see that the APE was up very strongly in Q1, close to 40%. Could you just explain how the margins are looking on that business? Because at the end of 2014, I think your IRRs and payback periods were around 6% and 10 years, respectively. So, that business doesn't seem particularly attractive to me. So, I'm just struggling to see why you're selling so much of it. Thank you.

A - Alberto Minali {BIO 16909383 <GO>}

Thank you. Let me start from your first question on the Italian Life sale and the strong net inflows. Yes, it's driven by Valore Futuro. You know that we are using this hybrid product in most of the countries in the group in order to push the sale of unit-linked business. And I have to say that the savings business is acting as a sort of ancillary business for selling more unit-linked, keeping very high the profitability of the whole production and of the whole group.

So Valore Futuro explains a lot. You have to remember that in Italy, we had roughly €4.3 billion of net inflows, of which €2 billion are unit-linked and only €1.2 billion are savings and pension. The Banca Generali network is doing a great job, but also the traditional sales network of Generali Italy are doing a great job in switching the production towards unit-linked.

And this explain why even if we have a very strong net inflows, the profitability has not deteriorated at all. On the contrary, really kept at a high level. The APE is only up 3% because, as you know, in the calculation of the APE, we do have one-tenth of the single premium that gets into the computation. And that's an interesting question, the sustainability of the crediting rate versus the charge on Valore Futuro.

Bear in mind that most of our business is a fee-based business, which means that in this very low-yield environment, we extract from the Life business always a portion of money of profitability that is, let's say, not sensitive to interest rate and not dependent upon the performance of the policyholder funds. We take out a fee from managing this business.

So, crediting rates are generous or not generous, that's in a way is a commercial issue but this does not impact on the shareholder account. The sustainability and the mutuality is always the same because this also happened in the past. When you have a policyholder funds, people there getting – also get a portion of the unrealized capital gains and people that leave, leave also portion of the capital gain there.

So, it's a normal phenomenon in the mutuality of the insurance business. What we need to avoid is to have a ballistic, let's say, production of saving business, which deteriorates the asset-liability management position of the policyholder funds. But that's exactly what we have avoided through the EBRI products because the saving business, as I said, is done ancillary – as ancillary business for the unit-linked.

So, my understanding is that this is sustainable over time and the profitability of the Life business, especially in Italy but in the group, is there because of the structure, the fee-based structure of the products we said.

On the French business, I totally agree with you that this business is not particularly attractive. If I look at the new business margin or the French Life business, it's the lowest in the group. We are working a lot with our colleagues to improve the profitability of this business, but there is also a market situation, a market environment and a higher volatility in the French Life industry than in other industries.

So, margins in France are not the one we do expect from the Life operation. But in this process or change in the production, we need also to feed the sales network. And so, the sale of this product, even if are not extraordinarily profitable, are very important for keeping our sales network. And so, we can have the better condition for restructuring also the Life portfolio.

You are right, not a fantastic margin but we are working on that because we are aware of this situation and we have already started to tackle it.

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

Okay. That's great. Thank you very much.

Operator

Our next question comes from Mr. Farooq Hanif from Citi. Please go ahead, sir. Your line is open.

Q - Farooq Hanif {BIO 4780978 <GO>}

Hi there. I just want to come back on one of James' questions and ask one other. So, just want to understand the net flows in Italy, you say that you're roughly half of – just under half of those net flows at unit-linked. But including the Valore Futuro product in there, that's not quite unit-linked entirely. So, I just want to understand exactly what you mean by unit-linked in Italy. And then, associated with that, are you kind of quite confident that €4 billion net flow or something around that level continues for the rest of the year?

And my second question is on your Italian combined ratio, obviously, claims frequency and severity is stable, but you have very, very intense competition on pricing. I just wonder when – it seems that your combined ratios have never deteriorated. I wonder what we're missing. So, if you have stable kind of experience but falling prices, you'd expect eventually that to come through to the bottom line. So, I was wondering how you would kind of square that for me. Thank you.

A - Alberto Minali {BIO 16909383 <GO>}

Thank you, Farooq. Let me give you some data and I apologize because in answering the question earlier, probably I gave you the data of the group. So let me recap the Life net inflow for the group, which are €4.3 billion, of which €2 billion are unit-linked. I must also say that the maturities in percentage are stable, even maybe decreasing. And the surrenders are decreasing. So, it means that our Life liability, Life technical reserves are stable overall.

In terms of the Italian business, we have a €2.1 billion Life net inflows, of which more than €700 million are from unit-linked. So in the accounting of the Valore Futuro, you are right. Valore Futuro is not 100% unit-linked. It's 90% unit-linked for the product we sell through Banca Generali, which is called Stile Libero. And the 70% unit-linked for the product we sell – 30% unit-linked for the product we sell through the AG's network. But we do account in separate ways. So, the products get into the accounting system and the unit-linked portion goes in the unit-linked bucket and the saving portion goes in the saving bucket.

The idea is not to have any cost subsidization between one bucket to the other. That's not the case. The idea is to sell more unit-linked business, providing also a savings rider attached to it. In terms of the net inflow trend, I do think that the trend especially in Italy is very strong, very good because also the general market condition, and honestly also because of the restructuring of the sales network that we have done in the last months, and this switching of the sales network towards unit-linked business, which is something very new for our network.

So, our network is really starting to sell different type of business with higher marginality, higher profitability and less capital absorption. And this I think goes in the right direction. For the Italian combined ratio, it is true that the frequency and severity are stable. There is a lot of competition in pricing especially I would say essentially in the motor business.

Our combined ratio does not deteriorate or it does deteriorate less than the peers. And honestly, you are not missing anything in this equation. We do have a frequency which is very low and still decreasing. Cost of claims are not increasing, but there is a huge price competition. The combination of these elements still delivers a very good performance in the motor business.

The Motor business was in 3.6 percentage points. The non-motor improves 5.3 percentage points. So the net impact, it's a positive on the overall P&C book. Bear in mind that Generali does not enter into any price war because we think that we needed to deliver better service to the customer. Price is not the only element. And we think we are working much more than the others on customer issues and on service in order to make our products less price-dependent but more customer-centric.

Q - Farooq Hanif {BIO 4780978 <GO>}

May I quickly ask? In Italy, did you have a higher reserve release in 1Q 2015 versus 1Q 2014?

A - Alberto Minali {BIO 16909383 <GO>}

Let me check the number, I don't remember by memory. The reserve release, my team here tells me that it's stable and I trust them.

Q - Farooq Hanif {BIO 4780978 <GO>}

Okay. Thank you very much.

Operator

Thank you. We will now take our next question from Federico Salerno from MainFirst. Please go ahead, sir. Your line is open.

Q - Federico Salerno {BIO 2565091 <GO>}

Hi, everyone. Alberto, still on Life, please, in Italy. Traditional – looking at premiums, these were up 18% year-on-year on the traditional side. I guess only a small portion of that being driven by the new hybrid products. Are you still doing something to rein in the agents? As you mentioned last year, considering the low and falling margins that we see on these products, is customer demand still very high? If you could spend a couple of words on that please. And the second question is on P&C, you still have about 10% of assets held in cash. Do you see these declining in the coming quarters? What do you think about this? Thank you.

A - Alberto Minali {BIO 16909383 <GO>}

Thank you, Federico. On the Life traditional premium, yes, are up. I would say that a small portion, yes you're right, is driven by EBRI products. We are doing – during the process of transforming Generali Italy and merging several companies and also making this very complicated IT integration, and the Life IT integration is over and completed with success, we are now spending a lot of time and resources on the training of the sales force. And the EBRI products is the first of these training process of the training idea in order to switch them towards unit-linked business.

We do see a customer demand very high in this space. There is a very little choice of alternative investments for a retail consumer at the moment in Europe. So, the life business is still on a strong demand. But what we need to do in the sales network traditional especially is to further increase the portion of unit-linked business in Valore Futuro, and then all the micro links are working in increasing this type of split.

For the non-life, for the P&C business, 10% of assets invested in cash. That's a temporary operational type of cash; nothing to do with the asset allocation. It's just a seasonal effect, but we will reduce it quickly over time.

Q - Federico Salerno {BIO 2565091 <GO>}

Thank you.

Operator

Thank you. Our next question comes from Nick Holmes from Société Générale. Pease go ahead, sir. Your line is open.

Q - Nick Holmes {BIO 3387435 <GO>}

Hi there. Thank you very much. Two questions. First one is can you give us a little bit more color on why the P&C expense ratio rose by 1%? I mean, it seems just a bit surprising given your focus on cost reduction. I know there's acquisition increases, but I wondered if you could elaborate more on the background there?

Then the second is with Life. You've explained you're writing a lot less guarantee business, a lot more unit-linked and protection. And my question is do you expect this to accelerate even more when Solvency II comes into effect next year? Now I'm thinking not just your own book, but what are your thoughts about the sector as a whole, I mean, if the whole industry is going to stock pricing this guaranteed stuff? Thank you very much.

A - Alberto Minali {BIO 16909383 <GO>}

Thank you for your questions. So the P&C expense ratio has increased by – if we split it, let's say, 0.2% for administration, 0.7% for acquisition cost. If you look at the detail, the dynamic of the acquisition cost, monetary terms, these have increased by 4% because of the different production type mix of products. The acquisition costs have increased very strongly in Germany because of the new non-motor business we are writing, and also in France and also in Central Eastern Europe, while in Italy have remained predominantly flat.

In terms of the guarantees and the unit-linked protection business, I must say that I don't believe that Solvency II is the real driver behind the consumer to get more unit-linked business. That's sort of a supply market where all the companies are trying to increase the offering of unit-linked business because they consume less capital, and they are trying to diversify away from the traditional one. So, I do expect that this trend will continue within the Solvency II, but not because of the consumer demand, but more because of an insurer offer of different type of products that will create their own demand in the market.

Q - Nick Holmes {BIO 3387435 <GO>}

Okay. Could I come back very quickly on the admin ratio with P&C? I mean, are you a little bit disappointed that there hasn't been improvement there?

A - Alberto Minali {BIO 16909383 <GO>}

In terms – your question is for the administration ratio?

Q - Nick Holmes {BIO 3387435 <GO>}

Yes.

A - Alberto Minali {BIO 16909383 <GO>}

No. I'm not disappointed. This is a marginal, let's say, variation. Bear also in mind that the first quarter of the year is particularly strange from a business point of view because we have huge renewal of business especially in some countries that traditionally have a lot of insurance business except in the first Q. So, I don't see these as a negative signal in terms of deterioration of the administration ratio. I don't have absolutely this view.

We still keep a lot of focus on administration and acquisition costs. And we still keep a lot of focus on the overall cost base of the group. And also, you'll see at the investor day that these will be still an important issue that we want to carry on in the future. So, I am not concerned about this slight pickup of administration ratio.

Q - Nick Holmes {BIO 3387435 <GO>}

Okay. That's great. Thank you very much.

Operator

Thank you. Our next question comes from Matteo Ghilotti from Equita. Please go ahead, sir. Your line is open.

Q - Matteo Ghilotti {BIO 2333793 <GO>}

Good afternoon. Just a question on the combined ratio because I think your indication was to expect a roughly stable combined ratio this year. And I wonder if given the first quarter and your indication that pricing is, generally speaking, soft, if you agree that the flat combined ratio is becoming probably a bit too optimistic forecast? Thank you.

A - Alberto Minali {BIO 16909383 <GO>}

Thank you, Matteo. The general rule of the house is not to give any expected or any forecast because it's impossible for us to do so. I want just to point out that in the Solvency, in the combined ratio of this quarter, we do have a very heavy burden for cat claims. These are honestly unpredictable things. And because we sell also policies with a cat cover in it, we are by nature exposed to the nature. So, it's very difficult to predict. I must also say that in the first quarter, we have €115 million of cat costs which cannot be recovered – because of the size of the claims, cannot be recovered from the reinsurance. So, they flow immediately into the P&L.

This has really changed the loss ratio in some countries. For example, in Germany, has increased by 5.9 percentage point at the local combined ratio, while, for example, in France, we didn't have any cat claims during the first quarter. So, if you look at the combined ratio of France, it seems that is dramatically improving. But we know very well that it's slightly improving, but not so hugely improved as you can see from the number because it benefits from zero cat claim.

So, I think the cat claim component in the combined ratio remains unpredictable, remains something outside our control. The best we can do is to have an effective reinsurance in place if they reach a certain level and to have a very well diversification business on the territory, on the country locally.

So, I don't share that maybe your implicit comment that we are becoming too optimistic. No. I think we still are very prudent and a portion, a component, of the combined ratio cannot be predicted at all. So, this is something that we need to accept.

Q - Matteo Ghilotti {BIO 2333793 <GO>}

Thank you.

Operator

Our next question comes from the Andrew Ritchie from Autonomous. Please go ahead, sir. Your line is open.

Q - Andrew J. Ritchie {BIO 18731996 <GO>}

Oh. Hi there. Three short questions. First of all, on France, maybe, Alberto, you could just bring us up-to-date on where we are on re-underwriting of the book and when that should cease. I think the expectation was in the second half of this year, but maybe just recap on how that's developing. And I guess on France, I mean, it did improve. As you just pointed out, it was all down to an absence of nat cat. Should we still be thinking we should see some underlying improvement this year? And maybe at what point you think we should be below 100% on the combined ratio?

A quick question on Italy. Just to clarify, of the 9% fall in motor premiums in the first quarter, how much of that was price effect? I mean, you suggested you weren't participating in the price wars, but I guess you're still taking some price effect. So, how much of the 9% was price?

And the third, just one observation, a technical question. In Italy, on the Life new business profit, the margin went up on an APE basis, but it went down on a PVNBP basis. I mean, which one matters more? And what - why was that - is that just to do with, I mean, the nature of single versus regular premium or some duration change? Or have you looked at that? Thanks.

A - Alberto Minali {BIO 16909383 <GO>}

Thanks for the questions. So, the re-underwriting of the book in France is not over for the simple reason that we had contracts in the portfolio with a two, three years maturity. And I think in the next probably one, two quarter, we will complete the re-underwriting the motor, fleet motor, and garage related business, which really created a lot of losses.

But we have been very tough in improving the portfolio. So the re-underwriting of the book so far has been very effective even if we don't have a combined ratio below 100%, which is the target we want to achieve very quickly.

France did not improve in P&C. We don't make any, let's say, forecast about the France combined ratio by the end of the year. Our colleagues know very well that they have to work a lot in cleaning the portfolio.

The improvement of the French combined ratio is predominantly due to the absence of nat cat claims, as I said. But we do see some signs of recovery in the portfolio. And especially, the season of losing customers is almost over. And we have now reached a level of, let's say, stickiness of the portfolio and customers and contracts, and we can work on it.

So, I think France, it's on the right path but there are still a lot of work to do. And I don't expect it to improve below 100% by the end of the year essentially. I feel there is a lot to do still in France, but we are doing that.

Q - Andrew J. Ritchie {BIO 18731996 <GO>}

Okay.

A - Alberto Minali {BIO 16909383 <GO>}

In terms of Italy, the motor business, we had a minus 9% in terms of gross written premium. Bear in mind that the new production premium has gone down by 6.5%. We are not losing contracts in Italy. We are not having an increase of the frequency. We are not having any increase of cost of claims. So, is it price effect? No doubt, but the underlying profitability is very strong and offset the price mechanism.

In terms of the margin on APE, I think there is a very technical explanation. Let me, one moment, read what my Egyptian colleague has written here.

[Foreign Language] (36:12-36:19)

Yeah, you – I think you spotted the duration of the business is different. So, new business margin in APE terms increased, but the margin in terms of present value of future premiums essentially is constant, 3.1% versus 3.2%. And this is due to the diverse different duration of the business. For any other technical question on these, Egyptian understanding please refer to our group (36:52).

Q - Andrew J. Ritchie {BIO 18731996 <GO>}

Okay. Thanks. Just to clarify, you say the price effect was 6.5% in Italy. That is the effect on new – I was a bit confused. Is that what you meant?

A - Alberto Minali {BIO 16909383 <GO>}

Yes. I was saying that the gross written premium overall is in the motor business...

Q - Andrew J. Ritchie {BIO 18731996 <GO>}

Yeah.

A - Alberto Minali {BIO 16909383 <GO>}

Quarter-over-quarter is minus 9%, while the average premium for the new production is minus 6.5%, which means that we start to see a lower price war in the premium in the market.

Q - Andrew J. Ritchie {BIO 18731996 <GO>}

Okay.

A - Alberto Minali {BIO 16909383 <GO>}

Which is a good sign for us.

Q - Andrew J. Ritchie {BIO 18731996 <GO>}

Okay. Great. Thank you very much.

Operator

Our next question comes from William Elderkin from Goldman Sachs. Please go ahead, sir.

Q - William H. Elderkin {BIO 3349136 <GO>}

Thank you, and hello, everyone. Two questions left. The first one is still on the Life new business profits. I think you may have partly just answered it. But I was surprised how resilient the margin was in the first quarter both compared to the sensitivities you've provided at the full year and also one of your peers have been reporting. Could you just sort of, in simple terms, walk through the maths of the downward pressure? Obviously, there must have been some from a low interest rate environment and then the balancing factors of proportioning more unit links, more protection. And then, you've also referenced having reduced crediting rates inside the pricing assumption, which would have helped as well as they became a lot more resilient than I was expecting. And then secondly, can you provide us an update with what source of new money rates you're achieving this quarter going into the P&C and Life books?

A - Alberto Minali {BIO 16909383 <GO>}

I think the first question, if I understand correctly, because it's a very wide question, the resilience and the sensitivity, we had during the first quarter further reduced the level of the guarantees, I would say quicker than the peers. We have now a level of the guarantees which is in the ballpark of 70 basis points for the new production. And this will help reducing the overall level of guarantees. And this will make our business very, very resilient.

On the other side of the coin is that we were very successful in changing the mix – the product mix. And the combination of lower guarantees and the changing of the product mix has really kept very high the new business profit.

If you look at the single new business margin movement, we have a positive recovery in Germany and CEE. We have roughly 1.7 percentage point improvement due to this changed product mix, while we do have a worsening financial condition in the calculation of the business margin which is in excess of 4.5 percentage points.

So, if you see the variation of the margin quarter-over-quarter from 22.5% – from 25.2% to 22.5%, I would say that 170 basis point come from the product mix, and the rest is negative variation coming from interest rate structure we have used for calculating this margin. I don't know if I've been clear but your question was...

Q - William H. Elderkin {BIO 3349136 <GO>}

That's really helpful. And within that 170 bps of positive mix effect, does that also include the crediting rate effect?

A - Alberto Minali {BIO 16909383 <GO>}

Yes. It's included and this 170 basis point comes predominantly from Italy which is positive and a minor portion also from France. The reinvestment rate on the P&C and life book, the reinvestment rate first Q 2015, in the Life business is 2.5% and in the P&C business, 2.1%. So, it's a very good reinvestment rate.

Q - William H. Elderkin {BIO 3349136 <GO>}

Can you give us a sense of what you're achieving this quarter?

A - Alberto Minali {BIO 16909383 <GO>}

Say it again, sorry?

Q - William H. Elderkin {BIO 3349136 <GO>}

What sort of reinvestment rates are you getting this quarter in 2Q?

A - Alberto Minali {BIO 16909383 <GO>}

The same, the same.

Q - William H. Elderkin {BIO 3349136 <GO>}

Thanks. Okay, cool. Great. Thank you.

A - Alberto Minali {BIO 16909383 <GO>}

We had towards the end of the quarter a contraction of the interest rate, on the spreads, and in the first eight months after the quarter, a re-bouncing back, so I would say the same.

Q - William H. Elderkin {BIO 3349136 <GO>}

Thank you.

Operator

Our next question comes from Michael van Wegen from Bank of America Merrill Lynch. Please go ahead, sir.

Q - Michael van Wegen {BIO 6435238 <GO>}

Yeah. Hi. One question please on the Life business. If we look at the different sources of profit, then I noticed that in the investment margin, the policyholder sharing was lower in Q1. I think it's around 80% right now. Is that mainly due to the higher capital gains? And how do you see that evolve the rest of the year? Should that go back to a more normalized level or do you think you can keep it as low as it was in Q1?

And for the other source of profit, your technical margin tends to be a little bit volatile. Q1 was perhaps a little bit weak. Is it indeed as simple as that or would you see it as a bit more structural? And for the expense margin, the acquisition cost being up € 91 million year-over-year. Obviously, it's driven by the strong sales efforts that you had. How do you see that evolve going forward? Thank you.

A - Alberto Minali {BIO 16909383 <GO>}

Yes, thanks for the question. The policyholder participation rate is not something that we can maneuver. It's already in the books. It depends on the dynamic of the reserves that we have already accounted for. So, I don't expect any policyholder participation rate in the next years to move dramatically. If we carry on pushing towards unit-linked business, the savings business will become less important, and the unit-linked much more important. In terms of profitability, we are switching towards something which is capital-light. So, the policyholder participation will have its own natural dynamic and I don't expect it to change - the level to change in the next years.

In terms of the technical margin, if I look at the operating result and the split, I see that the technical result is plus 1.6%, which is driven by the loadings and also by very good contribution of the unit-linked fees that goes into the technical result. Investment result is up because also we have decided to realize some capital gains also for the benefit of the policyholder. Expense result is very high as you said, driven only by the volume.

So, this €90 million acquisition cost is entirely due to strong sales that we had. And since that we carry on with these underwriting philosophy, I can expect that the expense result to be still a good chunk of negative of our operating performance. But I'm not concerned about the acquisition cost. I'm always much more concerned about the quality of the production and I'm pretty sure that we are moving in the right direction.

Q - Michael van Wegen {BIO 6435238 <GO>}

Okay.

Operator

We will now take our next question from Michael Huttner from JPMorgan. Please go ahead, sir.

Q - Michael I. Huttner {BIO 1556863 <GO>}

Hi there. Apologies because I joined the call later. If I asked a question which you probably said earlier you mustn't ask it, apologies for that. But on solvency, you did say in your prepared remarks that the new model, you're comfortable and strong. Can you an idea of what that exactly means? In the past, I've always sort of thought that strong meant anything above 160%. But any indication, any kind of around this wording would be great.

Then I noticed from slide 31, you've got this big hybrid redemption during 2016 of €1.2 billion, and I just wondered is this already prefunded or is that something we should expect soon?

And then finally, given how much we've spoken about Life and the new mix, et cetera, can you say a few words about Banca Generali which is doing differently and how much more strong performance we might expect there? I was just reading the transcript on Bloomberg, and they kind of indicated that they've acquired a big network last year, so Credit Suisse, and that there may be some more stuff like that in the pipeline. Thank you.

A - Alberto Minali {BIO 16909383 <GO>}

In terms of Solvency II, I mean I just made a comment that you'll need to wait until our next strategy day to have more indication about the capital position of the group. I reiterate once again that we are abandoning the old model. We are now cruising into a Solvency II framework, and we will show you the different components, available capital and the risk-adjusted capital, and so you can get a feeling of it. So, I'm not in a position to disclose anything else here and now because you need to be – you need to wait for the investor day in London.

On the big hybrid debt, €1.2 billion in 2016, yes, that's something that over time we will refinance. We are discussing internally if that makes sense to exploit favorable conditions that we see in the market. We are not in a hurry to refinance now, neither to buy it back. Now, we're in a very comfortable situation from a debt point-of-view because there are still many months ahead and we will refinance in advance, I would say, but with a calm and prudent attitude.

Banco Generali is an engine that is working very well, has very good strong performance. Probably, one thing that we have to do is to increase the target for Banco Generali but – because every single year, Banco Generali is able to beat the targets that the corporate center give them.

They are enlarging and recruiting new financial promoters. They are perfectly in line with the strategy of the group, selling unit-linked products. But also, they have additional sources of revenues because of the asset they manage and because of the banking products they sell. But they are a very important distribution network in Italy, which perfectly complement our traditional one we have in the country.

Q - Michael I. Huttner {BIO 1556863 <GO>}

And that comment, which they gave on the conference call, which was a couple of weeks ago, that because of their strong capital position, which is back to the level before the Credit Suisse deal, they could look at things again, can you put any color on that?

A - Alberto Minali {BIO 16909383 <GO>}

I mean, they have a very strong capital position also because Banco Generali does not have any real banking book and credit exposure. It's a bank servicing the financial promoter. They will use the capital for expanding, acquiring new financial promoters, only focusing on the business they run.

And I think because of the very good performance of the bank, they can restore, anyway, the capital position they had earlier than the transaction they concluded. So, it's a machine that is auto-generating capital that they want to reinvest and we want them to reinvest in the strengthening of the sales force.

Q - Michael I. Huttner {BIO 1556863 <GO>}

Brilliant. Thank you very much.

Operator

Our next question comes from Paul De'Ath from RBC. Please go ahead, sir.

Q - Paul C. De'Ath

Yeah. Hi there. Just one quick question if I may. Just looking at the Life business and the sort of earnings there, clearly, the investment return has been boosted by some of the actions that you've taken to realize some of the gains, which clearly has helped policyholders as well. I'm just wondering how much of that can we think of as effectively one-off impact in the quarter. You used to increase duration, et cetera. And how much is more of an ongoing amount? Any thoughts there on that would be good. Thanks.

A - Alberto Minali {BIO 16909383 <GO>}

Yes. You are right. The investment return has been boosted by the decision we took on realization of capital gains. Our colleagues on investment department believe that there are tactical situation in the market that we need to profit from. And so they have decided to reduce the allocation to some, let's say, lines of business. And they have decided to realize capital gains, which went also to the policyholder benefit because of the policyholder participation.

I don't think we can say this is as a one-off impact. It's part of our strategy to invest, to take duration risk in the past in advance of the market. And now, it's part of our strategy also to realize capital gains to support - I have to be very transparent on this point, to support the performance of our funds and the remuneration for our policyholder.

This is part of the overall investment policy that we have discussed with the group management committee. Bear in mind that what we have realized this quarter, €1.2 billion in the operating side of the coin, is just 2% of the unrealized capital gain we've got on the books. So, it's a minor fraction, but it's important that we keep this dynamism in the market.

Q - Paul C. De'Ath

Great. Thanks.

Operator

Thank you. Our next question comes from Thomas Seidl from Bernstein. Please go ahead, sir. Your line is open.

Q - Thomas Seidl {BIO 17755912 <GO>}

Yeah. Thank you. Good afternoon. Three questions on investment income, particularly Life, if I may. First question, also what you just discussed about the record high harvesting, especially on the bond portfolio, how should we think about the running year that it fell 40 bps year-on-year, sharper drop than reported by peers? Is that in the context of the big harvesting you did recently? The number you would expect also for coming quarters will contain a sharp fall in underlying investment income? First question.

Second question, impairments, up €100 million to €155 million. I think that's a number we haven't seen for like two years. And it seems like a ride. And so, my question is, would you agree, is there a tendency that we see a normalization of operating impairments here?

And the last question goes back to the reinvestment yield. Is that 2.5% in Life? I think at the full year call, you mentioned 3.2%. And you also mentioned it's mainly corporate bonds. I mean, I look at investment grade bonds in Europe, that's not something you should be able to get. So, I wonder if you could provide color how you get to even a 2.5% number which is again significantly above peers. Thank you.

A - Alberto Minali {BIO 16909383 <GO>}

I will start answering. Then I will leave the word to Nikhil on the reinvestment. But I will start to answer your question on the harvesting and the bond portfolio and also the impairments. Let's start from the impairments. We have a €231 million impairments this year. €141 million of impairments are the impairment we have taken on the bonds guaranteed by the Carinzia region of Austria on the Heta transaction.

You know that we have €300 million Heta bonds and we have taken an impairment of 50%, higher than the one that other peers have taken because I think we should be prudent on this point. The net impact on the operating performance has been €25 million, so a very modest one.

But I think impairments, because of the size of the group and because of the complexity of the group, is something that is very difficult to predict, first of all, and unavoidable in a certain way. So, we need every single quarter to think that there are impairments coming through from the different assets we've got in the book.

I pass the word Nikhil on the reinvestment, what we...

A - Nikhil Srinivasan {BIO 7419225 <GO>}

Yes. Thank you, Alberto. Just a couple of points, questions raised there. The reinvestment yields firstly on corporate bonds, how do we get the level in terms of rates? Essentially, we've got it through having a very active private placement business we started two-and-a-half years ago, which we are executing both in Europe as well as partly in Asia, but it's really been a European business. So, that's really how we've gotten it, and that's how we've managed to keep our yields relatively sustained through which is pretty much a difficult period.

Having said that, of course, yields have come down, and you'll continue to see yields coming down. Although Q2 should just – might be a bit of back up again. But I'm not proposing that we're going to have substantially surprising yields on the upside. But our edge, so to speak, has been the fact that we have a very active private placement business which we activated two-and-a-half years ago.

Your question on running yield, yes, of course, running yields will get hit. I don't think we get hit as much as you see in Q1, but the running yield will continue to get hit just simply because you get maturities in yield flow apart from having any realized gains. So, that's only a very, very small part of it.

I mean, the fact is we will have maturities in yield flow of several billion euros this year, and the reinvestment rate is as you see it. And that affects the running yield. So, to assume that running yield is consistent from year-on-year, I think you can assume that. But to assume another significant drop from where we are today until the next quarter, I think I wouldn't assume that.

Q - Thomas Seidl {BIO 17755912 <GO>}

Why would Q1 be specifically a sharp drop of 40 bps? Is there any specific reason for that?

A - Nikhil Srinivasan {BIO 7419225 <GO>}

No, I mean I don't – there's no specific reason for that. No, there isn't. I mean, it is the market. It is what – I have not seen our peers' results, but I can't imagine that their running yields have been stable year-on-year. I mean, that's just the way it is. But I mean, I want to assure you that our realized gains, which is €1.2 billion this year, is not the sole reason why our yield is coming down. It's just that we have a significant amount to invest. And I think that the (56:31) the front end of our business doing as well as it is, there is a lot of inflow. There's inflow we'd rather not deal with, but that's the way we have it.

Q - Thomas Seidl {BIO 17755912 <GO>}

All right. Thank you.

Operator

We will now take our next question from Ralph Hebgen from KBW. Please go ahead, sir.

Q - Ralph Hebgen {BIO 6297020 <GO>}

Yes. Hi. Ralph Hebgen from KBW. I'm afraid it's the same question. I mean, it's partially answered. Thank you very much. If you could just share with us perhaps your thinking on how you manage medium term the overall economic return you're getting from your investments because obviously, currently, you have a sort of optimization exercise to solve? There is realized capital gains opportunistically to be achieved from selling bonds. But then that will come at the expense of the investment margin of the running years going forward. So, how are you thinking about this? And what do you – do you target an overall economic return, which you'll be able to achieve? Any guidance on that would be helpful.

A - Alberto Minali {BIO 16909383 <GO>}

Yes. Thanks for this question, which goes back to the way we set the business plan for the entire group. We make an extensive analysis in terms of financial performance of the different units. So, we don't have any target of performance specifically at the group level. We do have several targets of performance in the different portfolios. We need to have an ALM approach. And we need to look at the assets that backs technical reserves.

So, it's not something that we set as a top-down ambition. It's something that comes from a bottom-up analysis of our portfolio and our investment. In general terms, we are not creating, let's say, overall economic return from real estate and equity by a huge tactical movement. I mean, we have a very strategic asset allocation approach, especially for the asset classes which consume a lot of capital, while for example, in the bond portfolio and in the corporate bond portfolio, we can become more tactical.

And as you've seen, we have lengthened the duration in the last years, benefiting from the drop of the interest rate. And this has really created huge capital gains. Now, we see it on huge capital gains, so it's a matter, as Nikhil said, of balance between the current running return and the way we use this buffer of wealth over time.

A - Nikhil Srinivasan {BIO 7419225 <GO>}

Thanks, Alberto. I mean, look, the entire industry is facing low rates. So, I think any time we have a call like this with any of our peers, you'd have the same issues. We addressed to that as I said partly through the private placement business. But really we addressed it fortunately by lengthening duration a couple of years ago and even a year ago. And I think that's really kept things stable right now. Stable in a way that it's declining, but because everyone's declining, but the decline, there's a stability in that decline.

And I think that's – today, we are with the market, but you saw what happened in the last month. You've seen yields back up. And what we have done is we will be opportunistic. I mean, obviously, we are governed by an SAA that's derived from an ALM, but we are opportunistic in that when we think opportunities might be right in the market to actually extend duration or go into corporate bonds, we will take them. And I think now, we feel coming into May and June, we have a better position to actually do the things we want to do and use some of the cash we built up than we have perhaps in Q1.

Q - Ralph Hebgen {BIO 6297020 <GO>}

Yes. Thank you very much. It's very clear.

Operator

We will now take our last question from Ms. Elena Perini from Banca IMI. Please go ahead.

Q - Elena Perini {BIO 4202240 <GO>}

Hello, and thank you for taking my questions. My first question is about the average level of guarantees in your Life portfolio. You have provided us the data for the new business which is approximately 70 bps. I was wondering about an average level if you have not provided it yet?

The second question is about the trend of your net inflows. It seems to be very strong. So, I was wondering whether we can assume a total net inflow for the current year above the level of last year.

And the final question is about the holding and the other businesses segment, given the strong performance and the strong business momentum for Banca Generali, would you expect this segment to provide a positive contribution to your operating income for the current year? Thank you.

A - Alberto Minali {BIO 16909383 <GO>}

Thanks for the questions. I will start from the average level of guarantees, which is around 2% at portfolio level. But I want to point out that the new business have a minimum guarantee rate which is much below that level. Just to give you some numbers, the minimum guarantee rates on new business is 86 basis points. For the Italian business, it's at 51. I can mention France where we have 15 basis point minimum guarantee rates. And the rest is Germany where the minimum guarantee rate is set in a different way according also to local legislation, which is 1.4%.

The net inflows trend, that's a very tough question again because it's difficult to multiply by four and say, okay, we will reach the same level last year. But I think that the macroeconomic conditions in the market are more or less the same with last year. So, the Life products will become a very important product for the wealth allocation of retail consumer. So, I don't expect it to have a drop of the net inflow in the next quarter. So, I do expect to have still a good level of this.

Banca Generali is already performing very well, and contributing to our operating income. Very difficult to say whether the performance fee of Banca Generali can be repeated in the future because this quarter, we had a fantastic injection of value from performance fee.

But because of the recruitment process of Banca Generali, a good management team, I do expect from Banca Generali to carry on contributing to our operating performance also in the next quarter and in the next years. So, it still it is something which is minor vis-à-vis the whole group, but important in terms of element in the holding and other business segment reporting.

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

Okay. So I think that wraps up all the time we've got. Thank you very much, everybody, for your questions, and goodbye for now. And we look forward to seeing you in London in a couple of weeks' time.

Operator

Thank you. Ladies and gentlemen, that now concludes today's conference call. Thank you for your participation. You may now disconnect.