Q4 2015 Earnings Call - Q&A

Company Participants

- Alberto Minali
- Nikhil Srinivasan
- Philippe Donnet
- Spencer Lee Horgan

Other Participants

- Alberto Villa
- Farooq Hanif
- Federico Salerno
- Gianluca Ferrari
- Giuseppe Mapelli
- Lance M. Burbidge
- Michael I. Huttner
- Michael van Wegen
- Niccolò Dalla Palma
- Nick Holmes
- Paul De'Ath
- Peter D. Eliot
- Ralph Hebgen
- Thomas Seidl

MANAGEMENT DISCUSSION SECTION

Operator

Good day, and welcome to the Generali Group 2015 Full Year Results Conference Call. This 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.

Spencer Lee Horgan {BIO 4241901 <GO>}

Thank you, operator, and welcome everybody to our 2015 results Q&A call. With me, as usual, I have Alberto Minali, our Group CFO, and as of last night, also General Manager of Generali. As you've also seen last night, the board formally approved Philippe Donnet as the new CEO of the Group. And it's also my great pleasure to welcome him onto the call.

I'm going to pass the word right now onto Philippe for some opening remarks, and then we'll be ready to take your questions. Philippe?

Philippe Donnet {BIO 4657671 <GO>}

Thank you, Spencer, and thank you to all of you for joining. I know that you want to get straight to the numbers, so I will be very brief. I'm taking the CEO position today – yesterday, actually, I took it after a very challenging but rewarding time executing the restructuring of Italy. I think that all of you have seen the success of this project and this is the testament of the commitment and the energy of all our employees in Italy. But this is not characteristic unique to the employees of Italy. I saw the same energy and commitments of all the Generali people all across the world and this gives me an enormous amount of confidence as we move the business forward.

My immediate priority will be to ensure that we maintain the excellent positive momentum without any disruption. We have a clear and sound strategy developed by our people around the world, and those people are fully committed and excited to see its implementation and to work on its implementation every day. It goes without saying that I feel very proud to be taking the CEO role as one of the most important insurers in Europe, but much greater than pride is the enormous sense of responsibility I feel towards our customers, our distributors, our employees, and of course, our investors all around the world.

Lastly, let me say that no CEO can be effective without a very strong team around them. I think we have one of the best management teams in the sector, and I am particularly glad to have Alberto alongside me in his new role as the General Manager, as well as remaining master of the numbers as the Group CFO.

Thank you for listening. And now, I will hand back to Alberto to answer your questions.

Alberto Minali {BIO 16909383 <GO>}

Thank you, Philippe. So, operator, we're ready to take the questions. Thank you.

Q&A

Operator

Thank you. Thank you. We'll now take our first question from Farooq Hanif from Citi. Please go ahead.

Q - Farooq Hanif {BIO 4780978 <GO>}

Hi there. Thank you for taking my questions. I've actually got three questions. I hope that's not too many. Firstly, you have made big commitments to digital investments in the next few years. So we'll be talking billions of euros. Has any of that really changed in light of the management changes? And which areas are you going to be looking at to change further? Where will we see the most investment? Will it be Italy, initially?

Second question is the Non Motor combined ratio in Italy continues to be a very positive source of underwriting profit. So could you just give a little bit more description of the portion that's Non Motor, whether that's growing and what you see as the combined ratio trends for that? So is it going to continue to be getting better? At what point does that start to plateau?

And lastly, capital generation is €3.1 billion. Holding company cash flow is €1.6 billion. What's driving the gap and how could you get it close? Thank you.

A - Alberto Minali {BIO 16909383 <GO>}

Thank you very much for the question. I will start and then we'll also ask Philippe to step into the conversation. I have to say that when we presented the strategic plan last May in London, this plan has been approved by the broad. It was not a plan elaborated by one single person. It was a corral, I would say, commitment by so many people in the organization that then, at the end of the story, the GMC approved the plan and the board of Generali approved the plan.

Even if we set very ambitious targets at the time and those markets have also changed, those targets remain valid and we are fully committed to execute this plan and to implement this strategy. By the way, we are now in March and we have already started to execute these strategies with the many actions we have already taken either in the business or also in the balance sheet management of the Group.

In terms of the Non Motor growth in Italy, yes, it's extremely good, the performance of our technical team in the underwriting of this sort of business. And also, I would say, in the rest of the Group, we are now seeing that the contribution of the Non Motor business is fundamental for the overall profitability of the P&C. We are investing so much in technical and underwriting skill and we are investing also so much in innovation that I think this remain a very important feature of our technical ability throughout the group.

There is a trend in the Italian combined ratio to deteriorate. This is a very big question. I don't see at the moment this trend. I see that in some cases we might have some negative spillover effects in the Motor business, more than offset by the Non Motor business. Overall, the technical profitability of the Group in the P&C business is very high, both in the retail and also in the corporate.

Going to your third question, the capital generation. Thank you very much for this question, because it's interesting and allows me to explain why also we have proposed yesterday to the board, and the board has approved such a level of dividend of €0.72 per share.

On one side, we think that the capital position of the group is very solid, and as our internal model tell us, we are in the ballpark of 200%. And if you remember some months ago when there was, I would say, black clouds over the capital position of Generali, I can say that that time is completely now over.

On the other side, the cash generation of the group through the remitting (07:18) capacity of the subsidiary is very strong. If you look at our presentation, you see that every single subsidiary of the group, maybe with the exception of the emerging market where we are investing money, so there is no point in getting money out through dividend, every single subsidiary is paying as dividend a fraction of the net operating return and also a fraction of the cash the subsidiary is able to generate.

This cash will go then to the holding company. There is also some intermediate subholdings where this cash can be part (7:53) temporarily, but in the end, the holding view means that through the pooling system, we can get the dividend levels on the subsidiary and we can get the 100% in the holding company. And this also serves the dividend we are going to pay. So, on the capital position, no concern whatsoever.

On the cash position, the holding is now able to receive cash, which is a multiple of the dividend we have decided to pay out this year. And the same is also true for the future because the dividend capacity and the cash capacity of our subsidiary will remit cash in a way that is a multiple of the dividend we are going to pay. So we think that the €5 billion are achievable even if the market conditions are difficult, even if there is competitive pressure, regulations is really changing.

But having said that, the structure of the Group, the way we manage the business, will allow us to get cash in a way that will sustain and support this progressive trajectory of dividend payment. This €1.1 billion we are going to pay this year is just a part of the €5 billion Philippe and the rest of the team and myself are committed to pay over the next additional two years.

Q - Farooq Hanif {BIO 4780978 <GO>}

Okay. Thank you.

Operator

We'll now take the next question from Gianluca Ferrari from Mediobanca.

Q - Gianluca Ferrari {BIO 15042989 <GO>}

Yes. Hi. Good morning and compliments for the new appointment. I have four questions. The first one is if you can quantify the capital charge you are including on sovereign debt. The second one is if you can give a bit of a sense of the royalties that the companies are paying to the holding. What is the rationale here? My third question is on the dividend paid by France, €200 million, despite the combined ratio still at 100%. Could we assume this €200 million paid by France to go up quite significantly in 2016 and 2017?

And my last question is on the non-operating holding expenses, €764 million in full year 2015. It is mainly related to financial charges on the debt. I noticed that in Q4, this line went pretty much up compared to the previous quarters. Typically, you pay €180 million per quarter. In Q4, it was €210 million. I was just wondering why. Thank you.

A - Alberto Minali {BIO 16909383 <GO>}

Thank you, Gianluca, for the question. I will start with the capital charge on sovereign debt. We don't provide this figure because the stress we run is both on domestic and non-domestic portfolio and cross country. So it's part of the interest rate charge that we have provided to the market, but we don't want to provide a more detailed figure in this very moment in time.

Going to your second question, the royalties. We decided to really understand better if there is a value in the brand. And certainly, in the case of Generali, there is a huge value in the brand, which is used by so many companies around the world. And this brand is any material asset that needs to be paid back by the subsidiary because they are using the Generali brand.

So we decided to charge every single subsidiary based on the gross written premium with a certain methodology. Define a charge, which now goes into the operating performance of each subsidiary, either Life or P&C, and then this amount of money in the ballpark of €70 million comes back to the holding company as a revenue for the charges. So the rationale is to really being able to identify the brand of Generali, which is quite strong in most markets as an asset that the company uses. And if they use an asset, they have to pay for that.

Going to the third question, the French dividend, as at the moment, France has an ability to pay at the moment €200 million. France is on a very nice recovery project. We need to carry on this recovery project and bring the combined ratio below 100%. In the plan, we do expect a growth of the dividend by roughly, I would say, 10%, 15% year-on-year. And so, this is really synchronized with the expected better performance of the P&C business, especially in France.

On the non-operating holding expenses, there are also – let me see the exclusions. The operating holding expenses, we have the interest expense on (12:58) financial debt, as you estimated, €180 million. And then we have other non-recurring expenses, which are related to some payments on share-based payments done in Italy, Switzerland, Austria and Latin America for incentive schemes of some of the colleagues in those countries.

Q - Gianluca Ferrari {BIO 15042989 <GO>}

Thank you.

Operator

We'll now take the next question from Paul De'Ath from RBC.

Q - Paul De'Ath

Hi there. Just a couple of questions from me. Thanks. So, firstly on the solvency position, so clearly, the 202% is where you want to get to. But technically, at the moment, you are at 175% on a regulatory basis. And I just wanted to check the timeline from getting from one to the other, I mean, is this a two-year project to get everything else approved or is there some indication of how long you think that process might take?

And then secondly was just on net flows in the Life business, and, obviously, very strong in Italy in the fourth quarter, but France and Germany seem to be somewhat weaker than expected in Q4. Is there anything specific carrying on that that you could tell us about? Thanks.

A - Alberto Minali {BIO 16909383 <GO>}

Thank you for the question. Going to the solvency position, we have a regulatory view that tell us that the capital position of the group is 175%, but this is not something that we use extensively internally because we do trust that our solvency position is 202% according to the expansion of the internal model to the old perimeter.

I really thank you for this question because it allows me to make two simple but very important explanation. First of all, this expansion of the perimeter to cover all the Group is not entirely in our hands even if our team have already started to work, and as you can understand, they've already started to talk to the different regulators. This is a pure regulatory matter that lies in the hands of the regulators. And as much as we can, as quick as we can, we will try to expand the perimeter in order reach 100% of the cover.

This is not something we can commit now. We can guarantee when we are able to achieve this result, because, again, we have already started to talk to the regulators, and we are in the process. Bear in mind that the 175% covers the most difficult and complicated, from a technical point of view, portions of the Group, because we cover Italy, Germany, France, the P&C in France and the Czech Republic business.

So from a complexity point of view, even if we cover two-thirds of the portfolio and roughly 60% of the total SCR, from a complexity point of view, we are really in excess of any expectation because we have modeled the most difficult and sophisticated products we sold in the Group.

So I do expect that the residual part of the journey is easier from a modeling point of view, even if it's in the hands of the regulators. So I cannot commit the company to any date. I would say the sooner the better and we are moving very fast now on this expansion of the perimeter.

On the net flows in Life, yes, the 4Q in France and Germany has been a bit weaker. We have to say that the impact of the financial market on some of the products that we sold in France and Germany was quite evident. And this depends very much on market condition, even if the net inflows in France and Germany have been, in both cases, positive.

So there is no particular reason. The only reason is the financial market volatility that has probably cooled off a bit our customers for the unit linked business, which are the aim of our effort in the Life new production.

Q - Paul De'Ath

Okay. Thanks.

Operator

We'll now take the next question from Peter Eliot from Kepler.

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

Thank you very much. First question, I guess I counted, I think about nine references in the Q&A talk script to how you compared with peers or to the industry. And I appreciate the comments you made that some black clouds in the past which, hopefully, are now in the past. So I'm just wondering looking forward how much you feel the need to compare yourself going forward from here? And how much you sort of feel (17:59) whether there's a danger of the fact of entering a race to the top?

Second thing I want to ask was on Germany. You mentioned at the Investor Day that you're making some progress introducing the ZZR and I noticed in some comments that you've made some beneficial changes in your model. I was wondering if you could just elaborate a little bit on that and if there's any sort of quantification you could give.

And then, thirdly, very quickly, I'm just wondering if you could say what the sensitivity to corporate spreads would have been without this volatility adjuster. Thank you.

A - Alberto Minali {BIO 16909383 <GO>}

Thank you, Peter. Starting with the comparison to the peers, I have to say that I don't look much at the comparison with the peers because we think we have our own positioning in the market, our own brand and franchise, our technical ability. But when I talk to people like yourself or the investors, I have to look also at the peers. And if I look at the peers at the moment, I see that, for example, the technical and the writing ability of the Group is quite strong. Our margins on the P&C business are much better, and our combined ratio is much better than the peers.

If I look at the performance on the Life business, we are more or less in the same league of the others. And if I look also at the capital position, we are now as strong as the other, even if we don't see the need of any race. There is no race in terms of capital position. And every single capital position needs to be assessed vis-à-vis the risks we have on the books and the business we are going to underwrite.

So to have 200%, 190%, 210%, for me and also for the rest of the Group doesn't make any real difference. Germany, ZZR. We have incorporated during February the so-called

ZZR recalibration that has been proposed by BaFin and this has brought to a significant reduction, I would say, in the ballpark of 10%, 15% to our ZZR needs in our capital.

I want to stress that what we use is what has been approved by the regulators. There is no subjective approach to the modeling of the ZZR. We do exactly by the book. And whenever there is a change in the regulation, we incorporate this change in our model.

In terms of the impact of the sensitivity of the corporate spread without the volatility adjustment, here, I think it's very technical issue. If you look at the corporate spread sensitivity, most of it is compensated or balanced out by the application of the volatility adjustment. The same case does not happen for them or for the government bonds where the volatility adjustment does not work properly as in the corporate spread. So very difficult to say how much.

I would say the vast majority of the volatility in the corporate spread business is absorbed by the volatility adjustment, and this was really the purpose of the EIOPA and the regulators when they set this rule in order, honestly, to mitigate the impact of any widening of the spreads.

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

Okay. Thank you. You're not able to give us sort of ballpark for where it might have been if you haven't used the volatility adjuster.

A - Alberto Minali {BIO 16909383 <GO>}

Sorry. I didn't hear you. Can you repeat?

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

Sorry. I was just checking, you're not able to give us a ballpark figure of where it would have been without use of the volatility adjuster.

A - Alberto Minali {BIO 16909383 <GO>}

There is one technical reason why I'm not in a position to give a precise number. You have to imagine that this volatility adjustment is applied at portfolio level in the modeling exercise. So the end-up figure is the sum of many different volatility adjustment applied at different portfolio levels. So telling you that is 50%, 90%, 10%, it doesn't make any difference. I would say that the corporate spread volatility is absorbed very importantly by the volatility adjustment.

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

Okay. Thanks a lot.

Operator

We'll now take the next question from Michael Huttner form JPMorgan.

Q - Michael I. Huttner {BIO 21417183 <GO>}

Thank you very much. I thought the transfer was brilliant. Thank you very much. And congratulations for becoming General Manager. I suppose that's well done. In your transfer, you talked about, and I quote, this is a section, there's no page numbers, but it's a section called own funds, SCR, and sensitivities in the second paragraph here.

And an important one is that's, obviously – why that starts to (22:51) improve. An important one is the overall better financial market conditions led to a strengthening of the position of some of the life funds of the Group. I just wondered if you could explain that a little bit more. Was it you who added money, or is it just interest rates? I think, they went down, didn't they? I'm not sure. Sorry. I couldn't quite work that out. That's the first question.

And then, separately, on German Life. I just wondered if you can explain a little bit more what's happening there. It's a bit of a favorite topic of me and it's a bit in comparison with Allianz, but if you could say how much your Life exposure is to this challenging German Life result, how much the figure is, how much the ZZR is, and how much you had in buffers, (23:41) and maybe the unrealized gains? Just to get a feel for the strength for the Group. That would be really helpful. Thank you.

A - Alberto Minali {BIO 16909383 <GO>}

Thank you, Mike, for this question, also for congratulation on the appointment. We receive, Philippe and I, a lot of compliments this day, but I see the stock price a bit down. So I would prefer to see the stock price up and to receive less compliment. But, apart from that, let's go to the question. Sorry. But I had to say that.

Q - Michael I. Huttner {BIO 21417183 <GO>}

No. It's very good.

A - Alberto Minali {BIO 16909383 <GO>}

The people might think (24:15).

Q - Michael I. Huttner {BIO 21417183 <GO>}

Yeah. That makes sense.

A - Alberto Minali {BIO 16909383 <GO>}

Thank you. Maybe at the end of the call, we can reconsider this. SCR and sensitivity, If I understand correctly, your question, there is a change in the sensitivity that we have provided this time, with this disclosure, with the one we had before. And it's because we had a different impact by the prevailing market condition on the buffer. So we had better ability to absorb some shocks, especially in terms of interest rate and corporate bond spreads.

And also, we have a positive impact from the unrealized capital gain that have gone up because of the compression of the spread. Bear in mind that also in this sensitivity, if you compare us with the sensitivity we published some months ago, there is a trend of reduction for the simple reason that the new business is going into the books with a lower content of risk. And this proves the point that we are really moving the production towards less capital intensive product and we are making a better use of the capital.

In terms of German Life, what's happening? The regulator has slightly changed the approach to the ZZR and we had some provisioning during 2015, roughly €100 million of ZZR in 2015 and the stock of ZZR is €2.7 billion at the moment. We are carrying on reinforcing the ZZR with the unrealized capital gains we got on the books. The position at the moment is safe and sound. We do have enough capital gains to support the ZZR by reducing the three RSP (26:06).

So, at the moment, the situation is under control, but our teams in Germany are increasing, strongly increasing the production towards unit linked and protection, and we are in Germany in negative production of saving business exactly for this reason. So, it takes time to change the portfolio, but the direction is the right one and we do expect to be able to change it almost completely the portfolio before the unrealized capital gains are not enough to cover the funding of the ZZR.

So, I would say that, there is no big issue at the moment in the German Life operation from this point of view. Although, the effort we are making with the team in Germany in changing the portfolio and integrating the companies is really a very big effort in front of us. It's also part of the plan and we need to have at least a couple of years to execute this restructuring project. The same we did in Italy is now happening in Germany and if we think about it Italy and Germany are 50% of the Group.

Q - Michael I. Huttner {BIO 21417183 <GO>}

Brilliant. That's very helpful. Thank you very much. Thank you.

Operator

We'll now take the next question from Niccolò Dalla Palma from Exane BNP Paribas.

Q - Niccolò Dalla Palma

Yeah. Good afternoon, everyone, and thanks for taking the questions. So, the first one, I think slide 10 is actually very helpful. It's simple, but I wish (27:38), the entire sector disclosed that. The 16 points of normalized capital generation and that compare with, I think, in the past you mentioned around 12 points, if I remember correctly. Just wonder if you have a view on how the new number reconciles with your earlier guidance. So, where did – what generated more capital than you expected? And I think, is it fair to assume that this is – because it's normalized capital generation, it should be a good guidance for the future. Just to make sure there's no specific elements related to 2015 in that. But, otherwise, it's a very helpful slide. Hopefully, you can give it also in the future.

Secondly, on the Italian net inflows, which are very strong at €7.6 billion. You mentioned 80% of that is hybrids. If I do the numbers correctly, stripping out Banca Generali, that means €3.9 billion has actually been sold by the traditional network, which is a clearly significant number. I was just wondering, I saw some quite strong statements by the regulator, the IVASS around the products. They are trying to advise consumers to make sure that they take time to understand how this work, understand the cost structure, go – and therefore, there seems to be also some actions in terms of going to the companies, reviewing the product and selling practices. And maybe question for Philippe, just to know, if this is something you had a conversation with the regulator. Do you think – was it minor adjustments you have to implement? Is there any adjustments you have to implement and so what you expect from these increased, let's say, attention of the regulator on the hybrid products.

Thirdly, on the P&C prior year development, it was pretty strong this year, around 100 basis points higher than the previous three years. Just checking, is this, in your view, a sustainable level? Is there something, let's say, one-off for 2015? How should we think about this? Thank you.

A - Alberto Minali {BIO 16909383 <GO>}

Thank you, Niccolò. And I've been very good in giving guidance of 12 points before the closing of the bond, but I'm now looking at the colleagues here. The 16% capital generation, it coincides with the 12 points I illustrated some months ago, because the 12 points was the nine-month figure and the 16% is the yearly figure.

Having said that, we shouldn't – we should trust this figure, but we shouldn't rely blindly on them, because the 16% can be volatile by its very nature. In this capital generation, you have the new business value of Life, the technical result of the P&C business, the unwinding of the profit, the cost of the debt.

So – but the components are, by definition, volatile even if we think that the capital generation of the group is in the ballpark of 16% yearly. And this allows me to say that the dividend we are going to pay is self-funded by the capital we are going to generate internally.

That's a very important number that we keep under-monitoring every single quarter because this shows effectively if the business is moving in the right direction and if the valuation of the business confirms what we have put in our business plan. So, 16% is the yearly approximation of our capital generation, at the moment, the best one. But please bear in mind that some elements are volatile and difficult to forecast, especially in the planning process.

I will move to the third question and then leave the second to Philippe. The Non-Life prior development versus last year, yes, we had this year a increased result in term of run-off reserve release. This is, honestly, unexpected on one side and not maneuverable on the other. If you look at the total reserving level of the company, even if the business has grown, the total reserves of the company have increased.

So, we have not this number in the accounts because we have squeezed the reserves. I want to stress this point, but because of the prudent claims of reserving policy that our colleagues around the world put in practice. And whenever there is a prudent claim on reserving policy, when you pay the claim, you got a bit of effect that goes into the account and support the P&L.

So, we think that the run-off reserve release result should be in the ballpark between 3% and 4%, and more or less, this is the case. This year, its 4.6%, but I do not expect to deviate significantly from this 3%, 4% corridor. Let me pass the word to Philippe for the second question.

A - Philippe Donnet {BIO 4657671 <GO>}

Thank you, Alberto. About the net inflow in Italy, I think we have two good news. The first one is that, in 2015, we're able to realize this very significant net inflow, very positive, very significant, probably one of the biggest of the Italian market.

The second good news is that the main share, the biggest part of this net inflow, as you mentioned, was made with the new hybrid products we launched a few years ago, and this is very positive as well. This has been achieved through all our sales channels, of course, with the financial advisors of Banca Generali, but also the employees of Alleanza and the general agents of Generali Italia.

It's, obviously, as we are the leading Life insurance company in the Italian market, it's obviously, a significant change in the Italian insurance market. And as it is a significant change, it's very normal that the Italian regulator is interested in how we manage this change.

We are talking – we are always talking to the Italian regulator, and obviously, we have discussion with the Italian regulator about how to manage this important change. Definitely, we will have to do some fine-tuning about the way we inform the customers about the way we sell this kind of products. So, we closely – with the regulator, we will work on fine-tune the sales process of this kind of products.

Q - Niccolò Dalla Palma

Thanks very much. Thanks very much for that. Just one quick follow-up for Alberto on the capital generation, is it – I thought the SCR remained pretty stable year-on-year. Is this something we should expect also going forward, thanks to the run-off of the back book probably financing some of the growth? Is that a fair assumption?

A - Alberto Minali {BIO 16909383 <GO>}

It is. forecasting the SCR is a job that I, with great pleasure, I leave to somebody else.

Q - Niccolò Dalla Palma

Okay.

A - Alberto Minali {BIO 16909383 <GO>}

But I have to say that, if we implement what we have in the plan, which means moving the production towards less capital-intensive products and keeping this strict underwriting control on the technical profitability, I think that the SCR would be much less volatile than the available fund. And I think it would be a valuation – I don't know how to estimate it between 5% maximum, 10% overall in the next years, if we are able to implement the plan we have in mind.

Then, you know that the SCR depends on calibration, volatility, curves and a lot of other sophisticated issues. So, honestly, it's difficult to say how it would evolve. But if the SCR mirrors the quality and the content of risks of our books going forward, I think it would be a pretty stable number.

Q - Niccolò Dalla Palma

Okay. Thanks very much and all the best to both of you in your new roles. Thank you.

Operator

We'll now take the next question from Nick Holmes from Société Générale. Please go ahead.

Q - Nick Holmes {BIO 21515144 <GO>}

Hi there. Thank you very much. I had couple of questions. First one is for Philippe. Just wanted to be clear, are you planning to review the financial targets that you have for 2018? And is there anything – I mean, if you can't give a kind of more definitive answer on that, is there anything that you feel you would like to review?

And then the second question is on Solvency II. Sorry to come back to this point. I know that you don't want to give a date by which time the internal model will be fully approved, but I just wondered can you at least tell us do you expect it to be by the end of this year?

And then, sorry, (37:23) a question actually. Can you tell us what the current level of the Solvency II ratios are? Thank you very much.

A - Philippe Donnet {BIO 4657671 <GO>}

I will answer the first question and Alberto will answer the following one. We announced our targets on cash and dividends last year in May, and those targets have not changed. Of course, we know that, due to the market conditions, which are not better now than what they were in May last year, we know that we will have to make more efforts to achieve our targets. But we are already focused on implementing this plan.

We started implementing this plan at the beginning of the year. It was already an ambitious plan. It's still an ambitious plan. But when I look at what we have achieved in the last three years, I'm quite confident that we are in the position to achieve ambitious targets. So, we are not working on thinking if we should change the target. We are working on what we have to do on cost, on the control of the combined ratio, on the quality of our Life net inflow to make it happen.

Q - Nick Holmes {BIO 21515144 <GO>}

That's great, Philippe. Sorry, just very quick follow-up. Is there a date you have in mind for the next strategy update, the next Investor Day, when you might give us more information on this?

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

Yeah. Nick, it's Spence here. So, we've not changed the date we published previously. So, on the 23rd of November in London, we look forward to welcoming you all to that presentation.

Q - Nick Holmes {BIO 21515144 <GO>}

Okay. That's great.

A - Alberto Minali {BIO 16909383 <GO>}

Nick, your question on the timeline of the internal model, the expansion of the project. Let's split it down in some elements. We have already started to talk to the French regulator for enlarging the model to the Life French business and subject, subject. I want to repeat subject to regulatory approval, we do expect in few months, hopefully, by the end of the year or probably the first month of next year to get the approval. And the work that has been done with the regulator is quite intense and we do expect a positive outcome from the regulator. Then we have a subset of other countries, the EMEA countries especially and some emerging markets, where it takes more time, but we already started to talk to the regulators.

And then there is a third pillar, the third block, which is the operational risk. I personally ask my colleagues to double, again, consider the operational risk, because there are some indication in the banking system that we are going towards more standardized, let's say, models than the internal one.

So, if you combine these three elements, we think that maximum by 2018, hopefully, we can get everything modeled and perfect (41:02) recover with different level of speed depending upon the response of the regulators, which we do expect to be able to handle.

The operational risk is a question mark, because nobody has really an internal sophisticated model on operational risk and also the attitude of the banking regulators is changing. And we need, by definition, to consider also these in our modeling to learn from experiences that other sectors have done.

The current level of Solvency II ratio, the 202% can be read 189% at 11th of March, so we have lost roughly 12 percentage points, 13 percentage points. And we have lost in terms of regulatory review (41:44) 11 percentage points. So, as you can see, there is volatility in the number, but nothing that can be disastrous or dangerous.

Q - Nick Holmes {BIO 21515144 <GO>}

Sorry. Just to be clear on that, it was 11 percentage points of the 175%?

A - Alberto Minali {BIO 16909383 <GO>}

Correct.

Q - Nick Holmes {BIO 21515144 <GO>}

That's brilliant. Thank you very much.

A - Alberto Minali {BIO 16909383 <GO>}

Thank you.

Operator

We'll now take the next question from Lance Burbidge from Autonomous. Please go ahead.

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

Good morning. Yes. I've got three questions, I think. The first is on the French Life business. The IRR has ticked up on new business, but still it's only 6.6%. So, I wonder what you are doing to improve that, because it is an anomalous part of your business, still.

And then I want to get back to 16 points of Solvency II capital generation. And I was trying to frame this in a sense of how much of that is intangible because, I guess, when looking at the embedded value report and if we put it into euro terms, the 16 points is about €3.3 billion. So I'd guess at least a third of that comes from the value of new business in Life, but could you sort of talk about that maybe a bit more?

And then in terms of Italian P&C, clearly, things are getting worse in Motor, but does that - and you seem very confident in terms of the Non-Motor, in terms of that not deteriorating. But I wonder why you're so confident that competition is not going to get more intense in that side of the business.

A - Alberto Minali {BIO 16909383 <GO>}

Thanks for the question. Let's go back to number one, the French Life business. Yes. It's correct. The internal rate of return of the French Life business is not satisfactory. It's also driven by some, let's say, mythological issues in calculating new business value. We have completely change the range of products in France in order to tackle this situation. We are also changing the way we structure the cost of the product in the Life operation in France. And all things been equal with the new product, we already would have double-digit internal rate of return. Now, the products are to be discussed with the colleagues of the corporate center and also with the distributors in France. But we think that going forward an internal rate of return of 6% is not anymore acceptable in the Group and we need to really to improve the profitability.

Having said that, France is a very difficult market, very competitive, with a huge volatility and the customer in France use the Life business as a parking, let's say, liquidity parking facility moving from banking products into Life. So, there is a inherent implicitly higher volatility and it's much more difficult to structure products in France vis-à-vis other countries that are performing and with a higher internal rate of return. But the all product range have gone through an important reanalysis and the managers there are really working hard to improve the profitability of this business. You need to wait some months. But, some signs will be visible, I think, soon.

Going to your second question, there is an intangible in the 16 points of capital generation. If you remember that the new business value is €900 million and the unwind of the value enforced is more or less the same. Immediately, you have an understanding of how much is intangible into the Solvency II capital. But this intangible is still capital also from the regulatory point of view. So, I understand your question, you want to split what is tangible, what is not tangible, but is all capital that we go also in the Tier 1 as you've seen in our number 12 slide. I will leave the word to Philippe also relying on his direct experience on the Italian markets. Philippe?

A - Philippe Donnet {BIO 4657671 <GO>}

Regarding the Motor insurance combined ratio, we were able to keep it as a good level in the past few years despite a very strong decrease of the average premium. You need to have in mind that in this past three years, the average premium on the Italian market decreased by something around 20%. Fortunately, the loss frequency went down as well and this is why despite the strong price competition, the market and especially Generali was able to keep the combined at reasonable – reasonably good level. I think that now we are close to the end of this price competition. So, I think that, that premium will be stable. The average premium will be stable and I think that our combined ratio will be stable as well.

Regarding the Non-Motor combined ratio, it improved significantly in the last three years in Italy, because we've been working on it. We've been changing the products. I mean, the integration was a great opportunity to get the rate of the non-profitable products and to keep only the more profitable products.

This was a great opportunity to align all the agents, channels on the same underwriting policy. And we had a very strong focus on portfolio pruning, because we took over three different portfolio from Generali INA Assitalia (48:10) and Toro. And that was a good opportunity to know much better the portfolio and to work on the improvement of the quality of the portfolio.

I think this had very positive impact on our Non-Motor combined ratio. We are quite confident that this combined ratio is under control for the next few years despite we had very good result, despite an increase of the cost of the catastrophic events, which were higher in 2015 compared to 2004. So, despite these, our combined ratio is fully under control.

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

Great. Thank you.

Operator

We'll now take the next question from Thomas Seidl from Bernstein.

Q - Thomas Seidl {BIO 17755912 <GO>}

Yeah. Thank you. Good afternoon. Three questions, please. First on slide 10. I'd like to know where we could see the €1.3 billion debt you issued last year. Is it part of normalized capital? Is it part of the variance? And so, where do we find that in the slide or did you exclude it from the slide?

Second question is on the embedded value over to page six. There's a significant reduction in required capital from €10.2 billion to €4.5 billion – €5.7 billion, sorry. My question is, what is driving this, Solvency II bringing down capital requirement by that much?

And my third question is basically to Philippe. With the CFO now taking over wide-ranging operational responsibility, my question is, how do you think the CFO can provide independent oversight over the operational businesses given the combined role now? Thank you.

A - Alberto Minali {BIO 16909383 <GO>}

Thank you, Thomas. The €1.3 billion debt that we issued last year is not in the slide, because it was a double accounting. So, it's not been considered in the slides of the slide number 10 that you refer in terms of movements.

On the second slide, yes, there is a reduction of the capital requirement, a sensible one, because this has increased significantly and this can be used as a required capital as a free coverage. If you remember, our methodology, until 2014, had required capital, which was calculated as a maximum between the Solvency I and the Solvency II. Right now, being into Solvency II framework, we consider the capital equal to the Solvency II requirement, which means that the value enforced is real capital, and we can use it for free coverage. I will leave the third question to Philippe. If you can please repeat it because the line was not particularly nice.

Q - Thomas Seidl {BIO 17755912 <GO>}

Yeah, sure. Maybe a follow-up on the other questions on the – I'm talking about the required capital, right. So, I think that it's down by 40%. I'm not sure I understand why you think that has to do with the risk. And is it really that between Solvency I, Solvency II, the difference is so much lower on the Solvency II.

And my third question was simply to Philippe, given the expanded role of the CFO, or being General Manager of wide ranging operational units, I wonder how you think about this independent oversight about those businesses? I mean, usually, you have a split between CFO and operating units. And now, we see management change, you basically combining those two roles, which could be seen as creating some conflict of interest?

A - Alberto Minali {BIO 16909383 <GO>}

Yeah. To go back to your second question, Thomas, in the past, we were considering the capital absorption, the embedded value model, as the maximum between the Solvency I requirement and the Solvency II. And in most cases, we have the Solvency I requirement much higher than the Solvency II. Now that we have abandoned this rule because now we are living into Solvency II framework and abandoning the rule of the maximum, we are just left with the Solvency II, which is, I would say, 35%, 40% lower than the Solvency I requirement. It's just purely technical, let's say, explanation that you can see also, I think, in the report, the supplementary information that we published.

I will now leave the question to Philippe.

A - Philippe Donnet {BIO 4657671 <GO>}

So, first of all, if you read well the organization, you will understand that the CFO is not in charge of the insurance business because the Chief Insurance and Reinsurance Officer is not reporting to the CFO, but is reporting to the General Manager. It happens that the CFO and the General Manager is the same person. Anyway, the business is not done by the Chief Insurance and Reinsurance Officer. The business is done in the business unit in the countries, and there is no business in the holding company.

What is the role of the Chief Insurance Officer? His role is to control the countries, the business unit and the insurance matters. So, it's a controlling role. It's not a business role. The business, once again, is done, realized 100% in the operating companies, and the operating companies are directly reporting to me. So, I think there is no conflict of interest in putting all this control function together under the responsibility of the new General Manager. I hope it's more clear to you now.

Q - Thomas Seidl {BIO 17755912 <GO>}

Okay. Thank you.

Operator

We'll now take the next question from Federico Salerno from MainFirst.

Q - Federico Salerno {BIO 2565091 <GO>}

Hello. Good day. I hope the line is good enough. Just two questions, please. The first is on Life, Philippe was referring to the quality of net inflows previously. You noticed that the share of unit linked in Italy remains very low at 17%, up just 1 percentage point year-on-year. Where do you think that number can really go in the next two to three years? Will it be possible to push it to something more meaningful or you are facing resistance by the agents? That's the first question.

And the second is on BTG. Do you have a net number for the write-down, meaning net of taxes and everything? Thank you.

A - Philippe Donnet {BIO 4657671 <GO>}

Well, three years ago, the share of the unit-linked in the net inflow was close to zero. Now, when I look at so-called traditional channel like Alleanza, last year, they were selling half of their new business through hybrid products, which is enormous cultural change for the so-called traditional products because this is true for Alleanza. This was true as well for the agent. So, they did a significant step because most of the net inflow has been made through hybrid products.

And then, now, within the hybrid products, we increased progressively the share of the unit-linked. We started with a product, Valore Futuro, with 70% of segregated fund and 30% of unit-linked. Now, we're doing the opposite. So, we considerably increased the share of the unit-linked within the hybrid products. So, I'm quite confident that we will continue on this road. It's not easy. It's not – it's very challenging because of the market condition. It's obvious that due to the high volatility of the equity markets, as of today, people are a bit reluctant to invest in unit-linked. But our hybrid products are a good combination that remains still attractive. So, we will continue our journey on this and we will increase steadily year-on-year the share of unit-linked in our portfolio, but it's a journey.

A - Alberto Minali {BIO 16909383 <GO>}

Federico, your second question, the net write-down net of tax is €89 million.

Q - Federico Salerno {BIO 2565091 <GO>}

€89 million. Okay. Thank you very much.

Operator

The next question comes from Giuseppe Mapelli from Equita.

Q - Giuseppe Mapelli {BIO 7269722 <GO>}

Yes. Good afternoon. I have two questions. The first one is on your asset allocation. I would like to know if you are increasing your risk appetite in order to sustain the financial return on assets.

And my second question is on the impact of Solvency II on small players that are on the market. Do you expect an M&A opportunity to, let's say, to appear in the next future on the market? And what's your view – what's your approach towards this possibility? Thank you.

A - Alberto Minali {BIO 16909383 <GO>}

Thank you for the question. I will start from the second and then leave the floor to Nikhil for the first one. We have not study a lot the impact of Solvency II on small players in the market. There might be different opinions. There are people that believe that Solvency II is so costly and so time-intensive and human resource-intensive that small players cannot afford it. And so, they are condemned to use maybe the standard formula, which signals a higher level of capital, I don't know. Or there may be also people that believe that the small players are more agile, more flexible. It's a question that really do not - we don't feel it as an important one for the size of Generali. And we are really looking honestly on the application of Solvency II on our capital model and our position.

So, I don't know how to answer the impact or if there are possibilities or M&A transaction coming out of Solvency II, we will see. Certainly, we are much more focused on completing the journey and improving the expansion of the model as quick as we could, as I said before. Nikhil?

A - Nikhil Srinivasan {BIO 7419225 <GO>}

Thank you, Alberto. The short answer to your question is no. We're not taking huge amounts of risk. If you look at asset allocation, 2014 versus 2015, you will see the government bonds declined by about 1.8% in terms of market value, in terms of ownership and corporate bonds went up roughly about the same the rest in other asset classes including alternative fixed income.

So, no. The short answer we will not be taking additional risk of any variety to make up for loss in income. Equity holding was lower at the end of the year than it was the year before (01:00:42) even equity markets was negative. So, that's it.

A - Alberto Minali {BIO 16909383 <GO>}

Thank you, Nikhil.

Q - Giuseppe Mapelli {BIO 7269722 <GO>}

Thank you.

Operator

We'll now take the next question from Michael van Wegen from Bank of America.

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

Yeah. Hi. Good afternoon. Thank you. Alberto, two questions, please, first on the P&C business. In Q4, we've seen an uptick in your loss ratio both in Eastern Europe and Germany. Eastern Europe, it's being flat. The regulatory changes in Poland have had an impact there. Can you quantify the impacts from that? And to what degree that is, indeed, a one-off or how you expect the Eastern European business to develop going forward? The same thing for Germany, there was some volatility. Q3 was a very good quarter in terms of loss ratio. Q4 was a lot weaker quarter. Can you talk a little bit about the outlook there?

And then, final question, looking at the holdco performance in the quarter and, I think it's slide 37, can you talk a little bit about the holdco operating expenses, the outlook there? If you correct for the reallocation of cost or the branding fees, as you guys call them, the holdco expenses in the quarter seem to be up about, if I'm not mistaken, 15% or so. What's the outlook for that? And are there any one-offs in the result of other businesses in that holdco line? Thank you.

A - Alberto Minali {BIO 16909383 <GO>}

Thanks for the question. P&C in the fourth quarter, yes, we had a negative impact on the Polish operation. We recorded €46 million increase in the technical reserves due to the unification of the reserving system, which proves against the point that we are very conservative and prudent on reserving and also some changes in the regulation that affect our Polish operation.

We have a deterioration of the result, both in the prior years and the current generation of business in the Polish Motor market, which we are tackling. We have also changed the management team recently and the new management team is really handling the situation with a lot of energy and dedication.

We also had a deterioration of the German Motor combined ratio in the fourth quarter due to an expected big Motor claim that happened in March 2015 and also a deterioration in a segment of customer below the €1 million sum insured which we are now tackling with a new underwriting methodology.

The outlook is not to expect further deterioration of the combined ratio, but I have to say, both in Germany and in CEE, what we have "lost" in terms of Motor combined ratio is being offset by the fantastic performance in the Non Motor account. So, I think the outlook, even if the market remain competitive, the outlook is still reassuring and positive.

The operating holding expenses, yes, we had an increase of the holding expenses predominantly due to the reinforcement of the corporate center and the increased run rate of cost for the people we brought in the corporate center. We spent also €20 million more for the regional offices. We spent some money also for the completion of the Solvency II business project.

And that's all I think that the outlook for the holdco expenses, and it's something that Philippe and I and the colleagues have to discuss thoroughly is to have a flat or maybe diminishing level of them. But we need to go through the details because in the last three years, the corporate centers really have been reinforced and the amount of projects we have been handling from the corporate center has been enormous. So, now we need to sit down and reconsider some of the projects in line with the expense ratio, we want to have a (01:04:57).

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

Thank you, and that's very clear. And on the last question, the Other businesses, are there any particular one-offs in there that you think require flagging? I think that the result in the quarter was particularly weak compared to the first three quarters of the year. Just wondering whether perhaps you realized less gains or there's some other funny one-offs in there? Thank you.

A - Alberto Minali {BIO 16909383 <GO>}

Yes. If you look at the Other business, the positive movement or the positive outcome during the year is due to a better-than-expected performance of Generali Real Estate and CityLife, while the negative item that is a bit of contradiction in a way but negative item we had to record in the fourth quarter is predominantly due to two effects.

One is the payment of some legal costs that we incurred in the past for some transaction that has been accounted only recently in the fourth quarter and also reclassification on interests, negative interests, on debt that were moved from one entity to the other, and according to our accounting principle, fell into the bucket of Other business. But I would not consider this really a recurrent issue, it is one-off.

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

And the number involved in that?

A - Alberto Minali {BIO 16909383 <GO>}

For the first one, element is €13 million (01:06:24); for the second, €17 million, which explain €30 million out of €40 million. The rest, we have some smaller other costs and, yeah.

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

Okay. Very helpful.

A - Alberto Minali {BIO 16909383 <GO>}

(01:06:40) to see the material.

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

Thank you. Thanks.

A - Alberto Minali {BIO 16909383 <GO>}

(01:06:43).

Operator

We'll now take the next question from Ralph Hebgen from KBW.

Q - Ralph Hebgen {BIO 6297020 <GO>}

Hi, guys. Ralph Hebgen from KBW. I've got three things. One is forgive me that I go back to the progress on the approval for the full internal model. I sense, Alberto, that you're slightly more, let's say, cautious on the timeframe over which this can be delivered. I believe in the past you indicated two years till the end of 2017, now it might be 2018. It will help me, I think, if you could perhaps indicate what the most important building blocks on the roads to the full implementation would be. Is it the French Life business and the operational module for example? And also, perhaps, if you could give us a guide of how much impact approval of the French Life business would have? That's number one.

Number two, on the regulatory model, could you help us with some rough sensitivities there? And number three goes away from solvency. I noticed that in the Life business, you had a high incidence of acquisition costs which are obviously related to good growth and also in sales of risk and protection business. Now, could give us an idea of what the sort of dynamics behind acquisition costs might be as you invest more in technology and also direct business? Can we expect acquisition costs to come down in the future over the delivery of the strategic plan? Thank you very much.

A - Alberto Minali {BIO 16909383 <GO>}

Yes. You are right. We have been very cautious on the timeframe because really we talk about the regulatory approval which is not in full control of ourselves. It depends very much on each single regulator. Each single regulator should take the time to analyze the staff. And I think that in terms of the first building block which is the Life French business, we do expect to have a significant contribution in terms of closing the gap between the regulatory view and the full internal model view, which I expect to be more or less one-third of this distance to be absorbed, to be covered by the French modeling. That's my personal estimate but again it is up to the regulator and we will discuss with them and talk to them and have to wait for their final decision without committing them in advance. I want to be very transparent on this point. That's my personal estimate.

The regulatory model sensitivities are more or less exactly the same of the Solvency II full internal model view, maybe lower in some cases because in some cases we also have the standard formula component which is not so volatile as the internal model component. So, if you read the sensitivity of the full internal model, you can read them also in terms of regulatory. You are taking a cautious approach if you read the first interpreting the second.

Life business, that's a tough question because the business plan and also the activity we are doing at the moment is not to – if you allow me this expression, to replace the old distribution model with a new one, is just reinforcing the distribution model. So, I do not expect to have acquisition cost going down in the short term. All the innovation, all the investment in technology, digitalization we are doing are for supporting the distribution network we have and on top, to develop other distribution network. So, we are not investing innovation for killing the traditional distribution network that have been fantastically performing in the last year.

And again, I do not expect to replace one with the other. So, for some years ahead of us, I do expect the acquisition cost to remain at the same level, at least, while I do expect to have efficiency gains in the way we handle the claims, in the way we handle the customers, and the way we service the customer. That's where we expect also to benefit from the experience on the field of Philippe. We do expect to have real significant benefits.

Q - Ralph Hebgen {BIO 6297020 <GO>}

Thank you very much. Very good. Thank you.

Operator

We'll now take our last question from Alberto Villa from Intermonte. Please go ahead.

Q - Alberto Villa {BIO 16005221 <GO>}

Hi. Good afternoon and congratulation from my side as well. Very quick questions because most of them have already been answered. But I wanted to just to add a flavor on how business at operating level is delivered and developing in 2016? Have you seen any significant impact coming from the volatility of markets towards your business and on the combined ratio? And generally, on P&C, are you seeing any particular different trends from what we have seen in the last quarter at the beginning of 2016?

And the second question is I understand you're not planning any major change on the asset allocation and on the investment strategy. I was wondering, on the other side of the P&L, on the financial structure given the ECB purchase program now is opening the window for a lot of issuance of corporate bonds by companies, if you're planning anything on that side. I know you already did a lot in the last two years. Just wondering if there is any opportunity for you to tap the market?

A - Alberto Minali {BIO 16909383 <GO>}

Yes. On the operating result development, Alberto, it's very difficult at the moment to forecast the quarters since they are volatile by their very nature and also we live in volatile time. What I see from my observatory is that the unit-linked business is becoming more difficult during tough times. And so, if you believe that we have tough times in terms of market ahead of us, the unit-linked effort in changing the production mix will become really a very important one effort for us.

So, I think the unit-linked business is becoming more difficult to be sold in the future if the prevailing market conditions are difficult. I do expect, as Philippe has said, especially in Italy and some countries, the end of the price war, even if I want to stress that in most of the countries, Italy included, we have defended the portfolio and the number of contract is stable. So, if there is an end of the war, we would have a repricing, positive repricing, let's say, of the existing contract portfolio, which will become positive.

Financial volatility is always there. We do not see huge impairment so far in the first two months, and we are prepared to handle them if this is the case. As Nikhil has said, we don't expect any changes – major change in the investment strategy. I was reading the

SCB (01:14:46) purchase program, but we are not planning to be part of that. Honestly, it's not our cup of tea. We don't feel the need of bringing that program for us in action.

Q - Alberto Villa {BIO 16005221 <GO>}

Okay. And thank you very much.

Operator

I will now hand the call back over to Mr. Horgan for any additional closing remarks.

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

Thank you very much, everybody. So, that concludes our call, and I hope we answered all of your questions. Obviously, the Investor Relations team is fully at your disposal in case we didn't. Otherwise, thank you for joining us, and good-bye for now.

Operator

Thank you. That will conclude today's conference call. Thank you for your participation, ladies and gentlemen. You may now disconnect.