Q3 2018 Earnings Call

Company Participants

- Delfin Rueda Arroyo, Chief Financial Officer & Member-Management Board
- Eilard Friese, Chief Executive Officer and Chairman
- Jan-Hendrik Erasmus, Chief Risk Officer & Member-Management Board
- [06F1LR-E Delfin Arroyo]

Other Participants

- Albert Ploegh, Analyst
- Ashik Musaddi, Analyst
- Bart Jooris, Analyst
- Benoît Pétrarque, Analyst
- Cor Kluis, Analyst
- Farooq Hanif, Analyst
- Henry Heathfield, Analyst
- Jason Kalamboussis, Analyst
- Matthias de Wit, Analyst
- Robin Eduard van den Broek, Analyst
- William Hawkins, Analyst

MANAGEMENT DISCUSSION SECTION

Operator

Good morning, ladies and gentlemen. This is the operator speaking. Welcome to NN Group's Analyst Conference Call on the Third Quarter 2018 Results. The telephone lines will be in listen-only mode during the company's presentation. The lines will then be open for a question-and-answer session.

Before handing this conference call over to Mr. Lard Friese, Chief Executive Officer of NN Group, let me first give the following statement on behalf of the company. Today's comments may include forward-looking statements such as statements regarding future developments in NN Group's business, expectations for its future financial performance and any statement not involving a historical fact.

Actual results may differ materially from those projected in any forward-looking statement. Any forward-looking statements speak only as of the date they are made, and NN Group assumes no obligation to publicly update or revise any forward-looking statements whether as a result of new information or for any other reason. Furthermore, nothing in today's comments constitutes an offer to sell or a solicitation of an offer to buy any securities.

Good morning, Mr. Friese, over to you.

Eilard Friese

Thank you, operator. Good morning everybody and welcome to this third quarter analyst call. I will start today's presentation by talking about the highlights of the third quarter results and the business developments in the past quarter. Delfin Rueda, our Chief Financial Officer, will then take you through the details of the financial performance and talk about the free cash flow and capital position. After wrapping up the presentation, I will open the call for Q&A and Jan-Hendrik Erasmus, our Chief Risk Officer, is also with us today to answer your questions.

So let's move to slide number 3, the highlights. NN Group's operating result of the ongoing business for the third quarter of 2018 was €463 million, which is up 7% compared with the same quarter last year. The higher operating result was driven by improved underwriting performance at Netherlands Non-life in both the disability and accident and the property and casualty books as well as €48 million of private equity and special dividends at Netherlands Life. Lower expenses also contributed to the increase, as we have continued to extract the synergy benefits from integrating Delta Lloyd.

We achieved further cost savings of €33 million this quarter, bringing the total cost reductions in the business units in the scope of the integration to €269 million compared with the full-year 2016 expense base. We are therefore progressing well towards our target of €400 million by the end of 2020.

In terms of commercial performance, total new sales in the third quarter amounted to €328 million, down 14% at the same period last year. This was mainly due to increased competition in the COLI market in Japan as well as lower volume of group pension contracts up for renewal in the Netherlands Life, which as you know are skewed to the first quarter of the year.

Our balance sheet and capital position remain strong. NN Group's solvency ratio at the end of the third quarter was 239%, up from 226% at the end of the second quarter of 2018, reflecting operating capital generation and positive market impacts. Free cash flow to the holding company was €293 million, bringing the cash capital of the holding to €1.9 billion at the end of the third quarter.

Let's move to slide number 4. Our ambition is to be a company that truly matters in the lives of our stakeholders. For our customers, this means developing innovative solutions and value-added products that meet their needs.

Let me give you some examples of how we're doing this across our businesses. NN Bank has recently launched mortgage products specifically geared to the needs of senior citizens and for expatriates wanting to settle in the Netherlands. A new accidental health insurance is being sold online in Poland and is a unique solution for children covering a broad range of accidents and care assistance.

We also look for ways to enhance the customer experience. For example, our non-life business in Belgium has a service called My Advisor@Home whereby an advisor is available within 24 hours to assess the damage and who takes care of all the necessary arrangements and repairs throughout the claims handling process.

Our asset manager NN Investment Partners uses partnerships to support its growth ambitions and to reach customers through new channels, for example in Japan where NN IP and Rakuten Securities have announced a new investment service for retail investors.

We take our social and environmental responsibilities seriously. ESG factors are embedded in our investment process and we are also incorporating these in our products. BeFrank is the first pension provider to introduce a Sustainable Impact Dashboard which allows employees of pension schemes to monitor the impact of their contributions on waste production, water consumption and CO2 emissions.

Let's now turn to slide 5. As you know, we have a target to reduce the administrative expense base for the business units in scope of the integration by €400 million by the end of 2020, of which at least half by the end of 2018. The integration of Delta Lloyd is progressing well. So far we have reduced expenses by a total of €269 million compared with the 2016 expense base. Looking ahead, we will continue to drive efficiency throughout the organization. However, please bear in mind that the expense reduction will not always be linear from quarter to quarter and some units may at times see expense increases to support growth and make the necessary investments.

We have submitted the application to include Delta Lloyd Life and Non-life in our partial internal model and we are on track to have this expanded partial internal model approved by the end of this year. This will allow us to complete the legal merges of the Dutch Life and Non-life (00:06:25) entities in 2019 as planned.

I will now hand you over to Delfin Rueda. Delfin, over to you.

[06F1LR-E Delfin Arroyo]

Thank you, Lard, and good morning, everyone. Let me start with NN Group's third quarter operating results of the ongoing business which was 7% on last year at €463 million. This increase was driven by an improved underwriting performance at Netherlands Non-life and higher dividends at Netherlands Life as well as a reduction in administrative expenses. This was partly offset by a lower technical margin at Netherlands Life as well as lower operating results at Insurance Europe and segment Other mainly due to nonrecurring benefits in the third quarter of 2017.

The net result of €788 million represent an increase of 7% on last year. In addition to the higher operating result this quarter, we also recognize an additional divestment result of €56 million related to the sale of ING Life Korea.

Moving on to slide 8, I will take you through the third quarter performance of the individual segments. Starting as usual with our largest segment, Netherlands Life posted a higher operating result supported by €48 million of private equity and special dividends as well as lower administrative expenses.

This was partly offset by a lower technical margin as last year included some nonrecurring benefits and favorable mortality experience variances.

The operating result of Netherlands Non-life increased to €46 million versus €1 million a year ago, reflecting an improved underwriting performance in both disability and accident and property and casualty and also lower administrative expenses.

The current quarter also benefited from favorable claims experience and a €5 million private equity dividend. It is encouraging to see that both D&A and P&C reported a combined ratio below 100% this quarter, with the total combined ratio coming to 97.1%.

Needless to say that the claims experience is volatile from quarter to quarter and that we will continue to implement measures to structurally reduce the combined ratio to 97% or below.

At Insurance Europe, the lower operating result reflects a lower investment margin and €5 million of nonrecurring benefits related to the Life business in Greece in the third quarter last year. The lower operating result at Japan Life was mainly due to higher DAC amortization on surrenders, which was partly offset by higher fees and premium-based revenues driven by higher in-force volumes.

The operating result of Asset Management of €43 million was due to lower fees, partly compensated by expense reductions.

Finally, the operating result of the segment Other was €28 million versus €41 million last year, which included a total of €38 million of nonrecurring benefits compared with €14 million in the current quarter. This quarter also reflects higher results at the reinsurance business. On the other hand, the banking business saw continued pressure on the interest margin partly compensated by lower administrative expenses.

Moving now to the next slide which shows our cash capital position. The holding company cash capital increased to €1.9 billion at the end of the third quarter of 2018 from €1.8 billion at the end of the second quarter. The free cash flow during the third quarter was €293 million driven by €338 million of dividends received from subsidiaries. This was partly offset by €193 million of capital flow to shareholders, representing the cash part of the 2018 interim dividend of €127 million and share repurchase in the current quarter for an amount of €66 million.

As always, details of the dividends upstreamed by segment can be found in the Appendix of this presentation.

To finalize my presentation, I will take you through the developments in NN Group's solvency on slide 10, starting with the movement for the quarter. Our Solvency II ratio increased to 239% at the end of the third quarter, up from 226% at the end of the previous quarter. Operating capital generation and market impacts each added 7 percentage points to the ratio this quarter.

Markets had a positive impact to Own Funds mainly driven by the widening of peripheral government bond spreads to which we are underweight compared to the reference portfolio. Real estate revaluations and higher interest rates also contributed positively to the ratio.

I will finish off by mentioning a couple of other items that may be relevant. Firstly, let me remind you that the 2018 interim dividend paid in September was already deducted from the Solvency II ratio at the end of the second quarter. Furthermore, as Lard mentioned, we are on track to get approval for including the main Dutch Delta Lloyd entities in the partial internal model by the end of this year. These will be taken into account in our solvency ratio when approved.

And lastly, we currently expect that the proposed corporate tax rate reduction in the Netherlands will have a negative upfront impact on our Solvency II ratio if and when enacted. Economically, of course, this will be positive, resulting in higher capital generation and profits over time.

And with that, I pass you back to Lard for the wrap-up.

Eilard Friese

Thanks, Delfin. NN Group has delivered another solid set of results for the third quarter of 2018, posting (00:13:12) an increase of 7% on the same quarter last year with Netherlands Life and Netherlands Non-life reporting higher operating results. The integration of Delta Lloyd continues to progress well. Total expense reductions to date amount to €269 million as we continue to extract the synergies of the integration and drive efficiency throughout the organization.

Our balance sheet remains strong with a cash capital position of €1.9 billion and a Solvency II ratio of 239% at the end of the third quarter. We are on track to have the expanded partial internal model approved by the end of this year and to complete the legal merges of Dutch life and non-life (00:13:51) entities in 2019 as planned.

This quarter's performance confirms that we are progressing well in executing our strategy which focuses on successfully integrating Delta Lloyd, further improving the operating performance of all of our segments, accelerating the transformation of the business model and continuing to allocate capital rationally.

Now before we go into Q&A, let me just mention the second press release that we issued this morning in which we announced the termination of the warrant agreement with ING for a consideration of €76 million. As you are aware, NN and ING entered into this warrant agreement at the time of the IPO in 2014. We are pleased to have completed this transaction as it eliminates a potential share dilution.

I will now open the call for your questions and hand over to the operator.

Q&A

Operator

Thank you, Mr. Friese. Ladies and gentlemen, we will now start the question-and-answer-session. The first question is from Mr. Cor Kluis, ABN AMRO. Go ahead please, sir.

Q - Cor Kluis {BIO 3515446 <GO>}

Good morning. Cor Kluis, ABN AMRO and congratulations by the way with solving the warrant for this (00:15:25). Further couple of questions, first of all on the bank, could you give somewhat more clarity about the dividend upstreaming from the bank going forward taking into account that the capital consumption of the growth of the bank is not so large anymore because year-to-date the mortgage book has been quite flattish.

So what can we expect from dividend, yeah (00:15:49), payments from next year onwards? And also maybe related to that, what might be the Basel IV impact on a fully-diluted basis for the bank? It will be not much probably because you already extended formula but could you (00:16:00), an indication how the 16.4% CET1 ratio might change as a result of Basel IV?

And my second question is about Solvency II. Could you give a little bit more clarity about the fact that in the fourth quarter, you highlighted about the corporate tax rate effect. What percentage effect could that be on the Solvency II ratio? And Delta Lloyd to the partial internal model in the fourth quarter, what that might be or could that maybe compensate the corporate tax effect? And if you might have done some or thinking about some reinsurance deals in the fourth quarter and what the market effects might be in the Solvency II in the fourth quarter? Those were my questions.

A - Eilard Friese

Yeah. Thank you, Cor. So I'm going to hand over to Delfin actually for both questions. So Delfin, the bank and Solvency II.

A - Delfin Rueda Arroyo {BIO 7032761 <GO>}

Thank you, Cor. So you're right that the bank has already found a level of profitability and return on equity that allows them to fund their own growth and in addition to that to contribute further to dividends going forward.

So they started with a small dividend in the last quarter in Q2 of €8 million and we will expect that depending on their profitability and evolution on the Solvency (00:17:31), this will continue to be the case. But you have to of course assume that these are going to be relatively moderate dividends coming from the bank going forward. It's well-capitalized as you said with a Common Equity Tier 1 ratio of 16.4%, and you are also (00:17:50) absolutely right that Basel IV won't have a material impact on that.

On your question on Solvency II on the corporate tax rate reduction first. Maybe a caveat to mention that still this has not been approved by the Dutch Parliament but we do expect that the changes in the corporate tax are going to come through. And if we were to look at the impact that the current proposal of corporate tax reduction will have on our Solvency II ratio, it will be around 10 percentage points, okay, but also very important to indicate that this is obviously a positive aspect in terms of the contribution to the net profit and the capital generation going forward.

Obviously, that will depend also at the level of the solvency ratio. That is very sensitive to the level of the solvency ratio when these taxes are going to be implemented as it affects mainly the solvency capital requirement due to the reduction on the EBITDA (00:19:05).

In terms of the beam (00:19:08), as we have mentioned in the past, we continue in the process. We do expect to have approval before year-end. So, we are doing everything on our hands to get into this goal. And don't forget that there is a benefit that is currently in place on the standard formula, on the calculation of the SCR under the standard formula for Delta Lloyd Life. And that benefit at the end of last year was €350 million will be lost. That's why we have said that there's going to be – we spent maybe a net positive at a moderate impact due to the introduction of the PIM.

Q - Cor Kluis {BIO 3515446 <GO>}

And the market FX in the fourth quarter?

A - Delfin Rueda Arroyo {BIO 7032761 <GO>}

Market during the fourth quarter was 7 percentage points. The main impacts were due to the reduction on the spreads of government bonds, particularly, peripheral bonds. But also, we benefited for revaluation of equity and real estate.

Q - Cor Kluis {BIO 3515446 <GO>}

And maybe just to add, the impact of the movements quarter-to-date have been broadly neutral on our solvency ratio.

A - Jan-Hendrik Erasmus {BIO 19801435 <GO>}

Okay. Okay. (00:20:35) Thank you very much.

Operator

The next question is from Mr. Ashik Musaddi, JPMorgan. Go ahead please.

Q - Ashik Musaddi {BIO 15847584 <GO>}

(00:20:43-00:20:52) what are you thinking about M&A at this point? I mean, clearly, there are few opportunities at the moment in Belgium and in Holland, and those are not that big M&As as well. We are talking about €300 million, €400 million. So, can you share some thoughts about what you're thinking, and how you're positioned for those potential deals? Any thoughts on that? Would you be considering, not considering? So that's the first one.

Second question is with respect to debt. I mean, one of the investor concerns on NN Group is around your high leverage. I mean, the way we look at high leverage is your Solvency II is fully (00:21:28), and even on IFRS basis, look a bit high. So, I mean, what can you potentially do to reduce your leverage ratio? Would that be a hurdle to do any sort of buybacks early next year? Any thoughts on that would be great.

And then, last thing, the last question would be around your Solvency II capital generation. I mean, this year, for first nine months, you have generated around 36%, 39% capital, or 40% capital? And that, too, is net of dividends. So, how should we think about – what really worked this year, basically? Why is the capital generation so high? Thank you.

A - Eilard Friese

Okay, Ashik. Thanks for your questions. I'm going to take the first one on M&A, and then Delfin will talk about the leverage and about the capital generation rate. So, first on the M&A, if we have an opportunity to strengthen our business, we will look at it and evaluate it carefully. And if it makes sense and it complies with the financial and non-financial criteria that we have for this, then we will look at it, and we will transact. The same thing – it happened with Delta Lloyd at that time. We've also, last quarter, announced two smaller transactions at the Czech and Slovak Republics.

Our priority is in markets where we already have a presence. Because we believe that you understand the business that you would acquire, and you can extract synergetic benefits and increased scale in the markets that you're present. We would evaluate opportunities in the Netherlands, but also outside of the Netherlands in markets, where we already have our presence. But please note in the Netherlands, our priority is obviously the integration of Delta Lloyd and extracting the full value of that. But if we can strengthen the business further, we will look at that.

Delfin, over to you.

A - Delfin Rueda Arroyo {BIO 7032761 <GO>}

Yes. Thank you. Ashik. Let me, for a moment, disagree on your assessment that there is a high level of leverage. We are certainly very comfortable with the level of debt. If you look at our fixed charge coverage ratio of close to 15 times in this quarter for the last 12 month, we calculated always on a last 12-month basis, that is certainly quite coverage of the interest expense.

Also, taking into account that NN Group is especially cash-generative in relation to the the IFRS reserves. The fact that the majority of the operating result convert to actual cash to the holding company in terms of EBITDA, basically gives you an actual interest cover, which is very high. If you combine that with the fact that the cost of debt is relatively cheap at this point of time and the fact that we have a very high level of financial flexibility due to our solvency, the level of cash capital upholding, I don't think that the level of debt can be categorized as being high or of any concern, which that answers with regard your question in terms of any plans in terms of reducing the level of debt, we currently don't have. I think that we are comfortable with the current debt structure.

Q - Ashik Musaddi {BIO 15847584 <GO>}

Thanks, Delfin. What you're saying, if I understand it correctly, is it fair to say that leverage will not be constraint if you were to consider doing the share buyback?

A - Delfin Rueda Arroyo {BIO 7032761 <GO>}

Yes. So, leverage is not a constraint for the fourth quarter.

Q - Ashik Musaddi {BIO 15847584 <GO>}

Thank you.

A - Delfin Rueda Arroyo {BIO 7032761 <GO>}

Then in terms of the Solvency II capital generation, you're right. In the nine months up to September, we have had a very positive growth of – the solvency ratio increased by 40 basis points. 17 percentage points was related to operating return. And we have a very good positive impact related to market. But I think that if you were to look back to the time since the introduction, because markets are always – can be volatile, can be positive or negative. And we have gone through a period of relatively positive impact.

But if you were to look at from the start of the introduction of Solvency II, we have actually in this, I think, 11 quarters, operating returns increased by 52 percentage points, where markets only contributed 22 percentage points. So, it will come up or down, but it's a measure, or if you were to look at it at NN Group in the current form, which is after the acquisition of Delta Lloyd from the second quarter of 2017, basically, we also have 43 percentage points increase in the capital generation, of which, 29 percentage points, the majority of it came from the operating return with only 21% coming from market. So, the explanation this quarter is a strong operating capital generation, but also positive impact on markets, as you mentioned.

Q - Ashik Musaddi {BIO 15847584 <GO>}

Thanks. That's very clear. Thanks a lot.

Operator

The next question is from Mr. William Hawkins, KBW. Go ahead please.

Q - William Hawkins {BIO 1822411 <GO>}

Hello. Thank you very much. I only got one question really. Are there any important actions that are awaiting the legal entity mergers next year before they can be executed? So, I'm kind of thinking in terms of where you are with the Delta Lloyd operational integration process, is there any operational action has to await legal entities?

Your expense efficiencies so far have been running incredibly well, but I wonder if there's going to be the need to increase the investments once the legal entities emerged. And also, I don't know if any capital management decisions that you may make have the legal entity mergers to precondition. Thank you.

A - Eilard Friese

Yeah, thanks Will. As we've said before that our objective is to merge the legal entities of the large Life and Non-Life businesses in the Netherlands in 2019. There's a lot of things that need to happen for that. We are working toward that.

So, as Delfin already mentioned, I mentioned in my script on the slides, Partial Internal Model approval and expansion, I think is an important step in that. Of course, we need to obtain a Declaration of No Objection from our regulator for those legal entity mergers. And there's a number of other steps that we need to do. Now, operationally, we are progressing well, and the operational integration itself is not, let's say, a factor that would be hampering the legal entity or mergers. So, in that sense, we're on track.

When it comes to the expense reductions, we are very pleased to see that we're now at €269 million of expense reductions and well on our way of the €400 million target by the end of 2020. And we do need to be mindful though, and we're very pleased, and I compliment my teams for doing so. Having said that, we do need to caution that we're now entering into the complex part of the integration process, which is all to do with migrating portfolios into technology platforms of companies that have been in existence for a very long time. So, I would be a bit careful to just look at the extrapolation of the past quarters and take the same speed for the cost reductions.

So, while we're confident that we will get to the €400 million to the end of 2020, you should be careful just extrapolating as a proxy the speed at which we did that over the last couple of quarters. Also, indeed, it may be volatile in that sense in the quarters over time, because you do need to invest also to get to the underlying expense reductions in technology for instance. But so far, I must say, we're well underway.

Q - William Hawkins {BIO 1822411 <GO>}

And just on the other parts of that question, with regards to how you manage capital. Is the legal entity separation at the moment and then integration at all relevant to how you think about capital management, or is it just a sort of ticking the box irrelevant to how you're managing the group as a whole?

A - Eilard Friese

The main benefit of managing in – if the legal entity are merged, the main benefit that we have for that is operational. And in governance, it just simplifies Life in that sense, which I think is helpful, and that's the main benefit of it.

Q - William Hawkins {BIO 1822411 <GO>}

Very clear. Thank you, Lard.

Operator

The next question is from Mr. Matthias de Wit, Kempen. Go ahead, please.

Q - Matthias de Wit {BIO 15856815 <GO>}

Yes. Good morning. I have three questions, please. The first is on the capital generation. Again, maybe I could come back on that. The €0.3 billion (00:31:04-00:31:08) in there. And just linked to that, to what extent are the cost savings already captured in that number? It's not entirely clear because some of them are reflected upfront in the best estimates at least for the Life business, that's mostly the case.

And then, secondly, on the capital ratio of the Dutch Life entity. Wonder if you could provide a pro forma for the merged entity including the impact of the legal merger? And is there any target you have in mind for managing the Dutch entity going forward? Thank you.

A - Eilard Friese

Yes. Thank you, Matthias. Delfin, can I hand over to you, please.

A - Delfin Rueda Arroyo {BIO 7032761 <GO>}

Thanks, Mathias. The question on the capital generation, the approximately €300 million, no, it's not rounded up, is actually slightly up. In terms of the cost savings already captured in the operating capital generation, you're right; it depends. Everything that is related to savings in the Life business and also the long-term Non-Life part, as long as it was already reflected in the assumptions, do not have an additional benefit. Any deviation, meaning, if cost savings are larger than what is assumed on those assumptions, then they will be reflected when the assumptions are reset. However, if for both the short-term in Non-Life business, as well as the other areas, the holding, the asset management, the bank, Belgium, to a large extent, that they are being reflected as they are being generated.

In terms of the pro forma of the merged entities in the Netherlands, it will be a simple add-on of the Own Funds and the SCR of both entities will come to 235% solvency ratio. And we have not set any particular target, but you have seen that the dividends are coming out from Netherlands Life increased from usually €150 million per quarter, it increased at €175 million. Obviously, the level of solvency is high. And as we have said, this is our priority to maintain a stable payment from the subsidiaries. Always with the aim to, over time, release some of this surplus capital in the different legal entities.

A - Eilard Friese

Okay, Matthias.

Q - Matthias de Wit {BIO 15856815 <GO>}

Okay, thank you.

A - Eilard Friese

I hope it was clear. Just to make sure there's no misunderstandings, to your point, the €0.3 billion, as Delfin indicated, is slightly rounded down and not rounded up. So, it's in fact a little bit north of €300 million.

Q - Matthias de Wit {BIO 15856815 <GO>}

Okay, very clear. Thank you, Lard; thank you Delfin.

Operator

The next question is from Mr. Farooq Hanif, Credit Suisse. Go ahead please.

Q - Farooq Hanif {BIO 4780978 <GO>}

Oh, hi there. Thank you very much. On the market movements, can you explain what the percentage point impact was from real estate revaluations? And remind us what's going on there, and what could continue to happen going forward?

Secondly, on capital management, in your answer to Will's question, I mean, there is a dependence isn't there? Because if you merge entities, you said that you will reduce your cash target at the holding. So, just wondering, what your latest thoughts are on that, and if you could give us any guidance.

And lastly, just on again, the question on operational capital generation, at what point are you going to feel confident in giving us kind of a vision of what you see as a regular, smooth capital generation number every quarter? Because obviously, kind of a lot of your peers do that. So, I'm just wondering cheekily whether you would be willing to say, Lard, this is it. Thank you.

A - Eilard Friese

Yeah. So, on the first and the third question, Delfin, but it's maybe also good to give Jan-Hendrik an opportunity. So, can you do the second question about the capital management dependence for the merger of legal entities, et cetera?

A - Jan-Hendrik Erasmus {BIO 19801435 <GO>}

Yeah. Hi, Farooq. You're right to refer to the 1 in 20 (00:35:44) requirement, but at the moment you see the solvency of both the legal entities in the Netherlands, the Life entities, is very strong. So, at the moment that 1 in 20 stretch (00:35:55) requirement is not having a big impact in this, so therefore, also not have a big dependency here for the legal merger.

Q - Farooq Hanif {BIO 4780978 <GO>}

But just going back on that, I think you did say that you would give the new target for the holding cash if that happened. So, you're saying that's already happened?

A - Jan-Hendrik Erasmus {BIO 19801435 <GO>}

We are going to stick to our guidance on the target cash capital. I mean, the range of €0.5 billion to €1.5 billion remains the range. What we said is that we might be comfortable at different parts of that range through time. But certainly, the range of €0.5 billion to €1.5 billion is something we plan to leave unchanged.

A - Eilard Friese

And with that, Farooq, I'd like to hand over to Delfin for the other questions you had about market movements and the potential run rate numbers.

A - Delfin Rueda Arroyo {BIO 7032761 <GO>}

Yes. Thank you very much, Farooq. Real estate revaluations in the quarter represented a little bit more than 1 percentage point on the market movement. What to expect going forward, impossible to say. It is very much dependent on what is going to be the valuation of real estate, particularly commercial real estate going forward.

On the range for the cost capital at holding, already Jan-Hendrik explained clearly that we will maintain that range between the €0.5 billion and €1.5 billion. And in relationship to our run rate of operating capital generation, as you know, it's relatively difficult to say, although by now, you have already got, I think, 11 quarters of operating capital generation and you have seen what is the evolution. And when I look in this capital generation, there's been around the €0.3 billion, around the €300 million over the last quarters.

On capital generation, you know that we have also benefited from regular release on the solvency capital requirement, which obviously depends on the speed on the run-off on the individual Life portfolio in the Netherlands, but also of the run-off of the Japan Closed Block VA portfolio. And keep in mind, as we have mentioned that by 2019, this run-off is very much coming to an end. And as a consequence, that benefit of a decrease the SCR will be more mitigated.

So, I think that in terms of operating capital generation, what you have seen this quarter in terms of the movement on Own Funds and the change in solvency capital requirement is nothing unusual. Whenever there is something special, we tend to mention there.

Q - Farooq Hanif {BIO 4780978 <GO>}

Just back on the real estate revaluation. Obviously, the number in market variance will be the one that's above your long-term assumption. Can you remind us what your long-term assumption is for real estate?

A - Delfin Rueda Arroyo {BIO 7032761 <GO>}

Yes. For real estate, it's a 4.4% assumption. And obviously, what it comes through the market variance is whatever additional rental deal that comes on top of these 4.4%, but also the revaluation of the real estate as well. So, the combination of these two will come through market variances.

Q - Farooq Hanif {BIO 4780978 <GO>}

Okay. Thank you very much.

Operator

The next question is from Benoît Pétrarque, Kepler Cheuvreux. Go ahead please, sir.

Q - Benoît Pétrarque

Yes. Good morning, everybody. So, the first one is again on the own funds capital generation. I think you have been consistent at around €0.3 billion, even a bit north of that. Looking at the cost cutting in the pipeline, when do you expect to hit the rounded €0.4 billion? Will that be early 2019? Could you talk around that? And also, year-to-date, could you provide kind of the figure because we have rounded figures per quarter but I like to get a kind of year-to-date figure?

And then the second one was on the dividends from the Life entities. So, the combined Solvency II ratio is 235%, if I understood correctly. Is there any room for distributing excess capital from the Life subsidiary post-merger? And then sorry I missed – I joined the call a bit late but what was the reason of the weaker technical margins in the Netherlands? That will be useful. Thanks.

A - Eilard Friese

Okay. Delfin, four questions.

A - Delfin Rueda Arroyo {BIO 7032761 <GO>}

Good.

A - Eilard Friese

Can you take them?

A - Delfin Rueda Arroyo {BIO 7032761 <GO>}

Yes. Good. Thank you, Benoît. So, I hope I won't forget any of them.

A - Eilard Friese

I hope you remember.

A - Delfin Rueda Arroyo {BIO 7032761 <GO>}

In terms of the operating capital generation and when we will reach the €0.4 billion, difficult to say. There are different dynamics here. As you know that the capital generation is driven by changes in interest rates and it's spread for every single quarter. So, the impact on the UFR drag, the release of the risk margin as well as the expected (00:41:40) on our credit fixed income securities including government bonds (00:41:45) vary actually from one quarter to another. So, that gives some variability there. Also, within this operating capital generation, you have new business, the operating variances, and the contribution from Japan Life asset management and the pension business.

So, obviously, we do expect that as we move to higher-yielding assets that we will have an additional contribution. We also expect that with the improvements in the underwriting resolved on our Non-life business that we will have some improvements there and also with the selective growth in areas like Europe and Japan. Then you will have other aspects like the release of the solvency capital requirement as the run-offs of Japan Closed Block VA, as I mentioned before, will reduce. And to some extent, to the movement to higher-yielding asset the SCR or is the (00:42:48) growth of new business (00:42:50) might, as you know, not contribute as much to the reduction or even, as you know, add to the SCR.

So, there are a few parts, but I think overall, our targets and objective is to increase, of course, this operating capital generation over time driven mainly by the improvement (00:43:10) in the operating results of the company as well as the movement to higher yielding assets.

In terms of second question.

A - Eilard Friese

The year-to-date figure for the operating capital generation.

A - Delfin Rueda Arroyo {BIO 7032761 <GO>}

Year-to-date figure for the operating capital generation is around €900 million. And the combined ratio of 235% of course, it provides room for excess capital dividends, but as I said before, we do prefer to have a regular contributor to dividends to the holding company. So, we are happy with the current rate of dividends coming from this segment and for the time being we'll maintain it like that until we change of course that approach.

In terms of the technical margin in Netherlands, I think we gave an indication to expect between 40 and 45 percentage points, and this is basically what we have seen this quarter. So, nothing too unusual. There was better results in the past, but this was a little bit, as you know, higher in the previews quarter. But between €40 million and €50 million, I think is something that is reasonable with the inherent (00:44:46) volatility for this technical margin.

A - Eilard Friese

Just to avoid misunderstanding, Benoît (00:44:53). So, it's Netherlands Life talking about and it's millions not percentage. So, it's €40 million to €45 million.

Q - Benoît Pétrarque

Yes. Thank you very much, guys.

Operator

The next question is from Mr. Albert Ploegh, ING. Go ahead, please.

Q - Albert Ploegh {BIO 3151309 <GO>}

Yes, good morning all. Three questions from my end, first one on the private equity gains. Can you remind us what let's say at the end of Q3 more or less the size of the book is and how you accounted for? Is it basically the equity measures or the fair value accounting? So, I'd like to understand better (00:45:34) gains or some fair value gains that could impact the quarterly numbers? That's the first question.

The second question is on Japan on the COLI market, you've mentioned increased competition in Q2. I mean the new sales were up still I think 18% if I'm not wrong there and you mentioned the bancassurance channel being strong in the Sumitomo partnership. So, can you help us a bit to understand what's going on in the Japanese COLI markets?

And finally on the Dutch Non-life business, clearly a very good underwriting result. Premiums are still pretty flattish but can you maybe give some more feeling on let's say on the pricing trend, so what is the underlying really growth in gross written premiums and what is the impact let's say of pruning the portfolio which of course has a negative impact on the gross written premiums. Thank you.

A - Eilard Friese

Yes, Albert. Private equity, I think that's Delfin. Delfin, can you do private equity? I'll take care of the Japan question and Non-life question.

A - Delfin Rueda Arroyo {BIO 7032761 <GO>}

Yes. Thank you very much, Albert. So, I think you're touching into a little bit of a complicated matter of how this flows through the profit and loss account. So, we'll be happy to explain that more extensively offline. Maybe I'll try quickly. The majority of our private equity investments are classified as associates and joint ventures and a smaller amount they are classified as available for sale. So, depending – if the dividends comes from associates and joint ventures or from available for sale, the treatment is slightly different. So, for associates and joint ventures, the dividends are reflected in the investment margin but at the same time, this is offset by a negative revaluation below the line, so that basically have not – have no net P&L impact but it is reflected in this manner.

However, for those that are available for sale as for example it is the case for our investment in Korea, this dividends are reflected in the investment margin but are only offset by a change in the revaluation reserve basically with a lower equity value on the balance sheet. I do expect that with this clarification, you got a bit of a feeling how this comes, but we'll be happy to explain it offline as well.

Q - Albert Ploegh {BIO 3151309 <GO>}

Yes. That's fine, offline, no worries.

A - Delfin Rueda Arroyo {BIO 7032761 <GO>}

Thank you.

A - Eilard Friese

Yes. So, on the Japan COLI, let's first talk about Japan COLI. Our Japan business over the last years has seen a marked growth in the segment that it has been operating in for 30 years. So, we're quite a specialist and very well positioned in that segment. We have seen competition increasing. And as you know, we prioritize margins over volume and I may also point out that we have moved and shifted to a different kind of product mix to improve the margins. And in Q2 we have presented a value of new business increase of 36% to demonstrate our efforts there.

But indeed, we are seeing more competition and of course we are well-positioned, so we're fighting against that competition as well. So, we've launched, for instance, a new product last week to maintain commercial momentum and this is something that we'll work through. And also the relationship with Sumitomo but also other distribution channels is working very well. And we have good confidence in our growth prospects in that market in the future.

When it comes to the Dutch Non-life area, well, as Delfin mentioned I think earlier on the call, we're quite pleased with the way that the program that we've rolled out and announced a year ago at the Capital Markets Day is taking effect. At that time, we've said that we need 12 to 24 months for the measures to take their full effect and it's a wide range of measures, as you know, a combination of cost reductions, pruning indeed of the portfolio for those products that we believe we don't – we can get an appropriate return on through the cycle. And also looking at each risk, making sure that it's priced well, price increases where needed, and where we believe it's appropriate. So, we're doing a lot of things to do that.

And if you look at the last four quarters actually and I know that events like storms, et cetera, are part and parcel of this business, but in order for us to gauge whether the measures are taking effect we're actually taking – looking through the storm effect and then you see for four quarters in a row already step by step improvement. And this quarter I think the important thing that we've seen both disability and accident and P&C improving.

In terms of the underlying premium, indeed it's flattish as a total which is a combination of the pruning on the one hand but then also price increases and premium increases on repricing risk as one of those measures that is coming through. So, the overall is flattish.

Q - Albert Ploegh {BIO 3151309 <GO>}

But do you think you're getting close to some kind of inflection point to show some more meaningful gross written premium growth or is it still too early to expect that in 2019 for example?

A - Eilard Friese

That's indeed too early to say that. Don't forget that we are really focused on profitability improvement here. Our objective is to structurally improve this business with a combined ratio of 97% or below. And that's our objective for this business to make sure it's structurally in a good and profitable situation.

Q - Albert Ploegh {BIO 3151309 <GO>}

Okay. Thank you.

Operator

The next question is from Mr. Henry Heathfield, Morningstar. Go ahead please, sir.

Q - Henry Heathfield {BIO 19760919 <GO>}

Good morning all. Thank you very much for taking my call. Just on the back of actually that last question on Non-life, just kind of interested in particularly on the pricing in the P&C portfolio that you've put through and whether that's kind of been finalized or how far through that are you basically whether there's more to come more broadly in the Non-life segment.

And then the second question is on the motor business that seems to be improving quite nicely. But the operating environment in the Netherlands seems to be quite a harsh one. And I was wondering I think basically average claims on the liability side have increased quite markedly around 40% over the past four years because of the discount rate and whether you will be able to hold onto the price improvements that you put through if the discount rate starts to rise again and the average claims cost starts to fall. Thank you.

A - Eilard Friese

Yes. So, Henry, when it pertains to the overall environment I would say what I observe is rationality improving in the market in general in terms of how much, how far along are we in the measures that we're taking to improve the profitability of this business. As I said, we haven't reached our target, right, and we want to have it 97% or below – don't forget the last piece of that as well. The 97% is one thing but, or below, we should not forget that either and I want to have it structurally in that place and that's really our priority. So, this is something that will take more time to put all those measures to be implemented and to take their full effect. And the kind of guidance we gave for that last year is that we need like 12 to 24 months before those measures would take their full effect. So, I think that's where we are. We're still working through this, happy with the progress, but still a lot of work to be done.

Q - Henry Heathfield {BIO 19760919 <GO>}

Are you kind of – (00:53:35) pricing within property and casualty kind of going forward or there'll be some more broader pricing improvements you think (00:53:42)

A - Eilard Friese

Well, we are always evaluating the importance of having risks appropriate priced whether they are in the P&C book or in the disability and accident book. So, we go through this product-by-product, risk-by-risk and that's how we work.

On the motor business, yes, we saw an improvement this quarter on the motor business, but again, also there, we believe that we have not implemented all the measures on cost reductions, et cetera, that we aim to implement. And don't forget that we also want to build structurally a capability and a stronger place on using data analytics to consistently and more quickly react to any actions that we feel we need to take for migration of the risk. And as a result, the necessary pricing of that risk. So, we will continue to work on that as well.

Q - Henry Heathfield {BIO 19760919 <GO>}

I mean do you think that on the average liabilities side, the average kind of claim on the liability side of the motor book, when that does start to come down, I mean I think that will start to come down over the next kind of half decade or something, are you going to be at hold on to that you've been put through or is that going to compress again?

A - Eilard Friese

I think, Henry, that – I'm not sure but I think that this is more UK market specific than I would say for our kind of business.

Q - Henry Heathfield {BIO 19760919 <GO>}

Okay. Thank you.

A - Eilard Friese

Thank you very much.

Operator

The next question is from Mr. Bart Jooris, Degroof Petercam. Go ahead, please.

Q - Bart Jooris {BIO 3470300 <GO>}

Yes. Hi. Thank you for taking my questions. They're basically following up, following on the last questions. If we look at the improvement of your combined ratio, we see that it is mostly due to the decrease of the claims ratio. Could you say what part of this is due to the underwriting improvement as you also had a favorable claim experience? And the expense ratio actually went up year from year, when did you expect the expense ratio to decrease because that was from the impression of the Investor Day that would take more time to improve the claims ratio and less time to truly improve the expense ratio.

And then a small following question on the change in the corporate tax, will there be a P&L impact? Your DTAs are relatively low. Your DTLs are higher. Are we seeing valuation movements there that need to be transferred to the P&L?

A - Eilard Friese

Yes, thanks, Bart, for your questions. So, first, the expense ratio, there was some noise I think in the expense ratio from last year given the Delta Lloyd acquisition. I think this is better to be explained offline. What I do see, and you can see that from the numbers, is that we saw a decrease of the expenses this quarter of the Non-life company of around 12%. So, I think also there, the expense reductions are taking place.

When it comes to the overall movement of claims, we saw that the D&A combined ratio was 94.3%. So, the claims improved compared with the last quarter and the comparative quarter in the third quarter of 2017. When you look at P&C, we're seeing a gradual improvement, and we had a little bit of a good claims experienced especially in the fire book this quarter which I think is important to mention. So, the change in corporate tax rate on the P&L, Delfin?

A - Delfin Rueda Arroyo {BIO 7032761 <GO>}

Yes. Thank you very much, Bart. Of course, the change in the tax rate will have an impact on IFRS because the corporate tax rate, as you know, will be smaller. But at the time of introduction, it can also and it will also have some impact, but that will be a split between the profit and loss and also another part will come through equity due to the impact on the revaluation reserves that is actually one of the largest, as you know, aspect of the deferred tax liabilities and therefore impacting, as you know, the balance sheet.

Q - Bart Jooris {BIO 3470300 <GO>}

Could you already give a quantified idea of that?

A - Delfin Rueda Arroyo {BIO 7032761 <GO>}

No. I think it's – I mean as you look at it from the perspective of our balance sheet of what is the impact, as you know, will not be that meaningful, but it is too early in order to consider to have a proper estimate on that.

Q - Bart Jooris {BIO 3470300 <GO>}

Okay. Thank you very much.

Operator

The next question is from Mr. Robin van den Broek, Mediobanca. Go ahead, please.

Q - Robin Eduard van den Broek {BIO 17002948 <GO>}

Yes. Good morning, everybody. Sorry to come back on the private equity dividends, but there tends to be a habit to fully exclude them from your operating results whenever you report them. So, I just want to follow up on Albert's question and basically ask you, do you think it's fair if these are fully deducted? My understanding is that if there's no cash upstream basically from the private equity dividend side, that you basically incorporate zero in your operating results. I would say that, yes, a return of, I don't know, 10%, up to 10% would be quite reasonable on your €700 million book? That's question one.

The second one is on IFRS 17, it will probably be to dragged out a little bit but one of your peers in the Netherlands has shown that the shadow accounting is a pretty sizable offset how the financial leverage ratio will behave after that adoption. I was just wondering – earlier on the call, you seem quite confident on leverage. Is this something that could change that narrative or are you quite comfortable that under IFRS 17, your leverage ratio will not go up too much?

And the last question is really the level of excess capital. I mean we're approaching the levels where you basically were before you acquired Delta Lloyd. I was just wondering if your feelings about how your balance sheet looks like are similarly comfortable compared to that point in time. Thank you.

A - Eilard Friese

Yes. I will hand over to Delfin in a minute but about the habit I hope you would agree with me that we're not apologizing for having good returns from our private equity book. So, we're quite pleased with them. But I would like to hand over to Delfin on the questions you have.

A - Delfin Rueda Arroyo {BIO 7032761 <GO>}

Yes. No. Thank you, Robin. You're absolutely right, private equity and public equity dividends is part of our investment return, and it will continue being part of the investment return. Maybe we are a bit guilty to highlight these. We were trying to provide useful information in order to see the deviation from one quarter to another because these don't come always in the same quarter, don't come with the same amount, in order to make you better informed of how this might be coming through. But absolutely, the returns on private equity will impact our IFRS but also our Solvency II operating return, as you know, on an ongoing basis. So, it's a very important element of our investment portfolio. So, it's not fair to exclude them from our investment return nor to our capital generation. The level of private equity, as you know, by the end of September were around €800 million.

IFRS 17, we, of course, don't use shadow accounting and the impact of IFRS 17 that as you might have already noticed yesterday, the IASB announced a delay of one year on the implementation of IFRS 17 and IFRS 9 to 1st of January 2022. And it's a bit early in order, as you know, to see what impacts that will have as it will fundamentally change how we measure liabilities and profit recognition. So, that applies, as you know, to all insurance companies. So, it will be closer to a market value, will be – but is still maintaining difference (01:02:15) with the Solvency II.

Your last question...

A - Eilard Friese

Yes. So, Robin, on your last question regarding capital and the deployment of that. Yes, no doubt we have a strong Solvency II ratio which has increased driven by operating capital generation as discussed this morning and by markets (01:02:43). The cash capital position is in a good place and the balance sheet overall is well. But as you know also, we said this morning, our focus is on the integration of Delta Lloyd on the improvement of the performance of the businesses and on accelerating the transformation of the business model and there's a lot to do on the integration. For instance, the largest units in the Netherlands, the PIM expansion that was mentioned this morning, the legal mergers, the Life and Non-life businesses and entities especially in the Netherlands, and as we said before on deployment, capital in excess of our ambition will be returned to shareholders over time unless we can put it to work in value-creating opportunities.

Q - Robin Eduard van den Broek {BIO 17002948 <GO>}

Okay. Thank you.

Operator

And the next question is from Mr. Jason Kalamboussis, KBC. Go ahead, please.

Q - Jason Kalamboussis {BIO 4811408 <GO>}

Yes. Hi there. I just got two quick questions. The one is on the Non-life side. When I look at the dividends that were upstream, it was €8 million versus €20 million in the second quarter. Can you explain – I would have thought that with a better combined ratio and basically reflecting what we see in the quarter, I don't understand very much the difference with the second quarter.

And the second question is just quickly on the private equity I think a banking peer has given a sort of guidance. Would you give guidance or shall we probably take as more normalized level we saw last year or you prefer to leave it – the answers you have given so far? Thank you.

A - Eilard Friese

Delfin?

A - Delfin Rueda Arroyo {BIO 7032761 <GO>}

Thank you, Jason. Basically, the dividends that we pay this quarter for Non-life were basically taken into account, also the results of previous quarters. So, you don't just pay the dividend of the profits of the quarter. So, I would not read too much into the level of dividend from Non-life as we do expect going forward that it will continue contributing regular dividends to the holding company. And as we have said in the past, this capital generation is more or less approximately is to the level of their operating result in terms of the solvency of capital.

Also take into account that the level of capitalization of the Non-life company is lower compared, for example, the level of capitalization of the Dutch Life entities which of course give us much more margin in order to have a more stable dividend quarter-per-quarter.

In terms of the guidance for private equity dividends, I think is maybe the only thing that I can mention is the guidance that we provided in terms of the contribution to our operating return, which was somehow higher, which is 6.5% expected return. So, sometimes we'll have significantly higher than that, sometimes we might have, as you know, lower than this. And that difference on the Solvency II capital generation will be reflected in market variances.

Q - Jason Kalamboussis {BIO 4811408 <GO>}

Great. Thank you.

Operator

There are no further questions. Mr. Friese, back to you, please.

A - Eilard Friese

Yes, thank you very much, operator. I would like to thank everybody for their questions. And before we end the call, let me conclude by saying that we have reported another solid set of results for the third quarter of 2018. We're progressing well with the integration of Delta Lloyd and extracting the synergy benefits and our balance sheet and capital position remains strong. Our focus remains on delivering on our strategic priorities and creating long term value for all our stakeholders. I wish you all a pleasant day and thank you very much for being here.