Q1 2017 Sales and Revenue Call - Trading Update

Company Participants

- Chris Figee, Chief Financial Officer
- Michel Hülters, Head-Investor Relations and Ratings

Other Participants

- Albert Ploegh, Analyst
- Arjan van Veen, Analyst
- Benoît Pétrarque, Analyst
- Cor Kluis, Analyst
- Nadine van der Meulen, Analyst
- Robin van den Broek, Analyst
- Steven Haywood, Analyst
- Syed Anil Akbar, Analyst

MANAGEMENT DISCUSSION SECTION

Operator

Good day and welcome to the ASR Conference Call on the Q1 2017 Results. Today's conference is being recorded.

At this time, I would like to turn the conference over to Mr. Michel Hülters, Head of Investor Relations at ASR. Please go ahead, sir.

Michel Hülters

Good afternoon, everybody, and good morning for those of you listening in from the U.S. Welcome to the ASR conference call on our first quarter results. With me here today is Chris Figee, our CFO, and he will talk you through the numbers that we have published this morning, and we'll be happy to take all your questions you have.

After that – before I give the floor to Chris, I would like to point out the disclaimer that we have in the back of the presentation and would appreciate if you would take a minute or two to review that after the presentation.

So, having said that, Chris, it's yours.

Chris Figee {BIO 18815839 <GO>}

Very good. Michel, thanks very much. Good afternoon and good morning, everyone, on the call. Very pleased to walk you through the first quarter results of ASR in 2017. We have provided you with a small presentation. I will walk you through that slide by slide with some further comment and color and, of course, time for questions afterwards.

Let's start. As you are aware, we're only giving a trading update. Insurance is a long-term business, (01:24) our long-term strategies. We believe, in the interim quarter, it's only appropriate to give trading updates and fully audited figures and full numbers as per half-year basis. The current quarter, however, trading was good. We have a very solid and benign quarter behind us, strong financial performance, and improvement in earnings quality in the first quarter.

Page 2 talks you through the key figures, an operating result in the first quarter of €191 million. Operating result means a result before taxes, but also before capital gains and before incidentals, up 38% versus the first quarter of last year, corresponding to a very attractive 17.3% operating ROE. Operating result, €191 million; operating return on equity, 17.3%, well above the targets that we set ourselves at IPO.

A Solvency II ratio, according to the standard formula, of 188%, down 1 percentage point versus the end of last year, but please note that in that delta, we have absorbed a share buyback in January as part of the government selldown of 2% and we allocated capital to market risk, about 5 percentage points as well. So the delta in the Solvency assumes full absorption of a 2 percentage point – a 2 ratio point share buyback and about a 5 ratio points additional market risk allocation. If you adjust for that the underlying accretion, the underlying growth in our Solvency was about 6 percentage points. So, that's, in a sense, for us a very decent number.

This is a trading update, and the business was trading well as evidenced by our combined ratio of 92.1% in our Non-life business, ahead of target, ahead of last year. So we believe that the quality and quantity of earnings have further improved in the first quarter.

Let me walk you through the details. Go to page number 3, talking to you about the premium levels. In understanding the premium development versus last year, you have to adjust for a few factors. One is, last year, we had the results with the premiums from NIVO. We had a portfolio transfer of a funeral business called NIVO of €323 million. Those were one-off transfer. That was in those numbers last year, so for comparison purposes, you take it out. And this year, we have a slightly different methodology of recognizing premiums in Disability, especially premiums in the mandatory agents channel where we changed the recognition of those premiums. That's a delta of about €50 million that one has to actually – of estimated €50 million that one has to adjust for in comparing premium to premiums.

If you look through those adjustments, you will find that the Life premiums effectively stayed stable at €516 million and that our Non-life premiums went up from €841 million to €884 million. So premiums increased about 2.9% (sic) [2.3%] compared to last year, mainly in Property and Casualty. And premiums in Life effectively stable.

On the cost side, page number 4, an increase in our cost base from €129 million to €137 million, 6.2% up. Couple of points to note, the increase in cost is, to one part, driven by additional cost bases of acquired companies. Last year, we acquired SuperGarant, Corins and BNG Asset Management. They were not in last year's cost base, are in this year's cost base, so the acquired cost bases explained part of the cost increase. Some cost increase are linked to the buildup of our Asset Management business, most notably the Dutch Mobile (sic) [Mobility] Office Fund. Last year, we acquired the portfolio from the Dutch [ph] Railways (05:36). This year, we went to the effort of marketing and equity raising that fund, and I'll talk a bit more about it during the page on asset allocation, but there is a cost to launching and raising that fund.

Then finally, additional pension charges due to the fact that we have an annual pension cost – the official term is the current net service cost – that went up because of the interest rate that was used last year. We fixed the current net service cost at the end of last year at a lower rate than the year before, which means that this year we have to deal with a higher regular contribution to our pension obligations. That could be a temporary phenomenon. If rates stay where they are this year, then in 2018, that increase will be reversed and the current net service cost will decline again. So it's a function of fluctuation in interest rates.

The underlying cost development in the group was still – in fact is in line with our long-term cost reduction objectives. I'll give you a bit of color for what we're doing on the cost side. In the first quarter, we have started to consolidate the number of head office functions, leading to the reduction of jobs in our head office by bundling together services-oriented functions in head office. We're on the way and will go further in integrating our P&C platforms.

Remember, we have a broker-based P&C platform, we have a travel and leisure insurance platform, we have a direct insurance platform. And on the back end of those platforms, we have started to integrate or will integrate further to further save costs. And finally, the Life migration plans are still progressing according to plan. We have once more completed a pretty challenging migration. So the 2018 completion timetable still looks realistic.

And in funeral, we have commenced the integration of this NIVO book. We added the portfolio last year, we first finalized integration of AXENT and now we've commenced the integration of the NIVO operations. So underlying cost – the operational cost developments are in line with plans, and a number of additional initiatives have been taken.

If you look at the operating result on page 5, we're pleased to report that all segments witnessed an increase in operating result. Non-life, Life, also the smaller ones, Banking and Asset Management, and Distribution, all went up for a operating result of €191 million. This is a pretty safe and stable number. It is not a profit before trouble (08:20) type of metric. It's all included, excluding capital gains, excluding incidentals, but there were hardly any incidentals during the quarter.

We do not report an IFRS profit number. We do not report a net profit number during the quarter. But if we have to produce one, think of a number around 180-ish mark for a net profit. So, again, a operating profit number that, to our view, is stable and robust, although there were some slight headwinds in the first quarter that caused it to be very, very attractive.

Those tailwinds bring me to our Non-life business, page number 6. In Non-life, the operating result went up from €32 million to €54 million in this quarter compared to first quarter last year. Premiums went up. Most notably, we observed a premium increase – underlying premium increase in P&C, about 6%, from €325 million to €345 million.

In Disability, the increase that you're seeing – that you're witnessing is, to some extent, adjusted or affected by the different calculation – or recognition of our mandatory agent premiums. If you adjust for that, the €50 million which is what we estimate to be the effect of the different recognition pattern, there's a stable to slight decline in the Disability book with the assumption of the (09:44) products. Last year, we announced that the government would attempt to privatize part of the social security system. But the (09:55), the government agency, is still active, and we've seen some of our clients moving back into the public sector, which ultimately cost us some premium in the beginning of this year. But we believe that in the long run, those clients will flow back to the private sector as the advantage of the government has effectively run out in a couple of years' time.

What we actually more (10:18) is the combined ratios as we steer our business on value of a volume, on margins of a volume. In Disability, we were able to hold on or even improve a tiny bit the very strong combined ratio at 91.2%, so continued to be strong.

Health combined ratio improved to 93.3%. There was a small benefit from the Health equalization system, about €7 million. Excluding that, the Health combined ratio would be around the 96% mark, which I think is slightly more representative of the underlying performance of the Health business.

And finally, in Property and Casualty, our combined ratio moved to 91.8%. There's an internal competition between P&C and Disability, who will have the lowest combined ratio? Well, the P&C guys are catching up. So, let's see what the next quarter brings us. They're very pleased with the 91.8% combined ratio in Property and Casualty.

Now, honestly, we need to give a few (11:16) to this. In the first quarter, everything that went well or could have gone well actually went well. It was Murphy's Law (11:25). We had no storms, no frost, no snow, and also no large (11:31) calamities, no large claims. Actually, 91.8% is actual number. We did book in 91.8%. But again, we have to be honest with ourselves. We were just having a bit of tailwind as well. Had we had the normal set of storms, the normal set of large claims, so the stuff we budget for the underlying combined ratio of P&C would have been around the 95% mark.

So, we're very pleased with the very strong quarter in Non-life. Operating profit from €32 million up to €54 million. If you look at the underlying performance, I think that was between €10 million and €15 million of additional results that we actually booked in Health and in P&C that may have a one-off nature or may have temporary nature. At some point, larger claims will kick in. But it's something we'll have to see during the year.

For us, we look back at a very strong quarter with continued strong, uniquely strong combined ratio in Disability, improving combined ratio in Health with some support from the equalization system, a significant improvement in the combined ratio of P&C, possibly one of the better ones in the country with some tailwinds from the benign winter.

Overall, premiums increased as well. And we want to take note of the fact that P&C, our volumes grew by 6% and the combined ratio improved to 91.8%. So, we see that's a very healthy development in our Non-life business.

Moving on to Life, which takes us to page number 7, further improvement in performance. Operating results, up from €121 million to €149 million. Premium levels down a bit because of the fact that last year there was a one-off portfolio transfer that did not reoccur. If you correct for that, premiums are actively stable, profits up, and profits up mostly from higher investment results, both really direct results and increased contributions from the capital gains reserve, a.k.a. shadow accounting capital gains release.

The direct results from the investment portfolio were at group level across all businesses, Life and Non-life, about €44 million increased direct results; €18 million (14:00) cash income, coupons, dividends, what have you; €5 million reduced depreciation on swaptions prices; an additional increase or – an increase in the capital gains reserve release, €21 million.

So, as a group level, €44 million of increased direct investment income. Again, €18 million direct yields, €5 million less depreciation on swaptions cost price, and €21 million increase in capital gains reserve. The bulk of it is reflected in the Life insurance business, as most of it are in Life.

So, our Life insurance profit is up due to increased direct investment results, offset to a smaller extent by lower mortality results and lower cost results. On the mortality side, if you remember, we have a significant funeral book, and there was a wave of influenzas in the first quarter that causes increased amount of casualties and deaths, increasing our funeral payout. So, a lower mortality cost Q1 this year versus Q1 last year due to the increase in influenza observations in the first quarter. And gradually, some pressure on the cost result in our Life business as the business – the volumes gradually declined. We're very pleased that the investment income, the direct cash investment income does indeed held up and overcame any downward pressures on mortality results, giving us a very solid handle to the Life insurance profitability.

We did add some more capital market risks, as we said in our opening. Page 8 shows you a bit more on that market risk developments. In January, we kicked off a review after our annual strategic cash allocation. We're optimally using the capital base that we have, and we initiated a small but not – but meaningful re-allocation of capital market risks. Effectively, what we did, we allocated more to equities, we allocated a bit more to real estates, allocated more to mortgages and credits at the expense of governments. The equity re-risking program is basically complete. We've done that. It has run its course. We are where we want to be.

On real estate, last year, we acquired the office portfolio of the Dutch Railways. At that point in time, there was – accounted for is a small overweight in real estate. The re-allocation of capital now show it is actually the level of capital where we want it to be. So, the overweight in real estate became the target rate in real estate. And we allocated more to mortgage and credits, and more of its re-allocation is about 70% underway – the credit re-allocation about 60%, 70% executed. So, that means we're nearly done on re-risking. Some small activities still flew over into the second quarter.

On the real estate portfolio, as you remember last year, we had €275 million of equity – of real estate capital. That was within a fund on offices. In January, we sold €60 million of non-core assets. And during the first half, we've been very busy signing up external customers. And without giving undue information, I wouldn't be surprised if at the end of the second quarter, we show you that we sold out on this fund as well because there appears to be significant interest from institutional investor to participate in this front.

So, in summary, re-allocation of assets to more risky assets. On equities, €300 million done. On real estate, last year's overweight is now our target rate, which will be reduced a bit if new customers sign up. Mortgage and credit is about 60%, 70% underway in achieving our target rate.

And to pre-empt one of your questions, how did French government bonds feature into your Solvency? We did have a portfolio of small government bonds, about €1.1 billion in OATs, but they tend to be smaller short-duration French government bonds. So, the spread widening and run-up to the French elections had a very small impact on our valuations and a very small impact on our Solvency. So, we were not concerned about it at all.

Also, we continued or we rounded off the swap spread rate that we announced last year. We traded about €400 million in government bonds and moved them into long-dated swaps to finalize the hedging of our swaps exposure. All in all, the re-allocation of assets to more risky assets, the completion of the swap spread trade will, in the long run, support the annual capital generation. Think about the number around €15 million to €20 million on annualized basis.

In terms of your models, we believe it's fair to have that additional number kick in in the course of the year, so not so much per one 1st of Jan. During the course of the year, the run rate capital generation will go up. And think about an annualized number of about €15 million to €20 million because of this re-risking. Of course, depending on your return and spread assumptions.

Solvency, page number 9. Eligible own funds and required capital both increased for a net delta in our Solvency ratio from 189% to 188%. The required capital up €133 million. That €133 million is made up of roughly €144 million increase in market risk, €53 million in insurance risk and €21 million in counterparty risk. Shows your market risk up, insurance risk up because of portfolio growth, counterparty risk up due to mortgage allocation. And you subtract from that (20:05) strategic benefits and the LACDT effect on the higher SCR, gives you net-net an increase in required capital of €133 million. But very pleased against that in a very robust and solid increase in the eligible own funds of €240 million.

So, net-net, own funds up €240 million; required capital, up €133 million. And we're very pleased that we're, even in a challenging rate environment, able to continue to grow our own funds and add €240 million own funds in the quarter. And this is consistent with an underlying increase in Solvency of about 6 points in the last quarter.

Please note that Tier 1 capital is very strong, 85% of the own funds. We have no restrictions on tiering. Restricted scope for Tier 1 with over €1.1 billion; Tier 2 or Tier 3, around €725 million. We do not have any Tier capital usage. Actually, we ended last year with a DTA, small DTA of €11 million. That flip side now has become a DTL in the first quarter. So, we're very pleased that the Solvency level is strong, the accretion is strong, but also the buildup is strong with a significant portion of Tier 1 capital and no tiering restrictions, actually headroom in Tier 1 and Tier 2 and Tier 3, which makes this a very safe and stable and solid number.

Also like to note, if you look at, for those of you who have a history at ASR, the quarterly Solvency numbers, I mean I looked at that yesterday evening. Between the first quarter of 2016 and the first quarter of this year, there have been five quarterly numbers. Our Solvency ratio actually fluctuated between 186% and 191% in those quarters. So, on a quarterly basis, the fluctuations tend to be very small and manageable and have been very, very stable.

Actually if you exclude last year's first quarter, we've always managed – or we put about four quarters in a row at a Solvency between 188% and 191%. So, very stable and robust set of Solvency numbers.

That brings me to the conclusion, to the end of our presentation. Although not before I said that our Solvency at a UFR of 2.2%. We've talked about it before as a interesting level of Solvency, a more economic type of Solvency level that is now 143%. At a UFR at 2.2%, our Solvency ratio would be 143%. So it's significantly above 100%, significantly above 120%, showing you again a pretty robust Solvency level.

So, to conclude, strong financial performance in the first quarter, great operating profit, strong operating ROE, some tailwinds especially in Non-life. Estimating the amount of tailwinds is judgment. I would personally estimate that if you exclude those tailwinds, the underlying operating profit was in the €175 million mark, which still corresponds to a 15.5% to 16% ROE, so the actual delivery is €191 million. Excluding a bit of luck, it's €175 million, and that's a pretty robust and strong underlying number, and still an ROE of 15% to 16% and above the quarters of last year – above first quarter last year and above the last quarter of last year. So we feel that Q1 was a strong and solid quarter, in which ASR demonstrated continued to – that discipline in underwriting ultimately will bear fruit and that the generation of capital also allows us to allocate capital to more risk-bearing assets and further support our profits.

We've just come out of the AGM this morning where all resolutions have been accepted. Most notably also the fact we are now allowed to buy back shares up to 10% of the outstanding shares. So now we have a market-conformist buyback mandate, but all the other resolutions have been approved. It took us three hours, but it was three hours well spent.

With that, I'd like to end our presentation on the first quarter numbers, hope to have given you some color and some feel about what happened, and leave the floor open for questions.

Q&A

Operator

Ladies and gentlemen, we will start the question-and-answer session now. First question is from Mr. Cor Kluis, ABN AMRO. Go ahead, please.

Q - Cor Kluis {BIO 3515446 <GO>}

Good afternoon. Cor Kluis, ABN. I got a couple of few questions, first of all, about the share buyback. Other than some share buyback approval, can you remind us how much of share buybacks you could do this year, taking into account capital return targets that you have mentioned? So, which part of 10% for 2017?

Second question is about P&C, 6% premium growth, and so it seems that you have been winning some market share. Can you indicate where – in which product lines is that? Is it across the board or fire or motor, or give us comfort that this is high-quality business?

And my last question is more on check. If I fully understand it, on the re-risking and the effect on the earnings/cash flow, I thought you mentioned that the re-risking was around €18 million post operating result pre-tax for one quarter. And you said that for the full year, it's €15 million to €20 million higher for the full year. How can we relate – after-tax of course, but how can we relate those two figures? Those are my questions.

A - Chris Figee {BIO 18815839 <GO>}

Cor, thank you very much. On the share buybacks, I said we've got a market consistent mandate of about 10% of the outstanding share capital. It does not mean that we're going to spend it tomorrow, but it's good to have a decent mandate. We've always said we think it's fair that, especially in a year where the shareholder may be willing to exit and has been demonstrating to be willing to exit, to support selldowns with share buybacks, we think it's a wise way to allocate capital.

We've said also as a long-term plan, it's fair to assume that the maximum capital distribution you do any year, on average, could be the annual capital generation. It could be a bit more, it could be a bit less, depending on the circumstances, depending on the year. But that's a good guidance, which means mentally we have a share buyback budget of up to €100 million (27:18). If and how and where we'll spend it, it depends. We have the headroom. We think it's fair to assume to spend some of it during the year to support and help management with selldowns. Especially if they come at a discount, we find the ROE on buying our own shares with discounts relatively attractive. But it depends on the time. But in the long run, we believe annual capital generation is a good guidance for what you can return to shareholders in the long run. And again, that on top of that depends also on other allocation, other means of deploying capital. But surely, we're not going to be capital holders just sitting on capital. We will think about what's the best way to dispense, allocate it.

On Property and Casualty, it appears that we have been winning some market share. We don't have the full market data, but 6% growth in P&C appears to be ahead of general market growth. Where did it take place? It's very much retail business. It's retail business in brokers. 50-50 split between the provincial broker and the mandatory agents. The bulk of the retail growth actually is in packages, so customers sell or acquire motor, home, fire through a combination of products. So it's a combi-product that tends to grow pretty well. So we feel that this is quality business because it comes through brokers that we know. All of it is a provincial intermediary retail combi package, which tends to be – historically has been highest quality business.

Please rest assured that every performance review that we have as a management board with the P&C team starts with the question, what about margins, what about underwriting material? And we're comfortable that growth that's coming in is not at the expense of underwriting criteria. The underwriting criteria are as strict as ever. We actually decline more business than we write, than we accept, and we only accept the business that we feel is actually value accretive.

Finally, on the re-risking, what you're pointing – alluding to, Cor, are two different metrics. The €18 million is a direct cash investment income, the coupons, rents, dividends received in the first quarter. They were up versus last quarter. Now, this is actually when they come in, and coupon and dividend quarter – dividends tend to take place in the first half of the year rather than the second half of the year, meaning most companies pay dividends in Q1 or in Q2.

So, it is actually upon receipt, you book these results. The €20 million is the increase in long-term investment results according to the OCC definition. So, in our operational organic capital generation, we have a number of long-term spreads that we assume at €20 million, basically multiplies the delta in asset allocation times the long-run spreads. So, the first is actually the – the actual received – have actually received coupons, dividends and rental incomes. The latter is really the modeled long-term investment income that we'd expect.

Q - Cor Kluis {BIO 3515446 <GO>}

Very clear. Thank you.

Operator

Next question, Albert Ploegh, ING Bank. Go ahead, please.

Q - Albert Ploegh {BIO 3151309 <GO>}

Yes. Good afternoon, everyone. Thanks for taking my questions. The first question I have is basically on the Life operating result. This was clearly quite strong. You mentioned to have basically re-risked the customer portfolio by around 70%, 75%, so something extra could still come. So, how sustainable is this run rate? I mean, can we basically start annualizing this number, or do you think there's still some seasonal element in there or some underlying pressure that make that conclusion maybe a bit too optimistic?

The second question I had is on the individual Life book. You mentioned that, due to the shrinking, that you have some crossover, and basically does this also make you actually more eager and willing maybe to look for some small bolt-ons in this space as well?

And my final question is on the re-risking budget. So, is it fair to assume that in the second quarter, there might be a further drag from market risk of around 2, maybe mix 3 percentage points? Thank you.

A - Chris Figee {BIO 18815839 <GO>}

On the Life business, we believe the run rate is pretty sustainable. I mean, this has increased due to direct investment income and increase in the capital gains reserve. So this appears to be a pretty sustainable number. As I said, the tailwind was more in Non-life than in Life. So, there could only be some fluctuations in your investment results – operating investment results in the Life business due to the fluctuation of when the actual direct investment income will occur. But there is nothing peculiar particularly to mention around volatility in these numbers. So, it appears to be pretty stable number.

On the cost side in Life, there is an estimated cost overrun. We don't have a cost overrun in Life, to be clear. But the cost margin – we have a positive margin on costs, so we make the result on costs, but the result on costs is gradually declining as the book declines and as the cost coverage declines. So, we still have a positive result on costs, but it's less than a year ago. Our response against that is to variablize our cost base and move cost policies on external platforms where we're paying on a cost-per-policy basis.

That program will be completed in the beginning of 2018. At this point, the program is ongoing, and so we're making programming costs or is it migration costs. So, what you're seeing today is that the cost coverage from the book is gradually declining and the measures to counter that create a number of one-off migration costs that we'll have to absorb. Net-net, at this point, the cost margin, the cost benefit actually is actually gradually declining and should be stabilizing as of 2018 and possibly grow over it again.

In terms of Life consolidation, we think it's good for the industry, it's good for the Life insurance sector as Life books generally consolidate because this, after all, is a scale gate, so more scale in Life is actually good. It does not mean we're about to go on an acquisition spree in Life. But in general, consolidation of Life books on single platforms to absorb the decline in cost basis or declining coverage basis is actually a good idea.

In terms of re-risking, there are some small re-risking to be done, I said mostly on the mortgage side and on the credit side. Will that be a capital drag? Less. First of all, these are the lesser capital-intensive estimates. So, equity and real estate consume much more capital than mortgages and spread products. Secondly, if and when we'll reduce some of our equity exposure declines, if they participate in the office front, that will create some capital relief.

So, in Q2, the amount of additional drag or additional allocation of capital to market risk, net-net, is expected to be very limited.

Q - Albert Ploegh {BIO 3151309 <GO>}

And can I have maybe one follow-up on the share buyback program from Cor earlier? You mentioned clearly to have preference to participate in selldowns. Of course, that depends on your – intentions of your shareholder in the end. So, is it fair to assume that you will first await their decisions and not start, let's say, normal underlying buyback program beforehand?

A - Chris Figee {BIO 18815839 <GO>}

Yes. Look, it's fair to say. In terms of our capital policy, we want to create value for our shareholders organically, inorganically, or by buying back shares or paying dividends, right? We believe it's fair that with the ROE that we have today, we think we demonstrate that we're doing good stuff with shareholder funds. If you look at the first quarter, the operating ROE was 17%. One can debate the cost of capital, but unlikely to exceed 17%. So, we think we've created value to shareholders.

We believe the selldown of the government present or create a unique situation to support shareholders and buy back some of the shares. And it's a unique situation where, of course, especially for existing shareholder, once we reduce (36:51) and does so at a discount, it's a great moment for the company to support it.

So the selldown of the NLFI is a special moment, a special situation that actually make it very attractive for us to hand back cash to shareholders through share buybacks. Is this then the ultimate proof that it will last forever? No. It's really centered around the share buyback program of the government. And we're living on the assumption that they're going to sell until the last share is sold. So, it's probably wiser to wait for additional capital distributions and participate in their programs than launch anything on top of that.

Q - Albert Ploegh {BIO 3151309 <GO>}

Okay. Great to hear.

Operator

Next question, Steven Haywood, HSBC. Go ahead, please.

Q - Steven Haywood {BIO 15743259 <GO>}

Good afternoon, gentlemen. Could you speak up on the walk-through of the Solvency II capital generation? I know you disclosed there was organic capital generation business and market developments. But if you could sort of split that 6 percentage points up between the three or any model adjustments or other assumption changes, that will be very helpful to us.

And then on your 45% to 55% payout ratio target range via dividend, how fixed is this range or are you willing to pay slightly above and below?

And then finally, you mentioned your sort of first quarter adjusted operating profit around the €175 million, maybe €180 million mark. If you annualize that, obviously you get to about €700 million and then you take away the perpetual coupon and also tax, you get to around a €500 million net operating profit. Is this sort of the run rate we should expect for the rest of the year and ongoing, or maybe you can't answer that question? Thanks.

A - Chris Figee {BIO 18815839 <GO>}

On the first question on Solvency II, we believe that the operational cap generation, we find if you have delta on Solvency, the most interesting element of it is how much own funds does one create minus how much required capital does one actually absorb? The market used to or is asking to bucket it into an organic cap generation and other, right? We believe that's something you should not follow so much on a quarterly basis, more on a semi-annual to an annual basis, because that is more in line to the long-term nature of the insurance industry.

If you look at what happened in this quarter, the 6% – the effect of 6% accretion in capital, there were no benefits from actually modeling changes. So, we didn't model up our Solvency. We definitely did not, so no changes in there. So, 6% is a function of organic – underwriting results, long-term investment results, and capital gains and capital appreciation of the investment book. So, we don't really split it, formally disclosed into the different sectors.

But let's assume the 6% divided by 2, half of it is extraordinary market development in the first half, first quarter, which are good. They booked it. And the other half is more long term on the run capital generation that we have based on underwriting and reasonable assumptions on investment returns. But, again, there was no modeling benefit. We didn't model up the Solvency. It really was all own funds based on underwriting results and markets. And we have to acknowledge the markets, we're pretty good in the first quarter. Splitting those 50-50 is probably a reasonable amount.

In terms of our payout ratio, we have an official policy that specifies 45% to 55%. The chance of us going below that, I would find it pretty slim. Actually, it would be real strange if we'll be below that number. Above that, we think if we get into situation that we feel that we want this to distribute more, we would have sufficient flexibility between special dividends or buybacks. So, the ordinary dividends were between 45% and 55%. It's reasonable to assume that we'll stick to that policy that had just been approved by the AGM. Dropping below that, highly, highly unlikely. Going above that, we have sufficient means to distribute capital if that is relevant.

And in terms of giving guidance for the year, we hear your calculation. Does not seem unreasonable to us. But at the same time, we're only one quarter in the way, and we do make a policy not giving guidance. So, it's too early for us to give formal guidance, but your numbers are well noted.

Q - Steven Haywood {BIO 15743259 <GO>}

Excellent. Thanks very much for your help.

Operator

Next question, Nadine van der Meulen from Morgan Stanley. Go ahead, please.

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

Good afternoon and thank you for taking my questions. Firstly, the underlying operational ROE that you mentioned, up 15%, 16%. Can you remind us why you're guiding for an ROE of up to 12% given your track record so far?

And the second question is, to have a bit of a better understanding of the income support from the amortization of the current realized gains reserve, could you remind us or give an update on what the realized gains reserve now is and also what is the shadow accounting reserve? Because I think you last disclosed at the 1H result, this was just over €6 million. But if you can give us an indication how volatile that is or where it is now.

And, yeah, lastly, given your capital generation and particularly given your comment just now of sort of 3 percentage points longer term, I assume that that includes the €15 million to €20 million increase from the re-risking. Sort of given that level, as you annualized that, that's quite significant and you have a very solid Solvency II ratio as it is. Can you comment on your plans to grow? I mean, in the past, you've done successful small-scale acquisitions. What are the areas that you're particularly interested in, or is there anything in the pipeline on the Distribution side, Funeral, Asset Management? But do you also consider participating in the Dutch Life consolidation as well? That's it.

A - Chris Figee {BIO 18815839 <GO>}

On the operating ROE, I said the achieved ROE was 17%. We believe the underlying ROE (43:28) been 15.5% and 16%. We are aware at the IPO, we've guided for something that went (43:35) up to 12%. But the average of what we achieved in the years, in the run-up to the IPO, it was a reasonable mechanical assessment. We understand the challenge of the markets. That's something that we are actually reviewing and thinking about, although it's less than a year since the IPO, so it might be early days to give new formal guidance about the ROE. But again, we feel comfortable with the current trading that we have.

In terms of shadow accounting and capital gains reserve, I need to be a bit (44:10) careful. Those are official IFRS type of numbers, and we're not supposed to show IFRS numbers in a trading update. But if you go back to last year's Annual Report, it's fair to assume that the capital gains reserve stayed remarkably stable for (44:26) at the end of last year. And the shadow accounting reserve, which is the underlying realized portion, obviously it fluctuates more. It fluctuates more with interest rates. But I don't think someone will kill me if I say it's still a four-digit number, it still starts with a 3. That's about as far as I can go without going too far into the IFRS domain. But again, cap gains reserve very stable. Shadow accounting fluctuates more with interest rates.

In terms of capital generation, we have to think about the 6% accretion, 50-50. Half of it is more longer term, direct-ish reputable yield. The other half is great capital market runs. And they may continue, they may not. In those 3%, there is some benefit of the re-risking, but not all of it, because the 3% which we've realized during the first quarter, so the actual influx of Solvency in Q1 and the re-risking was executed during Q1 and wasn't completely completed. So you may see some support going forward from that number.

And finally, maybe, how to spend that money? Do we participate in M&A? As part of our strategy, we always like to deploy capital in a most effective manner. We, of course, do look at M&A situations, but (45:57) in terms of communication, when it comes to M&A, there are two communication regimes. Regime A says, there's nothing to say. Regime B says, there actually is something to say. And we're still very much in regime A mode; and if we shift to regime B, you guys will be the first to know.

So I'm saying, we always look at files, we're very disciplined as we turned down more files than we have accepted in the last year because we have very strict criteria, operating ROE needs to be met, need to explain to our shareholders that we actually meet or at least can stand up in the face of a share buyback as an alternative, and rest assured that's something that we will apply in any future transaction. And again, there's nothing to say until there's something to say.

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

Thank you.

Operator

Next question. Benoît Pétrarque, Kepler Cheuvreux. Go ahead, please.

Q - Benoît Pétrarque

Yes. Good afternoon. A couple of questions on my side. The first one will be on the re-risking budget. It sounds like a 2017 budget which has been executed in the first quarter and you will be done in Q2. But what about kind of the long-term re-risking strategy, kind of long-term asset allocation strategy? Are you going to review that again in January 2018? Is there more re-risking potential beyond what you have done? And obviously, your Solvency II ratio is at 190%, good level, low leverage, standard formula. I mean, so long (47:38) kind of good level on Solvency II, can we expect kind of more re-risking going forward? And linked to that, have you seen any compression or tightening on the expected investment returns in the first quarter, but also in Q2? I mean do you see something special on mortgages, for example? Do you see something on other asset class as well?

Second question will be on the combined ratio. I was just wondering if you have seen any prior year's provision releases in your combined ratio in the first quarter, something unusual.

Then the last one was on the Asset Management business. I think you are targeting a growth of your third-party business. You clearly invested a lot to push the business. How much has been the inflow so far in the year and how much you expect for the rest of the year? Thanks.

A - Chris Figee {BIO 18815839 <GO>}

Benoît, thank you. In terms of re-risking, we run an annual strategic asset allocation process every year. We do that in the autumn of every year. And last year, we ran the asset allocation process, and we actually felt in November, December that there was room to do more. So we continued the work – the analytical work on asset allocation into January, at which point we concluded there was room to allocate a little bit more budget to market risks. At this point, we feel very comfortable with the target allocation asset (49:18) where there is some room to do, some runway to go, and declare the mortgage side. Then we have an asset allocation that we feel very comfortable with.

Will we re-risk more over time? Honestly, Benoît, I don't know. It depends on how market develops, how spreads develop, how the available capital develops. We run a process every year. So the next run will be in November in our regular annual (49:49) cash allocation program. And (49:53) safe to assume what is a reasonable – the asset allocation is where we want it to be in the long run. Keep our book growth. Suppose if we grow our asset base, then it will grow in these proportions. Further allocation to market risk, we feel comfortable with where we are.

How do we look at spreads in the first quarter? Obviously, on the equities side, we've seen a great run. Whether equities are cheap or dear or rich, hard for me to express an opinion given (50:25) deals appear to be holding up reasonably well. Credit spreads have been holding up also reasonably well. We've seen some signs of compression on the mortgage market. So competition in the Dutch mortgage market has been pretty strong. So there's some sign of mortgage compression. At the same time, mortgage losses are nil. I mean, I had a chat with the head of our bank. We have a small bank. They run an €800 million to €1 billion mortgage book. They had literally €18,000 of foreclosure losses on the entire €1 billion book last year. So we've seen some compression in spreads, but also a complete evaporation of credit losses on the mortgage side. So, net spreads are still attractive. We believe that the spreads that we actually were making and are able to generate are still very safe and sound as compared to our long-term investment assumptions, and that gives us some comfort around these numbers.

In terms of combined ratio, I can assure you there were no releases, no reserve releases in this book, except real regular when you close a file and you may have reserved a bit more than you actually need to settle the claim. But certainly, no extraordinary reserve releases. Also, no notations, so a very clean quarter. In Asset Management, the inflow of new Asset Management was between €300 million and €400 million of AUM in the first quarter.

We have just launched our mortgage fund, our mortgage product in the first quarter. That's where we expect to see inflows. We will expect to see some inflows in our credit proposition – credit proposal, and we expect to see inflows in the real estate office fund during the year. So, we believe the €300 million in the first quarter is a good run rate for the year. Can you multiply it by 4? Ask me again in Q4, but it seems to be ongoing well.

Q - Benoît Pétrarque

Right. Thank you very much.

Operator

Next question, Robin van den Broek, Mediobanca. Go ahead, please.

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

Yes. Good afternoon, gentlemen. First question is coming back again to the mental budget you mentioned for share buyback. I think the last selldown of NLFI had a 60-day blackout period. A blackout period that's going to end soon. And if they keep that 60 days intact going forward, they could basically sell down in full probably this year already.

Would you then still stick to that €100 million budget in that scenario? Because that's only 2.5% roughly of market cap and you've just asked and received approval for 10%. So, to me, also given your statements that your return on equity had it, it's a sensible investment basically. Would you shed some more color on that?

Secondly, on capital generation, you mentioned that there's an uplift from re-risking of €15 million to €20 million. I guess we should look at the full year, the 2016 run rate of €350 million to compare that. But then again, I think you also mentioned that the 3 percentage point in the first quarter is not fully reflecting that re-risking and if I would look at 12 percentage point of capital accrue in the year, you would get to over €400 million for the full year. So, I'm still a little bit in the dark on how I should look at capital generation for ASR this year. Those are my questions. Thank you.

A - Chris Figee {BIO 18815839 <GO>}

Okay, Robin. In terms of the mental budget, we said like given the dividends that we have paid out, given the shares we bought back in January, if you link it to the €350 million capital generation realized last year, the mental budget between €80 million and €100 million. If, how, where we spend it, it depends on the situation. First of all, I don't know, honestly, if, when and where the government is going to execute the next selldown and to what stake. Really, it's not our decision to make. We're only followers of that. We would like to make sure that we want to participate. You can count on us participating in a next move. How much? It depends. It really depends. And also we think that a share buyback as part of the government selldown should be in line with the amount of shares offered.

So, will the government sell its entire stake before the summer? We may need to think carefully how we participate in that. But that to be seen at this point, really, if there's a reasonable gradual rundown, the number we mentioned is probably fair to assume. And we have – there could be upside on that depending on the situation.

In terms of capital generation indeed, 3% in the first quarter times 4 is 12%. That will be a significantly high number. At the same time, we said, look, in the first quarter, some things went really well. The number – the P&C returns were quite strong, and we need to see how sustainable they are. So, it's fair to assume that the €15 million to €20 million is an annual run rate. You could compare it to the €348 million, €346 million (sic) [€345 million] we generated last year. What the actual number will be the during year also depends where the exceptional P&C performance will continue.

So far, things are looking good. Even the first months in the second quarter appear to be okay. But again, we still have eight or nine months to go before the full year is over. But we feel comfortable with the guidance we've given before on capital generation. We feel comfortable that re-risking will contribute to that. And we feel confident that the first quarter, actually we were trading at the level that was above that. If, how and when that will continue? We can only tell when the year progresses.

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

Okay. Thank you.

Operator

Next question, Syed Anil Akbar, Kempen & Co. Go ahead, please.

Q - Syed Anil Akbar {BIO 20166878 <GO>}

I have two quick questions. One of them is about the potential share buyback. Will you guys act in open market or should we – or would you guys be waiting for an NLFI placement?

The second question is on the Non-life market. So, in the modern insurance market, this might be a bit specific but I just wanted some color on this. So, in the modern insurance market, we've seen that you guys are the most aggressive when it comes to pricing compared to your peers. And what are the trends that you're seeing over there because the market is quite heated up? Do you see this kind of pricing going forward, or do you see something else happening over there?

And lastly, on the Tier 1. Like Tier 1 instruments and subordinate debt, are you looking for increasing this part versus (57:23) you have quite a lot of room in the space? Thank you very much.

A - Chris Figee {BIO 18815839 <GO>}

Yeah. When it comes to deploying share buyback that we return capital to shareholders, we believe selldown events should take center stage here. So, buying back shares in the open market, if you are sure that there will be selldown events going forward. How many?

We don't know. On what blocks? We don't know. But that they will come, that's pretty sure. So, we think it makes most sense to wait for those events as opposed to buying back in the open markets. I mean, it will be a waste of capital and shareholder returns if you buy something in the open markets, if next to that a buy-sell event would take place. So, think about (58:16).

Q - Syed Anil Akbar {BIO 20166878 <GO>}

Okay.

A - Chris Figee {BIO 18815839 <GO>}

In terms of Non-life, we actually do not see us as the most aggressive in motor; actually, the opposite. I think if you compare us to peers, we're probably one of the most conservative prices. We have two – actually, we have two product lines or brands, two attacker brands that are based in the mandatory agents and really focused on Internet-only called Click & Go and (58:47). It's fair to say those who experienced pretty hefty price increases in the coming months actually, we're going to use the current benign trading environment to focus on margin expansion. So, you may see in the second quarter, actually we're going to further strengthen our pricing positioning in the motor market by holding or changing the pricing on two of our most – two of our more aggressive channels. Although in general, we believe we are definitely not the most aggressive in motor pricing. There are peers and players who actually have much more sharp pricing than we have, but again, our focus will be further margin expansion over volume.

In Tier 1 instruments, look, we are pretty safe and sound when it comes to capital. We're very pleased with the headroom that we have. Do we look at issuing new restricted capital instruments? Always. We always assess the opportunity to attract capital at very favorable terms. And it's very important. We're very pleased with the fact that we do not have any tiering restrictions, no Tier 2, no Tier 3 restrictions. And those can come in handy in various situations. So, if it comes to raising capital, we will make sure that we'll always protect the Tier 2 and Tier 3 headrooms that we have.

So, we're looking at capital instruments all the time and always. We're always aware that there has been no Tier 1 instruments in euros issued yet, at least not on the public market. I've seen something between a holding company and a life insurance subsidiary, but I'm not sure we want to replicate that example. But we do look at instruments out there, and if we do something, we'll definitely protect and make sure there is remaining headroom in Tier 2 and Tier 3.

Q - Syed Anil Akbar {BIO 20166878 <GO>}

Okay. Thank you very much.

Operator

Last question, Arjan van Veen, UBS. Go ahead, please.

Q - Arjan van Veen {BIO 5197778 <GO>}

Thank you. My operational questions have been answered. I just have a quick question on the unit-linked mis-selling. There has been a bit more press. Particularly, there's an article today about two of the main claimant organizations joining forces and encouraged by one of the rulings against you in Den Bosch last month. So, I'm just curious. Could you give us an update as to how you're looking at the situation and maybe give some numbers around where the number of process were in 2006, where they are today, ongoing outreach programs, et cetera? Thank you.

A - Chris Figee {BIO 18815839 <GO>}

Okay. When it comes to the mis-selling situation, there have been a few rulings on KiFiD (01:01:32). In the first quarter, they have been generally positive for us, the KiFiD rulings. There has been one court case about the (01:01:40) case in Den Bosch, which has been a negative for us. To be quite frank, when we look at it, when our lawyers look at it, we are bewildered by the logic that has been followed, and we are still assessing whether we'll take it to the Supreme Court. We haven't made up our mind yet what we do and how we deal with it. But we deeply disagree with the outcome. I mean, we question the legal logic that has been applied. And how we deal with it going forward is something that has not been decided yet.

For the rest, no further cases. Any case we have seen had been postponed – that were planned had been postponed further. So, there's nothing coming up in the very short run. The next cases are scheduled for July. But they may be postponed again at the time. At this point, it is too early to say if there's anything meaningfully changing, except for this one court case where we're still assessing what to do with that outcome.

In terms of the number of policies, as indicated, the number of active unit-linked policies has fallen back to around 220,000. We started with over 1 million in 2008 when we did – we had the composition arrangements. Today, there are less than 220,000 policies still left, still active, and the rest has either been settled or has been lapsed. But for us, no real news on this topic rather than some press noise but no real material changes.

Q - Arjan van Veen {BIO 5197778 <GO>}

Understood. And the 220,000, you're still actively sort of having an average program to those to reduce that further?

A - Chris Figee {BIO 18815839 <GO>}

Yeah. They will either automatically lapse. Some of them will lapse as part of the composition program. And finally, for all the policies, we follow the AFM program of customer activation. So, AFM asked us, if you have a customer that may have a different policy, activate the customer so that he or she is aware and that he or she makes a constant decision to either lapse the policy or continue the policy, and they were completely in line with AFM regulations.

Q - Arjan van Veen {BIO 5197778 <GO>}

Perfect. Thank you very much.

Operator

There are no further questions. Please continue.

A - Chris Figee {BIO 18815839 <GO>}

Well, that leads me to the end of this call. I'll say thank you very much for your interest and for your questions. Again, we look back at a very strong first quarter, actually a record profit and a record ROE. And if you strip out some of the tailwinds, still a very strong, possibly even a record – still a record quarter, still a very high ROE.

So, whichever way you look at it, a very benign quarter. Again, it's a result without reserve releases, without undue elements. It is, just by doing honest insurance business, I would say, Solvency underlying growth about 6 points, invested into sharing back with our shareholders and investing into market risks, which will eventually again feed into new capital, feed in new profits.

And with that, growth in market share in P&C is very favorable underwriting criteria. So, we look back at a good quarter. We look back at a solid quarter. As you know, from us, we do not get carried away by one quarter. So, we stay firmly sober and realistic, but the year couldn't have started better.

A - Michel Hülters

Very good. Thank you very much for your attention. And we hope to see you soon on the road. Very good.

Operator

Ladies and gentlemen, this concludes the ASR conference call. You may now disconnect your line. Thank you.