Q2 2017 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

Other Participants

- Arjan van Veen, Analyst
- Ashik Musaddi, Analyst
- Bart Horsten, Analyst
- Benoît Pétrarque, Analyst
- Cor Kluis, Analyst
- Darshan Mistry, Analyst
- Farooq Hanif, Analyst
- Farquhar C. Murray, Analyst
- Matthias de Wit, Analyst
- Nadine van der Meulen, Analyst
- Robin van den Broek, Analyst
- Steven Haywood, 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 its Second Quarter 2017 Results. The telephone lines will be in listen-only mode during the company's presentation. The lines will then be opened 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 solicitation of an offer to buy any securities.

Good morning, Mr. Friese. Over to you.

Eilard Friese

Yes. Good morning. And good morning, everyone, and welcome to our conference call to discuss NN Group's results for the second quarter of 2017. I will kick off today's presentation by looking at the highlights of the second quarter results, as well as the commercial developments in the past quarter. I will also update you on the progress we're making to integrate Delta Lloyd into NN Group.

Delfin Rueda, our Chief Financial Officer, will then talk you through the details of the financial results at group level and for the individual operating segments. He will also talk about the capital position and free cash flow. I will conclude the presentation with a wrap-up, after which we will open the call for Q&A. Jan-Hendrik Erasmus, our Chief Risk Office is also with us today to answer your questions.

I suggest we start at slide number 3. Before we begin, let me say that this is special day for us as we present for the first time a full set of quarterly results for NN Group and Delta Lloyd combined. Some of the numbers we are presenting today are for the combined group, and where appropriate, we will highlight the contribution of Delta Lloyd.

The operating result of the ongoing business was substantially higher year-on-year, and included a healthy contribution from Delta Lloyd of €49 million. The standalone and end results were also generally higher with the exception of non-life where we took a €40 million strengthening of our property and casualty insurance liabilities to address the adverse development of bodily injury claims.

Commercial momentum was strong with total sales up 43%, and value of new business for the first six months of 2017, up 68% driven by higher sales and better margins in Europe and Japan. Our balance sheet also developed favorably. NN Group Solvency II ratio was 196% at the end of the second quarter. While market movements were favorable, we were pleased that the Delta Lloyd entity's contributed operating Own Funds generation of approximately €50 million.

In addition, as Delfin will discuss later, the Solvency II ratio includes the alignment of the Delta Lloyd balance sheet assumptions. We flagged in the announcement of the transaction that we expected to take adjustments in certain areas and we did. Of course, valuation adjustments in an acquisition work both ways. But overall, the final outcome is in line with our expectations. Cash capital at the holding company remains healthy, despite the provision for Australia. This means that we continue to have significant financial flexibility. Finally, we have today announced an interim dividend for 2017 of €0.62 per share.

Let's turn to slide 4. Successfully integrating Delta Lloyd is obviously our number one priority, but notwithstanding this, the organization continues to drive the innovation and change agenda that we have put in place over the last few years. For example, in our international businesses, we continue to push for additional distribution partners to leverage our market leading franchises, the most recent examples being in Turkey and Poland, which follow on from the distribution agreement that we have with Sumitomo Life in Japan, which came online in April and has made an encouraging start.

We continue to innovate our product set. For example in Hungary with our accident insurance, and in Greece with NN Orange Health, both of which are leading in the market. Our Sparklab in the Netherlands is piloting the new concept of prepaid car insurance called Bundelz in collaboration with Vodafone which we're optimistic about. To round off, I'm also pleased that our asset manager has again attracted third-party assets with €3.1 billion of net inflow in the second quarter.

Let's move on to slide 5. The entire acquisition process of Delta Lloyd has been completed, in fact within six months of announcing the recommended offer at the end of 2016. This was a lot of work but it went very smoothly. During this time, we agreed to purchase the Delta Lloyd preference shares held by Fonds NutsOhra and a subordinated loan NN provided to Delta Lloyd. This transaction was an important step in reducing leverage and improving our carrying capacity.

We also issued €900 million of senior notes at attractive rates. And we used the proceeds to repay the bridge financing for the acquisition. Finally, we completed the legal merger, which resulted in us issuing €165 million worth of shares. Our work has not stopped there. Immediately on completion of the transaction in April, we began the integration process. I look forward to updating you more at our Capital Markets Day on our plans.

In the meantime, I'd like to share a few key highlights. We have put in place management teams for all the business units and support functions. This allows those teams to begin the integration process of their relevant units and departments. We've also made sure that NN and Delta Lloyd have come together as one company for our customers. The front offices of NN and Delta Lloyd are working together to coordinate new product offers, and we have had intensive interaction with our intermediaries to address their questions.

While the integration will be a multi-year process, we have naturally looked for quick wins where they can be achieved. In this context, we have critically reviewed the project portfolio and stopped those projects that are no longer necessary under NN's ownership. Integrating two organization and business cultures requires effort and focus. We have a lot of work to do but I want to take this opportunity to express my delight at how our teams are working together, whether on the integration or just business as usual in what is obviously a period of significant change and challenge. It further strengthens my belief in the quality of the two companies, and my confidence in the quality of the combined company that will ultimately be created.

So let's turn to slide number 6. As we showed in the previous slide, we're holding our Capital Markets Day on November 30, at which we will give a strategic update of the combined group, including the announcement of our new cost reduction target. In the meantime, we continue to focus on improving efficiency across the businesses, and in particular at the operating units where we expect the integration of Delta Lloyd to create cost synergies.

This includes our asset management and banking units where we expect meaningful synergies, although we also expect this to be offset somewhat by expense increases to support growth. Compared with the expenses base for the full year 2016, we have reduced cost by a total of €22 million in the first half of (08:01-09:01) cash flow generation allows us to do so.

And with that, I would like to hand over to Delfin Rueda, our Chief Financial Officer.

Delfin Rueda Arroyo {BIO 7032761 <GO>}

Thank you, Lard, and good morning, everyone. As this is the first quarter that we have consolidated Delta Lloyd into the results, I would like to start by highlighting some of the accounting implications of this. We first have to draw up our day 1 balance sheet, in which all of Delta Lloyd's assets and the abilities were remeasured to fair value. We also recognize acquisition-related intangibles such as brand names, distribution agreements and client relationships for an amount of €447 million, as well as goodwill of €1.1 billion.

Starting from the second quarter, NN Group accounting principles are applied for all Delta Lloyd entities, and please bear in mind that this differs significantly from the principles previously used by Delta Lloyd. In particular, the investment yield on fixed income assets will generally be recognized using the market yield at the acquisition date, and insurance liabilities for the life businesses will generally be recognized on a lock-in basis using acquisition date assumptions.

The Delta Lloyd entities have included in the relevant segments of NN Group. And we have set out where this entity is included on a slide 24 in the appendix. We have also taken this opportunity to align the calculation method for the combined ratio of our non-life business in order to bring it more into line with market practice. Under the new methodology, we exclude the unwind of the discount rate on the insurance liabilities related to the disability and accident business.

Let's now look at the consolidated second quarter results on slide 10. NN Group reported an operating result of the ongoing business of €404 million in the second quarter of 2017, up 26% on the same quarter in 2016. This increase was driven by the €49 million contribution of the Delta Lloyd businesses, as well as higher results at most segments, partly offset by the impact of a €40 million strengthening of P&C liabilities at Netherlands Non-life. The net result for the second quarter was €240 million, this reflects higher non-operating items and an improved result Japan Closed Block VA offset by the special items and a €188 million provision related to ING Australia Holdings, which we had to recognize this quarter.

Moving onto slide 11, I would now like to take you through the second quarter performance of the individual segments, starting as always with Netherlands Life. The operating result of Netherlands Life increased to €290 million in the second quarter of 2017 of which Delta Lloyd contributed €57 million. The higher net result this quarter was supported by a €14 million dividend from an indirect stake in ING Life Korea, as well as lower administrative expenses.

Please note that the Delta Lloyd Life results were supported by €16 million of non-recurrent and seasonal impacts. The investment spread calculated on a 12-month basis was 85 basis points compared with 128 for the same quarter last year. The decrease reflects the inclusion of the Delta Lloyd invested assets and insurance liabilities at market yields, which have been re-measured at fair value as at the April 1, 2017.

I would now turn to slide 12 for the results of Netherlands Non-Life. I would like to spend some time on the results of the Netherlands Non-Life segment, which reported a loss of €27 million in the second quarter of 2017. The combined ratio was 107% based on the new calculation method. Let's look at the two businesses lines together separately. The operating result in disability and accident was €29 million for the second quarter of 2017, of which Delta Lloyd contributed €6 million. The disability and accident result for the second quarter last year was supported by a very favorable claims development in that quarter, plus an IBNR update. The D&A combined ratio for this quarter of 92% is, therefore, at a good level. The operating result in Property & Casualty was a loss of €63 million, of which, an €18 million loss is related to Delta Lloyd. The current quarter includes large fire claims of €16 million in the Delta Lloyd portfolio. You may remember that the second quarter last year included the impact of severe storms of €28 million, affecting both the fire and motor portfolios. The P&C combined ratio was 115% compared with 118% in the second quarter of 2016.

Within the P&C business, we have seen good progress in the NN Life portfolio, with a combined ratio of 96% for this quarter and a full-year 2016 combined ratio of 95%, excluding the severe summer storm. However, despite the measures taken so far, the motor book results are still not up to our expectations. We have had the liability to extensively review and adjusted the best estimate ultimate loss ratios, resulting in a strengthening of the technical provisions of the motor and miscellaneous books for bodily injury claims by a total of €40 million. This is part of a series of measures to strengthen the performance of the motor portfolio, including prospective price increases.

Please turn now to slide 13 on the results of Insurance Europe. The segment Insurance Europe reported an operating result of €73 million, of which, the Delta Lloyd business in Belgium contributed €4 million. The higher operating result reflects higher fees and premium-based revenues and lower DAC amortization and trail commissions. The results also benefited from some non-recurring and seasonal items, totaling €9 million. Value of new business for the first six months of 2017 increased to €72 million, of which, Delta Lloyd contributed €4 million, driven by higher sales at better margins.

Moving now to Japan Life on slide 14. The operating result of Japan Life was 68% from the second quarter of 2016, excluding currency effects. This was mainly driven by higher technical margin, higher fees and premium-based revenues and an improvement in the investment margin, partially offset by increased expenses. Value of new business was up strongly at €93 million in the first six months of 2017, driven by higher sales at better margins.

I will now turn to slide 15 on the Asset Management segment. Total assets under management increased from €194 billion at the end of the first quarter of 2017 to €245 billion, of which, €51 billion relates to Delta Lloyd Asset Management. The increase, excluding Delta Lloyd, was driven by net inflows of third party assets of €3.1 billion, mainly within the institutional segment, partly offset by negative market performance of €2.6 billion, primarily due to higher interest rates. The operating result increased to €37 million, driven by higher fees, partly offset by higher expenses. The contribution of Delta Lloyd was zero as fees were offset by expenses in this quarter.

The segment Other is set on slide 16. The operating result of the segment Other decreased to a loss of €7 million, of which, €5 million related to Delta Lloyd. The main components of this segment are the holding result, the reinsurance business and banking business. The holding result decreased to a loss of €50 million, of which, €14 million related to Delta Lloyd. The decrease reflects a €10 million increase in holding expenses, largely due to a revised methodology for charging head office expenses to the segment. The operating result of the banking business increased to €34 million, of which, Delta Lloyd contributed €9 million. The higher operating result reflects a higher interest margin and a lower addition to the loan loss provision.

And that completes the results of our operating segments. Now, in slide 17, we show the movement in the holding company cash capital, which decreased from €3 billion at the end of first quarter 2017 to €1.7 billion at the end of the second quarter. A lot has happened this quarter, so let me take you through the main movements.

The free cash flow during the second quarter was €34 million, reflecting €820 million of dividends received from subsidiaries. This was partly offset by a €500 million capital injection into Delta Lloyd Life, as well as €188 million deduction for the provision related to ING Australia Holdings, which is included in the category other.

The cash capital also reflects the inclusion of Delta Lloyd cash position at the beginning of the quarter. The cash payment for the acquisition of Delta Lloyd as well as capital flows to shareholders representing the cash part of the 2016 final dividend and share repurchases in the second quarter of 2017. The net increase of debt and loans reflects the issue in May of new senior notes of €900 million. The €200 million repayment of operational leverage by NN Bank to the holding company partly offset by the repayment, also in May, of the €476 million non-qualifying subordinated notes.

Although not included on this slide, the financial leverage of the combined group was €6.7 billion at the end of the second quarter, in line with the pro forma position that we gave at the first quarter results. The financial leverage ratio is 30.8% at the end of the second quarter based on our revised definition of this ratio, which is now more in line with market practice. More details are included on slide 28 in the appendix.

On the following slides, I would like to take you through the developments in our capital position. NN Group Solvency II ratio at the end of June 2017 was 196%, including the full impact of the Delta Lloyd acquisition and the alignment of actuarial assumptions. Starting on the left-hand side of the graph, you can see that the acquisition of Delta Lloyd initially brought additional own funds and SCR of €4.4 billion and €2.7 billion, respectively. We have then deducted the cash paid to acquire Delta Lloyd in the second quarter, as well as the deduction of the stake held at the end of the first quarter, for a total amount of €2.3 billion. The combination of these two items can be seen, and you will, as taking us to a starting position for the combined group for the quarter.

From here, we included a full quarter of operating return of the Delta Lloyd entities contributing approximately €50 million to own funds and a small release of SCR. The market variances were substantial this quarter, as we benefited from the tighter credit spreads on French government bonds and also a strong equity market and real estate performance.

In the other category, we have included the provision related to ING Australia Holdings, as well as actuarial assumption adjustments that we made, and I will expand on this on the following slide. But before doing that, please note that we have not included restructuring charges in this ratio as those will be booked over time. Finally, the capital flows reflect the deduction of the 2017 interim dividend which we have announced today.

Turning to slide 19, you can see there that as we already flagged in December last year, we anticipated and have made significant adjustments to the valuation of assets and liabilities on the Delta Lloyd balance sheet, above and beyond those taken by Delta Lloyd in the fourth quarter of 2016 and the first quarter of 2017. The first was an alignment on the longevity assumptions used by Delta Lloyd to those used by NN Group. This occurred within Delta Lloyd Life.

The second was to adjust upwards the asset management fees paid by Delta Lloyd entities. Given the larger asset base of our asset manager, we also took the opportunity to reduce the fees paid by NN Life. These and other adjustments led to lower own funds in Delta Lloyd Life and higher own funds in NN Life. These, together with positive market variance and operating return, allowed NN Life to pay a significantly higher dividend of €450 million to the holding company this quarter.

Thirdly, we reduced the valuation basis of mortgages on the Delta Lloyd balance sheet by using the same valuation curve that NN Group uses. Finally, we also adjusted several other items which have an overall negative impact on own funds of Delta Lloyd entities, including, for example, the allocation of head office expenses to some entities and some updating of the Non-life liabilities.

Because of the impact of the balance sheet adjustments we made on the capital position of Delta Lloyd Life, we decided to inject €500 million, which took the Solvency II ratio to 139% on a standard formula basis at the end of the second quarter. This allows Delta Lloyd Life to manage its balance sheet and commercial needs within the context of NN Group and its capital framework.

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

Eilard Friese

Yeah. Thank you, Delfin. Today, we have presented our first set of results for NN and Delta Lloyd as a combined group. The operating result was strong and there was a healthy contribution from Delta Lloyd. Most segments posted improved results and we kept up our commercial momentum with higher sales and value of new business at our insurance businesses and good third party inflows at our asset manager.

The loss reported in our Non-life business reflects the action we took this quarter to strengthen the Property & Casualty liabilities. We will continue to implement additional measures to improve the profitability of our motor business, including premium increases on the renewal of contracts. Our capital position is strong, with a Solvency II ratio of 196%.

Our priorities going forward remain the same. Firstly, to successfully integrate Delta Lloyd and extract the synergies. We are already making good progress to bring together the best of our businesses and cultures. We will give a full update on our plans and targets at our Capital Markets Day on the 30th of November of this year.

Secondly, we will continue to actively manage the balance sheet and capital position in order to keep them strong. And thirdly, we continue our drive for profitable growth, especially at Insurance Europe, Japan and our Asset Management business. We have a lot of work to do to integrate NN and Delta Lloyd in the Netherlands and Belgium, but throughout this process, our employees will remain committed to delivering an excellent customer service and to further innovate our businesses.

With that, I would like to open now the call for your questions.

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. Farooq Hanif, Credit Suisse. Go ahead, please, sir.

Q - Farooq Hanif {BIO 4780978 <GO>}

Oh, hi there. Thank you very much and good morning. Firstly, about the operational capital generation on the Solvency II. So, you've got roughly €300 million to €400 million of operating capital generation in own funds and SCR. Could you give some indication of sustainability of that underlying number? So for example, what comes from Japanese closed book that may disappear? And also, the €50 million that approximately is coming from Delta Lloyd, will that also increase due to the synergies? So for example, the guidance you give on free cash flow, can we apply that also to operating capital generation?

And secondly, on the P&C side, you've made some reserve strengthening, I believe, in the Netherlands – sorry, the old NN P&C portfolio. Do you anticipate having to look again at Delta Lloyd's reserve as well? Thank you.

A - Eilard Friese

Yes, Farooq, good morning. I will take the P&C questions and I will ask Delfin to comment on the capital generation, but maybe it's good if we start with the P&C first.

Indeed, the €40 million of strengthening of the bodily injury liabilities is taken in the NN book, so that's correct. When it comes to Delta Lloyd and the bodily injury, well, this quarter, we consolidated Delta Lloyd's financials and the NN Group financials, and part of that process is re-measurements of assets and liabilities. So, the liabilities, including the ones for bodily injury claims, are now at best estimate levels.

With that, I would like to hand over to Delfin for your first question about capital generation.

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

Yeah. Thank you, Farooq. So, you have a couple of questions, so I'll try to answer all of them. But all very much related to how sustainable the operating capital generation in the quarter, how sustainable that can be. I have been always a bit reluctant to talk about sustainable levels or give a firm guidance. And as you have seen, this has been – you have seen some volatility quarter for – quarter-by-quarter.

Japan Closed Block VA do contribute to the operating capital generation through their operating result that you see reflected in the segment Japan Closed Block VA, which is the difference between the management fees and the expenses that flows through the own funds. And then, Japan Closed Block VA has some impact or decrease in the level of SCR during the, well, every quarter as a result of the run-off. That decrease will vary over the next quarter. In this quarter that was approximately €25 million of decrease in the SCR.

The increase of the synergies that will impact the capital generation of Delta Lloyd, absolutely, you're right that that will come through, not only through Delta Lloyd but also through the other entities within the Netherlands and Belgium as these flow.

Maybe just to make a distinction or a clarification, you talk about the guidance in terms of free cash flow and the free cash flow is very much two components. It has the capital generation, how much the own funds increases in each quarter, as well as the evolution of the Solvency Capital Requirement. These two contributed to the operating capital generation. In addition to that, there is, of course, the variance, what happens with the level of surplus capital within our entities.

The guidance that we have provided in terms of €100 million to €150 million in the short term due to the acquisition of Delta Lloyd, relates to the free cash flow, basically, the expected net remittances that we expected to be incremental from the position of not having to acquire Delta Lloyd.

Q - Farooq Hanif {BIO 4780978 <GO>}

Thank you. If I may, just very quickly follow-up. I know I asked a lot of questions but the – so quantum-wise, what you're saying is the improvement in free cash flow, which I know is a net remittance number, that might be a little bit better than the improvement in operating capital generation from Delta Lloyd?

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

Yes, because you have seen that is already in the quarter, we have seen a capital contribution of approximately €50 million, and as a consequence, one could expect that in the short term, the capital contribution might be higher. However, you also have to take into account the fact that, still, the operating expenses would have to be – the restructuring expenses would also have an impact in the capital contribution and this need to come over the next period of time, next quarters.

In addition to that, when you look at the capital generation, it's important that you don't forget that within the segment Other, we have the interest on the hybrids that also impact the capital generation but they are not reflected in the bucket operating return. And that, in the quarter for Delta Lloyd, was approximately €15 million.

Q - Farooq Hanif {BIO 4780978 <GO>}

Okay. Thank you very much.

Operator

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

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

Yes. Good morning, gentlemen. First of all, on the €500 million capital injection, I guess that number is a bit higher than at least we were expecting. Is there any chance you can get that capital back after PIM or legal merger integration? And also, it's a 28 percentage point move, I think, roughly, so that would put Delta Lloyd Life at 110%. Is that just reflecting the issues you've encountered before or is there some surprises in there basically?

Second question is on leverage ratio. I think when you announced the deal, you said that you would be around 30% leverage ratio and I think you were still deducting goodwill from the capital base to get to that number. And you mentioned that it was at the high end of your appetite levels. So the fact that we're now at 31% with a more favorable calculation of that 31%, does that mean that deleveraging has focus for you in the mid-term? Thank you.

A - Eilard Friese

Yeah. Thanks, Robin. Delfin, I'm handing over to you for this.

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

Yes. Thank you, Robin. The €500 million capital injection, one important consideration to say is that has been, for its most part, financed within the segment Netherlands Life. So, we have seen a strong capital generation in both Delta Lloyd on an organic basis, as well as NN and we have managed to do this capital injection within the same segment, meaning that there was no additional need to reduce the cash capital at holding in order to do this recapitalization.

This obviously follows a careful rigorous exercise to update the assumptions and align policies in a prudent manner within Delta Lloyd. And we have basically done the capital injection to the level of which Delta Lloyd is under a standard formula, very comfortable level, as part of the NN Group. And that provides, certainly, a financial flexibility also for Delta Lloyd in order to make their hedging and investment decisions without capital concerns. And absolutely, in terms of the capital generation that the Delta Lloyd company - companies are generating, we will see some of the - that capital being returned over time.

As a matter of fact, already within the - within this quarter, we already have some dividends coming from some of the subsidiaries of Delta Lloyd and we would expect that with this strong capital generation, plus the operational synergies that we have flagged, that will help Delta Lloyd to pay dividends to the holding us any other subsidiary within the group.

In terms of the leverage ratio, yes, we have done the adjustment in the way that we calculate the leverage in order to make it comparable to what is market standard in the way that also the rating agencies look at it, and it has, I think, it's around 2 percentage points effect or so on the leverage ratio. So instead of the 30.8%, it will be around 2 percentages points higher.

A - Eilard Friese

Yes, and Robin, Jan-Hendrik will add something on the PIM comment that you made.

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

Thank you, Lard. Hello, Robin. Yes, you asked about PIM and whether that would help the Solvency position. Of course, we expect that, to some extent, we have to balance that against the current benefit for the longevity hedges within the Delta Lloyd entity that was disclosed in their SFCR which was, I think, €360 million at December 31, 2016. So, some benefit but we have to temper it a little bit.

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

Sorry. That's all very clear. Just on the leverage ratio, I think when you announced the deal last December, you were talking about 30% being at the high end of your appetite range. You're basically above that now. Deleveraging, is that something that you need to do or...

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

Yes. Robin, sorry for not following this up. We didn't say that 30% was at the high level of our risk appetite. What we said it was with - as a guidance, that we thought it was going to be within the range of 30% which that has been the case. And indeed, we indicated at that time that because of the strong capital generation of the group, that we will consider some deleveraging and, well, there is an opportunity which is very short term in November, which is a €575 million senior debt at Delta Lloyd. And then, with the level of solvency capital generation and financial flexibility that we've got, we will consider then if we need to refinance that partially or not.

Also, keep in mind that since we did the announcement, we have also, through the FNO transaction that we executed, that helped us reduce the leverage as well. So, we will continue taking opportunities when they come.

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

Okay. Thank you very much.

Operator

The next question is from Mr. Cor Kluis, ABN AMRO. Go ahead, please, sir.

Q - Cor Kluis {BIO 3515446 <GO>}

Good morning. Cor Kluis, ABN. Couple of questions. First question is about the Solvency II ratio at group which was, of course, quite good. What was the positive effect of the model changes for NN Group standalone? That's my first question.

And my second question is about Delta Lloyd Leven, the 139% solvency ratio-wise, is it enough that you've seen what Aegon recently did with its subsidiary to recapitalize, and we understand that in the future, you will merge it with NN Life, but you still have to take restructuring cost over there. How comfortable are you that that's enough?

And my last question is about Non-life. You saw that the premium quarter-on-quarter went up by 75%, of course, due to Delta Lloyd, but the investment income only went up by 16% quarter-on-quarter. Why is that so low? Is there some special item in there or was investment income of Delta Lloyd on the low side? That's all my questions.

A - Eilard Friese

Yes. Thank you, Cor. Delfin, can you start with the Solvency II ratios, et cetera.

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

Yes. Thank you, Cor. Within the quarter for the NN Group standalone, there has been some, apart from the positive evolution of market and a positive contribution on the operating return, there has been some positive impacts on model changes. The most important element of it has been the reduction on the investment expenses. So basically, that is reflected, as you know, within the segment Other for model and assumption changes. But the majority, as you can imagine, of the negative impacts appearing in the bucket Other for model and assumption changes related to the acquisition of Delta Lloyd, as I referred before.

Delta Lloyd Life at 139%, is it a comfortable level. Yeah, I think it is. It is a very comfortable level, as I said, first, because it comes from having look at, not only at the IFRS balance sheet but also at the Solvency II balance sheet in a rigorous and prudent manner, and therefore, we are very satisfied with the level of the starting position in terms of solvency of Delta Lloyd. And I mentioned before that we do expect a significant free cash flow contribution from Delta Life, the contribution of the acquisition, and on that sense, I feel quite comfortable, 139%, a standard formula within solid – solidly capitalized group, provides certain financial flexibility that Delta Lloyd needs to operate going forward.

In terms of the investment income, indeed, the investment income has decreased certainly for Netherlands Life but also for Netherlands Non-life. Both are impacted by the fact that their fixed income securities are valued to fair value to market value at the day of the acquisition, and as a consequence, the investment margin spread or the investment margin yield for Delta Lloyd is even for the same security is lower as for NN Group comes based on the historical yields at the time of acquiring the investments. So indeed, that decrease is reflecting that.

Q - Cor Kluis {BIO 3515446 <GO>}

Okay. Wonderful. Thank you very much.

Operator

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

Q - Ashik Musaddi {BIO 15847584 <GO>}

Hi. Good morning, Lard. Good morning, Delfin. Just few questions again, sorry, on Delta Lloyd. It's all on Delta Lloyd. So first of all, can you give us some color with respect to the capital position of this, just deal-related thing. Are you more or less done with respect to all model changes, capital injection or there is more to go? I mean, I understand that there's this partial internal model for Delta Lloyd and this longevity SCR change is expected. But except that, is there anything more we should be expecting on solvency capital from Delta Lloyd? That's number one.

Secondly is how should we think about the Non-life earnings? Because first of all, I mean, your Non-life earnings is still struggling in terms of delivering the combined ratio target. You had 98% if I remember correctly. And at the same time, if I look at Delta Lloyd Non-life, I mean, it delivered, say, €6 million, minus €6 million in the quarter. Even if we add back the fire claims, it's like €10 million in the quarter, and this compares with, say, €25 million in the quarter that Delta Lloyd used to report, I mean, in past. So, what is the underlying Non-life earnings for Delta Lloyd and for your NN Non-life as well going forward? I mean, should we be just expecting continuing, I mean, drag or is there any visibility that it will get better?

Just the last bit on your asset risk, can you give us a bit more color about asset re-risking strategy, i.e. it looks like the NN Life earnings keep on moving up and up on a consistent basis driven by cost saving, driven by asset re-risking. Would you expect the same thing to happen with Delta Lloyd assets as well?

A - Eilard Friese

Okay. Ashik, this is Lard. Thank you very much for your questions. We're going to take them, all three of us. So, Jan-Hendrik will take care of the asset re-risking question that you mentioned, Delfin will take care of the capital position discussion, and I will talk about the Non-life piece. Maybe it's good to start with the Non-life earnings.

Q - Ashik Musaddi {BIO 15847584 <GO>}

Yeah.

A - Eilard Friese

So on the Non-life earnings, also if you look at the combination, yeah, let's ground ourselves a bit. If you look at the combination, the disability and accident business on a full-year gross written premium basis, is roughly 40% of the entire Non-life business. That piece runs well, has been running well for a while and has continued to run well also in the second quarter.

Then, if you take the Property & Casualty side, that's basically the area where the profitability of the total Non-life company is dragged down. When it comes to fire, the fire business, actually, you see already for a while that the Dutch NN portfolios are fine and running at a roughly 95% combined full-year 2016, 96% combined, for the second quarter of this year. Obviously, that needs improvement in terms of expense reductions, et cetera, but that's also not a place which is a real big concern.

Then, you have the Delta Lloyd piece of fire. Yes, you had a €16 million negative of large fire claims this quarter. Those are not – there is no correlation or relation thing that around this that we can comment on at this point in time. The real issue, I think, is in the motor book, as we mentioned already for a while. The motor book, there's a couple of things there. First, the bodily injury side of it. So, this is basically when you have accidents and it's part of your third party liability. And the bodily injury experience, we've done the deep dive for this quarter with internal teams and external consulting teams as well to look into the need of taking an additional strengthening of liabilities. We've done that in the NN book for €40 million. And as I said earlier on the first question Farooq, that we also ensured that at the time we looked at the liabilities, take them on board for Delta Lloyd on day one, we also make sure that included the best estimate for those.

Now, moving forward, we will, obviously, first of all, on the bodily injury side, we take that new experience into account and we take the current claims in. So, that's one thing. Secondly, we will start additional re-pricing of the bodily injury risks as of the fourth quarter of this year. That's when we will start to re-pricing that book. That'll take some time before you see that back in the overall margin improvement. If you look at the contract duration, the bulk of it will probably be done in a year but it will – it's something that you need to see improve over time.

Then, when it comes about expense reductions, we will obviously continue to work on the expense ratio. We have some pockets, by the way, on the Delta Lloyd business where actually, the combined ratio for the motor book is in a good place, which is the ABN AMRO joint venture, which is the OHRA business model. So, that is an inspiring thing for us to drive the expense ratio down further, take the learnings also on the underwriting side, improve the underwriting results as a result of that as well. So, you can hear that we are committed to driving an improvement on this Property & Casualty business through in a very difficult market environment for motor which, as you know, is highly competitive, but for which we now have, together with Delta Lloyd, a considerable scale and that should help us as well.

Now with that, I would like to hand over to Delfin.

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

Yes, thank you. Thank you, Lard. Just maybe to add a bit to what Lard has said. When you look at the results of the Non-life business of Delta Lloyd in the quarter, you've got that the very negative result that we have already discussed due to the large fire claims in the Property & Casualty, there is a profit of disability and actually is of €6 million, but there is also the additional €6 million coming through the operating result of the health business and broker businesses. One point, of caution, you'll see is if you were to compare with the results of Non-life before looking at investment margin, keep in mind that investment margin will reduce because of what I have just explained.

You sounded, I think, a bit apologetic about asking again about Delta Lloyd but I'm very happy to talk about the acquisition of Delta Lloyd because I think that it has met our expectations in terms of the expectations of free cash flow generation, as you know, going forward. And as I said before, we have done all the model and assumption changes that we thought they were appropriate, and on that sense, there is nothing pending to do. Once said that, as for any other unit within the group, we will be reassessing on a regular basis the necessary adjustments as required.

Q - Eilard Friese

And then, Jan-Hendrik, on the assets re-risking discussion.

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

Thank you, Lard. Hi, Good morning, Ashik.

Q - Ashik Musaddi {BIO 15847584 <GO>}

Good morning.

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

Thank you for the question. Well, I think the short answer is yes. We are going to look at re-risking also the Delta Lloyd balance sheet. Of course, when you look at our overall portfolio there, we have fixed income portfolio of roughly €150 billion, and half of that is in govies.

So as we have guided in the past, it's relatively defensive and some might say conservative portfolio. It's certainly conservative relative to the VOLA reference portfolio. So in the re-risking, we'll consider, of course, risk return and the impact on our sensitivities which you can see that we manage very carefully and we hope to see an uplift in the coming quarters. I think we plan to provide more guidance in the Capital Markets Day also on this topic.

Q - Ashik Musaddi {BIO 15847584 <GO>}

Okay. That's very good. Thank you.

Operator

The next question is from Ms. Nadine van der Meulen, Morgan Stanley. Go ahead, please.

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

Yes. Good morning. Thank you for taking my questions. You talked about the strong capital generation in – on the Life side for both NN and Delta Lloyd. I was – and also, on the operational capital generation you saw on the slide, the 5 percentage points. I translate it into roughly €370 million for the second quarter. I suppose, the bulk of that is coming from NN Life and Delta Lloyd Life. But then, if you look at slide 11, the value of new business is €6 million and that includes Delta Lloyd, I suppose. Can you explain why this is so low in light of the very high operational capital generation? And in other words, well, if you can comment on that and explain that, and also, perhaps, what your outlook is for the value of new business in the Netherlands?

I suppose, second question is on the holdco cash position, the €1.7 billion, what will be a level or range that you would be comfortable with on an ongoing basis, if you will?

And then, lastly, on the Delta Lloyd Life, this Delta Lloyd Leven, when can we expect a consolidation into one legal entity with NN Life? Thank you.

A - Eilard Friese

Yeah. Thanks, Nadine. Delfin, I'm handing over to you.

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

Okay. Thank you, Nadine. Well, I've always been a bit reluctant to start talking about very precise figures on each of the – in each of the brackets. There are some roundings here and when you talk about the capital generation in the quarter, there are always movements up and down, but the €0.3 million (sic) [€0.3 billion], if you like, is around the top of the capital generation, if you like, and this is something that you need to take into account when looking forward. Then, also, within that figure, as always, different elements. And in this quarter, for example, Japan Life has become relatively low in terms of the contribution on the own funds.

In terms of how that's – I mean, value new business for the Netherlands Life has always been kind of breakeven and we expect that to continue being around breakeven. The main drivers of the capital generation coming from the existing business is coming from the investment spread, and this is what we will continue to be seeing going forward, as well, of course, the combination of the UFR drag and the risk margin release.

The experience variance in the quarter is always having an impact. So in this quarter, for example, the experience variance has been negative and this is what is dragging this €0.3 billion is below the €300 million. In the first quarter of last year it was a positive experience variance. So, you will always going to see some deviation that on a quarterly basis have to be taken into account. So, I would expect to continue seeing a very marginal, around zero value of new business within Netherlands Life.

In terms of the cash capital position, we had given a guidance between €0.5 billion and €1.5 billion. We are currently above that level, so we are certainly comfortable for that. And that always has to be taken into account, looking at two other factors, what is the level of capitalization of the subsidiaries and your situation in terms of leverage.

A - Eilard Friese

Yeah. Nadine, there is one question left, I think, which is about the legal merger, et cetera. Yes, we aim over time to merge the Life entities in the Netherlands. That's going to take a while because that has to – that coincides with obviously putting the liabilities of the Life company on the internal model of NN Group and that's the material change process going to Solvency II, which means that it's a quite elaborate process to do that. But we aim to work towards that direction but it's not going to be a short-term thing. It's going to be something that will take a bit of time.

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

Okay. Thank you.

Operator

The next question is from Mr. Steven Haywood, HSBC. Go ahead, please, sir.

Q - Steven Haywood {BIO 15743259 <GO>}

Good morning, everyone. Couple of math questions, I hope not too difficult. You've got €447 million of intangibles. You're amortizing that through the P&L at €33 million per quarter. Am I right that this is – this means that all these intangibles will be gone in less than four years? That's the first question.

And then, in terms of the capital generation per quarter, you've got about €300 million to €400 million capital generation per quarter or even net operating result per quarter, whichever one you want to focus on. Given your €1.2 billion to €1.6 billion per year and dividend is being paid out less than 50%, say, €600 million, so what are you doing with the remaining €600 million to €1 billion of capital going forward? Thank you.

A - Eilard Friese

So thank you, Steven. Delfin, please.

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

Yes, good morning. Thank you, Steven. The €447 million of intangibles, they are, of course, a split in different categories, the – like the Delta Lloyd brand, the client relationship, some of the distribution arrangements, and each of these categories has a different amortization period. And as you can imagine, the Delta Lloyd brand, as we have made the announcement, that it will be discontinued in the short term if that is being amortized on a very rapid way within a period of two years. That's why we are expecting approximately €33 million per quarter during the remaining part of this year and next year.

And then, after that, it will decrease lower and probably will come back more to €20 million to €30 million per year. And I think your calculation is right, taking short of the average, but obviously, there are some other intangibles like the client relationship or the distribution channels, the agreement with distribution channels that goes beyond that time. Obviously, as I think you know, the amortization of intangibles is an accounting negative impact on the IFRS profit but it has no cash implication.

A - Eilard Friese

And I think on the second question, Steven, so you make a number of calculations yourself. I mean, I'll leave it up to you, but the key thing was what are you doing with capital and your approach to capital management. We manage capital actively, as you know. Our priority is to maintain a strong balance sheet and a strong capital position, obviously, if over time, and our priority by the way is to focus on return on that capital. We just did a very large acquisition and our focus is really on extracting the synergies and making sure that we create a lot of shareholder value in that acquisition.

Obviously, we aim to continue in that sense with a sustainable and attractive ordinary dividend, and if, at a certain point in time, the capital position is – and the companies beyond our ambition, et cetera, then we look as we did in the past. We look at deployment opportunities in the company, strengthen the company further or we look at repatriating that capital in any form to shareholders over time. But in that sense, nothing has changed and our focus is really on the return on capital for our large acquisition that we just completed.

Q - Steven Haywood {BIO 15743259 <GO>}

Okay. Thanks very much.

Operator

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

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

Yeah, good morning. The first question on the capital synergies, presumably, you already benefited from a diversification benefit. I wonder what's still ahead, for example, in terms of LAC-DT? I'm not sure where you are at the level of Delta Lloyd right now. And could you, in this respect, also comment on the timing of the internal model project at the level of Delta Lloyd.

And then, the second question is on the holding company cash flow. I noticed that you remitted €450 million to the holdco from the Dutch Life business, but you're still at 220%, so I guess there is room to do more here. So could you please confirm what your – or provide some insights into your plan in this respect? Thank you.

A - Eilard Friese

Yes. Matthias, good morning. Thank you for your questions. Delfin will take most of it, but maybe it's good for Jan-Hendrik Erasmus, our Chief Risk Officer, comments on the internal model.

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

Thank you, Lard. Good morning, Matthias. Yes, you asked about the timing of the internal model application. Of course, anything that we do to expand the scope of our internal model is, of course, subject to DNB approval so we can never be fully sure of the final timing. It's not, in the end, up to us, but we are working towards year end 2018 to have the expanded PIM approved.

Maybe to touch on the capital synergies that you have already seen. Of course, there is a small synergy arising when you combine the standard formula of Delta Lloyd into the NN Group figures. But for an in-market acquisition with the same risks in the same countries, you don't expect to see a lot and we also didn't see a big diversification benefit there.

A - Eilard Friese

So Delfin?

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

Yes. So in terms of the LAC DT, really I don't have much to say about it. I mean, it's another quarter that we calculate our Solvency capital requirement following our methodology, following the guidelines of the Dutch regulator in what respect to the LAC DT so that we have not seen any necessary adjustment on the approach that we have taken so far or that Delta Lloyd took in the past. If anything, because of Delta Lloyd being within better capitalized group and the way of treating, some of the external debt of Delta Lloyd, the LAC DT of Delta Lloyd has improved somehow. But apart from that, nothing else to report or to expect in the future. Obviously, as any other element of the LAC DT, it's always subjected to doing a reassessment of assumptions as we do every quarter.

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

So, so far you have not recognized any material additional LAC DTs at the level of Delta Lloyd if I understand you correctly?

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

No, we basically have done the calculation as we always do in terms of assessing what is the total recoverable deferred tax amount for each of the legal entity. And as I said before in the second quarter, as Delta Lloyd is in a different situation, there has been a recapitalization of the company. And it is also part of a better capitalized group, therefore there is some improvements or some increase in the LAC DT deduction from the SCR in the second quarter.

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

Okay. Okay, thank you. And on holding cash?

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

Yes, in terms of the – you made the reference to NN Life being very well capitalized, 220%, that I certainly concur with you. And maybe is – if I look a bit back in history, NN Life was at the level of 216% Solvency II ratio at the moment of introducing Solvency II, so that was on January 1, 2016. Since then, according to my calculations, has paid including the €450 million of this quarter just a bit less than €2 billion of dividends to the holding company. And it is, as you know, at the end of June at 220%. So yes, it is very well capitalized but indeed NN Life has been – will continue, we expect to be a stable contributor to our remittance to the holding company.

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

Okay. Thank you.

Operator

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

Q - Benoît Pétrarque

Yes. Good morning. Benoît Pétrarque from Kepler Cheuvreux. A couple of questions on my side, the first one will be on your dividend guidance, the double-digit growth for 2018, cash is probably better, Solvency II also. So what is your view having worked on models and on the integration of Delta Lloyd. How do you feel about your DPS guidance? Are you feeling slightly more comfortable than say six months ago? I would like to have your view on that.

Second one will be on the Q2 contribution from Delta Lloyd, the €49 million. Trying to get a sense of view on the kind of clean figure for the quarter. Do you see any impact of seasonality as I've noted the €16 million from the large files that – what's kind of the level on a kind of clean business in the second quarter? I've seen the technical margin contribution from the Delta Lloyd in the Life result at €27 million. It's probably a bit high. On the other side, I see very limited contribution from the asset management and I was wondering why it was kind of zero this quarter?

And then maybe the last one on the 139% Solvency II for Delta Lloyd Life, what is the DNB view on the kind of life ratios? You are planning to merge both entities, but do they have already a kind of pro forma post merger attitude when they look at the capacity to pay, for example, a dividend from Delta Lloyd Life or are they still very much looking at the bulk ratios on a segregated basis? Thank you.

A - Eilard Friese

Yes, Benoît. Merci. I will hand over to Delfin for the answering of your questions.

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

Thank you, Benoît. So three questions, in terms of the dividend guidance, we aim to grow our dividend per share in a sustainable manner over time, and that I think is the main guidance that I can provide. We currently express that with reference to our payout ratio of 40% to 50% of the net operating profit from the ongoing business. We have said as well that with the acquisition of Delta Lloyd, as a result of the additional cash flow expected from this entity, that we anticipate one double-digit step up in the dividend per share in 2018. And that is basically we have focused on 2018 because it is the year that we do expect to already reflect – that is the first full year that all these benefits are coming through. So that guidance still stay in place.

In terms of your second question, in terms of the contribution from Delta Lloyd during the quarter. I think that there are gives and takes here. In the one hand, we have highlighted that within Delta Lloyd Life, there were some non-recurrent and seasonal items that impacted positively by around €16 million, but you can also look at – we do not expect such large fire claims coming in P&C. That, by coincidence, was of the same amount of €16 million. There is of course some seasonality in terms of the – as for the rest of the NN Group in terms of the investment income, and there is some a private equity dividends coming also in the quarter, as it happens with NN that you cannot – I mean, it's part of the year process, but usually in the second quarter there is more coming in terms of dividends.

So as you mentioned about the asset management, indeed it's breakeven. So we do expect some improvement in the asset management because of what I explained before that the Delta Lloyd entities will be paying more in terms of asset management fee to the asset management company, that has a negative impact on the capitalization on the solvency of that entities, particularly Delta Lloyd Life. However, that will improve somehow for a couple of million or so the asset management business.

On the other hand, NN Life has reduced the asset management fees, net net is a marginal positive for asset management going forward. And your third question was about how DNB or look at the 139% of Delta Lloyd Life and I think that I'm sure that the regulator looks at every separate entity in isolation. And already, Lard has mentioned that a legal merger is not imminent so that's not something that we're flagging for next year or so. So there will be time to go there. And I think as a consequence, you need to look at both entities as separate entities, but as I said before due to the expectations in terms of capital generation for the entity, I think that we do expect over time, not immediately, but over time that Delta Lloyd Life will also start contributing to the dividend capacity of the overall group.

Q - Benoît Pétrarque

But just to come back on that, so you do expect €100 million to €150 million dividend from Delta Lloyd Leven as from 2018, is that correct?

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

We have – first there is no – a fixed set of dividends from each entity, it will depend on the circumstances at that time. It's true that for NN Life we have had for a while a very stable dividend of €150 million per quarter. Delta Lloyd Life in terms of the contribution is expected to be lower than that of NN going forward and no indication on the amount of dividend that Delta Life in itself is going to provide.

However, maybe I can refer you back, but that's not specific for Delta Lloyd Life, but as a whole the acquisition of Delta Lloyd we expect to have marginal contribution of this €100 million to €150 million free cash flow, meaning dividends to the parent company within the short term, and the €250 million to €300 million as of 2020.

Q - Benoît Pétrarque

Okay. Great. Thank you very much.

Operator

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

Q - William Hawkins {BIO 1822411 <GO>}

Hi, guys. Thank you very much. The restructuring charges, I guess you're going to give us more in a couple of months, but could you just maybe try and be slightly clear about the timing of these things. Is it going to be one particular quarter when you make a big announcement on this number, or is it going to be spread over the next 18 months to two years. And could you maybe sort of try and give us an indication of the scaling of this? I mean, I'm still plugging in €200 million which I hope is conservative in the context of your synergy expectations or cost benefit, but if you could tell me whether I'm stupid or not, that'll be helpful.

And then secondly, thanks very much, the overall breakout of Delta Lloyd is extremely helpful. Could you just on slide 11 offer a bit more clarity on how the 85 basis points investment spread splits between NN and Delta Lloyd? It'd be helpful to get two separate numbers, and also just got a slight of detail questions. Understand that this is a four quarter rolling average, have you recalculated Delta Lloyd for the fourth quarter rolling average, or is it only one quarter and therefore, some weighting effects that will build in the future that have basically - but can we split the 85 between NN and Delta Lloyd, that'd be great. Thank you.

A - Eilard Friese

Yes. So thank you, Will. Delfin?

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

Thank you and good morning, William. So the restructuring charges, yes of the two observations that you have mentioned, it's the latter. So basically, we do not expect to have one lump sum restructuring charge coming. We are still working through the integration plans but it is more that it will come over the next two years or three years as you have mentioned. As we make the savings, the restructuring precise and they are communicated to the different business units and what relates to redundancies, but also for other investments and advisory expenses and the rest, these will be as incurred. It will be accounted as incurred.

In terms of the size, I think it's better just to wait for a couple of months until the Capital Markets Day, so that we can base that assumption, that guidance on the precise integration plans that the teams are very much advance working on. On the spreads, we will provide you separately, let's say the spreads, from one unit and the other. But I think it's relevant to explain what was going on here, because indeed, the reduction on the investment and spread in this segment is quite a mark. It dropped from 116 basis points the previous quarter to 85 basis points this quarter despite the fact that in the second quarter is when we expect due to dividends a higher spread.

This reflects the inclusion of Delta Lloyd at market base yields on the assets and liabilities, versus the historic book yields for the NN portfolio. And that results in a lower overall spread for Delta Lloyd, and that's something that you will see in the quarters to come. We do express these investment spread in a four quarter rolling average, and as I have just said, it is influenced by lumpy items like the private equity dividends. But you are right on your last part of your question, there is no more to come, if you like, except the seasonality that I have mentioned because as we're indicating, I think it's footnote 7 within the press release, we have actually – for the spread of the Delta Lloyd, we have annualized that spread instead of taking the previous spread. So let's say that the current spread is as good as an indication as any quarter, but taking into account the seasonality that happens every quarter.

Q - William Hawkins {BIO 1822411 <GO>}

That's very helpful, gentlemen. Thank you.

Operator

The next question is from Mr. Bart Horsten, Kempen & Co. Go ahead please.

Q - Bart Horsten {BIO 2390919 <GO>}

Yes. Good morning. I also have a few questions. First, to understand the capital generation of Delta Lloyd, you said it's €50 million on a quarterly base for this quarter so it's still in line with the mid-term guidance of Delta Lloyd on a standalone basis, €200 million and €250 million. You also said that it seems that Delta Lloyd Life is now well capitalized or capitalized enough, and still you gave a short-term guidance for free cash flow of €100 million to €150 million, would it be fair to assume that that would also be higher considering the capitalization and the possibility to upstream more in terms of free cash flow?

And my second question relates to the cost savings targets. Earlier, you indicated that pre-tax target of €150 million, we have a cost base pro forma or consolidated cost base of €2 billion, then the €150 million seems a bit conservative for 2020 target. And you also indicate a new target on the Capital Markets Day. So can I assume that you'll increase that savings target, and would that also lead to an adjusted free cash flow target for 2020?

And if I may, one more question on interest rate sensitivity or spread sensitivity, and so in the appendix that you changed the way you reported your credit spread sensitivity, and I was wondering has there been an underlying change in how you are positioned in terms of your credit spread sensitivity? Thank you.

A - Eilard Friese

Well, thanks Bart. Let me start and then I'll Jan-Hendrik to talk about the credit spread sensitivity and then I'll ask Delfin to talk about the first question you had. On the cost savings, we are pleased, number one, that both companies have continued their quest to reduce expenses like we did and we reported today, and we will continue to do so. We indeed said that we have an expense synergy expectation of €150 million pre-tax by 2020 in addition to the cost reduction exercises that both companies have standalone.

Now what we've done today is we've presented you the numbers and the expense baseline if you will on the way that NN Group has used to report this. So it's difficult to compare with earlier disclosures of both companies where we are so we understand that. And also we have added units to the expense reduction scope that were not in scope in the past, right? So the banking business, for instance, the asset management business, they did not use to be in scope of expense reductions, and to some extent we managed those businesses also for growth, so we need to be mindful of that. But having said that, we do believe that there are synergies also there to be extracted on the expense side with combining the asset managers and combining the banks so that's why it's not really comparable. So we do appreciate that you have bit – that you're a bit, at this moment, in limbo as to what it exactly will be.

Now we continue to say €150 million pre-tax by 2020 in addition to whatever the company has standalone, that's number one. Number two, the teams that have been appointed are finalizing their plans and we will present them, and update you at the Capital Markets Day at November 30, and then also express expense reduction target on the basis as we disclose the expense base today. So bear with me for a little while and then you'll have more clarity around that. With that, on the spread sensitivity, Jan-Hendrik.

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

Thank you, Lard. Hello, Bart. Yeah, you've spotted that we provided more detail on the spread sensitivity to govies. I don't think there is any underlying change that we have to discuss. I mean, of course the big change that you will be aware of is that we have added the Delta Lloyd portfolio since Q1 to the mix here. So that is of course now the sensitivity, including all the Delta Lloyd govies which were added to the portfolio.

When we looked at it and we guided last quarter, I think that govie sensitivity had moved to around 25 percentage points. When we look at this, moving all the govies by 50 basis points at the same time, it started making less and less sense to us, because we don't think all govies will move in exactly a fully correlated way at the same time in a 50 basis point movement. So we thought, well, given that's our view, let's at least allow others to form their own view by giving them a little bit more granularity in our disclosure.

A - Eilard Friese

Yes. And before I hand over to Delfin, there was one thing I haven't answered, which is the point do expense synergies create more capital generation, et cetera. Obviously, they do. They contribute to that over time and that's one of the synergies that we aim to extract from the acquisition. Delfin, over to you.

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

Thank you, Bart. So when thinking about the dividend capacity coming from the Delta Lloyd units, but also in general for any unit. You need to take into account the capital generation. This operating capital generation that we have referred to of approximately €50 million in the quarter, but obviously market movements might have and have every quarter a significant impact on the overall solvency. Just to state the obvious, I mean, in this quarter we have as a group 9 percentage points improvement in our overall solvency ratio. Last quarter, we have minus 9 percentage points due also to market movements, so that impacts at any point of time the level of solvency of an entity, which is the other element apart from the capital generation that needs to be taken into account, what is the level of the solvency of the entities for that generation?

But indeed, ceteris paribus, without assuming any negative impact on market movements or maintaining a stable level of surplus capital, this capital generation provide the capacity to distribute dividends. One to add to this capital generation is it does not include so far any restructuring expenses, and the restructuring expenses will be significant over the next period of time. And as I said before, that reduced the dividend capacity of the entity. And in addition to that, let me say it again, we have this €15 million in the case of Delta Lloyds on the interest of the external hybrid capital that represent €60 million a year, that also reduces the capital generation. So this is the things that you need to take into account into what it was and still is a very approximate guidance in terms of the free cash flow for the transaction that we need to go into the integration plans, the details and execute going forward. I hope that's helpful.

Q - Bart Horsten {BIO 2390919 <GO>}

Yes, it is. Thank you very much.

Operator

The next question is from Mr. Arjan van Veen, UBS. Go ahead, please.

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

Thank you, gentlemen. Just two last questions from me. The first question just on the bank, that's the only division we haven't really talked about. The profit generation from that was a bit above €15 million per quarter and quite consistent from Delta Lloyd, you reported €9 million. So just wonder whether there's any one-offs in there or does it change the methodology to bring that down?

And secondly, just on the dividend guidance. So I think if I'm correct, when you said that you might have assumed that there was two quarters of Delta Lloyd in 2017, now three quarters. So the fact that you're confirming that, that you expect the dividend to go up 10% in 2018, can I just confirm that base – so that's assuming no change in the payout ratio, giving you maybe for three quarters to four quarters in terms of contribution with Delta Lloyd? Thank you.

A - Eilard Friese

Yes, Arjan. So thank you for your questions. Delfin?

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

So yeah, the short answer to your first question is that they are not really various special items over this quarter, even on the side of NN Bank or Delta Lloyd Bank.The increase in profitability versus the previous quarters is just, as you know, the gradual increase in the size of the portfolio combined with very – or a more favorable evolution of the housing market in the Netherlands that has resulted into lower loan loss provisions.

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

But Delfin, can I just ask, in reference specific to Delta Lloyd bank which the run rate before was above 15 and then now it's 9 in this quarter, so just the change, and like you say, the market's been growing and we would expect it to go the other way unless the change in methodology or one-offs, and you're saying there's no one-offs?

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

No. The only thing that has changed there is, if you like, the revaluation to let's say fair market value on the mortgages that at the starting position and that has some effect. But I think overall, when I think about the banking segment as a whole, I don't see this quarter, especially higher or lower that I need to flag anything special.

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

Okay. Okay. Okay.

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

In terms of the guidance for the dividend, just to clarify, when we talk about this double digit increase in 2018, we're referring for the full year 2018 which is payable in part of it, the interim within the year but the final dividend paid in 2019. This was a guidance that we provided in order to show how we expected to reflect the marginal free cash flow generation deriving from the acquisition in the regular return to our shareholders, so that guidance, as Lard has mentioned still stays. And we never say 10%, we say double digit, and obviously we have to see how this evolved from this 2017 dividend first to 2018. The percentage from 2018 to 2017 will depend, but what you can be assured is that this double digit increase per share is as we have expected. And so far, what we have seen confirms that we can maintain that guidance.

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

Thank you.

Operator

The next question is from Mr. Darshan Mistry, Citi. Go ahead please.

Q - Darshan Mistry {BIO 19807857 <GO>}

Hi there. Thank you for taking my questions. My first question is on the movement in the SCR over the quarter. So you point towards €100 million reduction roughly in the SCR, and I think €25 million of that is coming from the run off the Japanese Closed Book VA business. How should I expect this to evolve going forward? And in particular, given your comments on re-risking on the asset portfolio on Delta Lloyd and continued re-risking with NN Group, is it fair to assume that the SCR actually continues to grow like it has been in previous quarters, or should it run off as we've seen in this quarter? That's my first question.

And secondly, you point in your slides towards a capital generation drag around €300 million coming from the reduction in the UFR over the next three years, so and how do you see that affecting your ability to upstream cash from your subsidiaries? Thanks.

A - Eilard Friese

Yes. So thank you very much, Darshan. So let's move on to – let's ask Jan-Hendrik to comment.

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

Hi, Darshan. Thank you for the questions. You're right in the movement we flag, there is €0.1 billion reduction in SCR in the operating return column and we've guided on €25 million from Japan Closed Book VA. The primary other contributions are from the run off of the NN Life and the Delta Lloyd books which also some made a small contribution. This number will be volatile quarter-by-quarter so we also need to bear in mind that the SCR could increase due to growth, for example, in Europe and Japan life and new business sales going into that figure. Re-risking will not necessarily come through there because portfolio changes are at the moment in a different bucket sort of in other, so you will see it more in a different area. Of course you will only do that if it continues to make sense to us from a risk return or return on capital perspective.

Moving on to your second question, the reduction in UFR, we have taken this – I mean, this guidance came out and we are aware of this change now, this 15 basis points reduction. We have said that it decreases on a group basis, our solvency ratio by 4 percentage points from 196 percentage points. This is of course also into our capital plans and we should consider the reduction of the UFR also against the unwind of the risk margin when we think about these elements and how it might affect the dividend capacity.

Q - Darshan Mistry {BIO 19807857 <GO>}

Okay. Thank you.

Operator

The next question is from Mr. Farquhar Murray, Autonomous. Go ahead, please.

Q - Farquhar C. Murray {BIO 15345435 <GO>}

Good morning, gentlemen. Apologies but I'm going to have to come back to the Solvency II ratio of 139% at Delta Lloyd Life. And I'm actually a little surprised you did not transfer more than €500 million of capital to Delta Lloyd given what we saw at Aegon Netherlands. And frankly, obviously this discussion to a certain degree is quite factious because we're obviously talking about money in one hand or the other within a group that's obviously very well capitalized. That said, I would appreciate understanding the rationale for running NN Life at 220% and Delta Lloyd Leven at 139%. For instance, if Delta Lloyd is so comfortable at 139%, are you telling me you can fund the share buyback from NN Life. And perhaps more seriously, is there any impediment to simply transferring capital from one entity to the other? Thanks.

A - Eilard Friese

Yeah. Thanks, Farquhar for your questions. By the way, I will add one thing to Darshan's question and to Jan-Hendrik's comment which is that obviously – before we hand over to Delfin for your question Farquhar. Obviously, a lower UFR increases capital generation moving forward, and in the operating return I think it's good to mention that as well. As Jan-Hendrik, by the way, mentioned in the unwind of the risk margin which is indeed part of that. So with that, Delfin, over to you.

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

Yes. Thank you, Farquhar. Well, I'm not surprised so 139%, as I mentioned, based on the capital generation of the entity is a good level to be, particularly being part of an integrated group. The reason why there is such a divergence between one entity and another is obviously for historical reasons. Everyone is evolving and coming from a different starting position, and that obviously drives how this tended to move going forward. And no doubt, an entity better capitalized has more certainty about their dividends that you can upstream from that entity. One that is lower don't have that same assurance and you need to observe how the level of capitalization evolves from here.

The capital from the different entities in the group, they are within the limits of what not only the regulatory regime in each of the country where we operate but what prudence determines is relatively fungible. And I think that one characteristic that we have emphasized about NN Group in the past is not only the diversification benefits of the different units that generate capital, but also the fact that there is certain flexibility in terms of this repatriation of profits capital being generated to a group.

Q - Farquhar C. Murray {BIO 15345435 <GO>}

Sorry. Just to follow up, would there be any impediment to transferring capital from NN Life to Delta Lloyd Leven?

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

The way you express it, I don't like it. You don't transfer money from one company to another. Any entity would certainly be able to pay dividends that they require, but even if we were to – we were willing or it were appropriate to capitalize Delta Lloyd at a higher level, we could have used the cash capital of holding. But let me remind you it's already above our range that we have indicated there. So we don't even need to transfer from one entity as another as you said.

Q - Farquhar C. Murray {BIO 15345435 <GO>}

Okay. That's fair. Thanks.

A - Eilard Friese

With that, we are at the end of the analyst call and the investor call today. I want to thank you for all your questions. But before we end the call, let me just conclude by saying that we have made a good progress in our first quarter together with Delta Lloyd. An energetic start has been made to integrate our businesses with the aim of taking the combined group into the next phase of our journey as a leading player in the Netherlands and Belgium.

I would like to thank the Delta Lloyd and NN employees for all the hard work that they've done over the past months. We look forward to going forward as one company with one ambition, and that is to help our customers secure their financial futures. Thank you for all your questions and your attendance this morning. I wish you all a very pleasant day.

Operator

Ladies and gentlemen, this concludes the NN Group Analyst Call. Thank you for attending. You may now disconnect your line. Have a nice day.