Q3 2017 Sales and Revenue Call

Company Participants

- Chris Figee, Chief Financial Officer

Other Participants

- Albert Ploegh, Analyst
- Ashik Musaddi, Analyst
- Cor Kluis, Analyst
- Farooq Hanif, Analyst
- Johnny Vo, Analyst
- Matthias de Wit, Analyst
- Robin van den Broek, Analyst
- Syed Anil Akbar, Analyst

MANAGEMENT DISCUSSION SECTION

Operator

Good day and welcome to the a.s.r. Conference Call on the Nine Months Trading Update. Today's conference is being recorded. Before we start, I would like to ask you attention for the disclaimer on slide 12.

Now, I would like to turn the conference over to Mr. Chris Figee, CFO of a.s.r. Go ahead please, sir.

Chris Figee {BIO 18815839 <GO>}

Good morning, everybody. Welcome to the conference call corresponding to the a.s.r. Q3 trading update. As you've experienced, luckily a.s.r. is better in selling profitable insurance contracts than organizing conference calls. Although I can assure you that our client contact center is slightly more effective than the call today. So rest assure this is not normal practice for a.s.r. Anyways, having said that, let's talk about the third quarter or nine months results of a.s.r. As you will be aware, this is a trading update, a relatively light set of reports. We don't report full IFRS profits in a quarter or quarterly numbers. And we're also a bit more light on the depth on solvency reports, but we'll give a little bit more color on the voice line along the way.

Q3 was a fascinating quarter in a sense that a lot of significant strategic events happened in that quarter. We may have already forgotten but, yes, we did announce the acquisition of Generali in the third quarter. We announced the acquisition of First Pensions

Investments (sic) [First Investments] (01:32) in the third quarter, and we managed to sell the final stake of the Dutch Government in the third quarter. And on the brink of the fourth quarter, we launched and placed a €300 million inaugural Euro Tier 1 insurance. So on the strategic side, lots of things going on but a good development at a.s.r. On the business side, a reasonably ordinary quarter where things happened as planned, happened as we envisaged, and the business has continued to work its way through our plans.

If you go to page 2 on the presentation, which I hope you'll be able to see on our website, if you could see the numbers, operating results year-to-date, €550 million, up almost 24% versus last year. Result in the quarter €165 million, up about 13% versus last year. Operating ROE north of 16%, still well above our target of up to 12%. A robust Solvency ratio, 193%. We'll give you a little bit more color on that later on. In that number, we absorbed 3 points worth of our share buyback at the final sell-down of the State. So we believe a continued set of solid results, a.s.r. to operate structurally at an elevated level. Even in the Q3 where we tend to have more claims in Non-life, more claims especially in the travel and leisure insurance business, in that quarter elevated performance versus last year, up 23% on the year-to-date.

If you flip to page 2 (sic) [page 3] (03:19), you can see the results on a quarterly basis, the quarter 2016 and the quarter 2017. As you know this last year and this year, Q3 is the result indeed where our travel and leisure insurance business tends to receive its claims. As a matter of fact, Dutch people do take out their caravans in the summer. They drive around. There's a time when they have their claims, and they have no claims in the winter. So that's a very peculiar Dutch phenomenon in the travel and leisure insurance business. That's something you have to reckon with. So think about 8 million of additional claims due to the seasonality effect in the summer.

There's a few interesting points to note on that very business. For example, due to the lower roaming charges, we see actually more people taking their phones with them on holidays, actually receiving more claims on damaged phones along the way. So you can see some of the societal developments being reflected ultimately in the insurance business. But again, typically in the third quarter, we incurred the claims on the (04:25), the travel business, and they no longer reoccur in Q4. Also in Q2 to Q3 from a development from the second to the third quarter, second quarter we always have our dividend reporting season, so the dividends flow into the operating earnings. So that's about €20 million of seasonal plus seasonal benefits in the second quarter.

So if you look at the year that we've gone through so far, the movement of Q2 to Q3 actually is a loss or relatively disappearance of €20 million of dividends that we only have in Q2 and the typical Q3 occurrence of €8 million of travel and leisure claims. That together explains and drives of the movement in Q2, Q3 in this year. And as compared to last year, same time, both years have similar claims in travel and leisure. But 2017, we report about €19 million higher earnings predominantly in the Life business where the impact of our more yieldy investment portfolio is structural and is there on an elevated level. So €19 million more versus last year where you have a seasonally-adjusted comparison. So as from our perspective, you can see the developments in the quarter during the year and versus last year.

Let's move to page 4. You can see the segmental results. All segments drive a strong increase in operating results. All our business segments continue to do better than last year, most notably the core businesses, Non-Life and Life. Totally €104 million up versus last year in the first three quarters. In the quarter itself, Q3-to-Q3, we find Non-life stable versus last year and we find Life elevated by about €20 million, €22 million to be precise in terms of elevated earnings in the quarter. Off slightly in the Holding where in Q3, as in most quarters, we do have slightly higher pension charges. As you may be aware, the annual current net service cost is, to some extent, driven by the level of interest rates, lower interest rates increased for this year, the current net service cost.

So in Q3, stable in Non-life; up significantly in Life; and like-for-like slightly higher Holding costs, slightly higher pension charges, reducing the Holding & Other/Eliminations (06:58) in our P&L. But overall, all segments continue to do better than last year, €104 million up in the core segments and about €5 million up in our growth segments, Banking and Asset Management and Distribution. So we feel very comfortable and confident with the amount of trading that this group actually shows and displays.

Moving to page 5, premiums. If you exclude one-offs, so one-off single Life premiums, premiums up 3% on the year. In Life, declined a bit, 2%. Though in Life, we're observing that of course our Life book is gradually declining, set to decline to (07:41), is reflective in the development of the Life premiums, countered by significant growth in defined contribution business, albeit from a relatively lower base. Today, DC makes up about three-quarters of our new pensions business, and it's very attractive. A low-margin but zero capital requirement business. So from a return of capital perspective, you can see an ongoing growth in attractive businesses. So in Life, the decline of the back book countered by growth in defined contribution, and that's exactly strategically the shift that we want to make for not but a small decline in Life premiums.

In P&C premiums versus last year, up about 5% versus the last nine months of 2016. We continue to see good growth in new production in P&C. Although we are actually on the process of sanitizing our portfolio somewhat if you double click, if you zoom in on the P&C volumes, you'll see a couple of developments, I think a general gaining in market share in the intermediary channel. Sanitize is a plus. There's gradual sanitizing of our business portfolio using the current conducive market circumstances to support our margins and selectively grow our business. And finally, you will see gradually feeding in some tariff increases that we announced and put through in autumn, and that will gradually feed into our premium levels as policies are renewed. So overall, we see that the healthy development in premiums in line with our value over volume mantra towards DC, towards high return on capital business intentions, and towards profitable new business in P&C.

Talking about Non-life, moving to page 6, shows you the results in the Non-life business. You will be able to read the text on the right-hand side, but let me give you some color on the different business lines. Disability, actually premiums in disability are recovering. Remember, in the first quarter of the year, we had some headwinds where the new BeZaVa market shaved off some volumes in disability. That is recovering. We see some business flowing back to us. So actually, premiums are stable to slightly up last year where we were looking at a small decline in the beginning of the year. So a top-line recovery on the disability side. Q3 was a very good quarter for disability. Combined ratio year-to-date is still at the 90s. In Q3, we'll actually go below 90 combined ratio in disability. Very strong and very stable when it comes to inflow of new claims. So comfortable on disability business, very profitable, and Q3 was actually very pretty strong.

In property and casualty, premiums up significantly from €844 million to €887 million. Continue to gain market share as we said. You will see going forward some further support for top line from tariff increases as they will gradually feed into the business. In terms of claims performance, bulk claims very strong. Bulk claims, I mean, the ordinary guy who put his car against a tree, someone who loses a phone, (11:12), really small average claims. Our bulk claims ratio continues to hover around 45%, so that's a very attractive level and that's unabated Q1, Q2, Q3. Good performance on bulk. We just (11:28) the bulk of the claims that we have.

We have some larger claims in the quarters, in Q3. Some larger claims for a total of about €8 million. There were no top claims but mid-size fires. To give some color, that was not addition to the bodily injury reserves. It was just a number of property claims, fire claims that we have to absorb. And it's part of our business that happened in the summer. The month of October, already normalized. So that's a couple of one-off events in claims in property and casualty, no sign of a trend there.

So, if you think about our Non-life business in the quarter, in Q3, think about an uptick in earnings from disability of about €8 million, think about €8 million higher claims in travel and leisure, think about €8 million in higher claims due to large fires. And those travel and leisure and large fires are typical issues for that season (12:29) and appear not to be continuing in Q4. So overall, we feel very comfortable with the underlying performance of the Non-life business especially as our bulk claims ratio, which is the majority of our claims, is still every quarter now around 45%, 46%. So comfortable on that business line.

Moving to Life, page 7, the Life segment. Operating results year-to-date up 15%, driven mostly by the investment margin. Investment margin up €85 million in the year. As you can see, part of it was due to we call management actions. Before, so if you claim that's a one-off event, now this management action actually is a dedicated rerisking of our investment portfolio to create structurally higher direct investment returns, so the €34 million (13:23) seen I guess in the first quarter and it's here to stay. A more elevated level of direct investment income due to allocation to real estate, allocation to more of this, allocation to credits, and a high release of the capital gains reserve of €51 million.

Our capital gains reserve was €3.5 billion at the beginning of the quarter and about €3.5 billion at the end of the quarter. So no erosion yet of the capital gains reserve. So this makes us feel comfortable of adding more elevated level of trading in the Life business with, most notably, good €30 million of actually higher cash investment income from higher coupons, dividends, rental income and what have you. Capital gains reserve, stable at €3.5 billion. Other good thing to note, in the first and a half quarters, we had a lower result on mortality due to an influenza wave in the winter. That actually appears to be an influenza wave in the winter that not continued in the summer. So in the third quarter, we saw the result on mortality stabilize, confirming that this was actually an incidental (14:35).

And finally, again, in terms of new business, no pursuit or relevant pursuit of large single premium business. We have very strict value criteria before we write single premium products. And if you don't meet our value hurdles, we just don't underwrite these contracts. But a lot of good movement in the defined contribution business, which is now 75% of our new business. We have upped our DC target and are already meeting that upped target even if it's only November. So we're very pleased with the development of our defined contribution business. Even if it's from a low base, the development of the growth is actually quite promising.

Solvency ratio, page number 8, the number you probably all been waiting for. Standard model, 193%. We do not provide you the full bridge in the quarter simply because those numbers are not a supposed look in our quarterly basis, but let me give you some color on where we are. Please note that the own funds of a.s.r. before share buyback increased by €92 million, so there's a continued and lasting growth in own funds, out of which we've got €101 million back to our shareholders as part of the government sell-down.

Organic capital creation in line with our earlier guidance. And in terms of the bridge, you guys have all pen and paper ready, so think about the following developments. Start the quarter with 194%, organic capital creation adds about 2.5% in the quarter, the net of market movement and mobile movement adds about 2%. The VA declined in the quarter that caused to drop shave up (16:25) about 2%, slightly higher SCR due to increase to rate effect, increasing the longevity charge shave up (16:34) about 0.5%, will give you a growth movement of plus 2%. You buy back shares for 3%, and then you get back to 193% to where we were.

Just to repeat, 194% start plus 2.5% OCC, plus 2% net markets and mobile adjustments, minus 2% VA contraction, minus 0.5% higher capital charge due to longevity risk gives you a growth of the plus 2% and we paid back 3% which brings the number back to 193%.

So, the results we've seen is fully, as far as we can see, in line with the guidance as suggested we get before and supports a very stable and predictable organic capital generation. The organic capital generation, itself, was slightly lower in the P&C side because we had some large claims. So, that feeds into the organic capital generation in the quarter, but higher from an investment side. The re-risking that we engage in during the year actually starts to feed into the OCC. That's compensating the higher claims in the third quarter. Also, good to notice, solvency of our main subsidiaries, the life insurance Solvency II north of 190%, the P&C life Solvency II north of 180%. So, very solid solvency level across the board, and consistent and predictable capital generation.

We did place the inaugural RT1 in October. So, technically speaking, it's not part of our trading update, but we mentioned it here, had a pre-tax coupon of 4.625%. So, it was something we're very, very pleased with, partially used to fund the cash payment of the Generali acquisitions.

On the Generali itself, we announced the transaction. In the quarter, we spent lots of time on that transaction around the sell-down. Please remember, we provided to you with a guidance of €30 million profits over a €200 million of fungible capital contribution for about a 15%-ish ROE. If you were to allocate €100 million from the hybrid to the Generali deal, that'll actually boost your ROE in the transaction a lot more simply because of the very attractive cost of capital of the RT1.

Brings me quick to page 9 rounding off that presentation. Not before except in Generali integration as far as it comes to the preparation of this integration, it's still fully on track. We have submitted the request for a DNO, a declaration of new objection. When do we expected that? We don't know. It's now in the hands of our regulator. But it's safe to say that we expect the closing of this transaction to be happening in the first quarter of the year. Somewhere between the first working day and our full-year results presentation, we expect the closing. End of January, early September is where we'd see the closing to take place. And the integration preparation work that we've done so far suggests that what we're seeing is in line with the assumption that we made when we embarked on the acquisition altogether. So, we feel comfortable and confident on the deal.

So, where does it leave within the quarter? Well, a reasonably uneventful quarter when you look at the numbers, eventful when it came to strategic developments, uneventful because the numbers confirmed the trends that we've been displaying so far when it comes to profit. When it comes to capital generation, some seasonality effects, the different season is unfortunately over in the summer. We have some higher claims on travel and leisure. Some large claims in the P&C business countered by continued strong performance and even better performance in the visibility business. Leaves us with a result, €550 million, about 24% up versus last year, an ROE of 16% and a solvency level of 193%. So, we are still proud of the robust and positive result that this group was able to deliver.

Having said that, back to you, and happy to take your questions.

Q&A

Operator

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

Q - Cor Kluis {BIO 3515446 <GO>}

Good morning. Cor Kluis, ABN. I've got a few questions. First of all, about the premium growth in Disability because as we calculated this, there was a 13% premium growth in the third quarter year-on-year. And then in H1, it was minus 2%. You explained, of course, that it was due to the less headwind from the BeZaVa legislation. What can we expect on Disability premium growth going forward, at Q4 but also going into 2018? Will we see a structural growth improvement there? Could you give some comments on that one?

And also about premium, the Health premium was quite high in the first year – first half of the year, 90% growth. I think in Q3, it was flat Health premium. Could you also comment on that, why is there certainly lower growth on Health premium? Are you becoming more selective or there's something technical change there?

And second question is about the solvency ratio. You've got 193% plus the 8% or 9% for the hybrid, so you're around 201% and 202%. Could you give a little bit more update on your Solvency II-ratio in the fourth quarter? You're already two months in the quarter, of course, given the market circumstances and other developments.

And last question is about Generali. I don't know if you're already have a full (22:38) to the books, et cetera. But could you give some comments about how are the resources are developing over there? Those are my questions.

A - Chris Figee {BIO 18815839 <GO>}

Very good. Cor, thanks. In terms of premium growth with Disability, indeed, in the first quarter we lost some business due to these BeZaVa developments, but then actually reversed or is much less pronounced in the – as the year progressed. So, actually, we have seen the resumption of some growth in Disability. But it has to do mostly with, I think, some of the BeZaVa trends not following through and some of the clients who speaks – speaking to the private sector and rather than going back to the public sector.

What's the long-term growth outlook? I would reckon generally speaking growing in line with GDP is the safest way to predict it. Although in one particular segment called absenteeism, verzuim in Dutch, we would expect to see for us and the markets some premium increases in the coming year which is 2018. So, in the long run, grow with GDP with some uplift for price increases, tariff increases in the verzuim, absenteeism business.

In Health, well, premium level in Health during the year only varies because of technicalities. I mean, last year's sales season in Health gave us about 20,000 new customers. That is the uptick in the gross written premiums, but there are also various elements that had to do with the Health equalization system that actually flow through the premium line item. So, movements during the year tend to have a technical nature. So, there could be some volatility, but there's nothing to do with us underwriting more timely or not. Your underwriting loans is once a year. We gained 20,000 customers last year and that was it. Not sure we'll return or keep going on at that level. If you look at the pricing level in Health, we're partly pretty strict and moved to our (24:41) valuable volume. So, I don't think going forward, you'll see the same level of growth in Health. But during the year, there could be fluctuations that are more technical in nature.

Third question on the SCR, you pointed out (24:54) plus RT1, where does it go to from here? In principle, our solvency ratio is developing as planned. You need to be aware, however, that the VA is declining during the quarter. The VA lost about 4 points or 5 points quarter-to-date. And then, there's a technical thing that provides a bit of a headwind in our solvency. If you look at the VA reference portfolio, our fixed income portfolio compared to the reference portfolio is a bit overweight in Dutch and German govies. It's a bit underweight in corporate, most notably financials and a bit underweight in peripherals. So, when spreads tighten, paradoxically speaking, we have some headwind because the VA premium declines a bit faster than the spreads on our actual portfolio. And rule of thumb, 1 point VA is 1 point of solvency. But again, this spreads widen if the market is (25:54) works at around (25:56) for us.

So, the VA is a bit of dampener in both directions. So, it takes away the fungible when the part is getting up. But again, it provides (26:05) when the market is turning against us. So, in Q4, we still have months to go. Take the SCR at your RT1, but adjust for the technicalities from the VA. And of course, in the final year number, we're also putting number ex-dividend. But we'll give you full disclosure on that and the fourth quarter numbers.

As far as the Generali Nederland is concerned, we have not closed. We're in this inter-balance between signing and closing. There is interaction, but we're very careful on not sharing undue information on the business whilst we're not officially the owner. So, we're preparing the integration, but don't have control on the business. And this is not the time and the place to report on the results of Generali NL. I think it's something for Generali to report. But again, there's nothing there yet that keeps me awake at night, if that could help you answer the question.

Q - Cor Kluis {BIO 3515446 <GO>}

Absolutely. Thank you.

Operator

The next question is from Albert Ploegh from ING. Go ahead, please sir. Oh, one moment.

(27:19)

Q - Albert Ploegh {BIO 3151309 <GO>}

...from my end. First, looking at the investment portfolio and the re-risking budget potentially for Q4, yeah, should we expect any re-risking of investment book in Q4 or maybe the first half of next year? So, maybe there are some guidance around a couple of consumption of that. And the second question is on the cost result in Life. I think that it was clearly down year-on-year. You're flagging cost discipline. Can you maybe give some color on potential additional measures to address the cost base on the Life side?

And the third question is a bit more the top-down on the – let's say, on the target set at the time of the IPO where you're clearly ahead on many. I know Q3 is probably not a (28:09) stage to come back on the targets, but how are you looking at your, let's say, overall combined ratio group targets that was set at the IPO and where you're currently running and also on your, let's say, return on equity as well. So, should we expect some sharpening of targets maybe at the full-year stage? Thank you.

A - Chris Figee {BIO 18815839 <GO>}

All right. Albert, thank you. On the investment portfolio, we've gone through a significant re-risking program that is by and large now completed. So, don't expect a re-risking run in

Q4. That's not something that will add or take away – so, it will add solvency but not take away solvency because the re-risking basically is done. At this very point, we are actually running the strategic asset allocation studies. It's going to be on the board's agenda in the coming weeks.

So, early to say whether we'll continue to re-risk. My last (29:06) tells me there is some opportunity to continue to re-risk during the year given our solvency base. But it hasn't been formally decided yet. That's something we'll give you more color and when we do the full-year results because by that time, we'll have the formal decision making around it. But there could be some opportunity there, but not in Q4. And we need to weigh your core (29:28) development in the market as well.

In terms of cost that's been in Life, you will see – I guess, what you saw in the year is a short decline on the cost result on Life, the result on cost which is a function of the declining Life book. We are countering that by migrating all our policies to variable cost platforms and by taking down staff costs as well, shrinking the cost base. I think that is going in line. The migrations are happening as planned. You will see the majority of the migrations behind us in 2018. So, we've done a couple of complicated ones and that we've been successful in that.

So, with that, I think, our cost countering measures in terms of migration and shedding individual staff are going as planned. So, I would believe that the cost results from here, I think the worse is behind us and you'll see some stability at least for the coming period.

Perhaps in the long run, if the book really declines further, we'll need to take further measures, measures within the medium term, we're comfortable with the measure we're taking on the cost side. And you'll gradually see more stable cost results in Life.

In terms of our targets, as you rightly point out, a trading update is not the venue, the place, the time to revisit the official targets. But actually, if you look at the results today, it would be hard to argue that we would not be comfortable where we are. It would be very complicated where we're saying, actually we're doing well, we're doing very good on our targets. But the trading update is not really the moment to go into details on that. But the business is doing better than that.

Q - Albert Ploegh {BIO 3151309 <GO>}

Good. Maybe one brief follow-up on the cost result, you mentioned the migration to the more variable cost platforms, and by and large, that seems incompleted. So, are you basically ready and maybe – and then, the second question will be also willing to consider maybe to add some small cluster books on your existing platforms or is that not yet on the agenda?

A - Chris Figee {BIO 18815839 <GO>}

Okay. Actually, we're doing it. There's again – if you look at the Generali business, it has a small- to mid-sized Life business, €100 million premium equivalent life insurance book. So, the Generali deal was actually will be the first test on the actual integration. I mean, there's a bit of pensions in there, but the Generali Life Insurance business de facto is a small closed life lock.

So, I think sneakily we started doing that on the back of what a – basically with a Non-life oriented transaction. There's a life closed lock that comes along. That will be interesting first test to see how we manage that migration. I think the teams are confident that they can actually pull off this migration in parallel to the existing migration that was so hard to do. And when that's in progress, then we know for sure how good we are about it and we have got to yield proof point. But the Generali one effectively, Albert, is the first life closed lock transaction that we're adding on our Life business.

Q - Albert Ploegh {BIO 3151309 <GO>}

Yeah. Thank you very much.

Operator

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

Q - Farooq Hanif {BIO 4780978 <GO>}

Good morning. Thank you very, very much for taking my question. Firstly, there's obviously been a very, very big merger in the Netherlands between two companies involved in pensions and also Life and Non-life. In the context of the Non-life business, firstly, I mean what impact is this having on the landscape in the short term while these guys are busy trying to integrate? But in the longer term, what do you think it might do to tariff increases, generally the market? Do you think this could be a positive development? That's kind of question one.

And question two, on the DB business specifically, what do you think is outstanding in terms of generically in terms of acquisition opportunities from others that want to shut down or leave either that market? Do you think that there is still quite a lot of potential both in bulk and in companies in the DB space to acquire? Thank you.

A - Chris Figee {BIO 18815839 <GO>}

On the larger merger, I think generally, we applaud consolidation in the Dutch insurance market. So, here let me say, it's a bit like the French Revolution, right? We can't say if this is successful or not. But in principle, the merger between NN and Delta Lloyd takes out a competitor. So, we think, in general, it's good. We do expect it to support rational pricing in the market. We do expect it to support healthier developments whether it will lead to increased tariff increases. But I think there is a trend of hardening in a market today which is happening kind of independent from the NN-Delta Lloyd merger. I mean if you – we're seeing competitors that have unprofitable books and increasing prices no matter what happens in The Hague or not.

So, it's a bit disconnected. I think in general, we're seeing a hardening market. We have seen a hardening market. I personally believe that you will now see a slight pause when it comes to tariff increases because most of our peers have gone through a significant round of price increases and people will see – want to see how the dust settles before we resume that trend. So, I would expect healthier market going forward possibly to be continuing to next year. But a little pause today because most of our peers and as everybody wants to see, if you have come through a 10% price increase, what does that do?

Secondly, taking out a competitor is always a good thing. So, we think this will support a more structural rational pricing in the market. When it comes to volumes, hard to see. I mean, there is volumes coming our way, isn't always easy to see where it actually comes from.

When it comes to defined benefit books, I think very few people today write new DB business. We see some competitors coming up with interesting pricing on DB contracts. And we're happy to let go of those. So, on defined benefit and bulk annuities, the market is fairly quiet. Most customers that we see are contemplating defined contribution or APF solutions from new business and seeing what to do with the existing business. Little volumes today, little appetite from competitors as far as I can see.

So, that market – that part of market relatively slow. There could be opportunities, but we are very confident of the capital consumption of bulk annuities. They tend to be more capital-intensive business. So, we've got very strict return hurdles. We'll try to do them on a reinsured basis, and that could be our first perspective is always reinsure the deal to limit capital consumption in our book. And that's how we look at it. At this point, the market is actually very quiet and the action is actually in the DC space. That's where the excitement is on the pensions market.

Q - Farooq Hanif {BIO 4780978 <GO>}

If I may, just quickly return on that topic, I mean, do you think you need the DB book to write DC?

A - Chris Figee {BIO 18815839 <GO>}

No, we don't.

Q - Farooq Hanif {BIO 4780978 <GO>}

A bigger one. Okay.

A - Chris Figee {BIO 18815839 <GO>}

It helps – it don't – you don't. If you look at the DC business either various DC players that have – do not have a DB business to write this. I think DC, the name of the game is scale. One is scale, you get good pricing and get margins. Second is portals. So, clients for some reason still want workstation, workplace marketing and also to portals. Surprisingly, there were usage of the actual portals, but still customers want to see it.

So, I think the success factor in DC is more volume, is durability – ability and willingness to invest in portals and systems, and then it's good decent investment results, that together drives success in DC. Having a defined benefit book on the side helps, but it's not the determining factor. I mean, it helps to say to their client, look, if you bring your DC business to me, we're willing to consider your DB book as well, but that that's – that is the order of the discussion that we're having, not the other way around. And I think having a defined benefit book helps, but if we – it doesn't necessarily change the outcome of the selection process in defined contribution.

Q - Farooq Hanif {BIO 4780978 <GO>}

Okay. That's really helpful. Thank you very much.

Operator

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

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

Yes. Good morning, everybody. My first question is on the impact of UFR coming through as of next year. I was just wondering if you can share your thoughts how this might speed up the consolidation in the funeral insurance business given the fact that that business will have a quite long duration, so maybe your thoughts there.

Second, with the H1 results, you were very helpful in giving some color on the outperformance of the long-term investment margins. And I was wondering if the run rate you mentioned with H1 basically saying that if you would align assumptions with peers and you would get a gun against your head, capital generation could be €50 million to €100 million higher. Is that the similar run rate you would see in Q3?

And thirdly is on the pending standard formula revision which is quite a lengthy document. I was just wondering if you could share maybe some initial thoughts on the potential impact for ASR. Seems that, in particular, NHG mortgages could get a more favorable treatment which for you guys is about, I think, 10% of the asset mix. So, that could be quite a big positive move for you. That's it for me. Thank you.

A - Chris Figee {BIO 18815839 <GO>}

Thank you, Robin. (39:50). Well, as you are about to point a gun to my head, I'm very glad we're doing this (39:55) rather than a physical meeting. But in any case, I'll still answer your question even without the gun, Robin.

Now, when it comes to the UFR lowering, as far as the lowering of the UFR, we'll shave about 3 points of solvency given where the development is, which for us is a not so much a material – it's an immaterial event. It will take us from solvency and add back some flow. So, it's a trade of moving stock, stock and flow. What does it do to funeral insurance companies? You'd have to ask them. I think it's – for funeral insurance companies, it's a lower UFR could be a challenge. If you refer to the EIOPA consultation paper, there is a discussion on mortality charges which might be difficult for any funeral business.

Generally speaking, I would say, whatever happens in Solvency II, and I make a step to your third question, the more diversified you are, the better your shield is against changes in models, changes in regulation. So, what does it do to funeral insurance companies? Definitely it will be a challenge for them to absorb a lower UFR, to absorb a higher mortality charge. But what does it do strategically, I mean I don't know. You'd have to – really you'd have to ask them. But it helps definitely a diversified business.

When it comes to the EIOPA consultation paper, if I jump on that. It is a consultation paper. And if you look at the past – I mean, from consultation paper to final recommendation has seen significant movement and shifts. In terms of timing, we expect end of Feb advice (41:37) to the European Commission. Then, the European Commission will debate, discuss, and then, convert some or all of it into law. And we expect the final to be introduced kind of January 1, 2020.

In that document, with just 200 pages of hard work through all of that stuff – I mean, there are still really many, many moving parts. It's kind of hard to say what the outcome will be. If you look at the document and you actually manage to reach the large – last page, which is an achievement per se, there are – a couple of points that – let me share with you (42:18) we look at without giving you a final conclusion (42:23), I mean, we look at the recalibration of premium risk, that's a piece on premium risk recalibration. There's a discussion of recalibration of mortality risk which is of interest.

Indeed, the document recognizes that any de-mortgages, government guarantee product should have a lower counterparty charge. There's a portion on interest rate risk where EIOPA discusses a number of alternatives downward shocks.

And finally, there's a PFD thesis (42:57) on LACDT where you find interestingly that for most elements, the document gives options and recommendations or emerging recommendations. LACDT is the only component whereas there's no blue box (43:11) with a clear advice. EIOPA just makes notes of different applications across Europe. So, those are the five points that we've been and we are studying and trying to get through.

There are many moving parts. Each of those five parts can move individually, so – but some of those parts can also move significantly. So, this is – it's too early to draw a conclusion from it. But our view is – if I go through it and look at all those moving parts and see what the upsides and the downsides are, note first is, having a diversified business helps, the monoline business are much more vulnerable to a single change and diversification – diversified businesses.

Secondly, I feel pretty confident with this. I mean, I lie awake from the line of work that comes from this, we do not get lie awake from the outcomes of those results. But also we know that at this point, it's mere speculation and we don't know what the ultimate outcome will be. So, I've given you the five matter of substance that we look at that could have each individually an impact. But collectively, they might diversify, might mitigate and might result in a reasonably flat outcome. And that's kind of the best where we hope for at this point in time. And the more we – can we say more when we see the final results.

And when it comes to your question on OCC, indeed if you look at the long-term investment margin in the actual spreads that we have, you'll find that the entire fixed income book, (44:51) govies including mortgages is about flat versus the LTIM. So, as the beginning of the year, our LTIM assumption on governance actually overstates the actual returns on the mortgages. It understates the actual returns, but the fixed income book is relatively flat.

The accrual of liability still assumes a VA of 20 (45:10) . Well, I think that actually is an understatement of the actual – understatement of the actual VA and thereby understatement of the actual OCC. And equities and real estate have done well. So, in the quarter, our organic capital generation added about 2.5 points, and then the net of all the other points added another 2 points to our solvency, to 2 points of market movements.

And if you zoom in on that 2 points of market – actually the market movement was a bit higher than 2 points. But during the quarter or during the year, we are observing a higher level of lapses in the life insurance business. Dutch people are redeeming their policies, most notably to pay down mortgages. So, we've modeled through a structurally higher lapse level. We think it's fair to see these observations are there for nine months. You'd have to put them through in your best estimates.

So, in the bucket other, when it comes to solvency movements, the net effect is 2 points, but there's a gross effect that's market a plus and a small minus for models to lapses that gives you 2 points. So, that illustrate that we believe that the ultimate assumption we've used are still reasonably conservative, and there's a structure continued adding to solvency from that. So, it's a very long-winded answer, but I want it to be as complete as possible.

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

No, that's very helpful color you've given. Thank you very much.

Operator

The next question is from Akbar Syed, Kempen & Co. Go ahead, please, sir.

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

Hi. Good morning. A few questions remaining. First is on P&C, can you be a bit more specific on the quantum of the rate increases you've implemented there, first of all? And I also wonder, to what extent, the hardening of the markets you referred to, to what extent that's a reflection of higher claims inflation that could be expected going forward. So, yeah, should we, in other words, expect the combined ratios to benefit or not from the higher rates? Secondly, just to continue on regulation. Next to EIOPA, there was also a DNB document on supervision, supervisory outlook. Just eager to get your thoughts on whether or not there was anything impactful or worth mentioning there?

And then lastly, on capital. As I look at your solvency position pro forma for the AT1 and Generali, it still looks quite strong. So can you elaborate on how you plan to spend any excess going forward? I guess it will be a mix of rerisking, buybacks, M&A. So any color would be helpful there. Thank you.

A - Chris Figee {BIO 18815839 <GO>}

Okay. Very good, Matthias. Good to see that you've landed well.

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

Thank you.

A - Chris Figee {BIO 18815839 <GO>}

On P&C tariff increases, think order of magnitude 5% on generic motor house, what have you. So think about the 5% is order of magnitude in terms of price increases. That would, by the way, feed in gradually, right? It's 5% on new business and then the same 5% on renewals, and that will take about 12 months to be fully factored in before the existing client base is completely renewed. I don't think, at this point, it's a function of claims inflation. It's a function of the combined ratios and claims ratios as they were, as they are today. So if you look at the Dutch P&C market, the cohort of P&C insurers, that is a – at the low margins on P&C business.

So I think tariff increases are more a function of profit as it is today than a reflection on expected in claims inflation or tariff inflation in general. So that's not in the cards yet. And honestly, we don't see at this point major claims inflation. There is some upward push in the bodily injury side, less so which is not so much claims inflation but more a regulatory change. We've seen some action in the market there. Again, we have looked carefully and are also looking carefully at our portfolio. There's no reason to add to (49:48) reserves there. But on bodily injuries, the only area where you can see prices moving up in response to general claims inflation but at a specific market segment.

Nothing for us with the existing book; it's just this is where we are very careful in pricing new business. DNB supervisory outlook, nothing to report there. I mean, we are taking note of the EIOPA documentations. We are taking note of the exit value discussions of DNB, but nothing that concerns us in particular.

When it comes to Solvency, indeed you will see in the coming months adding the RT1, taking out Generali, would give still a relatively high number on the standard model. What do we do with all of this? Our strict criteria is the cost of capital, the cost of equity. To be very precise, the cost of unrestricted Tier 1, to be fully still compliant in Solvency speak, we consider to be 10%. So anything we view need to exceed 10%, ideally 12%. So the four areas we have to deploy this capital is market risk, which is most straightforward and simple to execute where we also look at the return on capital applied should also be substantially north of 10%. And secondly, we would like our market risk budget to stay less than 50% of our total risk because, after all, we're an insurance company, not an investment firm. So there could be deployment in market risk as long as the return on additional market risk capital exceeds 10% by a margin and as long as the total market risk does not exceed 50%.

Then we'll be looking at acquisitions. And as we continue to do, we believe there are opportunities in the Dutch markets. They will take time to develop, will take time to mature, and we'll also be very much aware that P&C and individual life business is probably busy during the year integrating, and you can't load acquisitions on acquisitions. You want to make sure that what you acquire is fully and effectively integrated. So if we do something else, you probably see it more in the adjacent businesses than in the P&C and life business as such. So we also look – and our return hurdle is 12%, return on tangible capital, and that's pretty clear for us.

And then there is giving capital back to shareholders through dividends, share buybacks, is something that we add always on the cart. Don't expect a share buyback in the remaining four weeks of this year. But next year, we'll look at our distribution policy where we look at the actual dividend. We'll also be looking at an interim dividend next year, safe to say, and that will together make up a decent amount of capital distribution to shareholders. And then, Matthias, it depends a bit on how the acquisition space develop and what we see there.

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

Yeah. That's clear. Thanks a lot, Chris.

Operator

Your next question is from Ashik Musaddi, JPMorgan. Go ahead please, sir.

Q - Ashik Musaddi {BIO 15847584 <GO>}

Thank you. Just a couple of question. First of all, after you raised those recent debt, it looks like your IFRS leverage ratio is more or less around 30%, maybe a couple of points lower. So how do we think about that IFRS leverage, how hard (53:33) of 30%? Is that relevant or you can be at around 30%, 40% for a longer term as well. So that's something. One question.

The second question is how should we think about this realized gains that you book on the Life earnings because for the past three years this number has gone up. So is it fair to say that next year also this number could go up because you have a lot of reserves in that or is it a formula as to how this number moves because based on my understanding, shadow accounting means your total investment income should not move up, your direct income goes down but your realized gains as well goes up. But it looks like the realized gains is obviously going up every quarter. So any thoughts on those formula?

And thirdly, it would be a bit simple if we can move to a bit more market consistent assumption on the fixed income assets for OCC just because to see what is the real number versus the assumed numbers. So just a suggestion but totally up to you. Thank you.

A - Chris Figee {BIO 18815839 <GO>}

All right. Very good, Ashik. When it comes to the leverage ratio on IFRS, basically it moves towards the 30%. I think we'll end the year still below 30% as far as I can see if I have a look at our balance sheet. So it will be south of 30%. I think 30% is a decent number. I think we – in the ratings space that we have in our own (55:05). We could move up to 40%, but 40% we consider to be a relatively high number. So something at around 30% is something that we feel very comfortable with. End of the year, we'll probably be somewhere below 30% given what I know, what I can see today. Depends a bit how book equity develops. I mean, you can also look at – it depends a bit on how you define your book equity, right?

We don't have realized capital gains in our book equity. We did have unrealized capital gains in our book equity. So if you will look at our leverage ratio compared to book equity, 30% to 40% is actually pretty fine. If you look at it compared to our own funds, our leverage is still relatively low. So I'm pretty comfortable with where we are, and I think the headline number will drop a bit in the last couple of months of the year.

When it comes to the realized capital gains reserve, actually, interestingly I have no control on this number. I mean, it's a formulaic approach. When you realize a capital gain because you change an asset, actually the capital gain is amortized over the lifetime of the corresponding liability. So it's a given. I mean, the only way I could tweak it is by realizing huge amounts of capital gains, then the number would go up. But then you would immediately see it in my IFRS equity when equity goes up because of capital gains realizations, and that's something you do not see at this point. So it's not that we're gaming or playing. It's a bit...

Q - Ashik Musaddi {BIO 15847584 <GO>}

No, no. I mean this is what I'm not able to understand is why will it go up. I mean, I get your point that you're not tweaking anything. But then you mentioned that you can realize more capital gain, put it in the reserve, and then that number will go up. This is what I'm not able to understand. Why could it go up even in that scenario. So anyways, maybe we can take it offline.

A - Chris Figee {BIO 18815839 <GO>}

(56:58) that number goes up but, I mean, there's something else goes down. I mean – so in principle, you're right. Then if the numbers goes up, your direct investment income should go down and the sum of the two stays (57:11). What you find today is that the direct investment income has gone up because we risk and move to other more yieldy asset classes. So that actually compensates that development. Where we are today, it's about €3.5 billion in terms of reserves. I would expect this number to be relatively stable in the coming year. I mean, this year has gone up due to a variety of reasons, mostly technical in nature. But going forward, expect the release of the capital gains reserve to be stable. That is the way I planned it.

Q - Ashik Musaddi {BIO 15847584 <GO>}

Okay.

A - Chris Figee {BIO 18815839 <GO>}

When it comes to assumptions in the OCC, actually we believe we're reasonably market consistent. At least we're giving you a fair amount of disclosure on this. Maybe an interesting point. We also include the hybrid expenses and hybrid charges in the OCC. We did about €50 million a year which others I think do not. See, there is no one consistent OCC definition. Your point is noted. Something to chew on. We'll try to give you as much color as we can, but also not (58:20) change them all over time. And in essence, it's a fairly complete number. But your point is noted; something for us to chew on.

Q - Ashik Musaddi {BIO 15847584 <GO>}

That's very clear. Thanks a lot.

Operator

The next question is from Johnny Vo from Goldman Sachs. Go ahead please, sir.

Q - Johnny Vo {BIO 5509843 <GO>}

Yeah. Thanks. Thanks very much. Just a couple of questions. Just in terms of the cash in the holding company, I guess at the first half you had cash in the holding that stood around about €200 million, and that was before the buyback and the acquisition, so you've obviously raised money. So where are you in terms of cash? And then also, just in terms of the operating profit. In terms of some of your assets that are mark-to-market through the P&L, is there any mark-to-marketing of some of those assets through the P&L in the operating line or not? And then finally, just in terms of, again, the realized gains were higher than it has been. So how much higher is it above the normalized level? Thank you.

A - Chris Figee {BIO 18815839 <GO>}

Can you repeat the last question? I didn't get your last question completely.

Q - Johnny Vo {BIO 5509843 <GO>}

Just in terms of the realized gains. You made a note in the press release that the realized gains were a little bit higher than normal. So how much higher than normal is it?

A - Chris Figee {BIO 18815839 <GO>}

Okay. When it comes to cash at holding company, Johnny, it's not a metric we stew on a lot. I think you are aware. But they are – indeed the holding company has got the proceeds of the RT1 issuance. What you see during the year, there will be a combination of things where we will continue to upstream cash on the OpCos. I just told you, the Life OpCo solvency is above 190 and P&C above 180. So expect a couple of points. Expect some further upstreaming from the OpCos during the year. We'll end the year with a cash level north of €350 million. I'm pretty comfortable with that. But it's not something we spend a lot of time on. We rather have the cash in the OpCos but it will be north of €350 million by the end of the year for sure. But if anything, it's played there. I mean, there is tax payment, there is pension charges, there's upstream, et cetera. So we'll feed them into – together. If you think about the capital – in the operating results, there is no real mark-to-market. That means all the mark-to-market that are not in the operating results. The operating results really contain the direct investment income.

Q - Johnny Vo {BIO 5509843 <GO>}

Okay.

A - Chris Figee {BIO 18815839 <GO>}

Finally, when it comes to the realized gains, while there's a release of the realized gains reserve, which is €51 million during the year, (01:01:10) that's kind of a given. I think that we'll be at that level going forward as a reasonable continuation of that (01:01:17). I can see what the model spits out. I can see what the model spits out. So if you look at the investment margin in Life, there are €34 million really higher direct investment income which is yields, coupons, yields, dividends that are coming in in cash, and it is €51 million of increased capital gains reserve release. That's (01:01:39) there going to stay.

Q - Johnny Vo {BIO 5509843 <GO>}

Okay. Great. Thank you.

Operator

Go ahead please. There are no further questions. Please continue.

A - Chris Figee {BIO 18815839 <GO>}

Well, everybody, thanks so much for the call. A lively call for a trading update. Sorry for the late start. Good for all of you to hang in there and listen to our story. We are again – we look back at a good solid quarter, trading as it was, trading as it is, and comfortable with where we are today with our group executing our strategy. So thanks for your questions and hope to see you all in person sometime soon, hopefully without a gun this time but hope to you see in person and continue to answer your questions.

Operator

Ladies and gentlemen, this concludes the a.s.r. event call. You may now disconnect your lines. Thank you. Have a nice day.