Q2 2015 Earnings Call

Company Participants

- Alberto Minali, Group Chief Financial Officer
- Mario Greco, Group Chief Executive Officer & Managing Director
- Spencer Lee Horgan, Head of Investor & Rating Agency Relations

Other Participants

- Alberto Villa, Analyst
- Andy Hughes, Analyst
- Farooq Hanif, Analyst
- Federico Salerno, Analyst
- James A. Shuck, Analyst
- Matteo Ghilotti, Analyst
- Michael I. Huttner, Analyst
- Nick Holmes, Analyst
- Paul C. De'Ath, Analyst
- Peter D. Eliot, Analyst
- Rötger Franz, Analyst
- William H. Elderkin, Analyst

MANAGEMENT DISCUSSION SECTION

Operator

Good day and welcome to the Generali Group First Half 2015 Results Q&A Conference Call. Today's conference is being recorded. At this time, I would like to turn the conference over to Mr. Spencer Horgan, Head of Investor and Rating Agency Relations. Please go ahead, sir.

Spencer Lee Horgan {BIO 4241901 <GO>}

Hello, everybody, and welcome to our first half 2015 results Q&A call. We're going to follow the same format as you're all used to, so we've got about one hour to take your questions on the results.

But before that, I'm going to hand it over to Mario for some opening remarks. Mario?

Mario Greco {BIO 1754408 <GO>}

Thank you, Spencer. Good morning, everyone. Welcome to the call. As I'm sure you have seen from our release this morning, we have had a very successful first half of the year. There is clear evidence that Generali has successfully transitioned to a focused, profitable and well capitalized growth.

Our operating profitability is up 11%, with positive performances across all segments. Our net profits are up even more, 22%. This is despite the acceleration of restructuring charges in Germany and some other provisions which we booked in the second quarter, which will not recur in the second half. Bearing this in mind, we expect our full-year 2015 profit to grow at an even higher rate than the 22% we have produced in the first half.

Meanwhile, we're making some progress with our regulators in the preparatory phase for Solvency II. And with our internal model view of economic solvency ratio standing at 200% at the end of June, we feel that we are in a very reassuring capital position. To sum up, these results demonstrate immensely strong platform which we have built and from which we will execute our new strategy to secure leadership in European retail insurance.

With that, we're ready now to take your questions. Thanks.

Q&A

Operator

We will now take our first question from Mr. Farooq Hanif from Citigroup. Please go ahead, sir. Your line is open.

Q - Farooq Hanif {BIO 4780978 <GO>}

Oh, hi there. Thanks for taking my questions. Firstly, I'd like to just ask about your combined ratio and the mix in Italy. So would you be able to tell us what the combined ratio is by Motor versus Non-Motor? And can you comment on the pricing trend? So clearly, motor is negative, but just in non-motor, do you think you can maintain great stability and maybe greater profitability if you increase your weight there? That's question area one.

And secondly, just on Life, I noticed your good technical margin. But when I look at the mix of your profitability by region, I notice that EMEA and Asia were really strong versus 2Q last year, 1Q 2015 as well, and better than my own expectations. And there we're seeing a really good investment result and a very good technical result. Is there some comment you can give on what's going on and the sustainability of that? Thank you very much.

A - Mario Greco {BIO 1754408 <GO>}

Farooq, this is Mario. I start quickly on Italy and then I pass to Alberto for more data and more information. What's going on in Italy is that the model is clearly changing, it's clearly turning. Frequency is slightly up, slightly. We don't see a big movement yet. But clearly the trend towards the frequency reduction has stopped and is starting now to revert back half.

And the Non-Motor portfolio is the strong foothold that we have on the property in Italy. We have the market leadership on Motor and we think that the profitability will remain at the level of today and that the trends that we see in Motor are not common to the Non-Motor portfolio.

Of course, bear in mind that Italy is a cat-prone market, so there could be a cat influence. And this semester has been relatively high but not particularly acute. I mean, it was slightly above last year, but not too much higher than that. But we think the Non-Motor will remain pushing down the combined ratio of Italy.

Now I'll leave it to Alberto with a more precise information.

A - Alberto Minali {BIO 16909383 <GO>}

Hi, Farooq. It's Alberto. Going back to the numbers, we do have a combined ratio in Italy the first semester 2015 of 88.7%, which shows a slight deterioration vis-à-vis the 88.1% of last year. As Mario has anticipated, the Motor business is also changing; from a numerical point of view it's slightly deteriorating, roughly 2.3 percentage point of higher combined ratio in the Motor business, which is then almost compensated by the better performance in the Non-Motor which moves down from 87.4% to 86.7%. Bear in mind also that we are investing a lot of effort in the Non-Motor business which represents an important pillar of our profitability today and also in the future.

Going to your second question, the technical margin. For Asia, I have to say that we took profit and we made a fantastic transaction in anticipation of the drop of the Shanghai Stock Exchange, because we realized roughly €100 million of capital gains from equity position, ETF position. And once again, that's also part of our strategy to realize capital gains whenever we think is the right time market-wise and tactically.

In the EMEA, we do have a good effect from the Liability Asset Test reserves in Holland, which is roughly €40 million, and also positive effect from Switzerland in terms of Swiss franc exchange rate. So these are very strong results overall in the Life business, but from these two regions there are also distinctive reasons.

Q - Farooq Hanif {BIO 4780978 <GO>}

Just to ask on the LAT. That's obviously a one-off in the quarter but it came in your technical margin.

A - Alberto Minali {BIO 16909383 <GO>}

Correct.

Q - Farooq Hanif {BIO 4780978 <GO>}

Thank you very much.

A - Alberto Minali {BIO 16909383 <GO>}

You're welcome.

Operator

We will now take our next question from Peter Eliot from Berenberg. Please go ahead, sir.

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

Thank you very much. First area, so I just want to come back on your opening comment, Mario, if that's okay. You sort of implied that the economic solvency ratio didn't really need to grow much from here. I guess if I look at your current run rate of earnings, you're looking at over €10 billion to the end of 2018, which compares to your dividend target of over €5 billion, so sort of 50% payout ratio.

I appreciate that's a very simplified view of the world and to say there's a lot of potential economic solvency growth that maybe you don't need. But I'm just wondering if perhaps you can comment on whether the gap between the dividend payout and the cash generation needs to be that high.

And perhaps related to that, I'm just wondering whether if you can give us any update on how the Solvency II ratio might look compared to your economic solvency ratio. And then if I could quickly ask second area, going back Non-Life. I'm just wondering if you can tell us if there's anything special or give us any more granularity on the runoff result, whether it came from any countries in particular. Thank you.

A - Alberto Minali {BIO 16909383 <GO>}

Peter, I'll start from the second question, it's Alberto speaking. The Non-Life run off reserve, yes, in this semester we have a positive runoff reserve release result of 4.6%. This refers to the generation of business, let's call it n minus 2, so the generation of business that are about to be paid off or paid out in the process.

I want to stress that we did not change the reserving policy. If you also look another indicator which is the ratio of the total reserves of the P&C business over the earned premium, this has increased in the semester, semester from semester by 5 percentage points. So I would say the reserve release result is just the result of our claim settlement activity and the increased speed of settlement that we have done in order to be more customer-centric. So nothing from a purely, let's say, accounting maneuver, but from the technical result of the claim settlement process.

A - Mario Greco {BIO 1754408 <GO>}

Yeah, also, Peter - this is Mario. Let me add a point. Among the technical improvements that we committed to achieve for each year, the results of claims, set of actions that now are starting to show the results. So claims is one of the many things that we're acting on and that we're improving. And the actions become visible because we pay less than we initially thought, which is a good sign. So it is not a top-down change in anything. It is just the result of the actions we're taking on claims. And we plan to keep on building on this and improve it.

Then on Solvency II. First of all, let me repeat to all of you what the process is. So what we published today is the internal model results at this semester. The application that we present to the regulators will be based on the internal model for Italy, Germany, Czech, and the France P&C business only, not the French Life business, which means that roughly 65% of our business will be measured on the internal model numbers and 35% will be in the standard formula.

This has been agreed with the regulators for different reasons, not the least the bottlenecks that they have to solve to prove the internal models of everybody. Next year and the year after, we will keep adding more countries and we will get to over 90% of countries on the internal model by 2017. So the regulated numbers will converge towards the internal model numbers over time, but will not start being exactly at that level. I hope that this helps.

On the net cash flow and the dividends, let me just repeat what our numbers mean. The target that we gave is to generate more than €7 billion in net free cash flow. The net free cash flow is what remains to the holding after taxes are paid and all the costs and interests are paid, which last year was €1.2 billion. And fundamentally, we see that as the number from which we pay the dividends. So, last year, again, we paid €930 million out of €1.2 billion.

The commitment is to generate more than €7 billion and to pay more than €5 billion. The question I always receive is, why are you taking €2 billion? Now, what I can say is that in 2014 what we retained was €270 million. And so definitely we don't feel we need to retain anything as big as €4 billion. But the way we set the targets is that we set the floor and we left the sky open. So it should not be read as €7 billion of free cash against €5 billion of dividends. Again, I hope this helps.

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

That was all very helpful indeed. Thank you, Mario. I guess the obvious follow up to the 65% being covered by the internal model is whether you can give any guidance at all on what that means in terms of in numeric terms on the 200%. That's probably very optimistic, but I guess I've got to try.

A - Mario Greco {BIO 1754408 <GO>}

Yes. Well, we really cannot do that because this depends on what the regulators will decide. And partially, the regulators have not yet taken final decisions even on some policy decisions. So what we have in this internal model is our best knowledge of what the regulator position is today. It doesn't mean that the regulators will maintain it for the future. So we cannot speculate on that.

Also, let me stress another point that I think I often touch in one-to-one meetings and I take advantage now of your question to repeat to everybody. What really matters at all is not the global number, because capital is not fungible. What matters are the local numbers, because each regulator then approves a local number and the local number is the one that, if not high enough, so if it is not above the watermark of 100% or it's not in the comfort zone for the regulators of 100%, could lead to possible restrictions.

So I don't think it matters if the number is 180% or 190% or whatever. What matters is that we will have no countries that can pay dividend be restricted or being close to risk of any restriction. And that is the situation that we see today, so that's the reason we see this situations very reassuring because we do not expect to have any risk at this point of restrictions.

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

Thank you very much indeed.

A - Mario Greco {BIO 1754408 <GO>}

You're welcome.

Operator

We will now take our next question from Paul De'Ath from RBC. Please go ahead, sir.

Q - Paul C. De'Ath

Yeah. Hi there. Good morning. Thanks for taking my questions. A couple of things. Firstly, on the restructuring costs in Germany. You've kind of accelerated through, taking more restructuring costs earlier than you had planned. Does that then follow through to potentially getting through the restructuring process faster than you planned and, therefore, getting the positive benefits of those changes coming through earlier? And it'd just be interesting to get your thoughts on the timings there.

And then the second point was just on the one-off provisions that you've made in the quarter. And so you've strengthened some provisions against specific items in Germany and Italy, which make it around €220 million. If you could give us a bit more color on exactly what those specific items were that you were providing against. Thanks.

A - Mario Greco {BIO 1754408 <GO>}

Paul, let me first of all thank you for the question on Germany, because it's quite fundamental. We believe that one issue we had in the past years was that we were having a non-linear distribution of profits by quarters. And particularly, the last quarter was difficult to read because we had lots of one-off charges in the last quarter.

So knowing that this was seen as a weakness, we thought about what to do this year and this is our answer: we anticipated some of the usually last quarter provisions already now and this is fundamentally for Germany and for the Italian restructuring, so these are things that will not be repeated. And that's the reason also we highlighted that the growth of the net profits by year end will be higher than what has been the semester because the development of Q3 and Q4 will be different than what it was last year when we took these provisions only in the last or the third quarter.

It doesn't mean that the restructuring process in Germany will go faster. It is only that we decided to anticipate the charges for it as early as possible and make it transparent and make it public. The restructuring in Germany is progressing well, but it does have to follow the process in Germany, which is quite inflexible. And we're well in the process of doing that.

The other provisions are fundamentally for Italy, too, where we also still have some restructuring to take charge for. And so it is fundamentally Italy and Germany and then some minor things on top of it. But what is important – and, again, I want to be clear on this, is that this changes the path of the quarters and hopefully will make it more predictable and more linear, avoiding to have one very weak quarter where we take all the provisions all together. That should not happen anymore this year and so you should expect a different development of Q3 and Q4 compared with last year.

Q - Paul C. De'Ath

Okay, very helpful. Thanks.

Operator

We will now take our next question from Federico Salerno from MainFirst. Please go ahead, sir.

Q - Federico Salerno {BIO 2565091 <GO>}

Good morning. Two questions for me, please. The first one is on the French Non-Life. The combined ratio still seems to be improving. Do you feel like giving a more optimistic outlook at this stage, or do you still think the combined will revert to above 100% in the full year? That's the first question.

The second on capital. Could you please remind me how much of the 200% comes from the change in the scope of consolidation in France, in particular the removal of the pension business from the scope?

And lastly, do you have net of policyholders number for the allocation to the ZZR and PPE for the first half of the year? Thank you.

A - Alberto Minali {BIO 16909383 <GO>}

Thank you, Federico. The French Non-Life combined ratio has really improved thanks to the activity pruning and cleaning of the portfolio that our management team in France has executed in the last months. We do have an improvement of roughly 6 percentage point. If you take out the fact that France did not have cat claims, which accounted for 3.6 percentage point, we do have certainly a very good improvement. We don't want to provide any more optimistic outlook. What we can say is that France is recovering well.

The technical result in France moved from €11 million last semester to €88 million this semester.

So it's a very visible important result coming from a very good quality of the current generation of business. And this also allows me to say that France will start paying the dividend again, and this certainly is a very good important sign for our cash flow generation that Mario also mentioned before in another question.

Remaining in France and going to your second question, the IRP accounts were roughly 23 percentage point in our calculation. And as you know, we are in the process of identifying and segregating this business also in the capital model from a pre-application file (22:16) point of view.

In terms of ZZR, we have a net provision net of DPL of €58 million, while for France, the PPE allocation in our accounts for the first semester is €170 million.

Q - Federico Salerno {BIO 2565091 <GO>}

And that is net of policyholders?

A - Alberto Minali {BIO 16909383 <GO>}

Yes. Absolutely.

Q - Federico Salerno {BIO 2565091 <GO>}

Okay.

A - Alberto Minali {BIO 16909383 <GO>}

As you know, the PPE, it's a buffer that we need to pay out in the next eight years. So whenever we realize more capital gains and more performance, we do allocate to the PPE in order to steer the performance of this business. But that's money that we have to pay out to policyholders, so it's part of that, yeah.

Q - Federico Salerno {BIO 2565091 <GO>}

Thank you.

A - Alberto Minali {BIO 16909383 <GO>}

You're welcome.

Operator

We will now take our next question from Michael Huttner from JPMorgan. Please go ahead, sir.

Q - Michael I. Huttner {BIO 1556863 <GO>}

Thank you very much. Fantastic numbers. Thank you. Two questions, the unit-linked...

A - Mario Greco {BIO 1754408 <GO>}

Thank you, Michael.

Q - Michael I. Huttner {BIO 1556863 <GO>}

They are very good, well done. Very well done. Thank you. On the unit-linked, so the net inflows in Life rose 38%, I think to $8 billion. Of that, 52% was unit-linked. These are really, really amazing numbers. Can you say anything about the trend going forward? I saw that Banca Generali had raised the outlook for net inflows. Maybe you can say something about how sustainable this level or this growth in net inflows is and the mix with unit-linked?

And the second thing is on cash flow. Could you possibly have a figure at the half year or a feeling how it relates to your target of €1.5 billion? That would be very helpful. I know you've given an indication on France, but anything extra would be really lovely. Thank you.

A - Mario Greco {BIO 1754408 <GO>}

So, Michael, one point on Banca Generali that I want to stress is, first of all, Banca Generali is an excellent business unit. We're very happy and proud of the results. But what I want to stress is that I don't think that the value and the earning powers of Banca Generali are completely understood in our accounts. I often get questions in one-to-ones about what we plan to do in our asset management.

And I think instead of having an asset management company, we have a distribution company, like Banca Generali, which is very profitable, growing very nicely and extremely well managed. And, again, I don't think that this has been properly valued and taken into account in our numbers.

And I'll pass to Alberto for the other answers.

Q - Michael I. Huttner {BIO 1556863 <GO>}

Thank you.

A - Alberto Minali {BIO 16909383 <GO>}

Michael, the unit-linked in terms of net inflow, we do have an more than €8 billion net inflows. The unit-linked has been €4.2 billion, of which €1.7 billion in Italy, roughly €600 million in France and €1 billion in Germany. I want to stress that now more than one quarter of the new production comes from unit-linked business, so the idea of a reorientation of the business is going ahead according to the plan.

If you want the same number in terms of APE, we have €1.5 billion coming from savings, roughly €450 million coming from protection and €723 million coming from unit-linked, which grows 35% semester-on-semester. So it's a very strong trend that we've seen in the first semester.

In terms of cash flow, what we can say is that we are perfectly on track. And if you also consider the fact that France will restart paying the dividend, it is likely that we could exceed the level we had before.

Q - Michael I. Huttner {BIO 1556863 <GO>}

And just one follow up on the unit-linked, of the numbers in the first half, are there any one-offs or exceptionals I should be aware of? Or are they just normal growth?

A - Alberto Minali {BIO 16909383 <GO>}

No. There is no one-off in the unit-linked production at all. There is a continuous, let's say, expansion of the concept of hybrid products in different part of the group, Italy, certainly, France and Germany, and also Switzerland and Austria. So there is no one-off. That's exactly the strategy we had in mind.

If you also consider that the internal rate of return on the unit-linked business is in the ballpark of 19% with a very short payback period vis-à-vis the saving business, you immediately understand how profitably is this business and how much cash this also can generate in terms of reduction of this trend.

Q - Michael I. Huttner {BIO 1556863 <GO>}

Fair enough. Lovely. Thank you.

Operator

We will now take our next question from Nick Holmes from Société Générale. Please go ahead, sir.

Q - Nick Holmes {BIO 3387435 <GO>}

Hi there. Thank you very much indeed. I have a couple of questions. First one is on solvency. I was actually going to apologize for this, but you haven't really had that many questions, so I won't. My question is you have one of the best economic ratios in the sector, but you have one of the weaker Solvency I ratios. And I wondered if you could quickly give us your thoughts on the reason for that.

And also with the economic ratio, how comparable do you think that is? I mean, clearly, there is an issue over internal model versus standard model. Do you think you're doing things differently from other people?

Then second question is on the realized gains. I think Farooq kind of covered this a little bit earlier, but I just wanted to be a little bit more specific. I mean, on the Life side, you've had a very high level of realized gains. And I guess my question is, do you expect a soft landing going forward on the realized gains? Because if there's going to be a hard landing, then that is a bit of an earnings headwind. So any guidance on that would be very much appreciated. Thank you very much.

A - Mario Greco {BIO 1754408 <GO>}

Nick, this is Mario. So on solvency, I guess – then Alberto will better than myself explain why they are so different. But I'd like to touch on the point on the comparability of the result. Honestly speaking, although they are pretty comparable, because as much as we know what the peers are doing, I think we're using definitely the same concept because the regulators advise or force us to use the same concept, and the models are quite similar.

But the point is that I don't think it matters to compare the results. So I don't think the 200%, as I said before, is better than 190%. What matters here is to stay away and really far away from regulatory intervention. And I think we are in all the relevant countries. And so this is what matters, and that's about it. And, again, this also explains why we think that we should not have a target for Solvency II because the only point there is, again, I repeat myself, to stay away from a regulatory intervention.

On the capital gains also, let me be clear on a point. We're not taking and we've not been taking capital gains to window dressing the results. This is a very special market. It is a market where some assets are close to bubbles. And so we think it is fair to take the gains and to avoid these gains to disappear in the future. Some gains will disappear. We saw that with the Chinese stocks, where we were lucky enough or clever enough to take the gains before they walk away. And we will continue doing that.

So we don't think that this is going to be hard lending. We see more bubbles or more assets close to bubbles and we will take the gains before they disappear. And honestly, we don't think there is anything wrong in doing that.

And then I pass it to Alberto for the other one.

A - Alberto Minali {BIO 16909383 <GO>}

Thank you, Mario. Looking at the comparison between Solvency I and Solvency II, certainly they are different. They measure the same animal with different, let's say, yardstick. On one side, in the Solvency I, we don't have any, let's say, component of the Life business, which for Generali represent a very important source of capital. I refer to the value in-force. And so in the Solvency I, we are negatively exposed to an increase of the interest rates.

If you look at the dynamic of the Solvency I between quarters, you see that in the first quarter, we had an increase of the Solvency I ratio due to contraction of the spreads and interest rate at the end of first quarter. While during the second quarter, it was exactly the opposite; we lost some available for sale reserve and so we've lost some points of Solvency I.

Solvency II has one component which is the same. But also you add the market value of our value in-force which is certainly a very positive component for us, which has exposed positively to interest rate movement. So in this rebound (32:15) of the interest rate from an available capital of point of view, we have gained some capital.

Also, we have a lower deduction of the market value of the subordinated bonds because of increased interest rates and also a lower, which is negative, excess reserve components. So I think that in this context, they are not easy to compare. Solvency I is very static. Solvency II is much more dynamic. And the movement of the interest rate explains why there is this distance between the two models, which do not worry us because it's exactly what we have expected.

I don't want to make any other comment on the soft lending because Mario answered your question.

Q - Nick Holmes {BIO 3387435 <GO>}

That's great. No, thank you very much for that very detailed answer. I just wanted very quickly to follow up. I know specific questions on Solvency II are now flavor of the month. (33:12) But sovereign debt, what's the latest on that? Is there a charge for that in your economic model?

A - Alberto Minali {BIO 16909383 <GO>}

Yes, in the economic model, the house follows exactly the same rule. We do charge exactly in line with the position of the Colleges of Supervisors. So, in this calculation of the 200% Solvency II ratio, we have accounted for a charge on sovereign bonds for domestic exposure and not-domestic exposure. So, all the government bonds have been charged in this calculation.

Q - Nick Holmes {BIO 3387435 <GO>}

And any sort of guidance on the level of charge for those sovereign bonds or is that...

A - Alberto Minali {BIO 16909383 <GO>}

Not yet possible to disclose this number because still we are in the pre-application phase.

A - Mario Greco {BIO 1754408 <GO>}

Look, Nick, the regulators are still discussing it. So they are aware that we disclose the number with the charges, but they asked us not to disclose the specific amount of the charges. So what we're doing is compliance with the current knowledge of the regulators thinking on it, but it might change, and then, of course, we will see the consequences of it.

Q - Nick Holmes {BIO 3387435 <GO>}

Understood. Thank you very much for your answers. Thanks.

Operator

We will now take our next question from Matteo Ghilotti from Equita. Please go ahead, sir.

Q - Matteo Ghilotti {BIO 2333793 <GO>}

Good afternoon. Just a question on the Life business because both the technical margin and the cost were much higher than expected. The overall effect was a positive one. But I wonder if you can give us some more color on the reason why. I don't know if it was the very good volumes which benefited both the technical margin, but also cost in terms of payout to the network. So if there is any explanation that you can share with us. Thank you.

A - Alberto Minali {BIO 16909383 <GO>}

Hi, Matteo. Thanks for the question. The technical margin of the Life business gone up by €166 million, this comes from plus 1% loadings. If you look also the way we load our products, we can say that the profitability of the products remains very good for the shareholder. We do have a fantastic component from the risk result, but I would like to stress especially in this €166 million, more than €60 million of unit-linked fees which are perfectly in line with the type of production we have done in the last semester.

If you look at the expense, the €250 million higher expenses. Of this, €180 million comes from acquisition costs. And so these are again perfectly in line with dynamic of our production.

Q - Matteo Ghilotti {BIO 2333793 <GO>}

And when you talk about the unit-linked fees, these are the recurring fees or the entry fees component?

A - Alberto Minali {BIO 16909383 <GO>}

Yes, these are recurring fees. Because, as you know, the unit-linked business has this nice feature of spreading over the tenure of the contract the recurring fees. So, it's a recurring component.

Q - Matteo Ghilotti {BIO 2333793 <GO>}

Thank you.

Operator

We will now take our next call from Rötger Franz from Société Générale. Please go ahead, sir.

Q - Rötger Franz

Yes, hello. Thanks for taking my question. First of all, can you give us a brief update on the sale of BSI? Which regulators have actually still to approve that transaction and when do you expect that to happen? And is there a actually a risk that this will be past any long stop date and that you will probably have to renegotiate with BTG?

The second question is about your asset liability management, ALM, mismatch. How did that develop in the second quarter? And did any change of it have a material effect on the economic solvency? Thank you.

A - Alberto Minali {BIO 16909383 <GO>}

I really miss the question on BSI, so thanks for the question. BSI. We are in the process of getting the authorization. We have been authorized yesterday by the Singapore Authority. There are three authorizations still missing. One is France, the other one is Monte Carlo and the third one is Chile.

But we do expect and we got some positive feedback from the legal team of the BTG and Generali, we do expect to conclude this transaction very soon. In case we need to move the long stop date, it will just a lengthening of one month, two months, but we do expect to close it quite soon because we don't anticipate any problems.

Going to your second question regarding the ALM mismatch, yes, there is an ALM mismatch. But I want to point out that it depends very much on the way we calculate the duration of our asset portfolio. Having the level of interest rate increase at the moment in time when we run the calculation, this effect has determined a lower duration of the assets, which has increased the ALM gap. So it's just a mechanical type of effect which we do not consider of any relevance in our ALM strategy.

I want also to stress that in terms of either investment or strategy overall in the asset allocation, this mismatch is not considered at all and we have not changed our approach of keeping a very tight ALM mismatch in the Life business and allowing a mismatch in the P&C.

So, if you want, I cannot anticipate and it does not have any material impact on the economic solvency ratio. If you look at what's happened in the last six months, we have slightly decreased the exposure to government bonds and slightly, I would say, slightly increased the exposure to corporate. But overall, there is no material effect on the economic solvency ratio and on the financial risk charge of our portfolio.

Q - Rötger Franz

Okay. Thank you.

Operator

We will now take our next call from James Shuck from UBS. Please go ahead, sir.

Q - James A. Shuck {BIO 3680082 <GO>}

Thanks and good morning. Three questions from me, please. Just firstly, I was hoping you could help me understand your operating ROE target a little bit more because you're targeting over 13% on average across the cycle and you're currently making 16%, which in the first half of this year annualized, in fact slightly over that. So I guess what I'm wondering is, is the H1 number flattened (40:41) at all in any way?

And then when we look out kind of beyond 2015, where are we in this cycle that you refer to? Is this cycle an insurance cycle? Is it an economic cycle? Because when I think about

13%, it just looks very conservative. And I'm kind of inclined to view it as a floor rather something on average. So that's my first question.

Secondly, strong growth in France on the Life side. We've seen unit-linked sales. You talk about better productivity of the new products. Last time I looked, the IRR in the French Life business was 6% and the payback period was 10 years. So could you just clarify what those numbers are now that's driving that growth that you're seeing?

And then my final point was just on the potential investments in technology. You did a partnership with MyDrive and then you subsequently bought that company out. I guess, my question is seeing some of your peers are using their balance sheets in order to accelerate investments, so bench capital, start ups, seed capital these sorts of things. Is that something that you might consider doing as well? Thank you.

A - Mario Greco {BIO 1754408 <GO>}

So, James, on the operating return on equity - it is Mario speaking. Let me clarify two things. First of all, there is a seasonality in our numbers. If you look at first half, second half, they're not exactly well balanced and the second half is lighter than the first half. So last year I believe our operating return on equity at the first half point was in the 7% ballpark and we concluded the year with 13.2%. So we clearly see us exceeding the last year results this year, which will make us very much comfortable on above 13%.

But as I said already in London in May, I don't see why we should revise this plan over the cycle target considering that the 10-year bond yield is still very low. And at the time we announced our 13% target it was much higher, and I haven't seen any competitor getting close to this number yet. So we are happy to beat it and we are happy to deliver higher profitabilities, but we don't think it is serious or prudent to revise this. And we don't think that it's sustainable to run the business at 14%, 15% (43:40) with this financial market.

And then let me also address the investment in technology issue. I think there is a lot of marketing about it. We try to strip off the marketing aspect and just being practical and direct on what we do. So we are investing €1.2 billion over the next four years in technology developments, which are fundamentally to be understood as customer-oriented processes, databases, information systems to have and to process the information that we have on the customers.

Then we made already six investments in venture capital around the world, focused on disruptive innovation in non-insurance, (44:30) and we made that on purpose to understand what these innovations are and if possible to use for our purposes.

And then we bought MyDrive, which I's an important acquisition and not by the size of it, which is of course very relevant, but the strategic importance of MyDrive is something that I will not ever exaggerate on. It is fundamental for our strategy, it is fundamental for what we want to do to have their skills, their capacity in-house working on a captive basis to help us understanding better the customers and getting ready to provide the services for the customers.

And then I'll pass it to Alberto.

A - Alberto Minali {BIO 16909383 <GO>}

Yes, James, the question on France. The internal rate of return of the French at year-end 2014 was 6.6%, in the first semester it went down to 4.5%. And the payback period moved from 9.9 years to 13 years in the first semester, which means that we needed to completely change the product range or the product offering.

We have started with this process, which will be concluded I think at the end of the coming September. We have already started the right trajectory to reducing the saving business and increasing the unit-linked business. And if you look at the saving business, it went down in terms of APE 7.6% and the unit-linked business went up 3.5%.

Bear also in mind that all of the profitability and margin indicators at the end of the second quarter are really incorrect anyway because they take into account an extreme level of financial assumption. As you know, the numbers we produce for this profitability margin are done with the assumption at the end of the first quarter, where we had very low level of interest rate and very high level of volatility.

So if you, let's say, clean them up, you'll see that the profitability of the French business has not changed. Having said that, we needed to change again the profit offering in September in order to have a better performance from the French Life portfolio.

Q - James A. Shuck {BIO 3680082 <GO>}

If I may just follow up quickly. I mean, France has seen a big repositioning of the business and you're talking about France as if the new product positioning is going well and the new customer-centric model is on plan. The IRRs have got worse and the payback period has got longer and you're selling more of this product. Why are you selling any of this product at an IRR of 4% and a payback period of 13 years?

A - Alberto Minali {BIO 16909383 <GO>}

Yeah, that's a good question. Let me start it from the Life business. Certainly you need also to accommodate the need of a sales network. You cannot immediately change all the product offering in one single go. So we have to do it in a gradual way in order to preserve the distribution power.

Second, the internal rate of return went down because of the mechanical calculation, which is the convention we use in this house calculating the new business margin. Third, in September, we will change the approach to the market and the type of product. Bear also in mind that in France, we are the biggest pension player and, by definition, pension business is the business with the longer payback period by its very nature.

So we are changing the product offering and we are restoring the profitability of the Life operation. As I already said, the P&C business is in the good trajectory and it will create a good profit going forward.

Q - James A. Shuck {BIO 3680082 <GO>}

Great. That's very helpful. Thank you.

A - Alberto Minali {BIO 16909383 <GO>}

Thank you.

Operator

We will now take our next question from William Elderkin from Goldman Sachs. Please go ahead, sir.

Q - William H. Elderkin {BIO 3349136 <GO>}

Thank you. And hello, everyone. Two questions and a then just couple clarifications. Firstly, looking at the Life business and the Life investment result. Can you just give a sense of in which reporting geographies that Life investment result is materially ahead of a normalized level? I think you've already talked about the high-equity gains in the Asian business. But is there anything else that we should be aware of?

Secondly, on the P&C business. Can you give us an update in terms of your outlook for P&C pricing, particularly on the motor side in Italy? And I also understand there's been a couple of legislative developments in terms of new regulations of bodily injury and so on. Can you just give a sense of where that has got to and what the implications of that may be?

And then two clarifications. You were talking earlier about ZZR and PPE provisions within the Life business. My understanding was that those are local GAAP accounting effects and they don't impact the IFRS numbers. I may be wrong on that, but could you just clarify that?

And then, finally, in terms of the accounting for new business flows, with the hybrid products combining a unit-linked and traditional contracts within one bundle, would those be split in terms of the flows you report, so the unit-linked goes into unit-linked, traditional goes into traditional? Or is it all treated as one?

A - Alberto Minali {BIO 16909383 <GO>}

Thanks, William, for the question. I will start with number one, the Life business investment result. With exception of China, where, as I said, we've been very tactical in realizing a few days before the drop of the Shanghai Stock Exchange Index the equity position and the ATF in equity. There is no, let's say, extraordinary investment result affecting any other country.

And as Mario said, we do take profit whenever we think that the asset class is mispriced or there are tactical opportunities. And that's exactly the same concept we apply in every single portfolio. Bearing also in mind that we do have the one investment company in the group managing all the assets of the group, so there shouldn't be any difference.

Moving to the ZZR and PPE, yes, it's a local GAAP or local accounting effect. And in terms of the hybrid products and I want to reassure you that the hybrid products will be split and accounted as the saving components in the saving part and the unit-linked component in the unit-linked part.

Having said that, certainly what we are achieving is ever-increasing component of the unit-linked, especially in the financial for Motors (51:25) area. But also the traditional agents of Generali in Italy, in France, but also in Germany are increasing such a component, which means that we keep the profitability at least at the same level, but we certainly have a better performance in terms of capital and risk adjustment measurement.

I'll leave it to Mario for the outlook on the Motor pricing.

A - Mario Greco {BIO 1754408 <GO>}

Yes. So, William, I don't think there has been any development on legislation in Italy. And as much as I know, I don't think there will be any soon.

About the outlook for Motor pricing. I mean, we are in a kind of unique position because, although we do have a sizeable portfolio, but our agents in our business does not rely on Motor, different from some other competitors in our distribution channels in Italy. Our agents in Italy really rely on Property, Non-Motor and Life, and then they sell Motor whenever they find a chance for it and whenever it is convenient.

So we will be very careful on protecting profitability. And so we are even prepared to lose some portfolio, to lose some volumes in Italy if the prices are not right. We're not going to follow anybody in pricing wars on Motor. If anybody wants to grow their Motor portfolio in the south, for example, as we're doing, we will let them do that. This is not our core business. Our core business again is Non-Motor, Property and it is Life.

I think the market will stay soft. We don't expect it to harden. We see competitors playing a soft game. And so we are getting ready for losing some market share and protecting the margins that we have in Motor.

Q - William H. Elderkin {BIO 3349136 <GO>}

Thank you.

Operator

We will now take our next question from Alberto Villa from Intermonte. Please go ahead, sir.

Q - Alberto Villa {BIO 16005221 <GO>}

Hi. Good afternoon. Not many questions left on my side. Just if you can give us an idea of the investment rates in Life and P&C you're witnessing and if you anticipate any change in the investment strategy? You already commented in some ways, but just if you can give us an idea of the investment rates here you witnessed in the second quarter.

And then a more broader question on the acquisition side. I know that you're not planning any big acquisition. You just invested tactically also in Spain recently. There are some M&A going on in the sector globally. Do you think it's a good moment in time to consider M&A as an option or not? And what is the focus for Generali going forward on that? Thank you.

A - Alberto Minali {BIO 16909383 <GO>}

Thanks, Alberto, for the question. The investment rates in the Life business is at 2.4% versus 3.2% of last year and in the P&C business is 2.1% versus I think 2.1% also last year. And we don't have any change or we don't have any expectation of changing the investment strategy going forward.

For the M&A, I will ask my expert to answer.

A - Mario Greco {BIO 1754408 <GO>}

Thank you. Now, look, Alberto, in the past two years and a half, we sold €4 billion of assets and purchased €3 billion of assets. I think we have done enough M&A. Now we have to digest all these changes and grow the business organically, as we said.

Also, we don't feel that we strategically need to do M&A now to fulfill and achieve the strategical targets and the financial targets, we don't need M&A. And also tactically or financially, we didn't see anything which is so interesting to have us deviating from our strategy. So this is really out of our table at the moment.

Q - Alberto Villa {BIO 16005221 <GO>}

Thank you.

A - Mario Greco {BIO 1754408 <GO>}

You're welcome.

Operator

We will now take our next question from Andy Hughes from Macquarie. Please go ahead, sir.

Q - Andy Hughes {BIO 15036395 <GO>}

Hi, guys. Sorry if this is a bit (56:04) I'm just wondering about the comment you made about capital locally. In the economic capital model, do you assume it's fully fungible? Or do you penalize the lack of fungibility of capital around Europe?

And I guess the second question is on crediting rates. Obviously if your reinvestment rate for the Life business is 2.4% and you mentioned the guarantee rate dropping, but I'm more interested in what the crediting rate is. Can you give us an idea how they've moved over the period? Thanks.

A - Mario Greco {BIO 1754408 <GO>}

On the capital fungibility, let me try to be more clear than I was. So when you look at there our 200%, what I mean by fungibility is that actually we're regulated in each country and the regulators will look at that number for their specific country. And so the fact that we have capital elsewhere doesn't matter for them.

I think Alberto made in London an example of two companies being each in two countries, each of them having the same ratios globally, which is 150%. One company has 200% in country one and 100% in country two. The other company has 150% in two countries. Now, although they look the same, they're not the same because company one having 100% in one country will be forced to capitalize that country by the regulators, while company two, even though they have 150% in both, will not have any restriction and will keep on running the business without any regulatory intervention. This is the issue about the capital fungibility. The total number doesn't represent possible issues at local level.

We are carefully watching every local market where we have dividends generated and possibly transferred to the holding. And, again, we don't see any issue, we don't any risk of having these dividends trapped. Am I clear?

Q - Andy Hughes {BIO 15036395 <GO>}

Yeah, I think so. I think what you're saying is basically the economic capital is fully consolidated so it doesn't include that impact. And so we shouldn't assume that it will go down to 100% at a group level. It will be a lower level at which (58:26) which is more than 100%. But do we know roughly what the level might be?

A - Mario Greco {BIO 1754408 <GO>}

I'm not sure I understood your argument on that.

Q - Andy Hughes {BIO 15036395 <GO>}

Okay. I think I interpreted your answer as saying it's fully consolidated, i.e., obviously you're not allowing any penalty for local capital rules in your economic capital solvency, i.e., t's just the consolidated group position assuming the capital is completely fungible. So we shouldn't assume it goes down. You can actually take it down to 100%. There's a level lower than 100% at which you would then struggle to pay dividends. And any idea what that is currently?

A - Mario Greco {BIO 1754408 <GO>}

No, because it is clear that regulators will step in at 100%. But definitely it's also clear that they will not like the solvency to decline steadily towards 100%. They will intervene then before. But that is not clear. It's not mathematical.

We want to have in every country where we have dividend capacity especially, we want to have enough buffer, enough cushion, that in every circumstance or in every case it can happen, we don't run risks of restrictions. And this is where we are today.

Q - Andy Hughes {BIO 15036395 <GO>}

Okay. Thank you. And on crediting rates?

A - Alberto Minali {BIO 16909383 <GO>}

Yeah, crediting rate, last for the road. I mean, we don't have a figure at group level, because an average figure at group level doesn't make any sense. You need to go country by country, I would say more company by company and portfolio by portfolio. But if you also consider that in Italy most of the business we run is a fee-based business, the implied crediting rate is below 3% in Italy. In France, it's 2.75%. In Germany, it depends very much company by company, but I would say in the ballpark of 3%. And that's more or less the level of the crediting rate.

Please consider that most of the business we have in the portfolio has a fee-based structure, which means that we take out the fee for the shareholder and whatever is left in generating the policyholder funds is then credited to the policyholder. So you might draw the conclusion that's very high vis-à-vis the level of interest rate, but this depends on the good performance of the policyholder funds and the huge amount of unrealized capital gains we do have there from time to time, as I said, we use for policyholder funds performance.

Q - Andy Hughes {BIO 15036395 <GO>}

Okay. Thank you very much.

A - Alberto Minali {BIO 16909383 <GO>}

You're welcome.

Operator

That will conclude today's Q&A session. I would now like to turn the call back to the speaker for any additional or closing remarks.

A - Mario Greco {BIO 1754408 <GO>}

Yeah, I'd like to thank you all for having been on the call. Let me also say that this has been a very good first half of year for us, so we're committed to continue along the same path. And we think we have all the premises to be as successful in the third quarter and in the fourth quarter. The targets we have in mind are the targets for 2018. This calls for a good start in 2015, but then it's a four-year journey that would take us busy in transforming this company in the European insurance retail leader and in a very profitable company for the shareholders.

Thank you very much for your attention. And I wish you a very good holidays if you have not taken them yet. For sure now we will take some holidays. Thank you.

Operator

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