FINAL

Bloomberg Transcript

Q3 2018 Earnings Call

Company Participants

- Andrea Novelli, Unknown
- Guido Maria Nola, Unknown
- Matteo Del Fante, CEO, GM & Director

Other Participants

- Alberto Villa, Head of Analysts Team
- Anna Adamo, European Banks Analyst
- Ashik Musaddi, Executive Director and Co
- Federico Braga, Associate Analyst
- Filippo Prini, Equity Research Analyst
- Gian Luca Ferrari, Banca di credito finanziario S.p.A., Research Division
- Giovanni Razzoli, Financial Analyst
- Manuela Meroni, Research Analyst
- Michael van Wegen, Director

Presentation

Matteo Del Fante {BIO 6237992 <GO>}

Good morning, ladies and gentlemen. Thank you for joining us this morning as we present Poste Italiane Third Quarter results for 2018.

I will take you through the key highlights for the period before handing over to our CFO, Guido Nola, who will guide you through a more detailed review of the business. I will then provide some closing remarks before we open the call for questions.

Here with us in the room, we have the heads from all business segments to answer any specific questions you might have.

On Slide 3, we summarize the key points for this quarter. Our results show that we are well on track to meet all of the first year financial and operational targets laid out in our 5-year strategic plan, Deliver 2022. Our plan, which is built on strong fundamentals and evolving customer needs, has seen a significant number of actions already implemented. These measures are already contributing to improved operational performance across all business segments, driven by low-risk growth and cost discipline, while, most importantly, reducing reliance on capital gains. We have taken proactive actions during the quarter to mitigate market volatility. And I will outline the impact of current BTP spreads on our businesses. Guido will then share more details on the effective capital management actions we have taken in relation to our solvency ratio.

And finally, we reaffirm our Deliver 2022 commitment with 5% increase in dividend per share for the full year 2018 equal to EUR 0.44.

Let's now move to Slide four for an overview of the financial results for the Third Quarter of 2018. Group revenues have increased by 5.3% for the quarter and 0.7% for the first nine months of 2018 with positive contribution from all business segments. Revenues for the year-to-date clearly show our reduced reliance on capital gains, offset by a clear increase in recurring revenues.

Net of capital gains and other items, revenues increased by over 5% in the Third Quarter and by 3.5% in the nine months. From an operating cost perspective, levels are broadly stable in the Third Quarter. But as Guido will outline, this includes the impact of labor contract renewal at higher rates and higher variable cost, which had increased to support the revenue growth.

Total operating cost for the first nine months were down over 4%, on track with 2018 Deliver 2022 target. In the Fourth Quarter, we will book the majority of the early retirement charges for 2018 as well as higher costs related to higher business activity in the last part of the year. As a result, EBIT was EUR 456 million in the Third Quarter, contributing EUR 1.5 billion for the first nine months of 2018, up 28% year-on-year.

The strong progression of operating profitability is more visible on an adjusted basis, with EBIT increasing by 43% in the quarter and by around 65% in the nine months to date.

Reported net profit amounted to EUR 321 million in the quarter and EUR 1,056,000,000 for the nine months. As a result, earnings per share increased to EUR 0.25 in the quarter and EUR 0.81 for the nine months.

Let's move to Slide #5. Here, we provide you with a progress update on Deliver 2022 strategic plan. I'm not going to cover every detail of this very dense page. But I want to share with you some of the key highlights. The Mail, Parcel & Distribution segment is already showing the benefit of the Joint Delivery Model, which began rollout in April. 40% of the total planned delivery centers are now operating under the new model, which is our target for the full year 2018.

Combined with our streamlined structure and the new agreements with the National Federation of (Productiveness) and with Amazon will enable us to enter the busy Fourth Quarter in a stronger position. Going forward, our focus will be the continued integration of our new model to capture the growth in e-commerce in Italy. We confirm that we are on track against targets when considering the early retirement charges that will be booked in the Fourth Quarter and higher variable cost related to increased business activity.

Our Payments, Mobile & Digital segment demonstrated positive performance in the fast-growing and innovative space. The launch of Postepay, our own e-money institution, is a key milestone and we will continue to build on our position as Italy's leading digital payment ecosystem.

Earlier this week, we launched PostePay Connect, our new consumer app, which is driving the transition from traditional payments to an integrated Mobile & Digital Payments offer. The app invites customer to join a community where they can make payments to service providers such as petrol station, parking and public transport. Member will also benefit from the first integrated app for both giga or data and euro peer-to-peer transfer. As a matter of fact, we patented the G2G, the giga to giga trademark, which does not stand for government to government, as one would expect. But giga to giga.

In financial services, we're capitalizing on our powerful distribution capabilities and expanded product range to meet our customer evolving needs. The 2017 agreement with CDP to revamp postal savings has been a key driver in delivering the performance seen in the first nine months. We continue to reinforce the power of our distribution network with the release of a new CRM tool for relationship manager. This platform integrates MiFID II and IDD as well as new capabilities such as advanced customer profiling for wealth management and protection and a new dashboard to drive commercial opportunities.

In the coming quarter, you will see the benefit of both new and improved distribution agreements. Sales force training will continue with a focus on the new platform capabilities. We are also developing specific incentive schemes for relationship managers.

In insurance services, we continue to develop our nonlife offer, providing our customer with the highest choice of products, including Class III and multi-asset and P&C. Looking ahead, we're increasing our focus on innovation to explore the next generation of insurance products while retaining our leadership in life in a sustainable way. We are taking actions to address our solvency position to face market volatility, which we will explain in more detail later.

Let's move to Slide #6. Before I hand it over to Guido to take you through the business review, I wanted to provide a brief overview on the impact of the BTP spread. First and foremost, there is no operational impact on our business nor on our strategic plan targets. In fact, the current situation has even created some opportunities.

We're happy to answer any questions you might have during the Q&A. But let me highlight a couple of key points first. In the Fourth Quarter of 2017, as you might remember, we secured all capital gains needed for 2018. Then in the Second Quarter of 2018, we secured most of the capital gains needed for 2019. Now with the widest spread, we have secured the equivalent of the capital gains planned for the rest of Deliver 2022 plan through higher net interest income from reinvestment. In fact, quarterly net interest increased for the first time in the past four years.

I also remind you that unrealized capital gain or losses have no impact on our P&L or regulatory capital requirements. Moving to insurance services, I will provide you further detail on the strength of the underlying business later on. But we confirm that the business is resilient under stress scenario and we have proposed a range of effective capital market actions to strengthen our solvency ratio. Guido will guide you through this in more detail.

In summary, we recognize that we're operating in a volatile macro environment. But we can confirm that our business has not been affected and we're fully addressing all markets concerned.

I would like now to hand it over to Guido Nola, our recently appointed Chief Financial Officer, who will take you through a more detailed business review. Many of you have already had the opportunity to engage with Guido in recent months. I'm pleased by the immediate positive impact he has had on our business, thanks to his deep knowledge of Poste and the financial markets. And I'm certain that he will be a significant asset for us and for the company. Over to you, Guido.

Guido Maria Nola {BIO 20719012 <GO>}

Thank you, Matteo. This is my First Quarterly presentation as CFO of Poste Italiane and it is an absolute pleasure to be with you today.

I look forward to meet those of you whom I haven't already met very soon. Looking first at EBIT on Slide 8, we have seen a positive improvement in the Third Quarter driven by positive revenue contributions from all business segments. Mail, Parcel & Distribution delivered improved EBIT, up 91.4% year-on-year. This was driven in part by the first mail revenue increase in 10 years, which I will explain in more detail on the next slide as well as the ongoing strong cost discipline in the segment.

Mail, Parcel & Distribution EBIT for the first nine months was EUR 177 million, up from minus EUR 4 million year-on-year. Considering the seasonal increase in costs expected in the Fourth Quarter, we confirm our overall 2018 target. The Payments, Mobile & Digital segment reported continued EBIT growth, up 12.5% in the Third Quarter year-on-year and up over 9% in the nine months.

Financial services EBIT for the Third Quarter was down 5.3% due to one-off costs while confirming an increase on a normalized basis of 2% year-on-year. On a 9-month basis, EBIT was up 14.2%, fully in line with our 2018 targets.

Insurance services EBIT was up 32.2% in the Third Quarter and 12.6% in the nine months year-on-year, underpinned by life and P&C revenue growth and in line with Deliver 2022.

Moving to Slide 9. We will now look more closely at each business segment starting with Mail, Parcel & Distribution. Overall segment revenues decreased by 2.5% in the Third Quarter, leading to a drop of 2.7% in the first nine months of 2018.

However, Mail revenues were up in the Third Quarter for the first time in 10 years, driven by a pricing increase and a favorable volume mix with more high margin products. Parcel revenues continue to accelerate, up 11% in line with Deliver 2022 targets, driven by B2C where revenues were up 29% in the Third Quarter. This result confirms the effectiveness of ongoing rollout of the new Joint Delivery Model for Mail & Parcels. Combined, Mail and Parcel revenues in the Third Quarter were up 3% while broadly stable in the nine months.

We're seeing the first encouraging signs of the expected industry trends where the increase of parcel revenues is steadily offsetting the decrease of mail revenues. The item, other, includes contribution from our airline carrier, Mistral, which is now exclusively focused on cargo. The restructuring is completed and it has already contributed positively to our growing B2C business. Mail, Parcel & Distribution, the segment with the greatest challenges in terms of operating profitability in Deliver 2022, flows to the Third Quarter and the nine months with significant progression. While confirming our targets for 2018, let me remind you that in the Fourth Quarter, we expect higher variable costs related to an expected increase of business activity.

Let's now move to Slide 10, where we look more closely at the key volume and price trends for Mail & Parcels. Mail volumes decreased by 6.5% in the Third Quarter and 4.3% in the first nine months, which is just under the 5% expected in the Deliver 2022 strategic plan. The positive trend from the first half continues. Volumes for lower margin mail products, such as direct marketing in the postal business are decreasing at a faster rate, while volumes for higher-margin products, including recorded mail, remain resilient. Other volumes are down 9%, in line with expectations and our changing business model. The decrease is mainly related to mass printing, a service with low average tariffs. Average price in mail were up 6% in the quarter and 3% in the nine months, thanks to the positive volume mix effects just described.

The repricing of several products, including recorded mail in July, helped offset mail volume slowdown, leading to the first increase of quarterly mail revenue in the last 10 years. Parcel volumes increased by 17.2% in the Third Quarter and 9.2% in the first nine months, boosted by a significant increase in B2C volumes up by 24% in the first nine months. B2B volumes posted an increase of 13% in the Third Quarter, recovering from Third Quarter 2017, which was affected by industrial actions that affected the DA Express Courier unit. Our average price index for parcel was down 3% in the quarter. This was due to higher B2C volumes where tariff is lower than B2B and B2C. Total average, the lower average tariff is a near volume mix effect, while average B2C prices were, in fact, up in the Third Quarter and stable in the nine months.

Moving to Slide 11. I will now take you through the highlights for the Payments, Mobile & Digital segment, where Poste Italiane benefits from leadership in a fast-growing market. Revenues grew by over 13% in the quarter. Our payments were up 25%, driven by a growing number of Postepay cards and higher transaction volumes in both physical and digital channels. Other payment revenues, which includes bollettino, tax payment and money transfers were up 5% in the Third Quarter, benefiting from the temporary effect of certain utility providers, moving from bimonthly to monthly billing. Telecom's revenues increased by 6% in the Third Quarter as well as in the first nine months. This improved performance is taking place against the backdrop of an increasingly competitive environment in Italy and is driven by new commercial initiatives, which are supporting increasing mobile and fixed line sales.

On Slide 12, we show financial services revenues, including net capital gains. Adjusted revenues increased by 9.7% in the quarter and by 8.3% in the first nine months as we continue to leverage on our powerful distribution capabilities. Capital gains for 2018 were entirely booked in the First Quarter with an amount lower by some EUR 150 million on the previous year as planned. Continuing the trend of the year-to-date, this result demonstrate Poste's ability to substitute nonrecurring revenue such as capital gain with a more sustainable revenue mix, one of our most important commitments within the Deliver 2022 plan. Both postal savings and loan and mortgage distribution have delivered a growing contribution in the Third Quarter, driven by our increased commercial focus and improved distribution agreements.

Our MiFID II guided advisory platform has been upgraded during the quarter to add IDD compliance and we continue to invest in training our sales force with the help of our partners as envisaged in Deliver 2022.

Loans and mortgages is one area where we have seen the strong impact of increased commercial focus. Volumes increased by 38.2% in the Third Quarter while adjusted revenues increased by over 50%. We're growing faster than the market, thanks to our efforts to improve productivity and increase the number of post offices actively selling loans. We also launched a new multi-channel advertising campaign to increase the awareness of these products.

Results for the nine months demonstrate this improving trend with loans and mortgages revenues up 34.5%, thanks to volumes increasing by 21.1%. Interest income was up 7% in the quarter, thanks to higher average volumes and bond yields.

Financial services EBIT in the Third Quarter was down 5.3%, mainly related to one-off costs such as provisions on real estate funds and other minor items. Looking at EBIT and net profit on a 9-month basis, we continue to see solid growth and confirm our targets for the full year.

Let's move to Slide 13 in group total financial assets. Total financial assets increased by EUR 7 billion in the first nine months of 2018, driven by EUR 6.8 billion in positive net inflows from life insurance, mutual funds and deposits. This is a clear demonstration of our business model's resilience through volatile market conditions. The Third Quarter has been the best in recent years in terms of retail net inflows.

Year-to-date, retail net inflows improved by almost EUR 2.5 billion compared to last year. Insurance products represent EUR 6.4 billion of net inflows of which EUR 0.6 billion were unit linked and multiasset Class III insurance products. This inflows more than offset the decrease in market value of the government bond assets. Mutual funds posted positive net inflows of EUR 0.4 billion, thanks to a new product offering resulting from improved distribution agreement, increasing our market share in a complex market environment.

Deposits were up by EUR 4.8 billion, mainly coming from the public administration. Postal Saving's net inflows continue to improve in line with agreed targets. Net inflows were minus EUR 4.8 billion, much improved thanks to new commercial initiatives, more than offset by EUR 5.6 billion of positive market effects related to the accrual of interest on postal bonds.

Slide 14. Slide 14 focuses on Postal Savings where we can see the continued positive impact of the remuneration scheme agreed with CDP in December 2017 and our renewed commercial focus. The average stock slightly increased year-on-year thanks to the interest accrual on postal bonds, mitigating the negative flows as shown before. Postal Saving's net inflows in the Third Quarter where slightly negative at EUR 268 million, continuing the trend of significant improvement in 2018. We therefore remain in line with our guidance of improving negative net inflows, keeping an average of minus EUR 4 billion between 2018 and 2020.

In the Third Quarter, we continued our efforts to launch a new products and campaign aimed at attracting new inflows while also focusing on effectively communicating the advantages of Postal Savings. Fees from Postal Savings came to EUR 449 million in the Third Quarter, up 12% year-on-year and EUR 1.3 billion in the first nine months, up by 14.6%. We are therefore well on track to meet our revenue target of EUR 1.8 billion in fees for 2018.

Let's move to Slide 15 on insurance services. Insurance service's revenues increased by 9% in the Third Quarter while P&C and private pension plan revenues increased by 50% and 71%, respectively, as part of the ongoing diversification of Poste's insurance offer and in line with Deliver 2022 targets.

Life insurance revenues also grew moderately in the quarter. As a result, EBIT in the Third Quarter increased by 32.2%, up 12.6% in the first nine months supported by higher revenues as well as lower costs. This quarter was also positively affected by an earlier-than-planned financial margin contribution. We confirm that we are on track with our target for 2018 and expect results to be broadly stable year-on-year.

Let's move to Slide 16. Here, we focus on net technical provision, which increased by EUR 3.7 billion or just over 3% year-on-year. As you can see on the right, since the beginning of the year, net inflows amounted to just under EUR 6.4 billion, thanks to the positive contribution of all products. This more than offsets the negative flows from indexing products affected by maturities. As a result of market volatility, the value of Poste's government bond portfolio decreased by over EUR 7 billion without impact of the P&L results.

Minimum guaranteed returns to customer decreased by 8 basis points year-on-year, reflecting the gradual runoff of older Class I policies. Please bear in mind that the current level of minimum guaranteed returns is below our competitors and well expected as an improvement, thanks to the increasing weight of new business. As expected, statutory Class I return was down by 14 basis points year-on-year.

Moving to Slide 17. Poste Italiane Group's solvency ratio at the end of December 2017 stood at 279%. Since May, we have witnessed a deterioration of the market environment. As a consequence, the solvency ratio was equal to 172% at the end of September 2018, without factoring in any benefit from the country volatility adjustment. The decrease during the period was equal to 107percentage points, of which 87 related to 10-year BTP-Bund spread, which widened by about 110 basis points in the same period.

The regulatory framework of Solvency II is there to protect policyholders in case of adverse market conditions. As Matteo mentioned earlier, we have now seen any impact on our daily business -- we have not seen any impact on our daily business. We continue to benefit from a very low lapse rate of only 2.7%, which is best-in-class compared to our peers.

More importantly, we have not experienced a significant change over the past 10 years regardless of market conditions due to our solid business model and trusted brands. However, we have taken seriously the concerns that the market has raised in recent months and have taken proactive actions to strengthen our solvency ratio. First, we have limited the dividend payout from PosteVita to Poste Italiane to about 15% for 2018 with an uplift of 3% points to the solvency ratio on top of the 3% already booked at the end of September.

In the future, we will retain the flexibility compared to the fixed yearly payout to the parent company of 90% or 90% envisaged in the plan. Let me stress again that group dividend policy remains unchanged. Second, Poste Italiane has made EUR 1.75 billion hard commitment to PosteVita, of which EUR 1.1 billion will be immediately accounted for here through capital with a benefit of 26percentage points as soon as the regulatory approval is granted. In the next slide, I'm going to describe this measure in more detail. And third, the recognition of benefit from deferred tax assets is under assessment. Our peers have already taken similar measures and we envisage that this will provide us with an 8 to 10percentage point additional benefit.

Including those measures, the pro forma solvency ratio will reach approximately 210% on a fully loaded basis. Further support will come from the transitional measures recently announced by the Italian regulator. These measures, which is in line with European regulation, allows for deductions on technical reserves for a transitional period, which will gradually phase out in 2032.

Based on our current estimates, the benefit is expected to be approximately 20percentage points, leading to a pro forma Solvency II ratio transitional of approximately 230%. We also note that at the end of October, the Solvency II ratio gained an estimated further 15percentage points from September's level, following the triggering of the country volatility adjustment.

On Slide 18, we go into more detail of the new capital commitment. We are confident that we are presenting the best possible solution to address current market volatility. Poste Italiane has made EUR 1.75 billion hard commitment to PosteVita. This replaces the soft commitment to inject EUR 1 billion capital announced in Deliver 2022. From this EUR 1.75

billion and upon regulatory approval, EUR 1.1 billion will be accounted as Tier 2 capital with a benefit of 26percentage points. The remaining part will be accounted for if capital needs increase or following the expiration of EUR 750 million Tier 2 in May 2019.

This commitment is regulated by the provisions of Solvency II as an instrumental to support the capital position of insurance, particularly suited for intragroup measures. This is also known as ancillary-owned funds. This form of capital accounts as Tier 2 instrument until the commitment is fully paid in and converted into Tier 1, allowing us to optimize the capital structure.

In fact, with high-quality mix of owned funds, with Tier 1 capital covering 1.5x the capital requirements. This measure also has the advantage of being countercyclical. In fact, in case of our capital requirement, our capacity to account for ancillary funds will increase, mitigating the volatility of our solvency ratio. This instrument is flexible as more resources are required to move intragroup as well as being cost-effective at group level. This commitment is, one, unconditional. PosteVita has full discretion to ask for resources to be paid in, if and when needed. And two, fully backed by a strong liquidity position and further available funds.

As you can see on the right side of the slide, on top of the strong liquidity, Poste has already secured access to further facility as a contingency measure given market volatility.

From intercredit lines, from primarily Italian and European institutions, including the European Investment Bank, are available for a total of more than EUR 1.9 billion, up by a further EUR 1.1 billion, if you include short-term credit line.

Furthermore, please note that even including all credit lines, Poste Italiane has low leverage according to Moody's methodology. With additional unexploited debt capacity, Poste Italiane has built a strong and sustainable business and benefits from a solid financial position, far above what we need as a backup for our ancillary measures, allowing us to look at the future with confidence should external market volatility continue.

On Slide 19, we have provided details on group costs, which are well on track with our delivery 2022 target. The HR costs for the quarter were broadly stable with lower FTEs affecting higher labor cost as a consequence of the new labor contract agreement signed earlier this year. Looking at the nine months to date, HR costs are down 2% due to an average FTE reduction of 3,300 versus nine months 2017.

Looking ahead, we foresee an increase in costs related to a pickup of business expected at the end of the year and to book early retirement incentives in the Fourth Quarter.

Moving to non-HR operating costs, these were broadly flat in the Third Quarter with variable costs on goods and services increasing to support growing operations. Adjusting for the changes in perimeter, which took place in 2018, the Third Quarter costs would be down by 1%.

Looking at the nine months, the result of our cross efficiency drive are significant with a 4% decrease on an adjusted basis. The weight of non-HR costs on revenues is decreasing, both in the quarter and in the nine months, confirming that the result of our focus on cost discipline are tangible.

Let me now hand back to Matteo for some closing remarks before we open the call for questions. Thank you.

Matteo Del Fante {BIO 6237992 <GO>}

Thank you, Guido. Thank you, everyone. Before taking your questions, let me reiterate some key final points.

Our results demonstrate we're well on track to meet all of the first year financial and operational targets laid out in our 5-year strategic plan. Our improved operating performance is driven by: number one, higher revenues across all business segments, including better-than-expected performance in the declining mail sector; number two, control HR and non-HR costs, driven by cost discipline across the entire group; and number three, the decreased reliance on capital gains. We have already secured an important part of planned gains and higher rates will increase net interest margin during the rest of the plan, leaving additional upside on capital gains as soon as the market normalize.

Deliver 2022 is a 5-year journey made up of many small steps on strategy, cost and revenues aimed at delivering shareholder value. We're very pleased with the early progress earlier than expected in some areas and remain very focused on the execution of the plan. Thank you very much for your attention. And let's now open the call to questions.

Questions And Answers

Operator

(Operator Instructions) We will now take our first question from Anna Adamo of Autonomous Research.

Q - Anna Adamo {BIO 16893946 <GO>}

I have 2 questions. Firstly, on the financial services. I see that there are EUR 1.4 billion of additional unrealized losses on the bond portfolio, can you explain what is driving these unrealized losses, given that the spread move was only 30 basis points during the period? Then, on the solvency point, Poste EBIT already includes EUR 1 billion of Tier 2 in the available capital. So if I add EUR 1.1 billion then this Tier 2 capital will be 50% of the capital requirement. And if I look at your peers like Generale and the rest of the European sector, Tier 2 capital is around 10%, 15% of the solvency capital requirement. Do you think this will actually lower the quality of the Poste EBIT capital position here?

A - Matteo Del Fante {BIO 6237992 <GO>}

Okay. Thank you, Anna. I'll take the first question. The EUR 1.4 billion or EUR 1.5 billion negative move on the mark-to-market of the BTP portfolio is exactly on line with the 30 basis points move because we always announce and specify that the sensitivity of the mark-to-market of the portfolio to BTP spread is around EUR 500 million. It may be your...

Q - Anna Adamo {BIO 16893946 <GO>}

To follow up on this point...

A - Matteo Del Fante {BIO 6237992 <GO>}

If I can finish. Just, maybe the thing that is not fully appreciated by the market is the fact that we have high sensitivity to the spread because we have a long dated portfolio, the maturity of the portfolio is around 13 years. But given we hedge from the interest rate risk of the portfolio, the duration of the portfolio is only five years. So we have high sensitivity to the BTP spread, which is something that is not hedged but we each have a much lower sensitivity to the interest rate spread duration. And sorry, what's your follow-on question?

Q - Anna Adamo {BIO 16893946 <GO>}

Can you speak to these unrealized losses between the held to collect and held to collect and sell portfolio?

A - Matteo Del Fante {BIO 6237992 <GO>}

Yes. We don't disclose that figure. I can tell you that we have today in the portfolio, in the bond portfolio, a portion of the portfolio, which has around EUR 500 million of capital gain unrealized. But we don't give disclosure of -- we can take this specific question off the line with you, if you want, okay? On the second question, please, Guido.

A - Guido Maria Nola {BIO 20719012 <GO>}

On the second question, well, first of all, no, we don't believe we're lowering the quality using ancillary-owned funds. First, you need to bear in mind that, as we said, this is a commitment that will turn into Tier 1, Unrestricted Tier 1 should the Poste Italiane decide to draw this line. So this is very different from any other Tier 2. Second, I would just point out to the fact that we have 1.5x of equity versus SCR and the Tier 1 to Tier 2 ratio is 6:2x, including AOS. So that's how we justify that we think the quality remains extremely high. I cannot comment on the competition.

Operator

The next question comes from Gianluca Ferrari from Mediobanca.

Q - Gian Luca Ferrari

I have 3 questions. The first one is on the Universal Service Obligation. You made a EUR 88 million print in Q3, it's the highest reported ever. I was wondering what drove this robust contribution from the USO. The second question is on the net interest income. Am

I right in saying that if spreads will remain where they are today, probably you have upside risk to the NII putting Deliver '22, which could be to the tune of EUR 300 million, EUR 400 million accumulated from now to 2022. Can you comment a bit on this assumption? And the third question is, if you look at your banking book, I'm seeing deposits down for the Second Quarter in a row. At the same time, repos are growing quite materially. Can you tell us what is the strategy behind this?

A - Matteo Del Fante {BIO 6237992 <GO>}

Okay. Thank you, Gianluca. I'll take the first 2 questions and then ask Mr. Novelli, the CEO of BancoPosta to take the third one. On mail, the increase on mail and Guido highlighted in his presentation the fact that it is probably the first time in at least 10 years that we see a quarterly increase in mail is with no assumption and no contribution from the universal service. So this is really pure market revenues. And the explanation for that is the lower than expected decrease of high-margin mail products and higher than expected low-margin products, combined with a pricing measure, a price increase, that has kicked in, in July. And the second question and then I -- the answer is basically, yes. What allows us to basically say that in these market conditions, we have already started investing since May, June at significantly higher rates than we had planned in February in Deliver 2022 and those investments have already been made and will anyway yield additional net interest margin over the course of the plan. As you say, if the level of interest rates stays, we have incremental revenues. You mentioned EUR 300 million, EUR 400 million, I think you're a bit on the wide side. But you're clearly in the ballpark. And on the third question, on deposits, please Andrea.

A - Andrea Novelli {BIO 15185958 <GO>}

Good morning, everyone. So on deposits, as you can see from Page 13, the stock of deposits is growing from the end of last year. As Guido mentioned, this is mainly coming from public administration deposits. But I would like to stress the fact that also the retail part is very resilient and is growing as well from the end of last year.

Q - Gian Luca Ferrari

I was referring to the fact that retail are growing versus end of the last year but versus Q1 and Q2 are decreasing in Q3. At the same time, repos are now EUR 6.6 billion. They were EUR 5 billion end of last year. So I was curious to know why?

A - Andrea Novelli {BIO 15185958 <GO>}

The retail component is growing as well, just to be clear, compared to the other quarters of the year and going to the repo component, this is due to the fact that in our plan, we envisaged a very prudent increase in the leverage of our portfolio. Actually, given the current volatility in the market, we decided to do less leverage compared to what we expected to do this year.

Operator

(Operator Instructions) We will now move to our next question from Ashik Musaddi of JPMorgan.

Q - Ashik Musaddi {BIO 15847584 <GO>}

A few questions I have is, first of all, I mean, if insurance business starts giving lower capital back to the holding company, to the Mail & Parcels as a dividend, let's say, if it moves to a 50% payout versus your 90% payout for the next four years, how should we think about the group dividend? Do you have confidence that the group dividend is still covered? How should we think about that one? And what would be the scenario that needs to happen for that to get materialized? That's my first one. Second is, I mean, can you give us some color about the impact of GDPR on your mail revenues? I mean, where does it really hit? Is it direct marketing or is it something else? Because recently someone, I think Royal Mail in U.K. has done some kind of profit warning or revenue warning about the impact of GDPR. So any thoughts on that would be great. And lastly, just one thing is, I mean, clearly, the way your insurance solvency behaves probably is not really an appropriate way on the standard formula of Solvency II because of the way the spread moves versus volatility adjusted movement. So are you considering a move to internal model at some point? How much time it will take? Is it something worth looking at?

A - Matteo Del Fante {BIO 6237992 <GO>}

In terms of the dividend policy, I just want to remind -- take the opportunity to remind that we have a committed increase of 5% for 2018, 2019 and 2020. That's our commitment in February 2018. So an increase of 5% in absolute terms of the dividend. The reduction of the payout of PosteVita has no impact whatsoever. I mean, you have to consider that today, we announced nine months results with EUR 0.81 earning per share. And we have a commitment for the full year of EUR 0.44. We have, I think, a couple of years of reserves at the holding company level. So it's not an issue at all. If I may say, we should have probably -- when we launched Deliver 2022, we should have already considered a lower payout for the insurance company because if you remember, in that presentation, we were showing solvency declining over time with a stable market environment because the business is growing. So if the business is growing, you need to keep some of the profit generated by the business in the company. So this is, I think, an improvement on what we presented to the market in February as far as the solvency is concerned with no impact whatsoever on the dividend policy of the holding company that is the one committed with investors in the market. On the GDPR and the potential consideration on the internal model, I will ask Guido to answer, please.

A - Guido Maria Nola {BIO 20719012 <GO>}

So quickly on GDPR, Ashik, as you may know, as we said already before, direct marketing price is much less important as in Italy, in general, it's not as frequent as in the U.K. for example. You mentioned Royal Mail. For us it has a much lower impact and we had planned this to go down even before GDPR. So the effect is non -- is marginal for us. On internal model, I think, we mentioned this briefly before. Again, this is a measure that we are considering but you should bear in mind, that is a measure that would take more than a couple of years to be implemented. So we're not counting on this to manage our solvency in the near future.

Operator

Will take the next question from Michael van Wegen of Bank of America Merrill Lynch.

Q - Michael van Wegen {BIO 6435238 <GO>}

One quick question. Can you explain, under which circumstances the ancillary capital will be converted into Tier 1? So in other words, under which circumstances will either PosteVita decide themselves or be forced by the regulator to draw on the credit?

A - Matteo Del Fante {BIO 6237992 <GO>}

Please, Guido.

A - Guido Maria Nola {BIO 20719012 <GO>}

As I said before, there is no constraint. The Board of PosteVita has the right to call at any point of time it feels it's needed. And obviously, we will take into account any consideration that the regulator will have. But they will not -- we don't expect them to force us to take that decision at any specific point in time. Actually, to specify what I said before, I mentioned that AOS or the ancillary-owned funds, once they're drawn, become Tier 1, let me be even more clear, they become equity, not just Tier 1. So it's a capital increase. It's a capital injection.

Q - Michael van Wegen {BIO 6435238 <GO>}

Okay. But there is not -- for example, in the past, you've talked about the 130% Solvency II ratio being sort of a trigger level. I mean, obviously, today, your ratio goes up to -- well, between brackets, artificially because of the ancillary capital to 210%. I mean, the regulator is still happy if you have were to hit 150% or I mean, at some point, they are going to ask you to make this hard capital. And just trying to understand when that is.

A - Guido Maria Nola {BIO 20719012 <GO>}

Let me just say that, again, we retain -- the board retains that flexibility. But we maintain a commitment of 130%. So that line would be drawn at 130%. Next question?

Operator

We will take our next question Filippo Prini of Kepler.

Q - Filippo Prini {BIO 15149583 <GO>}

My first question is on cost. Given what you achieved both in absolute terms and your year trend in the first nine months of the year, if you exclude for the Fourth Quarter what will come from the early retirement cost and what you mentioned on higher variable cost for volumes in postal business, should we expect something different in the Fourth Quarter versus what you achieved in the Third Quarter and nine months? And my second question is on SIA, your participation in SIA, we have a lot of something in the newspaper in the latest couple of weeks. We know that SIA is not basically the busiest part of your business plan. But if you can add some comment on that?

A - Matteo Del Fante {BIO 6237992 <GO>}

On costs, basically, you've seen the trend, which is stronger in terms of reduction in the first half of the year. The specific quarter we're commenting has seen a specific increase because you have seen increase in revenue, which you had not seen in the first half of the year and some of the revenues are bringing, obviously, variable costs with it. So you see it then, obviously, at the margin level. And because we had specific on the HR component, as we mentioned, specifically, the new labor contracts are kicking in from 1st of July. But in terms of year-end expectation, we are confirming for the most important segment, absorbing the bulk of our costs, which is the Mail, Parcel & Distribution. On the cost side, we are confirming our guidance with a high degree of confidence at this point in time. On the second question, Filippo, on SIA, the topic has been going back and forth in the rumors in the media. The main -- I think, we're showing today once again that our business in payment is very solid. We're growing double-digits in revenues. We're basically growing double-digits in margins and we have a lot to do ahead of us to reinforce our leadership and the leadership of our payment ecosystem in order to say that we want to remain focused on Deliver 2022. And there is no intention to increase our stake in SIA, which, as you know, is a provider of processing services to Poste and Poste is very happy with what we get as a client of SIA. And that's it.

Operator

Our next question will come from Giovanni Razzoli of Equita.

Q - Giovanni Razzoli {BIO 7269718 <GO>}

I have 2 questions. The first one is on the Slide #14, which shows that the improvement in the trend in the postal -- net inflow of the postal savings, that's evident. And given the current market environment to where I suggest that -- I expect that the uncertainty on the market may create an opportunity for you, given your risk perception. Shall we expect an acceleration of this trend? And it would be interesting to know what are the gross inflows because -- net of redundancies so that we get a better perception of the amount of money that you are capturing at the network level? And the second question is on the average return of BancoPosta portfolio, if I'm not mistaken, it has gone up by a significant amount on a quarter-on-quarter basis. It is 5 basis points from 258 to 263, I think reflecting the purchasing you're mentioning of BTPs implemented in May and June. I was wondering whether given the amount of maturities that you add, we may assume a confirmation of these trends in terms of margins going forward?

A - Matteo Del Fante {BIO 6237992 <GO>}

And I ask Andrea to answer. Thank you, Giovanni.

A - Andrea Novelli {BIO 15185958 <GO>}

On the first question on Postal Savings, as you have noted and as we show on Slide 14, we are seeing a significant improvement of the net inflow compared to last year. And once again, I can confirm that we are fully in line with the guidance we have given for this year, in terms of revenue and net inflow. And of course, this is supported also from the mood of retail customers in this moment that have a preference for liquidity products. So this is a impact we see on Postal Savings. And as I mentioned earlier, it's also supporting our retail net flows for current accounts.

Going to the second question about the yield in our portfolio, the yield is increasing on a quarter-versus-quarter basis, as I've mentioned. This is due to the fact that, as Matteo has mentioned, we are investing at high yields the maturities in our portfolio and it is also supported by the fact that, as you may recall, we invest the liquidity coming from public administration deposits into a current account at the Ministry of Economy and Finance that is remunerated at a variable rate that is linked to the Italian government bonds. So once again, also on that part of the business, there is a positive impact coming from the increasing spreads. Then, in terms of expectation for the coming years, I think that Matteo has already answered that. Of course, this is providing an upside compared to the net interest income expectation we had in the plan.

A - Matteo Del Fante {BIO 6237992 <GO>}

Again, I'd just add, Giovanni, that you're right. We have a 2.63% average return, excluding capital gain on our portfolio for the first nine months of 2018. And it is the first time that it goes up in four years because in the first half of the year, we had 2.58%. So it is the first time in the last four years that we see an increase in the remuneration of our returns in the portfolio, excluding capital gains.

Operator

The next question will come from Manuela Meroni of Banca IMI.

Q - Manuela Meroni {BIO 1782610 <GO>}

My first question regards the revenues of mail, clearly a very positive result in this quarter also due to the repricing that you made in July. I'm wondering if we can expect further repricing going forward? And what we can expect in the Fourth Quarter 2018 and in 2019? Is there something that can change your projection for mail revenues compared to what you have included in your business plan targets? And the second question concerns the insurance service business. As you have mentioned during the presentation that the increased operating profitability is also due to the increase in financial margin. I'm wondering if you can elaborate a little bit more on this point? And if you can guide us in terms of financial contribution for the next quarter?

A - Matteo Del Fante {BIO 6237992 <GO>}

In terms of the first question, the mail revenues, no, we don't anticipate one specific repricing in the last quarter. The repricing of the 1st of July was agreed upon with the regulator. But obviously, that repricing stays in the prices of the volumes that we deliver. So you still have, obviously, the benefit of the increase, the tariff increase of the 1st of July. If you look at the increase in revenues of Q3, that brings the total decrease of revenues for the first nine months at EUR 38 million, which is a very low figure compared to our historical data. And if you compare that minus EUR 38 million with the increase in revenues that we experienced in the first nine months on the parcel side, you're finding revenues which are not too distant. So clearly, Manuela, we can not take a quarter as a signal because we have to be very cautious. On the mail side, we can experience acceleration on the decrease of volume. There is a e-substitution process taking place and we have no control on that process that can accelerate very fast but this has been priced, obviously, to a large extent in the plan. What we can say today is that so far this year. And specifically this quarter, revenues on the mail component have actually been better than we expected. And I can add that we have since one year now a new leadership on the commercial front, on the corporate side of the business, which is the one that is selling the mail products. And that is showing more focus and more commercial attention to our clients. And I must say that I have to give credit to our sales force for having been able to bring the results that we're proudly showing today on the mail side. On the second question, on the insurance and specifically the financial margin, I will ask Guido to answer.

A - Guido Maria Nola {BIO 20719012 <GO>}

Manuela, the answer is very short and very simple. We expect this to just be a seasonal effect. Some of the realized profits were anticipated slightly to this quarter, which we would normally expect in Q4. So we confirm the target for the year and I hope this answers your question.

Operator

The next question will come from Alberto Villa of Intermonte.

Q - Alberto Villa {BIO 16005221 <GO>}

I have a couple of questions. I'm sorry, I couldn't follow the entire call so maybe I apologize if you have already answered. But the first one is on the pension reform under discussion by Italian government. So the quota change to reform. I was wondering if this reform may be a positive for you in terms of acceleration in, let's say, in the change in the workforce or if you will continue as planned? And if you can give us guidance about the charges, the size of the charges and the provisions you're going to book in the Fourth Quarter related to the personnel? And the second one is on the customer behavior in this volatile environment in terms of Asset Management products. Are you seeing any, let's say, outflows from Asset Management products or you expect net inflows to continue in the coming months?

A - Matteo Del Fante {BIO 6237992 <GO>}

Okay. On the pre-retirement charges, as you know, it has always been company policy to do the final income statement provision in Q4. So as we stated today, this is not a change, it will happen with the last quarter of the year. We are on track in terms of one, the number of pre-retirement contracts we sign and what we expect and what we will provision at year-end for next year. But we don't disclose the specific figures. Sorry, Alberto. On the quota change, we already have 25,000 retirements and early retirements we announced in February with Deliver 2022. Quota changes, though, will accelerate the pace. But in order to give you a specific answer, we need to see the details and see how it will impact our workforce specifically, which I remind you is relatively aged. So it's probably an opportunity, I agree with you. On the retail flow in these market conditions, I will let Andrea Novelli, the CEO of BancoPosta answer it.

A - Andrea Novelli {BIO 15185958 <GO>}

So as you know, we start from a low penetration of Asset Management products on total customer assets compared to other players. So in this environment, we are not seeing negative flows that others are experiencing. Actually, we are still seeing healthy positive net flows coming to our Asset Management products and we are gaining market share in a market that, as you know, is shrinking. Of course, we also -- we will always put the interest of our customers first. So we are adapting the kind of products we sell in this changing environment. And as I mentioned earlier, of course, this is supporting Postal Savings, this is supporting net flows to current accounts and it is also supporting the significant growth that we are experiencing for multi-asset products in the insurance space, because this is a good mix of capital guaranteed kind of products and a very mild exposure to equity risk. So overall, this is positive for us and we are adapting to customer needs.

Operator

We will now take our final question from Federico Braga of UBS.

Q - Federico Braga {BIO 19916816 <GO>}

Actually just 2 follow-ups as all my questions have already been asked. The first one is on the insurance, the gross written premiums. So year-to-date, the gross written premiums are down 22% compared to your initial guidance of 15%. So just was wondering what is going on there considering that Class I premiums are actually dragging down gross written premiums and are going down worse than you anticipated. And looking at Q4. So if I understood correctly, we should expect a pickup in net premium revenues, I imagine, considering that you have anticipated some of the financial margin, which, of course, will decline sequentially in the next quarter. And the final follow-up on the mail revenues, just a clarification on USO revenues. So what we should expect for this year? Because the minimum guarantee revenues of EUR 262 million would imply a sharp drop of revenues in the last quarter of the year. So just was wondering, if you can give us a little bit more color on what to expect on this line?

A - Matteo Del Fante {BIO 6237992 <GO>}

Thank you, Federico. I will start with the second question. We are assuming in our plan a stable universal service contribution for 2018. On the first question, you're probably right in terms of slightly lower net gross premiums. But we are talking a few hundreds. And as Andrea was pointing out. And I tried to be clear, I hope, about this in my introduction, we are implementing MiFID II and IDD, which means that since October, all our clients buying also insurance products are profiled and they have to follow the process that is envisaged by the new regulations. That means that doing the last EUR 100 million budgeting on the basically over EUR 100 billion flows that we see every year in terms of gross product sales, is impossible. And we have also to accommodate and to follow our client inclinations and if that means that we will make a bit more money in mutual funds or postal savings and a bit less premium on insurance. So the financial targets, obviously, overall are more than confirmed for the financial services division and for the insurance division as well.

And thank you very much for your time today and generally on Poste. Thank you.