Y 2020 Earnings Call

Company Participants

- Bernhard Kaufmann, Chief Risk Officer
- David Knibbe, Chief Executive Officer
- Delfin Rueda, Chief Financial Officer

Other Participants

- Ashik Musaddi
- Benoit Petrarque
- Colm Kelly
- Farooq Hanif
- Fulin Liang
- Michael Huttner
- Robin van den Broek
- Steven Haywood
- William Hawkins

Presentation

Operator

Good morning, ladies and gentlemen. This is the operator speaking. Welcome to NN Group's Analysts Conference Call on the Second Half Year 2020 Result. The telephone lines will be in listen-only mode during the company's presentation. The lines will then be open for a question-and-answer session. Before handing this conference call over to Mr.David Knibbe Chief Executive Officer of NN Group, let me first give the following statements on behalf of the company.

Today's comments may include forward-looking statements such as statements regarding future developments in NN Group's business, expectations for its future financial performance and any statements not involving a historical fact. Actual results may differ materially from those projected in any forward-looking statements.

Any forward-looking statements speak only as of the date they are made and NN group assumes no obligation to publicly update or revise any forward-looking statements, whether as a result of new information or for any other reason.

Furthermore, nothing in today's comments constitutes an offer to sell or a solicitation of an offer to buy any security. Good morning, Mr.Knibbe. Over to you.

David Knibbe {BIO 17996037 <GO>}

Yes. Thank you and good morning, everyone. And welcome to our conference call to discuss NN Group's results for the second half of 2020. As always, I am joined today by Delfin Rueda, our Chief Financial Officer and Bernhard Kaufmann, our Chief Risk Officer, and rest assured we are sitting in a very large room at an appropriate distance from each other.

I will start off this presentation with the highlights of the second half year results, including the strategic and commercial developments. Delfin will then talk in more detail about the solvency position and operating capital generation as well as the financial results of the Group. After wrapping up the presentation, I will open up the call for Q&A.

Let me start with the financial highlights shown on Slide 3. A lot happened in 2020, the global COVID pandemic affected the lives of all of us. However, our employees showed exceptional resilience in adapting to remote working and they continue to provide an uninterrupted service to our customers and support them through these difficult times.

In financial terms the pandemic had a limited direct impact on our operating result of around EUR50 million. Our balance sheet remains strong, the volatile markets and further reduction of interest rates had a positive impact on the stock of capital which is a solvency ratio and a negative impact on the flow of capital or in other words OCG which amounted to close to EUR1 billion in 2020.

We saw new sales in Japan and Europe rebound in the second half of 2020, which is testament to how well our brokers and agents in particular have adapted to new digital ways of reaching customers. The operating results for the second half of the year was up more than 9% compared with the same period in 2019.

Strong results at Netherlands Life reflect a higher investment margin as well as lower expenses. In our Non-life business the lower underwriting results in disability and accident were partly offset by lower claims in property and casualty and the EUR26 million contribution of VIVAT Non-life, which became part of NN Group on the 1st of April.

The overall combined ratio was 95.7%, further expense savings were made across the company allowing us to achieve the cost savings target of EUR400 million. As expected and as already flagged at the Capital Markets Day last year, operating capital generation in 2020 was impacted by the exceptional market of circumstances and low interest rates.

On top of this in the second half of 2020 we saw higher claims in our disability portfolio, higher new business strain in Japan as a result of improved sales. As well as the suspension of dividend payments by NN Bank following the recommendation of the ECB. This was partly compensated by the accelerated shift to higher yielding assets and higher new business contribution from Insurance Europe.

Delfin will talk more about the various drivers of operating capital generation, later in the presentation. But let me confirm that the OCG of around EUR1 billion is very much in line with our expectations and we are still very much on track to reach our target of EUR1.5 billion of operating capital generation by 2023.

The year-end solvency ratio of -- is 210%, and this already reflects the deduction of the proposed 2020 final dividend of EUR1.47 per share. Our strong solvency position allows for resilient capital returns in line with the commitments we have made in our dividend policy. The 2020 full year dividend per share represents a growth of almost 8% on 2019, and we have also announced today a new share buyback program of EUR250 million.

Let's turn to Slide 4. The new strategy that we presented at the Capital Markets Day in June last year is geared to creating long-term value for all stakeholders. So in addition to our financial targets, we also measure our performance against non-financial indicators, because we believe that if we take good care of our customers, employees and society as a whole, this also allows us to deliver solid long-term results for shareholders.

We continue to provide an excellent customer experience through the challenges of the pandemic and this is reflected in a broadly stable customer satisfaction score. I'm particularly proud of our employee engagement, which increased substantially with an overall score of 7.9%. We aim to contribute to the transition to a sustainable economy through investing our assets responsibly, and we track this, based on the percentage of ESG integrated assets under management which increased to 74%. And we continue to play a part in supporting the communities in which we live and work through donations and gifts.

We are pleased to have received external recognition for our ESG performance by again being included in the Dow Jones Sustainability Indices both the World and Europe index. We announced these targets in June last year, so we are still at an early stage of the journey to meeting these objectives by 2023. However, we are working hard to improve our performance in all areas, and we intend to report our progress regularly.

Now moving to Slide 5, all of our business units are implementing initiatives, supporting our strategy to increase cash flow generation and drive growth in attractive markets. We took advantage of market opportunities in the first half of the year to invest in investment grade bonds, high yield bonds equity and emerging market debt.

We also made additional investments in mortgages, real estate and loans throughout the year, bringing the total investments in higher yielding assets to around EUR8 billion in 2020. Most of which in Netherlands Life. The additional returns that these investments generate are already visible in the higher investment margins.

In Non-Life, we are taking various actions to improve the results of the disability portfolios. We are continuing our drive for efficiency across the organization. Additional measures have been implemented in light of the pandemic. For example in Japan, we shifted to a more digital branding strategy and restricted new hires to key areas only.

The 2020 results reflect the contribution of the recent acquisitions of VIVAT Non-life as well as the acquired life and pension business in Slovakia and the Czech Republic in 2019.

These transactions have delivered better than expected returns and the integration into NN is progressing well. At the same time, we are committed to regularly assessing all of our individual businesses against our financial and strategic criteria, and we are disciplined in deciding if we are the right owners.

Last week we announced the sale of our business in Bulgaria, as we believe this is in the best interest of our local customers, business partners and employees as well as our shareholders. Similarly, we sold our broker business in Turkey in the fourth quarter of last year.

On the commercial side, we have launched many new products designed to meet customer needs. Let me give you a few examples. We entered the general insurance market in Romania with a new home insurance product. And in Japan, we have recently introduced a second round of products that have been adapted to the revised tax regulations in that country.

In the second half of the year NN Bank introduced a new label called Woonnu which offers mortgage solutions for the purchase or improvement of energy efficient homes by linking the mortgage interest rate to the property's energy label.

Given the interest in the first months, we are confident that this unique proposition will show a healthy growth in the future. Responsible investment is at the core of the strategy of NN Investment Partner, our asset manager. Investment performance was strong across most funds in 2020, particularly in the sustainable and impact investing strategy, underlining our belief that this approach is good for both the planet but also for returns.

I'd like to talk more about a commercial momentum on Slide 6. The COVID-19 restrictions throughout 2020 meant developing new and improved ways to reach our customers and supporting brokers and agents with digital tools and online sales processes. It is encouraging to see that the sales both in Europe and Japan picked up again in the second half of the year and that the value of new business also increased compared with the same period in 2019 and the first half of 2020.

The mortgage market in the Netherlands remains strong throughout 2020 and NN Bank originated a record level of mortgages, passing the EUR8 billion mark for the first time. The majority of these mortgages are transferred to the investment portfolios of our insurance companies and to the third-party mortgage fund offered by NN IP.

Our asset managers saw strong inflows of new assets, bringing total assets under management to EUR300 billion at the end of 2020. Performance across the different strategies was very strong. The over EUR10 billion of third party inflows was mainly in the fixed income and emerging market debt strategy.

Turning now to Slide 7. At our Capital Markets Day, we explained that a strong balance sheet is one of our priorities as it allows for resilient and growing long-term capital generation. We target operating capital generation of EUR1.5 billion in 2023 as well as mid-single digit annual growth of operating capital generation over time. This is the basis for delivering on our dividend policy, which consists of a progressive dividend per share and an annual share buyback of at least EUR250 million.

The uncertainty caused by the pandemic led various regulators to request companies to apply prudency around capital returns. We followed this advice and limited dividend flows from our subsidiaries to the holding during 2020.

At Group level we were able to fully resume our dividend payments to shareholders and a share buyback program in August last year. Today, we are announcing a proposed 2020 final dividend of EUR1.47 per share, which will be tabled at our Annual General Meeting on the 20th of May. We have also announced a new EUR250 million share buyback program.

We have made a balanced decision on capital returns, taking several inputs into consideration. On the one hand, we have observed unprecedented market volatility in 2020 as well as regulatory caution with respect to capital returns.

On the other hand, our balance sheet and capital generation is strong and resilient. All in all our commitments to grow long-term capital generation overtime in combination with the capital return announcements made today underpin our attractive investment proposition.

And with that, I will pass you over to Delfin.

Delfin Rueda {BIO 7032761 <GO>}

Thank you, David and good morning everyone. Let me start as usual with the movement in NN Group's solvency ratio in the second half of 2020. Our solvency ratio remains strong at 210% at the end of 2020 versus 221% at the 30 June. There are quite a number of items that have impacted the ratio. So let me take you through them.

Firstly, operating capital generation added 7 percentage points to the ratio. I will talk more about the drivers of operating capital generation later. On balance, market movements had a neutral effect on the ratio, mainly reflecting the positive impact of higher equity valuation offset by the negative impact of lower interest rates.

The category Other includes model and assumption changes and the reversal of the corporate tax rate change in the Netherlands as well as the additional capital requirement due to the move to higher yielding assets. Capital flows to shareholders reduced the ratio by 6 percentage points and represents the deduction of the proposed 2020 final dividend as well as the remaining part of the share buyback program that we resumed in August. Then we have included the bank in the calculation of the Group solvency ratio at the end of 2020, in line with the new requirements of the Dutch Central Bank. This had a negative impact to the ratio of around 9 percentage points. Our solvency ratio before capital flows and inclusion of NN Bank actually increased to 225%.

Let's now turn to Slide 10, which shows the movement of the ratio over the full year. The solvency ratio was 224% at the start of 2020. Looking at the movements during the year, operating capital generation contributed 14 percentage points to the ratio. This is lower than we expected at the start of the year, but is in line with the guidance that we gave at the Capital Markets Day and reflects the lower interest rates and the impact of the pandemic.

We experienced extreme volatility in the markets, especially in the first six months of the year, but as we've seen before the longer term market impact is relatively small, driven by our conservative asset mix. Market variances reduced the ratio by 4 percentage points in 2020, mainly due to the negative impact from credit spread movements, partly compensated by higher equity valuations.

The category Other includes various items. The main ones being the longevity transactions, the reversal of the government's planned corporate tax rate reduction in the Netherlands and the lowering of the UFR. On balance, all these items had a positive impact on the ratio of 8 percentage points. Capital flows to shareholders of in total EUR1.4 billion reduced the ratio by 17 percentage points. We also had a couple of non-recurrent events. One of them the acquisition of VIVAT Non-life and the other the inclusion of the NN Bank in the Group solvency calculations. Together this reduced the ratio by 15 percentage points. Altogether these movements brought the ratio to 210% at the end of 2020.

Let's now discuss the operating capital generation in more detail on Slide 11. Total operating capital generation in the second half of 2020 amounted to EUR450 million, compared with EUR653 million in the same period of 2019.

In the table on this slide as you can see the split by segment. At our Capital Markets Day, I already guided for a dip in operating capital generation in 2020, as a result of the exceptional market circumstances during the year. There was a net negative impact from the UFR drag and risk margin release due to the lower interest rates. This was partly compensated by the higher investment returns generated from the shift to higher yielding assets.

You can also see this in the breakdown by source that we have included in the appendix on Slide 20. Other items affecting operating capital generation in 2020 were the unfavorable developments in the Non-life disability and accident portfolio as well as the new business strain following higher sales in Japan.

In addition there was no contribution from the bank last year, as it suspended its dividend payments on the recommendation of the regulator. On the other hand operating capital generation was positively impacted by a higher new business contribution in Insurance Europe.

The next slide shows the movement in the cash capital position of the holding, which was EUR1.2 billion at the end of December 2020, compared with EUR1.3 billion at the end of

June. And therefore, remains comfortably within our target range of EUR0.5 billion to EUR1.5 billion.

Total remittances received from subsidiaries amounted to EUR592 million in the second half of 2020, bringing free cash flow to EUR613 million. As David mentioned earlier, we followed the advice of regulators in the light of the uncertainty caused by the pandemic, and limited the payment of dividends by some subsidiaries, including an NN Bank.

We intend to pay any suspended dividends in the future as and when the situation allows. As usual details of all the remittances upstream by each segment can be found in the appendix of this presentation.

The main cash outflow in the second half of the year was the payment of the 2020 interim dividend in September which included the catch-up of the suspended 2019 final dividend as well as the shares repurchased under the buyback program.

During the full year, we received EUR1.3 billion of remittances from subsidiaries and returned EUR1 billion to shareholders. Besides these capital flows to shareholders, we also had other cash outflows during 2020 for the acquisition of VIVAT Non-life and for the redemption of EUR300 million of senior debt.

Moving on to the next slide, I will take you through the IFRS financial results of the Group. Starting on the left, NN Group's operating result increased to EUR963 million from EUR881 million in the second half of 2019, which included EUR54 million of non-recurring benefits, while the second half of 2020 includes just EUR8 million of non-recurring benefits as well as an estimated negative impact of COVID-19 of around EUR23 million.

Excluding all these items, the increase of the operating result was mainly driven by the shift to higher yielding assets and higher dividends in the investment margin of Netherlands Life. On the right hand side, you can see that the net result for the second half of 2020 was EUR1.3 billion, the increase compared with the second half of 2019 is explained by the higher operating result as well as by a higher contribution from non-operating items, including a EUR100 million provision release following the completion of our tax audit of a legacy entity in Australia.

I will now take you through the operating performance of the individual segments on Slide 14. Starting as usual with Netherlands Life which reported an operating result of EUR500 million versus EUR397 million in the second half of 2019. I already mentioned, the higher investment margin as a result of the shift to higher yielding assets.

On top of that the life company managed to reduce its expenses further with the aim of lowering its cost base in line with the portfolio run-off. The result of Netherlands Non-life decreased to EUR130 million due to lower underwriting result in disability and accident where we saw higher claims in the Group income portfolio, as well as the impact of the reduction of the discount rate used to calculate D&A technical provisions.

On the other hand, there were lower claims in the Fire and Motor portfolios, and the inclusion of VIVAT Non-life contributed EUR26 million. The combined ratio was 95.7% for the second half of 2020.

Insurance Europe's operating result increased to EUR152 million, reflecting a higher investment margin in Belgium as well as higher pension fees in Romania. The operating result of Japan Life was EUR102 million, which is an increase of 6% excluding currency effects. This was driven by lower surrenders, reflecting increased persistency as well as lower expenses.

Asset management's operating result decreased to EUR78 million, mainly due to lower fees as the asset mix moved more to lower margin strategies as well as ongoing fee pressure. The operating result of banking decreased to EUR74 million as the comparative period in 2019 included EUR26 million of non-recurrent premiums on mortgage sales to NN IP Dutch Residential Mortgage Fund. On the other hand, the interest result was higher thanks to lower funding cost as well as higher penalty interest as customers continue to refinance their loans, taking advantage of the low mortgage rates.

Finally, the operating result of the segment Other was minus EUR47 million, mainly reflecting the higher operating result of the reinsurance business, which included an EUR8 million release of our claims reserve related to the non-life disability portfolio.

As David already indicated, the impact of COVID-19 on NN Group's operating results has been limited with a full year negative impact of around EUR50 million.

The last thing I want to talk about is cost reductions, which are shown in the next slide. At the Capital Markets Day in 2017 we announced our objective to reduce the 2016 cost base of the business units in the scope of the Delta Lloyd integration by EUR350 million by the end of 2020. And we later increased the target to EUR400 million.

With additional expense savings of EUR23 million in the second half of 2020, we have now achieved total cost reductions of EUR404 million, just ahead of our target. This does not mean the end of expense reductions. On the contrary, we will continue to focus on increasing efficiency throughout the organization and this is reflected in the segment cost guidance that we have given.

I will now pass you back to David for the wrap-up.

David Knibbe {BIO 17996037 <GO>}

Thank you, Delfin. Amid a global pandemic, our employees, brokers and agents showed incredibly adaptability to the new reality of remote working and online contact. And at the same time have continued to support our customers with excellent products and services, which is reflected in the ongoing commercial momentum shown by our businesses.

NN Group has also shown great resilience during a turbulent year. Our balance sheet remains strong in our financial performance has held up well. This allows us to deliver attractive and growing capital returns to our shareholders. Today we announced a proposed final dividend of EUR1.47 per share as well as a new EUR250 million share buyback program. The new strategy for NN Group that we presented in June is geared to creating long-term value for all our stakeholders. All in all we have made a promising start with the implementation of the strategy and have a solid foundation for delivering on both, our financial and non-financial targets.

I will now hand you back to the operator to open up the call for your questions.

Questions And Answers

Operator

(Question And Answer)

Thank you Mr.Knibbe. Ladies and gentlemen, we will now start the question-and-answer session. (Operator Instructions) As a reminder, in the interest of time, we kindly ask you to limit the number of questions to two. Your questions will be answered in the order that they are received. (Operator Instructions)

And the first question is from Mr.Benoit Petrarque Kepler Cheuvreux. Go ahead please sir.

Q - Benoit Petrarque {BIO 15997668 <GO>}

Yes. Good morning all, so two questions on my side. The first one is on the -- on the UFR drag going into 2021. So you had a kind of EUR130 million deterioration of the UFR drag between H1 and H2. And obviously you use a monthly reference for the interest rate to calculate this UFR drag in H2 and going into 2021 with the, increase of interest rate, roughly 30 bps up versus year-end, how much kind of will be the drag on the new basis. So, is the EUR560 million definitely lower starting into -- going into 2021. Could you help us to quantify this UFR drag into 2021 that will be extremely useful.

And then the second one is on the investment spreads again on OCG, clearly 2020 has been a good year in terms of -- for the -- on the investment spread side with various spreads especially in H1 and again looking into 2021, do you expect a bit of spread decrease versus the levels we've seen in 2020? I think, the corporate spreads and spreads are relatively low as we speak and I was wondering if there is a small negative effect to be expected there. Thank you.

A - David Knibbe {BIO 17996037 <GO>}

Yes. Good morning, Benoit. Let me give the first question on UFR drag to Delfin and Bernhard will cover the question on investment spread in OCG.

A - Delfin Rueda {BIO 7032761 <GO>}

Yes. Thank you very much, Benoit. Indeed, the changes in interest rate has quite a significant impact on the UFR drag and I mean, we'll see the 30 basis points that we have seen already over the year. That will give you approximately EUR140 million increase on the OCG. But of course, keep in mind that interest rates are all the time moving in one direction or another and it's always good to keep, more of a medium term trend but indeed, ceteris paribus, the increase of the 30 basis points, would be around 150 million, impact on funds on OCG.

A - Bernhard Kaufmann {BIO 18347993 <GO>}

Benoit and on your question on investment spread and how this comes through in OCG. Our investments in 2020 they are 8.7 billion in higher yielding assets that David referred to as we have done these investments over the year, we expect the full impact to come become visible now in 2021, and we assume this to be an uplift of 170 million in 2021, you're right. The risk premiums are moving but the impact should be in this order of magnitude in 2021.

Q - Benoit Petrarque {BIO 15997668 <GO>}

Okay. So I think there's another EUR50 million coming in on the OCG from the reinvestment but on the stock of investments, you do not see any specific pressure from the current low spread level. That's what you say?

A - Bernhard Kaufmann {BIO 18347993 <GO>}

Yes, right.

Q - Benoit Petrarque {BIO 15997668 <GO>}

Yes. Okay, cool. Thank you very much.

Operator

The next question is from Ms.Fulin Liang from Morgan Stanley, go ahead please.

Q - Fulin Liang {BIO 21126177 <GO>}

Hi. Thank you. I have two questions. Sorry to come back to the UFR drag, just so I am clear. So in 2020, you reported of the whole year reported about 1 billion UFR drag. But presumably in a normal year if I -- looking at a normalized, UFR drag in your sensitivity you did actually disclose that every 15 bps of drops of UFR would have about 300 million drag on own fund. Is that EUR300 million? Let's say if the interest rate remained flat, that EUR300 million would be a drag, would be a normalized number, right? And 2020, you have an actual above EUR700 million, mainly because of the interest rates dropped by maybe 40 bps over the whole year. If interest rates actually goes up from here, which already actually went up from here, then we would see some positive impact on the UFR drag on top of that EUR300 million normalized. Is that the right way to understand it?

And then secondly is on your non-life, I spoke to IR earlier today. So I understand the some of the so-called lower capital generation on the non-life is mainly because you basically cancelled the internal reinsurance, which basically -- which would -- you basically cancel out some of the pass-through to external re-insurance? So you essentially retained bit more business with yourself. Is that your plan going forward? Are you and presumably that will have positive OCG contribution in the future, is that fair? Thank you.

A - David Knibbe {BIO 17996037 <GO>}

Thank you, Fulin. Let me give these two questions to Delfin.

A - Delfin Rueda {BIO 7032761 <GO>}

Yes, thank you very much Fulin for your question. Maybe, because there is a lot of details here, it will be helpful that you call the investor relations to get into the details with more -- with a bit more details, but indeed the sensitivity of the UFR drag to the changes in interest rates is quite significant. And from I mean the sensitivity that we gave you on the increase of 30 basis points increasing by approximately 150 million. This is based on the sensitivities, on the OCG that we have published and that will be an increase, from let's say a decrease in the UFR drag from what was the situation at the end of 2020.

In any event, I think it's fair to say that even with the volatility in these interest rates, I think that it is very important to highlight because this is always going to change from one mode to another that we are comfortable with the target that we have set in terms of the OCG for 2023, but also that we expect a quite a rebound from 2020 that is for different factors that we could get in to a very depressed level. But we see OCG improving from mainly near every segment, into next year and towards 2023.

A - David Knibbe {BIO 17996037 <GO>}

Yes, and then the second question on capital generation for non-life related to the internal reinsurance, Delfin?

A - Delfin Rueda {BIO 7032761 <GO>}

Yes. Non-life, as you have seen has had a good result in terms of operating result. But in terms of operating capital generation has been quite depressed and one of the factors there for the full year, the reinsurance contract, the stop loss reassurance contract for the individual disability, which was a three years contract and terminated came to an end, at the end of 2020.

As a result, the solvency capital requirement, the capital requirement increased and increased substantially. So that was EUR65 million that is a non-recurrent item that happened in 2020 due to the increase in the solvency capital requirement.

Q - Fulin Liang {BIO 21126177 <GO>}

Thank you.

Operator

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

Q - William Hawkins {BIO 1822411 <GO>}

Hi guys. Thank you very much. I apologize, I think we all know there's more to an end than the ultimate forward rates. But my first question is on that. Delfin, so far your answers have been about sensitivity to changes in interest rates year-to-date. Can I just come back, if nothing had changed? I think I'm right, ultimately the UFR is something that will amortize to zero at some point in the future. So if there weren't any change in the markets, what would this 978 million be in 2021 and 2022. I'm just trying to get a feel for how it amortizes down. And I'm assuming I'm right, one day it will be zero. And adjunct of that, can you just remind us what is the benefit of the UFR to your Solvency II ratio. You wouldn't get any of these questions if the UFR didn't exist. But maybe that's another point.

Second question, please. Can you just remind us about how you're balancing capital distribution with M&A plans? I know you can't be too specific on M&A plans, but there is a worry given precedence for NN that you say good stuff about buybacks and then they get suspended because you need to raise capital to do deals, there's no hint of that in the past. So bluntly speaking, I'm just trying to gauge the risk of suspending buybacks for M&A and to the extent that I suppose a more precise question from that is can you remind us what your internal resources would be for any transactions before it started becoming vulnerable for the buyback? Thank you.

A - David Knibbe {BIO 17996037 <GO>}

Yes. Thank you, William. Let me start with the question on M&A plans and what you call capital distribution, and then Delfin will come back on the UFR question and UFR benefit to the ratio.

Well, in general all of our plans are based on organic growth and including the targets that we have set and we have very strict, criteria, strategic and financial criteria before we would embark on M&A. If you look at our capital return, we have a very clear capital return policy and we're very committed to this. We're very serious around this. And this is around a commitment to return to shareholders, but obviously also to keep long-term stable returns. Now this policy is around progressive dividend and around an annual recurring share buyback of minimum EUR250 million and additional capital also to return unless we see value creating opportunities.

Now, if you we take this commitment serious, like we have shown in 2020. And I think in 2020 we had very challenging market circumstances, there was the VIVAT acquisition. Of course, there was the senior debt of EUR300 million, it was not refinanced. But still we obviously kept the 250 million share buyback ongoing. So, I think that also shows that we take our commitment very, very serious. Yes, in terms of internal resources for transactions, yes, we're not going to speculate on this but clearly we have a strong balance sheet. We have flexibility in there. But at the end of the day it is -- this is really about that on the one hand we have our organic growth plans and any potential M&A would really have to meet both financial and strategic criteria before we would embark on that. Delfin on the UFR.

A - Delfin Rueda {BIO 7032761 <GO>}

Yes. Bill, thanks for your question. The UFR I mean first of January it decreased by 15 basis points. That in itself has a positive impact of approximately EUR25 million on our operating capital generation. The benefit of the UFR changes of course with the level of interest rates. It was certainly higher at year-end that it is now based on the higher interest rates. The important thing is to know that this decrease is expected to run down in 10 years, 15 years. So you're absolutely right. After year 15, there is basically not more benefit coming from the UFR but equally important, it means that there is no UFR drag in our operating capital generation and the capital generation, therefore, will keep be increasing gradually over that same period of -- same period of time.

Q - William Hawkins {BIO 1822411 <GO>}

Thank you guys. That's helpful.

Operator

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

Q - Farooq Hanif {BIO 4780978 <GO>}

Hi everybody. Thank you very much. Just going back on our favorite question on OCG. So when I add up some of the numbers that you've told us so far. I think, you said, 30 bps is a EUR140 million on the UFR drag. I think, you said EUR170 million on reinvestment, in higher risk assets. And then of course, you had some one-offs like the SCR impact of the internal reinsurance, in terms of the flow. I mean, when I add those numbers up, you're getting to quite a considerably higher number than the 1 billion guidance that you already gave. So is that sounding about right? I mean, I realize that there's going to be volatility, but getting to roughly 1.3 billion, does that sound to you to be achievable target based on the numbers you've just told us. And how much more re-risking, I mean are we going to see a similar sort of level every year?

So, sort of generally coming back on those questions and then secondly going back to Will's question on M&A. I mean, being more specific even more, I mean, clearly you've been linked in the press with targets in Eastern Europe. And I just kind of wondered about your ambitions there or your ability really to integrate given that you've just done a deal. Could you comment further? Thank you.

A - David Knibbe {BIO 17996037 <GO>}

Yes. Good morning Farooq. Let me just say a couple of things on the OCG first and then give it to Delfin and then after that I'll come back on M&A. So on OCG, the number we came out with of close to 1 billion is very much in-line with our own internal expectation. And as Delfin also said, we reconfirm our target of 1.5 billion that we set in the summer. And just as a reminder, where is this increase do we expect to come from, it's obviously the UFR and the portfolio development, a positive effect from both the lower UFR, the annual reduction as well as the run-off of the portfolio.

So that's one element, of course the other element indeed is the shift to higher yielding assets at a 170 million that was mentioned, it is on a full year basis. Then improvements in non-life both under-writing and expenses and then of course, there is the inclusion of the bank which didn't have a free cash flow or OCG in 2020. So that is another driver and then of course new business, the new business in Europe continuing to sell a profitable new business. So these are all important drivers which make us confirm the EUR1.5 billion target of OCG.

So, let me give it also to Delfin then.

A - Delfin Rueda {BIO 7032761 <GO>}

There is not much more to add to this. Indeed, I mean just maybe to complement, the investments, the move to higher yielding assets actually had estimated around EUR120 million positive impact on the OCG in 2020. EUR170 million as David has explained, is the annualized level for that. So, when you look at '21 compared to 2020, you can already expect another 50 million or so additional investment margin. And particularly non-life was really depressed in terms of OCG in 2020 for many, circumstances. The impact on disability and accident actually on a Solvency II basis, came a bit higher than under IFRS. But more importantly, the 65 million increase in capital requirement that has been mentioned and it will come. So, the cost savings for non-life coming from the acquisition of VIVAT non-life. They are still to come through together with improvement on underwritings. So there is quite an upside, for the non-life contribution to operating capital generation.

In addition, I think -- but I think, these are the main elements so that makes us confident. And that was of course, if on top of that you see some increase in interest rates. That will make that journey easier, but we're not counting on that to remain.

A - David Knibbe {BIO 17996037 <GO>}

Yes. Thank you, Delfin. And then on M&A and ability to integrate a business, we've just done a deal. Just to set the stage, I mean, have we done a small bolt-on acquisition in Czech and Slovakia with Aegon that has progressing well. It's actually have -- we had quite some benefits already from that deal. We just started also the integration of VIVAT, which as you might have seen also is already adding to our results.

So these two items the integration is actually progressing well, is that by itself a factor? No, I mean the non-life company obviously in the Netherlands is actively integrating the business and then for Czech and Slovakia there's still some ongoing integration activities on the back of the Aegon deal. In general, I wouldn't say that -- that is now an issue. What is at the end of the day very important is our own financial criteria and strategic criteria that are determining whether we would enter into M&A. And please keep in mind that, really our base case is organic growth. So that is our base case and you've also seen from the deals, I think that we've done in the past that we would only do that if they make strategically sense and when we can make an attractive return. By the way, M&A also includes divestments and we're actively looking at our portfolio. You might have seen that also we have divested our broker business in Turkey and recently our Bulgarian life and pension business as well.

Q - Farooq Hanif {BIO 4780978 <GO>}

Thank you very much.

Operator

The next question is from Mr.Michael Huttner Berenberg. Go ahead, please.

Q - Michael Huttner {BIO 21454754 <GO>}

Thank you very much. A follow-up question because you have answered several. The -- two things, one, there is little questions. The mortgages, you say the half on the year, but in the second half, the mortgage origination level, unless I read the --

A - David Knibbe {BIO 17996037 <GO>}

Sorry Michael. We have trouble hearing you. Can you maybe speak up a bit?

Q - Michael Huttner {BIO 21454754 <GO>}

Is this better?

A - David Knibbe {BIO 17996037 <GO>}

Yes, it's a bit better.

Q - Michael Huttner {BIO 21454754 <GO>}

Sorry about that. So mortgages level in the second half I think, and the software mortgage origination. So by -- what's happening there? And then the benefits in the Turkey and Bulgaria disposals, you mentioned that Turkey is already in the numbers. But maybe you could talk a little bit about the benefits --

A - David Knibbe {BIO 17996037 <GO>}

Sorry Michael, sorry Michael. We cannot -- we cannot hear you well. Maybe it's best that you dial-in again to try and reconnect and we'll make sure we'll get your question, but we can't hear you right now.

Operator

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

Q - Ashik Musaddi {BIO 15847584 <GO>}

Yeah, thank you, David. Thank you, and hello, David. Just a couple of questions I have is first of all, how do I think about dividend? Now clearly you have grown the dividend at 8% this year. So the does that mean that 8% is more or less what you are expecting when you gave the guidance of mid-single digit plus the lower share count related growth. Is that something we can think about as a normal dividend growth that we should be expecting in a normal market situation. So that's the first question.

The second question is on M&A, now clearly you've been linked with Aviva Poland, which I think is an asset which would make strategic and financial sense to you. But how do we think about your funding capacity for that? I mean one thing is that your SCR has gone up, your own funds has gone up. So a lot of leverage capacity has opened up for your -- for you at the moment. So, how do we think about funding capacity? How much excess capital you have at the moment you believe how much debt capacity you have? Would you consider doing -- raising equity if you need to do that M&A or you would mainly do it in-house and you don't see much issues with that. And given that it's would be a reasonable size acquisition, do you have any sort of hurdles in terms of ROE et cetera -- what you would want to achieve with that with any such big size acquisition? And just one more question on the Japan recovery. I mean, how much -- I mean Japan recovery has been pretty strong this year after a soggy 2019. So, how do we think about that going forward? Do you think that we are in the end state now or there is still some a lot of uncertainties on that. Thank you.

A - David Knibbe {BIO 17996037 <GO>}

Yes, thank you Ashik. Let me first -- give the first questions to Delfin and then I'll come back on Japan.

A - Delfin Rueda {BIO 7032761 <GO>}

Yes. Hi, Ashik, thank you for your questions. Yeah, we indicated that was a mid-term guidance of growing, OCG and as a consequence free cash flows mid-single digit over time, and we also indicated that of course, because of the share buyback the growth of dividends per share is obviously always, above that level. So I don't think there was anything unusual on the ordinary dividend paid in 2020 as full -- as full dividend. For your second question, I think the way I will answer it is in terms of our financial flexibility in general. I mean, 210% solvency ratio has also to be understood in combination with the sensitivities to market shocks that we publish every six months. And you have it as part of the press release within the appendix of the press release today and our risk profile. So on that sense, I think it is fair to say that we are very comfortable with the level of solvency and that we can absorb some deviations and we have also very well proved it in an environment of decreasing interest rates.

In terms of our tiering capacity, if you like, we have the ability of increase up to EUR1.3 billion in restricted Tier 1 and we have depending how you look at, Tier 2 you look at Tier 2 and Tier 3 together is approximately EUR1 billion at the year end. If you were to max the Tier 3 capacity then it's another EUR0.5 billion of Tier 2 capacity.

In addition to that our leverage ratio decreased slightly, this at the end of year-end versus June. As you know, we reduced the level of senior debt by EUR300 million in June earlier this year. So, I think there is no doubt that there is financial capacity to continue with our regular capital distribution to shareholders as part of our plan and if necessarily to take advantage of opportunities if they present themselves.

A - David Knibbe {BIO 17996037 <GO>}

Yes. Thank you, Delfin. Then on Japan indeed Ashik I think, we've seen a strong recovery of sales in the second half. VNB grew to EUR46 million versus EUR18 million in 2019. Now granted of course, 2019 was a very low level because the tax reform had just come out, but the good news is that we've always said that we believe that we can get the sales on a much stronger path also with the new tax rules. And we're starting to see this coming through.

So the EUR46 million is the first step. We're also introducing or we have introduced in February. So more products in the COLI space that we're actually optimistic on that that will further support the growth of our Japanese sales. So, we feel we're still on track to deliver the EUR150 million of VNB that we've set as a target for 2023.

And I wouldn't say I mean there's clearly uncertainties in the world everywhere, but I wouldn't say that Japan from that point of view. There's more uncertainty in Japan than in other markets. I would say it's comparable. The good news is that we are well on track and we see actually our sales channels being very active typically brokers already do well banks are starting to pick up as well. And banks have been across the globe less active in insurance sales, but actually November and December, we've also seen, trying to see a pickup of bank sales. So that further supports let's say the trajectory that we're on in Japan.

Q - Ashik Musaddi {BIO 15847584 <GO>}

That's very good. Thank you, David Thanks Delfin.

Operator

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

Q - Steven Haywood {BIO 15743259 <GO>}

Thank you very much. Looking at your operating capital generation, you had a negative EUR22 million experience variance in there, could you describe where this came from? And also did you take any mortality assumption changes or longevity assumption changes in the Netherlands last year because of the improved mortality tables. And then on the NN Re EUR30 million dividend, can you just tell me where that came from? Which business unit? Thank you.

A - David Knibbe {BIO 17996037 <GO>}

Yeah, Steven. Thank you, Delfin.

A - Delfin Rueda {BIO 7032761 <GO>}

Yes. Thanks Steven. In terms of the negative experience variance in Netherlands life, I think you have to take it, it's always a volatile item. Actually for the full year, because there were some, if you like, positive experiences in the first half and this has been negative. But these are driven off different factors. There are some related to lapses and some other, a small considerations there, but overall you should expect this to be around zero and as I said for the full year for Netherlands life it was I think a minus EUR3 million or something, very, very limited. We had, good technical result and it was on the actual, in 2020, we have some positive longevity results within the technical margin. However, we did not really change our longevity assumptions because of the new mortality table that came in the Netherlands. So, we're looking carefully into the no doubt recent experience of increased mortality. We are a bit cautious but I must say that there could be some upside on reviewing this within '21.

In terms of the dividend from NN Re, I mentioned before the negative that there was in the capital requirement from non-life because of the cancellation of the reinsurance contract for the stop loss reinsurance contract for individual disability. Here, you see the other side of the same coin as 75% of that reinsurance contract was reinsured with NN Re. NN Re has also got a release of their own capital requirement in addition, other parts of their business performed relatively well and that explains the somewhat elevated dividend from NN Re in the second half.

Q - Steven Haywood {BIO 15743259 <GO>}

Okay. Thank you, Dave.

Operator

The next question is from Mr.Colm Kelly, UBS. Go ahead please, sir.

Q - Colm Kelly {BIO 19140684 <GO>}

Well, thanks a lot. Thanks David and Delfin for taking my questions. The first one is on the move to higher yielding assets, clearly this is key to the OCG target. In the past, I think NN has predominantly done this through both residential mortgages and loans. But given the size of the UFR drag now, does it require an even more accelerated strategy around investing in illiquid assets beyond the typical illiquid assets that you have historically invested in or rather does it require more branching out into other illiquid credits where maybe NN doesn't have a stronger track record in? Related to that, does the regulator have full sight into the types of the illiquid credit, NN is looking to move into over the course of the 2023 plan? And are they comfortable with that? And then my last question is related to M&A and thanks for your comments on financial capacity. My question is more related to the disposal strategy, you mentioned the sale of the life and pensions business in Bulgaria. I appreciate it is small, but can you provide more detail on the rationale behind the sale of that business? Was it a case of market positioning i.e. a lack of scale? Was it due to lack of market or business growth or was it due to insufficient returns on capital? Some more detail on that would be appreciated. Thanks.

A - David Knibbe {BIO 17996037 <GO>}

Sure. So let me start on the question on Bulgaria and then Bernhard can talk about the experience around high yielding assets. Yeah, so the thinking around Bulgaria, well, as you know, Bulgaria is a relatively small country with seven million people. And also we have a relatively small business there. The life business is small and then we have a pension position. So the combination of a relatively small market and a relatively small business unit was the reason why we decided to divest. It was not related to a commitment -- broader commitment on the region, but specifically on Bulgaria itself.

The business itself, it was profitable, in terms of new business margin and returns, it made did make 3 million profit. So from that point of view it wasn't a -- so it wasn't insufficient return on capital, but it was really the size and, to be honest also the potential upside or lack of upsides that we saw in that market to get to a sufficient scale. I think we got a, good price for it, 77.7 million. I think it is a good value for that. So that's also helpful.

And to be honest, I think it's also important KBC has plans in Bulgaria. And they I think it's therefore also -- they are also a better owner that they can combine it with their business. They're also a better owner for this business than we are. So those were some of the rationales behind the sale of Bulgaria.

Then on high yielding assets Bernhard?

A - Bernhard Kaufmann {BIO 18347993 <GO>}

Yeah Colm, to give you some background on the strategy behind higher-yielding assets in 2020, we invested an additional EUR3 billion in mortgages. So that's also going forward or part of our strategy to build up our illiquid portfolio. But we also invested in EUR2.5 billion corporate bonds emerging market debt and around EUR2 billion in equities real estate. So we are really looking into a broader investment universe in this strategy. We have planned as part of our strategy until 2023 to step up OCG contribution by EUR200 million and like Delfin also pointed to, the assumption is that given the UFR drag that we are not really have to change here our strategy, but as we are so well on track, and we also see flexibility going forward. We are considering in a controlled way also to look into the next years. As this is the Risk Manager speaking, you can be sure that we do everything within our risk bearing capacity and tolerances and limits and also by the way reviewing our investment universe is part of our day-to-day business. So again, look, we're here very well on track.

Q - Colm Kelly {BIO 19140684 <GO>}

I am sorry, just a follow-up on the regulatory side of the boat. Look, as you say, it is branching out into other types of illiquids increasingly going forward than in the past. That is within your risk appetite and tolerance or I assume from a DNB perspective, are comfortable that with the path you're taking around the asset portfolio?

A - David Knibbe {BIO 17996037 <GO>}

Yes. Yes. So in all of the approaches or also discussions, this has never been a topic.

Q - Colm Kelly {BIO 19140684 <GO>}

Okay. Thank you.

Operator

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

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

Sir. Yes, sir. Good morning everybody. One follow-up question and I think the question is not too dissimilar from what Farooq was trying to get at. I am just going to ask it a little bit differently, for life your OCG in H2 was 266 million. If I just multiply it by two and I add the 140 million UFR improvement driven by rates, and I add the EUR25 million due to the 15 bps UFR reduction, I already get to EUR700 million. And I guess, I have to add something related to the negative experience that we just talked about and there's still some residual re-risking benefits to come on top of that level. Could you just quantify those for me, please? And maybe a small clarification question about the EUR140 million or EUR150 million from UFR drag that you mentioned, I presume that it includes also the VA still being at a lower average according to current levels, H1 this year versus H2 last year because I think that was one of the key things that was a bit of a surprise in the UFR drag move in H2 you're reporting today?

So that's question one and then secondly, more generically speaking the sensitivities you provided are more for parallel moves. So I was just wondering if we were assuming steepening, I appreciate that you in your sensitivities have disclosed that for your Solvency II ratio itself, that's a negative but should we also assume that if there would be steepening? That's your OCG generation would be -- would basically get stronger relative to your sensitivities as well. And lastly the SCR contribution in H2 versus H1 was strong. I was just wondering if in any way that could be driven by the new pension agreement where DB basically is now -- I think entirely dead and will not be renewed. So is that SCR contribution going to be structurally higher versus last year's level so to speak? Thank you.

A - David Knibbe {BIO 17996037 <GO>}

Yeah, thank you, Robin. Let me give the first question on life OCG to Delfin and then Bernhard will cover the sensitivities. And I will come -- of course first come back on the pension reform in broad terms. So let's first go to Delfin.

A - Delfin Rueda {BIO 7032761 <GO>}

Yes. Thank you, Robin. On the operating capital generation with about life indeed, you should not take the second half as a normal level. So I think it will be better to consider that the full year as this extraordinary effect on the life experience is level out. The shift to higher yielding assets for '21 for Netherlands life could easily be EUR50 million higher than it is for 2020. And we also have the EUR25 million additional coming from the decrease of the UFR, the 15 basis points already happened in January. So that together is already, 75 million, of course and I think it's always dangerous, to provide this guidance in relation of the impact of the change of the interest rates on the UFR because indeed there are many factors affecting there, including as well the level of the volatility adjustment but no doubt as the volatility adjustment a decrease, of course the spread on the investment assets also tends to improve. So overall, we have a target for life of 900 million for 2023 and we feel comfortable with that. The second question about sensitivities, I think it's better that Bernhard takes it.

A - Bernhard Kaufmann {BIO 18347993 <GO>}

Yeah Robin. So the steepening is -- so now, we are duration long meaning the steepening of the curve is impacting our own funds here and as pointed out negatively. But that is mainly because of the difference between -- then the discounting of our liabilities versus the investments on the long-end and steepening, then also really leads exactly to this reduction of the UFR drag over time. It depends a little bit on where it is. If it's a 20 to 30 year bucket, so a lot of our liabilities are -- it will be higher than if it's a 30 to 40 year bucket and I don't have a number for it. But conceptually the -- this is moving in the direction that you suggested.

A - David Knibbe {BIO 17996037 <GO>}

Okay, then the question on the pension reform related to the SCR. No, the pension reform, and I know there's a lot in the media and there's a lot of talk about. But that -- the implementation of that is expected in well, I guess 2026 maybe '25, but probably more '26. The pension reform by itself confirms, of course that the defined benefit is ceasing to exist and that everything will move to DC. But in terms of practically, what has been happening in the life business that was already the case.

We did very limited defined-benefit business. Every now and then we still do some renewals, but that's typically only in the context of -- to buy the employers some time to work it out either with his workers council or union to agree on the new pension scheme. So basically, we already see a slow run-off of the defined benefit book and a but all the new business is pretty much already in DC. Actually we had a very good DC renewal season.

In terms of new business and renewal our market share is, while we don't have the final numbers yet, because it's early in the year, but we do estimate that we will have again at least a 40% market share. So, we're doing well in the DC space in the overall, DC assets is now growing to 24.6 billion. So to make a long story short the transition from DB to DC is ongoing and it will continue to go on but keep in mind that the DB business most companies leave their DB book paid up. So therefore it's really the new accruals that go to DC, but the run off of the DB book by itself goes slower basically with the retirement of individual employees.

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

Okay. Thanks guys.

Operator

There are no further questions, Mr.Knibbe

A - David Knibbe {BIO 17996037 <GO>}

Okay. All right, then we will then start wrapping up and we will of course circle back to the one person that we lost unfortunately on the call.

So thank you very much. Thank you for all your questions. And before we close the call, let me just wrap up by saying that the strong financial performance and the capital position reported by NN Group today allows us to deliver on our commitment to attractive capital returns for shareholders and long-term value creation for all of our stakeholders. Have a good day.