S1 2019 Earnings Call

Company Participants

- Chris Figee, Chief Financial Officer
- Jos Baeten, Chairman and Chief Executive Officer
- Michel Huelters, Investor Relations Contact Officer

Other Participants

- Albert Ploegh, Analyst
- Andrew Baker, Analyst
- Benoit Petrarque, Analyst
- Cor Kluis, Analyst
- Farooq Hanif, Analyst
- Farquhar Murray, Analyst
- Fulin Liang, Analyst
- Matthias De Wit, Analyst
- Robin van den Broek, Analyst
- Steven Haywood, Analyst

Presentation

Operator

Good day and welcome to the ASR Conference Call on the H1 2019 Results. Today's conference is being recorded. All participants will be in a listen-only mode. After the presentation, there will be an opportunity to ask questions.

At this time, I would like to turn the conference over to Mr. Michel Huelters, Head of Investor Relations at ASR. Please go ahead, sir.

Michel Huelters

Thank you, operator. Good morning, everybody. Welcome to the ASR conference call on our half year results. On the call with me here today are Jos Baeten and Chris Figee. They will give you a presentation and a discussion and update on the results and the strategy and after that there is ample time to take any of the questions that you may have. As is customary, please do have a look at the disclaimer, which is in the back of the presentation with respect to any forward-looking statements.

And with that said, Jos, the floor is yours.

Jos Baeten {BIO 2036695 <GO>}

Thank you, Michel, and good morning to everyone. Hope you all have or are still having a very good summer and so thank you for joining us on this call. Ladies and gentlemen, as you have seen from the published numbers, we realized very strong results over the first half of this year. We continued to deliver a very solid performance with ASR. The numbers reflect our commitment and focus on operational excellence and disciplined execution hence I believe our performance shows that we are well on track to meet the medium-term targets. Having said that, however, we should be cognizant of the developments in the environment and the financial markets in which we operate. These are obviously not within our control and can be challenging to navigate from time-to-time.

So, let's move to Slide Number 2. As this slide shows, our performance over the first half of 2019 has been solid on every key metric. Operating result amounted to EUR459 million, significantly ahead of the strong result of last year. Operating results showed an EUR80 million of increase driven by very strong performance of the non-life segment, which was up EUR56 million, but also by a marked step-up in our life result of EUR28 million. Our costs remained well managed. Operating expenses were up driven by incidental costs predominantly due to the IFRS 17 project. When we look at the operating expenses from ordinary activities, which are part of the operating results, this declined by EUR6 million when we adjust for the acquisition of the cost base of Loyalis. So organic growth is fully absorbed by the existing platforms while we're still being able to lower our expenses, and I will come to that in a moment, in non-life and life due to reduction of FTEs and systems as a result of the integration of Generali Netherlands and the ongoing migration of individual life portfolios on our software as a service platform.

Our business yielded an operating return of 16.8% on an annualized basis, well over our target of between 12% and 14%. Overall, I believe this is an outstanding achievement. The combined ratio of ASR stood at 93.5%, also better than the medium-term target. The non-life business showed solid performance across all product lines and in particular we see an improvement in disability driven by solid underwriting and the price adjustments we have made on the sickness leave portfolio. Our Solvency II ratio remained very robust at 191% after the interim dividend and as you know, we are still using the standard formula. There have been many moving parts in the Solvency II and Chris will provide further details later on in our presentation. But basically we have been able to keep our Solvency II ratio robust while absorbing the 19 percentage points impact from the VA and the decline of the UFR.

Organic capital generation amounted EUR189 million adding 5 solvency points to our Solvency II ratio. Solid business performance fully absorbing the impact of the (inaudible) from the decline in interest rates. The quality of our capital also remained high with unrestricted Tier 1 capital alone representing close to 140% on the Solvency II and then there is still plenty headroom to maneuver. In total we have possibility to issue almost EUR1.3 billion of hybrid capital within the Solvency II framework. Our strong solvency position enables us to remain entrepreneurial. As we have said, everything above 160% allows us to be entrepreneurial and to pursue profitable growth, which we have proven to do so with the acquisition of Loyalis, which we closed on the 1st of May, which has -- and already contributing to our results as well as the recently announced acquisitions of VvAA and Veherex, which we communicated officially this morning.

Deals like the latter two are obviously on the smaller side of the range, but clearly meet our return hurdles and the bottom line and strengthen our strategic position. I'm sure you have noticed the increase in the net IFRS results. In addition to the EUR80 million increase of our operating result, we also benefited from incidental results from the acquisition of Loyalis as well as from higher indirect investment income. We are happy to offer an interim dividend of EUR0.70 per share, which is an increase of almost 8% compared to last year and represents 40% of last year's dividend.

Let's now move to Slide Number 3 and let me highlight some developments and achievements in the execution of our strategy. First of all, we've almost completed the integration of the Generali businesses on the -- on to the ASR platforms. The final part is the integration of the remainder of the pension book. As a result of the integration and the merger of the legal entities, it's no longer possible to accurately report on separate performance of Generali. However, more anecdotally, we believe we will achieve better business performance and results than anticipated. This will be likely more towards the EUR35 million, EUR40 million in net operating result instead of the EUR30 million that we initially expected and the tangible capital invested will be lower than we earlier expected. While we still need to integrate the last part of the pension businesses, we feel comfortable stating that overall this acquisition exceeds the financial expectations.

So, let's have a look at our solid back books in Box B. We continue to migrate the remaining books towards software as a service platform, making the cost base more variable in order to keep costs in line with the decline of the book. The acquisition of VvAA recently announced and comprising an annual premium of roughly EUR28 million and provisions of EUR430 million will be integrated on to the same platform. Looking at the capital life space in Box B, we have made further progress as well. Within DC pension, we see still very good momentum as employers decide to move to the so-called WerknemersPensioen. This half year we have reached over 75,000 participants, up from 50,000 participants end of last year and in the meantime we are already over EUR1 billion in assets under management. In asset management, there are also other good developments to mention. Just a year ago, we reported on a mortgage front that we had achieved the EUR1 billion of assets under management. Now the EUR3 billion landmark is already in sites and we are very pleased with this success. We also see that external investors appreciate our ESG funds and we've seen an inflow of EUR430 million in the first half there.

In the top left in Box A, you will find our businesses that provide opportunity of growing cash flows. As we announced this morning, we are happy with the acquisition of Veherex, which is an income insurer for the personnel of railway and affiliated companies. This transaction perfectly fits in our business domain of sustainable employability, which you will find on slide four. And as said, the acquisition of Veherex is the latest piece we added to this ecosystem and it strengthens our proposition in the field of sustainable employability. While the transaction itself is relatively small, it really fits well with the rest in the ecosystem and more importantly, it will be integrated onto the platform of Loyalis. This marks the fact that with Loyalis we have gains unique access to semi-public sector organizations. Later this year as you may know, we will start with the rollout of our Vitality program helping customers to live healthier and at the same time reducing place.

Having mentioned place, let's talk about non-life, which you will find on Slide Number 5. In the non-life segment, we reported a very strong performance, a EUR56 million increase of operating results to a total of EUR122 million. The increase is as high quality and driven by improvements in all product lines. In P&C, we experienced a EUR20 million lower storm claims than in the comparable period in 2018. Also bulk claims showed better performance, partially offset by some higher level of large claims. In disability, we particularly benefited from the strong underwriting and pricing adjustments in the sickness leave portfolio. As you may recall, last year we saw unfavorable claims development in the sickness leave portfolio, but we took pricing measures and over there, resulting in margin expansions within the sickness leave portfolio. The combined ratio in P&C and disability together was 93.5% in the first half, a strong improvement compared to the 96.7% in the prior year and also ahead of our 94% to 96% targets. Improvements across all business lines and driven by better results from expenses, commission and claims.

So we are very pleased with an expense ratio of 7.2% for our total non-life business, which as you may know includes health which show we chose a further improvement from last year, so clearly broad-based improvements in the non-life sector. Also our gross written premiums increased by 4.3% overall, mainly driven by solid organic growth of EUR56 million and the inclusion of Loyalis, which added an EUR18 million in the first half. Excluding Loyalis organic growth in P&C and disability combined were 3.3%, in line with the medium-term targets we have over there of between 3% and 5%. I should also add that this growth number also includes the negative impact from rationalization of the Generali NL portfolio. So we see continued good growth opportunities to grow organically the non-life segment.

And moving on to Slide Number 6, we will zoom in a little bit on P&C. I've already mentioned, the strong performance of our non-life business. Our P&C business has been market leading in the past few years. While large claims and storms can impact the bottom line performance from time to time over the years, we have built and strengthened the foundation of a successful and profitable P&C business. We've optimized our processes and harmonized or migrated to the admin system of Chris, improved the quality of our underwriting due to the use of fresh and implemented product rationalization to the benefit of efficiency service levels and customer satisfaction. We've been able to absorb organic and inorganic growth onto our platform with only marginal expense impacts. We've seen favorable developments in the non-life markets, driven by market consolidation and commitments by various peers to adhere the rationale and economic pricing. This has been a favorable backdrop for our performance in recent years, which we believe may continue for the near-term. The graph top left hand show the 3.2 percentage points improvement in expense and commission ratios over the recent years, while the graph at the bottom demonstrates the growth we have achieved in the same period. Our expense ratio in P&C amounted just to 8.3%, which we believe is market-leading and with claims ratio as the remaining parts behaving as anticipated, this provides basis for sustained growth and profitability going forward.

Let's have a look on Slide 7, the life segment. In life, we saw a strong increase of operating result of 8.3% to EUR368 million. This was mainly driven by an increase of investment margin of EUR25 million, about half of which is driven by a decline of required interest because all the part of the life books are expiry. This has a positive impact on the investment margin as we managed to keep our investment income relatively stable. The other part of the increase is mainly driven by an increase of the investment margin from the Generali Nederland's portfolio, which is the effects from an extra months of revenues. 2018 was 11 months as you may recall and also the impact from some re-risking activities last year. We see most of the increase of the life as sustainable, however please bear in mind that H1 is typically supported by dividends.

Furthermore, we are pleased with the continued inflow, which we see in the so-called WerknemersPensioen, the gross written premiums of the DC products increased by 55% and assets under management exceeds the EUR1 billion mark. Together with the premiums of Loyalis, this partially offsets the decrease in premiums coming from individual life and pension DB. Cost containment is critical in the life segment and I'm happy with the life expense ratio of 52 basis points, which is within the medium-term target range of 45 basis points to 55 basis points.

On Slide 8, we'll have to look at all the other business segments. The operating results of asset management showed an increase of 30%, up to EUR11 million. This reflects the higher fee income, particularly from mortgage fund and ESG funds as well as a higher fee income from our real estate funds. This is driven by both new inflows, as well as higher asset base from revaluations. The operating result of the distribution and service segments declined slightly as anticipated to EUR11 million. The decrease is primarily the result of the expected downward pressure on fee income of Dutch ID as a result of adjusted tariffs for mandated brokers. This decline is partially offset by organic growth. Operating results of the holding decreased mainly due to higher interest expenses, roughly EUR3 million on the newly issued EUR500 million Tier 2 subordinated loan. The proceeds of the bonds were primarily used to fund the acquisition of Loyalis.

Then on Slide 9. This slide puts the financial performance of our businesses in a historical perspective. As you can see, we've been able to sustain the growth of our operating results over-time. While from time-to-time business results may show some deviations, it is clear that we have been able to grow our results and deliver an operating return on equity well ahead of the medium-term target. Operating results for the first six months this year is truly a record performance and I'm pleased with the quality of the business that has been delivered. Noteworthy here is well, the increase in the non-life compared to the same period last year. While the Generali in 2018 provides for a favorable comparison and the EUR56 million increase of our non-life operating results clearly outstrips debt and reflects the quality of our business.

Surely, question on your minds is what we expect in the second half of this year? Now from my presentation, so far, you have got that we are really happy with the quality of our business and the performance. It has been delivery. So a good starting point will be to take the operating result from H2 last year. EUR362 million included some non-recurring items, which actually offset each other. Additionally, one could assume somewhat improved business performance as we have seen over the first half year and as the expected half year contribution from Loyalis. In line with our earlier guidance when we acquired Loyalis, it may seem reasonable to issue an amount in the range of between EUR15 million and EUR20 million for the second half of this year.

So, I now would like to hand over to Chris for further details on our capital and solvency.

Chris Figee {BIO 18815839 <GO>}

Jos, thank you very much. Ladies and gentlemen, I will go through the capital solvency position of ASR. I think (inaudible) IR team and the entire communication department to be brief. So, I will try to restrict myself to maximum two minutes per slide. Stock first, then flow, and finally sensitivities and some headroom.

Turning to Page 11, our balance sheet. You can see the Solvency II ratio of the group of 191%, a robust and solid number. A couple of points to note. This number did absorb the UFR decline from that 3 points. It didn't absorb the VA decline in last half year, which cost about 15 to 16 points, that's all absorbed in the 191% which is also showed on the right hand side. If you exclude the impact of the UFR reduction, which is in euro terms about EUR91 million own funds, the lower VA, which could be over EUR500 million of our funds, but also adjust for the fact that we acquired another EUR176 million of own funds to Loyalis. ASR on a gross basis pre all of that added about EUR550 million of capital in the first half year. I don't want you to double that for the full year, but it is testament to you, a clear bid to generate organically capital in our Group. Part of it is captured in the OCC, part of it is captured in the bucket, other. So by generating stand-alone over EUR500 million, we're able to absorb the UFR decline, the VA decline when we acquired Loyalis. So again evidence of solid capital generation ability which is also confirmed by development of our book equity, it is in Appendix E. Our IFRS book equity grew by another EUR300 million in the first half year and over EUR500 million in the last two years. Again, numbers pointing into the same direction.

This chart also show to the development of our required capital, more details in the Appendix F. I'd just like you to know that we did a conscious allocations of capital to the acquisition of Loyalis. We made an allocation of capital to real estate. We made an allocation of capital to the rest of our non-life business and reduced capital in interest rate risk. We reduced capital allocated the concentration and counter-party detailed risk and we absorbed who have to deal with increases in longevity charges, simply because of the rate decline and we absorbed higher valuations of equity which lead to higher capital charges on equity. Active capital allocation decisions were about real estate, were about Loyalis acquisition and were about growing in non-life, disability and P&C.

Turning to Page 12. It shows the flow of our solvency. Again OCC, EUR189 million. The chart shows from left to right we have the Tier 2 issuance in the Loyalis acquisition. Those of course extraneous factors. The second half of the chart shows that ASR have done itself. OCC up to EUR189 million, 5.1% of our required solvency. What I would like to note to point out is that the increase in our business capital generation compared to the restated numbers last year, up EUR33 million, which is the number I am pretty proud of. This is the capital generated by running the business, its underwriting results investment results, fee income and lesser cost. Business capital, up EUR53 million. Actually that more than offset the increase in the UFR unwind. UFR unwind H1 to H1, so first half this year to first half last year was up EUR13 million. So we were able in this half year to overcompensate or counter the UFR unwind with bigger business results, actually better underwriting results.

Release of capital, down a tiny bit, some part of the interest rate development, but mostly development of our new business. We wrote new business which affected the release of risk margin as we're building up new risk margin we're building up new business strength, which is an evidence of or the consequence of the amount of business growth in disability and non-life business. So OCC up from last year, about EUR179 million to EUR189 million. Business capital up significantly EUR53 million, absorbing increase in UFR and also you can see the impact of our new business growth and a net release of capital.

I would also like to point to Appendix G which shows you our OCC and our long-term investment assumptions that preempt the question that no doubt, someone is willing to ask, we are developing or defining our OCC business growth with specific long-term investment margins. If you look at where the actual rates are today, you can see that our long-term investment margins slightly overstates the contribution from government bonds, core and non-core that understate the contribution of credit and mortgages and they understates actually or make excessively conservative when it comes to the accrual of liabilities we're using at VA of 20. If we were to harmonize the entire fixed income component of the OCC to the actual market rates we have observed to-date, we lose a bit gov lease, we win the chunk of credit and mortgages and win on the VA. That will increase our OCC by about EUR20 million. Then also our real estate and equity assumption are also based on a spread over swap.

At this point of time for example, real estate we're issuing 300 basis points of the swap, the direct rental income of our real estate business is already more than that. So leaving aside any capital gains, that's a very conservative assumption. If we were to move, say for example to 5% absolute return on equities and real estate we'd add another EUR30 million of OCC, which is somewhat something that I think the industry does. So on a more harmonized of market consistent OCC definition, our number would be around EUR50 million higher in the first half year. Details are presented in Appendix G for your pre-appraisals. So that leaves me on cap gen, solid cap generation on conservative assumptions driven by what our business does and our business underwriting results have overcome the compensated increase -- UFR decline. So actually quite pleased with that development.

Page 13 shows the sensitivity of our Solvency II ratio to UFR. By now, a famous number, we think that the most appropriate way to look through the UFR and we are aware of the UFR criticism in the market and all those questions about what the right number is or could be or might have been or should have been, we think that the right UFR is actually something very limited or linked to your actual investment returns. We did between 2.2%, 2.4% every year we'll revisit that number. This year we picked up 2.4%, which is the cash income, the actual direct turn on our portfolio that gives a Solvency II ratio of 152%, actually quite stable for the last year again also absorbing the VA decline in that. And you can see the development within stock and flow if you change the UFR assumption increasingly clear that UFR is a flow element, not so much a stock element as long as your starting solvency is sufficient. So again economic UFR solvency of 152%, well above any norm that you might have.

Moving on Page 14, pay that you will shift as you will know, with clarity, the spread sensitivity is excluding any corresponding VA. It's a (inaudible) movement for the actual result there will be a compensating VA movement on the side, but that's the determinant on how, what it looks like, but you can see our sensitivities. Key message is that with reasonable sensitivities, the 191 chooses to be safely above and inside the independent real range of 160%. One other note I'd like to make, on the interest rate sensitivity, you can see if interest rates go up, actually it goes up by 7%, if they go down, they go up by 1% which is a correlation effect. We have really tightened our interest rate hedge in the last six months. Our capital allocated to rate risk is the lowest ever we extended our hedge up to the pointed rates decline from here, actually the dominant rate risk becomes rate up. Today we're way down, then it becomes rate up and modeling-wise secondly that changes the correlation that we apply which gives a Solvency uplift. We can question the economics viability of that, but modeling-wise, I mean if rates declines significantly from here, rate up becomes dominant, which gives us a temporary solvency uplift. I just want to be clear on that.

And then our balance sheet on Page 15. It's a strong balance sheet with ample flexibility. I think that's another statement. Market risk, financial risk are both low. Financial leverage today is 30.4% on an IFRS basis. Hybrids is a function of our own funds around 24%. Please note this is based on our own IFRS accounts. If you were to adjust for share of accounting and the capital gains reserve, which is more in line with what the industry does, this ratio would drop to around 24%, which gives us able to be low leverage versus the rest of the industry and a very strong interest cover about 15 times. Actually, it makes you wonder whether if we were to call the existing, the older Tier 1 instruments that are up for call, if you were to call those and our leverage ratio would fall to 28% with our Group would not be a bit under-levered in today's very low rate environment, something we're chewing on whether an opportunity to optimize our balance sheet post that potential call. Again, the potential call notifications will come at the relevant formal notification text.

When it comes to market risk. Market risk is about 43% of our total risk, which is something we're very comfortable with. As you can see too risky asset as a function of unrestricted Tier 1, our risky asset ratio, it went up 106 to 111 and release of valuation thing. We added about EUR116 million of normal exposure to real estate. That was an active decision. The other component is valuation. The valuation of our equity portfolio went up. The valuation of our spread portfolio went up, that caused the risk asset ratio to increase. Just when you look at the active decision, so the EUR116 million of real estate would have kept the risk asset ratio stable at EUR106 million. So we feel very comfortable with the amount of risk assets we have on our balance sheet, certainly in combination with the amount of the low leverage that we have.

And before I get back to Jos, our cash position. Holding cash at the end of the period EUR354 million, up from last year. Last year at this point in time was EUR229 million, EUR354 million of cash, a complete unused RCF so, our credit facility is undrawn. There is an undrawn EUR350 million credit facility at the group. We upstream cash from our life business and not more simply because there was no need to. There were no impediments, because there was no need to upstream and we're very comfortable with EUR350 million of holding cash and unused cash facilities. So holdco solvency life at 187%, no-life at 191%. The non-life solvency ratio is slightly overstated due to the acquisition of Loyalis. At this point, the Loyalis legal entities have not been integrated that is scheduled for second half of this year, which means in non-life Loyalis P&C is a strategic participation of ASR in non-life which artificially lifts solvency ratio of ASR non-life -- on the group life it consolidates -- solvency number of a group life is unaffected, but for a specific ASR Life entity, the 191% to be able to say that the underlying number is 174%.

Same accounts for double leverage. Post the integration and consolidation of the Loyalis legal entities, a better leverage will move to close to a 100% and as all scheduled and planned for actually end of October. And our debt maturity profile as you can see very robust. Weighted average life of 7.5 years in the next maturity date 2024 and again we've ample financial flexibility and room to add leverage to our balance sheet if we wanted to do.

Closing out, I think I did well spending no more than two minutes per slide. Comfortable with Jos, plenty of time for you to give a summary.

Jos Baeten {BIO 2036695 <GO>}

Thank you, Chris. I think on average you're right and you just bested the new world records in providing in some detailed information in such a short period of time.

So ladies and gentlemen to wrap-up this call, I would like to conclude that we are very pleased with the operational performance and the financial results the business has delivered as you can imagine. The record operating result and the growth of our business both organically as well as through acquisitions reflects our discipline of our value of volume at all times. Our balance sheet is strong with ample financial flexibility, allowing us to remain as Chris already said -- to remain entrepreneurial and pursue profitable growth. I've already provided some pointers for the second half of this year. And to conclude, I should mention that we will have a review of our capital management policy including capital return in the second half of this year. One of the reasons for us to review our policy is the notion that the current policies may be somewhat rigid, specifically with respect to capital return, which demands our Solvency II to ratio to be at least to 200%. We may consider to move to a policy that offers us more flexibility with respect to decisions in capital return. We will update you on that with the full-year results.

So having said that, I would like to hand over to you and the floor is open for questions.

Questions And Answers

Operator

(Operator Instructions) Our first question comes from Cor Kluis from ABN AMRO. Please go ahead, your line is open.

Q - Cor Kluis {BIO 3515446 <GO>}

Yes. Good morning. Cor Kluis, ABN AMRO. I got a couple of questions. First of all, on the non-life premiums. You had in P&C 2% growth and disability 9% growth. What was that non-life premium growth excluding acquisitions for both P&C as well as disability? This is my first question. Second question is about Tier 1. You currently have a well below usage of your Tier 1 capacity versus peers. If you would issue some, your solvency would easily be 10 percentage points, 15 percentage points higher given the current low interest rates and credit spreads. Are you considering to issue Tier 1 hybrid in the near term or could you comment on that way of thinking?

And my third question is about operating expenses in the holding, I think it was EUR32 million including EUR21 million incidentals. Last year I think it was EUR13 million incidentals. Could you give some kind of long-term guidance what the holding operating expenses might be? There always be some incidentals like IFRS 17 or what will come up later but at least I think this quarter was a little bit high on the operating expenses due to a few one-off like integration expenses et cetera. But could you give some indication in that respect? And last question is more generally about M&A. The M&A pace continues, VvAA and recently the national railway distributed the insurance company. What's your view about M&A in the future because this year you've done quite a few deals and could you comment on that and in respect to the capital return story as well? Those are my questions.

A - Jos Baeten {BIO 2036695 <GO>}

Thank you, Cor. I will take your last question and your first question and Chris will take question two and three. On the developments -- the premium developments in non-life excluding M&A. If you take out Loyalis, which I think I mentioned the EUR18 [ph] million of premium of Loyalis, then the organic growth of the non-life business excluding Health will be 3.3%. Of that growth, 1.6% comes from P&C and that number is somewhat deflated because at the same time we have sanitized the portfolio of Generali assets and that also did cost some topline and it's even more than EUR20 million because some of the risks in that portfolio were not very much liked by us. If you take a look at the disability, excluding Loyalis, the growth was 5.8%, up from 5.45% last year to 5.77% this year. So in total 3.3%, 1.6% from that is in P&C, 5.8% is in disability excluding M&A.

Then on your last question on M&A, we are happy with the deals we've done. As you know, we missed on VvAA so the team had some time and we asked them to look into Greenland, but in the meantime it has become clear that it's not for sale anymore. So, we are now preparing the next pipeline because we first want to take some time to integrate all the smaller business we've acquired. They are maybe small in the thinking or some of you, but the work to integrate them also reporting-wise will require some time and in the meantime we will prepare for the next year potential deals that we think that could be done and we still think in the Dutch market as well as in the individual life space and funeral as maybe in other spaces like distribution. We expect that we looking forward can do some interesting transactions for ASR. They may not be as big as Loyalis or Generali, but we still see some potential.

Having said that, Chris, I would like to hand over to you for the second and third question of Cor.

A - Chris Figee {BIO 18815839 <GO>}

When it comes to our balance sheet, indeed -- but first of all, I think our balance sheet has got headroom in each and every category both in Tier 1 but also in Tier 2. So the Tier 2 headroom is about EUR462 million, which was -- for a small increase in SCR move towards EUR500 million, which is a benchmark Tier 2 bond that one could issue. First one. Secondly, if we were to call the existing two instruments of EUR200 million of grand part of the instruments, indeed we will be probably under using our Tier 1 space. We have in our Tier 1 instrument out there and we have probably an unlevered balance sheet. So, we -- we will be very opportunistic on that if we do something because we also need to have a proper application of the funds. We are not going to raise capital just for the fun of it, we need to see an application for that. But again it would do something in the current environment and I would probably go for Tier 1 rather than Tier 2 simply because rates are very low. There appears to be cash to be invested by both holders. We actually have some reverse inquiries by some of our bondholders where there would be room, where there would be an interest, basically something to help them invest their cash, put their capital to work, is always good to reflect on that.

So, there is no yes or there is no no. We're going to be opportunistic, even do something more likely to be in the Tier 1 space than Tier 2, but again we don't need a whole lot and we need application for the funds. Application could be found in smaller acquisitions. It could be found in allocating capital to mortgages. Mortgage spreads have widened considerably and today are very attractive to add new mortgages to the balance sheet. So, we're going to be very economic on that.

On your holding cost question, my guidance would be stable for the next couple of years, declining thereafter and the kind of the mostly should have caused IFRS 17. We're spending more money on IFRS 17. If you look at this half year, project costs were up a bit from IFRS 17. There were some integration costs from Generali, which will grow (inaudible). We spend money on the Vitality project adjustments. So what we're going to see going -- as M&A costs, so what do you see I guess going forward is continued spend on IFRS 17 until that's really due date is there. Some decline in M&A integration spend as the recent acquisitions were lighter and require less M&A costs. Some spend on Vitality and possibly if rates stay where they are, saw them increase in pension charges. So, my best guess is you stable from this level next two years and decline thereafter if IFRS 17 is behind us.

Q - Cor Kluis {BIO 3515446 <GO>}

Okay. That's very clear. Thank you very much.

Operator

Thank you. Our next question comes from Albert Ploegh from ING. Please go ahead, your line is open.

Q - Albert Ploegh {BIO 3151309 <GO>}

Yes, good morning. I'm Albert Ploegh from ING. A few questions from my end. Maybe first question a bit more strategic. You've clearly shown discipline when it came to the Vivat file in terms of pricing, but in a way the landscape has changed of course fundamentally given the PE interest shown. So, what have you learned from this process? What's the price you did most and could this also have some implications for your own strategy going forward? Yeah, are you for example, willing to explore options to unlock capital locked in your closed books in the Netherlands or you're actually like to do more of the opposite expanding that book? So somewhat color there would be helpful.

The second questions is on the organic capital creation. I mean the target 2021 is still EUR465 million? It seems that, clearly operationally, you're very well on track and if rates would not have moved, you very likely would have started to over-deliver potentially on the target. So do you still see let's say mitigation actions that you can still probably even in the current rate environment to get close to that target and maybe just a little bit closer to home for 2019. So if I remember correctly, you were guiding something like 415 OCC by the end of 2019 including something like EUR15 million or EUR20 million from Loyalis but it still means capital bridge from the 190 and where rates are. Yeah. How comfortable are you with that and can you still get somewhat close to let's say the EUR390 million EUR400 million left for the full year? And I'll leave it that for now. Thank you.

A - Jos Baeten {BIO 2036695 <GO>}

Thank you, Albert. On the first question on what have you learned from the Vivat trajectory. Well, one of the things we clearly learned is that looking at a life insurance company and spending -- investing in a different way seems to give a higher valuation in life portfolios. However, we as you may know are a really insurance company and we balance the liabilities we have with our investment portfolio. So from our point of view, our learning is there might be more space to be a bit more aggressive in terms of investing from your life books. But on the other hand, we are that insurance company and we want to live up to the obligations we have guaranteed to our policyholders. So we will always be careful with that. So I think that's one of the main learnings, which we'd be willing to divest our own life book. Well, one should never say no upfront to any idea and however you need to take into account our Individual life book as part of a larger like book, it contains pension DB, it contains pension DC, our funeral business it's all managed as one investment pool.

So splitting that up would be quite complicated and would you require some time. And another question is whether the valuation of a company like Vivat, which is the first sale of a PE company in the Netherlands, it could be equaled in the second transaction. I think there was also a strategic premium involved and we yet don't know how DNB is going to react to whether the price is the whole investment or given the low interest and other findings in the solvency of Vivat they maybe need to add additional capital and then the question is whether the valuation of the next transaction would be at the same level as the first one. Our current strategy and we will continue to do so is that we are a good or maybe the best owner of our own individual life book. We want to add volume to that as we have done with the life portfolio of Generali and Loyalis and up until now we think we are the best owner and at least in terms of running it at a very low cost level, we're able to deliver very good returns also for our shareholders. So from that perspective, you shouldn't expect a big change in our strategy concerning life.

And Chris on the EUR465 million, I think you --

A - Chris Figee {BIO 18815839 <GO>}

Let me add a few points on Vivat if I may. Two points I'd like to add stuff that we learned or we think we learned, I mean one is, I cannot rule out that there are difference in assumptions when people have solvency numbers and we don't do assumptions based capital so to speak, mean that might put up the numbers on the short-term, but someone somewhere will pay the bill for that. So we will not go into assumptions based capital creation, we want to have a very robust numbers. I think that's one. Secondly on the re-risking the balance sheet, yes, there may be some opportunities, but we're going to be careful. This is not the time to load up on non-investment grade stuff. So we think there is opportunities to optimize the investment grade side of our fixed income portfolio, so with relatively little capital spend optimize the return on investment on our investment portfolio. Maybe do a little bit more on mortgages, especially given where spreads are today, optimize the investment grade side actually as a matter of fact we reduced the non-investment grade exposure. We did have a US leveraged loan mandate that we canceled if you wanted to move away from non-investment grade securities, so all the investment grade space.

And finally, when it comes to unlocking capital, indeed we've seen a longevity swap being executed. We know there is talk about longevity swap, there is appetite in the reinsurance market to take on longevity risk. That's something we are actively contemplating, not subject to be executed this side of Christmas, it takes more time to be prepared it, but it's some of that, then I think that on the shelf and non-executed longevity option we have one little caveat. The impact of ASR could be positive with not be double-digit solvency release simply because their certification. We have a fair diversified book, so longevity risk diversifies away, so also the longevity swap benefit will diversify away and secondly, the impact of such a swap is bigger if you got more in payment annuities and relative to others we may have less in-payment annuity, so a longevity swap will have a positive benefit, but maybe not as large as some others have it and again it's something that we are constantly evaluating and there is appetite in the market, it's a nice add-on a nice option to have and we're also checking ourselves whether if you want to think about raising capital whether the cost of the Tier 1 it is pointed more attractive than a cost of a reinsurance deal and that's how we think about.

So what's the economic cost of attracting capital? My hypothesis that in the market today if you see our rates are today that in our Tier 1 is a cheaper form of capital for us in longevity trade although longevity swap of course, I mean you want to add on you set. When it comes to the OCC indeed we've targeted EUR465 million in a couple of years' time. Of all the components stuff that's in our control, namely what the business generates is actually doing better than flat is doing very well. Also the early contribution from Loyalis are in line with and promising to be slightly better than planned, so anything in our control will be better. Of course the one thing that's out of our control is where the UFR drag will be. I don't know. We'll see when we get there. Who knows our rates will be in that very year. So I think on the components stuff that we are managing and is under our control are better than what we plan and the final hurdle would depend on what our records and we are very clear and transparent on that.

As far as the second half of this year, you mentioned the number, it's going to be hard work, I mean Loyalis will feed into the numbers that's good, which mean we have a full six month of Loyalis results, but again the UFR drag will be higher. Again for the second half of the year I see strong progress in business cap generation, strong progress in underwriting results. I see delivering as planned on SCR release, potentially countered by the fact that we are writing new business and new business trend is a bit higher. But with combines that we have I'm actually okay with that. I'd like to have new business with your combined ratio low 90s and then what do you have unwind ends-up, we see how we develop in the second half of the year.

Q - Albert Ploegh {BIO 3151309 <GO>}

Okay. Thank you for these detailed answers.

Operator

Thank you. Our next question comes from Farooq Hanif from Credit Suisse. Please go ahead, your line is open.

Q - Farooq Hanif {BIO 4780978 <GO>}

Hi, everybody. Good morning. Happy Friday. Just quickly on the underwriting in Non-Life. I noticed that as much as you see a decline in loss ratio, you're seeing quite a big decline in commission ratios, particularly when you look at commission ratio in the disability segment is a big drop. Can you just explain what's going on there? Secondly, going to your consideration of lowering the barrier for capital return. What has changed? So when you set the 200% versus your 150% target, what were you thinking and what could change qualitatively? So what are the drivers that you're looking at to make a decision on that? And lastly, could you remind us again where you are beating on the Generali Nederland portfolio? So you mentioned the higher profit versus target. So where does that beat coming from and what could that imply for the other transactions that you've done recently? Thank you.

A - Jos Baeten {BIO 2036695 <GO>}

Farooq, thank you. On the commission ratios, a few comments and especially in the Disability space. If you may recall, I mentioned that our distribution entity that we were 1 million lower there and that was due to the commission ratios that were down in the disability area. The flip side of that is that we do all of our brokers we deal with have to pay less commission because the average commission ratio went down over this year. That's one effect. The second effect is that we a number of years ago decided as an industry not to pay any commissions anymore of individual disability. The existing portfolio was left out from that decision. So people that already had a contract with us there, we still pay commission, but new business, it's not anymore down with commission. So over-time, you will see that the commission ratio in disability will be lower than it used to be over the last few years. And then finally, the last thing, but that's more technically we mentioned in the press release the EUR8 million of reinsurance in the Disability area, which was an additional profit and that affected also as a one-off the ratio, because it was a plus for us, but it was in our book keeping, it is because it was commissioned that we got from the reinsurance company, so that's a negative on the commission base.

Q - Farooq Hanif {BIO 4780978 <GO>}

So just to -- yeah, sorry.

A - Jos Baeten {BIO 2036695 <GO>}

Go ahead.

A - Chris Figee {BIO 18815839 <GO>}

Go ahead.

Q - Farooq Hanif {BIO 4780978 <GO>}

I was just going to say -- just to clarify what you just said. So although there might have been a one-off element that sounds small, so generally speaking, commission ratio should be lower might even get a bit lower going forward?

A - Jos Baeten {BIO 2036695 <GO>}

Yeah. In the long-term, commission ratio especially in disability will be lower because in individual disability we're not allowed to pay anymore commissions in for the new business.

A - Chris Figee {BIO 18815839 <GO>}

Farooq, on your second question on the capital framework. What were you thinking? What were we thinking at the time, which was around when the UFR was higher and the VA was higher at this point in time. So we are cognizant of the fact that since then the UFR has declined and also the VA has declined, also VA is volatile, but the UFR decline is structural. So if you don't act, there will be a bar creep, so to speak. 200% a year ago is actually less than 200% today and we are not capital holders, we want to be disciplined in our allocation of capital as you can see in our M&A decisions and our capital allocation is different. So we think it's fair to assume that the entire framework has probably shifted down somewhat with the lower UFR, although tactically speaking need to weigh where the current market and circumstances are and that's why we said, we already view the entire framework with the notion of what is an appropriate level given the assumptions and how they've changed over-time. And then we don't intend to sit on our capital and stare at it. We want to make it work and we think there is other applications. We definitely are happy to give it back to our shareholders, part of it. So with that in mind, we'll review the framework.

When it comes to where it will beat Generali. On many parts, I think most prominently on the cost side, I mean business is integrated. It's hard not to single out the total cost assumptions, but I think the FTE decline that we achieved was much, much bigger than initially planned. So on the cost side is the first thing that brings amount. Secondly, I think, the speed of integration on some of the operating business disability and life, the speed of integration is faster. I think we beat on the re-risking that delivered more than we anticipated even if it wasn't in the initial case. That was even more than we did not include. So the re-risking this was faster and on P&C, more volumes. It came in with more volumes in terms of claims where we work, on claims level itself, it's kind of what we assumed, but the volumes were higher. And I think we're now working on sanitizing the portfolio and improving the combined. That's why you saw some lower growth in the P&C business because we absorbed the loss of volumes and happily non-regretted loss of volume. So a bit of cost, a bit of speed, a bit of re-risking and a bit of P&C volumes and means of speak on claims ratio.

Q - Farooq Hanif {BIO 4780978 <GO>}

Okay, that's really good. Thank you very much.

Operator

Thank you. Our next question comes from Robin van den Broek from Mediobanca. Please go ahead, your line is open.

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

Yes, sir. Good morning, everybody. Thank you for taking my question. The first one is more follow-up to Albert's question. I think your H1 reporting indicates that you're year-on-year increasing UFR drag annualizes around EUR25 million, but that's still based on the average interest rate if the swap curve average in H1. So I'm just wondering if you could give some sense to how that would look on the back of the final H1 curve for H2. And if you could also maybe for a more actual rate curve.

Secondly, I think there also an effect towards your OCC from the flattening of the curve. I think your real estate and equity assumptions are based on the 10-year curve point which you need to re-base too early on the curve. So the fact that there is massive flattening there, will probably also take out some of your OCC generation. Can you specify those amounts as well. And I was wondering to what extent the EUR50 million you've given for H1 is a more market observable approach. What kind of further offset do you expect in H2 given that mortgage margins probably are better than the average in H1. So presumably that EUR50 million in H2 is going to counterbalance a part of the headwinds that we just discussed.

Then secondly on mortgages, the fact that you use your 110 bips long-term investment margin and you're correct for that in your market observable OCC. I was just wondering for your Solvency II ratio determination, I presume you use the same spread there. So I was just wondering if you would use a more observable spread in the market, what would the impact your Solvency II ratio be.

Question on OCC. You mentioned you're looking at the capital return framework. But shouldn't you also look at, yeah, basically redefining your OCC given the market headwinds you're facing on the flattening of the curve. For example, I think is a very counter-intuitive move that's happening. Are you willing to look at that as well in that capital framework update you're contemplating because in the past I think after the IPO, you did make statements that your capital return is somewhat limited to the OCC you generate. Yeah. Now these headwinds might give you a limitation, just your thoughts there would be helpful.

And lastly, I mean I don't cover real estate sector in Netherlands, but I did see some press articles suggesting that prime real estate in the Netherlands has seen write-downs in H1 and that there were some fears that there might be more to come later in the year. I appreciate you've always said you're focused on location. So I think you have some primarily setting your books. Any worries there or still all very solid and comfortable? Thank you.

A - Chris Figee {BIO 18815839 <GO>}

Robin, thank you. I don't know that was question or advice, I'll take it as the later. On the UFR track, it was about EUR25 million on an annual basis, but what UFR drag will be for second half year, it depends on the rating. We need to look at where rates will be at the end of the year. Clearly the UFR has managed to go up. That's probably to what the number is. Bear with me, I'm not going to give any guidance, because it depends on the rate, I mean rates already have been bouncing back. Who knows what the Fed will discuss later. Yes, the tendency to go up, but bear with me what the actual numbers will be.

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

Chris, maybe just quickly. You said it depends on where rates are at the end of the year. I understand from your peers most of them basically will base the Q4 capital generation on the interest curve for Q3, but you have more an average approach of H1 and year-end to determine the UFR drag. Is that what I should understand from your answer here?

A - Chris Figee {BIO 18815839 <GO>}

That's correct. We take the full 12 months of the year as we average on the entire year. So we take Q4 into account in the averaging of the year. Indeed, correct.

When it comes to OCC, you're right, I mean OCC of course is a, it's a constant guide. It's a way to break down the breach insolvency between different buckets. And as always a bucket other, anything it's not captured in the OCC is reflected in other. So actual returns of your investment that are not in the OCC bucket are in bucket other. As I said, the EUR550 million if you take the minus 92 UFR decline plus the VA plus Loyalis is somewhere we created EUR500 million of additional capital. That is partially excess returns above and beyond what's in the OCC. So it means the flattening of the curve that we likely described will put some pressure on the OCC but does not put pressure on the actual generation of capital and we show in another in the bridge, that's why of course a part -- 5% is probably hindsight a better representation of our capital generation than the spread method that we use. So will we reflect on that? Yes, we will. And something in life, the review of our capital management framework deliver the OCC properly reflects the actual capital generation ability to structure giving is our point of some reflection and because we are of course experiencing the same thing to do as you described. So any offsets will be of course in the bucket other with just excess returns over and beyond the ELTIS.

So when it comes to mortgage and evaluation of our Solvency II, we use the actual mortgage spreads. So the ELTIS has a fixed yield, but the solvency number that we produce has the actual spreads as they were at the end of June. So of course as always if we look at other, that balance is out there. The solvency based on the actual spread, not the ELTIS. Spreads are high, so there was a relatively --mortgages on a valuation side under-performed our liabilities in the first half simply because mortgage spreads widened. At this point, mortgages are very attractive. I think our colleagues and other insurance companies also comment on that and you can see mortgages government guaranteed is running from 30s in a 10-year segment, non-government guarantee goes to 160, 170 basis points already, so allocating new capital mortgage is very, very interesting, but that number is reflected in our solvency level.

When it comes to real estate, there was an article on potential markdowns in the retail space in the Netherlands, which was re-driven, it might be one specific real estate asset manager we just had a management change. We have got Frank, there real estate will see portfolio is not comparable to ours, it's much less core in terms of high street quality shopping in the core cities in hours. In our real estate portfolio we see rents well protected, vacancies actually falling, still lots of interest. I mean if you look at what we signed up on new leases in our real estate portfolio in retail, some very household names. And for example, the bankruptcy of Intertoys, all those parts were filled very shortly with other stores one thing to take that prime retail space. Actually, cynically speaking, some bankruptcies are actually welcomed by our real estate people because that gives an opportunity to refresh tenants and actually reset rental rate. So when it comes our real estate portfolio I don't share that concern. I think the one thing I would say is the level of capital appreciation may be less in the past, but the rental income was good and I don't see any immediate downside risk on that space.

So in summary, you have (inaudible), bear with us. We advertised in the year, we'll see where rates are. The ones, the things we can control are all moving in the right direction and in the first half of the year the underwriting results more than compensated the UFR decline. Will that continue to happen? That depends on where rates end-up. On OCC, fair point, the offset will flow in the bucket other. We just does not mean that our total cash generation goes down, but that segment in the OCC will go down and indeed a review of the OCC over definition is a rightful question and it really based on our mind in the next that few months.

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

And then maybe one last remark. I mean I got what you're saying on OCC and the market bucket. But I think for some, the perception will still be that one element is sustainable and the other one is more one-off and I got that your market bucket will be positively filled by this structurally, but I think it makes more sense I think to adjust your reporting to what structural and what's not.

A - Chris Figee {BIO 18815839 <GO>}

Okay. A very few people pay a multiple for other, right. But if you look at our -- the bucket of others has been structurally positive in the last years.

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

Thank you for your answers. Cheers.

Operator

Thank you. Our next question comes from Farquhar Murray from Autonomous. Please go ahead, your line is open.

Q - Farquhar Murray {BIO 15345435 <GO>}

Good morning, gentlemen. I have three questions if I may. Firstly on the acquisition of Veherex, could you just work through the rationale for integrating into Loyalis and perhaps outline the nature of the synergies you are hoping to achieve from that?

And secondly, are you seeing any consequences from the recent consolidation in the market in terms of ability to pick-up business and more generally how competition is behaving. On the call, you seemed a little bit more optimistic on the sustainability of pricing in non-life. I just wondered what might have changed there? And then finally in the interim report, there is a reference to limiting the impact of the mezz labs hedge. Could you just outline the rationale around that and perhaps whether it had any material impact at all? Thanks.

A - Jos Baeten {BIO 2036695 <GO>}

Okay. The first two questions will be answered by myself and Chris will take the third from Farquhar. Thanks for asking. Well, the strategic rationale for Veherex is it is semi-public organization, it's the National Railways and some affiliated companies. And with Loyalis, we also acquired a former Pension Fund owned disability business, also existing out of lots of semi-public organizations like municipalities, hospitals, et cetera. So the nature of dealing with those kinds of customers is one of the core qualities of Loyalis and that's why we've decided, well, it's better to implement this business within the Loyalis business, which is today 100% owned by us. In terms of our synergies as you may have noticed, it is in terms of premium, not a very large acquisition. So the number of people involved on that is not that big. It will be a number close to 1 million or something like that, but it will not be very significantly.

On your second question, what is the effect of the recent M&A activities in the Dutch market in terms of portfolio shifting. What we always see, but we did see when and NN acquired Delta Lloyd that some distribution partners decided, some brokers decided to move the portfolio partially to other insurance companies. We expect that the recent M&A activity -- that the same will happen. So we expected a part of our future growth will come from brokers that decides that too many eggs in the same basket is not good for their independent positioning and that we will be able to face further growth, especially in the disability and in the non-life area. So consolidation from a hardening of the market of the premiums in the market standpoint is good, but also from -- our distribution partners are not happy with the consolidation, but actually to be honest, we are happy with what is happening because it will give us the opportunity to increase our position in the distribution area.

And third question Chris, it's for you.

A - Chris Figee {BIO 18815839 <GO>}

Farquhar, we have a Mass Lapse reinsurance contract based on the recent specifications by IFoA, the impact of those contracts should be limited. They will be fading out. In agreement with the regulator we've agreed a fade out scheme. So the benefit of that has reduced significantly that has saved actually 1% of solvency in the first half of the year simply because we are lower -- if we take a haircut on the potential contribution, we think the Mass Lapse will be fading out by the end of the year, but it did cost us one point of solvency in the first six months.

Q - Farquhar Murray {BIO 15345435 <GO>}

Okay. And then just a quick follow-up, I mean you obviously want your Dutch peers kind of discuss the change in the liquid asset treatment with the Solvency II ratio. Have you heard anything similar to that?

A - Chris Figee {BIO 18815839 <GO>}

No, because our portfolio -- the liquid assets are very small. So most of our liquid assets are mortgages, which is -- the treatment of that in a standard formula is pretty clear. There may be some enlightenment or lightning of charges in the next IFoA review comes through, but nobody knows where it stands. But I mean you've all seen the IFoA documents on this and for the more liquid fixed income portfolio is relatively small. So we haven't had any major issues on that.

Q - Farquhar Murray {BIO 15345435 <GO>}

Okay, perfect. Thanks so much.

Operator

Thank you. Our next question comes from Fulin Liang from Morgan Stanley. Please go ahead, your line is open.

Q - Fulin Liang {BIO 21126177 <GO>}

Okay, thank you. I have three questions please. So the first one. So you plan to review your capital policy in the second half of this year. Does that include whether you want to continue on the standard formula or wanted to move to internal model because just in regards to that we'll actually for example using standard formula give you some kind of disadvantage in bidding for large-scale dues? So that's my first question. And then the second one is, looking at your asset mix on your slides on there is Appendix H, looks like that your mortgage actually percentage actually declined from full year 2018 and just wonder whether the plan is actually increase your mortgage exposure in the following couple of months because thinking that the yield is coming down and but thinking probably you would have some pressure from the investment return, we're actually moving to mortgage it helps on that pressure? And then the last question is, I noticed that you have in the first half of the year, you haven't really have the -- despite the very good operating results for Non-Life if you haven't actual upstream any pretty much, very few cash from the Non-Life business. Why is that? Thank you.

A - Jos Baeten {BIO 2036695 <GO>}

Thank you, Fulin for the question. I'll go into the second and third question. On your question whether our capital policy remark we've made is related to a decision of moving to a partial internal model. The shortest answer is no, there is no relation between those two. However having said that, we as stated earlier, we are thinking about what it would mean to move towards and internal or partial internal model. We haven't taken any decisions on that yet because we first want to finalize the IFRS 17 trajectory and that requires the knowledge and the time of the same type of people that need to look into a potential move towards an internal model, so our capital policy decision will be independent from that. However, management always needs to take into the back of their mind everything that it is preparing for the future. So decision-wise it's independent, but we of course will also remind our future steps when we take any decisions.

A - Chris Figee {BIO 18815839 <GO>}

Well, it's Chris. When it comes to mortgages, if you look at Page 8, the actual amount of mortgages went up EUR6.7 billion to EUR6.8 billion. So it was a small increase in mortgage exposure for the group. I mean the bank has been more or less de-consolidated. So the bank has obviously taken out some mortgage, but the life insurance business has actually increased mortgage exposure. We wanted to do more. Our mortgage production is up significantly. Gross production is up 10%, net production is up 25%, but also our clients are looking for mortgages, so the back of a mortgage is going on between kind of life in our clients deal one mortgage. So we are looking for ways to accelerate the production allocation of mortgages, so it went up and we are looking for ways to allocate more to that and it speed up the access to mortgages, especially at current valuations and current spreads.

When it comes to cash in non-life. Why didn't we used any cash? Because simply we didn't need to, I mean our policy really is to have the cash in the operating entities, not in the Holdco because we are one legal entity with one regulator with the same statutory directors at Group at business. So as we know we didn't need to have lots of holding cash. Our holding cash policy is a function of dividends that we plan to pay and holding costs. So we consciously decided to keep the cash in the business and we obviously when we need to. There is no limit or no impediment to upstreaming our holding cash. We could have some cash from the non-life if want to do, but at this point, there is no immediate need and whilst the operating entities are all using solid ROEs, I mean the ROI, the ROE of the life and non-life business are both growing 13% plus. We were very comfortable keeping the capital and the cash in the operating entities and when we need the money, we upstream it.

Q - Fulin Liang {BIO 21126177 <GO>}

Okay, thank you. Just to follow up on the standard formula question. I was wondering whether if you're doing, trying to do a large scale in the future, actually you using standard formula, well, your competitors are using in general more to actually put into a disadvantage.

A - Jos Baeten {BIO 2036695 <GO>}

We are fully aware of that potential disadvantage and one of the reason we are looking into new considerations whether we should move towards an internal model or not and is related to the role we had in the IFoA process then and we said, well, we at least need to look at it but it will take some time before you could move towards an internal model and as said, the decision is not taken yet and we are fully aware of the disadvantage we might have in certain potential future transactions, if there would be any bigger ones.

Q - Fulin Liang {BIO 21126177 <GO>}

Okay, thank you. Thank you very much.

Operator

Thank you. Our next question comes from Benoit Petrarque from Kepler. Please go ahead. Your line is open.

Q - Benoit Petrarque {BIO 15997668 <GO>}

Yes, good morning gentlemen. Thanks for taking my questions. So the first one is on the market and other impacts. So you have 19 bips as percentage points or negative from VA and UFR. Overall market now is over minus 15, probably have the negatives from rates and mortgage spreads as well. So could you talk a little bit more about let's say the positive effects, what have been the positives I guess other performance has played positively, but just wanted to get a bit of granularity on that. Second one is on the regulation. So just wondering if you could disclose the impact from moving the liquid loan [ph] on UFR to 30 years, what it will for the Solvency II ratio.

And also linked to that, why are you reviewing the capital in H2 framework, I mean with this is pool of regulatory uncertainty still for life insurance, so I was wondering what is the purpose of that. And the other one is on the business capital generation of EUR163 million. I was wondering if you included the EUR8 million positive non-recurring on the commission on reinsurance in that figure? And then last point is on the 5% returns on real estate on the assumptions. I understood that your rural portfolio is yielding 2.2% renting yield. So I was wondering why will just if I move to the 5% yield? Thank you.

A - Jos Baeten {BIO 2036695 <GO>}

Yeah. Benoit, on the what happens in our solvency, there is a significant revaluations on some of the real estate portfolio, especially in housing and to a lesser extent in and housing and to lesser extent in housing and land has been revalued. We do revaluation. We revalue our portfolio every quarter, actually every object is officially tax valued by independent valuator, basically once a year thus face the other three quarters, so we revaluation real estate, revaluation equities. We have some own implied haircuts on some of our facility. We had some prudence and conservativeness in there and it was one portfolio especially in the defined contribution business that was based on the assumption that our clients, I mean the solvency valuation based on some of our clients will actually leave after one year because it's a one-year contract and we know for a fact that the retention ratios will be 99.7%. So there was excess prudence when it comes to the modeling of our defined contribution portfolio. Those are the main components above and beyond what you mentioned valuation of real estate, housing and land to a lesser extent stocks, valuation of equity markets, some prudency in some elements in our modeling and especially around the retention rates and lifetime of our DC clients.

When it comes to the last liquid point, fascinating discussion. I think it's a very partial discussion. I think you can only discuss it when you see it in a integral framework with many other moving parts. If you were to move the last liquid point, I think you also can discuss about the cost of capital in the risk market. Let's talk about the UFR as a whole. You can talk about whether the Mass Lapse assumption is the right one. So I think it's a bit dangerous you talk just about the last liquid point. If you do, it would be a stock process sloping probably, your stock would go down, flow would go up significantly. I'd rather address it when I see the whole package going, going forward.

The question is the reinsurance benefit into the business capital. Yes, the GBP8 million is in there although also some other elements reserving elements are also in there. If you look at the non-life results, yes there was a reinsurance benefit of about GBP8 million. But as you can see in the document, there was also a notation to reserves, alignment of IFRS and Solvency II reserves and there was some notation to third-party liability, that's also in there. So I would think that net-net, the non-life results, the number that we produce is roughly what it is and releases and notations cancel out to be very, very, very specific.

When it comes to yield on land. Indeed the land portfolio is around 2.2%, but for example in our resident and housing portfolio to direct income of about, so retail is close to 5%. Houses are over 3%, offices are well over 6% and we've just launched the product about that is on science park yields and the science park going to use are over 7%. So yes land is a bit lower but especially with retail and offices are much higher than that to get it right, the total direct income from the real estate business north of the 3% than we're seeing today are very close to the 5% of the return.

Q - Benoit Petrarque {BIO 15997668 <GO>}

Thank you very much.

Operator

Thank you. Our next question comes from Matthias De Wit from Kempen. Please go ahead, your line is open.

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

Hi, good morning. I got two questions remaining please. The first one is on the guidance for the operating result in the second half. If I understood you correctly, you expected so much slower progression compared to the one seen in during the first half of the year on a constant scope basis. So did I understand that correctly and is there anything explaining or is there any driver or any reason to expect a slowdown in the earnings momentum? And then secondly on capital, what was the reason defer the update to the full year results. So are you waiting more clarity on the Solvency II review and do you want higher rates before you're willing to launch a buyback and just linked to that, can you confirm that the ex-UFR Solvency II ratio is still above 100% or is it below at this point in time. Thank you.

A - Chris Figee {BIO 18815839 <GO>}

Matthias, on the operating result, as Jos said, if you take the second half of last year, it had some additional results from the two dots, because our ASR standalone is actually outperforming ASR standalone last year and as Loyalis we're a bit reticent on the number. I don't think will add another EUR16 million, EUR17 million on the second half last year simply because Q4 last year was very good. But we think overall it's safe to add on average a markup for the result last year, may not the same, simply because Q4 was a good result last year. When it comes to the capital policy review, we want to do with borrowing. Look, lot of our smart people had spend lots of time working at VvAA in the first half of the year and want to make a forward and well informed decision, don't be too hastily about it. And then there is a more information is always helpful but I doubt whether by the end of this year we'll have all the clarity on IFoA that we want. I don't think you ever have full clarity IFoA, this is a progressing framework. So that is not the issue is more like we want to spend our time all through and make sure that people are working on those are fully available for and we did spent quite some time on M&A in the first half.

And your third question was also the ex-UFR again. I think it's a partial analysis. Our solvency view is very solid. There is no point in giving you a number because it's a partial analysis if you want to give me a solvency numbers ex-UFR that will assume that will also make no investment result whatsoever is probably effected this also stripe out the market risk component which can boost solvency again and you get it fully de-risk solvency number. Actually I think the relevant benchmark for Solvency ex-UFR can be quite frank is rather zero than 100, I mean do you have any owned funds left if you had no UFR because 100% is a arbitrary mark if you then still keep full allocated to market risk and it's way, way above zero. The exact number I don't care. I don't look at it. I look at the UFR 2.4 because that would be actually zero.

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

Okay. Thank you, Chris.

Operator

Thank you. Our next question comes from Steven Haywood from HSBC. Please go ahead, your line is open.

Q - Steven Haywood {BIO 15743259 <GO>}

I was going to say good morning, but good afternoon I think it is now. Just a few questions from me as well please. Thank you for the falling interest rate sensitivity explanation, but I see that your equities sensitivity has reduced significantly and now falling equities you have 0% change to Solvency II ratio. Can you explain what has happened here as well? I think you highlighted that you would potentially look at optimizing the balance sheet as well later in this year. Would you consider a potential debt issuance to pay for a share buyback in the future or is debt issuance is more geared towards doing business acquisitions and sort of business growth organically as well. And then finally just out of curiosity, the Loyalis, VvAA, Veherex acquisitions, I wonder if these were included in the number of possible small, mid-sized businesses you discussed at your Capital Markets Day? Thanks.

A - Chris Figee {BIO 18815839 <GO>}

Steven, it's Chris. When it comes to equities, the volatility change because of the way the equity dampener works, which is a technical thing, it's Solvency II. And secondly, we have got a put strategy under equity that we optimize in the first half. So it's a combination of equity debt that we do, just exactly technical thing and our put strategy that limits the amount of downside risk from falling equities. When it comes to issuing debt, I'm not sure that we can issue debt. So we're going to be opportunistic and if there's an opportunity to raise capital cheaply, you should not let that go. It appears that at this point, our key one is relative attractive form of capital with others. We've had a reverse inquiries. Our balance sheet can sustain itself, something which you remember we'd have a right application. Ideally you spent in inquiring companies. Would you use to buy back shares? We're not in the business doing a leverage recap, but portion of finance can be doable if your total solvency allows. To me, a share buyback or capital returns is a function of your total capital base and it looks like a three year post, rather than a function of one specific single transaction, So you need to look at in a more integral fashion.

When it comes to acquisitions, our famous pyramid that we produced on the Capital Markets Day, indeed some of these businesses were implied in a pyramid. When we produced this slide capital market day of course we were already working on Loyalis, because then we signed the deal two months later, so that was something we knew was coming. Veherex and VvAA were distance vaguely roomed at the time. So yes, they were included in that potential pool of acquisitions.

Q - Steven Haywood {BIO 15743259 <GO>}

Okay, that's great. Thank you, Chris. Thanks, Jos.

Operator

Thank you. Our next question comes from Andrew Baker from Citi. Please go ahead, your line is open.

Q - Andrew Baker {BIO 20402705 <GO>}

Hi, thanks for taking my questions. Just a couple. So a follow-up to the famous I guess. So there was I think EUR27 billion of GWP identified in that pyramid at the time. I appreciate that some transactions have come and gone. Do you see the size of pyramid now as similar or would it be reduced materially in anyway? And then maybe related to that, is there anything to read into the review of the capital policy and really freeing up the ability to potentially do buybacks as your outlook for M&A has -- and the pipeline for M&A has changed materially. And then just finally, can you just confirm there is still two year lag between when you make a decision to go to a partial internal model and when you can actually implement and have you actually started work on the partial internal model itself yet? Thank you.

A - Jos Baeten {BIO 2036695 <GO>}

Andrew, thanks for your questions. To your last question, we haven't really started working on that because as said, all the bright and smart people are still working on IFRS 17 which is a must do. From the start to the application and to the use in general one will need two to 2.5 years, even up to three years if the right people in the market are not available before you will see it in the numbers. The first year you have to build to -- the model, don't have to do the application, you have to prove that you use the model. So in general, it will require at least 2.5 years.

To your first question on the same experiments, as Chris already said, a number of opportunities that we in the meantime have done are in that pyramid. We also have seen companies for sale that we decided not to bid on. Those were also in this pyramid. There has been a -- it's already in the Dutch market for a number of years that there is one funeral insurance company that is for sale and we have not really looked at it and then decided that the value that we want to deliver to our shareholders will not be in such transaction and that was also in this pyramid? So yes, we still see opportunities. The size of the opportunities might be smaller than for example Loyalis or Generali but there is still some stuff out there. So we're still optimistic about our ability to do transactions, but the number indeed has decreased because we've done some and some of the potentials that were still in there are refused to do by us.

Q - Andrew Baker {BIO 20402705 <GO>}

Okay.

Operator

Thank you. At this time we have no further questions in the phone queue. I would like to hand the call back over to you Mr. Baeten for any additional or closing remarks.

A - Jos Baeten {BIO 2036695 <GO>}

Well, ladies and gentlemen, thank you for joining us during this call. Hopefully it was helpful again to get the detailed answers on the detailed questions. We're looking forward to see most of you soon. Chris and I will be on the road show over the next weeks and with some of you we already planned the dinner and lunch and we're happy to see you there and have a nice day for the remainder of this Happy Friday.

Operator

This will conclude today's conference. Thank you all for your participation, you may now disconnect.