Q1 2017 Earnings Call

Company Participants

- Delfin Rueda Arroyo, Chief Financial Officer
- Eilard Friese, Chief Executive Officer and Chairman
- Jan-Hendrik Erasmus, Chief Risk Officer and Member-Management Board

Other Participants

- Arjan van Veen, Analyst
- Ashik Musaddi, Analyst
- Bart Horsten, Analyst
- Cor Kluis, Analyst
- Farquhar C. Murray, Analyst
- Matthias de Wit, Analyst
- Robin van den Broek, Analyst
- Steven Haywood, Analyst

MANAGEMENT DISCUSSION SECTION

Operator

Good morning, ladies and gentlemen. This is the operator speaking. Welcome to NN Group's Analyst Conference Call on its First Quarter 2017 Results. The telephone lines will be in listen-only mode during the company's presentation. The lines will then be opened for a question-and-answer session.

Before handing this conference call over to Mr. Lard Friese, Chief Executive Officer of NN Group, let me first give the following statement 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 statement not involving a historical fact. Actual results may differ materially from those projected in any forward-looking statement. 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 solicitation of an offer to buy any securities.

Good morning, Mr. Friese, over to you.

Eilard Friese

Yes. Good morning, everyone, and welcome to our conference call to discuss the NN Group's results for the first quarter of 2017. I will start off today's presentation by looking at the highlights of the first quarter results, as well as the commercial developments during the quarter. I would also like to spend some time talking about the Delta Lloyd acquisition and the integration process.

Delfin Rueda, our Chief Financial Officer, will then talk about the financial details of the results at group level and for the individual operating segments, as well as our capital position including the pro forma numbers for the combined entity that we have disclosed today. I will conclude the presentation with a wrap-up, after which we will open the call for a Q&A. As customary, we also have our Chief Risk Officer with us, Jan-Hendrik Erasmus, to answer your questions.

So, let me start on slide number 3, by reminding you that the results reported today are for NN Group on a standalone basis. Delta Lloyd has issued its own press release this morning reporting on the first quarter of 2017. In addition, we have disclosed several pro forma numbers for NN Group and Delta Lloyd combined to give you some insight into the capital position of the combined entity. The pro forma Solvency II ratio for the combined entity is estimated at approximately 180% at the end of the first quarter of 2017. I will talk about this in more detail on the later slide.

In August, we will publish the full consolidated results and capital position for the combined group for the second quarter of the year. NN Group delivered a strong performance for the first quarter of 2017. The operating result of the ongoing business of €406 million represents an increase of 33% on the same quarter last year with all segments contributing to the increase. We continue to improve efficiency and Netherlands units achieved further cost savings in the first quarter, bringing the cost base down to €748 million.

Commercial momentum was also strong. Total new sales of our insurance businesses were up 28% at constant currencies. This was driven by higher Life sales across the insurance Europe region as well as sales of the COLI critical illness product introduced last year in Japan. Our asset manager attracted net inflows of third-party assets of €2.1 billion and NN Bank continues to report a strong production of new mortgages.

Our balance sheet and capital position remain robust. The cash capital of the holding was €3 billion at the end of the first quarter, driven by dividends received from subsidiaries, as well as the senior debt that we issued in January. NN Group Solvency II ratio at the end of the first quarter was 238%, down slightly end of fourth quarter last year reflecting market variances, partly offset by operating return.

Let's turn to slide 4. In order to deliver an excellent customer experience, we continually invest in new and improved products and in innovation. Let me give you some examples. NN Bank launched an innovative app called Brickler. House buyers using this app can search for a new home, calculate the amount that they can spend, and compare proposals from different mortgage providers all at the same time in this app.

Another innovative app that we're currently piloting is Gappie. This app allows customers to arrange on-demand car insurance when borrowing a car from family or friends. This is a unique concept as it links the insurance to the use of a car instead of the ownership. The insurance cover can be taken up by the hour, and you can switch it on and off as required. Gappie was developed by our innovation lab, Sparklab. And following its success in the Netherlands, NN has now opened Sparklabs in Hungary and in Turkey. At least six other labs will be launched shortly.

In line with our multi-access distribution strategy, our business in Poland has built a modern and innovative IT platform for banks which allows products to be introduced within weeks. And in Japan, we have started offering our COLI products via Sumitomo's Life's sales network of approximately 30,000 agents.

In addition to innovation at NN, we also look for opportunities to invest in third-party fintech companies. An example of this is OptioPay, which has developed an innovative business model that allows consumers to convert incoming payments into higher value product services or vouchers with a broad range of merchants and service providers.

Let's move to the next slide, slide number 5. The acquisition of Delta Lloyd by NN Group will materially strengthen our leading position in the Netherlands and Belgium. Most noticeably, we'll achieve additional scale and capabilities in the Dutch pension market that will allow us to enhance our customer proposition and capitalize and to shift to Defined Contribution products.

We will double the size of our Non-Life business. Our asset manager will receive additional assets under management, and we will double our presence in Belgium with a complementary product offering and distribution channel. Delta Lloyd also brings with it some valuable distribution capabilities, such as the joint venture with ABN AMRO and the OHRA Direct brand.

Overall, we believe that there is significant and compelling strategic logic for the acquisition. On the 23rd of December last year, we set out the financial benefits of this transaction. At that time, we indicated expected cost synergies of €150 million and an increase into free cash flow in the range of €250 million to €300 million both by 2020. And we also indicated that you should anticipate a double-digit increase in the dividend per share in 2018.

Moving on to slide 6. Just over a month ago, the offer for Delta Lloyd was declared unconditional, and we have already started the process of bringing the two companies together. Immediately after the settlement of the offer, we announced the senior leaders of all business units and the support functions at head office. These leaders then addressed the employees of their units at 65 town hall meetings held at 29 different locations, all on the 18th of April.

The integration process is being led by the Integration Management Office which we put in place sometime ago, charged with ensuring a smooth and successful combination of the two companies. The dedicated integration managers of all business units and support functions meet on a weekly basis with a regular interaction with us, the management board, who are of course ultimately responsible for executing.

I would at this point like to thank the Delta Lloyd and NN employees for their professionalism in what is, of course, a challenging time for all. It is gratifying to see all our colleagues working well together to integrate procedures and systems. There is much work to do to integrate the operations of NN and Delta Lloyd, and this will inevitably have consequences for employees. We are committed to doing this in a fair, balanced, and timely manner with respects for the talents and strengths of employees.

During the coming months, we will develop detailed plans for the new combined entity and we'll give a strategic update to the market during our Capital Markets Day on the 30th of November. We will then be able to give you more information on the integration, cost savings, and targets.

Let's turn to slide 7. Our balance sheet remained strong post the Delta Lloyd transaction. On the 23rd of December, we indicated to you three points. The first was that we saw the pro forma Solvency II ratio at the third quarter of 2016 at approximately 185%. We have updated that today to approximately 180% at the end of the first quarter of 2017. The adjustments we anticipate making for actuarial assumptions are in line with our original expectations. Overall, we feel comfortable with this level of Solvency II ratio.

The second point we highlighted was that the pro forma financial leverage was at the top end of our internal appetite levels. Since then, we have taken a significant step in bringing the leverage down through the transaction we did with Fonds NutsOhra which reduced the nominal debt by just over €400 million.

The third point we highlighted was that we expected to operate at the top end of our €0.5 billion to €1.5 billion cash capital target range. At the end of the first quarter this year, the pro forma cash capital was estimated at €1.9 billion, which is of course above our target range. This provides us with some flexibility to manage our leverage position going forward should we desire and also to fund any recapitalization of the Dutch Delta Lloyd entities that may be needed.

We continue to actively manage our balance sheet, and we took actions during the first quarter to reduce our capital sensitivities. Overall, therefore, I feel we're making good progress on the balance sheet with our Solvency II ratio remaining strong, already some reduction in our leverage and a very healthy level of cash capital.

I will now hand over to Delfin Rueda. Delfin?

Delfin Rueda Arroyo {BIO 7032761 <GO>}

Thank you, Lard, and good morning to everyone. NN Group reported an operating result of the ongoing business of €407 (sic) [€406] (11:30) million in the first quarter of 2017, up 33% of the same quarter last year. This increase was driven by higher results in all segments. The higher operating result together with a higher non-operating items and the lower hedge-related loss at Japan Closed Block VA is reflected in increasing the net result.

The center graph shows the items reconciling the operating result to the net result. The non-operating items include almost €100 (sic) [€150] (12:04) million of gains on the sale of government bonds and equities.

Let's now look at the first quarter performance of the individual segments on slide 10. As I already mentioned, all of our operating segments have posted higher results this quarter compared with the same quarter of 2016. The increase at Netherlands Life was mainly driven by a higher technical margin and lower expenses, partly offset by lower fees and premium-based revenues.

The current quarter includes €41 million of private equity dividends whereas the first quarter of 2016 was supported by €59 million of private equity and exceptional dividends.

At Netherlands Non-life, the improved result was generated by a favorable claims development in the individual disability portfolio. The D&A combined ratio for the first quarter was 95%. The results of Property & Casualty also improved, reflecting a favorable underwriting performance in the fire book, although this was largely offset by an unfavorable claims experienced in both Miscellaneous and Motor. The P&C combined ratio improved to 103.6%. For Netherlands Non-life, as a whole, the combined ratio improved to 99.7% from 104.3% in the first quarter of 2016.

The higher operating result of Insurance Europe reflects higher fees and premium-based revenues, while the first quarter of 2016 was impacted by a €4 million provision related to the terrorist attacks in Belgium.

The operating result of Japan Life went up 20% from the first quarter of 2016, that excluding currency effects. This reflects higher fees and premium-based revenues and a higher technical margin, partially offset by higher expenses.

The increase in the operating result of Asset Management was driven by higher fees despite higher expenses. Total Assets under Management decreased to €194 billion from €195 billion at the end of the fourth quarter of 2016 as net inflows of third party assets of €2.1 billion were more than offset by net outflows in Affiliated Business.

The main components of the segment Other are the holding result, the reinsurance business and NN Bank. The improved results of this segment in the first quarter were caused by a higher operating result of NN Bank of €24 million.

Please now turn to slide 11, which gives more details about the expense savings in the Netherlands. We have set ourselves a cost target, which aims to reduce the annual administrative expenses of Netherlands Life, Netherlands Non-life, and the holding entities to €685 million by the end of 2018. This is a reduction of around 15% compared with the annualized cost base at the end of the third quarter of 2015.

The expense reduction program is well on track. We achieved €14 million of additional savings in the first quarter of 2017, bringing total cost savings since the start of the program to €71 million. We will continue to focus on improving efficiency by implementing a range of cost containment measures to deal with upward cost pressures as well as investments in the business. On the next slide, I will take you through the free cash flows of NN Group.

On slide 12, we show the movement in the holding company cash capital during the first quarter of 2017. The holding company cash capital position increased to €3 billion at the end of the first quarter, that is from €2.5 billion at the end of 2016. The free cash flow during the first quarter was €242 million, driven by €296 million of dividends received from subsidiaries. Details of the dividends upstreamed by segment can be found in the appendix to this presentation, the cash divestment proceeds relate to the sale of Mandema & Partners which was completed in January 2017.

The cash capital position is temporarily boosted by the issuance of €500 million of senior notes in January, which were used to repay the €476 million non-qualifying subordinated notes earlier this month. And there were cash outflows for the acquisition of shares in Delta Lloyd in February for an amount of €180 million and for the NN shares repurchased in the first quarter for an amount of €82 million.

On slide 13, I would like to talk you through the developments in NN Group's Solvency II ratio. This slide shows the movement of NN Group's Solvency II ratio, the eligible Own Funds under Solvency Capital Requirements during the first quarter of 2017. During the quarter, the Solvency II ratio decreased slightly from 241% to 238%. This was mainly due to market variances, partly offset by the operating return.

I will start with the largest movement. Market variance had a negative impact on the Solvency II ratio of 9 percentage points. This was mainly due to the widening of credit spreads on French government bonds ahead of the French presidential elections, and which, as you know, have since tightened again. This was partially offset by positive performance of equity and real estate investments. The market variance this quarter also includes a negative impact from curve (19:00) steepening as well as an increase of the Solvency Capital Requirements due to higher equity risk.

The operating return had a positive impact of 7 percentage points. This quarter, it includes the impact of transfers from the separate account to the general account at Netherlands Life, which led to an increase in Own Funds of €55 million. As the balance of the separate accounts has reduced significantly in the past few years, we expect that the positive impact of such transfer will be limited in the future.

As you know, we disclosed the sensitivities of our Solvency II ratio every six months so we will provide them for NN Group, including Delta Lloyd at the second quarter results in August. However, I would like to give you an update now of the sensitivity to government bond spread as a result of management actions that we took in the first quarter of the year, such as the purchase of credit spread locks on government bonds.

As a result of these actions, the impact on our Solvency II ratio of 50 basis points increase in government bond spreads has reduced from 37 percentage points at the end of the previous quarter to around 25 percentage points now. While we generally hold these government bonds to maturity, and, therefore, consider their spread widening or tightening as temporary fluctuations, this action help us to reduce the short-term volatility of our Solvency ratio.

I will now move on to the pro forma numbers that we disclosed today for the combined NN and Delta Lloyd entity. We estimate that the pro forma Solvency II ratio of NN Group, including Delta Lloyd, at the end of the first quarter of 2017, is approximately 180%. This includes a number of items such as the amount paid to acquire 93.3% of the Delta Lloyd ordinary shares, as well as our current estimates of the impact from aligning actuarial assumptions, initial capital synergies and restructuring costs. It also includes the impact of the transaction with NutsOhra, which was completed in April.

The first quarter pro forma holding company cash capital position for NN Group, including Delta Lloyd, is estimated at €1.9 billion. This number reflects the cash movements since the end of the quarter being the cash settlement for the Delta Lloyd ordinary shares paid in April, the debt financing, the repayment of operating leverage by NN Bank to the holding company and the repayment of the subordinated notes in May.

As Lard has already mentioned, this is above our target range of €0.5 billion to €1.5 billion. Please bear in mind that this number is before the deduction of the 2016 financial dividend, which will be paid in June, restructuring costs and potential capital injections into Delta Lloyd units, as well as dividends to be received from operating units.

Let me just remind you that this pro forma numbers are based on current estimates. We will be reporting full consolidated results and capital numbers for NN Group and Delta Lloyd combined in the second quarter earnings release in August.

Both the pro forma Solvency ratio and cash capital at the holding are strong, giving us high level of flexibility. This is confirmed by the pro forma financial leverage position, which is set on the following slide.

Please turn to slide 15. In this graph, you can see the pro forma financial leverage position of NN Group plus Delta Lloyd, which is just under €6 billion at the end of 2016. Since then, we have issued new subordinated notes and senior notes, the proceeds of which were used to repay existing debt of NN Group.

The pro forma financial leverage position has increased as a result of the €900 million debt financing and the €200 million operational leverage repaid by NN Bank in April.

However, on the other hand, we have delivered through the transaction with NutsOhra, which reduced notional debt by €405 million.

So on balance, the pro forma financial leverage position of the combined entity has increased by around €750 million and now stands at €6.7 billion. Our strong free cash flow generation give us the option to further deleverage should we want to. We will continue to manage our financial leverage position so that it remains consistent with a single A financial strength credit rating.

And with that, I will pass you back to Lard for the wrap-up.

Eilard Friese

Yes. Thanks, Delfin. Let me on slide 17 round off the presentation by saying that we are happy with a strong set of results that we have reported today. I am particularly pleased that every segment has returned to solid performance and has contributed to the increase in the group's operating result.

Efficiency in the Netherlands improved further and commercial momentum was strong with a 28% increase in new sales at our insurance units, good third party asset inflows at our asset manager and healthy production of new mortgages at NN Bank. Our capital position remains strong with a Solvency II ratio of 238%.

Going forward, we have two priorities. The first is to successfully integrate Delta Lloyd into the NN organization and extract the synergies that we foresee. The integration process has been launched and we are working hard to ensure smooth transition. Secondly, we will continue to actively manage the balance sheet and capital position in order to keep them strong.

This is the final set of results for NN Group as a standalone entity. From the second quarter, we will be reporting results for the combined entity of NN and Delta Lloyd. We look forward to this new phase in our journey as one combined company. What will not change going forward will be our focus on further improving the customer experience through innovation, helping our customers to secure their financial futures.

I will now open the call for your questions.

Q&A

Operator

Thank you, Mr. Friese. And the first question is from Mr. Farquhar Murray, Autonomous. Go ahead please, sir.

Q - Farquhar C. Murray {BIO 15345435 <GO>}

Good morning, gentlemen. Just two questions if I may. Firstly, on the sovereign spread sensitivity, when precisely was that moderated, particularly relative to the peak in French spreads in late February? And consequently, how much of the negative drag that we saw in the first quarter might ultimately be reversed in the second?

And then secondly, this final question is actually partly a request. Is there any intention to publish the historic pro forma IFRS numbers up to, say, 1Q 2017 before the close period? I ask that because that will give us something to play with ahead of results in August. Thanks.

A - Eilard Friese

Yeah. Thanks, Farquhar. The first question will be answered by Jan-Hendrik, and the second by Delfin. Maybe it's good to start with the second one. Delfin, on the IFRS figures.

A - Delfin Rueda Arroyo {BIO 7032761 <GO>}

Yes. Thank you, Farquhar. Yes, that's – but the answer is, no, we won't publish any or give guidance of any pro formas, 1Q. You will see that with the opening balance sheet and the disclosure of the second quarter in August.

A - Eilard Friese

Yes, Jan-Hendrik?

A - Jan-Hendrik Erasmus {BIO 19801435 <GO>}

Thank you, Farquhar, for that question. To put that into context, I guess we did roughly €5 billion of spread locks during the quarter, which reduces sensitivity from 37 percentage points to around 25 percentage points. It wasn't done on one day, it was done through the quarter and also it wasn't specifically on the French sovereign, it was done on a basket of high-quality triple AAA sovereigns and AA, so it's not specifically to France. But there will be some muting of the mean reversion, if you can see it like that.

Q - Farquhar C. Murray {BIO 15345435 <GO>}

Okay. That's fine. Just coming back on the IFRS numbers because obviously that leaves us a little bit at sea in terms of what we might expect at the second quarter?

A - Delfin Rueda Arroyo {BIO 7032761 <GO>}

This is certainly. Farquhar, I understand that. You have to take into account that the accounting principles applied by Delta Lloyd are significantly different than those of NN Group, and we needed to finalize our alignment of actuarial assumptions and decide the balance sheet at day one. And that, as you know, takes some time and effort. So I think you will be well advised that we will not provide any interim guidance on that until we've got the final numbers ready for disclosure on the 17th of August.

Q - Farquhar C. Murray {BIO 15345435 <GO>}

Okay. Thanks so much.

Operator

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

Q - Ashik Musaddi {BIO 15847584 <GO>}

Hi. Good morning. Just a couple of questions. First of all, in terms of cost savings, how should we think about it? I mean, on one hand, you have given a cost saving from the merger of around €150 million, and if I look at slide number 11, you're still focused on your own cost saving as well, which has still left around €75 million. And then, you're also discussing about potential deleveraging if you have sufficient cash at the end of the year.

What I'm trying to understand here is how much of the overlap is here, i.e., for example, if you have your own cost saving, is it like fully baked into €150 million that you're guiding for the merger or there could be some mutually exclusive stuff in that as well and the debt refinancing as well. So, any color on that would be really helpful.

The second thing is thanks for your SFCR reporting. It's very useful to get more color on the adjustment factors. But one thing we noticed is the impact on VOLA on the regulatory basis is pretty high, the benefits. But then you're also flagging on page number 24 that you also take into account sovereign spread shock. So, why do you think we should look both together and not just the impact on the regulatory basis?

The third question is with respect to standard formula. I mean, is it possible for you to give us any color about how your standard formula has moved versus your internal model Solvency ratio since you last changed this model? Thank you.

A - Eilard Friese

Thanks, Ashik. I'll take the question first on the cost savings, and then I think Jan-Hendrik will do with the SFCR component. So, first, on the cost synergies. Our view on the cost synergy potential has not changed compared to the guidance that we gave earlier at the time that we announced the transaction. We expect €150 million pre-tax of annual cost synergies by 2020. But please bear in mind that these cost synergies are on top of the existing plans to reduce the expenses of both companies. So, both NN and Delta Lloyd have existing cost programs, the €150 million are on top of that and to be delivered by the end of 2020 and it's pre-tax.

Now, if you look at the split of where this needs to come from, it's different business units and head office that will contribute to this. We expect approximately half of the cost synergies to be realized in the Life and Non-Life areas, so the big units. And we expect that in terms of timing to materialize to integrate the same within three years.

While the efficiency improvements in the bank and the Asset Management business will account for approximately 30% of the expected annual cost savings, we expect that to be, let's say, more on the earlier end of the timeframe. And then, the remainder of the cost synergies are expected to achieve – to be achieved in the centralized functions where there's overlap and other segments. And also there, we expect those, the bank and Asset Management and the overlap of functions, et cetera to be on the earlier end of the expense synergy reduction program and the Non-Life and the Life to take a bit longer. As you may expect, this is more complicated to do from a technology point of view.

We will provide you the – on the Capital Markets Update, we aim to provide you a more granular update on this. And please note that the disclosure we did today on slide 11, for instance, the Delfin took you through on the expenses were on a standalone basis for NN. So, please note that, Ashik.

With that, I'm going to hand over to you, Jan-Hendrik, for the SFCR comment.

A - Jan-Hendrik Erasmus {BIO 19801435 <GO>}

Yeah. Thank you, Lard, and also, Ashik, for your questions. You're right, we published the SFCR this morning. We wanted to put this out on the same day as our 1Q 2017 release and you've also spotted there's a peculiarity in there, which is that you see a very large standalone VOLA effect in the appendix.

This is – you have to put this into context and you sort of answered the first part of the question almost for me by saying that you have to look at this together with the sovereign spread, the numbers which we show on page 24. And you have to realize that this is part of a combination, an internal model is made up of many different elements and this treatment is agreed with the DNB that we will also shock sovereigns and then use the VOLA in this way to offset some partly that effect.

You would not do this in the standard formula, which is also why we flagged the figure on page 24, because under the standard formula, you would not shock sovereigns and you would also not have spread risk capital against mortgages which is something we also flagged in that paragraph on page 24. So, you really have to look at the combination and also realize that this is an agreed thing, it's not a transitional that will go away and we don't really see it impacting our capital generation and crucially our dividend going forward.

Moving on to your next question on the standard formula, it's actually a bit uncontroversial. At the 4Q 2016, the ratio was 197%, we think it's 196% now, right. I guess I don't think I know it's 196% now so it's moved to down 1 point, which you can compare to 3 points for our overall ratio from 241% to 238%, so very similar.

Q - Ashik Musaddi {BIO 15847584 <GO>}

That's very clear. Thanks a lot.

A - Jan-Hendrik Erasmus {BIO 19801435 <GO>}

Yeah. You're welcome.

Operator

The next question is from Mr. Cor Kluis, ABN AMRO. Go ahead please, sir.

Q - Cor Kluis {BIO 3515446 <GO>}

Good morning. Cor Kluis, ABN AMRO. A few questions. So first of all, it was good to see that you reduced your sensitivity for government bond spreads. Going forward, are you willing to reduce the sensitivity for, let's call it, macro effects further for your Solvency II ratio? And if so, in which fields? And related to that, on the 180% Solvency ratio, could you give an indication, of course it's not exactly clear yet about numerator and denominator of the 180%.

And the second question is about the Solvency at this moment. It's obvious that Solvency ratio should be somewhat higher at this moment, especially given what happened in the French government bonds and on equity markets. Could you give some idea about, the uptick is 5% higher or at least in that field?

And the last thing about slide – on slide 20, there was some dividend of upstreaming of €73 million from the category other that includes the interest on the subordinated loans. How large was that interest rate on the subordinated loans? Is that the total amount or could you give us an idea about that? Those are my questions.

A - Eilard Friese

Thanks, Cor. Four questions. Let me see how we're going to divide this. So, the first one that will go to Jan-Hendrik, the second one to Delfin and then maybe you can do one and three at the same time which is also the update on Solvency, yeah. And then Delfin will take the second question and the fourth. Yes, so please Jan-Hendrik you first.

A - Jan-Hendrik Erasmus {BIO 19801435 <GO>}

Yes, sir. Thank you, Cor, for that question. I mean, on the sensitivities, I think you have to realize that. As I said last quarter, we do keep this under review and we do actively manage the balance sheet within certain target ranges for us. On the other hand, we are a long-term investor so we try not to be too reactive and we try to balance the two concerns. I think we will continue to closely monitor the balance sheet sensitivities, especially now as we bring in the Delta Lloyd balance sheet and work on our Q2 disclosures. So I think you can continue to see active management there. I wouldn't like to flag now which areas we will bring down further, we will also speak about that when we do the Q2 disclosures.

And then the Solvency, at this moment, if you look at what's happened since the end of the quarter, you will see the French, I mean, reversion as you pointed out. On the other hand, we've also seen credit spreads tightened which is negative for our ratios. So I think net-net, we're slightly up. I wouldn't like to put a number on it at this point, but slightly positive.

A - Eilard Friese

Okay. Thank you. So, Delfin?

A - Delfin Rueda Arroyo {BIO 7032761 <GO>}

Yes. Thank you, Cor. I think your second question was about what to expect in the evolution of the denominator of the Solvency. So, I understood it as how do we expect the Solvency Capital Requirement to move going forward. Was that your question, Cor?

Q - Cor Kluis {BIO 3515446 <GO>}

That is more the absolute amount, so you indicate 180%. What's the absolute amount for the numerator as well as for the denominator that's more the idea?

A - Delfin Rueda Arroyo {BIO 7032761 <GO>}

Okay. I think that probably it'll be better that we come back to you with the precise numbers. I don't have them in front of me.

Q - Cor Kluis {BIO 3515446 <GO>}

Okay. Thanks.

A - Delfin Rueda Arroyo {BIO 7032761 <GO>}

Then there was a question on the interest on the subordinated debt, it's around €10 million a quarter more or less coming from Netherlands Life due to the subordinated loan that NN Group has provided to NN Life.

Q - Cor Kluis {BIO 3515446 <GO>}

Okay. And what's then the other €63 million?

A - Delfin Rueda Arroyo {BIO 7032761 <GO>}

Sorry. I'm a bit confused with the question on the dividend. You're talking about the €73 million...

Q - Cor Kluis {BIO 3515446 <GO>}

The slight...

A - Delfin Rueda Arroyo {BIO 7032761 <GO>}

Yeah, but that was a special dividend coming from a legacy business that we had in the UK related to all liabilities that has been finally settled and that was one-off dividend that had been received from this legal entity – this legacy entity, which won't be repeated.

Q - Cor Kluis {BIO 3515446 <GO>}

Okay. Wonderful. Thank you very much.

Operator

The next question is from Mr. Matthias de Wit, KBC. Go ahead please, sir.

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

Yes. Thank you. Two questions, please. The first is on the Own Funds generation. You report an operating return of €0.3 billion, but if I look at the 7 percentage points you mentioned on the opening SCR, I get to a number closer to €0.4 billion. So, can you provide the unrounded number? And also elaborate a bit on why it improved so substantially compared to the €100 million underlying number you reported for last year in Q1?

And second question is on the holding cash capital and the leverage. You're currently around €400 million ahead of your upper end of the target. And I guess it makes sense to use this excess to redeem the Delta Lloyd senior bond. Just wonder to what extent you plan to further delever the capital base, what is consistent with your targeted rating in terms of gross leverage? And is there also a need to spend a lot of cash on recapitalizing Delta Lloyd or is that not on the agenda at this point in time? Thank you.

A - Eilard Friese

Yes. Matthias, thanks for your questions. Delfin, can you take those, please?

A - Delfin Rueda Arroyo {BIO 7032761 <GO>}

Yes. Thank you, Matthias. For the capital generation and the operating return in the quarter, as you have seen, it is €0.3 billion, of which €55 million is related to the movement from the separate account to the general account, and that is something that going forward as the volume of separate account reduces is not expected that to be maintained and will reduce significantly.

I have indicated in the past as well that this operating return, as you know, will oscillate and vary, as you know, from one quarter to another. So, apart from this €55 million that I have just mentioned, there is nothing else or in particular that I'll mention has been extraordinary within that quarter.

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

Okay. Is there anything you can say on the unrounded number because I get closer to €0.4 billion if I'm using the 7% on the opening SCR?

A - Delfin Rueda Arroyo {BIO 7032761 <GO>}

Yeah. As you know that because of the changes in experience variance in the quarter, the contribution from the Non-life, but also from Asset Management and in Life, and due to the changes in the spreads and the value of our Solvency II balance sheet at the start of every quarter, we've been reluctant and we continue to be in order to provide any specific, as you know, run rate.

So I will repeat that in the quarter, apart from this €55 million there is nothing special or particular. There was some positive experience variance, but that as you know from one quarter to another, sometimes is positive, sometimes it could be negative, and that variation you will see reflected going forward as well.

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

Okay. Thank you.

A - Delfin Rueda Arroyo {BIO 7032761 <GO>}

In terms of the cash capital, indeed, the pro forma level of cash capital is €1.9 billion at the end of the quarter, and that, indeed, provide some further financial – it provides a strong financial flexibility and, indeed, that's something that we will consider to either reduce leverage and there could be a good opportunity to do that in November when the Delta Lloyd senior debt came to maturity or if we feel it necessarily to increase the level of Solvency capital at any of the Delta Lloyd entities, but that's something that of course we will decide over time within this quarter.

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

Okay. Very clear. Thank you.

Operator

The next question is from Mr. Arjan van Veen, UBS. Go ahead please.

Q - Arjan van Veen {BIO 5197778 <GO>}

Thank you. I just have two questions. The first one is just around the pro forma Solvency position you've given. I just want to clarify a couple of points in terms of assumptions. So, firstly, I think, at 3Q 2016, you said it was roughly a 5% reduction expected from the equalization of assumption. So, just I think Lard confirmed that in his call earlier. Can you just confirm that? Secondly, can you just confirm you've adjusted for the new LAC-DT guidance in your Solvency numbers?

And thirdly, the €476 million reduction in the sub-debt in May, you've adjusted your pro forma capital, holding company cash for that, you've adjusted the debt position for that in your slide. Just double checking that, that's also in your pro forma capital number of €180 million.

And then secondly, just following up on the question on capital generation. So it's much stronger underlying than what you would assume in one quarter and I know you said it's volatile quarter-on-quarter. But, can you maybe just give us some color as to whether that underlying number is improving because obviously it's very weak one quarter, but this is much stronger than even what we saw in 2Q, 3Q and 4Q last year. So, whether there's rising interest rates or we're seeing some improvement in the underlying cash flow generation on the Solvency II basis. Thank you.

A - Delfin Rueda Arroyo {BIO 7032761 <GO>}

Thank you very much, Arjan. So, four questions. Please tell me if I forget any of the four. So, the third (45:46) question about the impact of the actuarial assumptions but other factors. So, this 5% decrease that you're talking about is not only the actuarial assumptions, but also includes restructuring expenses and also our initial estimates of the initial capital synergies that are going to be extracted.

So, what we've seen when you compare the pro forma estimate that we did at the end of September that we disclosed in December and what we obviously know now with much more detail analysis looking into the same assumptions is that we are very pleased that in terms of the alignment of actuarial assumptions, they doesn't really change very material, which was something that we are very happy with.

Of course, there are things going up and down but very much the decrease in this Solvency pro forma ratio from 185% to 180% is very much related to the actual evolution, the decrease on the Solvency ratio of both entities and then on Delta Lloyd since September, and this is mainly driven by market movements.

Your second question on the LACDT, the answer is yes. Since the end of December for both NN and Delta Lloyd, we believe that we have applied the DNB guidance, as you know, accordingly.

And in terms of the debt reduction, yes, I think your question is if that is, as you know, what is included within that calculation of the pro forma, so, maybe I can take you through that. So, we are taking obviously the price paid to acquire the 93% that was €2.3 billion. Also the reversal of the equity charge on the 9.7% Delta Lloyd ordinary shares that they were included in the Solvency Capital Requirement at the first quarter 2017. The impact of the transaction that we did with NutsOhra that was completed in April, so, that's reflected in that pro forma. And also as you said, the alignment of the actuarial assumption, the initial capital synergies and the restructuring cost. So this is...

Q - Arjan van Veen {BIO 5197778 <GO>}

Delfin, sorry to interrupt you, but the €500 million sub-debt, is that also taken out in May, because you adjusted all the other numbers on a pro forma basis allowing for that (48:25)?

A - Delfin Rueda Arroyo {BIO 7032761 <GO>}

Yeah. But you must keep in mind that the €476 million is not a Solvency II qualify – it doesn't qualify for Solvency II purpose. So, it does not...

Q - Arjan van Veen {BIO 5197778 <GO>}

(48:38)

A - Delfin Rueda Arroyo {BIO 7032761 <GO>}

...impact the solvency ratio.

Q - Arjan van Veen {BIO 5197778 <GO>}

Okay. Understood.

A - Delfin Rueda Arroyo {BIO 7032761 <GO>}

So, that has been taken out when calculating the pro forma cash capital at holding.

Q - Arjan van Veen {BIO 5197778 <GO>}

Okay. Thanks.

A - Delfin Rueda Arroyo {BIO 7032761 <GO>}

Then in terms of the last question was about the underlying cash flow generation on the Solvency II basis. And I think as I explained before, yes, it was a strong quarter but nothing atypical (49:04) apart from this €55 million that I have already indicated.

Q - Arjan van Veen {BIO 5197778 <GO>}

Thank you.

A - Delfin Rueda Arroyo {BIO 7032761 <GO>}

One thing. Maybe because you're looking for some guidance in terms of the capital generation, probably you can refer to what has been the actual evolution over the full 2016. That takes a bit less, reduces the volatility from one quarter to another.

Q - Arjan van Veen {BIO 5197778 <GO>}

That's perfect. Thanks.

A - Eilard Friese

Okay. Next question.

Operator

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

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

Yes. Good morning, gentlemen. I was just wondering if you could talk a little bit – we know that Delta Lloyd reported 144% Solvency II ratio, but maybe you can provide some details on where Delta Lloyd Life sits because of your specific comment on potentially recapitalizing and the Delta Lloyd subsidiaries. I think that would be an interesting comment.

Secondly, we know the UFR is changing. Could you confirm that the impact for your combined ratio would be around 16 percentage points? And connected to that, can you maybe give some indication on how the quality of the capital looks like? So, basically how much steering space do you have in the restricted Tier 1 bucket and the Tier 2, Tier 3 buckets? Thank you.

A - Eilard Friese

Yeah. So, thanks, Robin. I'll ask Jan-Hendrik to comment on the impact of the UFR and the combined. And then, I'll ask Delfin to comment on your other two questions.

A - Jan-Hendrik Erasmus {BIO 19801435 <GO>}

Yeah. Thank you, Lard, and hello, Robin. Well, we've all seen the announcement from EIOPA that they will reduce from 1 January 2018 the UFR to 4.05%. So, the impact of that on the NN Group standalone Solvency ratio is around 4 percentage points, and on the pro forma number, we have estimated around 5 percentage points. So I don't know quite where your figure comes from, 16% (sic) [16 percentage points] (51:19), but that's the number as of 1 January.

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

The fully loaded, I mean, from 4.2% to 3.65%.

A - Jan-Hendrik Erasmus {BIO 19801435 <GO>}

Yeah. I see. So, you're rolling it forward already into the future for quite a few years. The interesting thing is that they've also said it will reduce by 15 basis points per annum. So, you cannot actually ever get to 3.65% if you go down from 4.2% in steps of 15 basis points. So it is a little bit a theoretical number. I think the NN Group standalone number is roughly in the range that you've indicated there, but to reiterate, this will happen over many years. It's not that this will be the position today or in fact, in one year. And it will, of course, come back through higher capital generation. As the UFR comes down, the UFR drag, of course, also goes down and also as rates go up. So, we will see increased capital generation as the flipside of that.

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

Yeah. But this could maybe be a topic of discussion also with the recapitalization of certain Delta Lloyds units with the Dutch Central Bank. So that's why I'm basically asking these two questions to see, yeah, a likelihood there basically.

A - Jan-Hendrik Erasmus {BIO 19801435 <GO>}

Understood.

A - Eilard Friese

So Delfin, the other questions.

A - Delfin Rueda Arroyo {BIO 7032761 <GO>}

Yes. The Solvency II ratio of Delta Lloyd Life was 135% at the fourth quarter 2016. That was disclosed by Delta Lloyd. And the quarter has improved somewhat in the quarter, and this was driven by the positive impact of changes in the portfolio as well as the higher interest rates. Please maybe just, of course, to flag that this does not yet reflect, the actuarial assumption alignments that we have indicated in the pro forma for the combined ratio. But the evolution in the quarter was slightly positive.

In terms of the tiering, as you know, in Q4, both NN and Delta Lloyd, as you know, had some tiering constraint for the Tier 3. And that is also when you look at the combined entity, that will be a constraint, that, as you know, it's expected, as you know, to persist after the combination. And that, as you know, is driven by the limitation of the 15% of the Solvency capital requirement, and that's very little that we can do to amend that.

However, maybe just to flag that with the Fonds NutsOhra transaction, that has given us some flexibility in the tiering as we increase the unrestricted Tier 1. And with that, we open some small, as you know, capacity on the Tier 1 restricted on a pro forma basis. As well as, as you know, the Tier 2, there is also not significant but there is – we estimate pro forma to have some scope there. And as I said, as you know, the cap on the Tier 3 is expected to continue with the combination.

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

Okay. That's very clear. Thank you.

Operator

The next question is from Mr. Debart Jooris, Degroof Petercam. Go ahead please, sir.

Yes. Hello. A few questions. First of all, on the dividend upstream, could you give us some clarification on why there is no dividend upstream from Netherlands Non-Life this quarter? And still on Netherlands Non-life, we see some improvements on the combined ratio, especially on D&A. P&C is also improved but it's still at 104% almost. Could you give us an idea when you expect this to fall below 100%? And then, very, very shortly, at which exact date will the consolidation with Delta Lloyd start ? Will there be a full second quarter or a partial one?

A - Eilard Friese

Yeah. Thanks, Bart (55:21). So, let me take the Non-Life question, then Delfin will take the other two questions. So, first on Non-Life. This quarter we saw the Non-Life combined ratio of NN dropping below 100%, which is mainly driven by the favorable results we saw in the individual disability business. If you look at the P&C business, also in fire, we saw a good result versus the same period last year. Having said that, the motor book and the miscellaneous segment were not as strong.

You do need to note that we will continue to drive through a combination of expense reductions, underwriting improvement, stopping non-profitable products, et cetera. We will continue to work toward our 2018 target of 97% or lower than that. This is a good quarter. We're pleased with that, driven by disability. Please note that on the P&C side, this can be volatile. With that, I'd like to hand over to you Delfin.

A - Delfin Rueda Arroyo {BIO 7032761 <GO>}

Yes. Thanks, Bart (56:30). So, on the dividend upstream from Non-Life, I don't think there is anything special to mention or anything to read. So, dividends come, as you know, some quarters, others not and the only thing that we have flagged. So, we do continue seeing the capacity of the Non-Life company to distribute dividends and they will do in due course. The only thing to flag is, as you know, that there is some – for particularly Insurance Europe, there is, as you know, some tendency to have the majority of the dividends been in the second quarter of the year. But you have in the appendix to the presentation, as you know, the details and you can see also how this dividends has evolved over the last, as you know, two years as well.

In terms of the days for the consolidation, in terms of – as you know, in legal terms, we acquire control of Delta Lloyd on the 12th of April. However, for accounting and reporting purposes, it is the day that the offer was declared unconditional. And that was the 7th of April. So, we believe that it will be very easy to account for the transaction for the full quarter, so, that as if the transaction has happened on the 1st of April. Of course, there is a few things that we need to check from an accounting point of view that there is not any significant deviation for that week. But as you can anticipate that in the second quarter of the year, you will see fully reflected the profit of the combined entity already for a full quarter.

Q - Operator

Okay. Thank you very much.

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

Q - Steven Haywood {BIO 15743259 <GO>}

Good morning, again, and good morning, everyone. On your Solvency II pro forma ratio, I wonder whether you've included any capitalized cost synergies there at all. And then I see in your press release that you've highlighted the unit-linked mis-selling again. And there is a couple of collective actions that are happening at the moment. We'll get some update in the second half of this year. But you say they're similar to the November 2013 claim. What happened with that claim and also what are your expectations for the two new claims? Thank you.

A - Eilard Friese

Yeah. So, let me talk about the unit-linked – while you call it mis-selling, but unit-linked file, but first maybe, Delfin, on the Solvency II.

A - Delfin Rueda Arroyo {BIO 7032761 <GO>}

Yes. Steven, so the answer is no. We have not included any assumption or any impact of the capitalized cost synergies. However, we have taken into account, as you know, some estimate in the same way that we did it in December for the restructuring cost, but not for the potential benefits in terms of cost synergies going forward.

A - Eilard Friese

And when it comes to the unit-linked file, first and foremost, the most important thing is that we have an active reach-out program, as you know, to customers. And we continue that, which is the most effective way of addressing any customer complaints. And we're making good headway there. And when it comes to the legal proceedings that we see in the industry and also against us, we update you regularly if there is something to update you on.

What we've said is that at this point in time, there is nothing that changes our disclosures at this point that we cannot reliably estimate if and if so, to what extent something would come out of this. We do expect around the summertime some first rulings to come out in the cases against us. And for the remainder, we obviously follow the various cases in the industry on this file closely and monitor that.

Q - Steven Haywood {BIO 15743259 <GO>}

Okay. Thanks. But just on the previous one, just what happened to the collective action that started in November 2013?

A - Eilard Friese

Well, the collective proceedings, I don't know where you get that 13th of November date from, but if you talk about the collective proceedings against us in courts, we expect the Rotterdam Court to do some rulings on this in the summertime.

Q - Steven Haywood {BIO 15743259 <GO>}

Okay. Thanks. I was just referring to the press release, there is a comment about November 2013.

A - Eilard Friese

That is when they started. I'm sorry, yeah, now I see it Steven this is when they started. But again, we expect the first ruling to come out before the summer.

Q - Steven Haywood {BIO 15743259 <GO>}

Okay. I understand. Thanks so much.

A - Eilard Friese

Around sometime in July I think.

Q - Steven Haywood {BIO 15743259 <GO>}

Thank you.

Operator

The next question is from Mr. Bart Horsten, Kempen. Go ahead, please, sir.

Q - Bart Horsten {BIO 2390919 <GO>}

Yes. Good morning. So I have a few questions left. First, on the pro forma cash position at the holding level. You still have a bandwidth of €0.5 billion to €1.5 billion. Is it fair to assume that you will keep that bandwidth after consolidation of Delta Lloyd? I could imagine that it could also increase because the increasing of balance sheet. More or less related to that is could you also give on the pro forma – you gave your leverage, what would be the pro forma leverage ratio at this stage?

My last question related to Japan Life. With the significant drives in underlying result there, is it fair to assume also looking at the premium growth still going on that this trend will continue there? Thank you.

A - Eilard Friese

Okay, Delfin.

A - Delfin Rueda Arroyo {BIO 7032761 <GO>}

Okay. Thank you, Bart. So, that indeed, we have indicated as a target to have cash capital in the range of €0.5 billion to €1.5 billion cash capital at the holding. As you might recall when we were presenting this target, I said that we have made it in a relatively broad range in order to accommodate different scenarios. And also I think at the time of announcing the acquisition of Delta Lloyd, I said that that was one of the scenarios that we think they are still – can be accommodated within this group.

I don't think it's right just to assume that because the SCR of the combined entity that they require cash capital at the holdings should increase. Obviously, this is because the – in each of the operating entities, there is also Owns Funds and we need that to basically, as you know, look at how the Own Funds, the SCR and the risk for each of the units interact. And as a consequence, at this stage, we are very comfortable with the range of €0.5 billion to €1.5 billion and there is no intention to change it.

It's only logical, if I may add, that as we are in the process to fully integrate in Delta Lloyd that initially that we want to stay in the upper end of this range. But the range as a target stays the same.

Q - Bart Horsten {BIO 2390919 <GO>}

Okay.

A - Delfin Rueda Arroyo {BIO 7032761 <GO>}

Then in terms of a pro forma leverage ratio, it's difficult to do it until we have finalized the day one balance sheet of the entity because of the accounting difference that I mentioned before. So, this is, as you know, our ratio for which you need to have the shareholders, IFRS shareholders equity. But what I would say is that we do expect that to be comfortable and more importantly is that debt service capacity. And that debt service capacity that is currently for NN Group standalone around 13 times is obviously going to reduce but we do expect that still to be at a very good level, and certainly in accordance with our rating objectives.

And in terms of the Japan Life, as you know, profitability, indeed, we are very pleased with the growth in the revenues and we do expect that there is some positive momentum in their profitability. But keep in mind that Japan Life has significant seasonality. And as a consequence, the first quarter and the third quarter of the year tends to be higher in terms of IFRS profit. And also in the first quarter, there has been a very good technical result, tends to be volatile and usually, we would expect to have a lower technical result in Japan.

Q - Bart Horsten {BIO 2390919 <GO>}

Okay. Thank you.

Operator

Ladies and gentlemen, if there are no more questions, we're ending the Q&A. Back to you, Mr. Friese.

A - Eilard Friese

Yes. Everybody, thank you for all your questions. Before we end the call, let me conclude by saying that we are looking forward to the next phase in our journey as one combined company. We will continue to work hard to smoothly and successfully integrate Delta Lloyd into the NN organization and extract the synergies that we foresee. At the same time, we will continue to actively manage the balance sheet in order to keep it strong.

As always, our main purpose is to deliver an excellent customer experience based on transparent products and services and long-term relationships or in other words, to help our customers to secure their financial futures. I wish you a pleasant day. Thank you very much.