Q4 2018 Earnings Call

Company Participants

- Chris H. Figee, Chief Financial Officer
- Jos P. M. Baeten, Chairman-Executive Board & Chief Executive Officer
- Michel Hülters, Head-Investor Relations & Ratings

Other Participants

- Albert Ploegh, Analyst
- Andrew Baker, Analyst
- Ashik Musaddi, Analyst
- Benoît Pétrarque, Analyst
- Cor Kluis, Analyst
- Farooq Hanif, Analyst
- Johnny Vo, Analyst
- Matthias de Wit, Analyst
- Robin Eduard van den Broek, Analyst
- Steven Haywood, Analyst

MANAGEMENT DISCUSSION SECTION

Operator

Good day and welcome to the ASR Conference Call 2018 Results. Today's call is being recorded. There will be time for Q&A at the end of the call. At this time, I would like to turn the conference over to Mr. Michel Hülters. Please go ahead, sir.

Michel Hülters

Thank you, operator. Good morning, everybody. Welcome to the ASR conference call on the full year 2018 results. On the call, we have Jos Baeten, the CEO; and Chris Figee, our CFO. They will present and give you an update on the financial results, strategy and solvency and capital position. After that, there's ample time for Q&A.

But before we start, I would like to mention that we have a disclaimer at the back of the presentation, and I would like you to review that at the end whenever you have some time today for that.

So, without further ado, Jos, can I give you the floor?

Jos P. M. Baeten {BIO 2036695 <GO>}

Thank you, Michel, and good morning, everyone, happy to have you all here. Thank you for joining on this call. And as you may have seen from the numbers, ladies and gentlemen, which we have published this morning, 2018 was financially a strong year with overall, surpassed the record operating performance of 2017.

2018 concludes a string of three consecutive years since our IPO in 2016, during which we showed consistent delivery against ambition – ambitious medium-term targets. All targets have been met or exceeded. And as announced at our Capital Markets Day, we have raised the bar further for the next plan period.

Also, from a strategic point of view, we are very pleased with the progress that we delivered in 2018. We acquired Generali Nederland and the integration is running smoothly and ahead of

plan. Generali is, as you may have seen in the numbers, also delivering higher results than originally planned for this year.

We're also quite excited about the acquisition of Loyalis, which we believe is a truly promising transaction that enhances our unique position in the field of sustainable employability. Further strengthening our position is the exclusive corporation with Discovery and agreement to introduce the Vitality program to the Netherlands. So in sum, clear financial success and disciplined execution of our strategy.

Now, without further ado, let's look into the financial highlights of 2018, which you can find on page 2 of the presentation. As this dashboard shows, our performance in 2018 has been really solid. Operating results amounted to €742 million, exceeding the already record level of 2017 by €14 million, despite the €30 million impact on the severe January storm in 2018, while 2017 had an exceptionally favorable claims experience.

Underlying, our Non-life performance continues to have very strong and – to be very strong and each of the other segments reported higher results, reflecting higher investment margin, particularly driven by the acquired business of Generali and good momentum in the fee-based business segments. Our business yielded an operating return of 14.2%, well over our targets of up to 12%. Combined ratio of ASR stood at 96.5%, ahead of our target of 97%. This number includes the impact of the January storm of a roughly 1% point and the Generali Nederland's portfolio with a combined ratio of approximately 100% for 2018. We also remained sharply focused on our cost level. Operating expenses declined 3% or €17 million, when adjusting for the cost base of the acquired Generali business. Our Solvency II ratio remains robust at 197% after the proposed full-year dividend.

And as you know, we are still using the standard formula. Organic capital generation amounted to €372 million, being 10 solvency points (04:47). Our solvency ratio also takes into account the 9 percentage point impact from the acquisition of Generali and roughly 6 percentage points impact from the forthcoming lower tax rates, which we decided to take up front. There are a number of other items that impacted solvency in the past year. And Chris will provide further details on this later on.

Our strong solvency position and financial flexibility enables us to remain entrepreneurial. As we have said at our Capital Markets Day, we see good opportunities to be entrepreneurial and to pursue profitable growth for both organically and through acquisitions, which we have proven to do so with the acquisition of Generali and the announced acquisition of Loyalis.

Based on strong performance and our confidence in the outlook for 2019, we proposed to raise our dividends almost 7% to €1.74 per share. Taking into account the interim dividend, which we paid in September, there remains a final dividend of €1.09 per share. In line with our dividend policy, we strive to offer our shareholders a stable to moderately rising dividends per share for the long-term.

So, let's now move to slide 3, which reports on the progress made in executing our strategy. I will not discuss all the developments we listed here and which we have reported in our press release, but let me just mention some key developments and achievements in executing our strategy, starting with our solid back books in Box B.

We finished last year the migration of three Individual Life books towards the Software-as-a-Service platform making cost more variable and in line with the decline of that book. The Generali Individual Life books are next in line for migration and this will be fully realized in 2019. And the pension book of Generali will be completed early 2020, which will be roughly 9 to 10 months ahead of our schedule.

We also completed the integration of the Funeral portfolio of Generali and the PC Hooft Funeral book in October. Key message on this box is, we got a team that has actual experience in buying and integrating books of business successfully and we are open for business. New books will just be added to the queue for smooth integration.

In the top left, the Non-life business that provides the opportunity of growing cash flows. Very pleased to report that we have continued to deliver solid organic growth in gross written premium of 4.7% overall in 2018. And this is business that generates profitable growth through attractive combined ratios. Key message in this box is, our products and services clearly appeal to customers, allowing us, again, to outstrip overall market growth.

Also, not mentioned in this slide that we recently completed a major migration in our P&C business, over 1 million policies have been migrated from the mainframe to a new Software-as-a-Service platform, another step in simplifying our organization as this business is now running on one single system.

In the Asset Management related growth business, we have made considerable progress as well. Within DC pensions, we continue to see good momentum for the Werknemers Pensioen. We have reached over 55,000 active participants, and assets under management for this product rose to roughly €675 million, up from €480 million last year.

In new business, we are a clearly top three player, an another example of interesting developments in Asset Management are our mortgage fund continues to appeal strongly to institutional investors. Mortgage fund recorded an inflow of €1.3 billion, driven by third-party mandates and committed external assets under management exceeds in the meantime €2.3 billion. Key message in this box is, we are gaining traction and a shift to generating income from capital-light products.

Now, most recently, we announced the acquisition of Loyalis, and I can add, as said in the introduction, the exclusive cooperation with South African Discovery. These two play very well to our strategy and the disability ecosystem. Let me now show our unique proposition in this domain on the next slide, being slide 4.

This graph depicts our unique coverage in the field of sustainable employability. It encompasses capabilities in four areas of expertise. First of all, distribution, we are able to target the right customer with the right product. We have added prevention and added services, which is aimed at enhancing employees' productivity and reducing absenteeism.

Thirdly, claims management aimed to be short in the duration of absenteeism and to provide income during absenteeism. And lastly, price and risk selection to optimize our underwriting result. As you can see, both Loyalis and Vitality proposition of Discovery fit and complement our coverage in this area. This is another example of how we execute our strategy, both to pursue profitable growth and to remain socially relevant.

So, let's now move to slide 5 on our group operating results. This slide shows the momentum in our operating results since the beginning of 2017. Despite the severe January storm, we managed to surpass last year's results which benefited from exceptionally low level of claims. Comparison of the first half of 2018 to the same periods of the prior year shows the impact of the storm on Non-life.

Also, clearly visible to the performance in the second half of 2018 compared to the second half of 2017, and this shows healthy recovery with an increase of 5.6%. Higher results from Life, plus €31 million; Bank and Asset Management, plus €11 million; and Distribution and Services, plus €8 million, more than offset the decline in Non-life and Holding. IFRS net profit is above net operating profit for – both for the full year and the two half years. So, overall, also below the operating result line, there has been a positive contribution from non-operating and incidental items to the net IFRS result.

Let's have a closer look at the business segments and let's start with Non-life on slide 6. We are generally pleased with our performance in Non-life. While operating results shows as such the impact of the storm in January and a higher level of large claims, the underlying business performed strongly and better than previous year. The bulk of the claims, so to speak, showed ongoing favorable developments. Claims frequency in bulk improved from 43.1% to 42.7%.

The combined ratio of 96.5% beat the target of 97%. The Generali portfolio ran at a combined ratio of approximately 100% and did not yet contribute to the operating result. When adjusting for the exceptional impact of January storm and taking into account the higher combined ratio from the acquired Generali portfolio, a normalized combined ratio would be in the 95% range, so fairly stable to the prior year.

Our gross written premiums increased by almost 17%, driven by a solid 4.7% organic growth by all business lines and the inclusion of Generali Nederland. And as mentioned earlier, we continue to upbeat on the organic growth opportunities in the Non-life segment. In the breakdown of the combined ratio, the uptick in the commission ratio is a mix of business effect as a consequence of inclusion of the Generali Nederlands portfolio. This portfolio comprises mostly B and C products which, in general, come at a higher commission ratio. Our cost ratio improved from last year's 7.6% to 7.3% in 2018.

If we were to look at the combined ratio for each of the different business lines, you can see continued strong performance in the Disability portfolio. Last year, however, we experienced unfavorable claims development in the absenteeism portfolio, but we took measures over there, resulting in margin expansions within this portfolio. Nonetheless, we will continue to monitor claims experience in this business closely in order to keep pricing appropriately in sync with the underwriting risks.

So, let's now turn to slide 7 on Life. In Life, we saw a solid increase of operating results of 4.7% to €663 million. This increase was mainly driven by an increase of investment margin of €37 million, mostly driven by the addition of the acquired Generali business. The increase of investment margin was driven by a number of factors.

Firstly, our direct investment income benefited from re-risking of the investment portfolio, including the Generali portfolio. This more than offset the impact of the decline of the Individual Life portfolio on direct investment income. It also offsets the decline in amortized realized gains, i.e., from our shadow accounting.

Furthermore, as the Individual Life book runs off, there is also a decline of required interest, which is positive for the investment margin. The addition of the Generali portfolio had only limited impact on required interest. Generali Nederlands had a total contribution to the operating result of approximately €40 million, mainly within the investment margin. While there were some nonrecurring positives in the technical results, we believe that going forward €30 million is a sustainable recurring number for the Generali portfolio.

Gross written premium is up almost 8% and reflects both organic growth and the addition of Generali asset. I already mentioned our continued success in the DC pension products. Currently, 73% of new business APE is for new DC solutions, which is a very positive development from our perspective.

Let's now turn to the other segments where we are clearly gaining traction and that's on slide 8. Operating results for the two fee-generating segments, Asset Management and Distribution and Services, combined amounts to €41 million and it's now already adding a full percentage point of organic capital creation on an annual basis. Asset Management showed a very strong increase to €16 million. This was driven by strong inflows in the mortgage funds and in the ESG-Funds, which resulted in additional fee income from third parties for the asset manager and higher fee income from the real estate funds.

As bank has been classified as non-core, it's no longer included in these results. Operating result of the Distribution and Services segment increased to €25 million. This was driven by a strong contribution from Dutch ID, which we acquired two-and-a-half years ago, and the contribution from the Generali Nederland distribution companies, namely ANAC and Stoutenburgh. However, we anticipate some pressure on fees in 2019 as a result of lower commissions for mandated agents.

The operating result of the Holding amounted to a minus of €108 million. The decrease is mainly due to a onetime alignment for – of personal benefit schemes. In addition, interest paid also increased due to the full year inclusion of the interest on the RT1, which we issued in October 2017.

So, let's now move to slide 8 (sic) [slide 9] (00:18:32) and measure our performance against our targets set at the IPO. Our performance has been strong on all key metrics in 2018. We've been able to keep – we've been able to keep our business momentum at a high level, and our performance is better than our medium-term targets. The strong ongoing operating performance of the various segments, the disciplined execution of our strategy, and our robust capital position make us confident that we can continue to attain the operating results of recent years throughout 2019.

And having said this, I would just like to hand over to Chris for further details on our capital and solvency.

Chris H. Figee {BIO 18815839 <GO>}

Thank you, Jos. Ladies and gentlemen, let me walk you through our solvency and capital position. In order to speed up and quickly go to the Q&A, I'll take what I call a – it's a magpie approach to presenting, taking just the nuggets, the shiny elements and not going through each and every slide in the fullest detail.

Speaking of the key elements, let's move to slide number 11. You can see the development of our Solvency II ratio moved up to 197%. Couple of points I'd like to make irrespective of what's said on the right-hand side of the chart. The solvency number includes the tax effect, so we already implemented or reflected the lowering of the corporate tax rate and the LAC DT that shaved off about 6 percentage points of our solvency. So, if we had not done that our solvency would have been around 203%, 204%. So, it obviously also includes the benefit from the VA. Admittedly, the VA includes what I'll call an Italy premium. From a VA perspective, we are short in Italy, so when Italy spreads widen, our solvency is supported. We estimate the Italy effect to about 4 points of 4 VA points or 4 points of Solvency.

So, if you take that perspective, the 197%, you add that to tax takeout, the Italy effect, your underlying would end up around 200% after dividends. Interestingly, in the absence of future M&A, that 200% and the ongoing capital generation brings us in spitting distance of what we would call the capital distribution moment, as we communicated during our Capital Markets event. And of course, we'll always try to deploy capital in the business organically; or inorganically, if and when it meets our existing and unquestionable return targets. But again, the solvency level moves closer and closer to the distribution threshold that we have communicated.

Second point to make, we still have a net DTL position. I'm actually pretty proud of that. It's a great asset to have. We have sufficient amount of tiering headroom. As you can see on the page, the Tier 3 headroom itself was already €500 million. And if you actually include Loyalis, which is not on the page with pro forma, we'd estimate that adding Loyalis would add another 100 million to the Tier 2 headroom, another €50-odd-million to the Tier 3 headroom, which actually means that if you think about funding the Loyalis transaction with the hybrids, where we said we consider either Tier 1 or Tier 2, taking potential transactions and capital synergies in mind, we estimate today with the amount of Tier 3 capacity we have.

We could issue a Tier 2 hybrid instrument, still be left with well over €300 million of surplus Tier 3 capacity after these instruments, which would give us more ample room to absorb any ineligible capital of a potential acquisition. So, we're trying to say is, including Loyalis, we have sufficient headroom to issue a Tier 2 and have remaining room for capital synergies going forward.

Final point on this chart I'd like to make is that we manage to still grow our own funds, the eligible own funds grew about €100 million even after dividends. And after the rocky second half of the year, the own funds and unrestricted Tier 1 both grew in absolute amounts. And given the long run, looking at book value you're looking at market values still is a good measure for performance.

Moving then to page number 12, the Solvency II ratio movements throughout the year. The chart is by now well-known. The way we decompose or bucket the delta in solvency in the various components, you can see the organic capital generation of €372 million for the year. Then taking out dividends will leave you 197% solvency post-year. And again, three things I'd like to point out on this chart. €372 million OCC for the year, if you compare H1 to H2, actually we added €14 million of capital in H2 of – H1. So, OCC went up by €14 million in the year and €9 million for the last year.

If you look at the business capital generation, the stuff that the business generates excluding book release, excluding UFR unwind was 283 for the year. Actually, that was up significantly. It was €130 million in HI, €153 million in H2, so the business cap gen actually went up by €23 million during the year. So, in that perspective, we've seen an increase in capital generation in the year, driven by an increase in business capital generation in 2018. So, business cap gen up €23 million for H1 and up €40 million versus same period last year.

Second point I like to make is the market and operational developments. You can see minus €59 million in EOF. Actually, the number in H1 was minus €53 million, which meant that the other element of own funds accretion was flat in the second half of the year and I'm actually very proud of that, given the fact that we've seen financial markets go down, significant movement there. We've been able to keep the own funds generation above and beyond what's in the OCC, keep that flat in a couple of months where we see still rocky developments on the financial markets.

Third point is to preempt the question that undoubtedly will come, what is the impact of your long-term investment margins? As you know, we reported OCC based on long term-investment margins. We confirmed that stance again during our Capital Markets Day in October. If we had actualized and to the actual end of year long-term investment actual spreads, plotted them into the OCC, our OCC would have been roughly €30 million higher.

If you look at the individual components, you'll see governments moving a bit away from our long-term investment margins, but non-core sovereigns, credits, and mortgages actually moving towards or even above our long-term investment pricing. So, at this point, our mortgage assumption and credit assumption is actually conservative versus the actuals that we have shared today. So, where we can move from a long-term investment results to actual investment spreads, our OCC would have been €30 million higher.

And then, if we – had we moved our equities and real estate to an absolute recurring number to do a spread, indicatively, if we've locked in 7%, we would have add €130 million of additional OCC. And that's something we will not do ourselves, but for comparison purposes, so it's good to have that in hand. No doubt, you can ask questions on the further details on the OCC and business cap gen, we'll leave that to the Q&A.

Page 13 talks about the sensitivity of your Solvency II ratio. As you will understand, the UFR is likely to decline, the formal decision is about to be announced. But we expect it to decline by 15 basis points from €4.05 million to €3.09 million. That would take another 3 points to 4 points of our solvency. Similar as happened in this year, it will add about €8 million to our annual flow, from stock to flow, €8 million to our OCC.

And UFR at 2.4%, which we consider to be the most economic form of UFR, so a UFR that is consistent with or in line with the actual cash returns we make on our investments. So UFR, in line with the coupons, dividends, rental income and what have you at 2.4% gives a solvency of 156%. And 156%, we actually didn't adjust any tiering impact of that level as well. So, it's a fairly robust and kicked solvency ratio at 156%, safely above our risk appetite of 120%. So, again, there, it gives you comfort on the robustness of our solvency. Final point, if we were to strip out the UFR, altogether, our solvency ex-UFR is over 130%. Actually it went up a few points during the year.

Page 14, strong balance sheet and financial flexibility. We show in a number of pages the interest and debt capacity that we have. In our thinking, our balance sheet drives the amount of debt capacity. Our solvency drives actually the amount, the instant we would choose. Our balance sheet has sufficient amount of debt capacity, the leverage is about 26% points in the year, interest cover still safely above 10%. On an S&P leverage ratio, the last time S&P lift was 2017, and 90% ratio, we think that number is broadly unchanged. We have surplus capital compared to the AA and if any, how you look even AAA component of the S&P model.

So, sufficient room to absorb additional debt if we wanted to. Just for your perusal, a 26.7% leverage, if we wanted to move that leverage to 30%, we could add a net of €300 million of debt. If you wanted to move to 35%, we could add net €800 million of debt to our balance sheet. Given the fact that we got two instruments up for call for €200 million, and of course the call decision, we can and will only make at the time of call, but these are 10% coupon instruments, so we need to see humongous debt movements for us to make another decision, assume that net €300 million or gross €500 million debt increase would bring us towards a €500 million room. And as I said, we've got Tier 2 and Tier 3 eligibility. And the pro forma analysis including Loyalis shows us that if we were to raise a Tier 2 instrument, we still have surplus Tier 3 capital available.

Final Point, financial leverage at 26.7%, if we were to include our realized capital gains, which is industry practice, but we didn't do that given our shadow accounting methodology. If we were to include capital gains reserve in our leverage calculations that ratio would drop to just over 20%. So on a like-for-like basis or more like-for-like basis, our leverage ratio is more like 20% including the capital gains reserve.

Page 15, our Holding cash. We take a very mechanical approach to Holding cash. It maybe by German ancestry, but it's not. We take a model, Holding cost per annum plus dividends is your Holding cash, aiming at €394 million and ending up at €394 million. We upstreamed about €260 million in the second half year versus €179 million in the first half, so more upstreams in H2 than H1, not just on Life, but also for example in the supplementary health business, we upstreamed tiny bit of capital to show that every business unit in our business contributes to Holding cash. So, we upstreamed our capital to the Holding and achieved our Holding cash targets.

You'll be able to see our Solvency II ratios of our legal entities. Life is very strong at 202%. Non-life is 154%. We're a bit less pleased with that, to be quite frank. Five reasons why our Solvency in Non-life is, I would say, temporarily lower than we would normally strive for. Of course, the tax effect, so we fast-forward implementation of tax, which affected the LAC DT in the Life business; market effects where the VA – the corresponding VA effect has less impact on Non-Life than in Life; it is the growth of our book, we grew our Non-life business substantially, organic growth was about €100 million of premiums in P&C and disability; it is the impact of Generali, net-net the Generali acquisition was a positive. I mean, we spent less capital on Generali than we originally anticipated, but all the pluses were in Life and they drove actually additional reserves rotations were in Non-life for net-net less capital investments, but the pluses in Life and the additional reservations in Non-life.

And finally, we made a small additional rotation on the absenteeism business, because we see sickness leave actually growing across the board in the country. The trend is up and we applied our trend. That, together, caused the Non-life Solvency to move to 154%. If I look at the business today, I would expect it, I'm pretty confident it moves to something north of 165% before the summer already. So, that will restore itself organically.

Page 16, asset and financial leverage. Of course, we're living in an unstable environment with lots of risks, lots of volatility, and volatile financial markets. As we did in the Capital Markets Day, present our leverage from a liability and an asset perspective. Our leverage is actually stable; on a solvency basis, down a bit; on IFRS basis, up a bit, but effectively very stable low leverage. And on the asset side, reduced our market risks during the year from 46% to 43% and the risky asset ratio, the asset leverage ratio, is effectively stable. It's a more old-fashioned approach (00:32:49) through market risk models.

But in time of the fluctuation, I think we should move from market risks, move to nominal exposures. We've given you lots of details in the Appendix H to L, you can see more details on our investment portfolio before and also the calculation of the asset leverage, which I think is increasingly an important metric for us to look at. It looks at the nominal asset risks compared to the solvency cap that we have. It's effectively stable. For those of you (00:33:19), you can see it's slightly twisted, slightly amended towards the Capital Markets Day. We made a little more deeper analysis of our nominal exposure on risky assets.

To remind you, it's the equity position. It's a real estate excluding lands, because we think land is really not that risky asset. It's collateralized lending to farms. We took out, as opposed to the Capital Markets Day, the real estate own use because our own office, our own tenants, so that's a less risky position. We actually added mortgages with a loan-term value of over 110% added back. And we specified we're going to be deeper into the whole non-weighted fixed income segment, almost a line-by-line item to estimate which of those elements have a lower rating on us.

This includes equities, real estate excluding lands, and non-investment group debt. That is about 100% of our unrestricted Tier 1 ratio that we feel comfortable with. We think it's very important to look at nominal exposures in these volatile times as well. But the summary of my perspective is, stable on – and low on financial leverage; stable and very well controlled on the asset leverage, which has allowed us to seal relatively well through the volatile financial markets.

So, we will get back to Jos for some final perspectives from the CFO, good H2, capital generation up from an organic perspective and a business perspective; operational profit up in H2; and underlying metrics have been good combined ratios in H2 have been better than H1; production in DC better H2 than H1. So, solid underlying performance by the business.

Secondly, I think we still do relatively well through the volatile financial markets in H4. You can see that we managed to still grow our own funds and our unrestricted Tier 1 during the year. The solvency impact of those market fluctuations were very well manageable, we reduced our market risk and kept our nominal asset exposures very much in check and given you more disclosure on the asset exposures in our appendix. And as Jos said, I can only confirm, comfort on the earnings outlook 2019. If I look at the way we ended last year and the momentum that we have in the beginning of the year.

With this, I give back to Jos.

Jos P. M. Baeten {BIO 2036695 <GO>}

Thanks, Chris. And if this is the less detailed fruition of the story, I would love to hear the details later on. So, as you may have noticed, we are quite pleased with our financial results, the operational performance of our business, and the strength of our balance sheet. This makes us, as Chris already reconfirmed, very confident that we can continue to attain the operating results of recent years throughout 2019.

So, where does this lead us in terms of dividends for 2018? We propose a full year dividend of €1.74 per share, which is an increase of almost 7%. This outstrips the growth of the operating results and reflects our confidence in the outlook for 2019. This provides us the comfort to raise the payout ratio to 48%.

Within the framework of the existing dividend policy, it's our intention to offer shareholders a stable, slightly growing ordinary dividend, capital that we generate in excess of our ordinary dividend will be deployed for profitable growth, and value creating opportunities. As we've pointed out in our earlier meetings and on our Capital Markets Day, we believe a very disciplined and rationale approach to capital management. Excess capital that we cannot deploy, as I said before, will be returned to shareholders.

Now, before my final conclusion, a remark on larger scale consolidation that may take place in the Netherlands. As we have done in the past, and what we continue to do today and in the future, our approach is a rational one and we will maintain in all cases our strict financial discipline when evaluating emerging opportunities. You all are well-informed on our strategic priorities and our views and the importance of maintaining a strong balance sheet post any transaction. And frankly, at this point, there's not much we can add to this. I do not want to add to any speculation, or be in the way of any orderly process. As soon as there is information to share, we of course, will do so.

Now, to wrap up this call, I would like to conclude that I am very pleased with the strong set of results. We were able to surpass our record of operating results of 2017 despite the impact of the severe storm in January. Our businesses all are very performing very well and that enables us to remain entrepreneurial. We have shown that we put our excess capital to work. And as said, we started 2019 with lots of confidence and everything being equal, we are convinced to be able to deliver strong results on this year.

And with that, I would like to conclude the presentation and to hand over to our operator.

Q&A

Operator

Thank you. We'll now take our first question from Farooq Hanif of Credit Suisse. Please go ahead, sir.

Q - Farooq Hanif {BIO 4780978 <GO>}

Hi, everybody. Thank you for that. I just want to go back, Chris, to what you said about operational capital generation. So, all other things being equal, so ignoring UFR impact, ignoring Loyalis, are you basically indicating the second half, we can basically multiply by 2 as a basis? That's question one.

Question two on the combined ratio, as you integrate and improve Generali, can we see the P&C going back towards the sort of 95% to 96% level over time? How quickly will that happen? And very lastly, if I may just say, on your – getting close to the distribution threshold, what does that practically mean for us? Thank you.

A - Chris H. Figee {BIO 18815839 <GO>}

Thank you, Farooq. On your question, could we multiply this – OCC in the second half was 193% (00:40:28) 179%. Could we multiply it by 2? I think that's a reasonable approach. I can make a very long story short, but the answer probably is, yes. I mean, what will happen in the next year is that, if you look – now let me spend a few minutes on this, now that we are talking on it. And Jos wanted to have more details, so I'll take it. No, if you look at what happens during the year and during first half of the year, I mean the UFR unwind in our OCC was less than last year. H1 to H2 stable, but less than last year, given the fact of the UFR declines, and that's actually that's going to continue probably into the next year.

If you then look at the release of capital, some changes happened in H1 to H2. We made a small restatement during the Capital Markets Day. So, I'm referring to those figures. We saw, in this year, a slightly higher release of SCR, a slightly lower release of risk margin, but also a significantly higher new business stream, because we actually wrote more new business. Organic growth in Non-life was higher. Significant release of capital buckets, H1 to H2.

Effectively, the SCR release was roughly stable, the EUF release was less. Why is that? SCR release is stable. SCR was up a bit, but new business stream was also up. Net-net, the release of required capital was stable. The risk writing release was a bit less. And on the new business, we also write more new business margin. So, the new business stream actually takes out a bit of it additional release of book (00:42:08).

And then, on the business cap generation, we saw actually during the year gradually moving up technical results in Non-life (00:42:18) in the second half of the year. So, technically underwriting results up; investment results, relatively stable; holding cost, up a bit because of one-offs, I think we disclosed that I think in our press release; and finally, fee-based business, up versus last year, first half a bit higher than H2, but not really meaningful.

So, in that number, we can see a gradual decline of the UFR unwind, gradual decline of a risk margin release, captured by an increase in SCR release, but new business stream may hold back cap gen at this point. Obviously, we think it's a good point, because our Non-life business clearly is value-creating. So, a new business stream on Non-life to us is often a prediction of good results to come in the future.

And thirdly, on the business side of things, gradually improving technical results towards a level that you expect it to be, irrespective of any storms; investment results, stable;

holding cost, up by a one-off. So, it's a long story short for saying, multiply the second half by two, probably yes. But I wanted to give you a little bit more clarity and detail on that.

A - Jos P. M. Baeten {BIO 2036695 <GO>}

And on your second question, Farooq, on the combined ratio, the main driver that influenced the combined ratio this year was threefold. First of all, we had a storm that influenced the P&C combined ratio, negative with 2.1 percentage points. So, if and when we wouldn't have such a storm or a comparable event in this year, that would be a positive.

Secondly, the combined ratio of Generali portfolio is still not to the level where we want to have it. We're working on that. So, that will definitely add some positive trends. And the third driver in the combined ratio for Non-life is in absenteeism. As Chris said, we have added some reverse because of the trends – the underlying trends we have seen in sickness leave in this area. If that doesn't need to happen again in the ongoing year, then your assumption that we would return to the level within our targeted combined ratio, the answer to that question is clearly, yes.

A - Chris H. Figee {BIO 18815839 <GO>}

Okay. Farooq, and to your dividend distribution point, we said in our Capital Markets Day, the threshold at which we will distribute capital through a supplementary additional distribution to shareholders is when the solvency ratio is 200 and something. That's kind of where we got to. And that something depends on where the market is and what the economic situation is. To that point, we will, of course, take out some of the, for example, lesser economic factors like VA support by spread wide in Italy. A new government in Italy should not improve our solvency, but actually it does.

So, when I say I adjust for Italy effect, I adjust for the tax effect, that means that the underlying solvency, the kind of more economic solvency moves towards 200%, which means in the absence of M&A, in the absence of deploying a capital to a large extent in value-enhancing activities, we get to the point that we meet this 200-and-something mark of economically justifiable capital. And then, I think it's fair to engage in a debate with our shareholders whether we should deploy it and in what way.

So, I think we are getting there. But again, if there would be ways to deploy this capital on a meaningful and value-creating way, in line with our investment philosophy and our thresholds, that's probably a better use of capital to our shareholders. But again, I'm looking at a situation where maybe in a year from now no M&A has happened and then we might look at things differently.

Q - Farooq Hanif {BIO 4780978 <GO>}

Thank you very much. Very candid. Thank you.

Operator

The next question will come from Cor Kluis of ABN AMRO. Please go ahead.

Q - Cor Kluis {BIO 3515446 <GO>}

Good morning. Cor Kluis, ABN AMRO. Got a couple of questions. First of all, on your investments in real estate, I think it went up by €0.5 billion approximately in half a year, especially the category other funds. Could you elaborate a little bit on what the expansion is there? And also related to that, if you've done some real estate revaluations in the second half of the year? And if so, what was the size of that tuning that solvency ratio?

Second question is about the partial internal model, if you've been doing quite a few acquisitions now, Generali, Loyalis, and who knows more, how actually are you looking to paying that? I understand, of course, that you still believe the standard model is more logical. You've been looking somewhat towards the PIM. The larger you are, it might have more benefits. Could you give some progress or what you think about it going forward and if you have already some insights on that one?

And last question is about the solvency ratio. I thought that you said during your performance that the solvency ratio of the market effects rose by a few percentage points year-to-date and the piece where you were talking about the ex-UFR of solvency ratio. Could you elaborate a little bit on that, what's the solvency ratio was of markets effects separately year-to-date? Thank you.

A - Jos P. M. Baeten {BIO 2036695 <GO>}

Chris?

A - Chris H. Figee {BIO 18815839 <GO>}

Yeah. On real estate – Cor, on real estate, yes, we are investing in real estate. If you recall, the Investor Call we had in the summer, we said we think there's value or room to re-risk and spend some money on capital on risky assets. The initial thinking now is possibly the equities. We quickly adjusted of getting where equity markets were and given the real estate opportunities that we saw. We are predominantly invested into Dutch domestic and Dutch real estate, where we think those assets are in today's fundamentals, I think more or less decoupled from global market generations.

I mean, never fully, of course, but trade wars, Brexit do not take away the shortage of housing in the Netherlands. So, we're looking for asset classes that have their own supply/demand dynamics in their own fundamentals. And if you allow me to walk you quickly through where we are on real estate on the directs and the other funds, we invest in high streets in our retail fund. Actually, we've got a very strict investment policy there.

We invest in high streets of the top 20 cities. And actually in those high streets, we look at the best parts of those streets. And if you challenge our real estate people, they tell you that the investible space in retail is less than 10% of the total retail space in Netherlands. So, it's high streets in top 20 cities plus effectively Albert Heijn supermarkets. And that is kind of – our universe is about 10% of the universe in the Netherlands. Vacancy rate today is 1.4% in those high streets.

Then, we've got an office strategy, again, very strict. We invest in offices that are in walking distance from train stations. So, it's actually literally 750 meters away from an intercity station and 500 meters away from a non-intercity station, and that's literally the investment guideline that we have. Vacancies are less than 5% in those offices and filling actually rapidly. And again, that investable universe, within walking distance from train stations, obviously is less than 10,000 square meters is – or at 10% to 12% of the investable office universe in the Netherlands, so again, a very focused strategy.

Then we have residential housing. We invest in middle-income housing meaning average monthly rent is €922. The bulk of our business is between €700 and €1,200. So, it is actually affordable housing where there is real shortage. I mean, it's estimated that the Netherlands has 230,000 too few houses at this point in time, 230,000 houses or apartments. We're building 70,000 a year, and we need 100,000 a year. So, the shortage is increasing by 30,000 a year.

We didn't mean that house prices can't go down, but we think they're really well protected. Vacancies are less than 2% as well. I know it's got a land portfolio which is 80% agricultural positions. And effectively, it is leased – it's leases to farmers with land as collateral. That is the heart of the investment portfolio and our strategy is very core, very disciplined on a very small focused investment universe and don't do anything outside. That actually drives our investments in real estate.

On the sites, we do a couple of funds. We've invested in a few housing funds in the Netherlands by some of the larger housing asset managers, simply because they came available and we got to buy them relatively cheap and we want to add housing experience in the Netherlands. And we've done a little bit in Europe, you can see we've partnered with BlackRock on the European core funds where we can act as an anchor investor in those funds. And as an anchor investor, you tend to have relatively good terms in terms of fee, in terms of core decision rights, in terms of our co-investment rights.

So, we have a small portion of, what I call, other which is funds by other investment managers. Often it's actually supplementary to our Dutch real estate business and there are some European exposure to it. That is actually at the heart of our real estate portfolio. And if you look at the total risky assets, the increase in real estate actually is a mirror image of the decrease in equities. Effectively, we moved out of equities into real estate. And we think at this point in time that is a more protected, more robust investment strategy.

A - Jos P. M. Baeten {BIO 2036695 <GO>}

And on your second question, Cor, where are we on the discussion on PIM. Let me put it this way, PIM is a good friend, but still at a distance. We have added Generali and Loyalis, but that actually didn't change the profile of the company. So, from that perspective, there is no direct reason to invite PIM to live with us. We, however, have said before that if and when we would do a large transaction, that would be the first moment to reconsider that view. And from that point in time, we would need two to three years to implement it.

So, currently, we prefer to implement the acquired businesses to get IFRS 17 done and not spend too much time on implementing a partial internal model. However, if the future of the company would – in terms of profile, would become different than it is today, then we would reconsider that viewpoint.

A - Chris H. Figee {BIO 18815839 <GO>}

Cor, to your point of what happens, what are the market movements that went through our solvency, market movements, back to your solvency in a couple of points, you can see declines in your own funds as the market value of your asset decline. You can also see a compensating decline in required capital, because if your own funds – if your assets value declines, the required capital also declines and then there is the VA.

If you net own funds and requite capital, excluding the VA to adjust what happened to the asset classes, and if the VA had moved, we probably would have lost around 5 points of solvency, which is kind of minus 2% to 3% for equities, minus 2% in credits, minus 2% in sovereigns. And then, on real estate, our valuations were plus 3% in the year. So, that gives you a net of minus 3%, minus 4% on market movements. And that is then compensated by an increase in the VA, of which a part is the equity effect which we see. We take it as it is. It's great to have solvency go up, but there is a known economic component to it. But think about gross effect minus 5%, which is minus 3%, minus 4% which includes AR in the 3-percentage-point revaluation of our real estate business.

Now, how do we do real estate valuations? All our assets are physically revalued once a year. So, basically, we have a quarterly process. Every quarter, we do a 25% of all our buildings and objects are visited in person and the remaining three-quarters is – have a desk revaluation based on the physical revaluations and based on market trends and in the next quarter another around. So, every asset, every piece of brick and mortar is visited in person by a valuator once a year. So, every asset is being revalued once in person during the year.

Q - Cor Kluis {BIO 3515446 <GO>}

And the year-to-date developments?

A - Chris H. Figee {BIO 18815839 <GO>}

On what, sorry, Cor, real estates?

Q - Cor Kluis {BIO 3515446 <GO>}

No, on the market movements because you said...

A - Chris H. Figee {BIO 18815839 <GO>}

2019, you mean.

Q - Cor Kluis {BIO 3515446 <GO>}

Yeah. That's correct.

A - Jos P. M. Baeten {BIO 2036695 <GO>}

Relatively stable. Sorry. The market is up, so that's a plus. VA down, I think net-net neutral. I mean, the VA moved down a bit. I think it's good that there's some area of the VA – some of the Italy effect actually appears to be disappearing. So, I think year-to-date, market effects were relatively neutral with the decline in VA countering the positive revaluations on equity markets and the contracting spreads.

Q - Cor Kluis {BIO 3515446 <GO>}

Wonderful. Thank you. Very clear.

Operator

Our next question will come from Ashik Musaddi of JPMorgan. Please go ahead.

Q - Ashik Musaddi {BIO 15847584 <GO>}

Hi. This is Ashik here. I'm using Jackie's (00:56:29) line. I have a few question if I may. So, first of all, I mean Chris, you mentioned about the business operating capital generation, just the first bucket of the three. I mean, I look like that there's a significant increase from €118 million in the first half to €289 million, that's like a 50% increase in second half. So, what's driving that such a big jump, because I mean you have reduced your equity exposure as well? So, any thoughts on that would be great.

Secondly is if I look at your remittance for the full year, it was €395 million, which if I look on your full year operating profit before Holding company costs, it's around 70%. How shall we think about this remittance, I mean, because you're releasing capital from back book as well, Non-life is all cash business, so shouldn't this number be more like 80%, 90% or even 100%? So, when shall we expect this number to move towards operating earnings?

And thirdly, I think, Jos, you mentioned about you want to maintain a strong balance sheet after M&A, but then at the same time you mentioned that going to PIM may take two, three years. So, without PIM, how would you define a strong balance sheet immediately after an M&A? I mean, any sort of metrics you can give like, okay, this is the Solvency II ratio. It should be above this, et cetera, any thoughts on that would be great? Thank you.

A - Chris H. Figee {BIO 18815839 <GO>}

Okay. On the first one, on the business cap gen, you're right, it increased. There was a small restatement, which we explained in the Capital Markets Day, Ashik.

Q - Ashik Musaddi {BIO 15847584 <GO>}

Okay.

A - Chris H. Figee {BIO 18815839 <GO>}

It has to do with the reclassification of risk margin, the €118 million moves to €130 million on a restated basis, and €130 million is then comparable to €153million.

Q - Ashik Musaddi {BIO 15847584 <GO>}

Okay.

A - Chris H. Figee {BIO 18815839 <GO>}

The €23 million really is the improvement in underwriting results, by and large.

Q - Ashik Musaddi {BIO 15847584 <GO>}

Then, it's okay, yeah.

A - Chris H. Figee {BIO 18815839 <GO>}

It's effectively no storm, but a bit more larger claims in H2. And then that's what it is, yeah. On the remittance, I mean, Ashik, our policy is, we don't need to hold cash at the Holding. That's been our policy and I understand that it may deviate from some other market practice, but we feel very strongly about it. Holding cash is a function of holding costs, so you want to – what we keep at the holding is 1 times the operational holding cost of full year holding cost plus the committed dividends. So, that means, if we were not able to upstream cash at Holding, we could then pay Jos and my salary for a year, and other Holding people as well.

So, it's one year Holding cost plus dividends. The remainder we keep in our business as long as the business yields an attractive return. And if you look at the ROEs, the return on equities of our business – and I may dwell a bit, but I think it's important. In Non-life, the return on equity with around 10%, 10.3%, but excluding storm, if we haven't had the storm, the Non-life ROE would have been about 13%, operating ROE. The Life operating ROE is about 13%, 12.7% to be precise. So, our businesses create ROEs that exceed the cost of capital.

So, we feel comfortable keeping the cash in those businesses. If we want to, if we need to, we can upstream. So, every year, as I said, it's kind of mechanical. We say what – and are your Holding costs plus dividend commitments. That's what we want to have at Holding. If we were to, for example, distribute more cash to our shareholders through increased dividends or special buybacks, then we'd upstream the cash, keep it at Holding until we distribute. That's the model we work. So, there's no impediment to upstream in cash. It's just our policy that we keep our cash in the business not at Holding.

As to your point, what does a strong balance sheet look like, or what do you want to have for a strong balance sheet? I think today we have a strong balance sheet, and we said, in terms of leverage, in the Capital Markets Day we outlined 35% is a ceiling that we could live with. Not that we need to strive for where we would could live, we would leverage up to 35%. Above 35%, you need to have a very good cost and you want to bring it back. So, moving it to 30% would give you sufficient room to absorb an increase of 35%, but levers at the 35% would be variable and consistent with a A rating.

In terms of solvency, solvency today is very strong. We don't need to hold 197% per se, but it depends a bit on the situation at hand. I think what we want to have is make sure that solvency and UFR of 2.4% is safely and significantly above the 120% and you want the solvency as is to be able to absorb the decline in the UFR. The declines in the UFR to 3.6% and then still be safely above 160%. So, I work my way back technically saying, hey, look, our management lever is 160%, the UFR is going to decline, I want to make sure that I can absorb this UFR decline, add that back to 160% because it's a small buffer, and that's kind of the lower limits for which you want to run a standard model solvency and still claim to have a robust balance sheet.

Q - Ashik Musaddi {BIO 15847584 <GO>}

Yeah. That's very clear. Thank you.

Operator

Our next question will come from Johnny Vo of Goldman Sachs. Please go ahead.

Q - Johnny Vo {BIO 5509843 <GO>}

Yeah. Hi, guys. Thanks for allowing me to ask my question. Just a first question, I noticed that there's an extra senior loan of a bit over €105 million that you've issued since the half-year stage. Was that issued at the Holding company and what was the purpose of that?

The second question is, just can you give us an update on – I mean, I think you've given a little bit of an indication on the refinance of the bridge loan that you took out for Loyalis. So, can you give us an update on when you hope to refinance that bridge loan?

And the third question is, just in regards to the €200 million of debt that is due to mature this year. Are you still committed to paying that off, or will you look to refinance that? And just one more final question, just in regards to the dividend payout. I know you listed the dividend payout now to 48%, but how do we determine where in the range of between 45% to 55% you're likely to go with that dividend payout? Thank you.

A - Chris H. Figee {BIO 18815839 <GO>}

On the senior loan, that's actually very opportunistic. It's a holdco loan. At the end of last year, we said that our Holding cash target is €394 million, so literally, Johnny, we had ready to upstream on a push of a button €100 million from the Life business. And then we found that a couple of banks who were really awash with cash wanted to offer us Holding financing at negative yields. So then we felt, I can fund it myself at negative yields or I can take out cash from the Life business where the ROI is north of 12%. And we thought having a negative yield financing could be hard to resist. Really opportunistic but negative yields financing at holdco, the benefit from...

Q - Johnny Vo {BIO 5509843 <GO>}

Is that Chris?

A - Chris H. Figee {BIO 18815839 <GO>}

...the amount of cash – yeah.

Q - Johnny Vo {BIO 5509843 <GO>}

Yeah. So, just on that then the remittance that you say is from the Life business of €300 million and whatever, €100 million of that is actually a senior loan that you've issued?

A - Jos P. M. Baeten {BIO 2036695 <GO>}

No, no, the remittance (01:03:51) is in the bucket other.

Q - Johnny Vo {BIO 5509843 <GO>}

Oh, it's in the other. Okay. Fine.

A - Chris H. Figee {BIO 18815839 <GO>}

Yeah. So, that's in there. So, the €395 million is actually what is really remitted from the Life business. The bucket other – yeah, the bucket other contains a senior loan from another bank minus holding cash payments, minus during the year the injections that we made in the Generali businesses as well. But actually the €395 million is actually what is actually upstream in cash from the Life business. Okay?

Q - Johnny Vo {BIO 5509843 <GO>}

Okay. Thank you. Yeah.

A - Chris H. Figee {BIO 18815839 <GO>}

On the bridge, I mean we haven't taken out the bridge yet, because the deal with Loyalis needs to close. The terms and conditions are all committed, are affirmed. If and when the day comes Loyalis closes, we will take out that bridge, which I assume to be early May. If we look at the timetable which we submitted the request for DNO by DNB at the normal time period I think it's going to be early May for closing of the transaction and then we'll take out the bridge.

In terms of refinancing it, as I said, we have the option to use either Tier 1 or Tier 2 instruments. As we said at the Loyalis call, it requires a bit of a look-through on potential M&A opportunity to determine which instruments you would want to use, because it might be the case that you want to protect your Tier 3 eligibility for future capital synergy. So, that means (01:05:20) Tier 1 or Tier 2.

However, Johnny, if you look at what happened in the second half of the year and you asked us for formal Loyalis situation to it. We think that Tier 3 headwind that we have is actually quite large, and it is estimated that if you were to issue a benchmark Tier 2 because they tend to come in benchmark sizes, you still have sufficient Tier 3 left.

So, we will keep our options open, but working hypothesis is that a Tier 2 at this point is more likely than a Tier 1. It's cheaper, it's simpler to place and the Tier 3 headroom is actually far insufficient to capture any future capital synergies. So, base plan is Tier 2. When will we do it? When the time suits, somewhere during the year, depends on market, depends on preparation, and you need to be very opportunistic in it.

The bridge loan that Loyalis has a two-year maturity at reasonably attractive rates, so we're not at all in a hurry to do that. When it comes to the tier 1s, Johnny, I can't commit to confirm whether we'll call them or not. That actually has a call date, an announcement date at which we will make that formal decision.

Of course, it has a 10% coupon, so that call decision is probably relatively easy. But as we've seen in the 81 markets, easy decision when it comes to calls no longer exists. But it's fair to assume that we'll make the easy decision, but we can only make the decision, really, when we get to that point. We have sufficient cash in the Life business to upstream and refinance at 202% solvency, it's so baked into our plans, so that's kind of what you probably should expect us plan A, but we can only confirm it when we get to that point in October.

As for the dividend payout ratio, interesting to note that our dividend payout ratio, there's 48% of our net operating profit. It's about 65%, 66% of our OCC. It's about 80-something percent of our business cap gen. If you look at our business today, it is not a law, but I would think that you should be very careful not to commit to dividends that exceeds your business cap gen, okay. If you want your capital to be supported by release of your book, at some point, the release of book will be over, right.

Q - Johnny Vo {BIO 5509843 <GO>}

Yeah.

A - Chris H. Figee {BIO 18815839 <GO>}

So, I think it's fair to assume that your business cap gen should – your business generate should drive your dividends. Interestingly, which is pure coincidence, but sometimes things work out nicely. If you were to move dividends today to €283 million, that will exactly be a 55% payout ratio today. So, I think if you look at the business as it is today, we're committed to €45 million. As ASR is today, you could move it to €283 million and be still in line with your payout ratios. Where will the payout ratio move? We'll be very careful. We want to make sure that our dividend never goes down. We want to be the quality stock and behave it's a quality stock that are investors expect from us. So, we want to have a safe and gradually moving-up dividend. And we'll set our payout ratio in line with that.

Q - Johnny Vo {BIO 5509843 <GO>}

Okay. Thank you.

Operator

Thank you. We'll now take our next question from Albert Ploegh of ING Bank. Please go ahead.

Q - Albert Ploegh {BIO 3151309 <GO>}

Yes. Good morning. Albert Ploegh, ING. A couple of questions, maybe coming a little bit back also the previous questions on the dividends, and I heard what you said, Chris, on linking it with cap generation. But when looking at your Capital Markets Day planned 2019-2021, in terms of operating earnings, it seems you're pointing towards something like 2% to 5% growth, again, without any bolt-on M&A. And I think the OCC growth probably, as of this year's basis, probably around 3% CAGR as well. So, stable and growing, should we then link also your, let's say, base case dividend growth in line with something like a 3% to 5% or, as you now already did 7% and you expressed quite some confidence in 2019, that would be a little bit on the conservative side. So, maybe you can grow by 5%-plus. So, maybe a little bit of color there still.

And then, two small questions on outlook, if you like, on Life and Non-life. On the Life, your operating earnings were €664 million, flagging €10 million's kind of one-off but, I guess, let's say, the Capital Markets Day guidance was some kind of flattish outlook, excluding this €10 million is still a reasonable starting point and again, excluding any bolt-on M&A impacts there? And on Non-life, I think if you add back the storm, you're basically reporting something like €175 million operating earnings level. Is this also a good starting point? So, is this reflecting, let's say, what you would say a normalized level of large claims in that kind of figure as a starting point for our models? Thank you.

A - Jos P. M. Baeten {BIO 2036695 <GO>}

Albert, this is Jos. Let me start with the last questions. That's the most simple one to answer. And that yes, the €175 million, I think that's a number that we would recognize and not argue that that you have seen it wrongly. On your first question on dividends, I think the scenario you painted is not an unrealistic one. Let's call it the debate scenario. However, including your summary, you said, well, not counting with all kind of acquisitions you do, in the meantime, we have done Loyalis.

So, we will add Loyalis to our potential dividend stream. So, I think the way you mentioned it is the best-case scenario, but running the company based on the best-case scenario is not as exciting as building a franchise. We keep on building the franchise and looking how we can deploy capital in the most efficient way to investors, but let's assume your numbers could be the base case.

Q - Albert Ploegh {BIO 3151309 <GO>}

Okay. And then, on the Life outlook?

A - Chris H. Figee {BIO 18815839 <GO>}

Albert, on the Life outlook, I think our Life earnings were supported by the inclusion of Generali. I mean, Generali really added a fair amount of profit to Life business, both from a re-risking, but also from a mortality and technical-result perspective. If you allow me to give a little more color on Life, investment margin was up by €37 million, both actually in absolute terms and in relative terms. The capital gains release was down a bit. We did actually fine. I mean, the quality of the earnings goes up. We think that is a reasonably sustainable level.

Generali, the few one-offs but I think your debt level is probably reasonably sustainable. On the technical result, it was down from 99% to 90%, mostly due to the decline of the book, some one-offs, and reasonably okay on technical results, assuming to be relatively stable here with the twist, a tendency to decline as the book runs off. Cost results, it was 24% to 26% stable. I think the movements that we see today in our cost base will allow us to keep our cost base stable. I think both technical result on cost may have on the long run some headwinds because the book that declines every year may have seen a bit up from that. Although, the short-term outlook is relatively favorable and on the investments income, the €37 million is probably really sustainable.

So, to make a long story short, I'm okay with keeping the Life earnings where it is. If you want to be conservative, take the average that we have for 2017 and 2018. That's probably a reasonable estimate for Life earnings going forward.

Q - Albert Ploegh {BIO 3151309 <GO>}

Okay. Thank you for the details.

Operator

Thank you. We'll now take our next question from Robin van den Broek of Mediobanca.

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

Yes. Good morning, everybody. My first question is on the financing of M&A. You basically connect that to hybrids. I was just wondering also in the line of the remittance flexibility you seem to have. Surely, the excess capital within your units are not generating the return on equity of the average, I was just wondering to what extent could the remittance power of your subsidiaries become a financing source. And at what cost would that actually come? That's my first question.

The second question is on Generali Nederlands. Could you give a little bit more indication on the path – I think you mentioned €10 million, €20 million, €30 million from a net perspective when you did the deal. I think you said that re-risking should come on top. For Life, you have €30 million sustainable growth already. So, can you tell us what's going right there and to what level should we expect this to grow on a revised basis?

Then, thirdly, I'm still a bit confused on the guidance for OCC. I think said 193 times 2 basically is reasonable. And in the answer to that question, I didn't get whether Loyalis probably still needs to come on top of that and potentially also the further improvement of Generali. Could you talk a little bit more about the operational building blocks rather than the technical ones? Thank you.

A - Jos P. M. Baeten {BIO 2036695 <GO>}

Robin, thanks. On the source of financing, look, indeed we could remit cash out from our operating entities and use it to finance acquisitions. The cash is not idle at the operating entities, I mean, effectively, it's invested. It supports the business, but effectively, the surplus cash is invested. At the Investor Day, asset classes that – we look at that surplus capital and the investment, I want to make sure it's invested to do assets and asset class add some value to our shareholders, value from a return perspective, and value from a sourcing perspective.

Do you think about the Life business where surplus capital is mainly invested into mortgages and real estate because those are assets that we can uniquely source, most of our shareholders cannot source mortgages or Dutch real estate themselves. So, we add value by sourcing those assets and we add value by creating value with the return of those assets. So, I think it may be the simplest return on the marginal euro in the Life business, not 12-point-something percent, but it's certainly above 10%.

So, it would be very cost – it yield the investment in our Life business. Could we upstream it? Yes. Honestly, Robin, any acquisition, I would need to look at the balance sheet of what you acquire and take a NewCo approach. So, there is no impediment as such to upstream cash from the Life business. But if you were to acquire, for example, a Life legal entity with a solvency of 156%, if they can do it to countries, ultimately you want to merge it to Life entities.

So, to me, it's more a function of what does NewCo look like and how do you construct a balance sheet of NewCo that is robust, solid and can withstand any market generations. And then, we'd solve around that. That means there is no impediment to upstream cash for Life. But it starts with what do you want your target balance sheet to look like and then work your way back?

On the OCC, any old numbers that we've guided to our ex-Loyalis, we still don't officially own Loyalis. The ownership of Loyalis only come early May. So, the Loyalis results will probably kick in and count for 7, 12 of the year. So, what we guide to today is ex-Loyalis in 93 times 2 is I think a reasonable guidance. There could be a bit of upside indeed if the Generali Non-life performance growth could be improved, but also the renewal of the Generali P&C portfolio takes place on commercial basis. So, we've double up technical migrations like the Generali P&C portfolio, we will renew commercial.

We basically means that everybody with a Generali policy gets an ASR policy return, which means it takes about 12 months for that to take place. So, some of it will happen during the year, the first half, some of it in the second half. So, the Generali Non-life operating improvement will gradually kick in and fading during the year. So, I'll be hesitant to add a huge number to that. So that's why I'm saying 193 times 2 is probably a good estimate if you look at what's happening underlying.

Then, on the Generali earnings contribution, I think the operating result contribution actually is quite large this year. It's around €40 million, to be quite precise. It contrasts with the €10 million, €20 million, €30 million prediction that we had. Delta 1 is a core T investment result, so the €10 million, €20 million, €30 million is the operating result contribution, not so much the investment results. So, there isn't an investment element to it.

Secondly, there's a one or two, what I'd say, non-recurring elements more PPA effects, purchase price accounting effects in the Generali numbers that I would not see as recurring. So, the recurring level of the Generali earnings contribution this year, ex-investment portfolio, is probably on the €25 million to €30 million mark. I think that's reasonable to assume and that we should be able to grow, to grow further.

And I think, what this all tells is that the Generali benefits will be achieved, certainly earlier than planned and probably go up a bit higher than planned, not double. So, the idea of €10 million, and €10 million expected, €40 million achieved, does not mean we're going to go multiply the numbers by four, but it's earlier than planned and it's going to be a bit more than planned.

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

Okay. And then, maybe on the OCC generation, I mean your market risk is still I think, at 43% compared to 50%, where you feel comfortable. I think your re-risking assessments always takes place at the end of last year, I guess, any conclusions there?

A - Chris H. Figee {BIO 18815839 <GO>}

Conclusion for now is, we think our market risk is stable. I mean, we need to be a bit opportunistic here. I think you expect our market risk to be broadly stable. I feel comfortable in today's volatile markets with only 43% in market risk and be a bit away from the 50% in today's environment.

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

So, no new – no re-risking plans?

A - Chris H. Figee {BIO 18815839 <GO>}

Nothing major. Certainly less than what we did last year.

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

Okay. Thank you.

Operator

We'll take our next question from Steven Haywood of HSBC. Please go ahead.

Q - Steven Haywood {BIO 15743259 <GO>}

Good morning, everybody. Thank you. On your 2019 to 2021 targets, which one of these targets, do you think, is going to be the hardest medium-term target for you to achieve?

And then secondly, I wondered if you can give us a update on the process or how you're finding, getting a new member for the executive board? Thank you.

A - Jos P. M. Baeten {BIO 2036695 <GO>}

Thank you, Steven. I think all the targets we have set are realistic and doable. Otherwise, we wouldn't have set them. I think the most challenging one will be combining profitable growth in the Non-life area and at the same time, keeping up the combined ratio in the lower sides of the set target of 94% to 96%. I think that will be most challenging, because that is all also set by market developments' competitive behavior, and I think that will be the most challenging one from a managerial perspective.

The other ones like the €40 million in the in the capital light business, as reported, we are close to delivering that in a sustainable way. We delivered a bit more this year, but said also that in the business of the distribution, we already know that the commissions will go down a little bit, because all the insurance companies like ourselves have lowered the commissions on mandatory agents. That will influence that number a little bit, but it's not going to be challenging to move towards the €40 million. So, all in one, we feel confident that we are able to deliver on those targets. However, it will be hard work.

On your second questions, where are we in selecting a new board member. We've seen a number of candidates of which we are quite enthusiastic. We are in the middle of the process. And hopefully, within a number of weeks, we can take a decision on the right candidate. But as you may know, then we have to take DNB hurdle. And normally, a process at DNB for new people takes around two to three months. So, hopefully somewhere in May, we can be clear on this.

Q - Steven Haywood {BIO 15743259 <GO>}

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

Operator

Our next question will come from Kepler Cheuvreux. Please state your name before posing your question.

Q - Benoît Pétrarque

Benoît Pétrarque.

Operator

Your line is open.

Q - Benoît Pétrarque

Hello?

FINAL

Bloomberg Transcript

A - Jos P. M. Baeten {BIO 2036695 <GO>}

Benoît, go ahead.

Q - Benoît Pétrarque

Yeah. Hi, guys. Sorry. First one on the side on business capital generation in H2. I think you've done €163 million (01:24:19-01:24:25)

A - Chris H. Figee {BIO 18815839 <GO>}

Benoît, can you repeat your question? We could not hear your question actually. The line is pretty bad. Benoît, can you please redial because perhaps you would have a better connection and then we can hear you. So, operator, can we go to the next question please?

Operator

We'll now take our next question from Mr. Andrew Baker of Citi. Please go ahead.

Q - Andrew Baker {BIO 20402705 <GO>}

My question. So, just on the debt side, can you give me a little bit more detail on how you guys are thinking about interest coverage? So, I know you have the minimum level which is 4 times, but what's the level that you'd actually be comfortable running the business out there?

And then just on Solvency II, can you give a quick update on where we are on the standard – Solvency II standards formula review. So there were three elements I think impacted you guys, so the interest rate risk shock, the government guarantee mortgages and LAC DT. I think the interest rate risk has been pushed out to 2020 review now. Are you still expecting the benefit from the government guarantee mortgages? And I don't think you changed your LAC DT assumption in these results today, correct me if I'm wrong there. So, is that still a potential benefit to come through? Thank you.

A - Chris H. Figee {BIO 18815839 <GO>}

Okay, Andrew, it's Chris here. Thank you. On the interest cover, the A target rate is 4 times to 7 times. We want to be safely A, so assuming we want to be at the upper end or above the 4 times to 7 times. I think if you were to move to 4 times in today's environment, you'd be pushing it in terms of your rating and I think at today's amount of debt, you'd have a humungous amount of debt in order to get to a 4 times interest cover. So, I think north of 4 times to 7 times.

And allow me just to full clarification purposes on the debt and refinancing side. Although, yeah, as we said, we'll finance it with the hybrids, we'll pre-finance with the bridge, we'll just issue a bridge which is a senior and then that gives us time to optimize the hybrid capital situation, pick the instruments and pick the moment we need to issue the instruments. And hybrid today can become relatively – or bridges can become relatively cheap.

On that, in terms of picking the instrument we chose, we will weigh potential future M&A and protect our capital eligibility. We said (01:27:00) you wanted to have more clarity on the (01:27:04) situation because that's why that we want to issue a Tier 1 or Tier 2. The new insight we have this year is that our Tier 3 capital is actually quite large. Loyalis at Tier 3, so actually we have less need to wait for that situation to evolve, because basically that we can do with Tier 2 anyway and still have sufficient capital headroom to absorb ineligible capital by someone we acquire. So, that means plan A is probably get Tier 2 instruments and actually, we've gotten more flexibility to do that.

On top of that, there is the call option under Tier 1 instruments which we have in October. We can and will only make that decision at that point in time. It's fair to assume or to expect that we could it if you look at the coupons, but we can only and will make a decision at that time, and we have got plenty of cash in the Life business to upstream cash to do that. So, in practice, think about Loyalis, is a hybrid with a bridge allowing us to pick and choose the moment to issue the hybrid at the most attractive rates for our shareholders and then there is the refinancing of the Tier 1s, which we will do in principle out of existing cash from the Life business.

Now, that all together will be taken to one funding plan, but that's the way how we think about it. I just want to make that very clear to all of you. And in terms of interest cover, 4 times to 7 times is what these A rating stipulates. We want to be on the upper end, we want to be a very safe and sound A credit. So, think north of the 4% to 7% – or 4 times to 7 times cover.

When it comes to the Solvency II review, interest rate delta has been pushed out a bit. The impact of that is limited. Our interest rate risk is small. Actually our rate exposure has declined in the second half of the year. So, I think that is something that's going to be – could be a small negative but relatively small because interest rate also has weak exposure has declined. Movement to – recognizing that non sort of government guarantees energy mortgages is a small plus.

And on LAC DT, it's kind of neutral to a plus in a sense that we've been very conservative on our LAC DT assumptions, LAC DT usage. We have actually increased the life factor a tiny bit from 70% of potential to 75% of the potential in this last half year, which is still not full. I mean, we could take it further than that if we really wanted to max out the model. We could take the life factor up by a fair amount.

Today, the use of what I would say the future profit component in LAC DT substantiation is still relatively small. It's less than a third of the potential that's included today. So, Life went up to €75 million a tiny bit. We will be unaffected by the LAC DT review because the element that the LAC DT review refers to are actually not used by us. So, that means LAC DT neutral, upside left, government guaranteed mortgages plus interest rate risk could be a small minus. But that's what we thought before because we've tightened interest rate risk.

Q - Andrew Baker {BIO 20402705 <GO>}

Very clear. Thank you.

Operator

The next question will come from Matthias de Wit of Kempen. Please go ahead.

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

Hi. Good morning. I've got two questions remaining, please. First one is on the 2019 earnings guidance. You mentioned that you want to obtain results similar compared to the one in recent years. Just wonder does that include Loyalis? Also, yeah, I'm a bit surprised by the flattish guidance, because of the growth we see in Non-life, the Generali synergies coming through, et cetera. So, can you be a bit more precise on that, please?

And then, the second question is on M&A. I think you mentioned in the past that you're targeting return of at least 12%. Does that incorporate any benefits you could get from an internal model that could lower the requirements of the target, or would you not be willing to share those in calculating these hurdle rates? Thanks.

A - Jos P. M. Baeten {BIO 2036695 <GO>}

On the earnings guidance, Matthias, I think the message we try to bring across is that we are very confident that we can keep on running ASR as it is on the base on the healthy business. So, as said, if and when we wouldn't have a storm like we had last year, that would be a plus in our earnings. And the guidance we have given, that does not yet include Loyalis. As Chris already said, we don't own that business yet, so we haven't included that into our guidance.

On the 12%, the answer can be very brief and short. That's a no. That's based on how we look at our solvency today and how we calculate our today's numbers. And I think we have been clear on the partial internal model. If and when we would do a large transaction, we would start to build that model and to add it to ASR. But in assessing whether a transaction is a good transaction, we should not yet take into account any potential further movements towards an internal model.

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

Okay. That's clear, Jos. Thank you.

Operator

We will now move to our final question from Benoît Pétrarque of Kepler Cheuvreux. Please go ahead.

Q - Benoît Pétrarque

Yes. I mean, thanks for taking my questions. The first one was on the business capital generation in H2, €153 billion. It's up only €4 million versus H2 2017, also despite the consolidation of Generali, strong Non-life earnings in H2 2018, also better Asset Management and Distribution earnings. So, I was wondering if you'd comment on the kind of increase H2 2018 versus H2 2017, especially if there's any kind of one-offs on the Life capital generation, I would be interested by that.

The second one was on the premium growth outlook in Non-life for 2019. I think you've done like (01:34:01) underlying this year. Could you talk a bit about your outlook on the growth and also on pricing? And the last one was on the re-risking, since exposure to financials at €4 billion especially in H2, so it looks like you've taken opportunities in the market in the fourth quarter. Could you maybe come back on that, what's your plan here to re-risk going forward? Thanks.

A - Chris H. Figee {BIO 18815839 <GO>}

Yeah. Benoît, on the first question, on your business cap gen, H2-to-H2, so the second half of 2017 to second half of 2018, plus €14 million, basically what happened there is a combination of things. So, technical result up, but also we had somewhat larger – somewhat more large claims in the second half of the year. So, in our P&C business, we see in the absence of storms, the bulk claims ratio falling, claims frequency is actually below that of last year and going down, large claims were up, so we had a little bit more higher large claims in the second half of the year.

Secondly, for that last year, we had slightly higher hybrid costs because of the RT1 financing we did last year, and we had a slightly higher Holding cost, and those are one-offs, as Jos said, a one-off Holding cost metric, one-off Holding costs that fit in.

So, in the year-on-year comparison, for the last six months of the year, bulk claims ratio, much better; excess returns, up a tiny bit, compensated by higher larger claims and higher Holding cost and some higher hybrid cost. That explains the delta between second half of last year and second half of this year.

A - Jos P. M. Baeten {BIO 2036695 <GO>}

And Benoît, on your question on growth and pricing, let me start off with pricing, especially in the P&C and Non-life area. We still see price increases. The market still is hardening and is getting better, but I don't think we're yet there, especially in car insurance, I think the combined ratios are not at a level where they should be. So, we expect and we will raise our prices ourselves also over the next few months we expect a further price increase in the P&C business.

If I take out the storm and fire insurance, then I think the results are satisfying, but still room for improvement in terms of pricing. So, we expect that prices will go up slightly not as fast and as high as we have seen over the last 18 months. But there will be continued price increase in Non-life. In terms of growth, if I take a look at how the year started, we are confident that we are able to deliver on our growth objectives, especially in the P&C and Disability business.

P&C continued in the same pace as we closed the year, so still lots of new business. Same for the Disability business, positive developments in terms of new projection there. And also in the Pension DC, which we aim at – we still see the same trend as we have seen over the last year. So, we're confident that we will be able to deliver the growth base organically that we have delivered over the last 12 months.

A - Chris H. Figee {BIO 18815839 <GO>}

Yeah. Benoît, to your third question, the investment portfolio, you indeed see some increase in financials. Actually, in the second half of the year, when spreads widened especially on the banking sector, we added short-dated with others value in relatively short duration financials. All investment grade, as you can see, the non-investment grade hasn't barely moved. So, it's basically it's short-dated, subordinated-paper quality banks. That's exactly where it is. So, BBB and up, subordinated paper by quality banks in relatively short durations we saw from a return of capital perspective. That's where we saw value after the spread widening in the second half of the year and those don't consume that much of a capital. So, that explains actually the movement in financials.

Maybe one final point to make on guidance on the coming year, we talked about our business cap gen, we talked about our organic capital generation, we talked about multiplying numbers, ultimately, there are a number of moving factors in this. Multiplying H2 by H2 is a safe bet with all the rightly conservative way of looking at our solvency generation. We know we'd like to under promise and over deliver. We will try to do that, continue to do that. Multiplying H2 times is always a good idea. It gives you probably the floor and the lower end of what we can deliver next year. That's the number we can probably confirm to you and you know as – when we confirm to a number then often we try to outperform that.

So, I'll give back to Jos for some final words of wisdom.

A - Jos P. M. Baeten {BIO 2036695 <GO>}

Yeah. I think I couldn't spread more wisdom than you would have done in your last comment. So, thanks for joining us and, hopefully, you'll feel that we are very confident in how the company runs at the moment, the business is doing well. People at ASR are happy, so we are very confident to keep on delivering the results as we have done before. And we look forward to meet some of you in due time. Tomorrow, we will start our road show in London, and I believe Michel and this team have invited some nice people to have dinner with us tomorrow night. And then, we can continue to discuss ASR and the market in a broader way. Thank you for being with us, and I wish you all a very nice and good day.

Operator

This concludes today's call. Thank you for your participation. You may now disconnect.